

**Path Dependence and Institutional Reform: A Case Study  
on The Reform of Italian Telecommunications Institutions  
1979-2007**

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## Abstract

The theory of path dependence provides important claims to explain institutional development, relating to the roles of self-reinforcing process called 'increasing returns' since the theory is based on insights from economics. Countries remain locked-in onto a given trajectory. Reversals are possible only due to exogenous shocks.

Path dependence has been criticized because it provides an overly static view of the world and for its poor treatment of institutional change. The thesis seeks to remedy these shortcomings and presents a case study based on increasing returns and institutional change. It asks whether increasing returns affect institutional reform and, if so, how and why. The case study proposed concerns the trajectory of Italian telecommunications institutions between 1979 and 2007. The trajectory of British telecommunications institutions is used as a benchmark to offer a structured comparison.

In answer to the research question, the thesis argues that, between 1979 and 1992, there were increasing returns arising out of the relationships between telecommunications providers and elected politicians. These increasing returns contributed to the failure of proposals for reform, thus confirming that increasing returns keep countries on a steady trajectory. But, between 1992 and 1997 remarkable reforms took place. The thesis shows that new institutions were designed with a view to 'cut off' the opportunities for increasing returns to arise, thus indicating that increasing returns can contribute to institutional reform too. The new institutional trajectory of Italian telecommunications since 1997 continues to be shaped by increasing returns through a complex pattern of reactions and counter reactions by elected politicians.

Thus, the thesis makes a contribution to path dependence insofar as it demonstrates that increasing returns can also bring institutional change. New paths can arise without exogenous shocks. In addition, the thesis' findings illustrate that path dependence needs to specify the relationships between increasing returns and actors.

## Introduction

There is a paradox about Italian telecommunications. The same factors that were responsible for lack of institutional change in the period between 1979 and 1992, were then responsible for radical institutional change in the years thereafter. The paradox lies at the heart of the theory that is used to explain the evolution of Italy's trajectory, namely path dependence, and concerns the complex relationships between continuity and change in institutional development.

The paradox can be explained by filling a gap in the theory, which is the main task of the thesis. Path dependence focuses on the reinforcing effects that processes of increasing returns have on institutions. However, there has been little empirical research on what increasing returns mean in the world of politics. It is not surprising, therefore, that there has been equally little attempt to explain that increasing returns accrue to somebody and that the process of appropriation of increasing returns by actors can provide a much richer explanatory tool for the study of institutions.

The thesis shows that increasing returns in telecommunications in the period between 1979 and 1992 accrued to elected politicians. Thus, they had no interest in approving reforms that would have deprived them of such increasing returns. However, the process of appropriation of increasing returns, which consisted in the use of telecommunications providers' resources, created a split within elected politicians. When conditions for reform were ripe in 1992, some elected politicians proposed to overthrow the institutions that were responsible for enabling appropriation of increasing returns and designed institutions inspired by a logic of rejection of appropriation of increasing returns.

This was not a process without conflicts. Other elected politicians, while sharing rejection of appropriation of increasing returns, conceived the new institutions in a different way. The new Italian telecommunications institutions that were borne between 1992 and 1997 are inspired by the tension between these two logics and reflect a contested path of change. But change nevertheless happened and the thesis shows that Italy after 1992 indeed embarked on a new trajectory.

The period between 1997 and 2007 is further analyzed to resolve the ambiguity as to which of the two new logics prevailed. Through analysis of legislative measures passed in this period to make some adjustment in the institutional design, it shows that a logic of limited separation between elected politicians and suppliers has gained the upper hand.

Compared with the UK logic of complete separation between suppliers and elected politicians, Italy's new logic of limited separation provides both a refinement and a confirmation to path dependence for increasing returns can be responsible for radical change, but, even so, in the choices about new institutional trajectories, countries seem to be responding to a voice from their past and, between two alternatives, prefer the one that bear more resemblance with their history.

\* \* \*

The theory of path dependence in political science seeks to explain institutional development. One of its fundamental claims is that often nations follow different institutional paths even if faced by similar pressures. In order to explain institutional divergence across countries, path dependence argues that small initial events that differ across nations can be magnified and result in diverse institutional paths. Divergence across countries cannot be corrected over time. Even if its path is not the most economically



efficient, a country will find itself locked-in onto a given institutional trajectory, with alternative paths becoming progressively out of reach.<sup>1</sup>

The causal mechanism that is responsible for this effect is 'increasing returns'. Increasing returns is a key concept of the theory of path dependence. It is borrowed from economics where it was originally developed to explain the power of standards in modern economic systems. Contrary to 19<sup>th</sup> century neo-classic economics, which was based on *decreasing* returns, the concept of increasing returns makes reference to the fact that the sale of one additional unit of a good incorporating a standard makes it more valuable and attracts new sales, thus generating *increasing* returns. There are two aspects that are worth noting and that are crucial to export this concept to political science: self-reinforcing and repeated interactions. Path dependence in political science builds on the parallelism between the way in which standards operate on the market and the role of institutions. It argues that repeated interactions between actors and institutions and between institutions themselves can lead to a self-reinforcing pattern that is similar to increasing returns in economics. As with standards, this can bring about a lock-in effect, i.e. institutional choices become very hard to reverse. Increasing returns thus provide an explanatory mechanism for institutional lock-in and divergence across countries over time.

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<sup>1</sup> D. C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990). See also the contributions of path dependence leading scholar, Paul Pierson, 'When Effect Becomes Cause: Policy Feedback and Political Change', *World Politics*, 45 (1993), 595-628; 'The Path to European Integration: A Historical Institutional Analysis', *Comparative Political Studies*, 29 (1996), 123-63; 'Not Just What, but *When*: Timing and Sequence in Political Processes', *Studies in American Political Development*, 14 (2000), 72-92; 'The Limits of Design', *Governance*, 13(4) (2000), 475-99; 'Increasing Returns, Path Dependence and the Study of Politics', *The American Political Science Review*, 94 (2000), 251-67; 'Big, Slow-Moving and ... Invisible: Macrosocial Processes in the Study of Comparative Politics', in J. Mahoney and D. Rueschemeyer (eds.), *Comparative Historical Analysis in the Social Sciences* (Cambridge: Cambridge University Press, 2003), 177-207. Parts of these works have been collected in a book, *Politics in Time–History, Institutions and Social Analysis* (Princeton and Oxford: Princeton University Press, 2004).

Path dependence is gaining importance in current debates about comparative political economy and national institutions. Its claims go to the heart of the issues that concern students of these disciplines. Why do countries fail to converge on the most efficient institutions? Why are patently sub-optimal institutional choices so hard to reverse? Path dependence and its key concept of increasing returns can help to provide an answer to these questions. In addition, path dependence also encourages students to focus on the time dimension of institutional choices. Repeated interactions generating a positive feedback are not instantaneous. They take place through time. Path dependence remedies what is often called the ‘snap-shot’ approach to the study of institutions, i.e. a tendency to focus on the period immediately before a major institutional development, to unearth its causes. Path dependence suggests that institutional resilience and change can be linked to small events that were magnified through time. Tracing the origins of the institutions and exploring the reinforcing mechanisms that have enabled them to become embedded helps to obtain a more balanced and complete view, sometimes even providing a completely different perspective on the causes of institutional development in a country’s history.

Path dependence has its critics too. Some argue that path dependence has a natural bias towards explaining institutional stability, rather than change. In fact, it is argued that the lock-in effect that is associated with increasing returns portrays an overly static view of the political world and could result in a new form of determinism.<sup>2</sup> Others argue that path

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<sup>2</sup> C. Crouch and H. Farrell, ‘Breaking the Path of Institutional Development? Alternatives to the New Determinism’, MPIfG Discussion Paper (2002), available at [www.mpi-fg-koeln.mpg.de](http://www.mpi-fg-koeln.mpg.de). For a later version of this article, see *Rationality and Society*, 16(1) (2004), 5-43. For further criticism of path dependence, see also H. Schwartz, ‘Down the Wrong Path: Path Dependence, Markets, and Increasing Returns’, available at [www.people.virginia.edu](http://www.people.virginia.edu). For recent discussions of path dependence and institutional change, see T. Boas, ‘Conceptualizing Continuity and Change – The Composite-Standard Model Path Dependence’, *Journal of Theoretical Politics*, 19(1) 2007, 33-54; I. Greener, ‘Path Dependence, Realism and the NHS’, *British Politics*, 1(3) 2006, 319-343; F. Ross, ‘An Alternative Institutional Theory to Path Dependence: Evaluating the Greener Model’, *British Politics*, 2 (2007), 91-99.

dependence's treatment of institutional change is too limiting, because it only allows for exogenous shocks as the cause to explain the end of a path.<sup>3</sup> Thus, exogenous shocks play the role of *deus ex machina* in the ancient Greek tragedies.

In a first attempt to overcome these shortcomings, Richard Deeg proposes to introduce a definition of 'path' within the theory of path dependence.<sup>4</sup> He suggests that a path is defined by the set of institution-based constraints experienced by actors, which he calls the 'logic' of a path. Thus, the logic of the post-war German financial system is, according to Deeg, a 'bank-based logic'. Further, Deeg suggests to study interactions between different levels, such as an industrial sector and political parties, as a source of increasing returns. Another refinement of path dependence brought by Deeg is the distinction between 'on-path' and 'off-path' change and its relation with the 'logic' of a path. Given that institutions are far from being petrified entities, one is confronted with the issue of characterization of change that takes place continuously. Deeg argues that 'on-path' change designates alterations that take place in compliance with an existing logic, whereas 'off-path' change is the product of a new logic.

The thesis builds on this research to make a contribution to path dependence as a theory to study institutional change. It asks whether increasing returns affect institutional reform and, if so, how and why. The salience of this question for path dependence is two-

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<sup>3</sup> R. Deeg, 'Path dependency, Institutional Complementarity, and Change in National Business Systems', in G. Morgan, R. Whitley and E. Moen (eds.), *Changing Capitalisms? Internationalization, Institutional Change, and Systems of Economic Organization* (Oxford: OUP, 2004), 21-51, at 23.

<sup>4</sup> R. Deeg, 'Institutional Change and Path Dependency: The Transformation of German and Italian Finance', paper presented at the 14<sup>th</sup> International Conference of Europeanists, Chicago, March 11-13, 2004; 'Institutional Change and the Uses and Limits of Path Dependency: The Case of German Finance', MPIfG Discussion Paper 01/6, available at [www.mpi-fg-koeln.mpg.de](http://www.mpi-fg-koeln.mpg.de); 'Change from Within: German and Italian Finance in the 1990s', in W. Streeck and K. Thelen (eds.), *Beyond Continuity: Explorations in the Dynamics of Advanced Political Economies* (Oxford: Oxford University Press, 2005), 169-202; and 'Path dependency, Institutional Complementarity, and Change in National Business Systems'.

fold. First, the thesis seeks to provide an empirically based study of path dependence and institutions. Indeed, due to its relative novelty, few have attempted to apply path dependence to study real cases of institutional development. Second, the thesis seeks to overcome path dependence's current weakness insofar as increasing returns appear ill-suited to explain institutional change.

The central argument that is put forward in answer to the research question is that increasing returns bring also institutional change because of the reactions of actors to increasing returns. Actors within a path may be spurred to design new institutions in deliberate opposition to increasing returns and give rise to a new institutional trajectory that is shaped by increasing returns.

This has important implications for path dependence. It broadens the theory's explanatory power insofar as it reconciles increasing returns with institutional change without the need to call on *deus ex machina* explanations. In addition, it contributes to refining the concept of increasing returns. Sometimes path dependence seems to assume that increasing returns are faceless processes that, once set in motion, take a life of their own and do not need actors. The thesis shows that there are complex relationships between actors and increasing returns that play a central role in the institutional development. Path dependence can significantly benefit from paying a more sustained attention to these relationships since they enrich the notion of increasing returns and make it better equipped to cope with the challenges of explaining institutional change in a country's history.

### ***Overview of the thesis***

The key concepts of path dependence, the research question and the methodology used are set out in chapter 1. Chapter 2 provides a short history of telecommunications institutions in the two countries. It shows that the starting points of the institutional

trajectories in 1979 were very different. In Britain, provision of telecommunication services had been entrusted from the early days to a single, state-owned supplier, the Post Office. The Post Office enjoyed a complete monopoly “*throughout the British islands*” and it had the power to set tariffs. However, Post Office finances were part of the central government budget. In contrast, provision of telecommunications services in Italy was entrusted to a multiplicity of private companies operating under a licence. One provider, Azienda di Stato per i Servizi Telefonici (ASST), was a ministerial body. Through time, the number of private companies decreased to three: SIP, Telespazio and Italcable. Although limited liability companies, they were controlled by the state through Istituto per la Ricostruzione Industriale (IRI), a state-controlled holding entity. Their finances fell outside the government budget. Chapter two shows that pressures for changing the organization of the sector began already before 1979. Services provided by ASST and SIP largely overlapped, which caused inefficiency and acted as a hindrance to development at a time of fast growth and innovation. The inflationary pressures of the 1970s encumbered SIP with a precarious financial position as its tariffs were set by ministerial decrees, but the government did not allow SIP tariffs to reflect inflation and so the company found itself unable to provide services in a satisfactory manner. In addition, SIP lacked the resources to meet a surge in demand and to adequately invest in the network. Thus, the chapter underlines the considerable institutional differences between the two countries in 1979 and the pressure for institutional change in Italy pre-dating 1979, i.e. the period from which the thesis undertakes a detailed study of the Italian trajectory.

Chapter 3 sets out the British trajectory after 1979 and until 2007, which represents the benchmark trajectory. The chapter sets out how supply of telecommunications was given to a separate entity, British Telecommunications (BT) in 1981. The 1984 Telecommunications Act paved the way for BT’s privatization, opened the sector gradually

to competition and established an independent regulatory agency. The logic underlying these changes was one of separation between elected politicians and suppliers. First, elected politicians had little ability to influence pricing decisions by the suppliers. Second, they did not own the suppliers. Third, there were clear rules as to the independent regulator's tasks and those of elected politicians. This logic remained unchanged in the following years and represents the benchmark against which one can assess Italy's trajectory.

Chapter 4 plays a central role in the thesis, providing empirical evidence as to the existence of increasing returns in Italian telecommunications and how they affected the institutional trajectory. It shows how, after the crisis of 1979, SIP became highly dependent on political parties to obtain state funds needed to continue to provide services and expand the network in compliance with the terms of its licence. Political parties requested that SIP acted according to certain directions given by them. They appointed 'loyal' management in proportion to their electoral weight (*'lottizzazione'*) and then expected management to carry out their instructions. Tariff increases, another vital component of SIP's viability given that its revenues were entirely based on tariffs, were also in the hands of political parties, which used their power of approval to further condition SIP's behaviour according to their needs. In particular, SIP's resources were used to hire staff, to make investments in depressed areas, to buy equipment from 'friendly' firms and in a variety of other ways that could boost power and influence of political parties and, ultimately, bring votes. A similar, if even more pronounced, relationship bound political parties and ASST. Being a part of the central government as a unit within a department, ASST was even more subject to political control and it was in fact the preferred vehicle to carry out politically oriented manoeuvres as its accounting rules allowed for little outside oversight.

But investment decisions made in the name of political patronage dissipated resources. SIP and ASST were burdened with inefficient expenses and so were permanently in need of fresh funds to continue to operate. Telecommunications providers thus had to go back, cap in hand, to the political parties to obtain new resources. The process then restarted and a new round of financing carried with it new conditions. Therefore, this process had a crucial self-reinforcing aspect which made the relationship between suppliers and elected politicians extremely strong. Given its self-reinforcing character, this relationship embodies a case of increasing returns.

By tracing the attempts to reform the organization of the sector that took place between 1979 and 1992, the chapter shows how such increasing returns played a role in shaping the institutional trajectory of Italian telecommunications. The fragmented architecture of the telecommunications sector matched very well the multiple centres of power that governed Italy during the period studied. The several parties that formed the coalition governments and factions within the Christian Democratic Party could each control a sphere of power within telecommunications. Increasing returns fostered an institutional trajectory based on the continued fragmentation of the telecommunications sector. Until 1987, when EU legislation imposed change, there was no legislative measure to reform the split-supplier system. Yet, even when a law was passed to comply in 1992 with EU requirements, it still permitted the perpetuation of a split-supplier system.

The chapter shows that, as suggested by path dependence theory, increasing returns acted to keep Italy on a bounded trajectory of change. This can also be appreciated by benchmarking Italy's trajectory. Whereas in Britain supply of telecommunications services was opened to competition, BT was in private hands and there was an independent regulator, in Italy there was a tight monopoly, a split between different suppliers, all of which were in

state hands and regulatory powers were held by elected politicians. The overall logic of the Italian path was indeed based on elected politicians' control over suppliers, so much so that the two were bound together by a self-reinforcing relationship which ensured that institutional development followed a well-defined, continuous path, profoundly different from the one followed by Britain, whose logic was based on the opposite concept of independence of suppliers from elected politicians.

Based on the findings of Chapter 4, one should have expected that, in the years following 1992, Italy would have continued along a path of split-suppliers, state control and monopoly, according to a logic of control by elected politicians. However, chapter 5 demonstrates that the fundamental reforms which took place between 1992 and 1997 changed Italian telecommunications in an unexpected way. This is because, in 1994, all providers were merged into Telecom Italia. In 1995, a framework law was passed to set up independent regulators and in 1997 the creation of a telecommunications regulator, *Autorità per le Garanzie nelle Comunicazioni* ("AGCOM"), was approved. Finally, the rules on competition were also substantially changed in 1997.

These developments challenge the ability of path dependence to explain institutional development and raise the question of the role of increasing returns (as described in chapter 4) for institutional reform in Italy. In its current state of development, path dependence often invokes *deus ex machina* explanations that 'break' existing paths. Indeed, in 1992 very significant changes took place on the national political level that make 1992 a watershed in Italian history so that it is common to hold that 1992 marked the end of what was called 'First Republic'. Following such approaches, the end of the First Republic would be seen by current interpretations of path dependence as an 'exogenous shock' that ended increasing



returns, which therefore would play no further role in institutional change, which would therefore follow a new path.

The findings of chapter 5 reject this contention and show that past increasing returns contributed to shaping institutional choices and so affected institutional reform at the sector specific level. The chapter argues that, due to the end of the First Republic, increasing returns ended in 1992-1993. But policy makers charged with the task of designing new institutions looked at *past* increasing returns, i.e. increasing returns observed in the period between 1979 and 1992, and some of them opted to design institutions in a spirit of deliberate opposition to such past increasing returns. The government held by Giuliano Amato, which took office in 1992-1993, pursued a policy of economic reform that interpreted privatization, independent regulation and a single supplier as a way to 'cut off' mechanisms that had been instrumental to increasing returns. Others, though, drew a different lesson. Although inspired by the same rejection for increasing returns, they opposed the adoption of a UK-style logic of full separation and the loss of power that this would mean. This produced a conflict between the two logics, both of which, notably, took as their point of departure past increasing returns. The conflict surfaced prominently in the passage of the law of 1995 and the AGCOM law in 1997 and it shaped the way in which the rules on appointment of AGCOM Commissioners and Presidents were set out. These rules ensured that AGCOM Commissioners represented political parties' relative weight in Parliament, whereas the President was appointed by the Prime Minister, thus giving a slight premium to the ruling coalition.

The findings of chapter 5 are of great importance for the thesis. They show that increasing returns were at the origin of institutional reform. This is a so far unnoticed aspect of increasing returns and, in fact, responds to criticism that the theory can only explain

bounded change. In contrast, chapter 5 shows that increasing returns can also contribute to institutional reform. What is relevant for the theory is that an analysis of the beneficiaries of increasing returns and the way in which increasing returns are appropriated is crucial to inject a higher degree of dynamics in path dependence. These aspects may uncover a complex pattern of reactions and counter-reactions that in turn sets in motion a process of institutional reform. Provided they are incorporated into path dependence analyses, they can greatly expand increasing returns' explanatory power.

In 1997, Italy and Britain shared important formal institutional features. In both countries the leading supplier was privatized and there was full competition. Nevertheless, the rules on appointment of the regulator differed to a significant extent. More importantly, it was not clear whether the logic of the Italian path was consistent with that of the British path. In fact, some elected politicians in Italy had opposed the adoption of a UK-style logic and pushed for a lower degree of separation between suppliers and elected politicians. They had already obtained a significant result in 1997 in the way in which the appointment rules of AGCOM were crafted. Thus, in 1997 the logic of Italy's path was ambiguous and contested. This warrants a separate chapter to study the period after 1997 and assess the direction of the institutional trajectory.

The task of chapter 6 is indeed to continue the analysis of Italy's trajectory after the creation of new institutions in 1997, when a state of conflict between two possible logics of development made the direction towards which Italy was going ambiguous. The chapter shows that, between 1997 and 2007, legislative measures were passed under the second Amato government in 2001 and later in 2003 (under the Berlusconi government) to transfer licensing powers from AGCOM to the Ministry and entrust the latter with new, not well-defined, regulatory powers. In addition, there was a general climate of hostility against

independent regulators. Moreover, between 2006 and 2007, the government led by Romano Prodi, while putting forward a bill whose purpose was to strengthen the independence of regulators, became very actively involved in matters concerning ownership and market structure, by forcing Telecom Italia to abandon plans to sell its mobile telephony business and seriously discouraging a takeover of the company by foreign carriers.

This evidence shows that, after 1997, Italy embarked on a distinctive path compared to Britain's. Some of its formal institutions are similar to Britain's, such as full competition and private ownership. However, regulatory powers in Italy are divided between AGCOM and the Ministry, whereas in Britain most are clearly in the hands of the regulator. Moreover, the logic of the two paths appears different. Whereas the British logic is based on separation between suppliers and elected politicians, in Italy opponents of a UK-style logic emerged as strong contestants from the earlier conflict of the 1990s. The Italian logic is based on limited separation between elected politicians and suppliers.

The thesis' main contribution to path dependence relates to the role of increasing returns in processes of institutional change. The findings of chapter 4 buttress path dependence's current claims concerning increasing returns and bounded change. Chapter 5 provides new insights. Increasing returns were at the heart of a process that led Italy onto a new trajectory. This was made possible by the relationships between increasing returns and elected politicians whereby the latter staged a reaction against increasing returns and sought to design new institutions to prevent increasing returns to arise.

Thus, the thesis refines the current understanding of institutional change under path dependence since it shows that increasing returns and institutional change can be reconciled, provided that an increased attention is paid to the role of actors. Increasing returns processes

are not automatic. Path dependence can significantly expand its explanatory power if the relationships between increasing returns and actors are adequately taken into account.

# 1. INSTITUTIONAL REFORM AT THE SECTOR-SPECIFIC LEVEL AND PATH DEPENDENCE: A CASE STUDY ON ITALIAN TELECOMMUNICATIONS

## I. INTRODUCTION

The purpose of this first chapter is to set out the research question, its relevance for path dependence, and how the thesis plans to address this question. Since the groundbreaking study of North appeared in 1990,<sup>5</sup> “path dependence” is often used in studies discussing institutional change and continuity. Yet, there is still little empirical evidence to support the claim made by path dependence’s leading scholar Paul Pierson that “*it is the role of path dependence in explaining patterns of institutional emergence, persistence, and change that may be of greatest significance for the social science*”.<sup>6</sup> Moreover, some contend that the theory is in fact ill equipped to explain institutional change. As Deeg has argued, “*strong versions of path dependency (such as Pierson’s) imply that only an exogenous shock ... can lead to the end of the path. Short of this, change is incremental or on-path*”,<sup>7</sup> adding that such strong versions of path dependence are “*too limiting to cover the full extent of real institutional change*”.<sup>8</sup>

The thesis’s question concerning the role of path dependence in processes of institutional reform is therefore designed to address the theory’s current shortcomings as identified by its critics. More specifically, the thesis asks whether increasing returns, the core-concept of path dependence, affect institutional reform and, if so, how and why. This

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<sup>5</sup> North, *Institutions, Institutional Change and Economic Performance*.

<sup>6</sup> Pierson, ‘Increasing Returns, Path Dependence and the Study of Politics’, 256. Other path dependence scholars are also referenced in the thesis, but all build on Pierson, whose work is recognized by them as the most accomplished attempt so far to fashion path dependence into a full bodied theory applicable to institutions.

<sup>7</sup> Deeg, ‘Path dependency, Institutional Complementarity, and Change in National Business Systems’, 23.

<sup>8</sup> Ibidem.

question is discussed through a case-study of a selected institutional trajectory, namely telecommunications institutions in Italy because the changes that took place between 1992 and 1997 “run counter to decades of history”<sup>9</sup> and are thus an exceptional laboratory to study claims of path dependence about institutional stability and change. At the same time, there is a paucity of contributions on the legal history of Italian telecommunications and none uses historical causes to shed light on institutional reforms occurred in or after 1997. As a consequence, it can be expected that a study of the Italian case based on path dependence can provide new insights.<sup>10</sup> A benchmark type comparison with the trajectory followed by British telecommunications institutions is used to enable a systematic assessment of Italy’s direction of change.

In the sections that follow below the chapter first presents an overview of the thesis of path dependence and its central claims, and then discusses current criticisms about the theory’s limited explanatory power with respect to institutional change. This explains the salience of the research question in view of making a contribution to path dependence as a theory to study institutions. The following sections are devoted to methodological issues, including a discussion of the research design, the rationale for the choice of a case study on

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<sup>9</sup> See M. Thatcher, *Internationalisation and Economic Institutions - Comparing European Experiences* (Oxford: Oxford University Press, 2007), 192.

<sup>10</sup> See G. Ponti, *Storia delle telecomunicazioni* (Novara: Ist. geografico De Agostini, 1967); P. Bianucci, *Il telefono la tua voce: storia, aspetti e problemi della telefonia in Italia* (Firenze: Vallecchi, 1978); E. Pucci (ed.), *L'industria della comunicazione in Italia 1994-1995: nuove tecnologie, nuovi attori, nuove regole* (Torino: La Rosa, 1996); D. Giacalone, *Uscire dal monopolio: le telecomunicazioni italiane e il caso Telemar* (Milano: Sperling & Kupfer, 1992); F. Sabatucci (ed.), *Le privatizzazioni in Italia: il caso Enel, il caso Stet* (Roma: Ediesse, 1994); D. Gallino, *Il libro delle telecomunicazioni: le nuove regole del gioco: rischi e opportunità del mercato aperto* (Roma: Adnkronos libri, 1998); R. Spagnuolo Vigorita, *La liberalizzazione delle telecomunicazioni: dal monopolio alla concorrenza regolata* (Napoli: Editoriale scientifica, 1998); A. Maccanico, *Il grande cambiamento: gli anni della liberalizzazione delle comunicazioni visti da un protagonista* (Milano: Sperling & Kupfer, 2001); Perez (ed.), *Il nuovo ordinamento delle comunicazioni elettroniche* (Milano: Giuffrè, 2004); and P. Brezzi, *Economia e politica delle telecomunicazioni: imprese, strategie e mercati* (Milano: F. Angeli, 2004).

Italian telecommunications institutions with Britain as a benchmark, clarifications on the units of observations (institutions, increasing returns, institutional reform and actors) and on the fit between path dependence and the Italian case. The final section presents a summary of the central argument.

## II. AN OVERVIEW OF THE THEORY OF PATH DEPENDENCE

Pierson argues that “*there are ... compelling reasons to believe that political life will often be marked by dynamics of increasing returns...*”,<sup>11</sup> where “increasing returns” designates a key concept of path dependence, i.e. a self-reinforcing process generated by repeated interactions (positive feedback or reinforcing mechanisms are also synonyms of increasing returns). The way in which increasing returns can affect institutions can be illustrated as follows. When present, increasing returns eliminate choices that were available earlier. In other words, at the beginning of a sequence, two or more institutional options are available and the situation is subject to a certain degree of uncertainty and fluidity. One option is then chosen. This stage is also sometimes termed a “critical juncture” because of its momentous consequences for the rest of the sequence.<sup>12</sup> After the critical juncture, increasing returns take place, which embed the choice made and set the sequence onto an irreversible course (lock-in effect).<sup>13</sup> The institutional path not chosen at the critical juncture is no longer available. Path dependence therefore proposes a very distinct interpretation of institutional development. A country on a path-dependent trajectory experiences continuity across time and finds itself locked onto a given path, with each choice reinforcing the overall

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<sup>11</sup> Pierson, ‘Increasing Returns, Path Dependence and the Study of Politics’, 256.

<sup>12</sup> For studies based on path dependence and critical junctures see R. B. Collier and D. Collier, *Shaping the Political Arena* (Princeton, N.J.: Princeton University Press, 1991) and J. Mahoney, *The Legacies of Liberalism—Path Dependence and Political Regimes in Central America* (Baltimore and London: The John Hopkins University Press, 2001).

<sup>13</sup> See J. Mahoney, ‘Path Dependence in Historical Sociology’, *Theory and Society*, 29(4) (2000), 507-48.

direction of the path and options to 'branch out' or to move onto another path progressively diminishing. The presence of increasing returns or positive feedback is the core concept that explains this result.

Prior to Pierson, these views on how and why countries do not experience convergence and often remain trapped on sub-optimal paths in spite of pressures for change were espoused by North in a path-breaking study on the application of path dependence to institutions.<sup>14</sup> North, in turn, relied on earlier findings by economist Brian Arthur.<sup>15</sup> Indeed, path dependence theory is originally an economics theory. Because path dependence's usefulness in political life rests on the premise that the same mechanisms that are present in the economy, namely increasing returns, also apply in politics, it is worth summarizing some of the key aspects of the theory from the economics' point of view. In particular, reference to the economists' work on the notion of increasing returns is of great value to understand how and to what extent this concept can be translated into political life.

According to Arthur, increasing returns occur when the sale of one unit triggers a mechanism that generates more sales and so forth. The reinforcing mechanism was termed "increasing returns" to signal a shift away from neo-classic standard concept of *decreasing* returns. A classic illustration of increasing returns at work is the story behind the adoption of the QWERTY standard for keyboards. As economic historian Paul David showed,<sup>16</sup> the initial sales were corroborated by the fact that typists were trained to use this new keyboard. This, in turn, made it very difficult for anybody else to sell a rival keyboard since this would have required new investment in training and, at the same time, lost the investment already

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<sup>14</sup> North, *Institutions, Institutional Change and Economic Performance*.

<sup>15</sup> See W. B. Arthur, 'Positive Feedbacks in the Economy', *Scientific American*, 262 (1990), 92-99, later collected in the volume *Increasing Returns and Path Dependence in the Economy* (Ann Arbor: University of Michigan Press, 1994).

<sup>16</sup> P. A. David, 'Clio and the Economics of QWERTY', *American Economic Review*, 75 (1985), 332-37.



made to train typists on the QWERTY keyboard. This example shows the power of self-reinforcing mechanisms, or mechanisms of increasing returns, in the economy. Other notable examples of increasing returns mechanisms at work in the economy are the success of video recorder VHS over rival standard Betamax and, more recently, the success of windows' operating system over Apple. In all these cases, an initial advantage has been reinforced by increasing returns.<sup>17</sup>

Sources of increasing returns in the economy include large set-up or fixed costs (e.g., a high investment in a given technology creates the condition for a reinforcing sequence whereby the investor has an incentive to continue using the same technology), learning effects (e.g., as can be gathered from the use of word processing, the user will tend to stick to the chosen piece of software more easily than replacing it altogether), coordination effects or network effects (e.g., a good incorporating a standard is more valuable the more people use it), and adaptive expectations, which is really a magnifier of the coordination effect insofar as the people who purchase a good that carries a standard have expectations about its chances of success. In addition, North argued that increasing returns can also arise from “*the interdependent web of an institutional matrix*”,<sup>18</sup> i.e. increasing returns can stem from the interactions between different institutions.

Increasing returns are a condition for path dependence and lock-in effects. In fact, strictly speaking, path dependence is one of the properties of systems under increasing returns. In mathematics, path *independence* is a condition for the existence of exact solutions

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<sup>17</sup> For a critical reading of these examples see S. J. Liebowitz and S. E. Margolis, *Winners, Losers, and Microsoft: Competition and Antitrust in High Technology* (New York: The Independent Institute, 1999). However, this work does not consider issues of increasing returns and institutional change. See also, S. E. Page, ‘Path Dependence’, *Quarterly Journal of Political Science*, 1 (2006), 87-115 and Boas, ‘Conceptualizing Continuity and Change’, who is arguing that the Internet should be a better example to illustrate path dependence than QWERTY.

<sup>18</sup> North, *Institutions, Institutional Change and Economic Performance*, 95.

for differential equations. In probability theory, a stochastic process is path independent if the probability distribution for period  $t+1$  is conditioned only on values of the system in period  $t$ . In both cases, path *independence* means that it does not matter how you arrive to a particular point, only that you arrive there. Under increasing returns, sequence becomes crucial. Getting ahead early on means eventually to take on the entire market. This magnifies the importance of timing, as small events do not cancel out. If you were “the first out of the gate” due to sheer luck, that may feed-in into the sequence of events so that you get ahead of a competitor by that inch which eventually gives you the power to capture the entire market.

One of the implications of the foregoing is that, under increasing returns, outcomes may be contingent upon fortuitous circumstances and become independent of the actual merits of the product. Let us assume two competing products, which are both subject to increasing returns. Let us further assume that product A is superior to product B. If product B is marketed first, though, it will enjoy increasing returns and each sale will trigger new sales and so on. When product A comes onto the market, it will find it very difficult to “catch up” in spite of its superiority. In fact, students of path dependence show that product B will gain a monopoly, whilst product A will never take off. In the QWERTY example mentioned above, a rival standard, allegedly superior, never caught up precisely because QWERTY could capitalize on increasing returns at the expenses of the later standard. Thus, even a minor advantage over a rival technology caused by some contingent event may ‘tip’ the final outcome regardless of the merits.

Moreover, assuming that two products are competing, the reinforcing mechanism described above confers a permanent advantage over its alternative to the extent that the course of action is irreversible. This is an essential feature of path dependence theory.

According to David, “*the core content of the concept of path dependence as a dynamic property refers to the idea of history as an irreversible branching process*”.<sup>19</sup> Once more, the QWERTY examples shows that, even if a superior alternative were available, its pursuit became impossible since the investment in training on the earlier standard (QWERTY) stifled sales of other keyboard arrangements and this in turn prevented training on such alternative products. A lock-in occurred in so far as the choice of the QWERTY standard became irreversible.

### **III. PATH DEPENDENCE AND INSTITUTIONS: CURRENT SHORTCOMINGS AND THE RESEARCH QUESTION**

Path dependence can provide a significant value added to the study of institutions. By emphasizing the importance of sequence and time-dimension, it improves the researcher’s ability to assess institutional change. In particular, path dependence encourages more careful assessment of how a single episode fits into an overall trajectory, i.e., whether a single episode is merely another step in the same direction or whether, on the contrary, such a step falls outside the existing path. This may sometimes remarkably affect the perspective on institutional change. Some instances that appeared ‘major change’ if assessed without the benefit of the study of increasing returns can be re-branded as a ‘mere’ step along the same path, properly valuing the extent to which they bear the hallmark of continuity with past trajectory. Conversely, path dependence can point to the importance of apparently small events that set a path due to increasing returns. Moreover, the focus on increasing returns provides an empirically rooted explanation for discussing claims of continuity and change in institutional development. In other words, one is not only able to better discern change from

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<sup>19</sup> P. A. David, ‘Path Dependence, Its Critics and the Quest for “Historical Economics”’, in P. Garrouste and S. Ioannides (eds.), *Evolution and Path Dependence in Economics Ideas: Past and Present* (Cheltenham, UK: Edward Elgar, 2000).

continuity, but can also provide an empirical explanation as to the mechanisms that generate continuity during a path.

However, as a theory to study institutions, path dependence is currently facing the challenge of translating the rich economics' tools into operational concepts that may help explain political life and, in particular, institutions. For instance, the very notion of increasing returns, itself lying at the heart of the theory, is difficult to pinpoint outside the economic market place as students may initially remain too attached to the economist's vocabulary and look for "returns" in the sense of money quantities augmenting. In addition, despite Pierson's claim about the abundance of increasing returns in processes of institutional development, there is a lack of empirical evidence on which this claim may rest. This is compounded by theoretical problems that the theory is currently experiencing in dealing with institutional change.

It is difficult to deny that a universe riddled with increasing returns is more likely to be a static one than not. In fact, the very term of increasing returns points out to a set of phenomena whose hallmark tilts towards continuity more readily than change. Perhaps this is one of the reasons for which some even labelled path dependence as a form of "new determinism".<sup>20</sup> Reacting to this criticism, Pierson states that "[N]othing in path-dependent analyses implies that a particular alternative is permanently "locked in" following the move onto a self-reinforcing path ... Asserting that the social landscape can be permanently frozen is hardly credible, however, and that is not the claim. Change continues, but it is bounded change – until something erodes or swamps the mechanisms of reproduction that generate

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<sup>20</sup> Crouch and Farrell, 'Breaking the Path of Institutional Development? Alternatives to the New Determinism'. For a recent contribution of Crouch on path dependence, see C. Crouch, *Capitalist Diversity and Change – Recombinant Governance and Institutional Entrepreneurs* (Oxford: Oxford University Press, 2005), ch. 4.

*continuity*” (emphasis supplied).<sup>21</sup> These caveats usefully put the researcher on guard against the risk of over-emphasising continuity within path dependence. Yet, they seem rather negative statements about what path dependence does *not* say about change and continuity rather than attempts at theory building. In fact, we are still left with very general and unsatisfactory predictions on change and continuity issues, such as the following: “*when sequences involve self-reinforcing dynamics, we can expect periods of relative (but not total) openness, followed by periods of relative (but not total or permanent) stability*”.<sup>22</sup>

Furthermore, as recent contributions emphasise, institutions are far more plastic than one may think. Change and continuity may happily cohabit within the same institution.<sup>23</sup> There are different ways in which an institution can remain the same and yet change. For instance, institutions are often subject to adaptation in response to external pressure. While wholesale change is ruled out, in these cases institutions may respond by “layering”. According to Thelen,<sup>24</sup> layering “*involves the partial renegotiation of some elements of a given set of institutions while leaving others in place*”. Institutional conversion is another instance of change-cum-continuity that seems difficult to explain purely in terms of path

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<sup>21</sup> Pierson, ‘Increasing Returns, Path Dependence and the Study of Politics’, 265.

<sup>22</sup> Pierson, *Politics in Time*, 53.

<sup>23</sup> See K. Thelen, ‘How Institutions Evolve’, in J. Mahoney and D. Rueschemeyer (eds.), *Comparative Historical Analysis in the Social Sciences* (Cambridge: Cambridge University Press, 2003); K. Thelen, *How Institutions Evolve-The Political Economy of Skills in Germany, Britain, the United States, and Japan* (Cambridge: Cambridge University Press, 2004); and W. Streeck and K. Thelen, ‘Institutional Change in Advanced Political Economies’, in W. Streeck and K. Thelen (eds.), *Beyond Continuity: Explorations in the Dynamics of Advanced Political Economies* (Oxford: Oxford University Press, 2005).

