Preserving Financial Stability in Times of Crisis. A Tale of Two Public Banks: Monte dei Paschi di Siena and Banco di Sicilia, 1929-1940

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Abstract

In this paper, we investigate the contrasting business strategies and models adopted by two major Italian public banks in the 1930s. Monte dei Paschi di Siena and Banco di Sicilia are interesting case studies for a number of reasons: their strong regional connections; their prolonged struggle for political independence from the national monetary authorities; their common attempt to modify the scale and scope of their business with the creation of integrated banking groups; and their early internationalization of activities. We examine how the two banks were affected by (and involved in) the major financial and economic crisis of the 1930s and show how external shocks altered their banking strategies and models. We also reconstruct the role played by the banking authorities and other important stakeholders.

1. Introduction

The interwar period saw the birth of modern banking regulation in Italy, as in many other countries. It was then that the structure and functioning of Italy's banking system was shaped along

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the lines that would dominate in the decades after the Second World War and last at least until the 1980s.

During the 1920s and early 1930s, several episodes of crisis shook the Italian banking system, involving both the major universal banks and an extensive network of small and medium-sized credit institutions. The former, having undertaken an aggressive transformation of their short-term liabilities into long-term investments and industrial shareholdings, found themselves extremely illiquid and exposed to heavy losses. The latter had taken advantage of the absence of a specific regulatory framework to multiply their leverage, speculate in low-quality commercial or financial paper and build a complicated web of interlocking financial and political relations. These factors augmented systemic risk at the regional and national level, compelling the Government and the Bank of Italy to adopt a battery of *ad hoc* emergency measures while preparing the ground for a regulatory framework to prevent massive failures and contagion (Gigliobianco and Giordano, 2012; Conti, 1999 and 2003).

While the major commercial banks were bailed out and nationalized under the Industrial Reconstruction Institute (IRI), many small regional banks were either taken over by sounder banking institutions or supported by financial facilities from the central bank or IRI itself. Between 1926 and 1936, two banking laws established new limits and requirements: commercial banks were prohibited from making long-term loans and acquiring industrial shareholdings; capital-to-deposit and reserve-to- deposit ratios were imposed for the first time; the opening of new branches and long-term credit sections was made subject to authorization. The new system had the shape of a pyramid, with the Bank of Italy at the top and, immediately below it, a set of eight big public banks under its close surveillance.

In the last two decades a wealth of studies have given us a detailed picture of the processes described above and shed new light on several episodes of banking crisis (for general references see: Giordano 2007; La Francesca, 2004; Cova, La Francesca, Moioli and Bermond, 2008). Nevertheless, some important cases still require deeper historical inquiry.

Monte dei Paschi di Siena (MPS) and Banco di Sicilia (BDS) were two of Italy's most important banks in the twentieth century and two of its oldest financial institutions. By 1936 both had been transformed into public-law credit institutions (PLCIs); they would retain that legal status for most of their history up to the early 1990s, when they were turned into private limited companies with two newly established foundations as their main shareholders.

Throughout those decades, Monte dei Paschi di Siena and Banco di Sicilia were under the close control of the national monetary authorities: the Treasury had the power to appoint (and, if necessary, remove) their respective chairmen and general managers, while the Bank of Italy wielded extensive powers of supervision and control over credit aggregates. The central bank also relied on public-law banks (together with a group of three major "banks of national interest") to enforce its objectives of monetary control over the whole banking system and, more generally, over macroeconomic aggregates. The public nature of BDS and MPS was not limited to their close relationship with the Government and the central bank: under their statutes, their governance was widely exposed to the influence of local institutions (provinces and municipalities) that appointed the majority of members of their management and administrative boards. In this respect, the two banks' governance differed from that of the other public-law credit institutions, where the representation of local powers was weaker and their influence less intrusive.

Another important feature of the two banks was the geographical concentration of their branch networks: in Tuscany for MPS, in Sicily for BDS. Their performance therefore depended to no small extent on economic trends in their respective home regions and they faced considerable difficulty in differentiating their assets more widely both geographically and by productive sector; on the other hand, both banks did enjoy substantial market power that enabled them to capture a large share of total deposits raised in their respective regional areas and to record relatively high operating margins.

However, MPS and BDS were dominant players in two regions with contrasting features and divergent development trajectories.

Tuscany (especially its more backward provinces where MPS maintained a strong presence) was an agricultural and commercial region that never attracted investment from big industrial enterprises. A diffuse process of sustained industrialization only began in Tuscany in the 1970s with the emergence of industrial districts populated by SMEs mainly producing traditional labor-intensive, high-quality manufactures. By contrast, the Sicilian economy centered on the primary sector, both mining and agriculture, the latter characterized by large-scale landholding and monoculture. Industrialization got under way in Sicily in the 1950s thanks to the efforts of regional and national political forces to attract large-scale investments by public and private firms mainly in capital-intensive sectors (chemicals, energy, engineering, and shipbuilding) to turn out semi-finished products for the more advanced industries of northern Italy.

The differences of context may help explain the divergent banking models adopted by MPS and BDS in the mid-twentieth century. In the postwar years, MPS carried on business as a quite traditional, not particularly innovative commercial bank, whose activity consisted chiefly in providing short-term credit to a growing number of small enterprises and local governments; BDS, instead, emerged as a development bank widely engaged in providing long-term credit to spur new economic initiatives and support regional economic development, mainly in construction and heavy industry.

This paper draws on two monographic essays devoted respectively to MPS and BDS (Asso and Nerozzi, 2016; Asso, 2017), based on extensive archival research, for a comparative analysis of some turning points in the history of the two banks. More specifically, we shall examine how MPS and BDS were affected by the banking and economic crisis of the 1930s and how they reacted and changed their banking model. We shall also analyze the role played in this respect by the banking authorities and other important stakeholders, such as the regional and local authorities, that were deeply involved in the governance of the two banks.

Our investigation raises some problems of interpretation. Was the increasing concentration of the banking system and the tighter controls imposed over public-law credit institutions just a necessary corollary of the short-term emergency measures or was it part of a more comprehensive and deliberate long-term strategy? Was the limitation of the territorial expansion of the two banks meant as punishment for their turbulent management during the crisis, or was it instead intended to restrict banking competition and assure monopoly gains to each player, with a view to strengthening financial stability? Did the particular relationship that the Bank of Italy had with MPS and BDS during the 1930s follow a sort of "moral suasion" approach, limiting their expansion in relation to their ability and willingness to cooperate loyally in preserving financial stability and regulating credit conditions? In the rest of this article we shall try to provide an answer to these questions.

