

**Changing interactions.
Universal banking in Italy in the interwar period**

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1. Introduction

The interwar period provides useful insights into the universal banking model when occurring financial instability and economic slowdowns. Indeed, the Italian universal banking experience during the 1920s is an example of adapting to dramatic and sudden up and downturn economic trends through a trial and error process. As recently observed, the Italian banking system proved to be rather procyclical in the long run, but with some stronger peaks in the interwar period when universal banking was largely practised. This procyclicality was certainly stronger in the 1920s and 1930s than after the second world war, partly because macroeconomic policies were wrongly conceived or weakly tempered by central authorities over business cycles. Moreover, in an age of high financial and monetary turbulence, Italian central authorities were persuaded to stabilise the domestic currency by the common tendency that followed the pegging of the British pound in April 1925. As a consequence, a deflation affected all major European banking systems, essentially via a credit crunch, with negative effects on investments and economic growth.

That macroeconomic policies mismatched the universal banking model in presence of high financial international instability is a relevant point of the discussion on the economic slowdown of the late 1920s. Considering the Italian case in a comparative perspective, this paper will try to investigate to which extent universal banking was sensitive to business cycles and how much it was connected to financial instability, both by producing a certain degree of instability and by depending for its performances on the instability itself. Second, as macroeconomic policies were rather restrictive from the mid-1920s, the paper considers whether

such a policy might have influenced stability and affected the very existence of this banking model in the subsequent years by introducing more and more stringent constraints to risk and assets management.

Indeed, in the last years historical literature has emphasised the importance of information and risk management in the evolution of the Italian mixed banks in those decades. Facing a volatile growth, major mixed banks did experience methods and techniques to better manage information about their industrial partners, in order to be able to reduce, or at least efficiently monitor, risk. In fact, in the late 1920s major universal banks were more and more strictly involved in the ownership structure of the largest manufacturing groups as (majority or controlling) shareholders. Nevertheless, they were not always able to monitor information flows and firms' accounting, thus suffering a dramatic failure in the early 1930s. An opening string of severe difficulties had emerged after the Bank of Italy adopted a restrictive monetary policy in the second half of 1926. After the stabilisation of the lira, a deflationary phase occurred which affected banks' portfolio and assets. All the big banks were concerned by such a tough monetary policy, both because it rapidly reduced the production of related industrial firms, especially through a harsh meltdown in domestic demand and export flows, and because Bank of Italy was compelled to ration credit in order to maintain "quota novanta" (90 liras against one British pound). When the world crisis hit the country in the early 1930s, universal banks were forced into credit specialization by the government as a double result of bail-outs and regulation. Thus, the former universal banks were compelled to change their banking pattern, even if it is not clear at all whether they actually gave up their previous behaviour or they tried to gradually adjust to the new regulatory context.

The paper will provide a comparative analysis of the evolution on the Italian banking architecture in relation with that of three other European experiences, using both qualitative and quantitative methods. The aim of the paper is to verify whether major European banking patterns were really so different from each other, as the literature tends to reckon, either if economic policies were responsible, at least partially, of the banks' performance, and, finally, if some convergence

may be observed in those national patterns in the interwar period changes. Even though the Italian case will be at the centre of the analysis, the paper's perspective is essentially comparative. We will focus mainly on some macroeconomic and institutional variables, on the one hand, and on the business-level dimension, using balance-sheets data, on the other hand.

What the paper may suggest is that macroeconomic policies were relevant in shaping interwar banking patterns in the long-run and that a comparative analysis may offer an interesting perspective on adjustment processes in the banking industry whenever a high instability phase occurs.

2. Some stylised facts on the Italian case

The Italian banking system was interested by notable regulatory changes in the 1920s and in the 1930s, the latter having even a more relevant impact on banking patterns. Briefly, the Italian banking system was weakly regulated in the 1920s, as the most systems were at the time, and became highly regulated in the subsequent decade as a consequence of the crisis¹, thus following a common trend in financial regulatory policies². In particular, all the major Italian banks operated as German-style mixed banks from the mid-1890s and experienced an evolution in their operational models after the economic and monetary turbulences of the post-war phase. According to some authors in the mid-1920s the three largest mixed banks – that's to say, Banca Commerciale Italiana, Credito Italiano, and Banco di Roma – acted mostly as investment banks, or even as a sort of holding companies³. In a few years Banca Commerciale and Credito Italiano were especially involved in the ownership structure of their industrial clientele. In fact, the collapse of the domestic financial market in 1925 forced them to increasingly transform their loans to manufacturing firms in shares or bonds. While previously

¹ Ciocca and Toniolo, 1984; Toniolo, 1993 and 1995.

² Bordo *et alii*, 2001; Eichengreen and Bordo, 2003; Goodhart, Hofmann and Segoviano 2004.

³ Saraceno, 1978; Toniolo, 1978. According to Raffaele Mattioli and Pasquale Saraceno both Banca Commerciale and Credito Italiano, above all, were operating as “banche holding”, a weird financial institution half-way between a commercial bank and a holding company.

they financed industrial companies offering short-term loans which actually tended to become long-term credits via roll-over practices, after 1925 impossibility of refinancing the debt of industrial firms through the financial market forced the three major mixed banks to modify their business model. As they experienced more and more difficulties operating on the stock exchange whenever they tried to settle bonds or shares, they were forced to take on the unsold industrial bonds and shares. This fact entailed a deep, even though gradual, change in the nature itself of those banks. Thus, they became more similar to investment banks, though they continued to directly collect deposits, than to traditional universal banks. Moreover, after the tough monetary policy of August 1926, they were to face serious and increasing problems with the central bank, as Bank of Italy significantly reduced the whole amount of the refinancing operations to the banking system in order to limit the growth rate of the monetary basis and to reach a stable exchange rate against the British pound (and the American dollar as well)⁴.

Therefore, in the late 1920s a credit crunch affected all the major Italian universal banks as well as a number of local small and medium-sized banks, then operating as “pocket mixed banks”⁵. In the early 1930s Banca Commerciale and Credito Italiano were seriously hit by the industrial crisis and started talks with the government to organise a “soft rescue” by asking a refinancing operation for several hundreds of millions of liras⁶. The Treasury and the Bank of Italy offered their financial aid but, as it became clearer and clearer as the crisis went on, they also decided to put some unbending conditions to the banking bail out. Essentially, Italian central monetary authorities aimed to reorganise the whole financial system by introducing a severe credit specialisation regulatory principle. This idea was not uncommon in those years, as the American case well testifies with the Glass-Steagall Act of 1933. In fact, in January 1933 Istituto per la Ricostruzione Industriale (IRI), a State-owned holding company, was established by the government to rescue banks and manufacturing firms. In March 1934 all the long-

⁴ Toniolo, 1995; Cotula and Spaventa, 1993.