<sup>24</sup> K. Thelen, ‘Institutions and Social Change: The Evolution of Vocational Training in Germany’ (2003), available through <http://repositories.cdlib.org/cgi/viewcontent.cgi?article=1005&context=uclasoc>.

dependence as it involves a complex process of reinterpretation of existing institution in the face of new pressures.<sup>25</sup>

The foregoing shows that path dependence seems currently ill equipped to provide an explanation for such a rich phenomenology of institutional change. More specifically, in its current state of development, path dependence seems to offer arguments to mainly explain instances in which previous choices limit actors' ability to initiate institutional reform. Under the current state of development of path dependence, one could argue the following:

- Actors seeking to design new institutions will find their discretion is limited by reinforcing mechanisms of existing institutions.
- Therefore, institutional change will be bounded change as argued by Pierson in the sense that, from a given institutional configuration, only a limited number of options are eligible for choice.

To use a simple example, from institutional configuration A, present increasing returns, path dependence would claim that only configurations B and C are options of institutional reform, while configuration X has been removed from the choice menu. The shortcoming of this argument, though, is that it caters only for certain types of change and, indeed, perhaps not the most important ones. Moments of institutional reform are of crucial importance in a country's history. A theory that can account for bounded change only runs the risk of becoming confined to explaining 'small' change, or to argue invariably that what looks like change is in fact more of the old.

In an effort to overcome these weaknesses, Deeg has proposed, first, a definition of 'path' within path dependence theory. Indeed, although path dependence has been the

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<sup>25</sup> Ibidem.

subject of numerous contributions, this is a surprisingly underdeveloped point and it is true that very little effort has been made to define what is a path. Deeg proposes that a path be defined “*by its logic, that is, a distinct pattern of institutionally rooted constraints and incentives that create typical strategies, routine approaches to problems, and shared decision rules that produce predictable patterns of behaviour*”.<sup>26</sup> In clarifying his proposal, Deeg also stated that the definition of a path must incorporate “*the institutions that constrain the behaviour of actors (and make it predictable) by establishing a matrix of (dis)incentives*”.<sup>27</sup> Thus, for instance, he labels as “*bank-based*” the logic of the German financial system in the period after the Second World War.<sup>28</sup> One of the main advantages of defining a path by its logic is that it allows for a more nuanced treatment of institutional change because it prevents a simplistic equation between the continuation of a formal institution with the absence of change.

A second point illustrated by Deeg concerns the distinction between ‘on-path’ and ‘off-path’ change.<sup>29</sup> Some changes can be understood as ‘big changes’ as opposed to small or incremental change. The notion of ‘off-path’ change to designate the former (and ‘on-path’ change for the latter) brings an added dose of clarity to the terminology used to describe different instances of changes. According to Deeg, “[U]sing a definition of a path as a ‘logic’ allows for the possibility that some institutions may be altered or changed, but if the patterns of actor behaviour, strategies, etc. remain largely unchanged (i.e. the logic), then we are seeing on-path change”.<sup>30</sup>

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<sup>26</sup> R. Deeg, ‘Path dependency, Institutional Complementarity, and Change in National Business Systems’, 29.

<sup>27</sup> Ibidem, fn. 7.

<sup>28</sup> Ibidem, 39.

<sup>29</sup> Ibidem, 29.

<sup>30</sup> Ibidem.

A third clarification to the theory of path dependence brought by Deeg is his emphasis on the need to distinguish the level at which institutional change occurs. He proposes three levels “(1) *individual institutions and organizations ...; (2) institutional systems or complexes – a banking system, an industrial sector, a welfare system; (3) a national political economy or regime ...*”.<sup>31</sup> By adding a specification of the level at which path dependence takes place, Deeg’s suggestion has several advantages. First of all, the focus on a given sector enhances analytical clarity as to claims of path dependence and the empirical evidence. Secondly, a specification of the level where path dependence takes place points researcher to the interactions between such level and other levels, particularly higher ones. By identifying a given level as the terrain of study, one is in a better position to understand complex patterns of interactions involving different levels. Equally, institutional changes in cases where increasing returns stem from interactions between different levels are often national changes of significant importance. Being able to address these types of changes under path dependence would be a significant step forward in the theory, given that so far path dependence seems more apt to explain why countries do *not* change.

Deeg’s contribution is useful insofar as it allows specifying better what is the current gap of path dependence. The theory suffers from a divorce between increasing returns, its core concept, and ‘off-path’ change. If increasing returns work to restrict the menu of choices available, how is it that sometimes the menu opens up? In other words, where do ‘big changes’ come from under path dependence? Relying on exogenous shock as the explanation for ‘off-path’ change, path dependence seems to rely on *deus ex machina* explanation. In sum, the challenge for path dependence to evolve as a theory of institutional change is to expand its understanding of how increasing returns work to affect institutions, so that path

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<sup>31</sup> Ibidem, 30.



dependence can continue to be a useful pair of lenses to look at the full gamut of institutional life, not just consolidation, but also reform.

The thesis takes up this challenge by investigating precisely what is the role of path dependence and, more specifically, increasing returns in processes of institutional reform. Building on Deeg's contribution, the research question aims at investigating institutional reform at a well-defined level, i.e. within a sector of the economy. As discussed, this promises to be a fruitful avenue to refine path dependence since it caters for a richer type of institutional change. The methodology used to address the research question is discussed below.

#### **IV. METHODOLOGICAL ISSUES IN THE STUDY OF PATH DEPENDENCE AND INSTITUTIONAL REFORM**

The first methodological issue concerns the choice of research design. A case study methodology recommends itself because it enables the study with a high level of detail and makes it possible to organize the empirical material fruitfully.<sup>32</sup> In order to address the familiar downsides of this methodology, i.e., selection bias and the inability to arrive at conclusions that go beyond the specific facts at issue, the strategy adopted in the thesis has been to look for a form of critical case study.<sup>33</sup> Critical case studies may be assumed as the

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<sup>32</sup> For a discussion of case studies, see P. Pennings, H. Keman, J. Kleinnijenhuis, *Doing Research in Political Science* (London: Sage, 1999); B. Geddes, *Paradigms and Sand Castles-Theory Building and Research Design in Comparative Politics* (Ann Harbor: The University of Michigan Press, 2003), ch. 2, 'Big Questions, Little Answers'; G. King, R. Kehoane, S. Veba, *Designing Social Inquiry* (Princeton, NJ: Princeton University Press, 1994).

<sup>33</sup> See H. Eckstein, 'Case study and Theory in Political Theory', in F. Greenstein and N.W. Polsby (eds.), *Handbook of Political Science*, vii (Reading, Mass.: Addison-Welsey, 1975); D.E. Ashford (ed.), *Comparing Public Policies: New Concepts and Methods* (Beverly Hills, Calif.: Sage, 1978) and, 'Introduction: Of Cases and Contexts', in D.E. Ashford (ed.), *History and Context in Comparative Public Policy* (Pittsburgh and London: University of Pittsburgh Press, 1992); M. Dogan and D. Pelassy, *How to Compare Nations: Strategies in Comparative Politics* (Chatam, NJ: Chatam House, 2<sup>nd</sup>. Edn., 1990).

extreme in a continuous spectrum of cases. This enables the conclusions reached in a critical case to be applicable to other less extreme cases.

A set of related issues concerns the design of such a case study. In this respect, it is important to stress that studies of path dependence must necessarily encompass long stretches of time. Since the theory is premised on the self-reinforcing effect of increasing returns and since these effects take place through time, it is necessary to take into account not just single key moments, e.g., the years in which the institutional change took place, but also the time before and after. This seems an effective remedy against what Pierson calls a “*tendency to focus on the immediate sources of institutional change*” that, in his opinion, besets studies of institutional change.<sup>34</sup> Equally, by paying attention to the time preceding the moment of institutional change, the research design also reduces a second methodological fault that Pierson attributes to current studies of institutional change. Pierson argues that “*understanding the preconditions for particular types of institutional change requires attentiveness not only to the pressures for reform but also to the character and extent of resistance to such pressures. Change and stability are two sides of the same coin. .... An adequate theory of institutional development must pay sustained attention to the issue of institutional resilience*”.<sup>35</sup> An extended time horizon before the time of change helps to understand the operation of increasing returns and how they successfully manage to keep the institutional development on a given path. This may shed light on aspects that make a given set of increasing returns vulnerable and help to identify the causes for change at a later stage. In other words, to understand times of change, one must get the full picture with long stretches of resilience too.

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<sup>34</sup> Pierson, *Politics in Time*, 139-42.

<sup>35</sup> P. Pierson, *Politics in Time*, 142.

Another methodological challenge that is specific to the study of path dependence is how to characterize a path. To study change within path dependence, the researcher should as a preliminary matter be able to tell where a path is going. The answer in the thesis has been to adopt a benchmark-type comparison. To benchmark a country's institutional trajectory means to be able to tell whether that country is converging and to what extent with another trajectory that is assumed as the benchmark. If increasing returns lead to path dependence and bounded change, trajectories that are diverging at an initial point of observation in time should continue to diverge through time. By contrast, deviation from this trajectory, e.g. convergence between paths, offers a simple but effective way to detect an anomalous functioning of increasing returns. Similarly, changes in the distances between the chosen trajectories can also be used as a proxy to indicate that some alterations in the way increasing returns work has taken place.

Issues of convergence and divergence, though, need to be assessed not only from the point of view of single institutions, but also from that of the logic of the paths. This is because convergence in formal institutions may conceal ongoing divergence if one does not look at the logics of the path too. Thus, the thesis explores convergence and divergence by using two levels of analysis: the first one concerns formal institutions and the second concerns the logic of the path, which, as explained before, is defined by the way in which institutions provide a set of incentives and disincentives for behaviours by actors.

It is important to underline in this connection that the object of inquiry is the "benchmarked" country and not the benchmark nation. That is to say that the thesis is interested in the increasing returns dynamics that occur in the former and that the benchmark is used purely to better evaluate these. As a consequence, the thesis does not purport to

analyse in detail increasing returns dynamics in the benchmark country. The latter's trajectory is simply assumed as a point of reference and not as the object of study.

An important feature of the research design at issue is its inductive approach. The aim of the thesis is to contribute to the emerging body of literature that addresses issues of path dependence and institutional dynamics. The explanatory toolkit of path dependence has been so far limited in this domain. Therefore, through the systematic observation of increasing returns and their impact on institutional dynamics it is expected that the thesis will arrive at a better understanding of the ways in which path dependence can help to analyze institutions. This angle of research is clearly inductive as there is no pre-defined hypothesis on the way in which increasing returns affect institutional development. To expand the reach of path dependence, one needs experiments to foster the theoretical toolkit of path dependence.

Further, consistent with the theoretical premises illustrated above, the case study concerns institutions at a sector-specific level, given that interactions between different levels may contribute to enrich the explanatory power of path dependence.

A final methodological point is in order concerning the definition of institution that will be used in the course of the thesis. Definitions of 'institution' abound in political science.<sup>36</sup> All of them concur in identifying institutions as rules. Thatcher has criticized the inclusion of informal rules, practices and norms within the definition of institution as it blurs

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<sup>36</sup> See, e.g., P. A. Hall, *Governing the Economy* (Cambridge: Polity Press, 1986), 19, who defines institutions as "*the formal rules, compliance procedures and standard operating procedures that structure the relationship between individuals in various units of the polity and economy*". According to E. M. Immergut, *Health Politics: Interests and Institutions in Western Europe* (Cambridge: Cambridge University Press, 1992), 3, 24-26, the definition of institution covers *de jure* and *de facto* rules that mediate conflicts and organize political systems as a whole.

the distinction between “institutions” and patterns of behaviour in policy making.<sup>37</sup> Indeed, when focusing on institutional change, the inclusion of informal rules within the scope of the investigation could undermine the achievement of meaningful results, expanding the range of units to be investigated. Similarly, the inclusion of behaviour within institutions can be done at the expenses of analytical clarity. For instance, one could claim that change in formal rules has taken place, but behaviour has not, leading to a blurring of the analytical findings and contrasting results. It is therefore both useful and necessary to adopt a narrow construction of the term.

Throughout the thesis, the term “institution” will be used to designate acts having a binding effect such as acts of law. Consequently, when analyzing the stability part of the historical sequence, the thesis concentrates on reinforcing mechanisms that made the law concerning prior institutional features difficult to reverse. Similarly, when dealing with institutional change and the design of new institutions, the thesis concentrates on the way the new rules of the sector have been created to connect this process to the past trajectory of institutional development. Adopting formal institutions as the units for comparison has two main advantages: (i) it helps to make the argument more precise and (ii) it enhances the ability to obtain empirical evidence. This is due to the nature of law as public acts. When a law is replaced, this happens usually in a public way. The same applies for other rules having the force of law. Thus, it is possible to obtain detailed evidence of the process of change.

It should also be borne in mind that institutions within the meaning illustrated above are the *object* of the enquiry. It is well-known that, once an institution is created, it will also

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<sup>37</sup> Thatcher, *The Politics of Telecommunications*, 21.

become an *actor* in its own right.<sup>38</sup> Due to the multi-level nature of regulation in the telecommunications sector, complex games can be played between national regulators, national governments, and the Commission.<sup>39</sup> However, the thesis focuses on institutions as the *explanandum* and does not attempt to also explore how institutions, once created, use their powers. For this reason, for the period after 1997 the thesis does not focus on the relationships between regulators and regulatees nor on the relationships between regulators at different levels (i.e. the Commission and national regulatory authorities). Indeed, to relate increasing returns to (i) institutional development and (ii) the use made by an institution of its powers, would exceed the task at hand.

## V. THE CHOICE OF CASE STUDY: ITALY'S TRAJECTORY OF REFORM OF TELECOMMUNICATIONS INSTITUTIONS IN COMPARISON WITH BRITAIN'S

Having described the general methodological issues connected with the research question, one can now turn to the rationale for the choice of the specific case study.

The thesis focuses on the trajectory of institutional reform of Italian telecommunications in comparison with the British trajectory as a benchmark. Italy's trajectory of stability and change promises to be an ideal candidate for the study of increasing returns in cases of institutional change because it experienced a long period of stability. In particular, Italian telecommunications services were provided by several suppliers until 1992, which makes Italy a unique case in the landscape of telecommunications in Europe, given that all other countries had adopted a model based on a single supplier.

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<sup>38</sup> See L. Hancher and M. Moran, *Capitalism, Culture and Regulation* (London: Routledge, 1989); and C. Scott, 'Analysing Regulatory Space: Fragmented Resources and Institutional Design', *Public Law*, (Summer) 2001, 329-353.

<sup>39</sup> S. Cassese, 'L'arena pubblica: Nuovi paradigmi per lo Stato', *Rivista Trimestrale di Diritto Pubblico*, 3 (2001), 601-650 and D. Coen, 'Business-Regulatory Relations: Learning to Play Regulatory Games', *Governance*, 18(3) (2005), 375-398.

The split-supplier model was commonly blamed in Italy as the source of inefficiency and there were several proposals for reform. Yet, until 1992 no law was adopted and the law that was eventually adopted in that year provided for change in the number of suppliers, but still permitted that several suppliers continued to exist. Thus, the trajectory of Italian telecommunications institutions until 1992 seems an ideal case of a path dependent trajectory, i.e. of a country whose institutional path is locked in onto a steady course, with change occurring but in the shape of bounded change.

Moreover, Italian telecommunications seems to offer a 'critical case' for increasing returns, given that Italy was the only country in Europe to hold onto its course in spite of very strong pressures for change, common to all European countries, notably technological change which transformed radically the sector from being a mono-product industry, whose revenues derived essentially from the provision of fixed-line telephony, into a multi-product one, with mobile telephony and Internet representing the fastest-growing areas of revenues.<sup>40</sup> In short, observations of increasing returns in Italian telecommunications can be assumed to have the potential for being relevant to other countries and sectors too.

After 1992, though, Italian telecommunications took a very significant turn and in the space of a few years, i.e. between 1992 and 1997, legislative measures were passed in Italy that embraced a model based on a single supplier, competition, privatization and allocation of regulatory powers to an Independent Regulatory Authority ("IRA"). This marked a convergence in key institutional aspects with Britain, a country from which Italy had long and profoundly differed. The table below summarizes the trajectory of Italian and British

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<sup>40</sup> See statistical data published by the International Telecommunications Union at [http://www.itu.int/dms\\_pub/itu-d/opb/reg/D-REG-TTR.8-2006-SUM-MSW-E.doc](http://www.itu.int/dms_pub/itu-d/opb/reg/D-REG-TTR.8-2006-SUM-MSW-E.doc). For the specific situation of the UK and Italian sectors, see the regulators' annual report (OFTEL's annual reports for the years before 1998 are available in paper form only; for annual reports after 1998, see the institutional website at [www.ofcom.org.uk](http://www.ofcom.org.uk); for Italy, see the website of Autorità per le Garanzie nelle Comunicazioni at [www.agcom.it](http://www.agcom.it)).

telecommunications institutions between 1979 and 1997 by reference to four key institutional aspects including:

- ***The number of operators.*** Usually, there was only one company entrusted with the provision of telecommunications services within a country's boundaries. Italy was an exception, with four telecommunications operators active in the sector.
- ***Ownership of suppliers.*** Provision of telecommunications services was, at its inception, in private hands. However, private ownership has been relatively short lived and the state has intervened, directly or indirectly in the provision of telecommunications services. The pendulum swung back when, starting with Britain in the early 1980s, a movement towards privatisation took place in Europe.
- ***Degree of competition permitted.*** State ownership was commonly associated with monopoly. The company (or the companies) entrusted with the provision of telecommunications services enjoyed exclusive rights that prevented the emergence of any rival provider and guaranteed, in the minds of those who devised this system, a well-functioning service. This view has been radically subverted and, starting from the early 1990s, competition has rather become the dominant paradigm in the supply of telecommunications services.
- ***Allocation of regulatory powers.*** The forms through which state intervention was channelled varied considerably across time. The creation of Oftel in 1984 was the avant-garde of a host of independent regulatory agencies. With the



passing of time, regulation by independent agency has become the standard way to oversee the sector in Europe.

**Table 1 - Italy and Britain before and after 1997**

		<b>Before 1997</b>	<b>After 1997</b>
<b>No. of providers</b>	<b>UK</b>	<b>1 (BT)</b>	<b>1 (BT)</b>
	<b>Italy</b>	4 (ASST, SIP, Italcable, Telespazio)	1 (Telecom Italia)
<b>Ownership</b>	<b>UK</b>	<b>Private / listed</b>	<b>Private / listed</b>
	<b>Italy</b>	Private companies under state control (SIP, Italcable, Telespazio) / Ministerial body (ASST)	Private / listed
<b>Competition</b>	<b>UK</b>	<b>Competition</b>	<b>Competition</b>
	<b>Italy</b>	Monopoly	Competition
<b>Allocation of regulatory powers</b>	<b>UK</b>	<b>Sector specific regulator/Competition Authority</b>	<b>Sector specific regulator/Competition Authority</b>
	<b>Italy</b>	Minister/ASST/CIPE	Sector specific regulator/Competition Authority

The convergence between Britain and Italy in 1997 promises to offer an opportunity to study the relationships between increasing returns and ‘off-path’ change, given the magnitude of the institutional turn taken after 1992. Thus, the study of Italy’s trajectory, with its sequence of long stability and change lends itself as a laboratory to address the research question at issue, i.e. whether increasing returns affected institutional reform and, if so, how and why.

Italy lends itself to a critical case study of path dependence and different levels of institutional change also because the year 1992 saw very important changes at the level of national politics. In fact, 1992 is commonly held in Italian history and the year that marked the end of the 'First Republic'. The end of the 'First Republic' thus confronts the student of path dependence and institutional change with further important issues. First of all, the occurrence of a large-scale event such as the political turmoil of 1992 may lead one to think that increasing returns were not longer relevant due to an exogenous shock. As a consequence, the institutional trajectory after 1992 may no longer be related to increasing returns. Secondly, the end of the First Republic also raises the question as to whether increasing returns continued to exist or not. Indeed, an often-overlooked point about increasing returns is that they may come to an end since they cannot be eternal. These issues add an increased level of complexity to the study of the Italian case that makes it suitable to generate propositions that can be of wider relevance for other cases.

With respect to Britain's role as benchmark country, it can be useful to recall that the benchmark device is used to trace the direction of institutional change. More precisely, given the difference in their institutional starting points, path dependence predicts that increasing returns would drive Italy and Britain onto different trajectories. This means that through time the direction of change should continuously diverge. Thus, divergence between the two countries' selected institutions provides an indicator of increasing returns at work in the process of institutional change. On the contrary, convergence and/or a nearing of the trajectories is an alert to the researcher, showing that increasing returns have either ceased to operate or that increasing returns operate in a way that has not been described by path dependence. Furthermore, comparison of the logics of the respective paths can also provide important insights into the degree of convergence/divergence and the role of increasing returns.

A word of caution is also in order about what the benchmark does *not* provide. The benchmark does not provide insights on the presence of increasing returns in the very country adopted as a benchmark. In fact, its role is purely instrumental to the study of increasing returns in the benchmarked country. Thus, the thesis does not argue that the trajectory followed by Britain during the period studied is linked to increasing returns nor that increasing returns have played a role in such institutional developments. This has also an impact on the breadth of the materials covered. The changes in the UK telecommunications regime have been the subject of extensive research.<sup>41</sup> In this study, these developments will only be detailed to the extent that this is necessary to fulfil the already mentioned benchmark role.

## VI. INSTITUTIONAL REFORMS AND INCREASING RETURNS IN ITALIAN TELECOMMUNICATIONS

As the foregoing discussion showed, the thesis focuses on institutional developments occurred across a long period of time. Some further remarks are in order on the empirical evidence to better understand its relevance and fit with the research question.

In trying to understand the role of increasing returns for institutional reform, the thesis does not focus on all four key institutional aspects at the same time. In different periods, different institutions have enjoyed more relevance than others and this varied across time. Moreover, the role of increasing returns has been different through time. One can broadly distinguish two periods.

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<sup>41</sup> See, e.g., J. Hills, *Deregulating Telecoms: Competition and Control in the United States, Japan and Britain* (London: Pinter, 1986); J. Vickers and G. Yarrow (eds.), *Privatization : an economic analysis* (MIT Press: Cambridge, Mass, 1988); M. Armstrong, S. Cowan and J. Vickers (eds.), *Regulatory reform : economic analysis and British experience* (MIT Press: London, 1994); M. Bishop, J. Kay and C. Mayer, *The regulatory challenge* (Oxford University Press: Oxford, 1995), Thatcher, *The politics of telecommunications*.

***Before 1992.*** Before 1992 efforts to bring about institutional reforms centered on the organization of the sector and the attempts to reform the split-supply structure on which it was based. The other institutional features, i.e. ownership, competition and allocation of regulatory powers, were not affected by any legislative initiative of reform. The empirical evidence relating to this period provides evidence of increasing returns for the period 1979-1992. These were based on the relationships between telecommunications providers and elected politicians whereby the latter sought to appropriate the resources of the former to obtain votes and power. Increasing returns had an essential institutional dimension since the fragmented structure of telecommunications providers matched the fragmented nature of the ruling coalitions. Thus, increasing returns worked to maintain the *status quo*, which is consistent with path dependence current claims.

***After 1992.*** This period presents a complex picture, where all four institutional units of observation were changed. The thesis shows how increasing returns played a decisive role in fostering 'off path' institutional change. However, increasing returns have not affected all institutional elements at the same time and in the same way. The table below lists the key institutional aspects and grades the role played by increasing returns in shaping the direction of change according to a low-strong scale; it also provides the year in which the institutional reforms were accomplished.



**Institutional reforms and increasing returns in Italian telecommunications 1992-**

**1997**

	<b>Role played by increasing returns in shaping direction of institutional change</b>	
	<b>Strong</b>	<b>Low</b>
<b>Institution</b>		
<b>No. of providers (1992-1994)</b>	X	
<b>Ownership (1997)</b>	X	
<b>Competition (1997)</b>		X
<b>Allocation of regulatory powers (1997-2007)</b>	X	

The table shows, first of all, a difference between the change in rules concerning competition and the other institutional factors with respect to the role played by increasing returns in shaping institutional change. Namely, increasingly returns had a more limited impact on the direction of change of rules on competition. This can be explained based on two factors. First of all, past increasing returns centered on the organization of the sector and the relationships between providers and political parties. A rejection of increasing returns after 1992 meant that there was a clear signal to (i) end the split-supplier system and (ii) cut

the relationships between political parties and suppliers by privatization and delegation to an IRA.

Rejection of past increasing returns also meant that rules to favour objective market criteria, hence competition, were preferred to the old pattern based on subjective criteria and relationships between suppliers and politicians. However, this did not translate into a pressure for a direction of change as clearly discernible as that for the other factors, where, for instance, one could detect that rejection for increasing returns meant the unification of the different suppliers.

In addition, there was a strong exogenous factor, namely EU legislation. The treatment of the EU in the process of reform of Italian telecommunications institutions within the thesis deserves a separate discussion, which is carried out in the following Section.

Before turning to this point, a remark is in order concerning another difference, that between the reform in the rules on allocation of regulatory powers and the other institutional features. The table shows that this reform spans a considerable period. This is because AGCOM institutional design has been the locus where a prolonged confrontation between different actors has taken place relative to the direction of institutional reform. This contested path of change continued until 2007, which justifies a longer time horizon and spans two chapters in the thesis (chapters 5 and 6).

Through a close tracing of the institutional changes accompanying this institutional feature, the thesis offers insights on the degree to which the new Italian telecommunications institutions have embraced a different logic compared to the old one. The study of the developments occurred after 1997 presents a unique challenge, though. The years between 1997 and 2007 are of course very rich years in terms of regulatory action since AGCOM started to operate and to interact with other regulators, notably the Commission, and a host of

regulatees and elected politicians. Moreover, as noted, AGCOM became an actor in its own right.

However, the thesis's focus on institutional reform justifies concentrating on AGCOM as the object of study and, in particular, on the legislative measures affecting AGCOM institutional design. When looked at from this angle, the period after 1997 in fact emerges as one of relative stability, since there were only few binding acts which modified the institutional design of AGCOM, i.e. (i) the law of 2001 on the power to assign licenses (transferred to the Ministry); and (ii) the law of 2003 assigning new and unspecified regulatory powers to the Ministry of Communications.

This focused approach does not mean that the changing nature of political intervention in telecommunications is ignored. Chapter 6 indeed shows what was the context in which legislative measure affecting AGCOM's institutional design were passed. Moreover, the chapter also provides empirical evidence on the way in which elected politicians used their powers after 1997. These findings converge with the earlier ones based on analysis of legislative measures on institutional design to confirm the existence of a new Italian logic based on limited separation between elected politicians and suppliers.

Finally, the 'new-ness' of the Italian trajectory after 1997 should not be obfuscated by the link with past increasing returns. In fact, the thesis argues that there was a movement of rejection of increasing returns at the origin of the initial institutional choices, i.e. that the new institutions deliberately sought to introduce a break with the past trajectory. At the same time, the past trajectory was not simply wiped out, but provided a rich source of inspiration for new institutions. By being able to trace this process to the original reaction to past increasing returns and the ensuing debate it created between policy makers, the thesis establishes the general validity of the path dependent approach. Indeed, failure to



acknowledge the historical causes at the root of the trajectory followed by Italian telecommunications would lead to severely downplaying the tension that is underlying the current institutional structure. This leads to considerations about the appropriateness of path dependence to deal with the Italian case, which –together with a discussion on the role of the EU - are developed in the Section below.

## **VII. THE CHOICE OF PATH DEPENDENCE TO STUDY THE ITALIAN CASE, OTHER RIVAL EXPLANATIONS AND THE ROLE OF THE EU**

Before undertaking the examination of the empirical evidence, it is important to deal with two issues of relevance for the structure of the thesis. First, is the choice of path dependence in itself a conditioning factor which makes the findings biased? In other words, is there a risk to become “prisoners of path dependence”? A second, albeit related issue, concerns the reasons for discarding alternative explanations, and, notably, exogenous factors, such as the impact of the European Union.

The reply to these questions requires that one first sets out what is the value-added of path dependence compared to other theories to study institutional change; then, one should reflect on the fit between path dependence and the Italian case; finally, due to its importance, the role played by the EU needs to be discussed separately.

Path dependence’s most distinctive trait is the attention to the time dimension of processes. To paraphrase one of Pierson’s contributions on this subject,<sup>42</sup> if increasing returns are present, *when* things happen is more important than *what* happens. Thus, as Mahoney stated, explanations based on path dependence “*reject common-place arguments*

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<sup>42</sup> Pierson, Not Just What, but *When*: Timing and Sequence in Political Processes.

*that emphasize solely or primarily short-term causes” and look for “more fundamental historical causes”.*<sup>43</sup>

In the Italian case, indeed explanations based on short-term causes are unable to account fully for some developments which thus continue to puzzle the researcher. The long period of continuity enjoyed by the organization of the sector is illustrative.

As it will be explained below, in 1924 the Fascist government had received a technical advice contrary to the allocation of several licenses for the supply of telecommunications services. In spite of this advice, it proceeded to award 6 different licenses. Thus, the split-supplier system was considered inefficient since its inception and it grew more and more “obsolete and irrational” through time. Yet, in spite of general agreement on the need for institutional change, no institutional reform took place for a long time and, when a law was passed in 1992, it provided for essentially the continuation of the *status-quo*. It was only in 1994 that the split-supplier system was eventually terminated.

Explanations based on short term causes, tend to start from existing institutions (in this case, a single supplier) and ask what functions they serve to arrive at an explanation of their origin.<sup>44</sup> In the Italian case, though, it would be odd to observe that, on the one hand, there was general agreement on the fact that it was “obsolete and irrational” to have several suppliers, and, on the other hand, that it took 70 years to arrive at institutional change.

The foregoing shows that there is a very good fit between path dependence as a theoretical framework and the Italian case. Thus, far from making the researcher a “prisoner”, this choice has the potential to bring additional clarity on the study of Italian telecommunications institutions.

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<sup>43</sup> See Mahoney, *Legacies of Liberalism*, 17.

<sup>44</sup> See, Pierson, *The Limits of Design*, 477.

It is also important to remember that the fit between the theoretical framework and the empirical evidence runs in the opposite direction too. That is, the thesis sets out to explore the ability of path dependence to cope with the complex phenomenology of institutional continuity and change. As a consequence, the thesis's relevance goes beyond the Italian case, since its main object of enquiry is path dependence and the Italian case is selected insofar as it provides a critical case for path dependence. Thus, the thesis does not deny that other theories may be able to also provide important insights to study the trajectory followed by Italian telecommunications. Isomorphism, policy-transfer or technocratic policy making are not dismissed. However, they fall outside the angle of enquiry adopted in the thesis, which is premised on fostering path dependence as a theory to study institutional change.

With respect to the EU, it is important to state at the outset that there is no attempt to downplay or deny the essential role played by the EU in promoting change in Italian telecommunications, as it has been highlighted in several contributions already.<sup>45</sup> Indeed, one of the interviewees described it as the real engine behind change in Italian telecommunications.<sup>46</sup>

However, as highlighted in the previous Section, a distinction must be drawn between rules on competition and other institutional aspects. Whereas the former were affected by EU rules to a high degree, as far as the design of regulatory institutions is concerned, one must

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<sup>45</sup> See, e.g., L. Radicati di Brozolo, *Il diritto comunitario delle telecomunicazioni. Un modello di liberalizzazione di un servizio pubblico* (Torino: Giappichelli, 1999); R. Perez, *Telecomunicazioni e Concorrenza* (Milano: Giuffrè, 2002); *Il nuovo ordinamento delle comunicazioni elettroniche* (Milano: Giuffrè, 2004); and F. Pammolli, C. Cambini, and A. Giannacari, *Le politiche di liberalizzazione e concorrenza in Italia* (Bologna: il Mulino, 2007).

<sup>46</sup> Director of Public and Legal Affairs.

recognize that the EU only provides a frameworks with several gaps.<sup>47</sup> This has been especially important in the Italian case. The following examples may be illustrative.<sup>48</sup>

- In 1990, a European Directive mandated the separation between regulatory functions and provision of telecommunication services.<sup>49</sup> However, the Directive did not contain any rule on the regulatory body. Thus, the European Directive made it possible that regulatory functions be exercised by the government through, e.g., a Ministry.
- In 1997, when AGCOM was created, the European Directives which provided for the liberalization of the market, still lacked any detailed institutional rule on the independent regulator, save for the mention of promotion of interconnection as one of regulators' most important tasks.<sup>50</sup>
- The new regulatory framework adopted in 2002 goes a long way in specifying the tasks of national regulatory authorities. As such, the 2002 European legislation certainly possesses a wider impact in terms of national institutions

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<sup>47</sup> See P. Nicolaïdes, 'Regulation of Liberalised Markets: A New Role for the State? (or How to Induce Competition Among Regulators)', in D. Geradin, R. Muñoz, and N. Petit, *Regulation through Agencies- A New Paradigm of European Governance* (Cheltenham: Edward Elgar, 2005), 23-43. See also M. Thatcher, 'Independent Regulatory Agencies and Elected Politicians in Europe', in Geradin, Muñoz, and Petit, *Regulation through Agencies*, 47-66, who shows that national regulatory agencies display a significant degree of variation across Europe in terms of institutional design.

<sup>48</sup> See also F. M. Salerno, 'Telecomunicazioni e autorità indipendenti: appunti sullo sviluppo dei rapporti tra diritto comunitario e organizzazione amministrativa interna', *Rivista Italiana di Diritto Pubblico Comunitario*, 3-4 (2003), 679-720.

<sup>49</sup> See Commission Directive 90/388/EEC of 28 June 1990 on competition in the markets for telecommunications services (OJ 1990 L 192/10), article 6.

<sup>50</sup> See Directive 97/33/EC of the European Parliament and of the Council of 30 June 1997 on interconnection in Telecommunications with regard to ensuring universal service and interoperability through application of the principles of Open Network Provision (ONP) (OJ 1997 L 199/32), Article 9 ("General responsibilities of the national regulatory authorities. 1. National regulatory authorities shall encourage and secure adequate interconnection in the interests of all users, exercising their responsibility in a way that provides maximum economic efficiency and gives the maximum benefit to end-users. ...")

that earlier legislation. However, even the 2002 EU legislation does not contain any provision about the regulator's independence from elected politicians.

The foregoing shows that a distinction must be drawn concerning the role of European law. Albeit playing a pivotal role in Italian telecommunications, the role of the EU was different depending on whether one looks at substantive rules on competition or rules on institutional design. For the latter, EU law provided at best a framework, whose gaps have been filled by national actors. In doing so, they have responded to domestic factors. For instance, while the EU can be said to have contributed effectively to the creation of a regulatory body for telecommunications, the design of AGCOM has a collegial body with eight Commissioners and a President responded to a domestic factor. Accordingly, the thesis does not ignore or downplays the role of the EU, but simply treats it as one of the factors that have shaped interactions between telecommunications companies and elected politicians.

## **VIII. CONCLUSION**

The use of path dependence as a theory to study institutional development promises to deliver an important contribution to the study of institutions. However, due to its relative novelty, there is a lack of empirical data on the correlation between increasing returns and institutional change and, moreover, path dependence currently seems conceptually ill-equipped to explain what can be defined 'off-path' change, i.e. institutional reform that breaks away with past trajectory. The thesis therefore seeks to make a contribution to path dependence by improving on the understanding of how increasing returns operate in cases of institutional reform. For this reasons, the research question asks if increasing returns affect institutional reform at the sector specific level and, if so, how and why, through a case-study

methodology based on Italy's trajectory of institutional development and a systematic benchmark-comparison with Britain.

Based on the empirical evidence collected in response to this question, the thesis upholds the claims of path dependence as to increasing returns generating a bounded trajectory of change. At the same time, the thesis shows that the notion of increasing returns needs to be refined by specifying to whom they accrue. This is because the empirical evidence shows the strong role played by increasing returns in shaping the views of policy makers as some actors staged a reaction against increasing returns which translated into an attempt to design new institutions in such a way as to prevent increasing returns to occur. Other actors in turn reacted by pushing for more limited change. This conflict had a profound impact on Italy's trajectory, which eventually settled around a distinctive Italian logic, based on limited separation between suppliers and elected politicians. This sets Italy on a diverging trajectory from Britain after a short time of convergence of formal institutions.

These findings confirm that the concept of increasing returns can be a powerful explanatory factor also for institutional change, provided path dependence studies pay a more sustained attention to actors' dynamics. By contrast, the language of increasing returns seems to imply that there is something almost automatic about their functioning as if, once set in motion, increasing returns start a sequence that admits no variations. It is by paying a more sustained attention to the role of actors benefiting from increasing returns, and the reactions to such appropriation of increasing returns, that path dependence can better cope with the rich complexity brought about by institutional change and overcome the dilemma in which it seems currently placed, between the *deus ex machina* of exogenous shocks and 'on-path' change.

## **2. THE ROOTS OF THE PATH: TELECOMMUNICATIONS INSTITUTIONS BEFORE 1979**

### **I. INTRODUCTION**

This chapter provides information on telecommunications institutions before 1979.

Although the thesis seeks to explore increasing returns in the period starting from 1979, it is nonetheless important to provide information on the history of telecommunications institutions from the beginning of telephony until 1979. This is because, firstly, through this account, one can better understand the institutions that will be studied in depth in the remainder of the thesis, namely (i) the number of providers; (ii) ownership (public, private or a mixture of the two); (iii) the degree of competition permitted; and (iv) the allocation of regulatory powers. Secondly, in 1979, i.e. the point of departure of the thesis, telecommunications institutions had already experienced almost a century of history. An exploration of long-standing features is therefore useful to put pressures for change and endurance in perspective. Thirdly, the chapter shows that significant institutional differences developed between Italy and Britain before 1979. Path dependence predicts that if increasing returns are present (which is regarded as likely for institutions), institutional differences will increase over time as countries follow different institutional paths. The thesis will show that such increasing returns were present after 1979 in Italy in following chapters.

This chapter therefore sets the starting points for analysis by outlining what differences had developed by 1979. The chapter thus provides a short account of the trajectory followed by telecommunications institutions prior to 1979. In keeping with the thesis' methodology, whereby British telecommunications institutions are used as a benchmark to study Italian ones and their trajectory of change, the chapter focuses on the latter, while providing only essential information for the former.

The chapter is organized in chronological order and by country. The first three sections deal, first, with the formative years of Italian telecommunications institutions, i.e. the period from 1878 and until World War II, second, the institutional changes that took place between the years following the end of World War II and 1968 and, third, the period between 1968 and 1979 in order to provide a suitable introduction to the years for which a detailed study is provided in chapters 4 to 6. Afterwards, the chapter describes the situation of British telecommunications before 1979 to better understand the reforms that took place in Britain and the direction of the British path.

## **II. THE FORMATIVE YEARS OF ITALIAN TELECOMMUNICATIONS INSTITUTIONS: FROM 1878 TO WORLD WAR II**

The birth date of telephony in Italy can be set at 1878, when the first official trial took place before the Royal family. It was a connection between the Quirinale Palace and the telegraph office of Tivoli, near Rome. The experiment was apparently very successful and their Royal Highnesses were “fully satisfied”.<sup>51</sup> At that time, the provision of telephony services was confined to a local network, normally encompassing a city.