2. Two long-established public institutions: MPS and BDS before the 1929 crisis

At the time of the great crash, MPS and BDS were certainly not newcomers. Indeed, MPS was one of the oldest financial institutions in the world. Created at the end of the fifteenth century as a *Monte di Pietà* (pledge bank) to protect poor borrowers from usury, it gradually evolved into a municipal institution mainly providing farm credit to landowners in the Siena area. In 1880, MPS started expanding into other provinces, primarily in southern Tuscany, Umbria and northern Lazio; at the same time, the bank was authorized to grant long-term credit to the building sector and to provide loans and other services to local governments. In 1909, MPS was entrusted with tax collection service at national level, soon gaining an important position in the field alongside with Banca Nazionale del Lavoro.

Between 1880 and 1930, MPS opened almost 250 new branches, mainly in small urban centers. The bank rapidly gained the trust of a population of small savers who, together with wealthy landowners, provided a large and stable deposit base for its geographical and business expansion. By the mid-1920s MPS was a highly liquid, sound bank, perceived as virtually risk-free and well-secured. Its strength rested on its credibility as the financial institution of the city of Siena, whose social elites had always entrusted the bank with the responsibility of holding most of their financial wealth and of assuring them a steady flow of income. Credibility also depended on the highly conservative practices of the bank's management: while the loan-deposit ratio was deliberately kept very low, credit was dispersed over a wide range of high-quality customers in traditional activities and short-term operations. MPS showed no propensity to embark on speculative adventures; it had no ambition to expand its business beyond the nation's borders and soon became one of the leading banks in central Italy.

By the end of World War I, the bank was composed of four separate bodies: a savings bank, the pledge bank, a commercial bank, and a farm credit section. Since the savings bank was the real engine of the bank's activities, the Government had plans to turn MPS into a fully-fledged savings bank, merging the other sections into it. As we shall see, the 1929 crisis led MPS down a different path from a plan which, in view of future developments in banking laws and regulations, would surely have limited its growth potential and prevented it from becoming one of Italy's largest banking groups.

In the early 1930s, MPS assets were mostly concentrated in mortgage credit (75 million lire) and real bills holdings, which together accounted for 50% of total loans, while customer accounts made up 20% and advances 10%. Long-term loans made up 15% of total loans. As Mussolini's farm policy gathered momentum, MPS stepped up its financing of agriculture stockpiles, with outstanding credits rising from 2 million to 40 million lire between 1930 and 1935. Government securities were equal to over 30% of deposits (a bit higher than the average of Italian banking system). Unlike the major commercial banks, MPS held no industrial shareholdings, but only shares of public financial institutions, such as Consorzio Sovvenzioni su Valori Industriali (CSVI), and Consorzio di credito per le opere pubbliche (Crediop). Uncollateralized advances were less than 20% of total loans (Asso and Nerozzi, 2016, p. 44). Let us now turn to Banco di Sicilia.

Established in 1867 as a bank of issue, BDS provided discount facilities and legal tender to small banks and enterprises mainly based in Sicily. The privilege of banknote issuance was part of a pluralistic banking framework that allowed six banks to serve as issuing institutions, with a view to fostering monetary and trade integration between the different parts of the newly united Italy.[1] On average, BDS accounted for quite a stable share of Italy's monetary base – some 5-6% of the national money stock. While a wide web of correspondents allowed BDS to extend its operations to the chief cities of the country, in 1874 the bank opened a branch in Rome, followed, ten years later, by one in Milan. Unlike the other banks of issue, BDS had almost no retail activity and scant direct relationships with the credit market: from 1880, its business focused mainly on rediscounting and was largely delegated to its branches, where local elites wielded powerful influence as members of the "discount committees." This loose governance paved the way to an overexpansion of discounting on behalf of companies that were either directly represented in the committees or well-connected with the committee members appointed by the local authorities (Piluso, 2017).

Credit misallocation and the poor quality of uncollateralized financial paper caused a swift and severe deterioration in the bank's balance sheets that was investigated by the Ministry of the Treasury and eventually led to the removal of its general manager. From 1875 to 1890, Emanuele Notarbartolo, a former mayor of Palermo, served as the managing director. Local elites strenuously resisted his persistent efforts to reform the bank's governance, reduce easy monetary facilities and redirect credit to the most promising enterprises at the national level. These efforts were stymied and their eventual upshot was his murder by members of the local Mafia, probably acting on behalf of Raffaele Palizzolo, a politician from Palermo and vice-president of the bank. In modern Sicilian history, Notarbartolo thus was the first outstanding personality to be killed by the Mafia (Lupo, 1996; Piluso, 2017).

[1] Actually, rediscount operations commenced around 1880; see Piluso, 2017.

In the following decades, BDS managers showed little ability or willingness to break with its worst credit practices. A series of speculative operations were set in train by the Milan branch during the banking and monetary crisis of 1892-94. The banking reform of 1893 established the Bank of Italy as the true national central bank but allowed BDS and Banco di Napoli to maintain their issuing privilege, though in a subsidiary role.

In 1922, Ignazio Mormino was appointed general manager of the bank. A competent banker who followed his own ideas, Mormino oversaw the complex transformation of BDS from bank of issue into public-law credit institution. The need for secure domestic credit management in view of the stabilization of the lira at its new gold parity in 1927 provided the final impetus for the definitive concentration of all powers of monetary control in the Bank of Italy. After putting up a strong fight against the Government's decision to strip BDS of its issuing privilege, Mormino bent his efforts to attaining the best conditions for institutional transformation. The bank's reserves were revalued by almost 500%, allowing considerable growth of its capital endowment and, thus, of its assets. A special credit line, amounting to 200 million lire (almost two-thirds of its reserves) was opened by the Bank of Italy. BDS retained the privilege to issue registered payment certificates ("*fedi di credito*" and "*vaglia cambiari*"). Supervision of BDS and Banco di Napoli was made the responsibility of the Ministry of Finance rather than of the Ministry of Treasury and the Bank of Italy. Finally, a large-scale program of branch expansion both in Italy and abroad was rapidly carried out.[2]

Between 1926 and 1933, the number of BDS branches almost doubled, increasing from 55 to 100, but most of them were located in Sicily and only a handful in large cities in northern Italy (Genoa, Trieste, Fiume, Venice, Turin). However, with the unrestricted open-

[2] On BDS and the unification of the right of issue, see also Balletta, 2011, and La Francesca, 1996.

ing of branches abroad, BDS compensated for its loss of status as a bank of issue with a drive to become the bank of Italian emigrants. It strengthened its relations with Libya and Tunisia, and expanded its activity in the new Italian possessions in the Aegean, with two branches on the islands of Rhodes and Kos. However, the most challenging undertaking of the Mormino era was the establishment of two financial corporations in the United States – the Bansicilia Corporation and SicilTrust, founded in 1924 and designed to stimulate remittance flows to Italy and support the commercial enterprises of the Sicilian community. After the institutional transformation of 1926, the capital endowment of SicilTrust was raised to $3 million and four new agencies were opened in Manhattan and Brooklyn.