⁵ Ferri, 1993.

⁶ Toniolo, 1978.

term assets, i.e. bonds, shares and long-term credits, of the three big mixed banks were broke up from their balance-sheet and were given to a special branch of IRI. In a couple of years, in 1936, the reorganisation of the banking system was completed by a new banking law. The new Bank Act requested a sharp separation between commercial banking and investment banking. Besides, as universal banking was formally banned, it encouraged banks to modify their relations with industrial firms and clientele. Before the Bank Act of 1936 all major German-style mixed banks tended to have long-term relations, as insiders, with their industrial clientele. Afterwards, banks were pushed to abandon exclusivity with industrial firms and manufacturing firms were encouraged to multiply banking relations, even if that goal was pursued more through moral suasion rather than via formal banking regulation. As a result, in the late 1930s banking relations were only partly shaped by the new regulatory scheme. Indeed, the former mixed banks did not completely cease to operate as universal banks in their day-to-day relations with industrial firms. The main change was the end of exclusive relations between the major banks and the largest industrial groups⁷. Thus, multiple loans (i.e., when a firm was able to obtain a plurality of loans from a number of banks) transformed the specific kind of relationship banking prevailing in Italy after the brand new Bank Act of 1936, even if this emerged in a more clear way only after the second world war, that is to say during the Golden Age⁸.

One of the main problems related to these changes in the banking system was how banks could be able to collect and process information on their industrial clientele. Since the mid-1920s Banca Commerciale, for instance, built up a special branch in order to monitor effectively its financed firms through an innovative array of financial ratios and frequent inspections of headquarters and plants by specifically trained consultants⁹. After the turning point of the early 1930s IRI took over technicians and engineers of these special branches, whilst all the major banks adopted and improved financial and information tools for screening and

⁷ Brambilla 1998.

⁸ Gigliobianco, Piluso and Toniolo, 1999.

⁹ Ricciardi, 1999.

monitoring the creditworthiness of firms. Relationship banking connected to universal banking deeply changed in the 1920s and 1930s. As it has been observed, it may be argued that three institutional changes affected relationship banking alongside with macroeconomic policies pursued in those years.

This first institutional re-design of the stock exchange by the government may be seen as an institutional shock which negatively affected the more dynamic component of the Italian banking system. German-style mixed banks were almost suddenly forced to leave their active and sometimes distortive presence inside the stock exchange with some heavy effects on the market value of their portfolios¹⁰. The strongly deflationary policy adopted by the Bank of Italy since August 1926 produced a second internal shock by negatively affecting the functioning of the banking system. Indeed, this shock produced a second chain of effects on the mixed banks' balance-sheets through the late 1920s, quite before the world crisis¹¹. The third institutional shock was the change of the whole regulatory architecture introduced by the new Bank Act of 1936¹².

Main stylised facts can be better understood if we observe the behaviour of the banking system as a whole over business cycles. Such an approach could be useful in order to catch a wider view of the supply side in comparison with the demand side. Therefore, we can put the major mixed banks in a more ample perspective while tracking the behaviour of other components of domestic banking system, such as savings banks and cooperative banks.

As it has been said, the tendency of the Italian banking system to follow business cycles in the long run¹³ may be specified by observing the data relating to the interwar period. A very simple test could be done through a basic descriptive charts. The plotting of the time series of some ratios suggests that the procyclicality of the banking system was relatively strong in the interwar period as well.

¹⁰ Baia Curioni, 1993.

¹¹ Cotula and Spaventa, 1993.

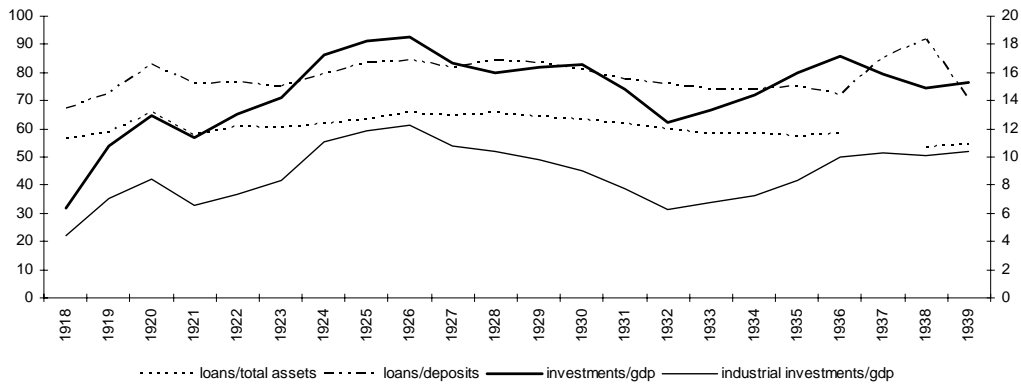
¹² Toniolo, 1993 and 1995.

¹³ Brambilla and Piluso, 2007.

Nonetheless, some specifications are useful in order to explain some specific phenomena of this phase. Here it has been checked whether intermediation, liquidity and profitability were sensible to the investments cycle, as a proxy of the business cycle. Moreover, it has been checked if the ratio between securities and total assets varied over the cycle. These checks have been done both for the banking system as a whole and for the three major mixed banks. Thus, it has been possible to assess to which extent there was a difference in the behaviour and in assets composition between the largest universal banks and the rest of the system.

Graph 2.1 shows a couple of ratios (loans/deposits and loans/total assets) that could be considered a good proxy of the intermediation ratio as a whole. These ratios seem to move along the investment cycle, even though with some exceptions and differences in the intensity degree during the 1930s. In fact, these two ratios follow almost perfectly the investment cycle – both its two components – after the first world war. Ratios move with the investment cycle in the subsequent years, whereas they anticipate the slight resilience of the aggregate investments in 1928 and 1929, but they move against the industrial investments cycle. This divergence between banking and investments could be regarded as a sign of the effects of the deflationary policy on the investment decisions by manufacturing firms and a backlash of the feeble injection of public spending by the government. From the early 1930s these two banking ratios move in a countercyclical way. It seems that the industrial component of aggregate investments is the major one over the entire period, but in 1928-1931 and in 1934-1937.