A ministerial decree of 1881<sup>52</sup> established that telephony services were reserved to the state, which could opt to license private individuals to carry them out under a licence (*concessione*). In 1881, there were 37 licensees (*concessionari*), some of them providing rival services in the same city. A law passed in 1892 enshrined the early relationships between the state and private individuals as far as telephony was concerned.<sup>53</sup> The law permitted private individuals to run telephony services; however, they could only do so under a licence, which was to last for 15 years. After such time, the state was entitled to claim back

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<sup>51</sup> *Relazione statistica sui telegrafi del Regno d'Italia*, 1878.

<sup>52</sup> Ministerial Decree of April 1, 1881.

<sup>53</sup> Law No. 184 of April 7, 1892.



all the assets, without paying any fee. This obviously created an uncertain climate, which was not beneficial for investments. As a consequence, the industry lagged behind and fell below the levels of other European countries. This was remedied in part by direct state intervention.

In 1907, the Ministry of Posts and Telegraph took control of the two most important licensees, *Società Generale Italiana dei telefoni e applicazioni elettriche* and *Società Telefonica alta Italia*. Under state control, though, the sector declined even further. In 1916, a ministerial commission presided by Mr. Semenza concluded that the state had to entrust telephony services to private investors. The First World War impoverished the State to a significant extent and the Mussolini government decided to embrace privatization, albeit retaining a licensing system.

In its 1921 manifesto, the national fascist party had stated its intention to return public services to the private sector. Once in power, the Mussolini government faced strong pressure to make good its promises. Several private groups were interested in investing in the telephone sector. The low penetration of telephony in Italy compared with other countries,<sup>54</sup> offered a good business opportunity that attracted the interest of equipment manufacturers and private investors who foresaw the potential profitability of the telecommunications industry. The main equipment manufacturers included Pirelli and Tedeschi, which merged after World War I to form Sirti. Private investors included both industry and banking institutions. In fact, at that time banks were co-venturers with industry in companies active in the sector. The leading Italian banks were Banca Commerciale Italiana (Comit) and Credito Italiano (Credit).

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<sup>54</sup> According to a study of 1927, there was one telephone per 392 inhabitants in Italy, against 12 in the USA, 45 in Germany, 116 in France and 58 in Britain. See B. Bottiglieri, *SIP* (Milano: Franco Angeli, 1987), 82.

In 1924, the government started the privatization process. The aim was to improve the provision of telephony services, which had languished under state control. For this reasons, the licences contained conditions imposing a demanding investment plan to develop the service across Italy.

Although it received technical advice on the superiority of a system based on a single provider, the government decided against it. Several factors explained this choice. Firstly, the government feared the concentration of power in the hands of a single company. Secondly, putting to tender a single licence would have attracted only very large groups, whereas the government also wanted to favour smaller investors. Finally, by awarding several licences the government could more easily please the plethora of private investors who expected a reward for supporting the party.<sup>55</sup>

Italy was thus split into five areas, each to be assigned to a licensee. A sixth licence comprised the provision of inter-area and international telephony. In 1925, the licences were awarded as follows:

- *Area 1*, comprising the North-west of Italy, to *Step-Società telefonica piemontese*, which soon after changed its name into *Stipel-Società telefonica interregionale piemontese e lombarda*, a company which belonged to the *SIP-Società Idroelettrica Piemontese* group, a holding whose primary activities were in the field of electricity production and sale and with strong ties with Comit bank. Stipel could also count on an alliance with equipment manufacturer Siemens. This licence was by far the most lucrative one, given that it covered the richest area of the country.

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<sup>55</sup> See Bottiglieri, *SIP*, 90.

- *Area 2*, comprising the North-East Italy, to *Telve-Società telefonica delle Venezie*. Originally Telve was a company founded by a group of local investors. It is important to note that in 1928, Telve came under the control of SIP, which, in turn, meant an alliance with Comit bank. This area, however, remained with limited prospects in terms of revenues and growth.
- *Area 3*, comprising the centre-North of Italy, to *TIMO-Società telefoni Italia medio-orientale*. Already in 1926, TIMO was bought by SIP, which thus controlled three out of five licensees.
- *Area 4*, comprising the North-West and central Italy and Sardinia, to *Teti-Società telefonica tirrena*. This area was the second richest one in the country, comprising Rome and Florence. Teti was controlled by two private groups: Pirelli and Orlando, a company with mining activities. The other major Italian bank, Credit, also supported Teti.
- *Area 5*, comprising the South of Italy and Sicily, to *SET-Società esercizi telefonici*. This company included Ericsson of Sweden and it was the only one with foreign investment. In fact, Ericsson exercised control over the company thanks to a complex corporate structure, which, through the creation of holding company *Setemer-Società elettrotelefonica meridionale*, was designed to circumvent the rules against control by foreign parties over Italian companies.

As to the sixth licence, since there was only one bidder, the government decided to take direct responsibility for the provision of inter-area and international telephony. It thus decided to set up a body, which could operate with significant latitude from the minister,

although reporting to the latter. Thus, in 1925 the government set up *ASST- Azienda di Stato per i Servizi Telefonici*,<sup>56</sup> under the control of the Minister of Posts and Telecommunications, itself a recent creation dating back to a law of 1924.<sup>57</sup> ASST, like its sister organisation entrusted with postal services, the Administration for Posts and Telegraphs (*Amministrazione PP. TT.*),<sup>58</sup> enjoyed significant autonomy within the ministry. First of all, ASST was the seat of expertise in telecommunications; thus the minister was dependent on ASST for advice on telecommunications, lacking any such resource directly in the ministry. In other words, the ministry itself was a rather light body, whilst the two *Aziende*, ASST and *Amministrazione PP. TT.*, had a significant number of employees and their heads wielded important powers that could be exercised with much independence from the Minister. Secondly, ASST also enjoyed financial independence since its budget was separate from the Ministry's budget. Its revenues derived from the fees that licensees had to pay to the state for grant of the licence. ASST could then use its resources to enter into contracts, subject only to a form of light supervision from the Comptroller (*Corte dei Conti*).

ASST was both a provider of telecommunications services and a regulator. This is because, while being in charge of providing inter-area and international services, ASST was also entrusted with monitoring the performance of the licensees. The relationships between ASST and licensees were further complicated by the fact that often ASST was in fact unable to fulfil its mission as a provider. For instance, in 1927 ASST entered into an agreement with the licensees for the building and operations of the telecommunications network linking the cities, which were the seat of regional authorities (*capoluoghi di provincia*).<sup>59</sup> Although it

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<sup>56</sup> Royal Decree No. 884 of 1925.

<sup>57</sup> Royal Decree No. 596 of 1924.

<sup>58</sup> Royal Decree No. 520 of 1925.

<sup>59</sup> See *Convenzioni aggiuntive* issued by Royal legislative decree No. 36 of 1926.

fell within its remit, ASST was unable to carry out the activities necessary to realize this project and so decided to contract it out to the licensees. This, however, started innumerable claims on both sides as to the compensation to which the licensees were entitled and lengthy disputes on the use of infrastructure, since the services entailed both ASST's network and the licensees'. The relationships between ASST and the licensees did not improve in the following years. In fact, the need for ASST to use the licensees gave rise to more contracting out, which, in turn, meant more disputes and litigation.

The financial crisis that hit the US markets in 1929 spread to Italy, albeit a few years later. The effects on the telecommunications sector were substantial. The licensees had borrowed heavily to finance the construction of the network. Comit and Credit banks had a very significant exposure with the licensees, both as lenders and as shareholders. In order to rescue the banks from the crisis, in January 1933 the Mussolini government created *IRI-Istituto per la Ricostruzione Industriale*. In October 1933, IRI created *STET-Società Torinese Esercizi Telefonici*, its first sector-specific holding.<sup>60</sup> STET acquired participations from Comit, including a controlling stake in SIP. By controlling SIP, IRI-STET became the most prominent operator of private telephony in Italy. Given that ASST was also a telecommunications provider and that IRI-STET was funded through state resources, the year 1933 saw a sort of re-nationalization of the telecommunications industry, the only private undertakings remaining outside state control being TETI and SET.

Thus, before the Second World War broke out, the situation of Italian telecommunications institutions could be described as follows:

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<sup>60</sup> See B. Bottiglieri, *STET: strategie e struttura delle telecomunicazioni* (Milano: Franco Angeli, 1987).

- ***Number of providers*** There were six providers of telephony services, five of which operated under a licence. The licences were drawn on the basis of the territory covered. The sixth provider, ASST, differentiated itself for the type of service provided – inter-area and international telephony -, although ASST often contracted out to the licensees its services and, in any event, was dependent on the licensees' collaboration to operate, since its network was connected to the licensees'.
- ***Ownership.*** There was a mix of public and private ownership, although the state played a major role. While ASST was part of the Ministry, the licensees were private companies. However, through IRI-STET, the State had control over three out of five private providers. IRI-STET aimed to manage the companies for which it had control according to market criteria, but it could not act independently from the government, which, ultimately, provided funding and had the right to appoint its management.
- ***Degree of competition.*** The licensees and ASST operated under exclusive licenses. In the allotted area, only the licensee had the right to provide the services for which it was awarded the licence. Thus, there was no competition between licensees, nor could anybody provide telephony services without a licence.
- ***Allocation of regulatory powers.*** Regulatory functions were entrusted to ASST. However, generally speaking, ASST did not exercise its regulatory functions effectively. As a consequence, there was a lack of guidance and planning.

### **III. FROM WORLD WAR II TO 1968: THE CONSOLIDATION OF ITALIAN TELECOMMUNICATIONS INSTITUTIONS**

Telecommunications infrastructures were badly hit by the war. Subscribers also dropped from 634,483 in 1942 to 459,361 in 1945.<sup>61</sup> However, conditions improved in the years between 1945 and 1948, thanks to a tariff increase granted by the government, a surge in demand and a stabilization of the economy. This translated into new investment to replace lost infrastructure and to build new, more modern one. In 1946, TIMO, one of the licensees under IRI-STET, implemented one of the first systems to enable customers to route calls outside of their areas without the need for an operator.

While Italian telecommunications were improving their performance, a cloud hung above the destiny of the licensees. The licences were to expire in 1955 and it was not clear whether the government intended to renew them or not. After the war, several plans were put forward to modernize telecommunications institutions, including plans from U.S. companies.<sup>62</sup> All of them proposed some sort of re-unification, given that the split of the service between six providers was largely inefficient and increasingly untenable from a technological point of view. However, some argued that such reunification should be led by ASST, with the state re-taking direct control over telecommunications. Some others, on the contrary, favoured the IRI formula and argued that IRI should control the licensees it did not already control, and, moreover, there was a plan for IRI to also acquire ASST' assets.<sup>63</sup> ASST mounted a vigorous and successful battle against such option and the final solution was dictated by the desire to preserve ASST' sphere of power.

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<sup>61</sup> See Telecom Italia, *L'Italia al telefono*, 2006, internal publication available on request (extracts are published in Telecom Italia's website, [www.telecomitalia.it](http://www.telecomitalia.it)).

<sup>62</sup> See, e.g., the plan by International Telegraph and Telephone corporation to acquire control over the entire sector, a plan which was met with favour by ASST and fought by IRI (see Bottiglieri, *SIP*, 250).

<sup>63</sup> See Bottiglieri, *SIP*, 337.

In 1957, TETI and SET came under state control through an acquisition by STET. The five licensees obtained a new licence, whose terms, though, were highly favourable to ASST. The latter was confirmed in its earlier role of provider of inter-area services and international services. The licensees were obliged to collect payments due to ASST and to guarantee such payments, even if the customer failed to do so. In addition, ASST continued to be empowered to monitor the licensees' compliance with the terms of their licences.

A further re-organization of the sector took place in 1964, when SIP (controlled by IRI-STET) incorporated all other telecommunications providers under IRI's control. This reorganization took place after a law of 1962 that nationalized the electricity sector, thus forcing SIP to sell its electricity assets to the state-controlled body *Ente Nazionale per l'Energia Elettrica* (ENEL).<sup>64</sup> IRI decided to use the sums obtained as consideration for such assets to buy out the other licensees, thus streamlining its holdings in the telecommunications sector. As a consequence, in 1964, *SIP-Società Idroelettrica Piemontese*, became *SIP-Società italiana per l'esercizio telefonico per azioni* and incorporated the other licensees. In the same year, a new licence was signed between SIP and the state.<sup>65</sup> One of the key issues underlying the 1964 licence was the criteria for sharing traffic between ASST and the licensees, including SIP. While at the beginning of telephony demarcation lines could be drawn between inter-district traffic and within-district traffic, as interconnection between districts grew, this division lost any economic or technical backing. Yet it was of paramount importance for ASST, whose role was directly proportional to the amount of traffic for which it could be held responsible. As a consequence, while economically or technologically unsound, at every licence renewal ASST sought to preserve its share of traffic as a means to defend its position vis-à-vis the licensees. In this respect, the 1964 licence perpetuated the

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<sup>64</sup> Law No. 1643 of 1962.

<sup>65</sup> See Presidential Decree No. 1594 of 1964.



pre-existing situation whereby traffic was shared between ASST and the licensees. In an attempt to reduce the uncertainty as to the respective allocation of traffic and the ensuing disputes, the 1964 licence adopted three categories, of which two were to be the exclusive competence of ASST and SIP, respectively, and only the third one constituted shared traffic, i.e. traffic for which both ASST and SIP were responsible. More specifically, the telephone calls were categorized as follows:

- the traffic that fell exclusively under ASST competence was traffic between the twenty-one cities that were considered as being important nodes of the network (*centri di compartimento*).
- The traffic between a *centro di compartimento* and another city, which was not a *centro di compartimento* was shared traffic, for which both SIP and ASST had competence (in the former Area 5, i.e. in the South of Italy and Sicily, due to the development of the network shared traffic also included traffic between different telephone districts).
- All traffic outside the two above categories was SIP's exclusive competence (in the former Area 5, this also included traffic between cities within the same telephone district or *compartimento*).

As can be seen, the division of competences between ASST and SIP was far from clear. There were several drawbacks: it was more difficult to plan network development, maintenance and provision of services; there were costs from duplication of equipment and networks; revenue sharing was difficult and lent itself to endless disputes. It also acted as a deterrent for investment and thus resulted into a low level of service. Only 15% of shared

traffic was through automated switching, as opposed to 90% and 70% for traffic which fell under the exclusive competence of, respectively, SIP and ASST.

The plan to bring automatic switching to the entire network by the end of the 1960s required a new division of competences between SIP and ASST. ASST, though, was reluctant to enter into this negotiation, as it feared to lose a share of its competences. This fear only increased when, in 1964, SIP merged with other licensees. In order to allay ASST's concerns and to promote the desired improvement, a new licence was signed in 1968.<sup>66</sup> The new licence increased the number of cities *centro di compartimento*, whose traffic fell within ASST's exclusive competence, from twenty-one to thirty-seven. In return, the licence set out that all other traffic would belong to SIP. Thus, the division was dictated by the need to compensate ASST for its loss, rather than by technological or economic reasons. Indeed, having more *centri di compartimento* meant that ASST could expand its presence by acquiring offices, infrastructure and hiring new staff. An expansion of its activities was in itself a guarantee for the future survival of ASST since, by having a sizeable number of employees and infrastructures, ASST could carry considerable weight in negotiations with the licensee as to the division of tasks. In exchange for letting ASST increase the number of *centri di compartimento*, SIP gained clearer boundaries and less interference by ASST.<sup>67</sup>

It is useful to summarize the main provisions laid down in the 1968 licence since they provide valuable information on the provision of telecommunications services in Italy at that time and the effects of a split system of providers (ASST, SIP and the other licensees).<sup>68</sup>

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<sup>66</sup> See Presidential Decree No. 427 of 1968.

<sup>67</sup> Bottiglieri, *SIP*, 395.

<sup>68</sup> It should be noted that licence terms and conditions were set out in a separate document attached to the licence, called the "Convenzione". While the licence was the formal act of appointment, the *Convenzione* contained the detailed list of rights and obligations of the licensee.

- **Investment.** SIP was under an obligation to invest in such a way as to ensure the development of infrastructure in accordance with a plan set out by the Minister of Posts and Telecommunications, acting in accordance with the Treasury and the Minister for State Holdings. In this respect, it is important to note that the licence incorporated by reference a development plan set out by the Ministry in 1957.<sup>69</sup> Further, SIP had to submit annual plans of the investments it intended to carry out and the plans were subject to amendments and final approval by the Council and the Board, two technical bodies, which were part of the Ministry of Posts and Telecommunications.
- **Ownership.** SIP was a publicly traded company. By law, the majority of its shares had to be in the hands of IRI, directly or indirectly.
- **Regulation.** ASST had ample powers to monitor SIP's compliance with the terms of its licence. For instance, ASST had to approve the equipment used by SIP to build infrastructure. Furthermore, ASST had to ensure that SIP complied with the investment plans and could for this reason conduct inspections, request information and conduct technical verifications.
- **Targets.** SIP's targets included the development of a system of direct dialling by the customer, i.e., the ability of each customer to call another user without the need to speak to an operator. Interestingly, SIP had to provide ASST with the means to enable the traffic which fell under ASST competence to also benefit from direct dialling. Further, SIP had to set up a telephone network every time that at least 25 subscribers so requested, with a time limit of 30

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<sup>69</sup> *Piano regolatore telefonico nazionale*, approved by Ministerial Decree of December 11, 1957.

days for the new connections to become operational. SIP had also to meet demand from rural communities who wished to be connected to the network. Finally, SIP had to publish the telephone directory.

- **Tariffs.** The licence set out the tariffs that SIP could charge to its users. Tariffs were to be updated every two years to be brought in line with industrial costs, taking into account a comparison with costs incurred for similar services by foreign operators. Tariffs were decided by a ministerial decree, following a deliberation of CIPE – *Comitato Interministeriale per la Programmazione Economica* (the Inter-ministerial Committee for Economic Planning), a body created by law in 1967 with powers over economic policy.<sup>70</sup>
- **Licence fee.** SIP had to pay ASST 4.5% of its total revenues each year as licence fee. This fee could be increased by 0.8% after one year from the start of the licence.
- **Duration.** The concession was to run until 1996.

Thus, at the end of the 1960s, Italian telecommunications services were provided mainly by SIP, which, after the incorporation of the former licensees, had become by far the most important provider, and ASST. In addition, specific services were provided by other two companies under STET control, namely Italcable and Telespazio. The former was founded in 1941 to provide international telephony services between Italy and non-European states and it came under STET control in 1964. The latter was created in 1961 with the participation of the Ministry of Posts and Telecommunications, Italcable and RAI, to provide satellite communications. It also became part of STET group in 1964.

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<sup>70</sup> See Law No. 48 of 1967.

Although this represented a more simplified organization of the sector compared to the earlier period, when provision of telecommunications services was split between six area providers (besides Italcable and Telespazio), it still meant a high degree of fragmentation. Moreover, the relationships between SIP and ASST acted as a hindrance to an orderly development of telecommunications services.

#### **IV. SIP 1968-1978**

Thanks to stability and strong growth in the economy between the end of the 1960s and the early 1970s, the Italian telecommunications sector fared well, compared with other countries. The table below shows that, *e.g.*, the penetration of telephony, as measured by the number of subscribers per 100 inhabitants, was higher in Italy than in France and it was not far from Germany and United Kingdom. This result was all the more remarkable given that, starting from 1968, a wave of strikes and industrial actions severely hit the growth potential of the sector.

**Table 2 – Number of subscribers and telephone penetration as of January 1, 1973** (Source: R. Abeille, *Storia delle telecomunicazioni italiane e della Sip 1964-1994*, 49).

	Number of Subscribers ('000)	Number of subscribers per 100 inhabitants
United States	73,849	35.2
Japan	25,675	23.8
Germany	10,830	17.6
United Kingdom	10,308	18.2
Italy	7,637	14
France	5,078	9.8
Sweden	3,578	43.9
Switzerland	2,166	34.3

In 1972, SIP signed a new licence, with a view to promoting further expansion of the service.<sup>71</sup> The 1972 licence provided, inter alia, the following obligations for SIP:

- to connect not fewer than 800,000 new subscribers per year, with priority for new subscribers in the South of Italy.
- To connect within a reasonable time and no later than by 1975 all subscribers who had already applied for service and whose demand had not been satisfied.

<sup>71</sup> See Presidential Decree No. 803 of 1972.

- Within two years, to start providing mobile telephony in the district of Rome and, progressively, to extend the service to the other districts.
- To upgrade the network in order to provide videotelephony and cable television.
- To start data transmission over the existing public telephony network and other network segments, to be developed accordingly.

At the same time, SIP tariffs were amended to enable the company to increase its revenues by approximately 15%.<sup>72</sup> Amendments to SIP tariffs were decided by CIPE having regard to the significant investment that was required to meet the ambitious targets set in the 1972 licence. The tariff increase of 1972 was the first one since 1964. In the same period, inflation rose by 40%, though. In France, Germany and the United Kingdom there had been already, respectively, three, two and four tariff increases in the same period. This increase notwithstanding, Italian customers still benefited from one of the lowest tariffs for local calls in Europe.<sup>73</sup> This already shows the delicate financial equilibrium of SIP. While the company had to meet the targets set in the licence, it was dependent on the government for its revenues. Tariffs obviously had a profound impact on the company's ability to finance investments and, consequently, to meet demand and bring about new services. This meant that the company was very vulnerable to political interference, as the government could use its power over tariffs as a tool of economic policy-making.

In the period between 1973 and 1978, the economic crisis brought about by the oil shock was compounded in Italy by a period of social unrest. The 'anni di piombo' as they

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<sup>72</sup> R. Abeille, *Storia delle telecomunicazioni italiane*, 41.

<sup>73</sup> *Ibidem*.

were defined, marked a very low point of confidence in Italian institutions. In 1978, the Prime Minister, Aldo Moro, was kidnapped and assassinated by a group of left-wing terrorists, the red brigades. These severe hardships took a heavy toll on the Italian telecommunications sector too, especially on SIP. This is because, faced with high inflation and the need to sustain investments, both to fulfil the licence terms and to avoid jeopardising even further industrial relationships, SIP saw its expenses far exceed its revenues and started to borrow heavily. A tariff adjustment was needed to enable SIP to comply with its mission and continue to supply services.

In 1975, CIPE granted a tariff increase to remedy SIP's disastrous situation. However, this increase provoked a backlash from public opinion. The company was not able to fight back with an adequate information campaign. Thus, shortly afterwards the government partly retracted on such increase. The period thereafter (i.e. 1976-1979) was characterized by a pattern of requests for tariff increase in the face of a worsening financial situation, and continuous delays as governments were short-lived and, in any event, hostile to such increases.

The role of CIPE as a regulator increased, as this body was in fact the ultimate centre of decision making over this vital matter. However, CIPE too, as a ministerial body, was prey to government instability. As a result, investment was lagging, the rate of increase of new subscribers slowed down and the financial burden escalated. In 1978, the company failed to earn a profit on its operations and in 1979 the company had a significant deficit. The table below shows the composition of cost items in SIP accounts between 1973 and 1979.



**Table 3 - SIP - Costs and profits in percentage 1973-1979** (Source: R. Abeille, *Storia delle telecomunicazioni italiane*, 61)

	1973	1974	1975	1976	1977	1978	1979
<b>Workforce</b>	59.9	62.7	58.9	53.4	57.6	61.7	57.8
<b>Financial interests</b>	13.7	16.8	17.4	18.5	23.0	25.8	27.8
<b>Amortization</b>	15.2	13.6	15.6	15.7	16.6	11.2	24.7
<b>Other</b>	6.3	4.7	5.0	4.8	5.0	4.4	4.7
<b>Profits</b>	4.9	2.2	3.1	2.6	2.0	0	-18.9
<b>Total</b>	100	100	100	100	100	100	100

Being unable to finance its operations and with tariffs systematically lagging behind inflation, SIP experienced a very serious financial crisis in 1979. The crisis had severe repercussions on SIP's ability to deliver telecommunications services, plummeting the sector into stagnation amidst public outcry about lack of adequate services. It is against this scenario that one must assess pressures for changing telecommunications institutions and increasing returns. Before turning to this matter, the section below provides information on British telecommunications institutions before 1979.

#### **V. BRITISH TELECOMMUNICATIONS INSTITUTIONS BEFORE 1979**

The provision of telecommunications services in Britain differed markedly from that of Italy since the very beginning of telephony. In contrast to the fragmented state of the sector in Italy, starting from 1869, the Post Office ran the services on the basis of a monopoly.

The Post Office had been created in 1840 as a government department, headed by a minister, the Post Master General.<sup>74</sup> Its remit originally encompassed the telegraph. However, when telephone systems appeared in 1877, the Post Office claimed that they fell within the definition of ‘telegraph’ as provided under the Telegraph Act of 1869.<sup>75</sup> Thus, the Post Office asserted a monopoly over telecommunications. The Post Office was not the only actual provider of telecommunications services. It chose to license private operators, alongside its own operations. However, the co-existence of private licensees and Post Office was progressively reduced and ended in 1912, when the Post Office completed the acquisition of the National Telephone Company’s assets.<sup>76</sup> By 1912, therefore, the Post Office was the only provider of telecommunications services in Britain (with the exception of the municipal network of Kingston upon Hull).

This can be usefully contrasted with the Italian situation. As noted, in 1925 the Mussolini government decided to award six licences for the provision of telecommunications services, based on geographic areas, rejecting an advice on the superiority of a single provider from the point of view of technology and economic efficiency. Thus, the split-supply model adopted by the Italian telecommunications sector contrasted with the single-supplier model of Britain. Moreover, the Italian licensees were private companies, with ASST being the exception. Ownership arrangements in Britain, by contrast, hinged on full state control over the provider, with the Post Office being a government department.

Small reforms were introduced in the 1930s, when a Post Office board was created and there was an attempt to separate postal from telecommunications services, and in the

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<sup>74</sup> See the Telegraph Act 1868; H. Robinson, *The British Post Office: A History* (Princeton: Princeton University Press, 1948); Thatcher, *The Politics of Telecommunications*, 32-9.

<sup>75</sup> See Thatcher, *The Politics of Telecommunications*, 32, who also explains that this position was endorsed by a judgment issued by the High Court in 1880.

<sup>76</sup> The Post Office had bought the National Telephone Company’s trunk network in 1896 and bought its local networks in 1911 (see Thatcher, *The Politics of Telecommunications*, 32).

1960s, when separate Deputy Director Generals for posts and telecommunications were created with a view to grant more autonomy to the two.<sup>77</sup> In 1961, the Post Office Act “*made the Post Office a hybrid between a department and a public corporation*”, thus altering the Post Office’s institutional position, albeit to a “*modest*” extent.<sup>78</sup>

Further to an act of law passed in 1969, the Post Office became a public corporation, thus ending its position as part of the government.<sup>79</sup> The Act created a Minister within the government, the Minister for Post and Telecommunications, with responsibility for drawing up policy measures and overseeing the Post Office. The status of public corporation was intended to afford the Post Office the ability to behave more independently from the government. The Post Office was responsible to provide postal, telecommunications and data processing services in the UK and abroad,<sup>80</sup> under an all-encompassing monopoly regime, as it enjoyed an “*exclusive privilege*” to run the telecommunications network. The monopoly thus conferred on the Post Office was as comprehensive as anything in Europe and a commentator claimed that under, this regime, the UK telecommunications market was “*the most closed within the OECD*”.<sup>81</sup> Moreover, the Post Office was free to decide charges and terms and conditions for its services.<sup>82</sup>

The duties it was charged with were phrased in very general terms. For instance, under para. 9.1 of the 1969 Act, the Post Office had to “*exercise its powers as to meet the social, industrial, and commercial needs of the British Islands in regard to matters that are subserved by those powers and in particular to provide throughout those Islands (save in so*

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<sup>77</sup> See Thatcher, *The Politics of Telecommunications*, 34-5.

<sup>78</sup> Thatcher, *The Politics of Telecommunications*, 38.

<sup>79</sup> See Post Office Act 1969.

<sup>80</sup> See para. 7 of the 1969 Act.

<sup>81</sup> J. Solomon, ‘Telecommunications Evolution in the UK’, *Telecommunications Policy*, (1996), 186-192, at 186.

<sup>82</sup> See § 27 of the 1969 Act.

*far as the provision thereof is in its opinion impracticable or not reasonably practicable)* such services for the conveyance of letters and such telephone services as satisfy all reasonable demands for these". When compared with the terms of SIP's licence, these obligations appeared both vague and difficult to be enforced. In particular, the requirement of "reasonable practicability" undermined the binding force of such provision, also given that the Post Office was ultimately the sole entity that could judge such requirement.<sup>83</sup>

The most significant constraint to the Post Office autonomy was in financial matters. The Post Office had to at least break even over the years, taking into account amortization.<sup>84</sup> Capital expenditure was to be agreed with the Minister.<sup>85</sup> Borrowing required approval by both the Treasury and the Minister and there was a limit to the amount of borrowing. The financial limitations that impinged on the Post Office autonomy also derived from outside the legal framework of the telecommunications sector. In fact, constraints outside the 1969 Act proved probably more severe.

The Post Office finances were part of the general public expenditures. An increase in the Post Office spending raised total public expenditure. In practice this meant that the Post Office's finances and the general budget were intertwined and that the government could deny a tariff increase in light of its objectives of macro-economic policy. For instance, the Heath government refused to allow a tariff increase that would have kept prices abreast of inflation and sacked the Post Office chairman for advocating commercial freedom from the government. In addition to price restraint, the Post Office also had to contend with sudden cuts in its capital investments programme as the government in 1973 imposed a cut of 20%

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<sup>83</sup> See Thatcher, *The Politics of Telecommunications*, 95.

<sup>84</sup> See para. 31 of the 1969 Act.

<sup>85</sup> See para. 11.8 of the 1969 Act.

with no prior consultation. Lack of resources and poor investments inevitably lead to growing unsatisfied demand among users.<sup>86</sup>

In order to tackle the Post Office situation, the new Labour government set up a major review of the Post Office in 1975. The review (the “Carter Report”) carried out an assessment of the Post Office efficiency compared to other postal and telecommunications authorities with similar tasks.<sup>87</sup> Although guarding against the difficulties of such assessment, the report concluded that “*Whilst the Telecommunications Business of the Post Office has much to be proud of, it remains significantly less efficient than the best of its overseas competitors*”.<sup>88</sup> On the marketing side, the Carter report pointed out that “*its customers get the feeling that they are being graciously permitted to use the systems*”,<sup>89</sup> and that “*the Postal and Telecommunications Business needed to understand a great deal more than they [did] about the profiles of the various markets they served*”.<sup>90</sup> Moreover, the Carter Report addressed the issue of relations with government. It found that there was a thoroughly confused relationship between government and the Post Office with no clear agreement as to their respective roles in policy formation. In particular, government intervention was short-term and concerned with ad hoc issues, with no ability to devise a long-term strategic plan.<sup>91</sup>

The report issued recommendations to overcome the *impasse*, among which the following are noteworthy:

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<sup>86</sup> A. Cawson, K. Moran, D. Webber, P. Holmes and A. Stevens, *Hostile Brothers* (Oxford: Clarendon Press, 1990), 90.

<sup>87</sup> Department of Industry, *Report of the Post Office Review Committee*, Cmdn. 6850 (London: HMSO, 1977).

<sup>88</sup> *Ibidem*, 19.

<sup>89</sup> *Ibidem*, 42.

<sup>90</sup> *Ibidem*, 43.

<sup>91</sup> *Ibidem*, 59.

- the division of the Post Office in two structures, the first comprising postal services and the second telecommunications;
- the establishment of a Council on Post Office and Telecommunications Affairs to serve as a source of expertise for the government;
- a reconsideration of the exclusive privilege of the Post Office as to telecommunications equipment.<sup>92</sup>

The recommendations of the Carter Report were not implemented immediately but they formed the basis upon which the next government would start to reform the organisation of the telecommunications market.

## **VI. CONCLUSION**

This chapter has provided an overview of the history of Italian and British trajectories, prior to 1979, i.e. the year that is the starting point for the study carried out in the thesis. As explained, the chapter does not purport to show dynamics of increasing returns, its task being confined to provide the reader with an introduction to this process. Nevertheless, given the weight that almost a century of history is bound to have on the subsequent institutional development, its importance should not be underestimated. It is thus useful to set out two concluding remarks.

First of all, what seems most prominent in the starting point of the Italian path is the fragmented organization of the sector. Whereas in Britain the Post Office appeared as dominating the scene as a provider of telecommunications (and postal) services, in Italy provision was divided among four entities in 1979 (down from eight). What is more, two of them (SIP and ASST) clearly had overlapping roles and the latter often times simply

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<sup>92</sup> Ibidem, 120-130.

contracted out to the former its duties. The system of split providers had started already in 1924 and passed unscathed the Second World War and the birth of the Italian Republic in 1948. Already during the period studied, the split-provider system was difficult to justify from a technological and economic point of view. It is worth remembering that in 1924 the government of the day had received advice on the technical superiority of a single provider system. Equally, after the Second World War, a project of re-unification of the telecommunications sector similarly failed due to political pressure.

A second concluding remark pertains to the difference in the starting points between Italian and British telecommunications. The table below provides an overview of the telecommunications institutions in Britain and Italy in 1979.



**Table 4 - Italian and British telecom institutions in 1979**

	<b>Britain</b>	<b>Italy</b>
<b>Number of providers</b>	1 (Post Office)	4 (ASST, SIP, Italcable, Telespazio)
<b>Ownership</b>	Public	Private companies under state control (SIP, Italcable, Telespazio) / Ministerial body (ASST)
<b>Degree of competition</b>	Monopoly	Monopoly
<b>Allocation of regulatory powers</b>	Minister	Minister/CIPE/ASST

Viewed in 1979, these two countries' institutional starting points could have hardly been more different. In particular, the fragmented organization of the Italian telecommunications sector provides a striking contrast with the single dominance of the Post Office in the United Kingdom, an organization entrusted with the sole responsibility to provide postal and telecommunications services "*throughout the British Islands*". Equally, the mixed ownership of Italian telecommunications, where a body fully under state control operated alongside private companies, can be contrasted with the situation in Britain where the Post Office was clearly in state hands.

Thus, by 1979 these two countries displayed a very significant difference in their institutional starting points. The differences were also long standing, given that Italy's fragmentation from 1924 found no parallel in Britain, where the Post Office already in 1912



held a legal and *de facto* monopoly. The differences between the two countries were set to continue until 1997.

### **3. SETTING THE BENCHMARK: TELECOMMUNICATIONS INSTITUTIONS IN BRITAIN 1979-2007**

#### **I. INTRODUCTION**

This chapter sets out the institutional development that took place in the benchmark country, i.e. the United Kingdom. During the period 1979-1984, a Conservative government was able to drive major institutional changes in the telecommunications sector. The adoption of the 1984 Telecommunications Act in particular marked the creation of a privatized operator, monitored by a sector-specific independent regulatory body. The same Act also started the transformation of the sector from a closed monopoly into a competitive market. These changes brought about a very significant break with the past. Moreover, the reforms made Britain the first country in Europe to adopt privatization and regulation. Taken together, these changes show that Britain had embraced a 'logic' based on delegation to an IRA of regulatory powers and elected officials relinquishing ability to control day-to-day operations of telecommunications companies – that were privately-owned.

In the period after 1984 the new British telecommunications institutions experienced a period of stability, which continued until 2007. Institutions did not remain frozen, of course, but the direction of change remained constant. This is to say that the logic of the British path remained unaltered, even if individual pieces of the institutional structure were replaced. The creation of Ofcom in 2003 illustrates this point. Ofcom replaced Oftel and merged other regulators in order to create a single regulatory body for the entire electronic communications industry. But the creation of Ofcom continued the same logic and thus represents another step on the same path embraced by Britain after 1984.

The task of the chapter thus consists in providing information on the British path of reform in order to enable the benchmark-type comparison with Italy that will be performed

throughout chapters 4-6. Before undertaking this task, it is useful to recall that the chapter does not attempt to establish that changes in Britain were linked to increasing returns nor to make any in-depth study on the creation of new telecommunications institutions, this chapter and the following being instrumental to the analysis on Italian telecommunications institutions and not *per se*. Rather it sets out the UK's institutional development with which the Italian one will be compared.

After concisely recapitulating the institutional situation pre-1979, the chapter will describe the economic and technological developments that created pressures for institutional change in both countries and how policy makers responded to pressures for change. In this respect, the chapter also notes that institutional reforms in Britain came about in the face of strong opposition, both in and outside Parliament. A section will provide a description of the new 1984 institutional arrangements, i.e. the rules on ownership, competition and licensing and the structure and powers of the regulator. Another section continues to provide information on the trajectory of the benchmark country by completing the description of the British path after the radical reforms that took place in 1981-1984.

## **II. THE STARTING POINTS AND TECHNOLOGICAL AND ECONOMIC PRESSURES FOR CHANGE: 1979-1984**

It is useful at the outset to briefly recall that the provision of telecommunications services in Britain was entrusted to the Post Office, established as a public corporation under the Post Office Act 1969. This meant that:

- The Post Office – in contrast with Italy – was the only entity in charge of supplying telecommunications services throughout “*the British Islands*”.

- The Post Office enjoyed a statutory monopoly, since the Post Office Act 1969 vested it with the “*exclusive privilege*” of running telecommunications networks.
- The Post Office was under state control, with the Minister of Post and Telecommunications appointing the chairman and its finances being counted within the overall public finances.

This also meant that, in 1979, there was no independent regulator, all rules concerning the sector being approved either by the Parliament or by the Minister. In fact, since the state was supplying telecommunications through the Post Office, there was limited need to issue such rules. This institutional background provided pressures for institutional change in the period between 1979-1984 due to technological and economic change in the industry. Starting from 1960s, the changes that were taking place in the microelectronics industry changed profoundly the telecommunications industry.<sup>93</sup> The two sectors had until then been separated by clear boundaries, telecommunications being based on electromechanical technology. The digitalization of information, coupled with the increased capability of microchips, meant that network operation, equipment manufacturing and customer premises equipment and other services were transformed and improved. As will be showed below, this carried significant implications for existing telecommunications institutions.

First of all, public ownership and, more generally, state control came under pressure. New technology offered the ability to greatly improve the quality, reliability and breadth of telecommunications services offered. However, this entailed heavy investment. Existing

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<sup>93</sup> See, e.g., OECD, *Telecommunications. Pressures and Policies for Change* (Paris: OECD, 1983); *The Telecommunications Industry* (Paris: OECD, 1988); and *Telecommunications Network-Based Services* (Paris: OECD, 1989).

telecommunications networks needed to be upgraded and existing equipment was to be written off as obsolete.<sup>94</sup> Moreover, there were economies of scale in replacing large chunks of the network as opposed to incremental upgrading. This is because having a network that is only partly digitalized implied added costs due to the need to transform signals from digital to analogue and viceversa. High investment, concentrated in a short space of time, though, run against tight financial limits imposed on public bodies and had negative implications for overall public finances. Privatization became a potential institutional solution to overcome these shortcomings. A privatized telecommunications operator would be able to borrow more easily the funds needed for the profitable investments and, moreover, such borrowing would not have an impact on state finances, while at the same time allowing for the provision of more modern telecommunications services.