A key aspect of the creation of a new banking model was the opening of new "long-term credit sections" to assist economic development. A mining credit section was established to provide both long- and short-term financial support to Sicily's extractive industry, particularly the sulfur mines, which, together with foodstuffs, accounted for the bulk of the island's exports. Both sectors had been hit hard by mounting foreign competition and the technological breakthroughs that had dramatically lowered international prices. Moreover, the drastic revaluation of the lira announced in 1926 by the Mussolini government throttled Sicily's exports. BDS offered emergency credit facilities while also helping firms cope with the challenge of productive restructuring. The activities of the "farm credit section" picked up substantially: large investments went to the Sicilian Land Reclamation Consortium and to creating agricultural cooperatives that would promote technical improvements and more efficient use of land while at the same time offering a shelter against deflation and shrinking margins. The growth of the mortgage credit section in the 1930s significantly increased BDS's capacity to act as a diversified development institution.

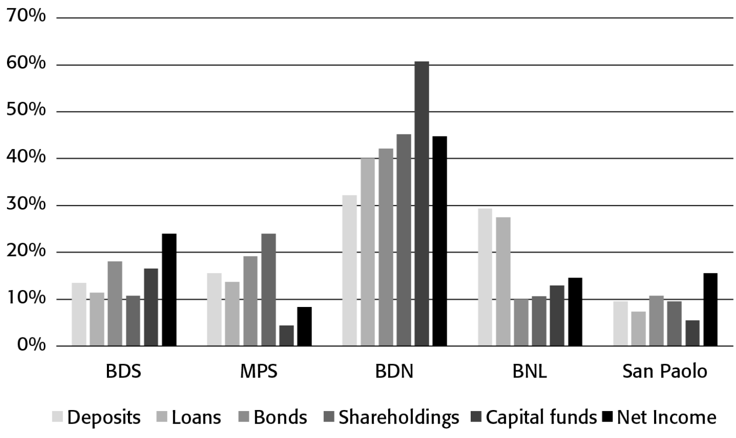
In just a few years after 1926, BDS's structure and operations were radically transformed: the most challenging objective for the bank laid in the field of commercial and development banking, traditionally marginal within its overall operations. Short-term commercial credit rose to 365 million lire, with a total turnover of almost 2 billion lire, most of it to support exports. The consolidation of the assets of the special sections and the savings bank into BDS's banking section further reinforced long-term lending. Between 1925 and 1928 the savings bank section dramatically increased the share of loans in its total investments (from 185 to 315 million lire) and reduced its public bond holdings (from 440 to 293 million lire).

As will be seen in the following section, much of the success achieved in the early years after BDS's transformation was to suffer a dramatic reversal with the onset of the 1929 crisis.

3. Facing the great crash: BDS from Palermo to Wall Street (and return, with a bailout)

At the end of the 1930s, BDS and MPS had similar shares of total public-law-credit-institution (PLCI) deposits and loans but differed markedly in terms of capitalization, net income and total holdings (Figure 1). These disparities were the outcome of the contrasting dynamics of the two banks during that decade of crisis.

FIGURE 1
Key indicators. PLCI market shares (average 1936-1940)

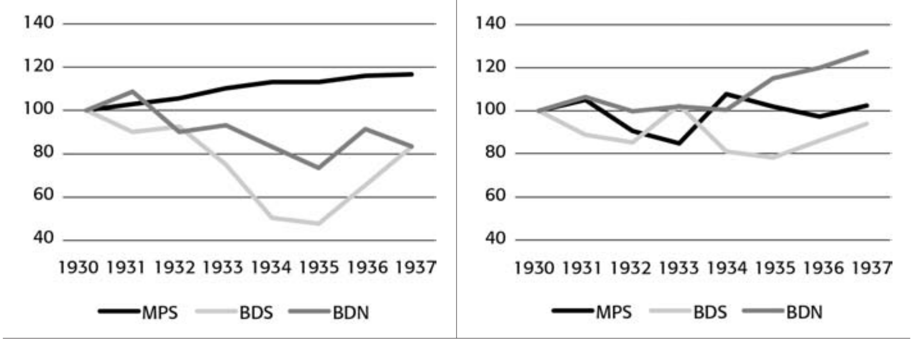


Source: Bank of Italy, *Archivio Storico del Credito in Italia*.

During the 1930s, most banks suffered a steep contraction of balance-sheet aggregates: for the Italian system as a whole, deposits and loans decreased by 30%. Whereas BDS fared worse with respect to the national average, with a 52% contraction in deposits from 1930 to 1935, coupled with a milder decline in loans, MPS maintained a slow rate of expansion during the decade, almost reaching 20% growth in 1937 with respect to 1930 (Figure 2a). Meanwhile, MPS's loans, after falling between 1931 and 1933, recovered and maintained their 1930 level in the following years. The decline in loans for BDS was also severe compared with the lending performance of Banco di Napoli, the other former bank of issue that had suffered a similar fate in 1926 (Figure 2b).

Figure 2
Deposits and Loans (1930 = 100)

a. Deposits (1930 = 100) | b. Loans (1930 = 100)



Sources: Bank of Italy, *Archivio Storico del Credito in Italia* and Monte dei Paschi di Siena, annual financial statements, 1930-1937.

BDS was rocked by the worsening of the Sicilian economy after the drastic shift in national monetary and agriculture policy. The 1927 revaluation of the lira and the abandonment of the gold standard by most countries between 1931 and 1933 further eroded the already weakened competitiveness of Sicilian exports. Thus, while its banking aggregates continued growing in its continental branches, the bulk of BDS's activities located in Sicily stagnated for most of the decade. The bank's assets fell from 628 million lire in 1928 to 550 million in 1931: most of the contraction was due to the most liquid assets, such as commercial paper, while the share of industrial and financial paper increased. The special credit sections also underwent a sharp contraction: farm credit loans fell from 154 to 97 million lire between 1928 and 1931, the value of agricultural investments in new techniques and land improvement plunged to just a few million lire; long-term loans for industrial reorganization of the mining sector were almost completely replaced by short-term advances designed merely to keep the old mining companies alive. Moreover, the quality of the bank's loan book deteriorated sharply: in 1931, an inspection ordered by Finance Minister Antonio Mosconi revealed a huge sum (almost 200 million) of non-performing loans.[3]

The hardest blow to BDS's survival came from its American holdings. In 1924, Mormino had convinced the Government that it would be advisable to set up branches in the United States, in order to provide financial facilities earmarked for the Sicilian-American community. By assisting the flow of remittances and the placement of Italian public bonds among Sicilian emigrants, he had argued, BDS's American operations would contribute to Italy's efforts to stabilize the lira. In 1925 – at about the same time of the new agreement on Italy's inter-allied debts and the new "Kingdom of Italy" loan – BDS established SicilTrust, a fully-fledged commercial bank with branches first in Manhattan and Brooklyn and later in Chicago and New Haven as well. While SicilTrust's shareholders numbered in the thousands, the majority stake was held by the Bansicilia Corporation, a wholly-owned subsidiary of BDS.

