

MIXED AND MARKET ORIENTED ECONOMIES: THE ITALIAN SITUATION

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1. Mixed economy and market-oriented economy

Enterprises are the production units which act as decision-making centres regarding economic choices. In joint stock companies the centre of decision-making is the board of directors.

In the ambit of competition in the negotiation of the factors which determine the costs and revenues of an enterprise, the dependence of the board of directors on the vote of the shareholders, the contendibility of the controlling stakes on the stock exchange and the risk of the capital invested by the shareholders bears witness to a *market oriented economy*.

When the board of directors of a company depends for its appointment on the influence of powers capable of reducing or containing market constraints, and likewise company management and business risk are so dependent, this means that there exists a *mixed economy* where the market merely serves as a signpost

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to guide the intervention of the authorities that regulate the economy. The powers need not necessarily be of State origin; they can also be privately exercised powers if by reason of their nature and concentration they are capable of exercising an institutional influence in a given economic system. As a rule in a mixed economy we can find a combination of State regulatory powers exercised by government policy making and supervisory authorities as well powers exercised by private authorities having a dominant influence on the management of the largest enterprises.

The two models reflect different regulatory regimes which in turn respond to opposite principles. In a mixed economy development and the stability of the economy represent not only values and political commitments but also take the form - overall and in general terms - of legal objectives in a technical sense, which are entrusted in the public interest to authorities endowed with strong administrative powers capable of being used directly on enterprises on a case by case basis. By contrast, in a market oriented economy development and stability are entrusted to the market itself and are thus the outcome of the interaction of supply and demand, which public authorities themselves have to take into account in their decisions regarding macroeconomic factors (expenditure, taxes, money, etc.). Therefore, while the market oriented economy is characterised by the distribution and spread of power and risk, the mixed economy is characterised by the concentration of power in a paternalistic way and individual risk is absorbed by the system thereby becoming political risk.

Obviously real life does not correspond to the purity inherent in models. A single economy may have sectors which are open to the market and those which are sheltered from the rigours of the market and even in the era of globalization

this will continue to be so. Moreover, models tell us what the predominant trends which characterise an economy are. As jurists, we are well aware of the importance to be attributed to clarity in the basic principles on the basis of which choices will then be made.

As we know the two models of market oriented economy and mixed economy respond to two different philosophies. Underlying the mixed economy is a philosophy which distrusts competition as a force which by itself is capable in backward situations of promoting development, and in advanced economies of bringing stability to development and justice in the distribution of resources. The lesser efficiency of the mixed economy in the short term is more than amply compensated in the long term by the balanced development of the economy which in turn reduces the risk of serious crises and promotes social solidarity in mitigating inequalities among individuals.

On the other hand, the mixed economy is less efficient over time. It is so because it depresses innovation and this occurs because of the reduced mobility of the factors of production, protected from risk and thus competition. In some regards the mixed economy creates public and private powers which are difficult to regulate according to criteria of transparency and democratic legality, and it confuses responsibilities both as regards who makes the decisions and as regards the nature of the decision: political, regulatory, administrative and business management. The reduced mobility of persons accentuates the rise of technostructures subject to the influence of corporatist interests of a bureaucratic, trade union and political nature.

A mixed economy can be organised solely in economies which are isolated and protected in the relevant sectors by paternalistic institutional powers, i.e. economies which function within the limits of State authority. The financial system and the ownership structures of the major enterprises are subject to a condition of autarchy.

The reality of the global market which is emerging today does not allow for the continued protection of national economies thereby meaning that if a national economy persists in maintaining a mixed character, it will lose out in the short term in comparison with the dynamic aggressiveness of market oriented economies.

The adaptation of the economic system to the new reality is a necessity if the given national economy is to be satisfactorily integrated into the global economy. Adaptation requires substantial modifications in the structure of existing entrenched interests and legal changes will be necessary to give effect to the important political choices made. The capacity to deal with this is a measure of the political quality of the country.