Secondly, the economic rationale for monopoly also became weaker. Network operation was traditionally regarded as a 'natural' monopoly, i.e. a service, which could be more economically supplied over one single infrastructure.<sup>95</sup> However, new technology meant that the cost of new networks fell. The opportunities thus arose to set up limited networks (as opposed to the ubiquitous public network) in highly concentrated areas and then interconnect such networks with the public network. The new networks in turn could be open to a variety of users or be 'closed' networks, designed to link together only the premises of, for instance, a multinational enterprise with a better and more secure connection. This meant that new technology also threatened the traditional network monopoly. Business users saw the added benefits of having more than one provider both in terms of variety and quality of services as well as prices. These developments meant that another pillar of

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<sup>94</sup> See O. Stehmann, *Network Competition for European Telecommunications* (Oxford: OUP, 1995), 15, 18.

<sup>95</sup> See R. Noll, 'The Future of Telecommunications Regulation', in E. Noam (ed.), *Telecommunications Regulation: Today and Tomorrow* (NY: Aspen, 1982), ch. 2.

telecommunications institutions, namely monopoly, became unstable. In its place, competition started to gain acceptance as a suitable institutional arrangement to allow several operators to co-exist.

The newly elected Conservative government commissioned a report from Professor Beesley to study the extent to which competition could take place in the telecommunications sector. The Beesley report, published in April 1981,<sup>96</sup> considered the benefits and costs of resale of leased lines. He concluded that competitors should be allowed to lease lines from BT and to sell all services through such leased lines, including “basic” voice telephony since otherwise it was impossible to enable viable competition. His conclusions were based on the US experience whereby the development of non-voice or “value added” services was linked to the ability to sell also “basic” or voice services. He argued that if BT moved to a cost-based structure for each service or to equalising returns on charges, then the loss to BT’s revenues could be accommodated by a balancing of its return on charges. Finally, although he did not advocate that a direct competitor to BT should be licensed, Beesley anticipated that resale would itself lead to full liberalisation and the creation of alternative networks to BT’s.

Thirdly, a privatized operator, competing with other suppliers on networks and services provided incentives to create a sector-specific regulator to supervise the development of competition in the sector. This was due to several reasons. First, the industry was achieving a very high degree of complexity. Indeed, one of the implications of technological change for telecommunications was the evolution from a single-product industry to a much more complex environment, where different products became available to users. In addition, technological change meant that there was a continuous process of replacing old products and services with new ones. A ‘generalist’ bureaucracy in a ministerial department was ill-suited

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<sup>96</sup> See M. E. Beesley, *Liberalisation of the use of British Telecommunications Network* (London: HMSO, 1981).

for a task that required very specialized expertise and involvement in the day-to-day operation. Second, even if placed outside state control, a privatized telecommunication operator would nonetheless continue to require a high degree of public supervision. For instance, such operator would continue to fulfil a public service mission. The state would therefore need to be involved in defining the scope of such mission. Finally, the provision of services where competition is not developed would require price controls.

Various types of price regulation mechanisms were analysed in the 1983 report prepared by Professor Stephen Littlechild to regulate BT profitability.<sup>97</sup> In carrying out his mandate, Professor Littlechild proceeded on the base of five criteria: (i) protection against monopoly; (ii) efficiency and innovation; (iii) burden of regulation; (iv) promotion of competition; and (v) proceeds from flotation and prospects. The assumption of his report was that competition was the most effective check for market power: regulation was merely a way of 'holding the fort' until competition arrived.<sup>98</sup> He therefore put great emphasis on price regulation mechanisms that minimized the level of discretion by the regulator.<sup>99</sup> A regulatory body would be needed, though, to enforce price regulation.

In sum, economic and technological developments during the period studied posed a threat to then existing institutional arrangements. They created powerful incentives to abandon direct state control, monopoly and a centralized supplier especially since new

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<sup>97</sup> See S. Littlechild, *Regulation of British Telecommunications' Profitability* (London: HMSO, 1983).

<sup>98</sup> See Littlechild, *Regulation*, 7.

<sup>99</sup> The choice fell on a local tariff reduction scheme, by which BT would be required to set tariffs so that a local tariff index increased by less than retail prices in general. The Littlechild proposal was accepted by the government (see Statement on Telecommunications Policy, HC Deb 7.2.83 c.633). What came to be known as the RPI-X formula was incorporated in condition 24 of BT's license. X was set equal to 3 until 21 July 1989 when a price revision was deemed to take place. Increases in the value of the price cap during the 5 years of its duration were subject to certain limitations so as to ensure stability in the regulatory framework. Thus, from 1984 to 1989 BT's retail prices were regulated at RPI-3%.

technologies meant that, through investments, new and better services could be delivered through alternative networks and/or by using the public network. Policy makers thus were faced with very important institutional choices, as privatization, competition and regulation by independent agency would have meant a complete institutional overhaul.

### III. NEW TELECOMMUNICATIONS INSTITUTIONS IN BRITAIN: 1981-1984

The period studied coincided with the victories of the Conservative party at the 1979 and 1983 elections. Reforms that changed the landscape of British telecommunications came about in two stages: first, in 1981 the telecommunications operations of the Post Office were incorporated as a separate entity; second, in 1984 British Telecommunications, as the new entity was called, was privatized and a sector specific regulator was established. The table below summarizes the main changes in the key institutional aspects.

**Table 5 - Changes in British telecommunications institutions 1979-1984**

	1979	1984
Number of providers	One Public corporation with responsibility for Posts and Telecommunications	BT and Mercury
Ownership	Public	Private/listed/51% publicly traded
Competition	Monopoly	Competition (Duopoly)
Regulatory Powers	Minister	OFTEL

The Act that created British Telecommunications was the 1981 British Telecommunications Act. It provided for the creation of BT as a public corporation entrusted with the provision of telecommunications and data processing services, separate from the



Post Office.<sup>100</sup> The main thrust of the Act was to vest the newly-created BT with generally the same powers as the Post Office pursuant to earlier legislation. In particular, the 1981 British Telecommunications Act maintained intact monopoly arrangements as BT continued to enjoy the “*exclusive privilege of running telecoms systems throughout the British Islands*”,<sup>101</sup> while giving to the corporation power to fix charges for its services and other terms and conditions.<sup>102</sup>

Limited exceptions to BT’s monopoly concerned equipment provision and sale of so-called value-added services, i.e. telecommunications services other than the transportation of calls over the network for the purposes of providing voice telephony. With respect to equipment provision, the 1981 British Telecommunications Act provided that standards to which subscribers’ apparatus had to conform could be approved by the Secretary of State after consultation with BT or by a person appointed by the Secretary of State after

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<sup>100</sup> BT acquired all undertakings belonging to the Post Office concerned with the provision of telecommunications and data processing services (see para. 1).

<sup>101</sup> See para. 12. Likewise, much in the same fashion as the Post Office 1969 Act, BT exercised its powers to provide such telephone services as satisfy all *reasonable* demands for them and with regard to efficiency and economy; the social, industrial and commercial needs of the British Islands, the desirability of improving and developing its operating systems and developments in the fields of telecoms and data processing (see para. 3). Furthermore, BT had ample powers to carry out its task, in particular it could “[c]onstruct, manufacture, produce, purchase, take on hire or hire-purchase, install, maintain and repair anything required for the purposes of its business” (see para. 2, subsection 2, lett (a)). In addition, BT could construct, manufacture, produce or purchase for supply to the Post Office (underlined not in the text) or any subsidiary of the Post Office anything required for the purposes of the business of the Post Office or the subsidiary and to install, maintain, repair and test for the Post Office or any subsidiary of the Post Off anything so required (para. 2, subsection 2, lett (b)). Finally, BT could perform the same activities with respect to outside persons with respect to any articles a function of which necessarily involved the use of telecommunications (para. 2(c)). In carrying out these tasks, BT had powers, among other things, to enter into agency, or other, agreements with any person for the carrying on by him of any of the activities which itself could carry on; to dispose of parts of its business and to acquire a body corporate if it deemed to do so for its business (see para. 2, subsection 3)

<sup>102</sup> See para. 21.

consultation with BT.<sup>103</sup> The 1981 British Telecommunications Act also empowered the Secretary of State for Trade and Industry to grant licences to operators other than BT to provide network and value added services.<sup>104</sup>

Under the 1981 British Telecommunications Act, the Secretary of State for Industry continued to enjoy direct control over BT. For instance, the Secretary of State had, inter alia, the power to appoint the chairman of BT, to exercise general control and supervision<sup>105</sup> and

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<sup>103</sup> In the equipment market, the practical necessity of phasing liberalisation over a number of years and dependence on BT for technical expertise limited the liberalisation programme. Formally the British Standard Institution took responsibility for setting standards for the equipment, but because of the time needed to formulate standards and because the equipment certifying body, a subsidiary of the British Electric Equipment board, was inadequately financed and staffed, BT continued to wield power over equipment certification. See Hills, *Deregulating Telecoms*, 95. In addition, para. 16, subsection 4 virtually immunised BT against any complaints. This is because the 1981 Act provided that if it appeared to the Secretary of State that BT was showing undue preference against a competitor as to the connection of a telecom apparatus, he should consult with BT before “giv[ing] it such directions as appear to him to be requisite to secure that it ceases to do so”.

<sup>104</sup> In the summer of 1981, the government announced that it had received a detailed proposal for a business transmission system to compete with BT and that it was in principle in favour of such a proposal (*Financial Times*, 15.7.1981). Fortified by a report prepared by Microelectronics Design Associates, an independent consultancy company, the government considered with favour the Mercury consortium, as it was called, formed by Cable and Wireless, Barclays Bank and British Petroleum. Mercury planned to lay optic fibre cables linking 26 major cities in Britain and to provide trunk and international services to business. In October 1981, the Mercury consortium received a letter of intent from the government, anticipating the grant of its actual license to operate a national and international digital network. Despite these assurances, the licence was not issued until February 1982.

<sup>105</sup> “The Secretary of State may, after consultation with the Corporation, give to it such directions of a general character as to the exercise by it of its powers as appears to the Secretary of State to be requisite in the national interest. If it appears to the Secretary of State that there is a defect in the general plans or arrangements of the corporation for exercising any of its powers, he may, after consultation with it, give it directions of a general character for remedying the defect ... Without prejudice to the foregoing provisions of this section, if it appears to the Secretary of State to be requisite or expedient so to do

*In the interest of national security or relations with the government of a country or territory outside the British Islands; or*

*In order*

*To discharge or facilitate the discharge of, an obligation binding on her Majesty's Government in the United Kingdom by virtue of it being a member of an international organisation or a party to an international agreement;*

*to attain, or facilitate the attainment of, or any other object the attainment of which is, in the Secretary of State's opinion, requisite or expedient in view of Her Majesty's Government in*

to give directions.<sup>106</sup> Moreover, if BT was to carry out any work, which involved “substantial outlay of capital account”,<sup>107</sup> it had to submit a general programme to the Secretary of State for approval. In addition, BT was under a duty to supply the information the Secretary of State may request from time to time, notwithstanding the submission of an annual report on the performance of its services.

Finally, BT had an obligation to consult with the Secretary of State for, e.g., relevant variations in the construction, manufacturing or production of telecommunications equipment;<sup>108</sup> or the construction, manufacturing or production of new equipment.<sup>109</sup> Unless so approved by the Secretary of State, BT could not engage in the production or purchase of things other than for its use or to supply the Post Office or outside persons in connection with telecommunications services or equipment.<sup>110</sup>

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*the United Kingdom being a member of such an organisation or party to such an agreement;  
or*

*to enable Her Majesty's Government in the United Kingdom to become a member of such an organisation or a party to such an agreement,*

*he may, after consultation with the Corporation, give to it directions requiring it (according to the circumstances of the case) to secure that a particular thing that it or any of its subsidiaries is doing, is no longer done or that a particular thing that it has power to do, but is not being done, either by it or by any of its subsidiaries, is so done” (see para. 6 of the 1981 British Telecommunications Act).*

<sup>106</sup> See para. 6, subsection 7. Para. 6, subsection 12 required the Secretary of State to lay a copy of the annual report sent to him by BT before each House of Parliament.

<sup>107</sup> See para. 6, subparagraph 10.

<sup>108</sup> “The construction, manufacturing or production for BT use or to supply the Post Office or outside persons for use in connection with telecommunications services or equipment, of things of any kind to an extent substantially greater than BT had done during the three accounting years before”.

<sup>109</sup> “The construction, manufacturing or production to a substantial extent for BT use or to supply the Post Office or outside persons for use in connection with telecommunications services or equipment, of things of a kind not previously produced, constructed or manufactured during the three accounting years before”.

<sup>110</sup> These provisions were carried on from the 1969 Act, which at para. 13, provided for the same restrictions on the Post Office activities.

With respect to BT's finances, BT had a general duty to break even.<sup>111</sup> The Secretary of State could lay down, with the approval of the Treasury, and after consultation with BT, certain financial objectives and BT was under a duty to comply with those; he could also direct BT to allocate to reserve certain sums. Moreover, BT could, with the consent of the Secretary of State, and with the approval of the Treasury, borrow money, be it in the form of temporary loans or otherwise, from third parties or in currencies other than sterling, to meet its obligations and discharging its functions, and to cover its capital expenditures.<sup>112</sup>

However, there was a cap to BT's total borrowing set at £5,000 million "*or such greater sum, not exceeding £6,500 million, as the Secretary of State may from time to time specify*".<sup>113</sup> A draft of the order by the Secretary of State to raise the limitation on indebtedness needed to be approved by resolution of the Commons House.<sup>114</sup> Finally, when the Treasury issued a guarantee in favour of BT, it had to lay a statement before each House of Parliament immediately afterwards.<sup>115</sup>

The limitations placed on BT's finances arising out of its status as a public corporation played a significant role in the subsequent decision to privatize BT. Indeed, in

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<sup>111</sup> "*It shall be the duty of the Corporation to secure that the combined revenues of the Corporation and its all subsidiaries taken together are not less sufficient than to meet all their combined charges properly chargeable to revenue account, taking one year with another; and to enable the Corporation and its wholly owned subsidiaries to make such allocations to reserve as the Corporation considers adequate, and as may be necessary to comply with any directions given by the Secretary of State under section 25*" (para. 24).

<sup>112</sup> See para. 26, subsections 1 and 2.

<sup>113</sup> See para. 27. Under para. 28, the Secretary of State could lend to BT certain sums with the approval of the Treasury.

<sup>114</sup> See para. 27 of the 1981 Act.

<sup>115</sup> See para. 29, subsection 2, of the 1981 Act. BT accounts were audited and a copy of the auditors' report was laid each year before the Houses of Parliament. When it became a public corporation, BT ceased to be subject to the Comptroller's and the Auditor General's review (see para. 39 of the 1969 Act); external auditors appointed by the Secretary of State audited its accounts (see para. 31 of the 1981 Act).

his announcement to Parliament on July 19, 1982, the Secretary of State stated that the decision to privatize was intended to resolve the problem of how to reconcile BT's investment programme with the government's tight limits on borrowing.<sup>116</sup> Although it did not form part of the Conservative party's manifesto in 1979, privatization of telecommunications certainly suited the Conservative party politics as it allowed it to claim that they were 'rolling back the State' by contrast with the pro-nationalization Labour party.<sup>117</sup>

It is worth noting that the plans to privatize British Telecom and to set up a regulatory body met with considerable opposition. In particular, besides opposition parties, the camp of those who were hostile to the institutional reforms enlisted trade unions and equipment manufacturers. When the bill to privatize BT and create Oftel was considered in the Lords in 1983, no fewer than three hundred amendments were made.<sup>118</sup> Thus, the ability to carry out the significant reforms that took place between 1981 and 1984 notwithstanding such opposition indicates how being able to draw on strong political support was key for telecommunications reform, a lesson that would be of great value for the study of Italian telecommunications in the following chapters.

BT privatization together with a number of very significant institutional changes, were carried out under the 1984 Telecommunications Act. The sale of 51% of BT shares in November 1984 proved the world's largest single share issue, raising nearly £ 3.9 billion for the UK Treasury.<sup>119</sup> A privatization of this scale had far reaching consequences for the

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<sup>116</sup> "Unless something is done radically to change the capital structure and ownership of BT and to provide a direct spur to efficiency, higher investment could mean still higher charges for the customer". See also Department of Industry, *The Future of Telecommunications in Britain*, Cmnd. 8610 (London: HMSO, 1982).

<sup>117</sup> See Thatcher, *The Politics of Telecommunications*, 144.

<sup>118</sup> See Thatcher, *The Politics of Telecommunications*, 147.

<sup>119</sup> The issue was heavily oversubscribed and the share price rose by 33% on the first day of trading, giving rise to criticism about the pricing of the offer. For a more detailed account of

government and the industry. Save for the golden share,<sup>120</sup> privatization ended the government's ability to influence BT conduct, e.g., by using BT's tariffs according to its anti-inflationary policy or denying funds for investment for reasons due to limitations on overall public spending. For the industry as a whole, privatization also meant a very significant break with the past. This is because privatization formed an integral part of a wider plan to introduce competition, which, in turn, created an incentive to create a specialized body.

Indeed, the 1984 Telecommunications Act ended BT "*exclusive privilege*" to run telecommunications systems. Instead it introduced a general licensing regime aimed at regulating entry into the different segments of the telecommunications market. Although licensing powers were formally in the hands of the Secretary of State, he could delegate such power to the Director General. The Director General was the head of the Office of Telecommunications (OfTel), a non-ministerial department<sup>121</sup>. The Director General, whose term lasted for five years, chose his staff, subject to Treasury oversight of the budget as OfTel was funded by monies voted by Parliament. The Secretary of State did not have power to give OfTel general directions, save in exceptional circumstances.<sup>122</sup>

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the sale, see K. Newmann, *The Selling of British Telecom* (London: Holt Rinehart and Winston, 1985).

<sup>120</sup> The special rights redeemable preference share of £1 par value in the company ("the Special Share") did not carry any rights to vote at general meetings, but did entitle the shareholder to receive notice of, attend and speak at such meetings. Certain matters, in particular the alteration of specified articles of the company, including the articles relating to limitations which prevent a person from owing or having an interest in 15% or more of the company's voting share and to the requirement that the executive chairman is a British citizen, required written consent of the holder of the Special Share. The issue of any shares with voting rights not identical to those of the shares also required the consent of the holder of the Special Share. As the holder of the Special Share, HM Government was also entitled to appoint or nominate two persons to be directors. The Government appointed Directors had no special powers and their duties, like those of all directors, were to the company as a whole.

<sup>121</sup> The legal form was borrowed from the Office of Fair Trading. See C. Hall, C. Scott and C. Hood, *Telecommunications Regulation – Culture, Chaos and interdependence inside the regulatory process* (London: Routledge, 2000), 20-2.

<sup>122</sup> See para. 47, subsection 3.

The 1984 Telecommunications Act laid down the general duties of the Secretary of State and the Director General and specified the objectives they had to secure.<sup>123</sup> Oftel's most important power derived from licence modification. Given that licences needed to be updated in light of changing market conditions, this became the chief avenue through which the Director General could wield very significant powers.<sup>124</sup> The case of BT's licence, by far the most important licence, is illustrative.

The 1984 Telecommunications Act did not contain any detailed condition on BT's licence, but it provided that such conditions could be determined separately by the Secretary of State or the Director. Before privatization, teams from the Department of Industry and BT

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<sup>123</sup> See para. 3, subsection 1, which stated: "*The Secretary of State and the Director shall each have a duty to exercise the functions assigned or transferred to him by or under Part II or Part III of this Act in the manner which he considers is best calculated*

*to secure that there are provided throughout the United Kingdom, save in so far as the provision thereof is impracticable or not reasonably practicable, such telecommunication services as satisfy all reasonable demands for them including, in particular, emergency services, public call services, directory information services, maritime services and services in rural areas; and*

*without prejudice to the generality of paragraph (a) above, to secure that any person by whom any such services fall to be provided is able to finance the provision of those services".*

<sup>124</sup> According to paragraph 12, the Director General had the power to modify licenses. The modification, though, had to obtain the licensee's consent. In addition, the Director General had to inform the Secretary of State who could direct him not proceed with the modification. In case the licensee did not consent, the Director General could make a reference to the Monopolies and Mergers Commission as to whether a matter relating to the provision of telecommunications services under a licence operated or could be expected to operate against the public interest and, if so, whether such adverse effect on the public interest could be remedied by a modification to the licence (See para. 13). A copy of the reference was also sent to the Secretary of State who could direct the MMC not to proceed with the Director General's reference. When the MMC report supported the conclusion that any of the matters specified in the reference operated against the public interest, the Director General was empowered under para. 15 to make the modification that appeared to him to remedy the adverse effect documented in the report. The Secretary of State could direct the Director General not to make any modification to the license for reasons of "*national security or relations with the government of a country or territory outside the United Kingdom*" (See para. 15(6)). The 1984 Telecommunications Act also contained procedural requirements that the Director General needed to follow in pursuing licence modification. These mainly dealt with the obligation to state his reasons in a notice and inviting representations with respect to the proposed modification (See para. 12, subsection 2 in the case of modification by agreement; para. 13, subsection 4 and para. 14, subsection 5 (b) in case of a reference to the MMC; final modification orders too needed to be preceded by adequate publicity as provided by para. 17).

negotiated BT's licence, which was to cover all major aspects of its activity. In particular, Condition 1 entrusted BT with universal service mission, condition 13 laid provisions to the effect that BT shall enter into interconnection agreements with other licensed operators. This condition specified that, if after a reasonable time, BT failed to reach such agreement, the Director General had the power to make a determination as to the permitted terms and conditions of interconnection.<sup>125</sup> Some of the conditions dealt with certain type of anticompetitive behaviour. Condition 17 prevented BT from discriminating against a competitor. Condition 35 similarly barred BT from pursuing certain exclusive deals. Furthermore, BT was not to enter into any agreement with a foreign telecommunications operator, which could unfairly preclude the provision of international services by another telecommunications operator.<sup>126</sup>

Finally, Condition 49 provided for a pre-merger notification system, whereby BT was under an obligation to inform the Director General 30 days before the taking effect of any joint venture whose purpose was to run a telecom network, to provide telecommunications services within the UK, the production of telecommunications equipment or any activity that required a licence. Condition 24 incorporated the RPI-X formula proposed by Professor's Littlechild Report.

The above shows that, through licences, Oftel had come to occupy a central role in exercise of regulatory powers. This was not contested by elected officials, mainly because the two held different powers. Notably, “[T]he *Secretary of State's powers over the DG's*

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<sup>125</sup> The principle upon which charges were to be set by the Director General in case of a determination was that of fully allocated historic cost, applicable rate of return on capital and access deficit contribution. As to the equipment business, Condition 21 provided that if BT became involved in such business, then it was obliged to transfer it to a separate subsidiary, which was in turn prohibited from entering the telecommunications services business.

<sup>126</sup> See Condition 47.



*day-to-day activities were limited*".<sup>127</sup> In other words, there was a division of tasks between the Secretary of State and the Director General, which ensured that, while exercising powers in the same sectors, the two did not encroach on each other's spheres. Oftel's power did not imply any form of hegemony over regulatory powers in the sector. Oftel and the Secretary of State happily co-existed, based on clear rules, which designed their 'territories' and provided for suitable coordination mechanisms. This is an important element to bear in mind when dealing with Italy's trajectory.

#### **IV. BRITAIN'S INSTITUTIONAL TRAJECTORY AFTER 1984: A PERIOD OF CONTINUITY**

In the years following 1984, changes happened that did not alter the direction of Britain's institutional trajectory. The Labour Party, which governed the country after the 1997, left intact the institutional trajectory. The table below provides an overview of developments in the key institutional arrangements between 1985 and 2007.

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<sup>127</sup> See Thatcher, *The Politics of Telecommunications*, 151. With respect to the powers granted to him under the 1984 Act, it is important to note that, as Thatcher states, "*the Secretary of State had strategic powers over the telecommunications sector. He controlled the issue of licenses. Under §7 [of the 1984 Telecommunications Act] he could either issue licenses for running a telecommunications system himself, after 'consultation' with the DG, or by giving consent to licenses issued by the DG ... The Secretary of State could block license changes agreed between the DG and licensee ... He also appointed the DG*" (Ibidem).

**Table 6 Changes in British telecommunications institutions 1985-2007**

	1985	1993	2007
<b>Organization of the sector</b>	BT/Mercury	Multiple suppliers of fixed line telephony	Multiple suppliers of fixed line, mobile telephony and internet/multiple platforms
<b>Ownership</b>	Private/listed/51% publicly traded	Private/listed/full floatation/golden share	Private/listed/full floatation/ No golden share
<b>Competition</b>	Competition/Duopoly/licences	Competition/ End of duopoly/licences	Full competition
<b>Regulatory body</b>	OFTEL	OFTEL	OFCOM

In 1992, the duopoly regime ended.<sup>128</sup> In 1991 and 1993, two sales of share disposed of all public shareholding in BT.<sup>129</sup> In 1996, competition was extended to the whole sector and in July 1997, the then newly elected Labour Government relinquished the Special Share that was held by the government after two sales of share in 1991 and 1993 had disposed of all public shareholding in the company, thus completing the process started under the previous Conservative governments. Given its traditional stance on public ownership, this

<sup>128</sup> See Thatcher, *The Politics of Telecommunications*, 207-212.

<sup>129</sup> In 1991, the Government made available 1,598 million ordinary BT shares (25.6 per cent of ordinary issued shares) for purchase in a second flotation (BT2) on 21 November, amounting to around half of its holding of 47.6 per cent of shares in the company, which remained from the original 1984 flotation. The sale raised over £5 billion for the Government, reducing its stake to 1,343 million shares (21.8 per cent of ordinary issued shares). In 1993, virtually all the remaining shares in BT left to the Government from the first and second share offers were sold in BT3, a third flotation of Government owned shares in July 1993, raising £5 billion for the Treasury and introducing 750,000 new shareholders to the company.

development showed clearly the Labour Government's intention not to alter the institutional arrangements.<sup>130</sup>

In December 2000, the Government published the Communications White Paper - *A New Future for Communications*.<sup>131</sup> The White Paper announced the Government's proposals for the reform of the regulatory framework for the communications sector. The proposals centered on the creation of a unified regulator for the communications sector, instead of having five bodies or office holders regulating the communications sector, i.e., the Broadcasting Standards Commission, the Director General of Telecommunications, the Independent Television Commission, the Radio Authority, and the Secretary of State, who has a regulatory role through the Radiocommunications Agency. The Government's objective was to replace all of these regulators with one unified regulator, the Office of Communications (Ofcom).

In November 2002, the Government presented the Communications Bill, whereby it proposed the replacement of Oftel and the other regulatory bodies by Ofcom. In order to help a smooth transition, the 2002 Office of Communications Act was passed to make it possible for the Secretary of State to create Ofcom before the main Communications Bill achieved Royal Assent. Thus, the transition effectively took place in two stages. The first stage was the creation of Ofcom through the 2002 Office of Communications Act. The second stage was the entrusting to Ofcom of his functions through the 2003 Communications Act.

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<sup>130</sup> For the sake of completeness, one should note the adoption of the 1992 Competition and Services (Utilities) Act of 1992 which gave Oftel the power to issue "*regulations prescribing, for any designated operator, such standards of performance in connection the provision of relevant services by that operator as, in his opinion, ought to be achieved in individual cases*" (see para. 1, which inserted a para. 27 A in the 1984 Telecommunications Act). In furtherance of these powers, the Secretary of State has the power to designate operators for the purposes of complying with performance standards and other obligations set forth in Sections 27A to 27K of the Telecommunications Act (as amended). The 1992 Act left Oftel's institutional position unaffected and for this reason it is not discussed in the text.

<sup>131</sup> Cm 5010, published on December 12, 2000.

The 2002 Office of Communications Act had two main purposes. The first one was to design Ofcom's structure from the point of view of its governance. The second was to put in place transitory arrangements between the pre-existing regulators and Ofcom. Ofcom's regulatory design represented a significant change, compared to Oftel. As noted, Oftel was headed by a single person, the Director General. The Director General, ultimately, was the person responsible for Oftel's decision. This had led to some commentators criticizing Oftel's model for the scope it left to personalism in the handling of regulatory matters.<sup>132</sup> Ofcom's design, by contrast, was based on a board and committee structure.

More specifically, the body, which is responsible for the regulatory decision-making, is the Board. The Board comprises a non-executive Chairman and both executive and non-executive members. Besides the Chairman, there are up to nine members of the Board. Four members, including the Chief executive (CEO), have executive responsibility.<sup>133</sup> The Board is appointed by the Secretary of State. It is intended that the Secretary of State for Trade and Industry will make the appointment jointly with the Secretary of State for Culture, Media and Sport. The CEO is appointed by the Chairman and the non-executive members, with the approval of the Secretary of State.

The Executive comprises Ofcom's CEO, the three executive board members and other senior staff. More specifically, the Executive is organized in committees: the executive committee, the policy committee, the operations board and the senior management group. The Board is assisted by a number of committees and advisory bodies, which either have been given delegated powers or offer advice to the main Ofcom Board. These committees and advisory bodies include the Consumer Panel, the Content Board, the Nations and

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<sup>132</sup> See C. Hall, C. Scott and C. Hood, *Telecommunications Regulation*, esp. Part III, "The absolutist myth in regulation".

<sup>133</sup> See [http://www.ofcom.org.uk/about/csg/ofcom\\_board/](http://www.ofcom.org.uk/about/csg/ofcom_board/) for more information in Ofcom board.

Regions Advisory Committees and the Older Persons and Disabled Persons Advisory Committee.

As to the transitory arrangements, the 2002 Act essentially provides that the existing regulators should act in such a way as to ensure that Ofcom is able to take up his duties, as specified in the 2003 Communications Act.

The 2003 Communications Act received Royal Assent on July 17, 2003 a few days before the second generation of EU directives were due to be implemented.<sup>134</sup> In fact, several provisions in the six parts in which the Act is divided concern implementation of the EU directives. Under the new EU legislation individual licences, such as the one granted to BT in 1984, no longer exist. Instead, there is a general authorization regime for the provision of electronic communications networks and services. The general authorizations provide for a set of basic requirements that all providers of communications services must meet. Then there are obligations that are specific for SMP (Significant Market Power) operators. BT is designated as having SMP in a number of markets<sup>135</sup> as well as having to comply with a universal service obligations.<sup>136</sup>

Below follows a summary of the provisions that relate to the organization of Ofcom and the telecommunications sector.

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<sup>134</sup> See OJ 2002 L 108.

<sup>135</sup> See BT 2005 Annual report (<http://www.btplc.com/report/report05/Operatingandfinancialreview/regulation.htm>).

<sup>136</sup> BT has been designated as the supplier of Universal Service for the UK excluding the Hull area, where Kingston Communications is the designated provider. The services covered by the Universal Service Obligation (USO) are defined in an Order issued by the Secretary of State for Trade and Industry. BT's basic obligation is to provide a single narrowband connection to the fixed telephone network. Additional USO conditions relate to issues such as schemes for consumers with special social needs and the provision of payphone services.

- Under paragraph 2 of the Act, Ofcom will take over the functions that were previously carried out by the Secretary of State and the regulators. Paragraph 3 sets out the duties of Ofcom. The list is extensive. It distinguishes between “principal duties” and specific ones. The former comprise (i) to further the interests of citizens in relation to communications matters; and (ii) to further the interests of consumers in relevant markets, where appropriate by promoting competition. The latter include the (i) the optimal use of the radio spectrum; (ii) the availability throughout the United Kingdom of a wide range of electronic communications services; (iii) the availability in the UK of a wide range of TV and radio services, comprising high quality services of broad appeal; (iv) the maintenance of a sufficient plurality of providers of different television and radio services; (v) the application, in television and radio services, of standards that provide adequate protection to members of the public from any offensive and harmful material; and (vi) the application, in television and radio services, of standards that safeguard people from being unfairly treated and from unwarranted infringements of privacy.
- Subsection 3 sets out principles of Ofcom regulatory activity, stating that Ofcom shall have regard to transparency, accountability, proportionality, appropriateness and consistency. Subsection 4 sets out a list of factors to which OFCOM must have regard, wherever relevant, in the performance of their general duties.<sup>137</sup>

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These are “(a) the desirability of promoting the fulfilment of the purposes of public service television broadcasting in the United Kingdom; (b) the desirability of promoting competition in relevant markets; (c) the desirability of promoting and facilitating the development and use of effective forms of self-regulation; (d) the desirability of encouraging investment and innovation in relevant markets; (e) the desirability of encouraging the availability and use of

- There follows in paragraphs 4-9 other general duties. Of note, the duty to act in accordance with certain EC principles of telecommunications regulation<sup>138</sup> and the duty to ensure the least possible level of regulation through periodic review of the regulatory burden<sup>139</sup> and impact assessment.<sup>140</sup>
- It is also important to underline the functions of Ofcom with respect to competition law. Ofcom is entitled to carry out market reviews as set out in the EU directives and to designate, if applicable, SMP operators.<sup>141</sup> Moreover, Ofcom will exercise the competition law powers exercised by

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*high speed data transfer services throughout the United Kingdom; (f) the different needs and interests, so far as the use of the electro-magnetic spectrum for wireless telegraphy is concerned, of all persons who may wish to make use of it; (g) the need to secure that the application in the case of television and radio services of standards falling within subsection (2)(e) and (f) is in the manner that best guarantees an appropriate level of freedom of expression; (h) the vulnerability of children and of others whose circumstances appear to OFCOM to put them in need of special protection; (i) the needs of persons with disabilities, of the elderly and of those on low incomes; (j) the desirability of preventing crime and disorder; (k) the opinions of consumers in relevant markets and of members of the public generally; (l) the different interests of persons in the different parts of the United Kingdom, of the different ethnic communities within the United Kingdom and of persons living in rural and in urban areas; (m) the extent to which, in the circumstances of the case, the furthering or securing of the matters mentioned in subsections (1) and (2) is reasonably practicable”.*

<sup>138</sup> See para. 4, according to which Ofcom must comply with the following Community requirements: (i) to promote competition; (ii) to ensure that Ofcom’s activities contribute to the development of the European internal market; (iii) to promote the interests of all persons who are citizens of the European Union; (iv) to take account of the desirability of carrying out their functions in a manner which, so far as practicable, does not favour one form of network, service or associated facility, or one means of providing or making available such a network, service or facility over another; (v) to encourage the provision of network access and service interoperability; (vi) to encourage compliance with international standards to the extent necessary to facilitate service interoperability; and (vii) to secure a freedom of choice for customers.

<sup>139</sup> See para. 6. Under this section, Ofcom has a duty to ensure that regulation does not lead to the imposition or maintenance of burdens that are or have become unnecessary. To this end, Ofcom must from time to time publish a statement setting out how it proposes to comply with this duty and must have regard to that statement when carrying out its functions.

<sup>140</sup> See para. 7. This section requires Ofcom to carry out and publish an assessment of the likely impact of the proposed new regulations on regulates.

<sup>141</sup> See paras. 78-104. For an update on market reviews by Ofcom, see <http://www.ofcom.org.uk/telecoms/ioi/mrs/>.

Oftel.<sup>142</sup> This means that Ofcom will have concurrent powers with OFT to enforce the competition law provisions in the field of communications services. As was already provided by the concurrency arrangements between OFT and Oftel, in general only one body will be acting to apply competition law and, in so far as communication services are concerned, this would be Ofcom.<sup>143</sup> With respect to market investigations, para. 370 gives Ofcom the power to make a reference to the Competition Commission for the purposes of launching such a market investigation. This section equally empowers Ofcom to accept undertakings in lieu of a market reference.

By making use of its powers under the competition law rules, in 2005 Ofcom addressed one of the longest standing issues of UK telecommunications regulation: the separation between network activities and other businesses to ensure a non discriminatory treatment to competitors.<sup>144</sup> In September 2005, BT offered undertaking in lieu of a market

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<sup>142</sup> See paras. 369-372.

<sup>143</sup> See Letter from the Office of Fair Trading (OFT) setting out OFT/Ofcom Concurrency Arrangements (<http://www.ofcom.org.uk/about/accoun/oft/>).

<sup>144</sup> In April 2004, it published a document called Strategic Review of Telecommunications (the "Telecoms Review"). The Telecom Review was designed to set out a strategic direction for Ofcom's activities in relation to telecoms, and to create a new settlement between the new regulator, the regulatees and consumers. One of the issues addressed in the Telecoms Review was the structural or operational separation of BT. The consultation process ended in November 2004. With respect to the issue of structural or operational separation of BT, Ofcom found that, despite twenty years of regulation, the fixed line segment remained dominated by BT, with competition being both fragile and limited. To address this issue, it put forward three options: Option 1: Full deregulation. Removing the existing mesh of regulation entirely and relying instead on ex post competition law to resolve complaints would significantly reduce intervention in fixed-line markets. However, given BT's continued market power, Ofcom believed that this would be unlikely to encourage the growth of greater competition and as such would not serve the best interests of the consumer. Option 2: Enterprise Act investigation. Ofcom could investigate the market under the Enterprise Act 2002, with the potential for a subsequent referral to the Competition Commission. Option 3: BT to deliver real equality of access. Ofcom could require BT to allow its competitors to gain genuinely equal access to its networks. This option would also require BT to commit to behavioural and organizational changes to ensure that its competitors benefited from access to products and processes, which were truly equivalent to those, offered to BT's own retail businesses.



investigation under the Enterprise Act. These undertakings represent a functional equivalent to a structural break up.<sup>145</sup>

With respect to the role of supranational regulation,<sup>146</sup> the changes that were required involved a change in some specific rules, but the overall direction of the British path remained unchanged. For instance, the notion of significant market power which plays a central role in EU regulation, implied a change in the former rules.<sup>147</sup> However, UK regulation was already based on the concept of asymmetric regulation. As a consequence, as Thatcher argued, “*EU regulation played almost no visible part in developments in Britain*

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<sup>145</sup> See Final statements on the Strategic Review of Telecommunications, and BT undertakings, [http://www.ofcom.org.uk/static/telecoms\\_review/final\\_statement.htm](http://www.ofcom.org.uk/static/telecoms_review/final_statement.htm). The key undertakings given by BT are to: - establish a new access services division to operate BT's local access and backhaul networks, and to provide services over those networks to the UK communications industry on the basis of equivalence – we established Openreach for this purpose on 21 January 2006; - deliver equivalence of input for key wholesale products, and increased transparency for others; - introduce new rules on access to, and sharing of, certain restricted information – in particular the commercial information of Openreach and BT Wholesale; - restrict the exercise of influence by other parts of BT on the commercial policy of both Openreach and parts of BT Wholesale; - ensure fair access and migration to BT's next-generation network – 21CN – for other communications providers; - publish and make available to all BT people a code of practice explaining what they must do to comply with the Undertakings; - create an Equality of Access Board (EAB) to monitor, report and advise on BT's compliance with the Undertakings and the code of practice. The undertakings were accepted by Ofcom on September 22, 2005.