Initially, SicilTrust maintained quite a conservative diversification of its investments, which included a large amount of Italian bonds and a broad portfolio of commercial paper. But as the stock market began to climb, SicilTrust, managed by Giuseppe Badami, began concentrating its new investments on Wall Street, with a preference for corporate bonds and shares in the industrial and building

[3] ASBDS, Direzione generale, C, V, 9, Memo from A. Mosconi, 19 April 1931.

sectors. In June 1928, after the bankruptcy of the "Bank of Italy" (not to be confused with Italy's central bank), headed by the Italian-American banker Amedeo Giannini, Mormino invited SicilTrust's director to reduce its stock-market holdings, as prices were "perhaps unduly" high and a downturn might be in the offing.[4] Warnings came also from Luigi Podestà, deputy director of the Bank of Italy in New York, who informed Governor Stringher of the increasingly speculative activities undertaken by SicilTrust and its concomitant opening of four new branches. Yet the management did not reverse its investment strategy.[5]

Paradoxically, Giuseppe Badami, the BDS-appointed manager of SicilTrust who was largely responsible for its persistent bull speculation, was designated in February 1930 to replace Ignazio Mormino as general manager of BDS on Mussolini's orders, a decision that may have been taken on the grounds of Mormino's links to the Freemasonry. After the stock market crash in October 1929, Badami, thinking a technical rebound would ensue, backed SicilTrust's decision not to discontinue its purchases of equities and corporate bonds, hoping to reap capital gains and to avoid booking losses that were deemed to be temporary. Nevertheless, in June 1930, BDS's board had to report that SicilTrust had taken heavy losses, estimated at $1.5 million, and that its net equity was seriously impaired.

An inspection by the New York State Banking Department in the summer of 1930 revealed major imbalances: "improper diversification; overlooking government and high grade municipal bonds; buying too few short term maturities; holding too large a percentage of foreign, industrial investment trust and real estate bonds; not accepting small profits on quality issues."[6] The Banking Department

[4] "We recommend calm and prudence." ASBDS, Trust, 1, Mormino to Palermo, 15 June 1928.

[5] ASBI, Vigilanza sulle aziende di credito, pratt. N. 912, fasc. 1, page 641, Podestà to Stringher, 23 April 1929.

[6] ASBDS, Trust, IV, 2. Report of the Banking Department, New York State, 25 June 1931. The report denounced a long list of "questionable bonds" acquired by SicilTrust and emphasized the risks assumed in the markets of industrial shares and foreign corporate bonds with respect to safer US government securities.

ordered the immediate liquidation of the Bansicilia Corporation for having violated U.S. banking law by offering its own capital as collateral for SicilTrust's desperate attempts to raise fresh liquidity. Further, the Banking Department asked for new capital injections directly from BDS in order to absorb SicilTrust's losses. Between 1931 and 1934, as the value of SicilTrust's assets sank further and new losses emerged, BDS was called on to provide almost $3 million of fresh capital (equivalent to 54 million lire).

Badami was forced to resign in 1932 when an inspection ordered by the Minister of Finance, Antonio Mosconi, found that since 1930 he had falsified the accounts in a desperate attempt to cover losses mainly relating to the SicilTrust case. Apart from the adverse effects of the recession, BDS had been the victim of repeated episodes of misconduct and outright defalcation on the part of officers and managers of the bank, especially in the most peripheral branches. The recurrence of similar episodes throughout the history of the bank can be ascribed primarily to poor internal controls and employee-selection criteria.

After just two years in office, Badami was ousted. The new Finance Minister, Guido Jung, a Sicilian, appointed Giuseppe Dell'Oro, of the Milan bank Credito Italiano to replace him. Dell'Oro was given exceptionally broad powers to restore proper management criteria and clean up BDS's balance sheet: he could take decisions without consulting the board in recruiting and dismissing staff and in reorganizing the tasks and procedures of the different offices.[7]

The SicilTrust crisis had national repercussions and provoked a heavy loss of reserves. To keep its subsidiary from going bankrupt, BDS had to advance huge amounts of cash. In April 1933, the newly founded public corporation, IRI, provided direct support to stabilize BDS, with a rescue package of 85 million lire of new capital, the fifth-largest such operation after those of Banca Commerciale Italiana,

[7] Royal Decree Law 1249 of 17.9.1932 established exceptional powers for the general manager.

Credito Italiano, Banco di Roma and Banca Agricola Italiana (D'Antone, 2012). Dell'Oro was invited to hide the true nature of the losses suffered by BDS, given the "speculative and unwholesome nature" of the transactions carried out by SicilTrust.[8]

Notwithstanding the huge cash infusion by BDS, a third inspection ordered by the New York State Banking Department found that, against $10 million of deposits, SicilTrust had $6 million of assets of doubtful realization and only $2 million of commercial paper. The department asked SicilTrust either to convert BDS's cash advances into reserves or to start the outright liquidation. Both solutions required the payment of another $5 million, an operation which neither BDS nor the Bank of Italy could accept, since it would have further depleted Italy's foreign exchange reserves and threatened the lira's survival in the gold bloc.

A compromise solution was devised by the New York State Banking Department itself, which recommended the merger of SicilTrust into Banco di Napoli Trust. The merger agreement drawn up in February 1936 between Banco di Napoli and BDS represented a serious blow for BDS, which had strenuously defended SicilTrust and was loath to cede its American branch to its historic rival. Dell'Oro procrastinated, seeking alternative solutions. His resistance angered the Bank of Italy's Governor, Vincenzo Azzolini, who worried that further delay might impact the stability of the lira and have contagion effects on other foreign subsidiaries of Italian banks. Dell'Oro finally gave in on 18 September 1936, writing to Finance Minister Paolo Thaon De Revel that he acceded to SicilTrust's merger into Banco di Napoli Trust.[9]

More generally, Dell'Oro's resistance must be read in the light of his efforts to restore BDS's balance sheets after Badami's disastrous management. In the second half of the decade, he achieved some initial results. BDS's profitability and capitalization reached fairly good levels. Net income averaged 3.3% of deposits between

[8] ASBDS, A, V, 5, Direzione generale, Dell'Oro to Menichella, 28 November 1933.
[9] ASBDS, Direzione generale, C, V, 2, Dell'Oro to Thaon de Revel, 18 September 1936.