2. The Italian system of mixed economy

Italy, like other European systems, comes from a mixed economy with strong elements of *dirigisme*. This situation was due in particular to the state of backwardness after the second world war, which required strong State intervention for development purposes. At a later stage promoting development in the southern part of Italy took centre stage with the further aim of promoting stability and social justice.

Let's try to outline the model of the past. The soul of the mixed economy lies in controlling financial flows with the help of the banking system. In fact, the Italian financial system was centred on the banking system: intermediation in the gathering of savings and the granting of loans. The stock exchange, which facilitated the direct access to savings by industrial enterprises, occupied a marginal position and was for the most part dependent on the banks. Bond issues were practically unheard of. In the banking system there was a separation between deposit banks granting short term credit and specialised institutions catering for medium and long term loans for investment purposes. The system was predominantly made up of State controlled institutions. The system was subject to strict supervision and it was impossible for banks and institutions to be subjected to bankruptcy proceedings. In the final analysis, banking was not a market system but rather a public service organised along sectorial lines. Through the granting of credit the public authorities were able to condition the largest industrial and service companies many of which in any case were either directly or indirectly owned by the State itself (state bodies and state controlled companies).

The Italian mixed economy had a number of cardinal reference points. First and foremost, there was the Government, the Treasury and the Bank of Italy as regards the banking system in particular and the economy as a whole in general. IRI [Institute for Industrial reconstruction] and ENI [National Hydrocarbon Corporation] were the principal holding companies for the management of the stakes held by the State in various industries and, through the Ministry for State Holdings, reported directly to the Prime Minister.

Another key player was Mediobanca, a credit institution and investment bank owned by the State but with operational autonomy and answerable to nobody but itself, initially by informal political agreement and later by a weighted distribution of the controlling stakes among institutions which ended up being influenced by the bank itself. Stability was guaranteed through voting trusts. For many years Mediobanca imposed itself as the reference point for the principal industrial enterprises in private hands through shareholdings in enterprises, voting proxies from the banks and cross shareholdings, all of which were regulated by voting trusts managed by the investment bank itself.

Of lesser importance but still with a role as regards State aid policies were the *Cassa per il Mezzogiorno* [Development Fund for the South of Italy] with its own ministerial department and the medium term credit institutions.

Overall, the principal reference authorities were the Government, the Bank of Italy, IRI, ENI and Mediobanca. The banks as such did not wield any power. On the other hand, considerable power was exercised by the trade unions particularly in the banking sector and other State controlled industries and services. Similarly, political parties - especially those forming the government - exercised great power and had a large say in appointments.

In a mixed economy system one must neither forget nor underestimate the influence which the relevant authorities exercise in an informal manner, a type of influence which can best be described as *moral persuasion*. This phenomenon occurred especially in relation to authorities with technical functions also in view of the longevity of the tenure of the individuals who headed these bodies (political scientists refer to this phenomenon as a *technostructure*). By virtue of

the concentration of power and the charisma which goes with having exercised power for such a long time, a practise grew up of such persons meeting and exchanging views among themselves as well as discussing the most important operations and sometimes appointments too. By reason of the paternalistic role exercised by the relevant authority, in a mixed economy decisions tend to be taken at higher levels in accordance with an ethic of confidential consultations. In the Italian system of mixed economy the fundamental authorities were above all the Bank of Italy and Mediobanca.

3. Changes to the system in view of international integration

In the light of the opening up to European markets and globalization, the Italian system has undergone profound change. These changes involve the privatisation of the banking sector and its orientation towards the market, the possibility for banks to engage in varied financial activities, the development of the capital markets and the stock exchange, the privatisation of State owned industrial enterprises, the privatisation of many public services, the safeguarding and development of competition in compliance with EU rules in this regard.

4. The inadequacy of the changes to the system

The foregoing changes have not turned out to be sufficient in themselves to transform the system into a market one. As a matter of fact, some of the changes have taken on a form which may well defeat the original objectives of such very changes.