Graph 2.1 – Intermediation ratios and aggregate investments ratios, 1918-1939

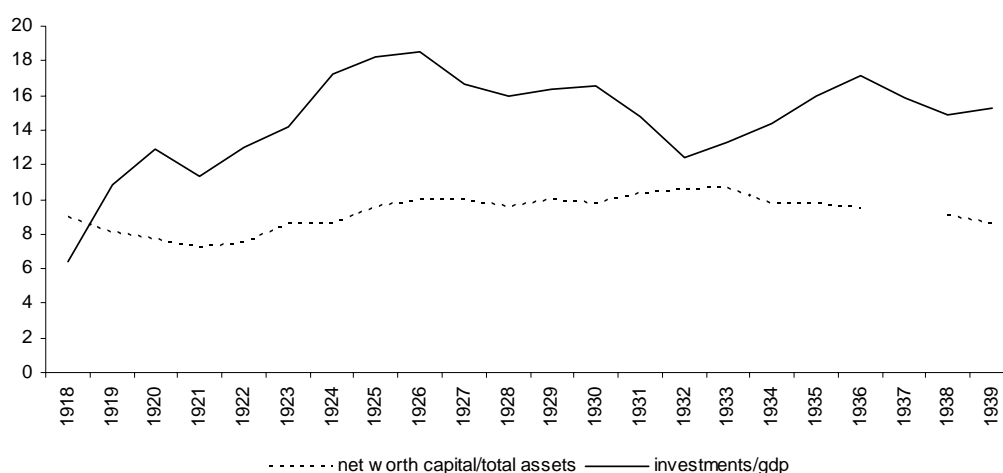


As usual profitability ratios are only partially reliable, depending on window dressing practices, thus a probably more reliable index of long run profitability could be the net worth capital on total assets ratio, that is properly a capital adequacy coefficient. As plotted in graph 2.2 the ratio shows a rather stable movement along the whole period, with a slightly declining trend since the mid-1930s. Such a steady trend in the ratio movement could suggest that the banking system as a whole adopted more or less tacit strategies of stabilisation over credit and business cycles¹⁴. The ratio appears to move in a rather different way in comparison both with the intermediation indexes and with investments cycles. Probably stabilising the capital adequacy coefficient to the cycle were strategies conceived as a sort of last resort wall against crisis and instability. The change occurred in the second half of the 1930s was probably depending on the stricter regulation imposed by the government. Thus, the government pursued the twofold purpose of healing the banks' balance-sheets and of fostering aggregate investments¹⁵.

¹⁴ Brambilla and Piluso, 2007.

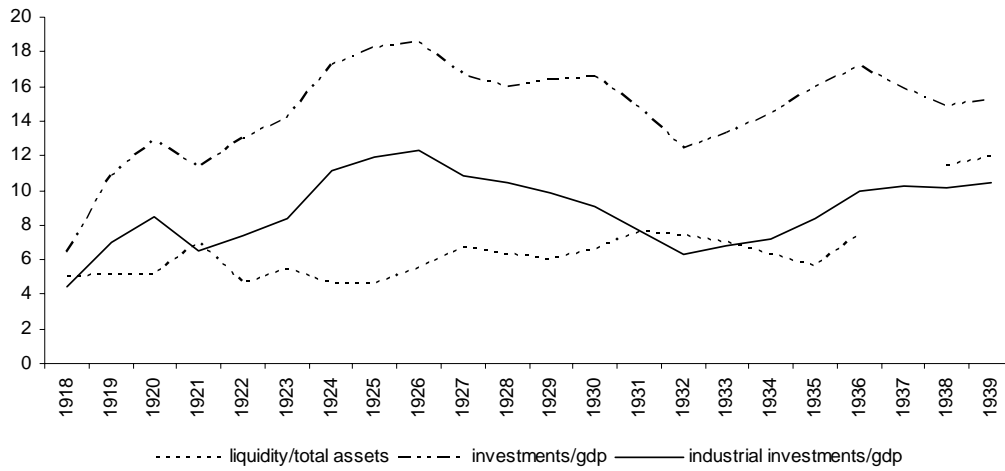
¹⁵ Nevertheless it is worth noting that to some extent the ratio worsened because inflation was rampant again and share capital was not adjusted.

Graph 2.2 – Net worth on total assets ratio and aggregate investments, 1918-1939



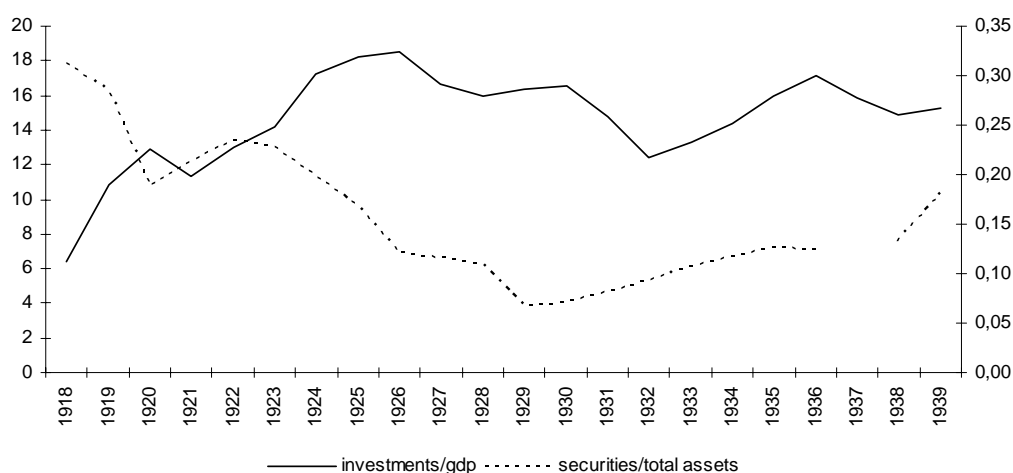
Another ratio could provide some interesting insights into the main banking changes of the interwar period. The liquidity on total assets ratio shows a wholly low level until the late 1920s, by up surging in the following four/five years when the crisis hardly struck the three major universal banks. As expected, at least to some extent, at a first sight this ratio moved by and large along the same trajectory of the intermediation ratios. Actually, this ratio shows a sharp counter-cyclical movement, a tendency rather consistent with the theory: during the upward phases, that is whenever aggregate investments consistently grew, the liquidity ratio was more or less lowering and, on the contrary, every time the investments cycle went down the liquidity ratio was increasing. A noteworthy exception is represented by the business and credit cycles that took place after the mid-1930s. In fact, in this phase both the liquidity ratio and aggregate investments, and above all industrial investments, up-surged strongly. A possible explanation of such a phenomenon could be seen in the growth of the public expenditure, on the real side, and in the adoption of more tight techniques of screening by the banking system, on the financial side (see graph 2.3).