<sup>146</sup> For studies on the role of supranational regulation in telecommunications reform, see M. Thatcher, 'Regulatory Reform and Internationalization in Telecommunications', in J.E.S. Hayward (ed.), *Industrial Enterprise and European Integration* (Oxford: OUP, 1995); id., 'The Development of European Regulatory Frameworks: The Expansion of European Community Policy Making in Telecommunications', in E. Stavridis, E. Mosialos, R. Morgan and H. Machin (eds.), *New Challenges for the European Union* (Aldershot: Dartmouth, 1997); W. Sandholtz, 'The Emergence of a Supranational Telecommunications Regime', in W. Sandholtz and A. Stone Sweet (eds.), *European Integration and Supranational Governance* (Oxford: Oxford University Press, 1998), 134-64; G. Natalicchi, 'Il tramonto dei monopoli di stato: telecomunicazioni e processi di integrazione nell'Unione Europea', *Rivista Italiana di Scienza Politica*, (2) (1999), 283-318. See also, E. Noam, *Telecommunications in Europe* (New York: Oxford University Press, 1992); K. H. F. Dyson, *The Political economy of communications: international and European dimensions* (London: Routledge, 1990); K. A. Eliassen and M. Sjøvaag (eds.), *European telecommunications liberalisation* (London, New York: Routledge, 1999); G. Natalicchi, *Wiring Europe: reshaping the European telecommunications regime* (Lanham, MD: Rowman & Littlefield Publishers, 2001).

<sup>147</sup> See Article 4 of the Telecommunications (Interconnection) Regulation 1997 implementing the Interconnection Directive.

*during the 1990s or after 2000. Britain had little adjustment to make to incorporate EU legislation: it had liberalized and privatized before EU action took place and its new reforms were compatible with the EU's regulatory framework”.*<sup>148</sup>

## V. CONCLUSION

Given that no other European Member State had undertaken similar changes at the time and that EU initiatives to adopt liberalization only started in 1987 and, even then, only proposed gradual opening, by 1984 Britain was at the forefront of institutional reform in telecommunications. Since 1984, the British institutional trajectory has remained stable, with the replacement of Oftel by Ofcom being an attempt to build upon an existing institution to modernize it.

Following Deeg, one could argue that the overall logic of the British path was based on separation between elected politicians and suppliers and delegation of regulatory powers to a powerful IRA. The British logic had several dimensions. First of all, pricing decisions and other commercial choices became a matter exclusively left to suppliers acting under the supervision of the IRA. The latter issued rules and had the power to request changes from the regulated firm under certain conditions. Elected politicians had few formal powers to affect pricing decisions by the suppliers and/or the rules issued by IRA after the issue of the initial licenses. Regulatees, in turn, engaged in a complex regulatory game with the IRA,<sup>149</sup> as shown by the case of BT interconnection charges mentioned above.

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<sup>148</sup> See M. Thatcher, ‘Reforming National Regulatory Institutions: the EU and Cross-National Variety in European Network Industries’, in B. Hancké, M. Rhodes and M. Thatcher (eds.), *Beyond Varieties of Capitalism – Conflict, contradictions, and complementarities in the European economy* (Oxford: Oxford University Press, 2007), 147-172, at 158.

<sup>149</sup> See Coen, ‘Business-Regulatory Relations: Learning to Play Regulatory Games’.

Secondly, elected politicians also lost power to affect market structure. In this respect, it is worth noting that the creation of a separate division to manage BT's network, which is regarded as a watershed in telecommunications regulation, was the result of interactions between the IRA and BT, with elected politicians playing no visible role in the process.

Thirdly, rules were established under which IRA and elected politicians cooperated, whereby the latter took care of policy issues and the former was in charge of regulatory functions, i.e. enforcement of rules and monitoring of compliance in the day-to-day operations. Thus, delegation also meant a division of spheres between IRA and elected politicians in a spirit of cooperation. In this respect, it can be noted that the Secretary of State, although formally entitled to do so, never issued directions to Oftel.

The British stable path between 1984 and 2007 and its logic sets the base-line against which one can more easily observe Italy's direction of institutional evolution. Thus, throughout the chapters that follow, one will be able to witness continued divergence until 1997, when an abrupt change in Italy's institutions will lead the two countries on a convergent trajectory. However, assessing convergence will require careful consideration of the logic of the Italian path between 1997 and 2007, when the powers of the independent regulator would be restricted in favor of the Ministry. This complex scenario will be analyzed in the following chapters.

## **4. The Italian Path: Increasing Returns and Telecommunications Institutions 1979-1992**

### **I. INTRODUCTION**

This chapter deals with Italy's institutional trajectory between 1979 and 1992. It performs an essential role within the thesis because it provides empirical evidence on the existence of increasing returns and how they operated in the Italian path. The findings of this chapter will form the basis upon which the following chapters will build to describe rejection of increasing returns and its consequences on institutional reform.

It is useful to summarize the main findings of the chapter at the beginning and their link with the research design. Based on the empirical evidence, increasing returns arose from the interactions between political parties and telecommunications suppliers. In particular, the chapter provides evidence that all the political parties in the ruling coalition during the period studied used telecommunications suppliers to foster their goals in terms of consolidating and expanding their power base. This is consistent with rational behaviour by elected officials, who try to maximize their goals in terms of power and secure re-election.

However, expenses carried out in the name of patronage politics were inefficient and dilapidated resources. In this respect, the behaviour of politicians damaged the business of telecommunications providers, that were profit-maximizing entities. This applies both to the licensees, which were publicly listed companies, and to ASST, which was also bound by rules of sound and economic management. When faced with a difficult economic situation and losses, the providers were forced to return to political parties to obtain new resources, either in the form of direct grants or higher tariffs. Political parties met the providers request with new obligations to act in their favour. As a consequence, there was a self-reinforcing

effect arising out of the repeated interactions between telecommunications providers and elected politicians, which embodies a case of increasing returns.

The effect of such increasing returns on the institutional trajectory were consistent with path dependence. The efforts for reform centered on the split-supplier system, which is therefore analyzed in depth; the other institutional features, i.e. ownership, competition and regulatory powers were not affected by legislative initiatives of reform.

There can be distinguished two phases. Between 1979 and 1987, there was no legislative initiative to reform the organization of the sector and end the split-supplier system in spite of the fact that the latter was blamed as the source of Italy's backwardness in telecommunications. In fact, SIP licence of 1984 even contained provisions that reinforced the split-supplier system by giving to ASST powers over new services, i.e. data transmission. In the second phase, between 1987 and 1992, when the 1987 EU Green Paper put pressure to end the role of ASST as regulator and provider and a bill was eventually tabled in 1992 to that effect, the reform that was envisaged provided for a continuation of the split-supplier system, albeit in a revised fashion.

The trajectory of institutional development followed by Italian telecommunications institutions between 1979 and 1992 is consistent with path dependence, as it shows how increasing returns drove Italy along a path of bounded change, firmly anchored to the split-supplier system in spite of pressures to switch to a single-supplier system. With respect to its logic, the chapter shows that the Italian path was based on elected politicians' control over suppliers.

The chapter's task within the thesis is essential for several reasons. First of all, it provides empirical evidence as to the existence of increasing returns in Italian telecommunications. Secondly, the chapter upholds the claim of path dependence on

institutional development. Increasing returns blocked institutional reform and kept Italy on a very different path to Britain despite many pressures for change in Italy. Thirdly, the increasing returns described in this chapter will form the point of reference for the rest of Italy's trajectory, which will be influenced by reactions and counter reactions to the increasing returns described herein.

It is also worth stressing that the thesis adopts an inductive approach and, consequently, the task of the chapter is to make sense *ex post* of the empirical evidence. Thus, there is no attempt to pre-define the type of increasing returns. In addition, the findings of the chapter about increasing returns arising out of interactions between elected officials and telecommunications providers are a novel contribution insofar as they provide an anatomy of increasing returns and point to the importance of defining to whom increasing returns accrue. As a consequence, it would have been impossible to make an *ex ante* hypothesis about actors' logics and mechanisms, because it was not possible to tell from the beginning what structure increasing returns would have had and whether actors would turn out to be present at all, let alone to have a key role.

Also, as it can be seen from the above, the inductive methodology does not prevent the findings from remaining fully valid. Indeed, the findings about actors' logics and mechanisms are consistent with rational behaviour of elected politicians and managers, acting as maximizers. Thus, assuming rational behaviour from the beginning (instead of an *ex post* finding) would have had no impact on the findings, which would have turned out simply to confirm the hypothesis. In sum, logics and mechanism of actors are an *ex post* finding for methodological reasons, which in no way detract from the validity of the results reached, since the findings in this respect are in line with common assumptions about rational behaviour.

The chapter is organized as follows: firstly, it focuses on the existing institutional structure as of 1979 and on its main characteristic, i.e. the split-supplier system whereby telecommunications services were provided by several companies. Secondly, it shows how increasing returns operated. Thirdly, it provides an account of how increasing returns were responsible for a bounded trajectory of institutional change, culminating in the law of 1992, which, in providing for a re-organization of the sector, left intact the possibility of continuing the split-supplier system.

## **II. THE STARTING POINT: THE SPLIT-SUPPLIER SYSTEM**

It is useful to recall that the essential institutional feature of Italian telecommunications at the beginning of the period studied was the split-supplier system, based on the fragmentation of the provision of telecommunications services across multiple companies. The efforts for reform during the period studied centred on this feature, whereas ownership, competition and regulatory powers were not affected by legislative initiative of reform.

The focus on the reform of the split-supplier system can be explained by several factors. First, the split-supplier system was an anomaly in the European landscape,<sup>150</sup> where provision of telecommunications services was firmly in the hands of one entity, be it solely entrusted with telecommunications or, more often, uniting post and telecommunications services. In any event, in other countries the multiplication of providers had been consigned to the archaeology of telecommunications. Second, the split-supplier system was blamed as the source of Italy's backwardness. This requires understanding that the split-supplier system was in itself based on more than one split.

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<sup>150</sup> E. Noam, *Telecommunications in Europe* (Oxford: Oxford University Press, 1992).

On the one hand, there was a split between public and private suppliers. The public supplier was ASST, a branch of the Ministry of Posts and Telecommunications. The private suppliers encompassed three listed companies, incorporated as limited liability companies, operating under a licence. SIP was the most important provider of telecommunications services in Italy. However, it should not be forgotten that SIP was under the control of STET, a holding company for the financial participations of IRI in the telecommunications sector and that IRI, the state-controlled super-holding entity, with diversified interests in several economic sectors, of which telecommunications was one of the most important, was under the jurisdiction of the Ministry for State Holdings. Thus, the so-called IRI-formula entailed a mix of private ownership and state control.<sup>151</sup>

On the other hand, the second split concerned the scope of services being entrusted to each of the suppliers. Among the three licensees, SIP held the most important licence, being entrusted with the provision of local and long-distance services within Italy. The other licensees' remit encompassed a narrower portion of telecommunications services, i.e. intercontinental (Italcable) and satellite telephony (Telespazio). ASST's scope of services historically comprised the provision of certain long-distance telephony services. With time, though, ASST's services largely overlapped with SIP's. In fact, it was the latter that often provided services on ASST's behalf because ASST leased circuits and asked SIP to handle technical issues from end to end.

The uncertain boundary between SIP and ASST had already created confusion before 1979, when telecommunications services enjoyed a relatively limited development. With time and as the number of users and services grew, the confusion was only bound to increase. It is not surprising, then, to see that the role of ASST and the validity of the continued split

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<sup>151</sup> See G. Amato (ed.), *Il governo dell'industria in Italia* (Bologna: Il Mulino, 1972) and F. Barca (ed.), *Storia del capitalismo italiano dal dopoguerra ad oggi* (Roma: Donzelli, 1997).



between the latter and the licensees came more and more under attack during the period studied. Yet, in spite of these pressures, reform only took place in 1992 and, even then, in a limited form. In fact, because of increasing returns, reform meant little else than an update of the *status quo* or the continuation of the split supplier system, albeit in a revamped way. These increasing returns and their effects on the institutional trajectory are now analyzed.

### III. INCREASING RETURNS IN ITALIAN TELECOMMUNICATIONS

The starting point of the period studied is the 1979 SIP financial crisis due to its impact on the relationships between SIP and political parties. SIP's crisis threatened the company's ability to provide basic services, invest in infrastructure and offer new services. SIP provided local telephony services and was responsible for universal service obligations. However, SIP was forced to cut back on investments and to stop them in 1980, while demand was soaring.<sup>152</sup> The waiting list for a phone became longer and longer (see table below) and connection times rose dramatically.<sup>153</sup>

**Table 7 - Number of applications for a phone connection 1978 – 1981 and their status** (Source: *Rapporto Morganti*, p. 83)

	1978	1979	1980	1981
<b>Number of applications (000)</b>	1.255	1.431	1.235	1.162
<b>Sorted applications (000)</b>	678	716	845	844
<b>Waiting to be connected (000)</b>	463	794	828	751

<sup>152</sup> IRI annual reports 1979-1984.

<sup>153</sup> See E. Pontarollo and A. Costa, 'Regolamentazione e concorrenza nei servizi di pubblica utilità: il caso delle telecomunicazioni', *L'Industria*, 2 (1992), 337-360, at 335.

When the SIP crisis took place in 1979, Italy was governed by coalition governments.

In the period between 1976-1979 the emergency threat of terrorism had led the Christian Democrat Party (*Democrazia Cristiana* or “DC”) and the other parties to govern in a unified fashion. At the beginning of the 1980s, when Italy saw this threat off, the Communist Party was consistently in opposition and the Christian Democrat Party had to form alliances with smaller parties to obtain the majority needed to form governments. The ruling coalitions were based on the agreement of five parties, including

1. the Christian Democrat Party,
2. the Socialist Party (*Partito Socialista Italiano* or “PSI”),
3. the Liberal Party,
4. the Republican Party and
5. the Social-Democratic Party.

The Christian Democrat Party was the leading party in the coalition. The Socialist Party was the second most important party, with the other three parties being considered as junior members in the coalition.<sup>154</sup> The Communist Party (*Partito Comunista Italiano* or “PCI”) was the largest party in opposition and in absolute terms it was the second party in Italy after the DC.

Coalition governments were very unstable due to the heterogeneous nature of the allies. Between the 1979 general elections and the 1992 general elections there were twelve

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<sup>154</sup> General elections were called in 1979, 1983, 1987 and 1992. For the results of these elections, see <http://www.batsweb.org/cultura/Geopolitica/Italia/elezioni1946.htm>.

governments.<sup>155</sup> In this climate of instability, political parties tried to secure their electoral base through patronage politics. The large apparatus of state-controlled companies provided an ideal instrument. Political parties would try first to appoint managers that were 'loyal' to the party and then use these appointments to foster their electoral base.<sup>156</sup> That explains why a practice grew whereby appointments were decided between political parties in a way that reflected their electoral weight. This practice was called 'lottizzazione' and the years in which it became more visible are those that coincide with the ascendancy of the Socialist Party between 1983 and 1992, with the PSI leader, Bettino Craxi, holding the premiership between 1983 and 1987.<sup>157</sup> Managers were political appointees and had to obey to the their

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<sup>155</sup> For information on the governments in Italy since 1947, see [www.governo.it](http://www.governo.it). Between 1979 and 1980, there were two governments held by Francesco Cossiga (August 4, 1979 – April 4 and from the latter date until October 18, 1980). Between 1980 and 1981 there was a government held by Arnaldo Forlani (October 18, 1980 – June 28, 1981). Between 1981 and 1982, Giovanni Spadolini was the first prime minister not belonging to the ruling Christian Democrat party. He held the premiership during two successive governments (October 28, 1981 – August 23, 1982 and August 23, 1982 – December 1, 1982). Afterwards, Bettino Craxi, the leader of the Socialist Party, held the premiership between 1983 and 1987, after the elections in 1983 had seen his party obtaining a larger percentage of votes (11,4% in the Chamber of Deputies and the Senate) than in the earlier 1979 elections. New elections were held in 1987, with the Socialist Party further ascending in popularity (14.3% in the Chamber of Deputies and 10.4% in the Senate). More precisely, the first Craxi government lasted from August 4, 1983 until August 1, 1986 and then the second Craxi government lasted until April 17, 1987. Afterwards, there were the Fanfani government (from April 17, 1987 to July 28, 1987); the Goria government (from July 28, 1987 to April 13, 1988); the De Mita Government (from April 13, 1988 to July 22, 1989); and two Andreotti governments (from July 22, 1989 to April 12, 1991 and from April 12, 1991 to April 24, 1992, respectively).

<sup>156</sup> See L. Cafagna, *La grande slavina* (Marsilio: Venezia, 1993), "Per stabilizzare il suo potere, poi, la nomenclatura Italiana ha per lo più infaticabilmente teso a selezionare i capi dell'economia pubblica («boiardi») in funzione pressoché esclusiva della loro disponibilità ad obbedire alle pretese crescenti della parafiscalità partitica" (175).

<sup>157</sup> See G. Carli, *Intervista sul capitalismo* (Bari: Laterza, 1977), 71; J. La Palombara, *Democracy, Italian Style* (New Haven: Yale University Press, 1987); P. Ginsborg, *A history of contemporary Italy: society and politics, 1943-1988* (London: Penguin, 1990); P. Scoppola, *La repubblica dei partiti* (Bologna: Il Mulino, 1991); S. Cassese, 'Le système administrative italien ou l'art de l'arrangement', *Revue Française de l'Administration Publique*, 67 (1993), 337; V. Bufacchi and S. Burges, *Italy since 1989* (London: Palgrave, 2001). For a discussion of *lottizzazione* within the Italian telecommunications sector, see Natalicchi, *Wiring Europe*, 158-161; V. Verdier-Bonchut, 'Regulation of the audiovisual and telecommunications sector in Italy: From Community challenge to national issue', *International Review of Administrative Sciences*, 69 (2003), 271-283 and Thatcher, *Internationalisation and Economic Institutions*, ch. 7, 'The Force of Inertia: Telecommunications in France, West Germany, and Italy 1965-87', 154.

political masters. One could say that they were ‘seconded’ to state-controlled enterprises from political parties (‘comando politico’, where ‘comando’ is the expression used to indicate secondment from one administration to another). According to the President of the Constitutional Court, Ettore Gallo, *“lo sviluppo delle carriere resta affidato più alle intese fra i partiti che all'effettivo merito dell'aspirante ... la spartizione politica delle funzioni direttive é arbitraria, perché la scelta dovrebbe essere determinata invece esclusivamente dalle capacità individuali e dalla particolare attitudine che caratterizza la personalità di un dirigente ... [gran parte dei mali che affliggono gli enti pubblici] sono determinati anche da queste spartizioni che tengono conto soltanto del colore politico del prescelto anziché della sua competenza specifica ... espressione di una totalizzante invasione di ogni settore decisionale da parte dei partiti politici, che ha finito per dominare persino lo sviluppo delle carriere interne”*.<sup>158</sup> Indeed, one could draw a ‘map’, based on which party controlled which position over which company.

Thus, for instance in 1991, at IRI, President Franco Nobili was a DC appointee, Vice-President Riccardo Gallo belonged to Partito Repubblicano, board members Massimo Pini, Bruno Corti, and Michele Tedeschi belonged to respectively, Partito Socialista, Partito Social Democratico, and DC; the Partito Liberale was ‘entitled’ to appoint another board member,

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<sup>158</sup> See *Il sole 24 ore*, 26.6.1991. *“Career opportunities depend more on dealings between parties than on the merits of the applicant ... the political assignment of executive posts is arbitrary because the choice should be on the contrary based exclusively on the individual capacities and abilities that characterizes the personality of a senior official ... [the great majority of the evils besetting public bodies] are determined by assignments that take into account only the political affiliation of the chosen candidate rather than his specific competence ... expression of a total invasion by political parties of every decisional sector that has become the dominant way to proceed even in internal careers”*.

but had not done so at that time. Similar arrangements applied to other state-owned companies.<sup>159</sup>

In the telecommunications sector there were several examples of ‘lottizzazione’. In 1987, IRI and Fiat decided to create a joint-venture for the production of terminal equipment (Telit). However, the project was sunk by the PSI’s demand to appoint Marisa Bellisario as Chief Executive Officer in spite of a prior different agreement between Fiat and IRI. As a Fiat representative later explained,<sup>160</sup> Fiat refused to accept the PSI’s demand because of its unilateral character and also because it was only dictated by party loyalty, without any consideration for technical competence.

The appointments to the state-owned companies under IRI were also an example of lottizzazione. By the early 1990s, the politics behind it became so accepted and well-documented through time that press sources started to openly report about them, by giving exact indications as to who was whose candidate. For instance, in 1990, under the government of Ciriaco De Mita (a key figure in the Christian Democrat Party and himself Prime Minister between 1988 and 1989) a new post of CEO at STET was expressly created to be assigned to a representative of one of the factions of the Christian Democrat Party, while the Socialist Party obtained an executive director. The Christian Democrats also held the other post of CEO and the presidency.<sup>161</sup>

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<sup>159</sup> At ENI, the oil company, the President, Gabriele Cagliari, was a PSI appointee, Vice-President Alberto Grotti was a DC-sponsored manager, the CEOs post were allotted to *Partito Social-Democratico* (Gaetano Cecchetti) and *Partito Liberale* (Beppe Facchetti). At EFIM, a holding company for the manufacturing sector, the President, Gaetano Mancini, was a PSI appointee, while Vice-President Mauro Leone belonged to DC, board members Roberto Buzio, Luigi Moscheri, and Roberto Savasta belonged to, respectively, *Partito Social-Democratico*, *Partito Repubblicano* and *Partito Liberale*.

<sup>160</sup> See *Il sole 24 ore*, 10.12.1987. See also *Il sole 24 ore*, 20.3.1986.

<sup>161</sup> See *Il sole 24 ore* 26.6.1990, 27.6.1990, and 28.6.1990. STET had two C.E.O.s., Giuliano Graziosi (associated with Giulio Andreotti and Antonio Gava-DC) and Umberto Silvestri

In 1991, when new appointments had to be made at SIP, the Christian Democrats and the Socialists fought hard to gain the upper hand. Until then, the Socialist Party had held the presidency and the DC the two posts of CEO. However, the presidency did not carry executive powers and therefore the Socialists aimed at one of the CEO posts.<sup>162</sup> The situation evolved in what was termed as a real ‘earthquake’ at the time.<sup>163</sup> All the existing officers were replaced. Giulio Andreotti (then Prime Minister) saw his power increased. He appointed former Italcable CEO Ernesto Pascale as SIP president. The CEO posts went to Vito Gamberale, an appointee of the Socialist Party, and to Antonio Zappi (formerly general manager of SIP). They replaced Michele Giannotta, SIP former president and socialist appointee, and CEOs Paolo Benzoni and Francesco Silvano. This turn was made possible by an agreement between Andreotti, with the help of Antonio Gava, and PSI secretary Bettino Craxi. As a matter of fact, the PSI increased its influence in SIP due to the fact that a post of CEO carried more power than the presidency. At the same time, Giuliano Graziosi left the helm of Stet, lacking political sponsorship.<sup>164</sup>

Having appointed ‘loyal’ managers, political parties requested licensees to carry out different actions in support of their interests.<sup>165</sup> These mechanisms operated at all levels, i.e. both at the local level and the central level. Each party claimed a share of influence over the licensees. Unlike RAI, the public broadcaster, where each channel was controlled

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(DC). The president was Biagio Agnes (Ciriaco De Mita-DC). The director general was Miro Allione (PSI).

<sup>162</sup> See *Il sole 24 ore*, 8.5.1991.

<sup>163</sup> See *Il sole 24 ore*, 17.5.1991.

<sup>164</sup> See *Il sole 24 ore*, 17.5.1991. See also interview by Graziosi in *Il sole 24 ore*, 3.12.1993.

<sup>165</sup> The information concerning the ways in which political parties directed licensees to act in their interests has been provided during personal interviews with STET official and senior academic and economic consultant.

exclusively by a political party,<sup>166</sup> control over the licensees was shared between the coalition parties.

First of all, it was common that licensees would hire personnel en mass on the basis of political directions. For instance, every time that a new Minister of Posts and Telecommunications was appointed, the licensees would hire people in the region from which the Minister was from.<sup>167</sup> Secondly, licensees would be directed to purchase goods or services from people who were close to politicians. For instance, one of the Annexes to SIP licenses included locations at which SIP undertook to have offices. The office premises were leased from landlords chosen by political appointment. Thirdly, licensees would use public tenders to reward ‘friends’. This partly explains why Italian authorities fought hard against European legislation, which sought to harmonize tender procedures in the public services, i.e. Directive 93/38. This legislation would have made more difficult to control the outcome of tenders and thus would have reduced the scope for using tenders to reward ‘friends’.

Besides appointment of managers, political parties influenced licensees’ behaviour through tariff setting. Tariffs were in the hands of political parties, as tariff approvals required the agreement of the Ministers of Posts and Telecommunications and the Treasury. In 1979, when industrial costs rose by account of inflation by 40% and tariff revenues increased only by 23%, SIP had painfully learnt that delays in tariff adjustments at times of burgeoning inflation could inflict severe damages to the survival of the company. After then, the tariffs were used as a tool for social and economic policy, in order to stave off inflationary pressures and make basic services affordable to the majority of the population. As a consequence, tariff increases were systematically delayed. For instance, the tariff increase

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<sup>166</sup> Rai Uno was traditionally allotted to the DC, Rai Due to PSI and Rai Tre to the Communist Party.

<sup>167</sup> Personal interview senior economic consultant.

announced in 1977 took effect only in 1980. In 1986, SIP requested a tariff increase to obtain an extra 720 billion lira, while it obtained merely 367.<sup>168</sup> After the increase approved in 1986, tariffs remained unchanged in spite of SIP formal requests for a 3.5% increase, when inflation rose in the same period by 5.5%.<sup>169</sup> Still in 1990, the tariffs remained at the 1986 level.<sup>170</sup>

This shows the key link between SIP (and the other licensees) and political parties, whose support was needed to obtain adequate revenues. Given that licences provided for high investment targets to expand the network, the level of dependence was even magnified as tariffs had to cover not only current expenses, but also extraordinary ones. In order to free itself from this dependence, SIP repeatedly asked for the introduction of a system of automatic tariff adjustment. This system would have curtailed the discretionary powers of political parties and so eased the grip they exerted on licensees.<sup>171</sup>

In 1985, SIP's CEO argued that tariffs should be updated automatically, i.e. without the need for an express ministerial decree.<sup>172</sup> Similarly, in 1991 Romano Prodi and Luigi Prosperetti (both acting in their capacity as members of an independent research centre, NOMISMA, headed by Romano Prodi) proposed the creation of an agency with tariff setting powers with the aim to free tariff setting from the hands of political parties and thus to curb

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<sup>168</sup> See *Il sole 24 ore*, 15.2.1986 (interview with SIP CEO, Paolo Benzoni).

<sup>169</sup> See *Il sole 24 ore*, 25.11.1989 and 24.2.1990.

<sup>170</sup> See *Il sole 24 ore*, 10.5.1990 and 12.5.1990.

<sup>171</sup> See, e.g., *Il sole 24 ore*, 13.11.1984 and 22.2.1991.

<sup>172</sup> See *Il sole 24 ore*, 12.4.1985 (“*In Italia da sempre le tariffe vengono gestite «alla giornata»: gli adeguamenti hanno un andamento quanto mai irregolare e riflettono esigenze di ordine politico del Governo*”). See also *Il sole 24 ore*, 4.5.1985, and 30.6.1985.



the latter's power vis-à-vis the licensees.<sup>173</sup> Political parties reacted by rejecting these proposals out of hand.

According to Romano Prodi, then speaking in his capacity as former IRI President, when he requested for the application of a price-cap mechanism, i.e., a system of automatic tariff adjustments, his request was quickly brushed aside. "*The politicians*", Romano Prodi stated, "*rebuked me by saying «for tariffs, you will always need to ask us»*".<sup>174</sup> The undersecretary to the Minister of Posts and Telecommunications, Francesco Tempestini, an MP belonging to the PSI, similarly stated that IRI and STET should stop requests for automatic tariff adjustments, arguing that tariff adjustments should remain with Comitato Interministeriale Prezzi ("CIP", i.e. the committee of Ministers in charge of economy and finance) and the Ministry of Posts and Telecommunications.<sup>175</sup> This shows how tariff setting was regarded as a chief avenue through which political parties could influence licensees' behaviour in a way that was conducive to their needs.

The self-reinforcing character of the above-described relationships between political parties and telecommunications providers lay in the fact that the execution of political instructions hurt licensees' finances, as investment decisions taken on the basis of political directives were sub-optimal and did not result in higher efficiency.<sup>176</sup> Licensees had to hire an unnecessary work force or to purchase goods of lower quality and at an inflated price

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<sup>173</sup> See *Il sole 24 ore*, 4.2.1991.

<sup>174</sup> See *Il sole 24 ore*, 17.1.1992 ("*Quando ho proposto il price cap al Parlamento mi sono sentito brutalmente rispondere di no. Per le tariffe, mi dicevano i politici, dovrei passare da noi. Qui sta l'anomalia italiana: nella debolezza dello Stato come regolatore e nella conseguente invadenza della politica nella gestione delle aziende pubbliche*"). Apparently, this sentence was pronounced by Paolo Cirino Pomicino, a key DC leader. See also *Il sole 24 ore*, 15.11.1991, where Pontarollo and Costa showed how the tariff system was an impediment to the development of a more efficient telecommunications sector in Italy due to the cross-subsidies between long-distance calls and local calls.

<sup>175</sup> See *Il sole 24 ore*, 11.5.1990.

<sup>176</sup> Personal interviews, IRI official and senior economic consultant.

because they could not carry out tenders in a proper way. The damage done to their finances meant that telecommunications providers could not cover their expenses with ordinary revenues and needed to go to political parties to obtain new funds. For instance, in 1989, SIP was able to finance only 83% of investments through its own resources.<sup>177</sup> New funds came with new obligations to invest according to the instructions of the political parties and thus the process restarted.<sup>178</sup>

The practices described above with respect to the ways in which licensees were used to foster political goals and how this gave rise to a self-reinforcing sequence were also broadly applied with respect to relationships between ASST and political parties. In fact, due to its institutional position as a branch of the Ministry, ASST was considered to be a better instrument to foster political goals than the licensees.

First of all, ASST accounts were not bound by the same rules applicable to limited liability companies like the licensees. Secondly, because it was embedded within the Ministry, ASST stood shielded from the public eye (contrary to the licensees which were listed companies and therefore had to publish periodically accounts and reports). This meant that ASST was an ideal instrument to channel resources. Relatively little information was made available to the public on the ASST's financial situation. ASST financial statements were at best cryptic and based on inconsistent accounting methodologies. ASST was thus

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<sup>177</sup> See *Il sole 24 ore*, 21.4.1989 (“SIP chiede le nuove tariffe e un aumento di capitale”).

<sup>178</sup> See L. Cafagna, *La grande slavina* (Venezia: Marsilio, 1993), “... la corruzione politica esiste dovunque ... la differenza italiana ... sta nel fatto che altrove i percettori dei proventi di fiscalità politica parallela si sentono in dovere di fornire ... in cambio, prestazioni efficienti ai cittadini. In Italia, invece, no. Il che configura il caso italiano, come caso di puro saccheggio ...” (p. 109). See also *Il sole 24 ore*, 30.1.1987 (“Per ottenere un telefono occorre avere un «amico»”).

considered “*a treasure ark whose inside was clouded with mystery*”<sup>179</sup> and a treasure ark it was since it administered a significant share of the resources available for investment in the sector.

In 1987, ASST was entitled to 5,000 billion lira out of extraordinary funds made available by the Treasury in effort to improve telecommunications services.<sup>180</sup> In 1991, ASST’s turnover was equal to 2,975 billion Lira, of which 430 billion were profits.<sup>181</sup> This made ASST the number two telecommunications supplier after SIP. The heads of ASST, STET and SIP were referred to as the ‘three kings’ of Italian telecommunications. All of them were considered as ‘loyal’ to the Christian Democrats,<sup>182</sup> with ASST’s ties being perhaps the strongest due to the role of trade unions.

During the period studied, ASST had approximately 13,000 employees.<sup>183</sup> The large majority of these employees were affiliated to CISL (Confederazione Italiana Sindacati Lavoratori),<sup>184</sup> the trade union sponsored by DC. ASST employees were thus an important electoral constituency for the DC, which tended to protect its territory. The table below shows investment levels for the licensees and ASST. The low level of investment made by ASST shows that its balance sheet was free from investments and could be directed to finance political goals.

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<sup>179</sup> See *Il sole 24 ore*, 9.9.1988. See also G. Lizzeri and F. De Brabant, *L’industria delle telecomunicazioni in Italia* (Milano: Franco Angeli Editore, 1979), 18, (“[L]’Azienda di Stato è forse il mistero meglio custodito delle telecomunicazioni italiane”).

<sup>180</sup> See delibera CIPE 28.5.1987 (GURI n. 147, 26.6.1987) and *Il sole 24 ore*, 29.5.1987.

<sup>181</sup> See *Il sole 24 ore*, 2.10.1992.

<sup>182</sup> See *Il sole 24 ore*, 5.8.1991. In 1988, ASST was headed by the leader of the Christian Democratic Italian Union Worker’s Confederation.

<sup>183</sup> See *Il sole 24 ore*, 9.6.1988

<sup>184</sup> See *Il sole 24 ore*, 29.10.1988 (“[i sindacati] ... nelle poste, egemonizzate dalla CISL, ... «controllano» l’Azienda telefonica di Stato...”). See *Il sole 24 ore*, 3.11.1988 (“SUPERSTET, Il fattore CISL”), according to which CISL’s affiliates were 8,000 over a total of 13,000 employees. See also *Il sole 24 ore*, 27.12.1990 (“Un’Azienda inefficiente e misteriosa”).

**Table 8 - Investment level in percentage (1980-1987) (Source: D. Giacalone and F. Vergnano, *La Guerra del Telefono - Le telecomunicazioni, la gestione, la politica* (Milano: Il Sole 24 ore, 1990), 73)**

	SIP	ASST	Italcable	Telespazio	PP TT Admin	Total
<b>1980</b>	82	13	1	0,4	2	100
<b>1981</b>	79	13	1,8	0,4	4	100
<b>1982</b>	83	9	1,5	1	4	100
<b>1983</b>	87	7	1	0,9	2	100
<b>1984</b>	87	8	1,4	0,6	2,6	100
<b>1985</b>	87	8	1	0,6	2,6	100
<b>1986</b>	84	10	1,3	0,4	3,4	100
<b>1987</b>	81	11	1,3	0,9	4,3	100

The way in which political parties and ASST interacted was similar to that already explained for SIP. ‘Loyal’ appointees would ensure that ASST acted in a way that fostered political parties goals. The losses caused by ‘political’ investments were covered by State funds. The chief mechanism through which ASST fostered political goals and thus contributed to the process of increasing returns was through tenders and purchases. ASST could use tenders to reward ‘friends’ and to boost the economy of chosen areas. ASST tenders were often conducted according to a simplified procedure, which allowed ASST a large margin of discretion. For instance, in 1991 ASST became involved in a project for the

construction of a dedicated fibre optic network for business users, the so-called “start” project.<sup>185</sup> The contractors did not include Philips, in spite of the latter leadership in the sector, and included only Italian companies.

Other episodes have been documented by court proceedings that were opened after 1992 following the ‘mani pulite’ investigations (described in the next chapter). ASST and *Amministrazione Poste e Telegrafi* (PP.TT.) being part of the public administration, were subject to the jurisdiction of the Court of Auditors (Corte dei Conti). A judgement of 2002 by the Court of Auditors describes in detail how the Amministrazione PP.TT. bought 5,000 telex machines in 1991 from Olivetti in return for a bribe (‘tangente’).<sup>186</sup> This episode is worth recalling because it is an egregious and well-documented example of the type of interactions between political parties and telecommunications companies that were common during the period studied. It is important to state at the outset that the relevance of the episode for increasing returns lies in the feed back aspect exemplified therein.<sup>187</sup>

The judgement reports the purchase of telex machines by Amministrazione PP.TT. from Olivetti. The purchases were made in 1988, 1989 and 1991. The 1991 purchase concerned 5,000 telex machines for a consideration worth approximately 39 billion lira. However, the judgement reports that experts at the Ministry of Posts and Telecommunications had remarked that demand for telex was severely decreasing due to competition from new technology, namely fax machines, and that telex was quickly

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<sup>185</sup> See *Il sole 24 ore*, 13.6.1991.

<sup>186</sup> See Corte dei Conti, judgment of June 6, 2002. n. 1725/2002 (available at <http://www.corteconti.it/Ricerca-e-1/Gli-Atti-d/cartella/Documenti/Sezione-gi14/2002/Sentenza-n.1725-2002-del-6-giugno-20.doc>).

<sup>187</sup> It is not relevant that the protagonist of the episode is Amministrazione PP.TT. rather than ASST. Both entities were in the same institutional position, i.e. they were branches of the Ministry of Posts and Telecommunications. Therefore, from an institutional perspective, the evidence collected with respect to Amministrazione PP.TT. on the process of increasing returns is also highly relevant for ASST.

becoming obsolete. Thus, by 1991 the continuation of purchase of telex machines from Olivetti was halted. Olivetti, however, was relying on this purchase and it had apparently already committed workforce in anticipation of the purchase being confirmed. The stop in the purchasing process was therefore a serious hindrance to Olivetti.

Olivetti approached the head of the Republican Party at the time, Bruno Visentini. Bruno Visentini informed the Minister, Oscar Mammi, another member of the same party. Oscar Mammi instructed his advisor, Davide Giacalone and the head of ASST, Giuseppe Parrella. Olivetti was therefore invited to make a payment in return for the purchase. The amount of the payment was negotiated and was finally set at 2% of the total amount of the purchase.

According to the judgment, the payment ('tangente') was intended to benefit not only the Republican Party as the holder of the Ministry, but should respect 'political equilibria'. Thus, Olivetti was instructed to make payments to the other parties in the ruling coalition too, i.e. the Christian Democracy and the Socialist Party.<sup>188</sup> It is worth noting that of the 5,000 telex machines so bought, 3,600 were never taken out of their boxes. The Court of Auditors proceedings were intended to ascertain the damage to public finances made by this purchase, given that the manifest uselessness of the purchase was a clear loss for state finances.

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<sup>188</sup> See judgment of June 6, 2002, according to which "... fu lo stesso G. [a secretary to the Minister] che mi disse che sapeva della esigenza di versare del denaro al sistema dei partiti e che ora che il Ministero era affidato alla dirigenza di un repubblicano era necessario mantenere i giusti equilibri e che anche il partito repubblicano godesse di questi benefici; il G. mi disse che per il buon mantenimento degli equilibri politici era opportuno che i versamenti fossero equamente distribuiti fra DC, PSI e PRI e mi chiese che per quanto lo riguardava egli avrebbe gradito la mia persona come interfaccia tra il sistema delle imprese anche per ciò che riguardava il pagamento del denaro. Io ne parlai con alcuni imprenditori quali P. e S. e nel giro di poco tempo tutti gli imprenditori hanno conosciuto in me l'interfaccia con il sistema politico. Io a mia volta delegai una mia persona di fiducia tale L. Giuseppe a seguire tutta la questione relativa alle dazioni di denaro dal sistema delle imprese al sistema dei partiti, naturalmente fornendo al L. le direttive necessarie affinché potesse prendere gli opportuni contatti con i responsabili delle imprese".

The need to turn a normal commercial transaction into a political bargain exemplifies well how purchases made for political reasons resulted in a sub-optimal use of resources or in an outright loss. This in turn fuelled the need for fresh funds and re-started the process. The feedback was therefore due to the fact that these kinds of actions caused a straight loss and so there was a need for new funds, in addition to those needed to cover normal expenses. Thus, the 'system' of financing of political parties had an important increasing returns dimension in so far as it fostered a self-reinforcing process. Through time, political parties and telecommunications companies became more and more entangled in a spiralling relationship that possessed an important self-sustaining aspect.