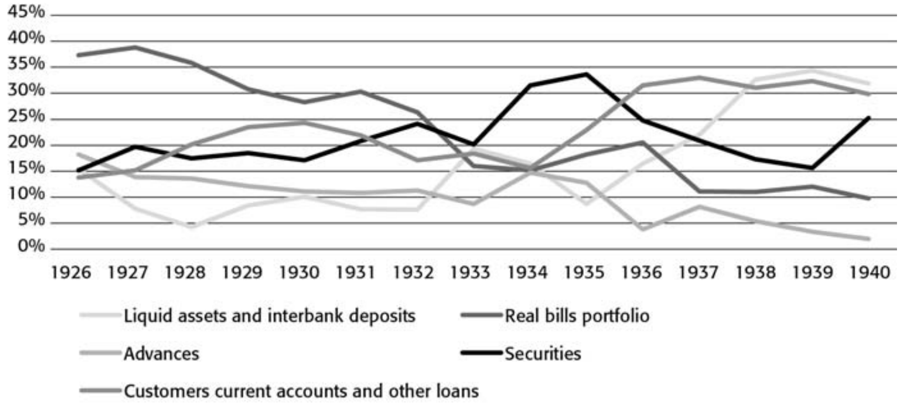
1935 and 1940, a much higher ratio than that of any other public-law credit institution. Capital funds, though declining, were still about 13% of total deposits. Yet all the efforts to recover some of BDS's former prestige and turn it into a fully-fledged national bank were frustrated by the monetary authorities, who did not let the bank expand in other regions. Although BDS was permitted to open four new branches in Rome and Milan, it opened no other branches in important cities after 1936. The Bank of Italy turned down all its requests to establish branches in Italian East Africa. BDS had the fewest branches of any public-law credit institution: 112 (of which only 12 outside Sicily), against Banco di Napoli's 376, Monte dei Paschi's 274 and San Paolo's 122.

Moreover, serious limitations were imposed on its ordinary activity. In 1936, the new Credit Inspectorate chaired by the Governor of the Bank of Italy terminated BDS's authorization to exchange checks with correspondent banks in areas not directly served by its branches. This was probably the single most serious blow to the bank's efforts to regain national bank status.[10] In the late 1930s, BDS also had to contend with the increasing instability of its deposits and short-term liabilities, which compelled it to resort to interbank loans and Bank of Italy advances. However, to finance its activities it could rely on the successful management of its continental branches, where its most important industrial and commercial lending operations took place. Total loans almost doubled between 1935 and 1940, providing abundant new income, mostly on current account loans and discounted paper.

Although the loss of the banknote-issuing function certainly diminished the bank's prestige and institutional importance, it also offered BDS a chance to become one of Italy's foremost universal banks, as the revaluation of its reserves allowed a significant expansion of its assets. This opportunity evaporated in the 1930s, owing to a com-

[10] ASBDS, Direzione generale, C, V, 5, Dell'Oro to Azzolini, 7 February 1939. All banks that did not have branches in at least 30 provinces were subject to this restriction.

Figure 3
BDS: percentage distribution of loans by type, 1926-1940



Source: ASCI. Other assets are not considered.

bination of exogenous causes (the 1927 revaluation of the lira and the 1929 crisis) and endogenous factors (the SicilTrust crash and the mismanagement of the bank, especially under Badami's leadership). Yet, if the bank rapidly dissipated the strong capitalization it had attained in 1926, the bank's transformation facilitated important developments in its structure and nature. The special credit sections established after 1926 – together with an industrial credit section founded in 1944 – soon became the main pillars of growth for the rest of BDS's history as a public development bank up to the 1980s.

In the second half of the 1930s, BDS registered a steep increase in commercial loans and a contraction in its advances and bill discounting (Figure 3). Its government securities portfolio decreased from 35% to 15% of total assets, giving way to steep growth in liquid assets (especially call deposits with other commercial banks). The real bills portfolio declined from 40% of total assets in 1927 to just 12% in 1937-1939. Advances with commercial collateral fell from 15% in 1933 to 3% in 1939. Most of BDS's net income came from the activity of the farm credit section and the savings bank. At a time of monetary stringency and high interest rates, interbank loans were a valuable source of income that BDS was able to exploit, thanks to the steady and cheap flow of savings it raised in Sicily and elsewhere. This process of interbank intermediation was encouraged by the poor state of the Sicilian economy, which, with the sole exception of farm credit, offered no serious outlet for real investments.

Dell'Oro's efforts to rescue BDS from the depths where it had fallen in the Badami era proved successful, though within the framework of the safety net and constraints established by IRI and the Bank of Italy. The monetary authorities and the Government were not immune from oversights and errors in the early stages of the crisis: the very choice of Badami as BDS's general manager in 1930 and his ouster just two years later blemished the record of those responsible for supervising banking stability. When the SicilTrust crisis broke out, it posed a serious threat to monetary stability. However, in the following years, the Government and the Bank of Italy showed a keener awareness of the risk of financial instability associated with loose banking management, and especially of the danger of local elites capturing banks' management and imposing their own interests. Guido Jung's deep knowledge of BDS's problems and of the social context abetted the selection of so competent and independent a man as Giuseppe Dell'Oro, who exerted firm and undivided control over BDS's personnel and management. Nevertheless, BDS's recovery came at the cost of its possible expansion nationwide. Prefiguring the approach it would take after the Second World War, the Bank of Italy's strategy for banking stability centered on limiting the growth of big public banks, preserving their profitability in some geographical areas but preventing their full expansion at national level. As will be seen in the next section, this strategy also shaped the transformation of MPS starting in the 1920s.

4. Who's going to save the savior? MPS and the stabilization of the Tuscan banking system

For MPS, the interwar years brought paradoxical developments:

at the beginning of the 1920s, its strong capitalization enabled it to intervene, both spontaneously and at the behest of the political and monetary authorities, to resolve the crises of several small and medium-sized banks, navigating in what had become turbulent waters. MPS's crucial role in preserving banking stability in central Italy was probably the most important reason why the new Banking Act of 1936 elevated it to the status of public-law credit institution. Yet, at the end of the decade, these achievements turned against MPS: its balance sheets began to show many flaws and weaknesses, and MPS itself became a threat to banking stability, requiring swift action by the monetary authorities. This section examines and explains this trajectory.