Graph 2.3 – Liquidity ratios and aggregate investments, 1918-1939



The last index considered is the securities to total assets ratio. This ratio is provided in order to measure to which extent the Italian banking system was forced to modify this component of its portfolio. It is well known, of course, that this voice of the balance-sheet could even noticeably vary according to the range of banking institutions considered. For instance, savings banks were largely disposed to acquire securities, especially government securities, in order to offer robust guaranties to their depositors. On the contrary, bonds and even shares probably accounted for the greatest part of the item “securities” in the balance-sheets of the three major mixed banks. This is the reason why chart 2.4 cannot explain at all the progress of securities to total assets ratio of the major mixed banks in the 1920s and 1930s.

Graph 2.4 – Securities/total assets ratio and aggregate investments, 1918-1939



The observable trends of graph 2.4 depended much more on the whole banking system than on the specific composition of the balance-sheets of the few but largest universal banks, whose weight on the system became less strong in the 1930s as a consequence of the regulatory intervention of the government.

3. A European comparison: money, banking, and regulation

To assess the real extent of changes in the more dynamic component of the Italian banking system we can try to compare it with other major European competitors of those years. Indeed, an effective European comparison cannot leave aside some general variables, such as monetary dynamics, regulatory schemes, and banking industry main features. A rather simple macroeconomic frame can be usefully applied to our analysis. First, monetary variables and regulation are relevant in order to correctly evaluate how central authorities shaped the macroeconomic context in which banks were to act in an age of turbulence such as the 1920s. In fact, the specific operational or business banking model, that is whether banks operated as commercial or universal banks, has to take into account both macroeconomic policies and domestic legal systems. As well known, in the first half of the 1920s high inflation (even hyperinflation in the German case) was

quite rampant, suggesting in several cases an expansionary strategy on the supply side. On the contrary, after 25th April 1925, when Great Britain got back to the gold standard, a wave of deflationary policies took gradually place in Europe with relevant effects on banking activities and strategies. A period of deflation or very low inflation followed in the subsequent years. According to some authors gold standard was largely responsible of industrial difficulties and financial downturn, while the end of the gold standard in the early 1930s made it possible to pursue slightly expansionary policies to recover the economy¹⁶.

Macroeconomic policies affected in a special way the Italian banking system, in the late 1920s, and the German banking system, in the early 1930s. In both cases State intervention was conceived to bail out major banks in order to avoid systemic instability. Yet, as said, in Italy the regulatory architecture underwent deep changes and universal banking was formally banned, while in Germany universal banking continued to be a main feature of the national financial system and some mergers amongst major banks took place in the 1930s¹⁷. On the contrary, France and Great Britain were affected by high inflation in the first half of the 1920s, experienced a deflation or very low inflation period in the following years, but with minor effects on their national regulatory system¹⁸. Nevertheless, in France investment banking was generally formally separated from commercial banking, while in Great Britain commercial banking and investment banking were definitely different functions. Yet, even in Great Britain major banks, such as Midland Bank and Lloyds Bank, were interested in the recovery or restructuring processes of some big businesses in the motor car industry in the 1920s and in the 1930s (Midland Bank and Lloyds Bank supported, respectively, Austin Motor Company and Rover Motor Company)¹⁹.

¹⁶ Temin, 1989.

¹⁷ See Hardach, 1995; Schnabel, 2004.

¹⁸ On those cases see Lescure, 1995 and Capie, 1995.

¹⁹ According to James Foreman- Peck such ailing of Austin and Rover produced some long-term negative effects on the British automobile industry (Foreman-Peck, 1981; Church, 1979 and 1994).

4. *Assessing European banking in the interwar period: a balance-sheets approach*

In section 3 we mentioned the evolution of markets, banking and regulation in Europe – and specifically in the largest European countries – during the interwar period, trying to sketch changes and to give account of the different policies adopted by banks and governments in those countries, in order to face the new issues risen with the end of the pre-WWI monetary and economic order. Here we adopt a more micro-level approach, trying to analyse the features of European great banks in this period using data from their balance sheets. Balance sheets are a very interesting kind of source, which presents both advantages and disadvantages. Being perhaps the first and more accessible source of quantitative data about companies, such documents not only give accounts on the development of a business over time, but are also a form of self representation of the firm itself, and a device managers have often used as an important signalling tool towards stakeholders. On the other hand – and to a certain extent for the very same reasons – balance sheets may present pitfalls, that sometimes can be misleading or even seriously limit their usefulness.

Our aim here is to try to assess European banking practices, as compared to those of Italian banks, taking into consideration the other big countries of the continent, namely the United Kingdom, Germany and France, and their banking systems, during the 1920s and 1930s. The analysis considers four benchmark years: 1923, 1927, 1933 and 1936-37. Our sample includes the first three biggest credit intermediaries of each country, that are assumed to be representative of their credit systems, given these latter high degree of concentration. The banks considered are: the Italian Banca Commerciale Italiana, Credito Italiano and Banco di Roma; the German Deutsche Bank, Darmstädter und Nationalbank and Dresdner Bank²⁰; the French Crédit Lyonnais, Société Générale and Comptoir National d'Escompte de Paris; and the British Midland Bank, Lloyds Bank and Barclays Bank. We collected data from these banks balance sheets and, after having opportunely reorganized and standardized all items in a common frame, we calcu-

²⁰ Since the Darmstädter und Nationalbank merged in 1932 with Dresdner Bank, in the subsequent benchmarks it has been replaced with the Commerz und Privatbank, third biggest bank for total assets in 1933.

lated a number of financial ratios through which comparing the structure and behaviour of these institutes²¹. We took into account solvency, liquidity and assets (and liabilities) composition ratios. Liquid assets are defined as the share of cash, money at call and at banks to total assets; solvency is calculated as the share of tier 1 capital to total assets. As for assets composition we considered both the two main indicators, that is direct loans to total assets and investments to total assets, and also engagements or commitments on behalf of customers (acceptances and guarantees) to total assets.