In sum, during the period studied telecommunications companies, including ASST and the licensees, developed close ties with political parties. A feed back mechanism started, fuelled by the use of telecommunications companies' resources for political patronage where expenses driven by political reasons dilapidated resources and telecommunications companies were obliged to obtain fresh funds from political parties. Each round of financing gave rise to new expenses. The section below focuses on the way in which these increasing returns affected institutional development and the efforts to reform the split-supplier system.

#### **IV. INCREASING RETURNS AND THE YEARS OF INERTIA: 1979-1987**

Technological developments made the co-habitation of ASST and SIP increasingly untenable, thus acting as a strong source of pressure to reform the organization of the system and merge the providers into a single entity. ASST and SIP operated two networks. However, since the early years of the telephone it had been very difficult to draw a clear line between the services which were provided by the two, due to the increasing level of interconnection which made undistinguishable who was contributing to what. Equally, it was no less difficult to calculate with exactitude how much each supplier owed to the other.

Through time and the development of more interconnections, the boundaries between what had originally been two well-defined systems (long-distance services as opposed to local ones) blurred.

The difficulty that was inherent in the coordination between SIP and ASST had a severe impact on the rate of innovation. At a time in which the telecommunications sector was undergoing a technological revolution, the introduction of new services in Italy was significantly slower than in other countries.<sup>189</sup> For instance, the first data network (*rete fonia - dati*) became available to users only in 1984 whereas a similar network was already operational in France in 1972 and in Germany in 1979. Similarly, a packet switched network, called Itapac, was available for general use in 1986, whereas in France such network could be used since 1978 and in Germany since 1980.<sup>190</sup>

The performance of Italy's telecommunications system was no less dismal. In 1988, the percentage of calls completed successfully was equal to 42% for ASST and 52% for SIP, both being very far from European standards.<sup>191</sup> In 1989, the Wall Street Journal declared that the Italian telephone system was one of the most decrepit in Europe.<sup>192</sup> In 1990, only 38,9% of the Italian population had a phone connection. This was below the EC average (approximately 40%) and put Italy in 19<sup>th</sup> position at worldwide level. According to the forecasts made at that time, the rate of increase in the penetration of phones was too slow to enable Italy to catch up with the other European countries. This is because the EC average in

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<sup>189</sup> See, e.g., *Il sole 24 ore*, 26.2.1991.

<sup>190</sup> See Pontarollo and Costa, 'Regolamentazione e concorrenza nei servizi di pubblica utilità: il caso delle telecomunicazioni', 352.

<sup>191</sup> See *Il sole 24 ore*, 20.7.1988.

<sup>192</sup> Quote reported in *Il sole 24 ore*, 10.2.1989.



1993 was projected at 46.17%, whereas Italy's could only increase to 44.52% (Great Britain's was set at 48.94%, France's at 50.51% and Germany's at 52.51%).<sup>193</sup>

In parliamentary discussions about the reform of the sector, the split-supplier system was time and again mentioned as the chief obstacle to having a well-functioning and modern telecommunications sector. For instance, in a hearing before the House of Deputies Committee for Transports and Communications held on September 28, 1983<sup>194</sup> Antonio Gava, a leading member of the Christian Democrat Party, who held the post of Minister of Posts and Telecommunications at that time, stated that the bringing onto the market of new technologies and the connected implementation of new services made the division between ASST and licensees obsolete and irrational. He also stated that there was "general agreement" on the fact that the convergence between information technology and telecommunications required single strategic vision and unitary planning.

In addition, users' dissatisfaction grew. In 1984,<sup>195</sup> the *Comitato Utenza Affari Telefonica*, a business users' group to which various industrial associations belonged (*Associazione Bancaria Italiana, Associazione Nazionale Industria Assicurativa, Assonime, Confagricoltura, Confcommercio, Confindustria e Federazione Italiana Editori e Giornalisti*), complained that prices for leased lines were too high and quality of service was poor. In 1986, business users issued another public complaint against poor service.<sup>196</sup>

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<sup>193</sup> See *Il sole 24 ore*, 8.4.1991.

<sup>194</sup> Camera dei Deputati, 10<sup>a</sup> Commissione Permanente (Trasporti, Comunicazioni), *Comunicazioni del Ministro delle Poste e delle Telecomunicazioni sui principali problemi di settore con particolare riferimento allo stato di attuazione della legge 10 febbraio 1982, n. 39 ed alla regolamentazione delle emittenti radiotelevisive*, *Bollettino Commissioni* (Roma: Tipografia della Camera, 1983).

<sup>195</sup> See *Il sole 24 ore*, 9.11.1984.

<sup>196</sup> See *Il sole 24 ore*, 3.10.1986. See also *Il sole 24 ore*, 25.7.1987.

Split-supply of telecommunications services was also hit from another technological development: the rise of mobile telephony. Mobile telephony required interconnection between fixed and mobile networks. In Italy, this meant interconnection with two fixed-network operators, i.e. SIP and ASST. In other words, mobile telephony added to the already existing difficulties of coordinating interconnection between ASST and SIP networks. As a consequence, the advent of mobile telephony brought further pressure to unify fixed network management. Slow and/or poor interconnection in fact threatened to realize the full potential of mobile telephony as a new business product.

Options to reform the organization of the sector were considered in the context of the preparation of a Report by the Senate Standing Committee for Transport and Communications between 1980 and 1982.<sup>197</sup> The Senate Report carried out an extensive fact-finding exercise, aimed at collecting evidence from all parties involved. Members of the committee also travelled to the US to examine the role of the FCC and the American regulatory model. Various options for reform were then considered and there was a common understanding on the need to end the separation between SIP and ASST and merge the two entities into a single operator. This would have entailed a change in the institutional trajectory followed by Italy until then, which was based on a split-supplier system.<sup>198</sup>

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<sup>197</sup> Senato della Repubblica Italiana, 8<sup>a</sup> Commissione Permanente (Lavori Pubblici, Comunicazioni), *Indagine conoscitiva sul settore delle telecomunicazioni* (Tipografia del Senato: Roma, 1982). There were both oral and written submissions by managers of SIP, Italcable, STET, IRI, Olivetti, the Minister of Post and Telecommunications, the Minister of State Holdings, the Minister of the Treasury, business users' groups and trade unions representatives. There were no submissions by ASST representatives or by the Post and Telecommunications Administration.

<sup>198</sup> The legal status of such single operator was still unclear, though. The Report considered two options: (i) either a public corporation (Ente pubblico) in the like of Enel or ENI; or (ii) a State-owned company modelled after the licensees. The latter option was seen as more in tune with the need to grant a certain degree of flexibility, which would be difficult to achieve for an Ente Pubblico. It was furthermore held that the new company would have to be structured along two lines, one focusing on national telecommunications services and the other on international telecommunications services in order to ensure more transparency as to

As to the role of the Minister of Posts and Telecommunications, the Senate Report held that, after divesting from the provision of services through the incorporation of ASST into SIP, it should become the centre of policy-making. At the time of the Report, the committee maintained that the Ministry of Posts and Telecommunications was ill-equipped to carry out this mission because it had little staff and heavily relied on the *Aziende di Stato*, ASST and the Amministrazione PP.TT., for expert advice.<sup>199</sup> Furthermore, certain senators looked with interest to the American model of regulation based on independent agencies and went as far as advocating the set up of a similar system in Italy.<sup>200</sup>

Almost in parallel to the Senate enquiry, the Government also commissioned a report to a group of senior officials. The “*Dipartimento Analisi e Verifica del Programma di Governo*” (Task force on analysis and control of the Government action), formed under the government of Giovanni Spadolini in 1981, carried out an enquiry on the telecommunications sector and drew a report which was ready in 1982. Due to a government crisis, the fall of the Spadolini government and forthcoming elections, the report was only published in 1984 with the title of Commissione Morganti, *Rapporto al Presidente del Consiglio sulle Telecomunicazioni*.<sup>201</sup> It drew on various experts and managers belonging to SIP, STET and the *Istituto Superiore delle Poste e Telecomunicazioni* (a body within the Ministry of Posts

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the financial situation relative to each service. See *Indagine conoscitiva sul settore delle telecomunicazioni* (cit.), hearing held on December 22, 1982, 332-333.

<sup>199</sup> *Indagine conoscitiva sul settore delle telecomunicazioni* (cit.), hearing held on May 5, 1980, 305. It should be remembered that ASST and Amministrazione PP.TT. were separate entities, albeit reporting to the Minister. Thus, the latter could in fact rely on little staff, whereas the *Aziende* directly employed several thousands.

<sup>200</sup> See *Indagine conoscitiva sul settore delle telecomunicazioni* (cit.), hearing held on March 26, 1980, 46, showing that there was serious attention for the set up of an independent agency that “*following the Anglo-Saxon model, would be structured outside the conventional bureaucratic organization and staffed with top level experts. This body would be responsible for drawing a strategic plan for the sector and monitoring its implementation, especially as far as investments and technical standards are concerned*”.

<sup>201</sup> The report was published in 1984 by Franco Angeli (Milano).

and Telecommunications). With reference to the institutional structure, the report also called for reform, articulating various solutions: (i) a rationalisation of the status quo (a better separation of competencies between ASST-Amministrazione PP. TT. and the licensees); (ii) the unification of the various telecommunications operators outside the Minister of Posts and Telecommunications; and (iii) separation between operation and regulation.

After the publication of the Senate Report, Law No. 192 of 1983 - “*Determinazione del canone di concessione dovuto dalla SIP*” - <sup>202</sup> the law that lowered SIP licence fee, also contained a provision to the effect that the Government was under an obligation to propose a bill within one year since the coming into effect of the law in order to re-structure the system with a view to merge all telecommunications services into one operator.<sup>203</sup>

In 1984, the Minister of Posts and Telecommunications stated at a Parliamentary hearing that he envisaged either the creation of State-owned company under the control of IRI, or two companies, one in charge of the network and structured like a ministerial department, and the other entrusted with the provision of services, under the control of IRI.<sup>204</sup> In 1985, a bill to incorporate ASST under the control of STET was labelled as being “imminent”<sup>205</sup> and the Minister of Posts and Telecommunications proposed at a hearing held in the same year a new tripartite structure for the provision of telecommunications services in Italy, comprising: (i) a department within the Ministry entrusted with planning, supervision

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<sup>202</sup> See GURI n. 134, 18.5.1983. However, since the law provided only for the year 1982, a new legislative measure was passed in 1984. Law n. 870 dated December 22, 1984 repealed article 275 of the Postal Code, lowering the license fee to 3% of licensees’ total revenues and confirming the reduction enacted by the 1983 law (See GURI n. 355, 28. 12. 1984).

<sup>203</sup> Law No. 192 of 1983, Article 1.

<sup>204</sup> Camera dei Deputati, 10<sup>a</sup> Commissione Permanente (Trasporti, Comunicazioni), *Audizione ai sensi dell’articolo 143, secondo comma, del regolamento, del Ministro delle Poste e delle Telecomunicazioni in ordine al piano nazionale delle frequenze di radiodiffusione, al riassetto del settore delle telecomunicazioni ed all’aggiornamento del piano decennale delle telecomunicazioni, Bollettino Commissioni* (Roma: Tipografia della Camera, 1984).

<sup>205</sup> See *Il sole 24 ore*, 22.2.1985.

and granting of state resources; (ii) a public corporation for postal services; and (iii) a separate one for telecommunications (in the form of a limited liability company), owned by the State, placed under the supervision of the Minister of State holdings.<sup>206</sup> Similar plans to end the split supplier system were also advanced by the heads of IRI (Romano Prodi), STET and SIP (Paolo Benzoni).<sup>207</sup>

In spite of pressures for change and proposals to reform the organization of the sector, no legislative initiative to change the direction of institutional development was undertaken. On the contrary, the new SIP licence signed in 1984 showed that split-supplier system was not only continued, but also reinforced by giving more powers to ASST.<sup>208</sup>

Firstly, ASST was given powers to oversee the development of the networks in furtherance of its position as a regulator. In particular, the 1984 licence laid down provisions requiring a higher level of interconnection between SIP and ASST networks.<sup>209</sup> Secondly, the 1984 licence envisaged the joint development of the integrated service data network (*rete numerica integrata dei servizi*) within 1990<sup>210</sup> and it detailed coordination procedures with respect to data transmission.<sup>211</sup> It is worth underlining that the development of data transmission was a joint project between SIP and ASST. As noted, though, there were sound

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<sup>206</sup> Camera dei Deputati, 8<sup>a</sup> Commissione (Lavori Pubblici, Comunicazioni), *Comunicazioni del Ministro delle Poste e Telecomunicazioni in ordine al riassetto istituzionale del settore delle telecomunicazioni e conseguente dibattito* (Roma: Tipografia della Camera, 1985).

<sup>207</sup> See *Il sole 24 ore*, 27.2.1985, 2.2.1985, 20.6.1985.

<sup>208</sup> CIPE deliberation dated March 24, 1982 (GURI n. 105, 17.4.1982) established that licenses would have to be renewed by 1982. They were in fact renewed in September 1984, under Presidential Decree dated August 13, 1984, n. 523 (GURI 1984, 30.8.1984, n. 239).

<sup>209</sup> See article 9 - “*Competenza degli impianti e dei collegamenti*” and Annex B - “*Unificazione della rete intercompartimentale*”; see also article 20 - “*Piani pluriennali di massima e piani tecnici esecutivi*”.

<sup>210</sup> See article 1 - “*Oggetto della concessione*”.

<sup>211</sup> See article 10 - “*Competenza degli impianti e dei collegamenti relativi alle reti pubbliche specializzate*” and article 20.

technological reasons to end the split-supplier system, which applied *a fortiori* in the development of such new services as data transmission.<sup>212</sup> In addition, since 1983 SIP also offered data transmission over its circuit switched network (*rete fonia-dati*), providing services such as fax transmission, audioconferences and closed-group telephony. SIP was therefore well qualified to take over data transmission services. The 1984 licence not only ignored these reasons, but also envisaged that in future the split-supplier system should extend to new services since it explicitly stated that data transmission fell outside the scope of SIP licence.<sup>213</sup> The split provision of data transmission remained in force until 1988.<sup>214</sup>

The choices in favor of an expansion of ASST's role and, in essence, the continuation of the split-supplier system in spite of calls to merge all providers for reasons of efficiency, can be linked to increasing returns. The reinforcing process that linked together political parties, on the one hand, licensees and ASST, on the other hand, had an essential institutional dimension. The fragmentation of telecommunications supply between licensees and ASST matched the fragmented structure of power prevailing at the time. Having a split-supplier system enabled each political party and the various factions of the Christian Democracy<sup>215</sup> to preserve its sphere of power and influence. As Giuliano Graziosi, head of Stet, later stated, "*all of the ruling parties were hostile to a single supplier. The reason was obvious: with a*

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<sup>212</sup> See *Il sole 24 ore*, 15.6.1985.

<sup>213</sup> See article 1 of the 1984 licence. In addition, the Minister of Post and Telecommunications reserved the right "to use the telex network to provide whatever services became technically possible."

<sup>214</sup> See Presidential Decree dated December 20, 1988 "Approvazione delle convenzioni stipulate in data 22 settembre 1988 tra il Ministero delle poste e delle telecomunicazioni e le società SIP e Italcable, relative al servizio di trasmissione dati a commutazione di pacchetto in ambito nazionale e internazionale, al servizio di dettatura fonica dei telegrammi ed all'instradamento del traffico telefonico internazionale" (GURI n. 172, 25.7.1989).

<sup>215</sup> For a study on the internal structure of the Christian Democracy and the role of its internal factions (*correnti*), see R. Leonardi and D. A. Wertman, *Italian Christian Democracy—The politics of dominance* (London: MacMillan, 1989). See also *Il sole 24 ore* 16.5.1991, 17.5.1991, 26.6.1991, and 6.8.1991.

*single supplier they would lose seats in the boardrooms*".<sup>216</sup> The expansion of ASST's competence to data transmission thus was an attempt to control resources by political parties who could use ASST as a means to their ends. It is worth recalling that data transmission services represented one of the most important developments in the field of telecommunications at that time. In 1988, a new plan to improve the state of the sector was launched, the Piano Europa.<sup>217</sup> The Piano Europa envisaged very significant investment: SIP was entitled to 36,300 billion lira investment over the period 1988-1992, whereas ASST was entitled to 8,000 billion lira. Since control over resources was vital for political parties and since ASST was an ideal instrument to channel resources, political parties preferred an institutional arrangement where ASST had its sphere of powers preserved.

The foregoing shows that increasing returns operated in the way path dependence would have expected. Pressures for changing the direction of the institutional trajectory were kept at bay and instead an improved version of the existing institutions was preferred, i.e. better coordination between the different suppliers. The period after 1988 offers a more complex picture due to the proposals to adopt a law on the reorganization of the sector, eventually adopted as Law No. 58 of 1992.

## **V. THE YEARS OF BOUNDED CHANGE: 1988-1992**

In 1987, the pressures to end the separation between ASST and SIP acquired a European dimension when the European Commission adopted the Green Paper on

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<sup>216</sup> See *Il sole 24 ore*, 3.12.1993 (“[answering to the interviewer’s question “who sabotaged the plan to create a single supplier, nda”] [T]utte le principali forze di governo. Per ovvie ragioni: con l’unificazione dei gestori perdevano posti nei consigli d’amministrazione e, soprattutto, si sopprimeva un centro di affari perversi come si è scoperta essere l’Asst”). Also personal interview, STET CEO.

<sup>217</sup> See *Il sole 24 ore*, 29.9.1988 (“Investimenti accelerati per agganciare l’Europa”).

Telecommunications.<sup>218</sup> The 1987 Green Paper called into question the legal framework applicable to the organization of the sector since it advocated the separation of regulatory powers and telecommunications operation. In so doing, the Green Paper made the existence of ASST, with its double role as regulator and telecommunications operator, incompatible with the principles that, according to the Commission, should apply under Community law.<sup>219</sup>

In a further step, in 1990 the Commission passed Directive 90/388 on competition in the markets for telecommunications services.<sup>220</sup> The directive concerned the rules on competition, but it also required termination of potentially conflicting situations whereby telecommunications organizations acted as providers and regulators. More precisely, the 29<sup>th</sup> recital of the Directive stated that: “*The delegation to an undertaking which has a dominant position for the provision and exploitation of the network, of the power to regulate access to the market for telecommunication services constitutes a strengthening of that dominant position*”. The Directive established that by July 1, 1991 all Member States should have

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<sup>218</sup> *Towards a Dynamic European Economy- Green Paper on the development of the common market for telecommunications services and equipment* (COM (87) 290, 30.6.1987).

<sup>219</sup> See Disegno di legge n. 1685, Comunicazione alla Presidenza: “*Dal punto di vista organizzativo si è stabilito che nei paesi della CEE i compiti di programmazione e di controllo devono essere nettamente separati da quelli di gestione e, comunque, direttamente operativi. Ciò significa che i governi di questi paesi non possono direttamente gestire servizi di telecomunicazioni, ovvero il contrario di quello che oggi avviene in Italia con l’ASST*” (underlined not in the text), 2.

<sup>220</sup> *Official Journal* 1990, L 192/10. In 1988, the Commission had adopted a directive on liberalization of terminal equipment (Directive 88/301, *Official Journal* 1988, L 131/73). The impact of this directive on the organization of the sector in Italy was however much more reduced compared to Directive 90/388 and for this reason this directive is not discussed in the text. For the Commission overall role in the liberalization of the sector, see, e.g., V. Schneider and R. Werle, ‘International Regime or Corporate Actor? The European Community in Telecommunication Policy’, in K. Dyson and P. Humphreys (eds.), *The Political Economy of Communications: International and European Dimensions* (London: Routledge, 1990); W. Sandholtz, ‘Institutions and Collective Action: The New Telecommunications in Western Europe’, *World Politics*, (1993), 242; P. Larouche, *Competition Law and Regulation in European Telecommunications* (Oxford: Hart Publishing, 2000); Thatcher, *Internationalisation and Economic Institutions*, ch. 6-9.



complied with the Directive, including the provision on separation between regulatory functions and provisions of services.<sup>221</sup>

There was little doubt that these provisions affected ASST's role as holding both regulatory powers and the provision of telecommunications services. In fact, already before Directive 90/388 was adopted, however, the impact of EU legislation on the reorganization of the sector was significant. For instance, in 1989 the Minister of Posts and Telecommunications mentioned that the Green Paper obliged Italy to take action in respect of the role of ASST, with the consequence of favouring a re-unification of the latter with SIP.<sup>222</sup>

EU law thus increased pressure for an end to the split-supplier system. It is worth pausing for a moment to state what EU law did *not* require. Directive 90/388 did not prescribe a given organization of the sector, only defining in negative terms what was contrary to EU law, without binding Member States to adopt a set structure. In other words, EU law provided a framework, which could be filled by Member States in a variety of ways. The institutional choices were, thus, open to be influenced by domestic factors, with the only limit that regulatory functions should have been separate from provision of services. It is therefore correct to focus on domestic factors to understand how the opportunity for reform provided by EU law was used at the national level.

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<sup>221</sup> Article 7: “Member States shall ensure that from 1 July 1991 the grant of operating licences, the control of type approval and mandatory specifications, the allocation of frequencies and surveillance of usage conditions are carried out by a body independent of the telecommunications organizations. They shall inform the Commission of the measures taken or draft measures introduced to that end no later than 31 December 1990”.

<sup>222</sup> See statement by the Minister of Post and Telecommunications at a hearing held on May 10, 1989 before the Senate Committee for Public Works and Communications (8<sup>a</sup> Commissione, Lavori Pubblici, Comunicazioni); see also the statements by Senator Andó as the ruling coalition representative, at a hearing held on September 21, 1989 and by the Minister of State Holdings in a hearing held on November 23, 1989 before the same Senate Committee. Both statements made reference to the Green Paper's provisions relating to the separation between regulation and commercial operations and their impact on the ASST role.

IRI and STET managers were eager to seize this opportunity to foster the creation of a single provider under IRI/STET.<sup>223</sup> In March 1988, IRI's board, acting under the presidency of Romano Prodi, approved a resolution that mandated the creation of a single supplier. This project was advanced by STET CEO, Giuliano Graziosi.<sup>224</sup> The new entity would have been the new sole licensee of telecommunications services, reuniting under a single umbrella the dispersed provision of telecommunications services to the public. The concentration would have taken the form of incorporation of the operating companies, SIP and the other licensees, into STET, the holding company. The new umbrella entity thus became known as 'Super STET'.<sup>225</sup> IRI's resolution also mentioned the merger of ASST into super-STET, although it also stated that this required specific legislation and so it was outside IRI's powers.

Since it threatened to limit their ability to use telecommunications providers, political parties opposed the Super STET plan. As the party with the relatively stronger clout in government, the Christian Democrat Party was also the one that stood to lose the most from the Super STET plan. It is worth remembering that the heads of ASST and most of the top managers in the boards of STET and SIP were DC appointees. The Super STET plan would have limited the number of posts available and so curtailed opportunities to allot sphere of influences. The other parties were also opposed to Super STET for the same reasons.

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<sup>223</sup> See, e.g., the statement by Miro Allione, one of the key STET managers: "*Il primo gennaio del '93 scatta la direttiva Cee che stabilisce che il ministero delle Poste e Telecomunicazioni non può avere un'attività produttiva: è inutile che io mi scaldi adesso perché il riassetto delle telecomunicazioni non va avanti. Prima di quella data qualcosa dovrà accadere ...*" (see *il sole 24 ore*, 15.2.1991).

<sup>224</sup> Personal interview STET CEO.

<sup>225</sup> *Il sole 24 ore* 29.3.1988, 31.3.1988, and 1.4.1988.

Super STET plan was first halted by a government crisis in 1988.<sup>226</sup> The Minister of State Holdings then in charge, Luigi Granelli, wrote to IRI's board to warn IRI's president, Romano Prodi, that IRI should not proceed any further in its plans to create Super STET as this needed political endorsement from the government, such endorsement to be provided as soon as the crisis would be resolved.<sup>227</sup> Once the crisis was over, the parties in the ruling coalition started to re-design the Super-STET plan in a way that was more conducive to the existing relationships between political parties and telecommunications companies.

In the second-half of 1988, a rival plan to Super STET was conceived. The new plan centred on an increased role of SIP and was thus called Super SIP.<sup>228</sup> In particular, Super SIP involved the merger of all operators into SIP, but left open the possibility to set up other companies vested with special tasks, such as the management and operation of value-added services. In addition, STET would have also continued to act as the holding company with power of direction over strategic decisions. The rationale behind the Super SIP plan was therefore clear insofar as it aimed at leaving intact the geography of power and the possibility to allocate spoils in proportion to electoral weight ('lottizzazione').<sup>229</sup>

Also Oscar Mammi, then Minister of Posts and Telecommunications and the proponent of a bill to re-organize the sector, admitted that the major hurdle on the way to the creation of a single operator was the power play by political parties surrounding telecommunications. This power play was also halting the formal introduction of the bill

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<sup>226</sup> In April 1988, the Gorla government was replaced by a government presided by Ciriaco de Mita.

<sup>227</sup> See *Il sole 24 ore*, 12.4.1988. In addition, Italcable, the most important licensee after SIP, started to mount opposition against the merger (see, e.g., *Il sole 24 ore* 17.12.1988, 13.1.1989, and 2.3.1989).

<sup>228</sup> See *Il sole 24 ore*, 29.10.1988.

<sup>229</sup> See *Il sole 24 ore*, 29.10.1988. The Super SIP plan was not precisely defined and so it is not possible to say if Super SIP was intended to even *increase* the possibility for *lottizzazione*.

Oscar Mammi had many times announced as imminent. As Mammi stated,<sup>230</sup> *“Il maggior scoglio da superare esula dal testo vero e proprio del disegno di legge ma politicamente è ad esso strettamente connesso: se si conviene sull’opportunità di dar vita ad un’unica società concessionaria per i servizi di telecomunicazione è possibile che si voglia anche sapere quale sarà il suo assetto e in quale struttura essa si articolerà...L’unificazione della gestione della rete è un bisogno del Paese, non la bizzarria di una stagione. Questo non esclude che la società concessionaria, che dovrà essere unica, possa articolarsi in più società controllate. La legge deve prevedere questa opzione, anche se non può imporla”*.

In December 1988, the Minister of State Holdings, Carlo Fracanzani, an MP belonging to the DC, explicitly suggested that Super STET was soon to be abandoned in favor of a solution that preserved the split-supplier system. According to the Minister, the split-supplier system appeared “more rational”.<sup>231</sup> It should be added that the Super SIP plan started to receive also explicit endorsement from political parties. Silvio Lega, the Christian Democrat MP responsible for economic affairs, voiced his preference for a Super SIP plan.<sup>232</sup> Gianni De Michelis, a key Socialist MP expressed disagreement towards Super STET.<sup>233</sup>

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<sup>230</sup> See *Il sole 24 ore*, 17.11.1988. *“The most difficult hurdle goes beyond the actual text of the bill, but is closely linked to it: if one agrees on the opportunity of having a single licensee for telecommunications services, it is possible that one also wants to know its organization ...the unification of network management is a priority for the country and not a temporary wish. However, this does not mean that the licensee, which should be a single company, could not have subsidiary companies under its control. The law should envisage this option, even if it cannot impose it”*.

<sup>231</sup> See *Il sole 24 ore*, 7.12.1988. According to the Minister: *“si tratterà di vedere se dovrà esserci un unico organismo oppure, come appare più razionale, un’unica finanziaria da cui dipende un numero ristretto di società operative, distinguendo l’attività di servizio telefonico (eventualmente articolata in due distinte strutture per i servizi regolamentati e per quelli in concorrenza) da quelle manifatturiere e dell’impiantistica”* (emphasis supplied).

<sup>232</sup> See *Il sole 24 ore*, 15.12.1988.

<sup>233</sup> See *Il sole 24 ore*, 28.10.1988. See also *Il sole 24 ore*, 29.10.1988 (*“Le ragioni del ripensamento, già segnalato l’altro ieri dal vicepresidente socialista del Consiglio, Gianni De Michelis, ma in atto anche ai vertici della DC, sono ... in larga parte dovute a più prosaiche logiche di spartizione partitica e a resistenze sindacali ... In ogni caso, se matureranno i*

Furthermore, the Minister of State Holdings, Carlo Fracanzani attacked openly IRI/STET for its plan to create Super STET and opened an investigation with a view to ascertain whether IRI/STET was responsible of violations of financial regulation since the news of Super STET obviously affected the stock market.<sup>234</sup> The move by Fracanzani seemed a sort of ‘vengeance’ by a faction of the Christian Democracy (the so called “left”) against Giuliano Graziosi and his plan to create Super STET.<sup>235</sup>

The differences between the Minister of State Holdings and his Super SIP plan and Super STET were resolved in a meeting held on Christmas eve of 1988 between the Minister of State Holdings, the Minister of Posts and Telecommunications, the vice-secretary of the Christian Democratic party (Enzo Scotti), the head of the political secretary of the Christian Democratic Party (Giuseppe Gargani) and the heads of the trade unions (Franco Marini and Sergio D’Antoni).<sup>236</sup> In an interview held shortly afterwards the meeting,<sup>237</sup> the Minister of State Holdings stated that:

- the plan to re-organize the sector envisaged a financial holding with a limited number of controlled entities, with separate companies for regulated services and services opened to competition.

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*disegni che covano in casa dc e psi, qualche amministratore delle società originariamente destinate a fondersi in Superstet salverà la sua poltrona, la Cisl potrà continuare a difendere il suo feudo sindacale dell’Asst, ma anziché un gestore unico dei servizi di telecomunicazioni avremo un gruppo ramificato in due o tre o forse quattro società operative. I piani di DC e Psi prevedono infatti l’attribuzione a una sola società (Telecom Italia) di una concessione unica del ministero delle Poste per la gestione dei servizi pubblici di telecomunicazioni, ma prevedono anche la distinta e concomitante permanenza della Stet ... nonché di due o più società controllate ... L’idea che caldeggiavano Piazza del Gesù e Via del Corso è di dividere la gestione dei servizi in concessione ... da quelli non regolamentati... e di parcheggiare transitoriamente l’Asst in uno spazio autonomo per non scontentare la Cisl ...”).*

<sup>234</sup> See *Il sole 24 ore*, 23.12.1988.

<sup>235</sup> See *Il sole 24 ore*, 23.12.1988.

<sup>236</sup> See *Il sole 24 ore*, 24.12.1988. The costs of paying off ASST employees had escalated out of control, raising tension with the trade unions (see *Il sole 24 ore*, 25.1.1989).

<sup>237</sup> See *Il sole 24 ore*, 29.12.1988.

- The Minister also argued that this proposal was the most adequate to respond to the needs of rationality and efficiency and met EC law too.
- Finally, the Minister dismissed the criticism that this arrangement was made to favour the practice of “lottizzazione” and sternly rebuked those who argued the contrary.

Thus, at the beginning of 1989, increasing returns had already affected the future plans for the re-organization of the sector. The Super STET plan having been discarded, the future bill can already be assessed as a step along the well-trodden path of institutional development, based on the split-supplier system. In particular, increasing returns played an important role in determining the direction of institutional change. While Super STET would have meant a significant innovation, increasing returns conditioned institutional choices in favour of continuity with the past. Super SIP, with the continued fragmentation of suppliers, should therefore be seen against this background as a step along the Italian ‘path’ of telecommunications institutions.

The subsequent developments of the bill confirmed that the institutional direction was strongly influenced by increasing returns. In this respect, it is important to note that the bill was not approved by the council of ministers until the DC congress took place in 1989.<sup>238</sup> This congress was an important appointment, as it was going to assign leadership of the party. The repercussions for the re-organization of the sector were potentially very significant, given that the ‘left’ faction of the DC was very keen to defend the status quo and,

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<sup>238</sup> See *Il sole 24 ore*, 27.1.1989 (“Consiglio dei ministri rinvia l’esame Superstet”); 4.2.1989 (“Per l’ASST alla Stet ancora fumata nera”). See *Il sole 24 ore*, 18.1.1989 (“La sorte della Superstet si chiarirà soltanto dopo il congresso democristiano ...”).

in particular, ASST, as long as it could. After the congress confirmed Ciriaco De Mita's leadership, the bill was approved by the Council of Ministers in March 1989.<sup>239</sup>

The bill provided a high degree of flexibility since it left intact the possibility for the continuation of the multi-supplier system, albeit under STET. Moreover, the bill delayed any effective choice to a separate decision to be made by *Comitato Interministeriale per la Programmazione Economica* (CIPE).<sup>240</sup> More precisely, it was envisaged that all public telecommunications services, save a few exceptions,<sup>241</sup> were going to be operated by a single licensee whose majority of shares were to be, directly or indirectly, in the hands of IRI.<sup>242</sup> Crucially, this was without prejudice to the establishment of operating companies under the control of the single licensee.<sup>243</sup> The composition and the identity of the single licensee were deferred to an act of CIPE.

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<sup>239</sup> See *Il sole 24 ore*, 4.3.1989.

<sup>240</sup> Disegno di legge n. 1685, *Disposizioni per la riforma del settore delle telecomunicazioni*, X Legislatura, in *Atti parlamentari - Disegni di Legge e Relazioni – Documenti* (Roma: Tipografia del Senato, 1989). Another bill regarding the reform of the Minister of Post and Telecommunications and in particular postal services was simultaneously laid before the Chamber of Deputies. See Disegno di legge n. 3805, *Disposizioni per la riforma del Ministero delle Poste e delle Telecomunicazioni*, X Legislatura, in *Disegni di Legge e Relazioni – Documenti* (Roma: Camera dei Deputati, 1989).

<sup>241</sup> Article 1 excluded certain telecommunications services, especially telematics service carried out through post offices, certain radio transmission and maritime telecommunications (the latter, though, were to remain outside the scope of the single concession only temporarily).

<sup>242</sup> Article 1, para. 1: “*I servizi di telecomunicazioni ad uso pubblico, nonché l’installazione e l’esercizio dei relativi impianti, attualmente gestiti dall’Azienda di Stato per i servizi telefonici e dall’Amministrazione delle poste e delle telecomunicazioni, sono affidati in esclusiva, entro sei mesi dall’entrata in vigore della presente legge, ai sensi dell’articolo 196 del codice postale e delle telecomunicazioni approvato con decreto del Presidente della Repubblica 29 marzo 1973 n. 156, d’intesa con il Ministro delle partecipazioni statali, ad una Società concessionaria, la maggioranza delle cui azioni aventi diritto di voto sia posseduta direttamente o indirettamente dall’Istituto per la ricostruzione industriale (IRI); la Società concessionaria svolge unitariamente tutti i servizi di telecomunicazioni ad uso pubblico ...*”.

<sup>243</sup> Article 1, para. 2: “*Qualora la Concessionaria, per lo svolgimento di parte dei servizi oggetto della concessione, intenda avvalersi di altre società controllate o collegate all’interno dello stesso gruppo deve ottenere il preventivo assenso dei Ministeri delle poste e delle telecomunicazioni, del tesoro e delle partecipazioni statali*”.

The bill elicited positive reactions from the Vice President of the Council of Minister, the Socialist MP Gianni De Michelis, and the Minister of State Holdings, Carlo Fracanzani, both of whom restated their preference for the Super SIP plan, or the split-supplier system.<sup>244</sup> Fracanzani repeated his preference for Super SIP several times.<sup>245</sup>

Once they had secured the institutional direction – which was settled around the split-supplier system<sup>246</sup> - political parties started to argue about “who should control what” in the newly designed order. The Christian Democrat Party and the Socialist Party thus entered into a skirmish. Each party had its own views as to how the re-organization should work. Both of them, though, acted on the basis of the desire to secure the maximum possible influence in

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<sup>244</sup> See *Il sole 24 ore*, 4.3.1989.

<sup>245</sup> See *Il sole 24 ore*, 8.4.1989 (“Un’unica finanziaria con efficace potere di controllo e coordinamento da cui dipenda un numero ristretto di società operative con specifiche missioni, distinguendo l’attività di servizio telefonico (articolata a sua volta in due distinte strutture per i servizi regolamentati e per quelli in concorrenza) dalle attività manifatturiere e dall’impiantistica ...”); 11.5.1989 (“una società finanziaria «con efficaci poteri di controllo e di coordinamento e da cui dipenda un limitato numero di società operative» e una concessionaria dei servizi telefonici regolamentati «responsabile delle infrastrutture di rete, eventualmente articolata nelle forme che dovessero apparire più opportune per il miglioramento dei servizi..»”); 4.8.1989.

<sup>246</sup> See *Il sole 24 ore*, 28.2.1989 (“Il Piano Superstet è tramontato”; “La delibera del consiglio di amministrazione sulla Superstet deve essere, infatti, cancellata e riscritta secondo Massimo Pini (Psi) e Sergio Trauner (Pli), esponenti del comitato di presidenza dell’Iri ...«La razionalizzazione – ha dichiarato Pini – può avvenire o secondo il vecchio schema [i.e. Super STET, nda], su cui non è più d’accordo nessuno, o secondo l’ipotesi della Democrazia Cristiana che mi sembra più interessante, creando una holding dalla quale dipendano le società operative ...»”).



the new system.<sup>247</sup> Holding a position that forced him to act as a super-partes arbitrator, the Prime Minister, Ciriaco De Mita tried to advance the passage of the bill.<sup>248</sup>

In May 1989, though, a new government crisis took place, causing a stop in the Parliamentary work, including those concerning the bill. Under the new government, held by Giulio Andreotti, another key DC party leader, the contrasts over the future of the telecommunications sector continued. In particular, the DC factions appeared divided. This caused not only a further delay in the approval of the bill, but took also an institutional turn. Lacking an agreement on the reform of the sector, a third plan, other than Super STET and Super SIP was proposed. Francesco Tempestini, a Socialist MP serving as the undersecretary to the Ministry of Posts and Telecommunications suggested that even Super SIP should be abandoned.<sup>249</sup> He called for the DC to solve its internal problems and voiced his preference for a situation whereby STET would hold a single licence, but the existing providers would continue to exist.<sup>250</sup> The plan suggested by Tempestini represented yet another version of the

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<sup>247</sup> See *Il sole 24 ore*, 27.12.1989 (“*Sulla Supersip si prepara una braccio di ferro Dc-Psi ... L’iniziativa della Dc ... si fonda essenzialmente su tre pilastri: 1) trasferimento dei beni e dei servizi dell’Asst dalla pubblica amministrazione direttamente al gruppo Stet ... attraverso la costituzione di un’apposita Spa che mantenga una sua autonoma identità per almeno tre anni; 2) attribuzione ... di un’unica concessione-quadro ...alla Stet, che a sua volta provvede a sub-concessionare a Sip, Italcable e Telespazio le missioni attualmente da esse svolte ed alla nuova società quelle oggi svolte da Asst ed Amministrazione P.T*”)

<sup>248</sup> See *Il sole 24 ore*, 11.2.1989 (“*Nonostante l’appoggio del presidente del Consiglio, Ciriaco De Mita, il disegno di legge del ministro delle Poste, Oscar Mammi, non è stato approvato per l’opposizione manifestata dai socialisti (in particolare il vicepresidente del Consiglio Gianni De Michelis e il ministro del Lavoro Rino Formica) e dai ministri democristiani Paolo Cirino Pomicino e Carlo Donat Cattin ... Cirino Pomicino vuole rinviare ogni decisione a dopo il congresso democristiano ...*”).