Between 1916 and 1939, MPS, under the stewardship of General Manager Alfredo Bruchi, recorded an impressive expansion of both its structure and the volume of credit intermediation: its number of branches rose from 38 to 248 and its deposits grew from 193 to 1,727 million lire. This progress was driven by the growth of the branch network, often the consequence of takeovers of local banks in Tuscany, Lazio and Umbria, including Banca del Trasimeno with six branches (1920-1921) and Banca dell'Umbria in 1929 (with 14 branches).[11]

Originally, MPS decided on its own to embark on these acquisitions in order to penetrate new regions, but after 1929 the Bank of Italy urged it to intervene to preserve deposits and prevent runs on troubled banks that risked being sunk by heavy losses, mismanagement and outright defalcation. The first case was Banca Agricola Italiana, with branches in 55 provinces, whose aggressive strategy of acquiring deposits by offering high returns had produced a steep drop in its income. While Banco di Napoli stepped in to guarantee

[11] Between 1913 and 1924 MPS incorporated Banca Popolare Cooperativa Livornese (1913), Banca Popolare Cooperativa di Arcidosso (1919), Banca Cortonese (1922), Banca di Sconto e Depositi di Montalcino (1921), Banca di Credito Valdarnese (1921), Banca di Valdinievole (1923). Banca di Sconti e Depositi di Dicomano (1924). See ASMPS, B. Bianchi, *Monte dei Paschi di Siena, Centoventidue anni di espansione territoriale*, unpublished, 1986, pp. 35-52.

deposits and liabilities for the branches located in southern Italy, MPS took care of the 33 branches and 23 correspondent offices in Tuscany. The second important case was Banca Mobiliare, headed by Alvaro Marinelli, whose speculative adventures built a far-flung but fragile financial empire (Conti, 2003).

As the storm of bank failures rose, the single most important operation undertaken by MPS was the bailout of two Tuscan-based banks, Credito Toscano and Banca di Firenze, both of them subsequently merged into one bank, Banca Toscana, wholly owned by MPS.

This complex operation began in January 1929, when Bruchi announced that Governor of the Bank of Italy Bonaldo Stringher had asked MPS to rescue Credito Toscano, a bank with 140 branches and capital of 20 million lire. Credito Toscano had immobilized most of its deposits in industrial loans and new holdings. It had made loans totaling 39 million lire to Credito Nazionale, which was only able to survive the 1923 banking with the support of a network of Catholic banks. In 1925, Credito Toscano had acquired Credito Tirreno, another Catholic bank sponsored by the Archbishop of Pisa, Pietro Maffi, who promised 5 million lire in government reimbursement that never arrived. With 250 million lire of deposits, Credito Toscano's fixed assets amounted to 80 million lire and its losses to 62 million. Its extensive financial relationships with the network of rural and artisans' banks in Tuscany amplified the potential impact of its bankruptcy.

The Credito Toscano crisis seriously troubled Benito Mussolini and his Minister for the National Economy, the Florentine Alessandro Martelli, who had sponsored the growth of the bank in the previous years. Moreover, the ultimate fate of Credito Toscano and of the other Catholic banks was an important issue in the complex negotiations underway between the Italian government and the Holy See. Not by chance, the bailout by MPS came on the very same day that the Lateran Pacts between Italy and the Vatican were finally signed.

In the spring of 1930, another critical episode rocked the Tuscan banking system. Banca di Firenze, teetering on the edge of bankruptcy, had to be relieved before depositors panicked and began a run on the bank. Governor Stringher asked MPS for a further effort. From the ashes of Credito Toscano and Banca di Firenze a new bank arose, Banca Toscana, with Bruchi as its chairman and former MPS Deputy General Manager Aldo Serafini as its general manager (Fineschi 1982; Roggi 1982). The whole rescue operation involved fresh capital injections of 56 million lire between 1930 and 1932, some half of which to acquire the two banks and the rest to cover their losses. The Bank of Italy also lent a hand, providing a credit line of 50 million lire directly or through MPS. To assist the building up of adequate capital and reserves, Bruchi announced that MPS would forgo dividends from the new institution.

MPS undertook this large rescue operation at a time when the Bank of Italy and the Government were trying to avert the bankruptcy of Italy's most important banks (Banca Commerciale Italiana, Credito Italiano and Banco di Roma), while also limiting monetary creation and defending the lira within the gold bloc. Thus, MPS stood out as an anchor for banking stability in Tuscany and central Italy, able to absorb a considerable volume of liabilities and losses produced by other banks almost on its own, with little resort to public financial help. This positive "public" role, highly appreciated in Rome, suggested that it would be advisable to include MPS among the new public-law credit institutions, to assist the Bank of Italy in exercising its new powers of monetary and credit control after the 1936 banking reform.

This decision was also designed to curb the power that local elites had traditionally exerted over MPS, which since its birth had been owned by the city of Siena. Town hall designated the members of the board (*Deputazione*) and had the power to choose the chairman and the general manager (*Provveditore*). Furthermore, under the bank's statute a significant share of its net income had to be distributed locally: a host of cultural and social institutions, from the University of Siena to the Accademia Chigiana to Siena's famous *Palio*, survived largely thanks to the steady flow of income from the bank. In addition, the local Fascist party, mostly in the hands of local elites and wealthy landowners, made large resort to MPS provisions.

The new statute of 1936, formulated by the Government and the Bank of Italy after consulting with Bruchi, concentrated all powers in the chairman, abolishing the figure of the *Provveditore* and reducing the role of the *Deputazione*. The national government now designated the bank's chairman, and his powers were extended to comprise both representative and executive duties. The Government also appointed three of the board's eight members. In case of a tied vote, the chairman's vote counted double.

The 1936 statute also envisaged a deep structural reorganization and a considerable enlargement of the bank's ability to operate in different sectors of the financial system and potential to enter new geographical areas.[12] The four sections composing MPS (savings bank, pledge bank, farm credit section and commercial bank) were merged and their capital funds integrated. Only the mortgage credit section remained a separate body within the bank.

Meanwhile, MPS's mix of assets changed significantly. Between 1930 and 1937 the real bills portfolio fell from 50% to 18% of total loans, while customer's accounts rose from 20% to 40% and long-term loans from 15% to 40%. At the same time, MPS became a stable shareholder of chemical and electricity companies and acquired an increasing amount of bonds issued by public utilities, iron and steel, and shipbuilding industries.