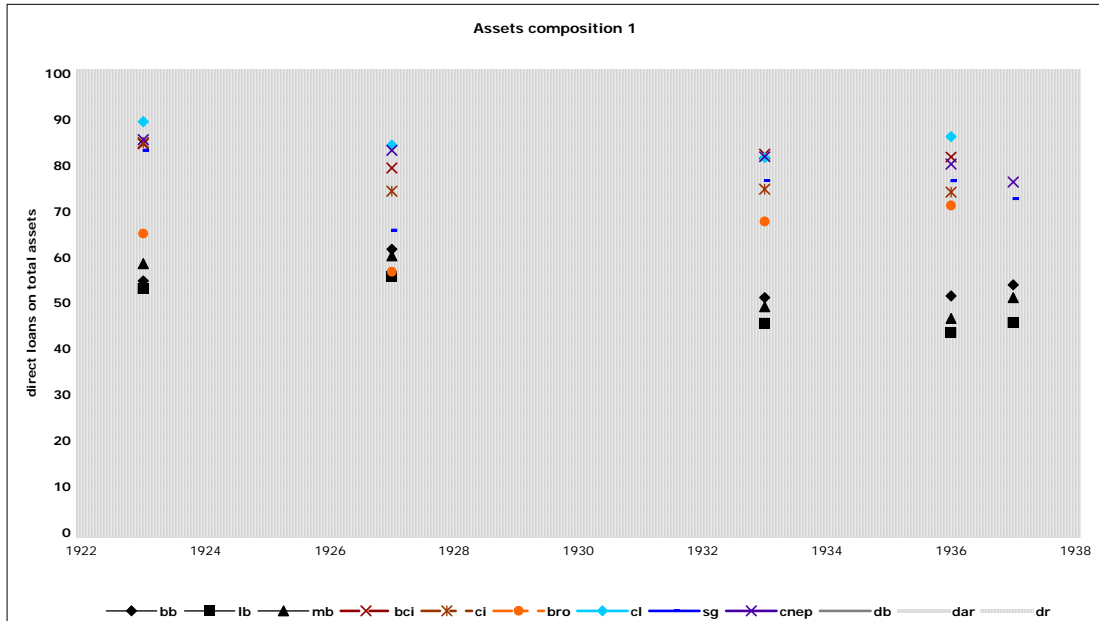
Very often in the literature, differences in banking structures and patterns are studied through the analysis of banks' assets composition²². Classically, a specialised investment bank would present high proportion of investments to total assets as compared to direct loans, while these latter would prevail in a specialised commercial bank's balance sheet. A universal bank, then, would usually have similar proportions of loans and investments in its assets. From this point of view, changes in assets composition would testify an evolution in the banking pattern, showing the adoption or more or less pronounced specialised functions²³. Charts 4.1 and 4.2 show direct loans and investments ratios, respectively, for all the banks in our sample. At a first glance to these two charts, it is astonishingly evident how little differences are in assets structure for all banks considered. Moreover, both charts show a counterintuitive result: it seems that British banks were more likely to have performed investment banking functions as compared to the other European great banks. In fact, not only French, Italian and German banks show higher proportions of direct loans in their assets than British banks, but these latter investments are almost always much higher than those of the other European banks, often as much as the double, or more.

²¹ Data were collected from *The bankers almanac and yearbook*, edited by Thomas Skinner & C., London, Waterloo and Sons, *ad annos*.

²² This is the case of most of the literature on national banking patterns, whether adopting qualitative or quantitative approaches. See for instance Bouvier 1961, Tilly 1966, Cameron 1967 and 1972, Collins 1988, Capie and Collins 1992, Paulet 2002, Forsyth and Verdier 2003, Bonin 2006, Fohlin 2007.

²³ Brambilla 2004; a discussion of such an evolution is for instance the case of Paribas as analysed in Bussière 1992.

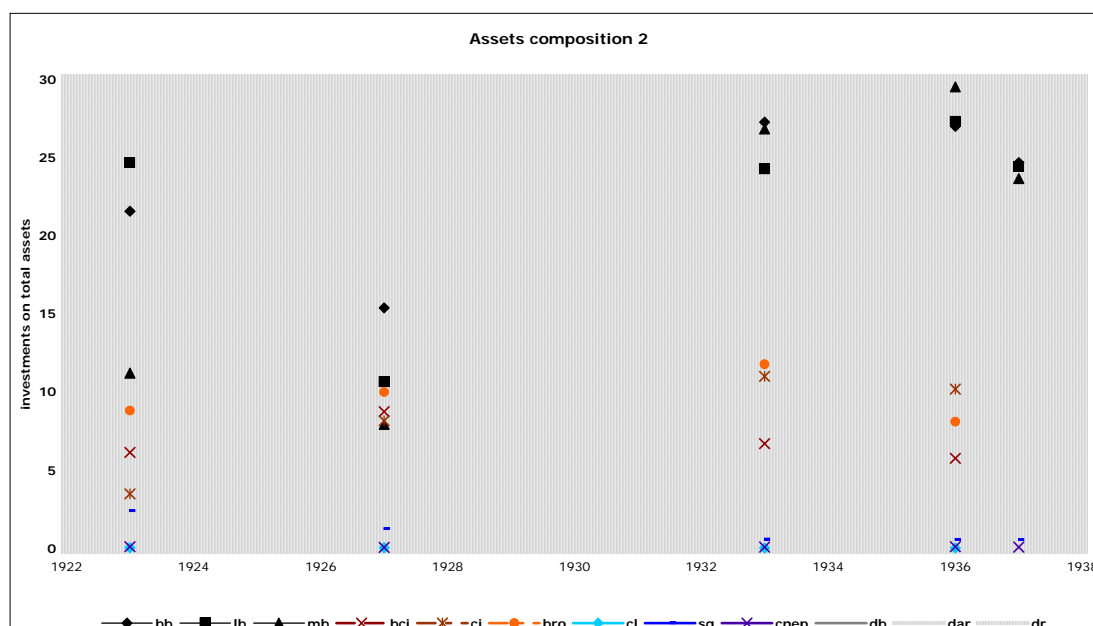
Graph 4.1. Direct loans



Source: our calculations on data from *The bankers almanac cit., ad annos*

Nevertheless, a closer look to the data confirms that things were more complicated than they appear in these charts. Let's consider again chart 4.2; it has to be stressed that most of the British banks' investments were represented by government securities (or government guaranteed securities) and often, above all, by participations in daughter banks. The big English banks used to highlight such participations in their balance sheets, while on the contrary most other European banks present aggregate data on that. Moreover, though direct loans record the pure banking activity, as opposed to investment banking one, they do not tell anything about the quality of loans, nor their duration. Anyway, letting apart accounting methods and traditions, what is clear is that, among continental institutes, only French banks seem to conform to a classic commercial banking pattern, with decreasing levels of investments and quite constant shares of direct loans to total assets. The slightly diminishing trend of the latter shown in chart 1 could well depend from the difficulties experienced during the downturns of the late 1920s and early 1930s.

