Available online at www.sciencedirect.com
SCIENCE DIRECT

Int. Fin. Markets, Inst. and Money 14 (2004) 203–219

Journal of INTERNATIONAL FINANCIAL MARKETS, INSTITUTIONS & MONEY

www.elsevier.com/locate/econbase

# Banking competition and macroeconomic conditions: a disaggregate analysis

Paolo Coccorese*

*Dipartimento di Scienze Economiche e Statistiche and CELPE, Università degli Studi di Salerno, Via Ponte don Melillo, 84084 Fisciano SA, Italy*

Accepted 3 July 2003

**Abstract**

In this paper, we aim to assess the competitive conditions in the Italian banking industry in the years 1997–1999, both nationwide and in the standard four macro-regions within the country (North-West, North-East, Center, South and Islands), by employing the Rosse–Panzar *H*-statistic. The empirical results confirm that Italian banks earn revenues as if they were under conditions of monopolistic competition. They also show that there is a positive relationship between the local economic performance and the degree of competition among banks, given that they appear to behave as perfectly competitive firms where local macroeconomic data reveal lower unemployment rates, greater per capita GDP and lower market loan rates.


*JEL classification:* G21; L10

*Keywords:* Banking; Competition; Market structure

## 1. Introduction

After the implementation of the Second Banking Coordination Directive[1] of 1993, banks from European Union countries can branch freely into other EU countries. The liberalisation of capital flows, the prospect of the European common market, the phenomenon of “disintermediation” (the deterioration of the role of banks as financial intermediaries), and

* Tel.: +39-089-962338; fax: +39-089-962049.
*E-mail address:* coccorese@unisa.it (P. Coccorese).

[1] The First Directive on credit institutions was adopted by the European Commission in 1977. For further details, see Molyneux et al. (1994).

1042-4431/$ – see front matter 
doi:10.1016/j.intfin.2003.07.001

the concern for the competitive pressure from foreign rivals have undoubtedly influenced the policy of domestic banks. The main result of the reorganisation of the credit systems has been a sharp growth in the number of concentration processes in EU countries: the enhanced competition has forced banks to look for a bigger size (in order to achieve economies of both scale and scope) as well as a better managerial capability (X-efficiency), in order to improve their overall efficiency. As a consequence, a reduction in the number of operating banks occurred in each EU countries during the last decade.

The above two tendencies (competition and concentration) seem to contrast each other, if we accept the theoretical proposition according to which a more concentrated market implies a lower degree of competition.[2] They also raise questions about the opportunity to allow banks to rely on a significant market power, since this industry plays an essential role in economic development. Through regulatory barriers to entry in banking, the resulting monopoly profits would help the stability of the industry (Greenbaum and Thakor, 1995), but this situation would also involve welfare costs, whereas banking competition would improve the efficiency of the whole financial system, with beneficial effects on macroeconomic performance. This outcome would be important for regional credit markets, especially in those countries (like Italy) where the economic gap between areas is of considerable magnitude.

This paper aims to evaluate the degree of competition in the Italian banking industry, taking into account both the whole country and its main macro-regions. For each area we assess the competitive conditions, so that they can be related with the local macroeconomic performance. To this purpose, we apply a methodology first proposed by Rosse and Panzar to a panel of banks. The next section delineates the main features of the banking market in Italy and its recent evolution, also recalling some links between credit markets and the economy. Section 3 illustrates the Rosse–Panzar test, with particular reference to the theoretical framework, the empirical implications and the existing studies employing this methodology. Section 4 presents and discusses our application to the Italian banking system. Some conclusions are given in the last section.

## 2. Structure and features of the Italian banking industry

Since several years, in Europe there has been a tendency to more concentrated banking markets, especially due to the prospect of the elimination of intra-EU barriers. Today, the new pattern of bank aims to offer a complete variety of services to families and firms. Large and small banks have been therefore forced to undergo organisational rearrangements, and many bank mergers have occurred.

In Italy, in spite of a 21.8% decrease in the number of banks from 1989 to 1999, there has been a growth of intermediated funds as well as an expansion of the banks' territorial network (Table 1). Particularly, in the same time interval there was a 74.3% increase in the number of branches. However, it has not been uniform across the country: Table 2 shows

[2] Other theories (e.g. contestability) maintain that, under particular conditions, competition and concentration can coexist.