<sup>249</sup> See *Il sole 24 ore*, 25.8.1989 (“*Si decide sulle Tlc: tramonta Supersip*”).

<sup>250</sup> Ibid. (“*«Sul riassetto io credo che i punti di riferimento debbano essere sostanzialmente due: l’unità della rete e il riconoscimento che le società coinvolte nel processo di razionalizzazione dei servizi ... hanno un modo diverso di stare sul mercato» e quindi debbano mantenere una loro autonomia operativa...*”). See also *Il sole 24 ore*, 24.9.1989.

split-supplier system, whose aim was to increase the PSI influence in the sector.<sup>251</sup>

Difference of opinions between DC and PSI arose.

In the meantime, Giuliano Graziosi put forward an alternative proposal.<sup>252</sup> In order to bypass the political deadlock, Graziosi proposed a technical solution that, without prejudice to the bill, would see the creation of centre for network control to be operated jointly by ASST and SIP. This centre would ensure the single management of the network that was needed to improve efficiency. The solution proposed by Graziosi was based on sound technological reasons behind the institutional proposal to create a single supplier, namely the superiority from a technological point of view of a single network management over spit-supply. But this idea failed to obtain support from political parties.

The year 1990 did not see the bill making any substantial progress through Parliament. Fracanzani continued to defend Super SIP.<sup>253</sup> Mammi worked to further amend the bill. The latest proposals envisaged several providers (as opposed to a single licensee with freedom to set up other companies). This amendment was even more in tune with increasing

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<sup>251</sup> See *Il sole 24 ore*, 1.12.1989 (“la commissione economica del Psi ha lanciato il suo forcing sulle telecomunicazioni con il duplice obiettivo di disincagliare la riforma dalle secche parlamentari e dalle sabbie mobili sindacali, ma anche di guadagnare spazio nella più ricca finanziaria dell’Iri (la Stet appunto), rinsaldando le sue posizioni al vertice della Sip ... La sortita socialista è un siluro evidente ai postelegrafonici della Cisl ... che, grazie alla loro forza elettorale, su queste posizioni hanno finora inchiodato i dc del Senato dove la riforma è in discussione ... I socialisti fanno capire che la concessionaria unica deve essere la Sip ... (dove i socialisti sperano di rafforzare le posizioni del presidente Giannotta) ... è consenziente il doroteo Lega ..., che mira a consolidare il ruolo dei due amministratori delegati della Sip (Paolo Benzoni e Francesco Silvano) ... ma non sembra che le altre correnti DC e soprattutto il ministro Oscar Mammi la pensino allo stesso modo”).

<sup>252</sup> See *Il sole 24 ore*, 7.3.1990 and 10.3.1990.

<sup>253</sup> See *Il sole 24 ore*, 14.2.1990 and 2.3.1990 (“... al vertice ci sarà una finanziaria-cassaforte (l’attuale Stet) con il compito di controllo e coordinamento da cui dipenderà un numero ristretto di società operative in funzione delle effettive esigenze del mercato e degli utenti. La Sip diventerà l’unica concessionaria dei servizi telefonici regolamentati e sarà la sola responsabile delle infrastrutture di rete con la possibilità di organizzarsi nei modi più opportuni ... Questa maxi-Sip sarà a sua volta affiancata da una o più società nel campo delle attività non regolamentate, ad esempio nei servizi a valore aggiunto ...”).

returns. It moved further away from anything like a single supplier of telecommunications and in practice was even more reflective of the status quo, the only difference being the 'IRIzation' of ASST, i.e. the incorporation of ASST within the IRI group. The amendment certainly mitigated the concerns of those who saw the reform as a form of reduction of the spoils available.<sup>254</sup>

These amendments notwithstanding, at the beginning of 1991, it was unsure whether the bill would ever be turned into law, as stated by the Minister of Posts of Telecommunications who had proposed the bill.<sup>255</sup> Between April and May 1991, the march of the bill was paralyzed one more time. This was because, concurrently with its passage through Parliament, it was also the time to renew the top positions at SIP. As noted in the section above, the politics surrounding these appointments were a key part of the increasing returns mechanisms. No prospects of reform, however limited, could be conceivable without the solution as to whom would be the victorious contestant of this round of division of the spoils.<sup>256</sup>

In May 1991, when Giulio Andreotti, who was Prime Minister for the 7<sup>th</sup> time and held the post of Minister of State Holdings ad interim too, emerged as the clear winner from the appointments of the top positions at SIP, the progress of the bill could re-start. Before the Senate concluded its debates in July 1991, the bill was further amended in a direction, which was, once again, consistent with the continuation of the status quo and, therefore, with what one could expect on the basis of path dependence. Namely, the original version of the bill

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<sup>254</sup> See *Il sole 24 ore*, 13.12.1990.

<sup>255</sup> See *Il sole 24 ore*, 6.3.1991 ("Mi auguro che ci sia una verifica morbida nei rapporti tra le forze politiche ma dura sui contenuti. Dalla verifica dovrebbe venir fuori la messa a fuoco di alcuni problemi e, per quanto mi riguarda, la conferma della volontà della maggioranza di portare avanti la riforma del ministero e il riassetto delle telecomunicazioni con il passaggio dell'Asst alle Partecipazioni statali").

<sup>256</sup> See *Il sole 24 ore*, 4.2.1991.

provided that ASST's successor could remain in operation only for one year and forbade any extension of this time limit. The Senators dropped this limitation and replaced it by giving to the Minister of Posts and Telecommunications the power to set a deadline.<sup>257</sup> In essence, this meant enhanced flexibility and a renewed opportunity to prolong the life of ASST (and of the split-supplier system) under IRI.

On July 19, 1991 the bill was ready to be sent to the Chamber of Deputies, which started its work on September 26, 1991.<sup>258</sup> The discussion in the Chamber was very limited.<sup>259</sup> The representatives of the parties in the ruling coalition, especially the Socialist party, the Christian Democrat party and the Republicans, urged the Chamber to approve the bill as it stood on the account that reforms had already been stalled for too long at that the bill was only a *primo passo* (first step).<sup>260</sup> The Minister of Posts and Telecommunications restated the same argument various times in subsequent hearings that took place before the Senate Committee in charge of examining the bill.<sup>261</sup> Notwithstanding an opinion rendered by the Antitrust Authority in one of its first public interventions, whereby the Authority

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<sup>257</sup> See *Il sole 24 ore*, 19.7.1991.

<sup>258</sup> See *Il sole 24 ore*, 26.9.1991.

<sup>259</sup> See debates held in the Senate on July 11, 1991 (Senato della Repubblica, 548 seduta (pomerid.) Assemblea – Resoconto Stenografico giovedì 11 luglio 1991 – Tipografia del Senato) and July 18, 1991 (Senato della Repubblica, 552 seduta (antimeridiana) Assemblea – Resoconto Stenografico giovedì 18 luglio 1991 – Tipografia del Senato); see also the debates in the Chamber of Deputies held on November 21, 1989 and on January 15 and 16, 1989 (X Legislatura - Atti Parlamentari – Camera dei deputati- Discussioni, Resoconto stenografico 715, 746 and 747).

<sup>260</sup> See the debates in the Chamber of Deputies held on November 21, 1991 and on January 15 and 16, 1992, when the vote on the bill took place (X Legislatura - Atti Parlamentari – Camera dei deputati- Discussioni, Resoconto stenografico 715, 746 and 747).

<sup>261</sup> See statement by the Minister of Post and Telecommunications at a hearing held on May 10, 1989 before the Senate Committee for Public Works and Communications (8<sup>a</sup> Commissione, Lavori Pubblici, Comunicazioni); see also the statements by Senator Andò (Socialist Party) as the ruling coalition representative, at a hearing held on September 21, 1989 and by the Minister of State Holdings in a hearing held on November 23, 1989 before the same Senate Committee.

raised doubts as to the compatibility of the bill with competition law,<sup>262</sup> the Chamber of Deputies passed the bill without any further amendments and it became law in January 1992.<sup>263</sup>

The provisions contained in law No. 58 of 1992 were much reduced in scope compared to the initial proposals. In terms of institutional reform, the law only provided for the winding – up of ASST<sup>264</sup> and it detailed the procedure to be followed in order to transfer ASST assets and staff from ASST to a new company. There were no provisions on the unification of all telecommunications operators into a single company and the restructuring of the sector. The law confined itself to laying down the steps to be followed in order to put such restructuring into effect. Namely, the law delegated to CIPE the task of setting out its main terms. CIPE's deliberation was to take place on a proposal from the Minister of State Holdings, acting together with the Minister of Posts and Telecommunications.

IRI was also closely associated in the process, as it had to submit indications on the restructuring plan and, after CIPE deliberation, IRI was charged with the implementation of the plan within strict time limits set out in the law. The law also provided that the Minister of Posts and Telecommunications, if so required by CIPE deliberation, had the power to

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<sup>262</sup> Segnalazione AS002, *Riforma del settore delle telecomunicazioni*, *Bollettino* 12/1991. This opinion was sent to the President of the Council of Ministers and to the Presidents of the two branches of Parliament on November 21, 1990. It was mentioned only in passing in the parliamentary debates held on January 15, 1991. The opinion expressed the Authority's concerns with respect to the role of IRI, whose already prominent position was reinforced by the bill.

<sup>263</sup> "Disposizioni per la riforma del settore delle telecomunicazioni" (GURI n. 29, 5.2.1992).

<sup>264</sup> Article 1, para. 3: "*L'Azienda di Stato per i servizi telefonici, istituita con regio decreto-legge 14 giugno 1925, n. 884, convertito dalla legge 18 marzo 1926, n. 562, è soppressa ...*".

supplement existing licences as he saw fit. Finally, CIPE deliberation was also subject to the endorsement from parliamentary committees.<sup>265</sup>

Other provisions dealt with the transfer of staff and social security payments,<sup>266</sup> without making substantial changes to the initial proposals. It is also noteworthy that the law was silent on the incorporation of the new company that was to be the successor of ASST, leaving the door open to maintaining ASST intact, although under the umbrella of IRI/STET.<sup>267</sup>

## VI. CONCLUSION

The law of 1992 offers a vantage point to pause and assess the empirical evidence discussed in the chapter in light of path dependence and the research question.

First of all, the chapter established the existence of increasing returns in Italian telecommunications. The increasing returns stemmed from the relationships between elected

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<sup>265</sup> Article 1, para. 4: “*Il Ministro delle partecipazioni statali, di concerto con il Ministro delle poste e delle telecomunicazioni, entro novanta giorni dalla data di entrata in vigore della presente legge, presenta al Comitato interministeriale per la programmazione economica (CIPE), sulla base di indicazioni dell’IRI, una proposta di delibera concernente i criteri generali di riassetto del settore delle telecomunicazioni*”. See also para. 6, “*Il CIPE delibera entro novanta giorni dal ricevimento della proposta di cui al comma 4 e l’IRI, nei successivi centottanta giorni, provvede alla conseguente attuazione. Qualora la delibera del CIPE lo richieda, il Ministro delle poste e delle telecomunicazioni emana appositi atti aggiuntivi alle concessioni dei servizi di telecomunicazioni ad uso pubblico in vigore e stipula atti integrativi alle annesse convenzioni. La delibera del CIPE è trasmessa ai Presidenti della Camera dei deputati e del Senato della Repubblica ai fini del deferimento alle competenti commissioni permanenti*”.

<sup>266</sup> Articles 4 and 5. The law also addressed the problem of tariffs, entrusting to *Comitato Interministeriale Prezzi (CIP)*, a committee of ministers in charge of setting prices, acting together with the Minister of the Treasury, the Minister of Economic Planning and the Minister of State Holdings, on a proposal from the Minister of Post and Telecommunications, the task of rebalancing tariffs, bringing them in line with costs and harmonizing them with the other Member States

<sup>267</sup> In particular, the law set out that the new company acquiring ASST assets and staff was going to be a company under the sole control of IRI. The new company operated under a temporary concession whose main terms were laid down in the law. The company duration was ten years, however, the concession was going to last the time necessary to carry out the restructuring of the sector and in any event no longer than one year, albeit with the possibility of renewal.

politicians and telecommunications suppliers. The starting point of the chapter's observations on these relationships is the financial crisis of SIP in 1979, which made the company greatly dependent on political parties to obtain state funds needed to continue to provide services and expand the network in compliance with the terms of its licence. Political parties divided between themselves the top posts (*lottizzazione*) and requested that 'loyal' management carry out their instructions. Tariff increases, another vital component of SIP viability given that its revenues were entirely based on tariffs, were also in the hands of political parties, which used their power of approval to further condition SIP's behaviour according to their needs.

In particular, SIP's resources were used to hire staff, to make investments in depressed areas, to buy equipments from 'friendly' firms and in a variety of other ways that could boost power and influence for political parties and, ultimately, bring votes. A similar, if even more pronounced, relationship bound political parties and ASST. Being a central government administration, ASST was even more subject to political control and it was in fact a preferred vehicle to carry out politically oriented manoeuvres as its accounting rules allowed very little outside control.

But investment decisions made in the name of patronage politics dilapidated resources. SIP and ASST were burdened with inefficient expenses and so were permanently in need of fresh funds to continue to operate. Telecommunications providers thus had to go back, cap in hand, to the political parties to obtain new resources. The process then restarted and a new round of financing carried with it new conditions. This self-reinforcing feature gave a special force to the relationship between political parties and telecommunications, 'gluing' together its protagonists. Thus, the chapter shows that the relationship between telecommunications providers and political parties generated a self-reinforcing sequence that

embodies a case of increasing returns. It further shows that increasing returns accrued to political parties. This is an important specification and a novel contribution as path dependence studies often overlook the role of actors and, by the same token, to specify who are the beneficiaries of increasing returns. This specification also helps to understand how increasing returns were one of the factors responsible for Italy's institutional trajectory.

Indeed, having several suppliers was instrumental to political parties' appropriation of increasing returns. This is because with a multiplicity of providers, each political party, and different factions within the leading Christian Democratic party, could better divide resources between themselves. This explains why any attempt to alter the number of providers was rejected until 1987, when EU law imposed that ASST must end its roles as a supplier and a regulator. Crucially, though, the law passed in 1992 to wind up ASST did not state that the latter and the other operators were going to be merged into a single entity, the Telecom Italia of which STET CEO Giuliano Graziosi had dreamt.

On the contrary, the law of 1992 left intact the possibility that several suppliers could continue to divide among themselves the provision of telecommunications services in Italy and, even more tellingly, it could not be dismissed that ASST could be reborn under the guise of a company under IRI/STET. The law of 1992, thus, continued the split-supplier albeit in an updated form. This outcome is consistent with path dependence since it shows that, present increasing returns, Italy followed a bounded-change trajectory and essentially continued on the same path as before. Thus, the chapter also shows how increasing returns shaped the institutional trajectory in a way that confirms path dependence's claims.

Before undertaking the exploration of the following period, it is important to reflect on the overall logic of the Italian path. This is a fundamental step in the process of assessing Italy's direction of institutional development so that one can be in a position to detect



continuity or change in the various episodes of institutional alterations. In order to achieve this result, it is useful to benchmark Italy's trajectory with that of Britain by, first, comparing key institutional aspects as of 1992, and then contrasting the logic of the British path with Italy's.

The table below summarizes key institutional arrangements.

**Table 9 - Britain and Italy 1992**

	UK	Italy
<b>Number of providers</b>	2/not predefined	4
<b>Ownership</b>	Private/listed	State control
<b>Degree of competition</b>	Competition	Monopoly
<b>Regulatory body</b>	OFTEL	Ministers

- Number of providers.** Since no one could provide telecommunications services without being entrusted to so by the state, the number of providers was limited by law and in 1992 it included four entities, namely SIP, ASST, Italcable and Telespazio. This can be usefully contrasted with Britain, where the progressive opening of the sector to competition meant that the BT/Mercury duopoly was temporary and that there was no predefined number of suppliers from 1992 onwards.
- Ownership.** By floating the majority of its shares in BT, the government had relinquished ownership over the company. In Italy, the State controlled the providers either directly, such as in the case of ASST, or indirectly, such as in the case of the licensees.

- ***Degree of competition.*** One of the key premises of the reform of the British sector was the introduction of competition in what used to be a closed monopoly. In Italy, the four existing suppliers enjoyed a monopoly protected by their exclusive licences.
- ***Allocation of regulatory power.*** Perhaps the starkest contrast between the two countries can be found in examining the differences in the arrangements concerning allocation of regulatory powers. By choosing to entrust to an IRA regulatory powers, Britain took a radical step. The Secretary of State lost the ability to control BT operations, whereas an independent body, free from governmental interference, became the repository of such an important power. Italy's arrangements stood in direct contrast, as the Minister of Posts and Telecommunications and, indeed, elected politicians in general, enjoyed control over the suppliers. As shown by the discussion concerning the existence of increasing returns, political control was magnified through a self-reinforcing relationship that embodies a case of increasing returns. This is the starting point to characterize the Italian logic of institutional development.

The changes that took place in Britain led to a path whose logic was characterized by the separation of suppliers from elected politicians. In Italy, on the contrary, elected politicians enjoyed control over suppliers to the extent that the former used the latter to foster their needs in a systematic way. This had several dimensions that can be examined to better appreciate the logic of the Italian path.

First of all, all pricing decisions were taken under the influence of elected politicians. In particular, tariff setting was formally in the hands of the Minister of Posts and Telecommunications and the Treasury. They used this power not only to foster goals of

general economic policy, such as combating inflation, but also as a lever to cajole the suppliers in fulfilling their instructions. Thus, SIP repeated claims for automatic tariff adjustment were consistently rejected. Elected politicians jealously guarded their margin of discretion to ensure unfettered control over the suppliers. In contrast, once BT was privatized, all pricing matters fell within the sole discretion of the company, albeit acting in compliance with rules set by the IRA. In this respect, the suppliers were separate from elected politicians and only answered to Oftel for their pricing behaviour.

Secondly, market structure in Italy was also tightly controlled by elected politicians. The chapter showed how proposals for reform centered on the reduction of the number of suppliers and the merger of all operators into a single company. These proposals were long opposed because of the threat they posed to the workings of the political system. A reduced number of providers would have impaired political parties' ability to divide between themselves the spoils, since it would have resulted into a fewer number of top positions. This eloquently shows the extent to which market structure was in the hands of elected politicians. Whereas in Britain joint venture agreements between BT and other companies or the disposal or reorganization of BT assets was again purely a matter for the company and the regulator, and, in any event, assessed on the basis of economic or technological reasons, in Italy the dominant considerations were increasing returns for elected politicians.

Third, given the high degree of control by political parties over suppliers, it is understandable that there was no discussion of having an Independent Regulatory Agency, hence there was no need for rules to allocate powers between the latter and elected politicians. Timid proposals advanced by academics and consultants were rejected out of hand, as leading politicians asserted their prerogatives over the suppliers undisturbed. An Italian Oftel was therefore unthinkable in those days.

The foregoing shows that the overall logic of the Italian path was based on elected politicians' control over suppliers. This relationship was an especially strong one due to its self-reinforcing character which represents a case of increasing returns. Given privatization, competition and regulation by independent agency in Britain, it is not surprising to see the two countries continuously diverging through time. Unexpectedly, though, the Italian logic was challenged by the events that took place after 1992.

## 5. Increasing Returns and New Directions of Institutional Development: Italian Telecommunications 1992-1997

### I. INTRODUCTION

This chapter focuses on the period between the adoption of law No. 58 of 1992 and 1997, i.e. the period when major institutional reforms were introduced. Based on path dependence, one should have expected the continuation of a split-supplier system and a logic based on full control of telecommunications providers by political parties.

Yet on the contrary, this period experienced changes that are difficult to reconcile with the past trajectory. In 1994, all providers were merged into Telecom Italia. In 1995, a law was approved to create independent regulatory authorities to neutralize political interference in the day-to-day management of public utilities. In 1997, the law on the creation of a sector specific authority for telecommunications was approved and, shortly afterwards, Telecom Italia was privatized by a share offering while new rules on competition were enacted.

It should also be said that in 1992 very significant changes took place at the level of national politics that make 1992 a watershed in Italian history, so that it is common to hold that 1992 marked the end of what was called the 'First Republic'.<sup>268</sup>

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<sup>268</sup> For bibliographical references to studies on the end of the First Republic, see the review article by J. Bull, 'The Roots of the Italian Crisis', 1(1) *South European Society and Politics* (1996). For studies in English, see P. Ginsborg, 'Explaining Italy's Crisis', in S. Gundle and S. Parker (eds.), *The New Italian Republic: From the Fall of the Berlin Wall to Berlusconi* (London: Routledge, 2000); S. Koff and S. Koff, *Italy, From the First to the Second Republic* (Routledge: London, 2000); G. Pasquino and P. McCarthy (eds.), *The End of Post-War Politics in Italy—The Landmark 1992 Elections* (Boulder: Westview, 1993). For academic works in Italian, see G. Sartori, *Seconda Repubblica? Sì, ma bene* (Milano: Rizzoli, 1992); P. Barucci, *L'isola italiana del tesoro – Ricordi di un naufragio evitato 1992–1994* (Milano: Rizzoli, 1995); Cafagna, *La grande slavina*; M. Cotta, 'La crisi del governo di partito all'italiana', in M. Cotta and P. Isernia (eds.), *Il gigante dai piedi d'argilla* (Bologna: Il Mulino, 1996). See also M. Gilbert, *The Italian Revolution—The End of Politics Italian Style?* (Boulder: Westview Press, 1995). See also J. L. Newell, *Parties and Democracies in Italy*

The period studied in this chapter thus poses a key question for path dependence. Given that increasing returns were present (as was established in the previous chapter), how is one to reconcile what ostensibly seems ‘off-path’ change with increasing returns? A common way out of this dilemma would be to call on a *deus ex machina* explanation. One could simply argue that path dependence has nothing to say about the changes in telecommunications institutions because, like an earthquake, the end of the First Republic changed everything, including telecommunications institutions. This would mean discarding increasing returns as irrelevant for the study of institutional reform of Italian telecommunications. The chapter refutes this contention. The central argument of the chapter is that when pressures are sufficient for change to happen, increasing returns remain fully relevant to studying institutional reform.

It is important to state at the outset that the increasing returns discussed in this chapter are the increasing returns detailed in the previous chapter. More specifically, this chapter relies on earlier findings about the mechanisms through which increasing returns arose in the pre-1992 period, i.e. the tight links between elected politicians and telecommunications suppliers. The present chapter shows that these links broke down in 1992-1993 because of developments at the national level caused by the *mani pulite* investigations and the end of the First Republic. By the same token, the increasing returns of the pre-1992 period also ceased to exist. In sum, one could say that the present chapter discusses increasing returns *post-mortem*. But, far from being defunct, the chapter shows that increasing returns (or *past* increasing returns, for the sake of clarity) were very much alive in shaping the institutional trajectory.

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(Ashgate: Aldershot, 2000), ch. 1 ‘The Revolution in Italian politics’ and M. Rhodes, ‘Financing Party Politics in Italy: A case of Systemic Corruption’, in M. Bull and M. Rhodes, *Crisis and Transition in Italian Politics* (London; Portland, Or.: Frank Cass, 1997), 54.

Indeed, the chapter shows that there are two intertwined ways in which past increasing returns affected institutional direction. First of all, increasing returns sparked a process of rejection. Some elected politicians dissatisfied by past increasing returns staged a reaction aimed at designing new institutions in such a way that increasing returns could not operate. They pressed for a logic inspired by the complete separation between suppliers and elected politicians, or a UK-style logic. Thus, these actors were notably in favour of delegation to IRA of sweeping regulatory powers and the creation of an Italian version of Oftel.

The second way in which increasing returns operated was through a counter-reaction to rejection of increasing returns as other elected officials tried to limit the push for embracing the UK-style logic. In particular, they tried to influence proposals for institutional reform in order to limit the loss of power that would have occurred if such a UK-style logic had been embraced in full in re-designing new institutions. In other words, they were in favour of more limited separation between elected politicians and suppliers than in the UK. Thus, through reactions and counter-reactions, the increasing returns shown in the previous chapter remained at the heart of the post-1992 institutional reforms.

It is worth stressing again that increasing returns means *past* increasing returns. That is, elected officials after 1992 did not try to resurrect the ‘old’ increasing returns or to reinstate the same pattern of relationships with suppliers that was the fabrics of past increasing returns. In this respect, when discussing ‘counter-reactions’ the thesis does not argue that elected officials who opposed a UK-style logic of separation claimed a wholesale return to the past. There is no evidence, for instance, that Senator Castelli, who complained that the political power was relinquishing too much power to AGCOM,<sup>269</sup> thought that the

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<sup>269</sup> See *infra*, Section IV.

Minister of Communications should be entitled to hire personnel to rewards 'friends'. Rejection of increasing returns and counter reaction to this tendency thus share a common position in so far as both camps started from the premise that past increasing returns were ended.

However, such past increasing returns influenced both, since the lesson that one group took from their death was that there should be complete separation between suppliers and elected politicians, whereas the others opted for a more limited degree of separation.

The debate between these two groups played out differently on the different institutions that are used as the key units of observations:

- ***Number of providers.*** Past increasing returns centred on the fragmentation of suppliers. Rejection of increasing returns provided a strong and unequivocal impetus for unification. This reform was accomplished between 1992 and 1994, when Telecom Italia was created as the single supplier.
- ***Ownership and allocation of regulatory powers.*** These two features became intertwined because privatization was subject to the creation of a sector specific regulator. The debate on the creation of an IRA was an essential component of rejection of increasing returns. Delegation of powers to an independent body was viewed as a way to impede the resurgence of new increasing returns. However, the degree of independence of the IRA was contested. Thus, the logic of institutional reform of Italian telecommunications did not become apparent in 1997. This justifies extending the inquiry beyond 1997. Privatization, though, occurred in 1997.



- ***Rules on competition.*** Past increasing returns concerned to a lesser degree rules on competition. Moreover, there were strong exogenous factors. Thus, the impact of past increasing returns on the direction of change was more limited. Institutional reforms were accomplished in 1997.

Taken together, these findings show a feature of increasing returns that has so far not received attention by the literature on path dependence, namely the fact that increasing returns can cause reactions by actors and counter reactions. This view can bring a much-needed dose of dynamism to the theory and dispel the tendency towards determinism that is often a criticism of path dependence.<sup>270</sup> Through the case of Italian telecommunications, the chapter shows that increasing returns can have a far richer explanatory power. It encourages focusing more on the empirical evidence before assuming that increasing returns operate only to drive countries along a steady trajectory.

It is also important to clarify that actors' reactions were connected with the end of the First Republic, or a macro-development at the level of national politics. Hence, the chapter shows interactions between different levels of decision making, although the task is not to explain the causes of the end of the First Republic. Rather, in keeping with the focus of the thesis, the present chapter continues to explore whether increasing returns at the national level affected the direction of institutional development and, if so, how and why such changes took place at the national level. The key finding in this respect is that sectoral increasing returns did affect the new direction of institutional development through a series of reactions and counter reactions by actors when major changes took place at the national level. To the extent that these reactions coincided with the end of the First Republic, the latter is relevant for the argument of the thesis.

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<sup>270</sup> See, for instance, Crouch and Farrell, 'Breaking the Path of Institutional Development? Alternatives to the New Determinism'.

This chapter is organized as follows. The first section below sets out the starting point, i.e. the situation of Italian telecommunications institutions at the beginning of the period studied, focusing on the aftermath of the adoption of Law No. 58 of 1992. The following sections trace the trajectory of institutional development and try to connect institutional developments to rejection of increasing returns and counter-reactions to such rejection.

## **II. THE STARTING POINT: LAW NO. 58 OF 1992 AND THE PREMISES FOR THE CONTINUATION OF THE SPLIT-SUPPLIER SYSTEM**

When it was adopted in January 1992, Law No. 58 provided for the transfer of ASST to IRI, subject to a plan by the latter to be approved by CIPE. The IRI/CIPE plan was therefore the centrepiece of the new organization of the sector. Under Law No. 58 this plan could have envisaged several suppliers, i.e. a continuation of the split-supplier system that formed the backbone of the institutional path of Italian telecommunications until then. Indeed, between May and June 1992, the President of IRI (Franco Nobili) and the President of STET (Biagio Agnes) drew up a plan, which was based on a three-company structure.<sup>271</sup> The companies were called with acronyms, Alfa, Beta and Gamma.

- Alfa coincided with SIP and was in charge of telecommunications services within Italy. Alfa could also spin off certain activities into separate companies, such as mobile telephony.
- Beta would be in charge of international and inter-continental telephony services. Beta, in essence, coincided with Italcable.
- Neither Alfa nor Beta included the networks. This was to be the main asset of company Gamma, which would inherit the assets of former ASST, of which it

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<sup>271</sup> See *Il sole 24 ore*, 10.6.1992.

would be a direct successor. Gamma would also encompass the satellites under the control of Telespazio, whereas other activities of Telespazio would be part of another company (Nuova Telespazio). Gamma's shareholders would be Stet and the other two companies (Alfa and Beta), who would be the main users of Gamma's infrastructure.

- Finally, the single management and planning of telecommunications services would be a central remit of Stet, to be exercised through its holding role.

As can be seen, the Nobili/Agnes plan left almost intact the organization of the sector: STET continued to exercise its holding role, while there continued to be at least three different suppliers; ASST would have been 'reborn' as company Gamma, albeit under the control of IRI/STET. In sum, the plan fitted very well in the overall trajectory of the Italian path.

As to the other relevant institutional features, it can be noted that there were plans about opening the supply of mobile telephony to a second operator, thus introducing a degree of competition.<sup>272</sup> However, no concrete steps had been adopted. Moreover, in 1991, Prodi and Prosperetti (both writing in their capacity as representatives of Italian research centre NOMISMA) had advanced the idea of setting up a single regulatory authority for all public services, eminently with price-setting powers.<sup>273</sup> As it was the case for the introduction of competition, these plans also did not yield any concrete result. Finally, privatization had not received consideration in terms of legislative process.

This was the institutional starting point at the beginning of the period studied.

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<sup>272</sup> See, e.g., *Il sole 24 ore*, 18.1.1992.

<sup>273</sup> See *Il sole 24 ore*, 4.2.1991.

### **III. THE REJECTION OF INCREASING RETURNS AND THE BIRTH OF TELECOM ITALIA: 1992-1994**

Elections held in April 1992 had returned an uncertain verdict for the ruling coalition. The DC was still the largest party, although it fell for the first time behind 30%. Moreover, the Socialist Party failed to make any advance relative to the results obtained five years before. By contrast, new political formations reaped a significant share of votes. In particular, the Northern League (Lega Nord) emerged as the fourth party on a national scale and the first party in certain areas of Northern Italy. These electoral results already showed signs of growing unease between the public about the traditional ruling coalition.

The uneasiness only increased with the ‘*mani pulite*’ investigations, which started in 1992 with the arrest of a member of the PSI charged with corruption. A series of depositions by businessmen publicly accused leading political figures.<sup>274</sup> These investigations harmed mostly the Socialist Party and made its leader, Bettino Craxi, unsuitable to become prime minister. Bettino Craxi represented in many ways an embodiment of the increasing returns process.<sup>275</sup> The pact signed between the socialist leader and Arnaldo Forlani, the secretary of the DC, before the 1992 elections, to assign top posts in the government even before elections took place, was emblematic of the way in which political parties had taken control of the state.

Later on, “*mani pulite*” investigations led to the indictment of several protagonists of Italian telecommunications. In May 1993, the head of ASST, Giuseppe Parrella was arrested for having accepted bribes by companies involved with the construction of the telephone

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<sup>274</sup> A caveat is in order with reference to these investigations. The thesis does not discuss whether the people who were investigated were in fact guilty. It is well-known that, in some cases, people have been fully acquitted. The investigations are relevant for the thesis only in so far as they contributed to the rejection of increasing returns. Therefore, the mention of people being investigated does not imply any judgment as to their legal position.

<sup>275</sup> S. Andò, *La resa della Repubblica* (Roma: Koinè Nuove Edizioni, 2006).

network.<sup>276</sup> The investigations uncovered how the money illegally received was then used to finance the electoral campaigns.<sup>277</sup> Mr. Parrella apparently admitted that the money had been paid to the Socialist party, the Christian Democracy, the Republican Party and the Socialdemocratic Party.<sup>278</sup> ASST's role as the hub of a system, which was meant to drain resources from telecommunications in favor of political parties, came fully into light.

The investigations did not stop at ASST, though. The licensees' managers became also involved. A manager of Italtel, a manufacturing company, was accused of bribes.<sup>279</sup> Giuliano Graziosi too, a former head of STET, was placed under investigation.<sup>280</sup> Vito Gamberale, one of the two C.E.O.s. of SIP was arrested, together with the secretary of the socialist party, Giulio Di Donato.<sup>281</sup> In May 1993, the President of IRI, Franco Nobili was also arrested.<sup>282</sup>

The investigations did not spare the Ministry either. Oscar Mammí, a member of the Republican Party, who was Minister of Posts and Telecommunications between 1988 and 1991 in the De Mita and Andreotti (VI) governments, came under investigation in May 1993.<sup>283</sup> Carlo Vizzini, a member of the Social-Democratic Party, who was Minister of Posts

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<sup>276</sup> See *Il sole 24 ore*, 15.5.1993.

<sup>277</sup> See *Il sole 24 ore*, 16.5.1994, 18.5.1993, 19.5.1993, and 22.5.1993.

<sup>278</sup> See *Il sole 24 ore*, 12.6.1993.

<sup>279</sup> See *Il sole 24 ore*, 4.6.1993.

<sup>280</sup> See *Il sole 24 ore*, 27.6.1993. Charges against Giuliano Graziosi have been dropped and he has been cleared of any wrongdoing.

<sup>281</sup> See *Il sole 24 ore*, 1.6.1992, 3.6.1993, 29.10.1993, 5.1.1994. Vito Gamberale was imprisoned. He was later released from prison and charges against him were dropped in their entirety. This was an unfortunate episode from the point of view of administration of justice. However, it is important to remember that the relevance of the episode for the thesis lies in the fact that Mr. Gamberale was considered an appointee of the PSI. This is an objective fact that is independent of any issue of criminal responsibility or lack thereof.

<sup>282</sup> See *Il sole 24 ore*, 13.5.1993.

<sup>283</sup> See *Il sole 24 ore*, 11. 5. 1993, 15. 5. 1993, 16. 5. 1993, 19. 5. 1993, 20. 5. 1993, 22. 5. 1993, 4.6.1993.

and Telecommunications between 1991 and 1992 in the last Andreotti government, came under investigation in June 1993.<sup>284</sup>

The investigations thus exposed the misdemeanours of political parties and telecommunications companies. By discrediting all the protagonists of the 'old' path of Italian telecommunications, *mani pulite* ended elected politicians' unfettered ability to use divisions of spoils (*lottizzazione*) and tariffs to foster their goals. The mechanisms that had generated the pre-1992 increasing returns ceased to operate. These developments in the telecommunications sector occurred at the same time as important events were taking place at the political level.

In 1992, President Scalfaro appointed one of Craxi's closest collaborators, Giuliano Amato, as Prime Minister. The tenure of Giuliano Amato came at an especially critical time. Most of his ministers had to resign because they were caught in the '*mani pulite*' investigations. Giuliano Amato had to face a very serious economic crisis, with public debt mounting out of control and Italy's economy at risk of failing to meet the Maastricht criteria.<sup>285</sup> In addition, brutal mafia killings shocked public opinion when two magistrates were blown up in Sicily.<sup>286</sup>

The extreme gravity of the situation and the weakening of traditional parties gave to Giuliano Amato an opportunity to introduce sweeping institutional reforms. As he stated upon his appointment, Giuliano Amato was determined: "*to change the rules*".<sup>287</sup> His

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<sup>284</sup> See *Il sole 24 ore*, 9.6.1993.

<sup>285</sup> The Amato government used a vote of no-confidence to push through an emergency budget package worth a record L30,000bn. See *Financial Times*, 4.8.1992.

<sup>286</sup> See P. Ginsborg, *Italy and Its Discontents*, 264-267.

<sup>287</sup> See G. Amato, in a *Financial Times* interview, 16.7.1992. See also G. Amato, 'Un governo nella transizione. La mia esperienza di Presidente del Consiglio', *Quaderni Costituzionali*, 3 (1994).

government immediately distanced himself from the traditional party-based allocations of charges when he chose to reduce the cabinet post from a record 32 to 24 portfolios and to appoint six 'technocrats', chosen for their competence and not for party affiliation, including Mr Piero Barucci, the managing director of Credito Italiano, who was given the Treasury Ministry.

The push for institutional reform was especially visible in the economic politics of the Amato government, where he sought to pursue simultaneously economic reform and to restore public morality.<sup>288</sup> On economic reforms, Amato started an ambitious privatisation programme, whose first step was the transformation of state-owned holding companies, including IRI, in joint stock companies. In addition, Giuliano Amato decided to abolish committees and boards in state-controlled entities, including IRI, that were composed of up to 15 political placemen, chosen to reflect the balance of power between the governing parties.<sup>289</sup>

Instead, the new board of IRI would comprise the existing, politically appointed, chairman, with reduced executive power, a new post of managing director (to be filled internally) and a senior civil servant. Future acquisitions, disposals or flotation were to be decided by shareholders' meetings, thus giving the Treasury, as the leading shareholder, the ultimate say. Compared to the earlier situation of *lottizzazione* between political parties, this already meant a higher degree of separation between suppliers and political parties, since the Treasury was trusted for technical independence and, moreover, had a clear mandate to seek

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<sup>288</sup> See *Financial Times*, 29.6.1992.

<sup>289</sup> See *Financial Times*, 12.8.1992.

privatization in order to allay Italy's disastrous budget situation. It is understandable, therefore, that this move was hailed as 'revolution' and 'earthquake' by business circles.<sup>290</sup>

The transformation of IRI into a joint stock company was meant as a facilitating device for privatisation of the operating companies controlled by these entities. As he would put it, this was "... *a machine that will be forced towards privatisation*".<sup>291</sup> The privatization program that was launched was not only an answer to the financial problems of Italian economy, but was also a way to cut off state resources from the parties' hands.<sup>292</sup> In other words, privatization was for Giuliano Amato a political solution to past problems. Taken together, these policies showed a rejection of increasing returns.<sup>293</sup>

The sale of public companies was intended as a source of 'moralization' in the political life because it sought to end the mechanisms that had permitted elected politicians to reap increasing returns and to make it impossible for them to spring up again. Privatization was thus conceived as an explicit reaction to the mechanisms of increasing returns that were common in the pre-1992 period (described in the previous chapter). Furthermore, privatization was part of a push to embrace a UK-style logic, based on separation between suppliers and elected politicians. In this respect, privatization represented a fundamental element in the attempt to substantially alter Italy's trajectory of institutional development in a way that would have made it converge with Britain's.

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<sup>290</sup> See *Financial Times*, 12.8.1992.

<sup>291</sup> See G. Amato, in a *Financial Times* interview, 16.7.1992.

<sup>292</sup> Personal interview senior legislator, April 2002.