Graph 4.2. Investments



Source: our calculations on data from *The bankers almanac* cit., *ad annos*

The upward trend experienced by German banks in both charts, then, seem to depend from crises too. The first upward trend is most likely linked to the extremely low levels recorded in 1923, during the hyperinflation; in the second half of both charts we can observe slightly diminishing loans and rapidly increasing investments, coherent with the post 1931-32 crisis recovery and with the universal banking pattern the German banking system continued to rely upon even after the Great crash²⁴. As for Italian banks, we know that most of the “mixed banks” investments were promptly transferred to daughter holding companies or to special (hidden) out-of-balance accounts, not to let them weight down banks’ balance sheets²⁵. That can explain the extremely low level of investment ratios shown by Italian universal banks. Anyway, it has to be noted that a closer look to these data confirms well known behaviours by Italian universal banks. In fact, especially Banca Commerciale and Credito Italiano, the two biggest ones, increased their investments during the ephemeral stock exchange boom of 1925, as it is evident by

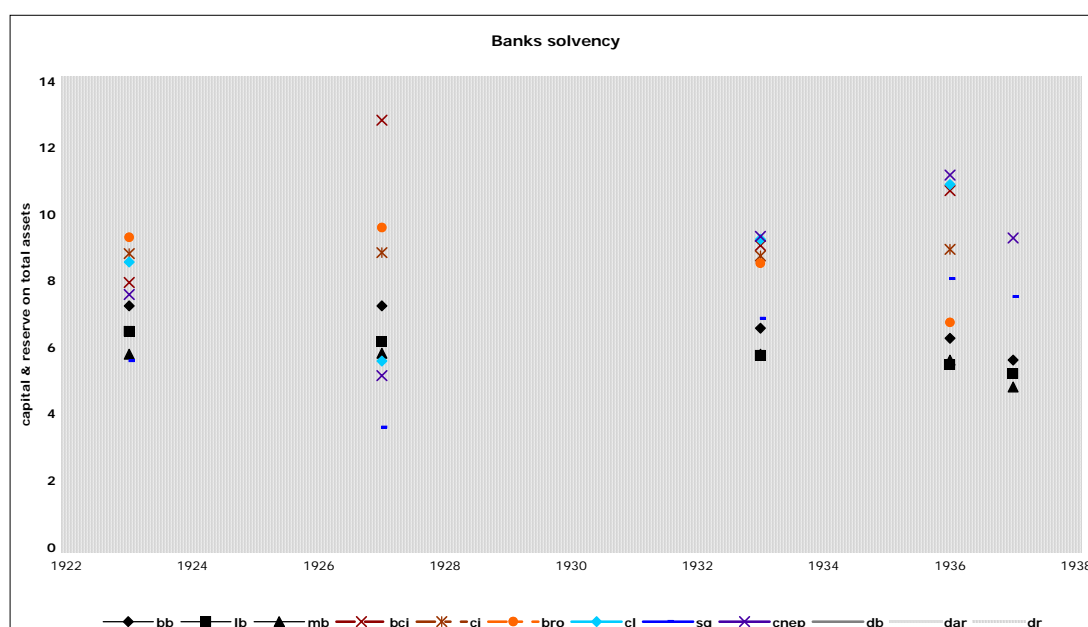
²⁴ Born 1984, Deutsche Bundesbank 1988

²⁵ On “window dressing” techniques – or better, disguising practices – by Italian great banks see Toniolo 1978 and Confalonieri 1994.

the 25-30% increase in securities and participations in 1927 as compared to 1923. As it is clear from data on the last two benchmarks, anyway, direct loans and investments ratios do not tell the whole, nor the exact story of the Italian system evolution during the interwar period. As noticed, this is quite the same as for the other countries considered. Some better insights thus come from the other charts.

Let's consider chart 4.3 and 4.4. Chart 4.3 shows banks' solvency in the period, that is the ratio of tier 1 capital (capital, reserves, retained profits) to total assets.

Graph 4.3. Banks' solvency



Source: our calculations on data from *The bankers almanac cit., ad annos*

As known, this ratio show the financial strength of a bank, and historically tend to lessen as banks start raising mass deposits and to root themselves into the credit system offering services of payment and managing cash and liquid assets on account of the public²⁶. So, being all other things equal, similar banks, i.e. banks with the same assets structure and functional specialisation, would show similar

²⁶ At the beginning bank managers have to “conquer” the public’s trust by signaling their commitment, usually with relatively high shares of capital; as the bank root itslef in the system, and as this latter grows larger, capital adequacy ratios tend to diminish (Brambilla and Conti 2007).