The winding up of IRI and the privatisation of ENI as well as the transformation into companies of important State services have not always been transparent or linear. In any case, important businesses remain under State control or influence. This control and influence is strengthened by the presence of the banking system whose central role in the economic system and the direction of large enterprises has been accentuated in as much as the banking system is still State oriented.

To tell the truth, the privatisation of the banking and financial system is not satisfactory. In order to privatise the principal banks (including savings banks) controlled by State entities, joint stock companies were formed. The banking institutions were conferred on these companies whose shares were then allotted to the public entities which had previously owned the institutions directly. In the meantime these public entities were transformed into so called "foundations" [a form of trust], which by law were private - but only formally. Supervision is carried out by the Treasury and appointments of members of the boards of directors of the foundations are made by public authorities. The successive offering of shares in these companies to the public through the stock exchange meant that the foundations were able to raise huge amounts of capital while at the same time retaining control of the banking institution or at least a significant stake in the company. In this regard we have witnessed a sort of nationalisation of the private capital absorbed by the foundations.

The principal banking institutions have undergone a process of agglomeration according to a particular formula which has allowed the continuance of the single institutions grouped together under a holding company. A limited number of groups has emerged. There are five principal groups and in

each one the foundations hold a significant stake. The three banks formerly held by IRI (Banca Commerciale Italiana, Credito Italiano and Banca di Roma) have become part of new groups which in turn now indirectly feel the influence of the foundations. The holding companies hold reciprocal stakes in each other and even if in a reduced amount, such stakes at the same time allow the said holding companies to be represented at board level. Mediobanca has remained with its own characteristics.

The banking groups have taken advantage of the new right to hold stakes in the principal industrial enterprises some of which in turn, even if to small extent, hold stakes in the banking groups. This means that each is represented at board level in the other company. In this way the so called "Mediobanca phenomenon" has been replicated and multiplied even if in a different context.

It is also necessary to take into account that institutional investors hold significant stakes in the share capital. However, these institutional investors are controlled by the banking groups themselves such that the votes of the former are in a best case scenario frozen or in a worst case scenario aligned with the interests of the banks controlling the institutional investors themselves.

In essence the appointment of the directors of the main banking groups depends on the banking foundations and cross shareholdings with a limited say on the part of independent entities, whether Italian or foreign. The system continues to be managed through voting trusts. Moreover, it is not rare for directors to be appointed on the suggestion of the Treasury, due to the fact that it still has a range of powers in this regard vested in it by law and also due to the position the Treasury occupies in mixed economy model.

The banking system is supervised by the Bank of Italy whose powers in this regard are paternalistic in nature and have actually increased in recent times. The Bank of Italy is entrusted with the objective of the stability of the system considered as a whole. It is an objective superimposed on the market which by definition is held to be unstable. It is an objective managed administratively through formal administrative powers and, as in the past, informal intervention and moral persuasion. The main formal instruments are the following:

- a) Authorisation to acquire significant stakes in banking institutions. This is a power which is highly discretionary in nature due to its general aims and the absence of procedural constraints. It is also a power which has allowed bank mergers and tender offers for banks to be controlled and foreign takeovers to be contained.
- b) Regulation of the degree of competition in the banking system in furtherance of the objective of maintaining stability in the overall system. This is considered of prime public importance and thus competition in this sector has been excluded from the remit of the Italian Antitrust Authority.
- c) Regulation of banking crises. In fact banking institutions are not subject to ordinary insolvency procedures and in particular a Court declaration of insolvency is not a precondition to extraordinary measures being taken to rescue a bank.

The dominant authorities in the system outlined are thus the Government (chiefly in the form of the Treasury), the Governor of the Bank of Italy in the exercise of its supervisory functions and the principal banking groups in a position analogous to that once held by Mediobanca. On the one hand, they have less institutional authority while on the other hand they enjoy greater dynamism

by reason of the reduced force of political power in these last years and also certainly by reason of the new national economic context that is becoming more integrated in the global economy.

