The Minsky's two masters in Italy

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My personal experience on banking crises

- I lived three monetary and banking crises in Italy from the 1970s to 2014:

I. The first one was in the 1970s, after the world oil crisis, as a director of the Research Dptm of the Bank of Italy and, later, as General Manager of the Confederation of Italian Industries (with Jan Kregel as member of the research staff and Hyman Minsky as consultant)

II. The second was in the 1990s, after the 1987 East crisis, as Chairman of the voluntary Italian Deposit Guarantee Scheme and, later, as Minister of Industry

III. The third was in 2008-2010, again as Chairman of the Italian Deposit Guarantee Scheme, by that time compulsory according to the European directive.

The alternance of the institutional bank features in Italy

- The 1936 Banking Law was the answer to the 1929-33 Great Depression for industries and banks. A large part of Industry went under the control of the State and the banking system was largely nationalized. The Law was based on the specialization of bank's activity according to the maturity of liabilities and assets; it was under the control of the Treasury Minister, but the supervision was entrusted to the Bank of Italy
- In 1993 the Government chaired by the former Governor Ciampi (and I as Minister of industry) obtained by the Parliament a new Banking Law. The 'specialization' approach was abandoned in favor of the 'universal' approach. The 'hope' was to serve the second Minsky Master, the availability of credit for capital investment.
- The first Minsky Master, the stability of the payment system, was introduced creating a voluntary guarantee fund for banks' deposits

The Eurosystem and the Euro

- In 1992 Italy signed the Maastricht Treaty; the Italian Parliament ratified the agreement with a very modest discussion on its consequence
- I define this choice as "*An Europe on Clayay Foundations*"; I fought the decision to enter immediately into the Eurosystem, suggesting to invoke the "opting out" clause of the Treaty, used by the UK
- Until May 1998 the Italian Government pursued the objective to enter the Eurosystem; any instrument was used to abide by the obligation to stabilize the exchange rate of the Lira and re-enter in a budget deficit of 3%; both parameters had been agreed in an addendum of the Maastricht Treaty
- The most relevant decisions taken were to invest a large part of the official reserves in order to: peg, mainly in 1992, the Lira exchange rate; cut public investments to reduce public expenditures; and, introduce an Euro-tax of 3%

The impact of the decision

- The result is that no Masters have been served
- We cannot say if our low growth and high unemployment is due to either domestic weakeness or to European decisions; but we know that both are in action without the possibility to escape using traditional instruments of adjustment
- In the past, Italy used money creation, interest rates, fiscal interventions, and devaluations of the Lira; these instruments are now lost without having any equivalent tools in the EU
- The unbearableness of the situation emerged after the Great Recession of 2008
- Recent monetary policy helped us; but the European fiscal policy constraints have been reinforced with the 2002 "fiscal compact agreement" to push public budgets to equilibria. The EU approach to the crisis is to make "reforms" mainly on labor market and public services; but they produce deflation, at least in the short run

The impact on the Italian banks and the European Banking Union

- At the beginning of the crisis the management of Italian banks was "traditional" (It was said that "they did not speak English", to stress that they were not involved with financial innovations), deluding authorities and bankers on the capacity to absorb the shocks, also because the Governments insisted that a rapid recovery of the economy was around the corner
- The transmission of financial crisis to the real sector increased non performing loans. The delay of the Italian banks' crisis met with a UE directive - promptly and wrongly ratified by the Italian Parliament - prohibiting public intervention to save banks, in order to limit the heavely interventions already made by other EU member-countries
- It was also decided to create a European Banking Union, transferring the supervision of big banks to a new EU Authority, and a common law on Deposit Guarantee Schemes and Resolution of banking crises, under the surveillance of the ECB

The sovereignty went to Brussels and the two Masters are not served

- The joint result of the crisis and political decisions is that Italy lost the possibility to serve either one the two Masters: money and financial stability, and credit availability to real investments
- The will of the Italian élites to stay in the European Union at any cost is paid by low growth and high unemployment
- If we want assistance we should accept to loose the residual fiscal sovereignty, as Greece, accepting the control of the "triade" (ECB, Commission, and IMF)
- Despite these situation, we leave?? in a new miracle: the ability to survive. Industrial exports are growing and the foreign current account is in surplus; people live well and the Government is still increasing its social expenditures; but public debt is increasing
- The EU is insisting to reform labor market and public administration to increase productivity, but people refuse to accept it. Social problems bypass economic ones.

Conclusions

- The Italian banking crisis is not the direct result of the 2008 world financial crisis; its transmission to the real economy is due to wrong choices of political economy (deflationary taxation and cut in employment and salaries) and wrong forecasts on the time for recovery
- Non-performing loans increased and banks reacted pro-cyclically, rationing credit
- The European decisions - accepted too quickly by the Italian Parliament - to create a Banking Union, a new deposit guarantee scheme, and a new resolution mechanism weakened the confidence on the Italian banking system
- The waiver to monetary sovereignty prevents Italy to use the "traditional" instruments of adjustment without having a better policy by the UE
- Italy is now forced in an institutional shell, in front of a drastic choice to stay in the EU-Eurosystem, hoping for a better future or accepting to go backward.
- Banks are approaching the problem, reducing credit and gaining from the payments system

What to do?

- A great reform of the bank and financial system based on specialization:
- 1. the payment system should not be managed by banks; it should be transferred to a block-chain mechanism guaranteed by the State, but managed directly by the owners of the means of payments (zero risk for the payment system, no needs for deposit guarantee scheme, as US-FDIC or FITD in Italy)
- 2. the "pure" managers of savings should not give credit directly (risk and responsibility on managers & savers; better information to be available to savers)
- 3. the "direct" managers of credit (banks *et similia*) are responsible for the valuation of the merit of credit, asking for an equivalent fee (problems as n.2; perhaps more public controls)
- 4. Less formal controls on Stock Exchanges and more direct inspections, to get on spread a better information for savers