

Italy's Fazio problem is a symptom of its perverse bank system

By Alberto Alesina and Luigi Zingales

After announcing his support for domestic ownership of Italian banks, critics this summer accused Mr Fazio of openly favouring Banca Popolare Italiana over ABN Amro in a takeover contest. In doing so, he overruled the opinion of his own employees about BPI's financial stability, and for this decision he will be questioned by Italian prosecutors. Since then, Silvio Berlusconi, the Italian prime minister has declared the permanence of Mr Fazio's position as head of the central bank "incompatible with the international credibility of our country"; one economy minister has resigned, refusing to travel with him to Washington; and the new one denied him the right to represent Italy in a World Bank meeting. How can he still be in office?

One reason is the archaic statute of the Italian central bank. Designed in 1936 by the Fascist regime, the Bank of Italy's statute cossets its governors with lifetime appointments, considerable power and relatively few obligations of transparency. Hence, none of the governor's decisions can be challenged on merit. In the past, the problem was mitigated by the fact the prime minister had the power to remove the governor. But this was eliminated under the rules of the European Central Bank. Only the 13-member governing council of the Bank of Italy has the formal right to initiate a dismissal procedure, but guess who sits on that board? Appointees of Mr Fazio. Not surprisingly, these people are among the few in Italy who do not think Mr Fazio has to leave.

The second reason is the inability of Italian institutions to deal swiftly with this kind of problem, an inability that has seriously compromised Italy's international reputation. The government has been timid, afraid of upsetting the hardline Lega Nord, or Northern League, which defended Mr Fazio in exchange for his support of a northern bank. Mr Berlusconi has oscillated between applauding Mr Fazio and asking him to leave, depending, it would seem, on the demands of his coalition partners. Part of the political opposition, also, has been reluctant to demand Mr Fazio's resignation, possibly because Unipol, a company linked to the main opposition party, benefited from the governor's staunch defence of the Italian banking system against foreign acquisitions. The Italian president (himself a former central bank governor who, as prime minister, appointed Mr Fazio) has been remarkably silent on this issue, in spite of an appeal by 270 Italian economists asking him to intervene.

But the real reason for Mr Fazio's resilience is a textbook case of "regulatory capture", in which the regulator internalises the benefits of the regulated, rather than those of the nation. In Italy's perverse system, under which the Bank of Italy is "owned" by the banks it regulates, the central bank's statute lacks safeguards against the possibility that a governor such as Mr Fazio may act to protect Italian banks, shielding them from foreign competition in exchange for their support.

Clearly, the central bank's statute needs serious reform and Mr Fazio must go in order to restore the bank's credibility. If, however, Mr Fazio sticks by his refusal to resign, what to do? First, the ECB should clearly state it does not approve of Mr Fazio's actions, although it would be a bad precedent (both for the ECB and for Italy) if it tried to force his resignation. Second, the central bank's governing council should vote on Mr Fazio's tenure and revoke his appointment. Unfortunately that is unlikely to happen, given the dominance of Mr Fazio's appointees in this body. But let them vote: the council meets tomorrow and such a move would clarify the situation.

If the council's members find nothing reprehensible in Mr Fazio's behaviour, they must declare this openly, putting their reputation on the line. If, as we expect, Mr Fazio survives this vote, the only hope is decisive intervention by Carlo Azeglio Ciampi, the Italian president. He can exert moral authority on the bank's council members. But in this case he must act soon. Thus far, his silence has been interpreted as recognition of his limited constitutional power and respect for the

central bank's independence, but this situation is so serious and extraordinary that he cannot abstain any longer. Italy's reputation is at stake. President Ciampi should speak openly and clearly to Mr Fazio and to the nation. We expect nothing less from him.