In relations with the Government and supervisory authorities, there still prevails the habit of informal and confidential discussions in relation to matters like privatisation, transfer of shares, restructuring, agglomeration and key appointments, all of which is an evident sign of the persistence of the mixed economy and the paternalistic State presence. The general changes made to the system have not managed to affect this practise and neither have they succeeded in orienting the system towards the market where ethics dictate respect for the independence of the market regulatory authorities and prohibit the prior, informal and confidential involvement of those same authorities in business management decisions.

For the foregoing reasons the system which has actually emerged can still be classified as being a mixed economy one but lacking any clear strategy. In fact, the system seems to have adopted its current form not in response to a strategic approach implementing a well thought out political policy but rather in response to the resistance exhibited by entrenched interests which fear having to face up to endemic instability of the market and the unforeseeable consequences that may entail.

Naturally, in the Italian economy the important sector of medium sized industrial and commercial enterprises has been strengthened. New important independent national enterprises have emerged. The role of international companies and institutional investors has been growing in importance.

Nevertheless, at the same time new authorities have emerged along the lines of the past, particularly in the telecommunications sector. However, we will not deal with that issue here.

5. Sticking points to be overcome to enter a market oriented economy

The current situation I have depicted does not depend exclusively on the behaviour of the persons concerned but is characteristic of the law in force which has not been amended sufficiently to encourage practises more in line with market principles. This conclusion is particularly true for the banking and financial system whose characteristics in turn affect the shape of the economy. What I wish to say is that if complaints have been made about the persistence of behaviour which is not consistent with a market oriented economy, as has recently been the case with reference to the agglomeration of banks and the administrative rules governing takeovers, this is not the fault of the regulatory authority in question but the law which makes that authority responsible for the administrative management of the system consistent with a paternalistic approach. The behaviour of the authority is not different from that of the past precisely because the law is not any different either. In order to better illustrate this conclusion, I'll limit myself to listing the principal issues which are deserving of legislative intervention.

With regard to banking supervision, it is above all necessary to eliminate administrative responsibility for maintaining the stability of the system as a whole through administrative instruments governing intervention with regard to individual companies. Stability must become a market risk which either punishes

or rewards the single companies. Extraordinary situations which forecast serious crises must be regulated according to extraordinary procedures and powers.

Intervention by the supervisory authority must be formal such that the boundary between the responsibility of company management and the responsibility of the administrative intervention remains clear. This is also necessary to allow for recourse to the Courts.

Banking crises must be subject to the general law of bankruptcy with a Court making the declaration of bankruptcy. Such a declaration should be a precondition to any administrative intervention which interferes with the management of the crisis.

Competition in the banking sector should also fall within the sphere of competence of the Italian Antitrust Authority in line with various proposals which have been advanced in this regard.

A delicate issue is the restructuring of the banking foundations. Above all, it is necessary to exclude any public interference in the appointment of directors and certainly the informal interference in relation to appointments and management. Privatisations need to be subject to better rules and a more suitable arrangement devised for State equity holdings.

Finally, there should be greater liability for damage deriving from conflict of interest and the elements of this tort should be clarified. Prohibitions should be carefully laid down with reference to conduct not otherwise constituting a conflict of interest. A more widespread availability of an action for damages

deriving from conflict of interest could well be a way regulate group conduct from cross shareholdings to voting trusts in order to protect managed savings.

6. Final reflections under European legislation

Notwithstanding the impression that the Italian situation is more backward, the difficulties that arise in passing to a market oriented system are also present in other European countries, and likewise in these countries the problems concern banking regulation.

Complaints have been rightly voiced that the credit sector has not yet been integrated in the European Union. One may well ask whether the Community rules in this regard need to be reviewed in depth in order for them to be constructed on a more advanced foundation so as to better respond to the principles of "an open market economy with free competition" as the new article 4 of the Treaty clearly establishes.