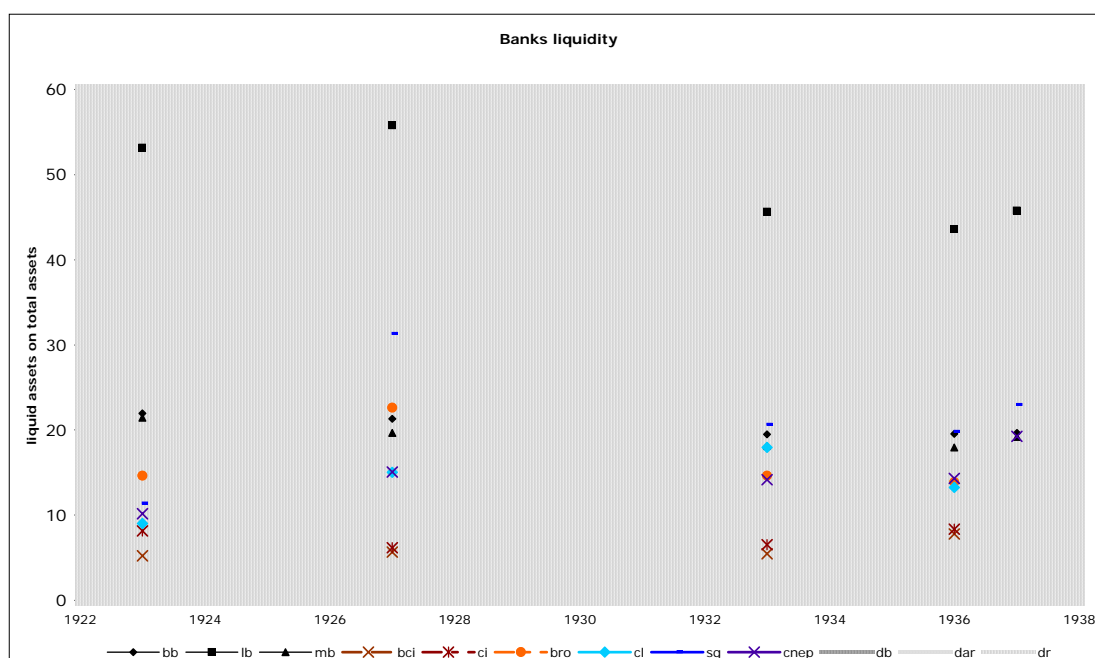
capital adequacy ratios. Thus, chart 4.3 presents interesting results. Indeed while British banks maintain relatively constant solvency ratios, at most a little decreasing ones, throughout the period, at comparatively low levels (5-6.5% with only a couple of minor exceptions), things are different on the continent. On the one hand, French banks seem to confirm their commercial banking pattern, with ratios around similar values as their British counterparts, during the 1920s, which nevertheless tend to increase significantly in the second half of the period, most likely as a reaction to the early 1930s crisis, or may be as a consequence of it, as shown by the reduction of these banks total assets in the last benchmarks. Data on Italian banks, as they appear in the chart, show, on the contrary, that these institutes maintained higher level of solvency, between 8 and 10%, which suggests a higher degree of risks associated to their activity, thus confirming their universal banking vocation. In fact, Credito Italiano and Banco di Roma kept their capital adequacy ratio substantially constant throughout the period, at about 8.5-9.5%. Moreover, the latter decreased it under 7% just after the *de facto* nationalisation of great banks in 1933-34, when industrial participations and financing were either banned or more strictly regulated and, on the other hand, risks of bankruptcy definitely averted. Both Banca Commerciale Italiana and Deutsche Bank show peculiar trends for they issued a considerable amount of new capital in 1927. The increase in the ratio shown by the former in 1936, however, is consistent with qualitative and quantitative evidence on its pursuing a universal banking strategy even after the banking reform of 1936, which characterised also the post-WW2 period²⁷.

Another way to address such an issue is to consider bank liquidity (see chart 4.4). As expected British banks maintain high and constant degrees of liquid assets in all benchmarks. French banks too, confirm their commercial banking specialisation and short-termism with ratios spanning from 15 to 20-22%. On the other hand, data on German and Italian banks suggest a more pronounced long-termism and a balance sheet structure more coherent with universal banking pat-

²⁷ Brambilla 1998; Gigliobianco, Piluso and Toniolo 1999.

terns²⁸. It is anyway amazing how ratios for German banks follow exactly the same trend and how the level they reach in the last two benchmarks is approximately the same as that of Italian banks. Quite interestingly – as it is the case for other indicators too – the Italian banks do not behave all the same. Banco di Roma liquidity ratio, in fact, is far higher than those of Banca Commercial and Credito Italiano, suggesting once again how this institute can hardly be considered a bank with the same specialization and structure as the Big Two.

Graph 4.4. Banks' liquidity ratios



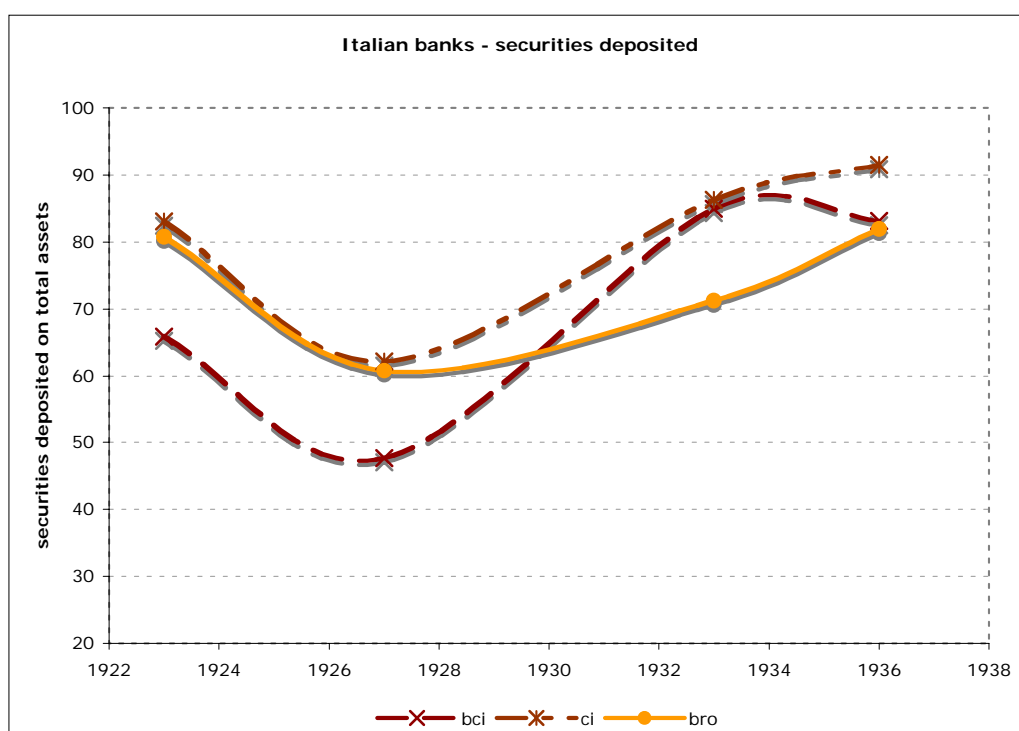
Source: our calculations on data from *The bankers almanac* cit., *ad annos*

Some other indicators could cast light on the evolution of banking patterns in Europe between the wars. This is the case of two other assets composition ratios, which refer to more specific activities, such as services concerning deposits of securities and engagements on behalf of customers – such as acceptances and guarantees. The first is indeed a peculiarity of Italian banks, and it was not found in the other institutes balance sheets (chart 4.5). Its relevance has to do with the

²⁸ The high ratios for German banks in 1923 are clearly outliers which depend on hyperinflation phenomena.

well known fact that most of investments and participations of Italian mixed banks during the 1920s were hidden either in daughter holding companies, or in other accounts, sometimes in special ones. In this sense, the high proportion of securities deposited is quite suspect. Even if we would discard the hypothesis that such accounts did hide banks' own investments instead of collecting securities belonging to customers, it is far from unlikely that these "deposits" belonged to daughter holding companies, or represented securities deposited as collaterals for long term loans and advances to industrial companies, or both – the latter being probably the better explanation. This latter hypothesis seems to hold also as far as the post 1934 period is concerned, given the strict relationships existing between the three former big universal banks and the IRI, the State owned holding company to which Banca Commerciale, Credito Italiano and Banco di Roma belonged after their bailout in 1933-34.