The new statute gave Bruchi all executive powers, subject to the advice of the Ministry of the Treasury. This sweeping transformation opened a major conflict between the bank, the Government and the local community: the whole city of Siena felt that "its" bank had been defrauded by an act of *imperium* and delivered into Bruchi's hands. Mayor Fabio Bargagli Petrucci fought to defend the "ancient

[12] MPS was now allowed to engage in most commercial banking operations and to issue different kinds of deposits (denominated in lire or foreign currency; savings as well as current account deposits). It could also issue banking certificates and checks; make investments in the public as well as in the private sector, participating in the capital of public institutions and consortiums designed to support projects of eminent public interest; and provide payment, tax collection and credit services to local governments and public institutions.

rights" of the city of Siena over "its institution" and to avoid a radical overhaul of the bank's governance. After the new statute was published in October 1936, Bargagli Petrucci resigned; staging an open protest of a kind almost unheard of in Italy at the time, he refused to appoint the four municipal members of *Deputazione* and brought legal action against the national government before the State Council (Catoni, 1972 and 2010). In the fierce battle over the bank's new statute, Bruchi won the support of the Government and of Alberto Beneduce, the founding father and president of IMI, IRI and many other important financial institutions whose creation and activity had received strong support from MPS in the previous years. Yet, Bruchi's almost hegemonic command did not endure. Shortly after his elevation to the chairmanship, serious problems came to light. His reign of three decades at the helm of MPS ended when the Government opted for his rapid replacement and for a new change of governance that restored the balance of power in favor of local authorities.

Strains surfaced at MPS after its first inspection by the Bank of Italy, carried out between September 1937 and July 1938, which showed the bank's profitability to be very limited and capital endowment far below any prudential standard. The massive growth of deposits and branches had not been accompanied by significant capital strengthening. Although the new rules of the 1936 statute obliged MPS to set aside 70% of its net income, Bruchi, in its attempt to appease the local elites and, probably, to reward some of his political allies, was still distributing the bank's profits with largesse. Moreover, profits themselves were but a very thin flow, produced only by dispensing with a prudential policy of amortization and provisioning. The weak balance sheets were mainly the consequence of the rescue operations undertaken for the two Tuscan banks and the effort to build up and support Banca Toscana, but they also reflected other loss-making or unprofitable investments. According to the Bank of Italy's inspectors, MPS's accounts were burdened by "more than 192 million lire of completely unprofitable assets [i.e. claims on Banca Toscana, its affiliate Soc. Immobiliari, bad debts, etc.] and almost 150 million of low-income operations [Banca Toscana's share, shareholdings in several institutions, etc.]."[13]

Overall, two-thirds of total loans and investments were illiquid or non-performing. The most important loss was on a real estate investment MPS had made in the Rome's new Monte Mario quarter. According to Paolo Ambrogio, the Bank of Italy's deputy inspector in Siena, the Monte Mario building corporation had incurred 54 million lire of losses, more than half of which pertaining to MPS loans.[14]

Even MPS's rapidly growing portfolio of public and private bonds, equal to more than 35% of its total deposits in 1937 and the backbone of Bruchi's strategy to improve profitability without embarking on other hazardous operations, was exposed to the risk of a sudden drop in market value. Ambrogio noticed how MPS failed to set aside specific provisions against such an event.

Yet, the structural weakness that would continue to mark MPS was the low profitability of its commercial banking business. Its highly fragmented territorial structure, with many small branches located in territories offering few business opportunities, inflated its administrative costs without offering a sufficient volume of turnover and liquid assets. In 1937, according to a memorandum submitted by Deputy General Manager Piero Valiani to the Government, 23 out of the bank's 47 main branches (each comprising a group of branches located in the same territory) closed their accounts with a loss. The rather profitable activity of the mortgage credit section was frustrated by prohibitive financial markets that left virtually no space for its long-term bonds (Figure 5). Only the extra-profits from providing tax collection services to many local governments allowed some relief and made it possible to close the annual accounts with wafer-thin positive net income (Figure 4).

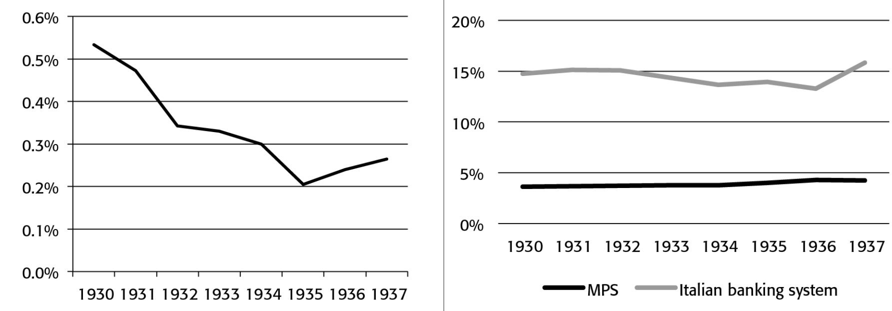
The Siena community took advantage of the poor state of MPS's balance sheet to launch a new campaign against Bruchi's autocratic

[13] Report by Ambrogio (Bank of Italy Inspector) to Azzolini, 30 April 1938, in ASBI, Banca d'Italia, Vigilanza sulle aziende di credito, pratt. N. 1058, fasc. 1, pp. 592-644.
[14] Ibid.

management, arguing that only by restoring close and effective control by the *Deputazione* could safe and balanced management be ensured (Catoni, 2010).

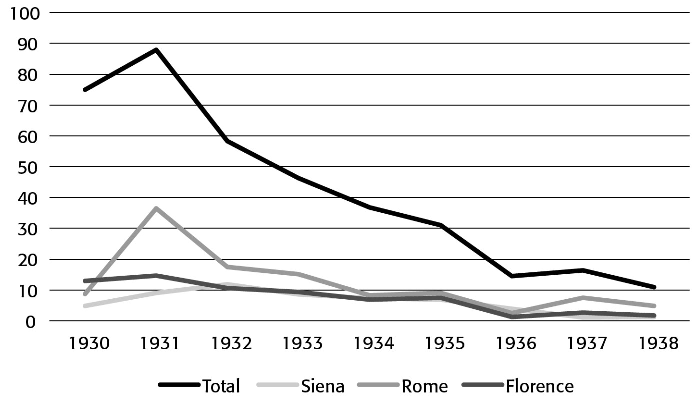
Figure 4
Net income/deposits and Capital funds/deposits

a. Net income/deposits 1930-1937 (%)	b. Capital funds/deposits 1930-1937 (%)



Sources: MPS financial satements, various years, and Riccardo De Bonis, Fabio Farabullini, Miria Rocchelli, and Alessandra Salvio, *Nuove serie storiche di banche e altre istituzioni finanziarie: che cosa ci dicono?*", Banca d'Italia, Rome, 2011.

Figure 5
Mortgage credit. Areas of activity, 1930-1938 (millions of lire)



Source: MPS annual financial statements, new loans.