Graph 4.5. Securities deposited

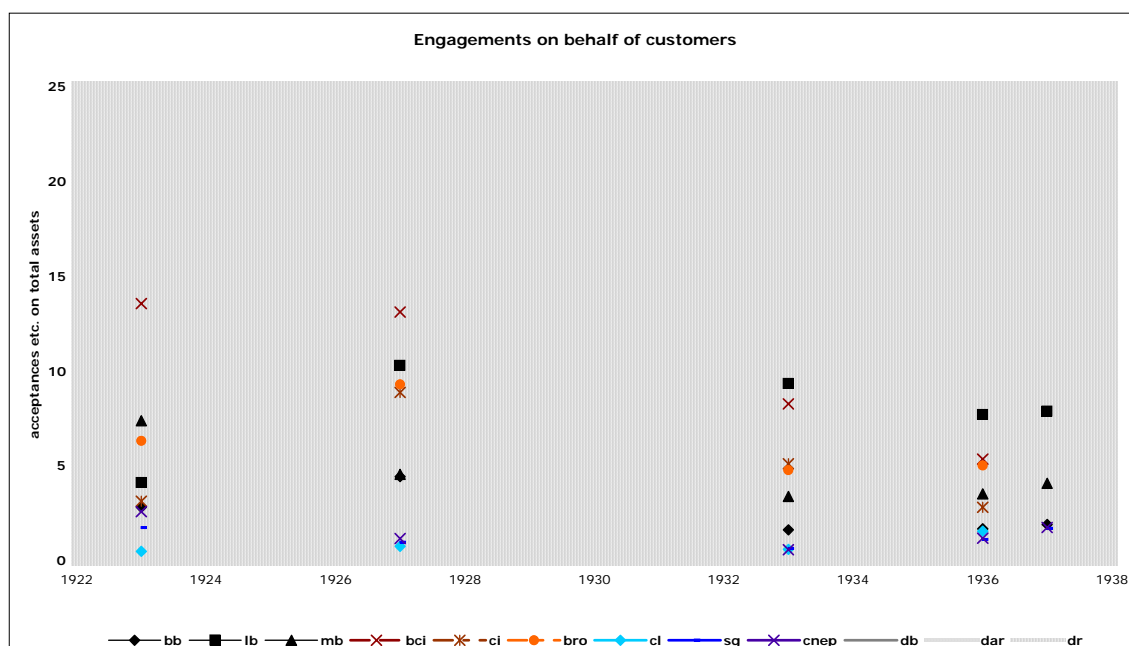


Source: our calculations on data from *The bankers almanac cit., ad annos*

The ratios fall in 1927, then, can be explained as a reaction to the deflationist policy introduced by the government to stabilize the currency external value, provoking a credit crunch and thus the attempt by banks to mobilize their assets.

The last indicator considered – engagements on behalf of customers – is a rough measure of the risks banks are committed to take, in other world of the potential – and as such unknown – outlays. In this sense it can be considered a further indicator of the intrinsic riskiness of a bank’s assets structure. Again, both Italian and German banks show the profile associated with the higher risk, while French and British banks have tiny levels of exposure, showing a much more provident and safe behaviour. What is not that clear is the anyway considerable difference between the ratios maintained by the banks of these two countries. As for Germany, then, it has to be noted that the trend in the ratio is not only quite high but – with the exception of the Deutsche Bank – it tend to increase. In the case of Italian banks, on the contrary, it seems that both the difficulties they faced after the deflationist turning point of 1927 and the consequences of the 1930s crisis led them to decrease their exposures.

Graph 4.6. Engagements on behalf of customers



Source: our calculations on data from *The bankers almanac cit., ad annos*

The balance sheet approach to the assessment of European banking patterns in the interwar period has revealed less fruitful than expected, mainly because of the questionable quality of balance sheets and of the peculiar – so to speak – accountancy and bookkeeping methods typical of the different national traditions and regulation. Nevertheless, despite the opacity of the sources some evidence did emerge. Generally speaking, data seem to suggest a change in structure and patterns in European banking did not occur between the 1920s and the 1930s, and that national banking models, on the contrary, tended to remain unchanged along the whole period, despite the significant changes both in markets and in regulation provoked and introduced in all these countries as a consequence of the 1930-33 crisis.

5. Conclusions

As we have observed, the interwar period may provide interesting insights into the universal banking model when it has to face both financial instability and economic downturns. The Italian universal banking experience before and after the Great Depression could offer an example of adapting strategies to dramatic up and downturn economic phases. Our starting point is that macroeconomic policies were not at all fitting to the universal banking model in presence of financial instability since the mid-1920s when Italian central authorities decided to steer their policies towards a rather restrictive heading. By considering the Italian case in a comparative perspective, this paper tries to assess to which extent universal banking was actually sensitive to business cycles and how much it was connected to financial instability. Second, as monetary policies were largely restrictive from the mid-1920s, the paper considers whether such a policy might have influenced stability and affected the very existence of the universal banking model in the subsequent years by introducing more and more stringent constraints to risk and assets management.

Financial regulatory schemes and monetary policies have been compared for a group of European countries – Italy, France, Germany, and the United Kingdom – in order to reach some conclusions under a microeconomic point of view. We have considered some balance-sheet's data for the three major banks operating in each country at some benchmark years of the interwar period. despite the opacity of the sources some evidence did emerge. Even if balance sheets do not ever provide sufficiently detailed and reliable numbers, data suggest that a change in structures and patterns in European banking did not actually occur between the 1920s and the 1930s, and that national banking models, on the contrary, tended to remain unchanged along the whole period, despite significant changes in markets and in regulation emerged as a consequence of the financial instability of the early 1930s.

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