Given this state of affairs and the growing pressure brought to bear by the Bank of Italy, the Government revised its strategy, revoked the broad powers it had bestowed on Bruchi and enacted a new sweeping reform of MPS's governance. In January 1939, a new statute was approved: the *Provedditore* was restored as the chief executive within the bank; the powers of the chairman were substantially reduced; and the *Deputazione* was enlarged to include a new member appointed by the Province of Siena, thus giving back the majority of votes to local powers. Piero Valiani, a competent and independent banker whose career Bruchi had long sought to obstruct and who was highly esteemed in the city of Siena, was appointed *Provveditore*.

In the end, the city won its long battle to retain control over the bank. Nevertheless, MPS could not be considered an institution of the city of Siena, exclusively devoted to improving the local population's welfare by distributing the profits of its financial activity: MPS was in fact a public-law credit institution playing a significant public role at national level under the close supervision of the Bank of Italy. Governor Azzolini himself personally undertook to explain to the *Deputazione* the scope and implications of the bank's transformation between 1936 and 1939. The *Deputazione*, he observed, had to radically alter its priorities, which now were: building up a structure and selecting staff able to manage its increasingly complex and geographically diversified banking activity; cleansing its balance sheet of a wide array of unproductive assets; devoting the bulk of net profits to capital strengthening; assuming a national perspective in its investment and support activities.[15] It was along these lines and with the responsible cooperation of the *Deputazione* that MPS managed, in the following decades, to follow a stable growth path that allowed it to be counted, in the 1980s, among the "big five" Italian banks.

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[15] Speech by Azzolini to the Deputazione Amministratrice, 10 February 1939, in ASBI, Banca d'Italia, Direttorio Azzolini, cart. 74, fasc.3, sfasc. 1, pp. 3-13.

5. Conclusions

The history of BDS and that of MPS in the 1930s present some features in common and many differences.

On the one hand, both banks were among the few that were transformed into public-law credit institutions; their respective geographical bases of operation were relatively small and predominantly agricultural; and their governance was strongly influenced by powerful local elites.

Conversely, in the interwar years, they followed diverging trajectories. MPS began the 1930s as a solid but not very dynamic, large savings bank, with some specialization in farm and mortgage credit operations. Its prudent investment activities were funded by a broad base of stable and highly fragmented deposits. Its managers had no major speculative activity or ambitious project for international expansion in mind. Moreover, when the ground began to tremble beneath many small and medium-sized banks in central Italy, making some of them collapse, the monetary authorities regarded MPS as a pillar for the preservation of banking stability. Yet, after they had made resort to its services and substantially enlarged its role and raised its status at national level, serious cracks appeared in the bank's foundations and its majestic facade risked crumbling while local interests raised their voice in dissent.

As for BDS, its history as a public-law credit institution began as a downgrading from its status as a national bank of issue. But the loss of this privilege was compensated by a generous legacy: BDS increased its capital endowment, gained new functions in various financial sectors, and acquired a strong grip on its Sicilian geographical base. The bank opened some new city branches on the Italian mainland and expanded in Italy's colonies and in the United States. Then its growth perspectives suffered a sudden downturn: between 1929 and 1932, the bank recorded heavy losses on most of its undertakings, posing a serious threat to banking and monetary stability at both the national and the international level. IRI's rapid intervention averted the worst both for BDS and for the whole country; the bank's dreams of glory reverted to the realm of Neverland. In 1935, all its ambitions to become a fully-fledged national bank with a network of branches in Italy's chief cities and significant international operations were punctured once and for all. Disillusion did, however, have some favorable side effects. After 1935, the bank began to recover profitability and its capital base remained among the strongest in the Italian banking system. BDS also started showing a new business profile, largely dominated by specialized credit sections and its ability to channel financial resources for the development of the Sicilian economy.

While local governments traditionally had a strong hold on both MPS and BDS, the effects of their influence differed considerably. Within MPS's *Deputazione*, debate focused mostly on how to distribute the net profits accruing from banking activity. Local politics had limited influence on the bank's managers in matters other than general strategies or institutional choices. Conversely, BDS's governance and management were intertwined with a dense web of personal relationships, private interests and political conflicts that colored virtually every activity and decision concerning the bank, its operations, investments and staff, not to mention its strategies.

Against this backdrop, the Government's decision to give a strong and independent general manager extensive powers proved highly effective for BDS but produced ambiguous effects on MPS. In the latter case, it certainly helped foster institutional transformation and ensured that the bank responded rapidly to national priorities. However, Bruchi seized the opportunity to build a sort of autarchic power within MPS that did not coincide with the interests of proper and effective management. The recasting of the bank's governance in accordance with a more balanced representation of central and local authorities certainly helped to create an effective network of internal and external controls on the management of the bank.

We have one final point to make about the monetary authorities' role in the two banking crises. In both cases, supervisory powers had been only recently bestowed and were quite late in becoming effective. The monetary authorities did not have an accurate understanding of the real conditions of the two banks; moreover, it took time for the authorities to overcome the informational asymmetries and to grasp the true dimensions of their crises. The framework of banking supervision was still in the making, dispersed among different authorities and not yet strengthened by established intervention procedures. The very fact that BDS remained under the supervision of the Ministry of Finance instead of the Bank of Italy's Inspectorate may explain the delay in addressing the internal crisis and the serious mistake made in replacing – apparently for his critical attitudes toward the Fascist regime – a competent banker like Mormino with a speculative manager like Badami. Likewise, in the case of MPS, a significant mistake was committed in overestimating Bruchi's ability to steer the bank through such a vast and complex bailout process, at a time when MPS's most profitable activities (such as farm credit) had been severely hurt by the financial crisis and the compulsory reduction of bond yields.

In any event, both crises were finally resolved by making resort to tighter direct controls on the part of the Bank of Italy and by limiting the powers of local elites over the banks' management. More generally, the history of MPS and BDS shows how the monetary authorities fostered a process of banking concentration and the rise of five public-law credit institution which, together with the three banks of national interest, formed the bulk of the postwar credit system, offering a secure tool of credit and monetary control under the direct "moral suasion" of the Bank of Italy.

Meanwhile, by the end of the 1930s both BDS and MPS had learned at their own expense that no single public-law credit institution could aspire to become a true national bank capable of securing economies of scale and scope in exchange for a greater degree of market competitiveness. Each of them was assigned a specific geographical area in which a sort of monopolistic primacy over a wide set of banking operations could be maintained. Their crisis in the 1930s proved to be a valid test of how the Bank of Italy was seeking a way to manage the trade-off between stability and competition, clearly anticipating the approach that the central bank would adopt in the years of postwar reconstruction and growth.

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