<sup>293</sup> See S. Cassese, 'Le privatizzazioni: arretramento o riorganizzazione dello Stato?', *Rivista Italiana di Diritto Pubblico Comunitario*, (1996), 579-90, at 581-2; Cafagna, *La grande slavina*, "Le privatizzazioni, correttamente amministrate, sono non la chiave di volta, ma l'essenza stessa di una moralizzazione politica, unitamente a nuove norme di rigore concorrenziale ... non perché «non si rubi» ... ma perché non si possa più costruire la politica stessa sulla base dell'eccitante possibilità di taglieggiare una base imponente" (emphasis in the original), 176.



Consistent with this policy of rejection of increasing returns, Amato acted to end the split-supplier system too, which was an emblem of political parties' grip over telecommunications institutions. On his appointment as Prime Minister in June 1992, Giuliano Amato took the rather unusual step of directly writing to IRI's president, Nobili, to tell him to delay the plan of a three-company structure until the new government had been formed.<sup>294</sup> Giuliano Amato considered that the three-company structure proposed by IRI was tainted by increasing returns.<sup>295</sup> This structure was too closely modelled on the old system of split-suppliers, where each political party and factions was at home. In contrast, he saw a single supplier as a way to carry out precisely the reform that Giuliano Graziosi had declared impossible because of the opposition of political parties.

Giuliano Amato's determination to create a single supplier as a way of carrying out the policy of rejection of increasing returns had to overcome several obstacles. First, Amato's views were not unanimously shared by other members of his government. In particular, the Minister of Posts and Telecommunications, Maurizio Pagani, a member of the Social Democratic Party, complained about Amato's direct intervention.<sup>296</sup> Indeed, the Minister of Posts and Telecommunications was accused of deliberately trying to sabotage the incorporation of ASST into IRI because he would have lost control of a strategic project to create a dedicated network for business users.<sup>297</sup> Maurizio Pagani promptly dismissed the speculations.<sup>298</sup> However, the fact remained that the Minister of Posts and Telecommunications had an interest in keeping the funds relative to this project

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<sup>294</sup> See *Il sole 24 ore*, 25.6.1992.

<sup>295</sup> See *Il sole 24 ore*, 17.5.1992.

<sup>296</sup> See *Il sole 24 ore*, 30.7.1992.

<sup>297</sup> See *Il sole 24 ore*, 2.12.1992.

<sup>298</sup> See *Il sole 24 ore*, 4.12.1992.

(approximately 1,500 billion lira) within his ministry, rather than surrender them to IRI (and the Treasury Minister).<sup>299</sup>

Second, there was still significant resistance on the part of IRI to abandoning its original three-company structure. In September 1992, IRI put forward a new proposal, which was still based on a split-supplier model.<sup>300</sup> The plan envisaged two companies, one of which would be in charge of services and the other would handle infrastructure. Eventually, though, IRI abandoned its resistance since the complete paralysis of the plan to merge ASST in IRI was putting in danger the latter's shaky financial position. In fact, the Minister of the Treasury, Piero Barucci, pressed for a speedy transfer of ASST to IRI for reasons linked to the latter's economic position.<sup>301</sup> Thus, on December 18, 1992 Biagio Agnes called publicly on Giuliano Amato to take action and ease the deadlock that had halted any plan to reorganize the sector.<sup>302</sup>

After an initial hesitation due to the opposition the plan met,<sup>303</sup> on December 24, 1992 the government declared that ASST had been transferred to IRI by means of the creation of a new company, IRITEL.<sup>304</sup> This marked the definitive end of the split-supplier system as, in the government's intention, the creation of IRITEL as the successor company of ASST was a

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<sup>299</sup> See *Il sole 24 ore*, 9.12.1992 and 16.12.1992.

<sup>300</sup> See *Il sole 24 ore*, 27.9.1992.

<sup>301</sup> See *Il sole 24 ore*, 3.12.1992.

<sup>302</sup> See *Il sole 24 ore*, 18.12.1992.

<sup>303</sup> The Amato government at first took steps to postpone the wind up of ASST. In drawing up the budget for 1993, it was forced to indicate ASST as a separate entity. This fuelled speculation as to the fact that the government was in fact trying to keep ASST alive (see *Il sole 24 ore*, 2.10.1992).

<sup>304</sup> See *Il sole 24 ore*, 24.12.1993.

procedural step towards the creation of a single supplier, by then baptized as “Telecom Italia”.<sup>305</sup>

The role played by rejection of increasing returns cannot be easily dismissed. IRI’s proposals based on separation between network and services were rejected because they would have reproduced the fragmentation of suppliers that was used during the previous period in order to deliver increasing returns for the different parties and factions. Indeed, increasing returns had found an ideal climate to grow in the split-supplier system. By the same token, the wind that turned against increasing returns in 1992 helped end any organization of the sector that was reminiscent of increasing returns. In fact, the single-supplier model was part of the policy fostered by the Amato government of rejecting increasing returns.

The institutional turn was marked by the CIPE deliberation of April 1993, which, implementing Law No. 58 of 1992, drew up a plan for the re-organization of the system. Contrary to the premises that had generated Law No. 58, i.e. the continuation of the split-supplier system, CIPE’s deliberation led to the creation of Telecom Italia, the new single provider.<sup>306</sup> According to the recitals of the deliberation, the creation of a single operator was an “indispensable step” to bring Italy in line with EC and world trends in the sector.<sup>307</sup>

The CIPE resolution further considered that (i) there was a need to find a suitable institutional solution for the regulation of the sector; (ii) there should be a distinction between the ‘reserved’ telecommunications services and telecommunications services open to

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<sup>305</sup> See *Il sole 24 ore*, 30.12.1993.

<sup>306</sup> Comitato Interministeriale per la Programmazione Economica – Deliberazione 2 aprile 1993 “*Determinazione dei criteri generali di riassetto del settore delle telecomunicazioni*” (GURI n. 85, 13.4.1993).

<sup>307</sup> See third recital, lett. c) “[L]’*unificazione in un gestore unico delle società del gruppo IRI, attualmente concessionarie di servizi di telecomunicazione sia un passo indispensabile [...]*”.

competition; (iii) tariffs should be brought in line with costs through a price cap system; (iv) a separation between telecommunications operation and equipment manufacturing was indispensable; (v) finally CIPE also considered that the role of the state as the controlling shareholder, direct or indirect, in the company resulting from the merger of the existing licensees, had to decrease so that the State become a minority shareholder, although a “significant” one.<sup>308</sup>

Based on these premises, CIPE’s resolution called for a) a merger of all existing licensees, including the new company resulting from the winding-up of ASST, IRITEL S.p.A.,<sup>309</sup> b) separation between telecommunications services operated under a concession and other telecommunications services; c) separation between telecommunications services and equipment manufacturing.<sup>310</sup>

The CIPE resolution requested IRI, the Minister of Posts and Telecommunications, the Minister of the Treasury, the Minister for the Reorganization of State Holdings,<sup>311</sup> the Minister of Economic Planning, and the commission in charge of the evaluation of ASST

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<sup>308</sup> See recitals 4 - 8, lett. d) – e), h): “d) [I]n armonia a quanto verificatosi negli altri paesi europei, si debba dare una nuova definizione del soggetto regolatore del sistema delle telecomunicazioni; e) [L]a gestione dei servizi di telecomunicazione debba essere condotta in modo tale da consentire trasparenza tra le attività svolte in regime di concessione esclusiva e quelle svolte in altri regimi di autorizzazione o di concorrenza; [...] h) [L]a presenza dello Stato, diretta o indiretta, quale azionista di controllo del gestore unico debba gradualmente ridursi fino a restare minoritaria ma comunque significativa”.

<sup>309</sup> IRITEL S.p.A. formally began operating on January 1, 1993 pursuant to the terms of the licence granted by the Minister of Posts and Telecommunications, as provided for by article 1, para. 1, of law No. 58 of 1992. See Ministero delle Poste e delle Telecomunicazioni Decreto 29 dicembre 1992 “Concessione in esclusiva alla società Iritel dei servizi di telecomunicazioni ad uso pubblico attualmente gestiti dall’ASST e dall’Amministrazione delle poste e delle telecomunicazioni ed approvazione della relativa convenzione tra il Ministero delle poste e delle telecomunicazioni e la società Iritel” (GURI n. 306, 31.12.1992).

<sup>310</sup> See CIPE Delibera, nn. 1)-3).

<sup>311</sup> The Minister of State Holdings had been abolished by a referendum in 1993 (see *Il sole 24 ore*, 20.4.1993).

assets under law No. 58 of 1992, to undertake the necessary steps to implement the above.<sup>312</sup>

In furtherance of these provisions, on June 30, 1993 IRI S.p.A.<sup>313</sup> proposed a plan for the unification of the existing providers, including IRITEL S.p.A.<sup>314</sup> The Minister of Posts and Telecommunications, acting together with the Minister of the Treasury, the Minister for the Reorganization of State Holdings and the Minister for Economic Planning approved IRI's plan in August 1993, subject to the condition that the single concessionaire be privatized, so as to reduce state ownership below 51%, albeit retaining a golden share.

After the approval of the government, the boards of IRI, STET and the licensees worked to implement the merger.<sup>315</sup> In March 1994, the boards of the five concessionaires voted in favour of the merger.<sup>316</sup> After a slight delay for the shareholders meeting, all the necessary procedures were completed. On August 10, 1994, the Antitrust Authority gave its approval to the merger, however warning at the same time that the creation of a single operator had to be accompanied by an adequate re-regulation of the sector, aimed at the

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<sup>312</sup> “[Il Cipe invita] a) Il Ministro del tesoro, in quanto azionista unico dell’IRI S.p.A., a far sì che tale piano di riassetto sia presentato entro il 30 giugno 1993; b) il Ministro delle poste e delle telecomunicazioni, d’intesa con il Ministro del tesoro, con il Ministro per le funzioni connesse con il riordino delle partecipazioni statali e con il Ministro del bilancio e della programmazione economica, ad accertare, entro i trenta giorni successivi, la rispondenza di tale piano alle condizioni espresse nella delibera stessa; c) la commissione di cui all’articolo 3, comma 2, della citata legge 29 gennaio 1992, n. 58, ad anticipare al 31 dicembre 1993 il termine previsto per la valutazione definitiva del complesso aziendale ex Azienda di Stato per i servizi telefonici (ASST) e amministrazione PPTT, oggetto di trasferimento della società controllata totalitariamente dall’IRI ...”.

<sup>313</sup> See *Il sole 24 ore*, 1.7.1993.

<sup>314</sup> Taking into account that the implementation of the measures contained in the deliberation was going to carry on until 1994, CIPE also invited the Minister of Post and Telecommunications to prolong IRITEL concession, which was due to expire at the end of 1993. With a decree dated December 22, 1993 “*Proroga della concessione per l’affidamento in esclusiva alla Iritel S.p.A. dei servizi di telecomunicazioni ad uso pubblico e approvazione della relativa convenzione tra il Ministero delle poste e delle telecomunicazioni e la società Iritel*” (GURI n. 305, 30.12.1993), the Minister complied with CIPE deliberation, renewing the concession until December 31, 1994.

<sup>315</sup> See *Il sole 24 ore* 7.9.1993, 10.9.1993, and 11.9.1993.

<sup>316</sup> See *Il sole 24 ore* 20.3.1994.

creation of a level-playing field.<sup>317</sup> On August 18, 1994, the shares of Telecom Italia began trading on the stock exchange.<sup>318</sup>

#### IV. REACTIONS AND COUNTER REACTIONS: THE LAW ON INDEPENDENT AGENCIES (1995) AND THE BIRTH OF AGCOM (1997)

The creation of a single provider was the first step in a more general plan born out of rejection of increasing returns, aimed at changing the direction of Italy's institutional trajectory according to a UK-style logic. Another key component of this plan was the creation of IRAs.<sup>319</sup> By being separated from government and removed from political pressures, these agencies were seen as a complement to privatization in the attempt to cut off parties' hands from telecommunications providers' resources.<sup>320</sup> Together with privatization, the reform to create a single supplier and the plans to create an IRA formed the cornerstones of a transition to a different logic of institutional development so much changed from the previous one that it envisaged a convergence with Britain, whose logic had been at cross-purposes with Italy's until then.

Plans to create IRAs were already aired during the Amato government. The Amato government, though, ended in April 1993 and was replaced by a government led by Carlo

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<sup>317</sup> See the decision approving the merger, No. C1454, *Costituzione Telecom Italia* and the advice sent to the President of the Council of Ministers and the Minister of Posts and Telecommunications on the same subject, No. AS27, *Gestore Unico Telefonía*, both published in *Bollettino* 32-33/1994.

<sup>318</sup> See *Il sole 24 ore*, 20.3.1994.

<sup>319</sup> See *Il sole 24 ore*, 9.4.1993 and 14.4.1993.

<sup>320</sup> See S. Cassese, hearing before the I Commission of the Chamber of Deputies on March 24, 1999, Inquiry on Independent Administrative Authorities (available through the Chamber's web site [http://legislature.camera.it/chioschetto.asp?content=/\\_dati/leg13/lavori/stencomm/tabindag.htm](http://legislature.camera.it/chioschetto.asp?content=/_dati/leg13/lavori/stencomm/tabindag.htm)). See also S. Cassese, 'Chi ha paura delle Autorità indipendenti?', *I(3) Mercato Concorrenza Regole* (1999), 471-3, at 472, where he argued that independent regulatory authorities were the product of the rejection against the appetite of political parties ("*i partiti piglia-tutto*").

Azeglio Ciampi, the governor of the bank of Italy.<sup>321</sup> The appointment of Carlo Azeglio Ciampi in itself was a 'revolution' of sorts. Carlo Azeglio Ciampi was the first prime minister to be a non-parliamentarian. Contrary to the long respected custom of holding meetings with party leaders, President Scalfaro appointed Carlo Azeglio Ciampi with no prior consultation with political parties.<sup>322</sup>

On being appointed, he stated that his government would try to respond to the desire for change that Italy had showed through the referenda held in 1993.<sup>323</sup> The referenda were another sign of rejection of increasing returns. They were promoted by Mario Segni, a member of the DC and the son of a former president of the Republic. Segni broke ranks with its former party and championed a movement of reform. This movement promoted referenda as a way to give a direct voice to the citizens. The movement capitalized on the sense of uneasiness against the established power of political parties and the way in which they used state resources.

Segni's Pact mobilized an heterogeneous coalition (Liberals, Republicans, Radicals and Communists as well as associations of civil society, including the Italian Association of Christian Workers, the National Association of Women Electors, the Italian Catholic University). The amalgam between the various constituencies was indeed the reaction

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<sup>321</sup> In 1994, Giuliano Amato became president of the Italian Antitrust Authority. During his tenure, lasting until 1997, the Authority was extremely active in investigating Telecom Italia's behaviour (3 investigation for abuse of dominant position were opened in 1995, another one was opened in 1996 alongside one for a cartel offence; in 1997, other two important abuse of dominant position cases were opened). Furthermore, the Authority issued several advices to the government on the implementation of the European regulatory framework and the promotion of competition. See AGCM Annual Reports.

<sup>322</sup> See *Il sole 24 ore*, 27.4.1993.

<sup>323</sup> See *Il sole 24 ore*, 27.4.1993.

against increasing returns “to remove the sources of patronage, and undercut the power bases, of the established political parties”.<sup>324</sup>

The referenda included, inter alia, the following.<sup>325</sup>

- ***The reform of the electoral law.*** The electoral law then in force was based on the proportionality principles. The referendum campaign characterized the proportional system as one of the chief causes for increasing returns. By preventing the emergence of a clear majority, the proportional system was conducive to coalition governments, based on unstable alliances, which came at the price of intensive use of state resources to preserve electoral base. Therefore, the promoters of the referendum saw a majoritarian system as antidote to increasing returns.
- ***The financing of political parties.*** This issue was at the heart of increasing returns. The public outcry that surrounded the abuses of political parties fuelled much of the campaign. The referendum proponents vehemently campaigned for the abolition of the existing laws.
- ***The abolition of the Ministry of State Holdings.*** Finally, the abolition of the Ministry for State Holdings is very relevant for increasing returns rejection. This Ministry was formally charged with the mission of managing the state participations in limited liability companies such as the licensees. As such, it was one of the key ‘infrastructures’ of increasing returns. Through this ministry, political parties controlled directly state resources and could direct

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<sup>324</sup> See Bull, *Parties and Democracy in Italy*, 96.

<sup>325</sup> There were eight referenda in total.



investments to their ends. The abolition of this Ministry by a 'yes' vote was therefore part and parcel of the broad movement against increasing returns.

The popular verdict on these issues was, therefore, an occasion to 'moralize' public life, embrace change and to denounce the old system based on increasing returns.<sup>326</sup> The results exceeded even the most optimistic expectations of the pro-change front (i.e. the yes movement). The average turnout was 77%. The referendum on the electoral law saw the yes reaching 82.7%. The majority for ending state subsidies to political parties was higher still: 90.3%. This was perhaps the most open condemnation of increasing returns. The result was interpreted unambiguously as 'punishment' for the past practices and in particular for the use of state resources through control of state-owned companies. Finally, the referendum on the abolition of the Ministry of State holdings also obtained an overwhelming 90%.

Probably one of the most eloquent testimonies on the meaning of the referenda for the mechanism of increasing returns which had prevailed in the period until 1992 was Giuliano Amato's speech to the Chamber of Deputies on April 22, 1993. As he tendered his resignation, Giuliano Amato asserted that the referenda had brought to an end the party-state model that had been in force in Italy since 50 years.<sup>327</sup>

At the same time, the '*mani pulite*' investigations reached a climax. In October 1993, the first hearing in the judgment against Sergio Cusani was televised and it obtained a record share of audience. The judgment concerned an alleged bribe paid by the Enimont group to

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<sup>326</sup> See J. Newell and M. Bull, 'The Italian referenda of April 1993: real change at last?', *Western European Politics*, (1993), 607-615; P. Corbetta and A. Parisi, 'The referendum on the electoral law for the Senate: another momentous April', in C. Mershon and G. Pasquino (eds.), *Italian Politics—Ending the First Republic* (1995), 88.

<sup>327</sup> The Amato government ended on April 28, 1993.

political parties and an impressive number of political leaders were called to testify (Craxi, Forlani, Altissimo, La Malfa, Martelli, Vizzini, and Cirino Pomicino).<sup>328</sup>

The Ciampi government therefore took place at a time of rejection of increasing returns and continued the efforts to this effect started by the Amato government. The budget was approved by the council of ministers “without any party intermediation”, as the Prime Minister stated,<sup>329</sup> and one of the key points in the Ciampi government’s economic policy was the privatization programme. This involved by and large IRI’s companies. Due to its level of indebtedness, the State was forced to inject new financial resources into IRI. However, this action attracted criticism from the European Commission, which regarded the contributions as illegal aid prohibited under the EC Treaty. In July 1993, the then Minister of Foreign Affairs, Beniamino Andreatta and European Commissioner for Competition, Karel Van Miert, agreed on a compromise solution which involved a privatization plan that had a large impact on IRI’s holdings and specifically included the privatization of IRI’s telecommunications business, besides an obligation on the Italian government to report at periodic intervals on the debt level and action taken to lower the state involvement.<sup>330</sup>

The tenure of the Ciampi government saw the first signs of a counter reaction against rejection of increasing returns that limited change in the institutional trajectory and, more precisely, opposed the creation of IRAs. It should be stated that pre-1992 mechanisms of increasing returns had been completely discredited and no one advocated a wholesale restoration of *lottizzazione*. However, at a time of institutional reform, the push for a UK-style design of the new institutions brought forward by the Amato government met with

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<sup>328</sup> See, e.g., *Il sole 24 ore*, 7.12.1994. See also P. Pamparana, *Il processo Cusani* (Milano: Mondadori, 1994).

<sup>329</sup> See *Il corriere della sera*, 6.9.1993.

<sup>330</sup> See *Il sole 24 ore* 30.7.1993, 11.1.1994. See also Thatcher, *Internationalisation and Economic Institutions*, 193 and 195.

opposition from those who stood to lose from this change. It is worth recalling that a few days after passing the 1993 CIPE resolution on the merger of telecommunications providers, the council of ministers presided by Giuliano Amato had approved a bill to create independent regulatory authorities.<sup>331</sup>

However, ministerial bureaucracies saw the new authorities as a direct threat to their powers.<sup>332</sup> Ministerial bureaucracies thus reacted against the proposal to create independent regulatory authorities, representing a counter reaction to rejection of increasing returns. The Industry Minister, Paolo Savona, openly opposed the creation of independent regulatory authorities to govern tariff setting. He rather preferred to see his ministry officials continue to handle this matter.<sup>333</sup> In addition, the Minister of Posts and Telecommunications also

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<sup>331</sup> See *Il sole 24 ore*, 21.4.1993.

<sup>332</sup> See *Il sole 24 ore*, 21.4.1993 (“... *E non é un caso se le resistenze a un approccio più radicale si sono fatte sentire fino all'ultimo proprio da parte delle nomenclature ministeriali (prima fra tutte quella del ministero dell'Industria ... Esce così ridimensionato il ruolo delle Autorità rispetto all'originario disegno del Governo Amato: dovevano fissare e aggiornare <i parametri di riferimento per la valutazione della congruità dei prezzi e delle tariffe>, ma si limiteranno più genericamente a <valutare le condizioni generali di contratto>. Garantiranno la tutela degli interessi degli utenti, la qualità delle prestazioni erogate, l'effettiva competitività allargando il mercato ove possibile, maggiore efficienza, sviluppo di nuove tecnologie. Sono disegnate più come un osservatorio per la trasparenza che come un vero regolatore con poteri di intervento*”).

<sup>333</sup> See *Il sole 24 ore*, 16.10.1993 (“*La rivoluzione nel sistema tariffario per i servizi pubblici ha finora diviso il Governo: il presidente del Consiglio conferma l'orientamento espresso già nell'intesa del 3 luglio, ma il titolare dell'Industria ha più volte osteggiato la scelta di creare un'autorità esterna per governare le dinamiche tariffarie e, quindi, anche il meccanismo del price cap (che lega l'incremento di prezzo a precisi andamenti della produttività e della qualità e non solo, come è sempre avvenuto in passato con il sistema dei rimborsi a piè di lista per i diversi gestori, all'andamento dell'inflazione puro e semplice). Per Paolo Savona meglio sarebbe utilizzare la struttura interna al ministero senza abolirla del tutto. Un emendamento alla legge finanziaria prevede l'introduzione del price cap, mentre per la costituzione dell'autorità é in atto una mediazione della commissione Attività produttive della Camera*”-emphasis supplied). See also *Il sole 24 ore* 11.10.1993 and 26.9.1993 (“*Il titolare dell'Industria, pur precisando che una decisione finale in materia sarà presa dai ministri competenti entro un mese, non ha nascosto la sua contrarietà all'istituzione di Authority di controllo dei servizi a rete nel timore che ciò possa dar luogo a una duplicazione delle strutture e ha invece caldeggiato il rafforzamento delle competenze dell'Antitrust e l'organizzazione, nei diversi ministeri, di unità di vigilanza sulla qualità e le tariffe dei servizi*”).

opposed this proposal and entrusted to a group of his officials the task of reviewing tariffs.<sup>334</sup>

Thus, during the Ciampi government the creation of independent regulatory authorities did not move forward, in spite of the fact that a law approved on December 24, 1993 gave to the government delegated powers to set up “*organismi indipendenti per la regolazione dei servizi di rilevante interesse pubblico*”.<sup>335</sup>

Although plans to create an IRA were adamantly opposed from ministerial bureaucracies, this was a case of turf-war within the public administration. From the point of view of increasing returns, it is more important to examine the opposition that was brought by elected politicians.

General elections took place in 1994 that saw a victory for Silvio Berlusconi's new political creation, the Forza Italia party. The victory of Forza Italia and the rise of the Lega Nord also show the extent of rejection of increasing returns in political life. The 1994 general elections were the first elections after the end of the First Republic and the referendum of 1993. Old political parties, i.e. the protagonists of increasing returns, disappeared from the scene completely. On the other hand, the victory of Forza Italia, Silvio Berlusconi's party, can also be interpreted as a sign of rejection of increasing returns.

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<sup>334</sup> See *Il sole 24 ore*, 1.10.1993 (“*In questo spirito il Governo Amato aveva presentato un progetto di legge che istituiva le cosiddette <Authority>. E in questo spirito Ciampi, nelle dichiarazioni programmatiche, aveva parlato su questo tema di una <continuità d'azione> con il Governo precedente. Ma contro questo spirito il ministro dell'Industria, Paolo Savona, sostiene, senza essere smentito da Palazzo Chigi, di preferire soluzioni "ministeriali". E contro questo spirito il ministro delle Poste Maurizio Pagani ha messo in cantiere una regolamentazione delle tariffe telefoniche affidata a un organo ministeriale*”-emphasis supplied).

<sup>335</sup> See Law No. 537 of 1993, *Interventi Correttivi di Finanza Pubblica*, “*Art. 1 (Organizzazione Della Pubblica Amministrazione). 1 . Il governo è delegato a emanare, entro nove mesi dalla data di entrata in vigore della presente legge, uno o più decreti legislativi diretti a: a) riordinare, sopprimere e fondere i ministeri, nonché le amministrazioni ad ordinamento autonomo; b) istituire organismi indipendenti per la regolazione dei servizi di rilevante interesse pubblico e prevedere la possibilità di attribuire funzioni omogenee a nuove persone giuridiche ...*” (GURI n. 303, 28.12.1993).

In his first speech as Prime Minister, Silvio Berlusconi underlined how his government stood for change and renewal. As Silvio Berlusconi stated: *“il rispetto per la tradizione repubblicana ... non deve essere usato impropriamente come un freno a quell’opera di profondo cambiamento e rinnovamento che la nostra gente ci chiede con urgenza e passione e che i cittadini hanno tutto il diritto di aspettarsi da chi li rappresenta nel governo della nazione ... Una delle fondamentali caratteristiche della maggioranza che oggi dà vita alla nuova compagine ministeriale è sotto gli occhi di tutti: le forze che sostengono questo governo non stanno insieme per una qualche alleanza o alchimia decisa nelle sedi dei partiti...il nostro stato d’animo é quello di persone che, esperte più della vita e delle sue durezze che non delle malizie della politica di palazzo, sanno tuttavia che le istituzioni e lo Stato sono la casa in cui si specchia la società”*.<sup>336</sup>

Furthermore, the success of Forza Italia cannot be explained without reference to the ‘1992 Revolution’. As McCarthy has argued, *“the Berlusconi phenomenon cannot be reduced to a television ‘Blitzkrieg’ ... Rather it reflects the response to the crumbling of the state ... In a crisis caused by the political class’s invasion of economic territory, a businessman won out by boldly invading the territory of politics ...”*.<sup>337</sup>

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<sup>336</sup> See S. Berlusconi, *Discorsi per la democrazia* (Milano: Mondadori, 2001), speech of May 16, 2004, 18. “Respect for the republican tradition ... should not be used improperly as a brake on the process of deep change and renewal that our people demand with urgency and passion from us and that citizens can rightfully expect from their representatives in the govern of the nation ... One of the fundamental characteristics of the majority that today takes government responsibility is before everybody’s eyes: the forces that back this government are not bound together by alchemy or alliance decided in the seat of political parties ... our attitude is that of people that, expert more about life and its hardships than about the cunningness of palace politics, are aware of the fact that the institutions and the State are the home in which our society is mirrored”.

<sup>337</sup> P. McCarthy, ‘Forza Italia–The new politics and old values of a changing Italy’, in S. Gundle and S. Parker (eds.), *The New Italian Republic* (London: Routledge, 1996), 133-4.

The ability to capitalize on distrust of old parties by new formations is also of the key factors behind Lega Nord's success.<sup>338</sup> Lega Nord's main political claim was a rebellion against old parties, an open condemnation of the systemic corruption and a call to the electorate to break this system.<sup>339</sup> Lega Nord identified the North of Italy with the "healthy" part of the country, where people produced and contributed actively to Italy's prosperity. In contrast, it pitted the 'good' North against the 'bad' South, and most importantly, against the political parties based in Rome, bent on squandering tax payers' money, i.e., according to the Lega, the money of the industrious people of the North.<sup>340</sup>

With his characteristic belligerence, in 1993, Lega leader Umberto Bossi wrote in the introduction to his book "La rivoluzione": *"Il regime dei partiti sta crollando, la rivoluzione è alle porte. La Lega si batterà per una svolta pacifica, ma molto dipende dalle scelte dell'oligarchia che dopo mezzo secolo di dominio incontrastato sull'intero Paese è ancora asserragliata nei palazzi del potere, come la corte francese alla vigilia del 1789 ... La Lega Nord ... ha aperto la strada ai magistrati ed ha reso possibile una prima bonifica della nomenclatura ... La notte è scesa sulla Prima Repubblica e del buio approfittano trasformisti di tutte le risme, cascami della partitocrazia abbattuta"*.<sup>341</sup>

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<sup>338</sup> On the Lega, see, e.g., T. Gould, *The Lega Nord and Contemporary Politics in Italy* (London: Palgrave, 2003).

<sup>339</sup> See Cafagna, *La grande slavina*, 135.

<sup>340</sup> See Bull, *Parties and Democracy in Italy*, "By claiming that the larger proportion of the total tax take needed to finance public expenditure necessarily came from the richer North, and by blaming the inefficiency of public services on the efforts of a corrupt, party-dominated bureaucracy in far-away Rome to maintain its clientele-based power in an underdeveloped South, the League was able to tie small-business discontents firmly to its own autonomist concerns" (77-8).

<sup>341</sup> See U. Bossi, *La rivoluzione* (Milano: Sperling&Kuper, 1993), 1. "The parties' regime is about to collapse, revolution is at the doorstep. Lega will fight for a peaceful transition, but this depends on the oligarchy that after half a century of unchallenged domination over the entire country is still holding on in the palaces of power, like the French court on the eve of 1789 ... Lega Nord ... has opened the way to magistrates and made possible a first cleansing

He then went on to describe the ‘moribound’ old guard and how the Lega vindicated the right of Italians, or, in his own words, how “... *la Lega liquidò i vecchi gerarchi del regime ...*”, only to conclude that “*tutto questo [the end of the First Republic] é avvenuto grazie alla Lega*”.<sup>342</sup>

Finally, he portrayed the Lega has the force that could bring about a pacific revolution and so lead to a complete demise of increasing returns, not without using a menacing tone and warning that “*coloro che rendono impossibile una rivoluzione pacifica, renderanno inevitabile una rivoluzione violenta*”.<sup>343</sup> In terms of economic policy, it is interesting to note that Bossi sided with the policy of privatization of the Amato government. He saw ‘the retreat of the State’ as a policy of the Lega because of its ‘moralizing’ effects on the way in which the economy was run.<sup>344</sup>

In spite of the fact that rejection of increasing returns played a prominent role in the 1994 elections, the period that followed saw a strong counter reaction to rejection of increasing returns by elected politicians. As shown in the previous chapter, in the pre-1992 period, elected politicians used telecommunications companies to enjoy increasing returns. The means through which they obtained this result, such as *lottizzazione*, became the object of public scorn and were ended. At the time of re-designing the new institutions for the telecommunications sector, while some elected politicians, such as Giuliano Amato, were in favour of severing all links between elected politicians and suppliers, other elected politicians disliked this proposal and pressed for the introduction of new means through which they could control suppliers. When the law on creation of IRAs in Italy was discussed, the

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of the nomenklatura ... The night has fallen on the First Republic and in the dark transformists of all kinds, the remains of the old partitocracy, try to take advantage”.

<sup>342</sup> Ibid., 3 and 5.

<sup>343</sup> Ibid., 17.

<sup>344</sup> Ibid., 185-187.

contrast between proponents of separation between elected politicians and suppliers and those who sought to retain a degree of control emerged.

IRAs were the centrepiece of the attempt that had started during the Amato government to bring about change in Italy's institutional trajectory by embracing a UK-style logic, based on full separation between suppliers and elected politicians. They were the embodiment of this new logic, since their mandate was premised on delegation from elected politicians, which thus ended the latter's involvement with the day-to-day operation of suppliers. In contrast, some elected politicians pressed for retaining a measure of political control over IRAs. They therefore tried to push through amendments to the UK-style model of IRA independence. This can be shown by tracing closely the passage of the bill to create independent agencies through Parliament between 1994 and 1995.

After the 1994 elections, the Berlusconi government took office on May 10, 1994 and promised to carry on the economic reforms that had been initiated by the Amato and Ciampi governments. However, this government envisaged a reduced role for independent agencies. In particular, the Berlusconi government favoured the ministerial appointment of the authorities' heads and asserted the government's prerogative over tariffs.<sup>345</sup> Moreover, one of the parties, which formed the ruling coalition, Alleanza Nazionale, saw a very limited role for independent agencies. Gaetano Rasi, Alleanza Nazionale's representative in charge of economic affairs, maintained that independent agencies should focus on consumer satisfaction and not on tariff setting.<sup>346</sup>

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<sup>345</sup> See *Il sole 24 ore*, 2.9.1994.

<sup>346</sup> See *Il sole 24 ore*, 13.10.1994.



The Berlusconi government attempted to push through the bill on independent agencies through delegated legislation,<sup>347</sup> but there were significant delays.<sup>348</sup> By law, the creation of regulatory agencies was a legal condition for privatization. This is because under law No. 474 of 1994, sale of shares in company under state control that supply public utility services – defined as “*defence, transports, telecommunications, sources of energy, and other public services*” - were subject to the set up of independent bodies vested with the task of setting tariffs and overseeing quality of services.<sup>349</sup> The delay in the legislative process concerning regulatory authorities was therefore particularly unwelcome for its impact on the privatization plan. In particular, these delays prevented the long-awaited privatization of Enel and Stet, whose proceeds were regarded as a very important element in the plan to cut the deficit. The government therefore opted for a different route. Namely, it sponsored a bill introduced by Filippo Cavazzuti in June 1994, a senator belonging to the opposition.<sup>350</sup> This initiative shows that the coalition promoting rejection of increasing returns was heterogeneous and, most importantly, subject to sudden shifts. Indeed, it would seem a rather odd course of action for the government to back a bill proposed by a member of the party in

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<sup>347</sup> See *Il sole 24 ore*, 2.9.1994.

<sup>348</sup> See *Il sole 24 ore*, 17.11.1994. In 1993, the bill was effectively introduced at the same time as the privatization process (*disegno di legge n. 2579*). The relevant Committees in the Chamber of Deputies (Commissione 9<sup>a</sup> and Commissione 10<sup>a</sup>) carried out a number of meetings and adopted a text in November 1993. However, during the passage of the 1994 budget, the Parliament approved a measure that empowered the government to pass legislation with a view to set up “*independent authorities for the regulation of services of relevant public interest and assign functions to new legal entities*” (para. 1). Once approved as law n. 537 of 1993, this provision superseded the bill and therefore the Committees stopped their work.

<sup>349</sup> GURI n. 177, 30.7.1994. See Article 1-bis: “*Le dismissioni delle partecipazioni azionarie dello Stato e degli enti pubblici nelle società di cui all'articolo 2 sono subordinate alla creazione di organismi indipendenti per la regolarizzazione delle tariffe e il controllo della qualità dei servizi di rilevante interesse pubblico*”.

<sup>350</sup> Senato della Repubblica – XII Legislatura, Disegno di legge Cavazzuti e a., n. 359, “*Norme per la concorrenza e la regolazione dei servizi di pubblica utilità. Istituzione dell’Agenzia di regolazione dei servizi di pubblica utilità*”, June 1, 1994.

opposition. Yet, the alignments on the issue of increasing returns were different from party allegiances.

The bill by Senator Cavazzuti envisaged three authorities (energy, telecommunications and transport). Each authority would be a collegial body, composed of three members. The power of appointment of the members was the bone of contention between those who pursued rejection of increasing returns and the coalition who sought to preserve the power of elected politicians. Under a UK-style logic of separation, IRAs should be as distant from government as possible in order to guarantee effective independence from political power. In this respect, it can be noted that in 1994 Sabino Cassese, speaking about Consob's independence,<sup>351</sup> underlined that it is essential that the government does not hold the power of appointment to ensure that the authority is really independent from political influence. A solution in line with this principle, Cassese argued, was the one adopted for the Italian Competition Authority. Under Law No. 287 of 1990, the President and the Commissioners are appointed by the head of the two chambers. In spite of being elected politicians, the presidents of the two chambers are regarded as figures commanding high respect to be acceptable to both the majority and the opposition. They can therefore be trusted to act in furtherance of objective criteria. To entrust appointment in their hands was thought as a way to guarantee a high measure of independence. On the contrary, the opponents of rejection of increasing returns favoured giving the power of appointment to the government as the ideal avenue through which the government could continue to control an important policy outlet.

The Cavazzuti bill was already a compromise between these two tendencies. On the one hand, the Industry Minister had the power to appoint IRA's members, acting upon a

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<sup>351</sup> See *Il sole 24 ore*, 8.6.1994.

binding opinion from Parliamentary committees, voting with a two-third majority.<sup>352</sup> On the other hand, IRA's members could not hold office as elected officials nor serve in political parties. In any event, the progress of the bill was halted by a government crisis. Silvio Berlusconi tendered his resignation and a new government presided by Lamberto Dini took over on January 17, 1995. Lamberto Dini, who had served as Treasury Minister in the Berlusconi government, announced the government's intention to accelerate privatizations.<sup>353</sup> Given the link between privatization and authorities, this meant that the government would press for speedy approval of the law on independent agencies. However, the bill would only become law in November 1995.

There were several reasons for the long and tortuous march of the bill (no less than three thousand amendments were made).<sup>354</sup> First of all, being opposed in principle to privatization, Rifondazione Comunista staged a ferocious opposition against the bill, engaging in deliberate obstructionism.<sup>355</sup> Secondly, the original bill was meant to include not only telecommunications, but also media among the regulated sectors. Forza Italia, Silvio Berlusconi's party, was against anything, which could impinge on the stakes of Silvio Berlusconi in the media sector and therefore also opposed the bill. Thirdly, it should not be forgotten that the Dini government was an emergency government. It was not backed by a solid parliamentary majority. In fact, it derived its support from the losers of the 1994

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<sup>352</sup> See *Il sole 24 ore*, 24.11.1994 and 27.11.1994.

<sup>353</sup> See *Il sole 24 ore*, 24.2.1995.

<sup>354</sup> See *Il sole 24 ore*, 10.11.1995.

<sup>355</sup> The main reason behind Rifondazione's opposition was precisely the fact that the bill paved the way for privatization of public utilities companies, a policy that run against Rifondazione's vision on how to best protect the interest of consumers. Rifondazione Comunista tabled hundreds of amendments and consistently antagonised with the government and the rest of the ruling coalition on privatisation. See *Il sole 24 ore*, 2.3.1995, 16.3.1995, 17.5.1995, 18.5.1995, 29.6.1995, 30.6.1995, 20.7.1995, 1.8.1995, 5.8.1995, 6.8.1995, 7.9.1995, and 9.9.1995.

elections. Its duration was therefore limited and so was its mandate and its ability to push through reforms.<sup>356</sup>

There was only very little conflict during the first reading of the bill in the Senate. The only significant amendment in this respect was presented by Senator Franco Debendetti, a member of the left-wing PDS party. The amendment reinforced the Parliament's control over privatization.<sup>357</sup> The passage of the bill through the Chamber of Deputies was significantly longer and more difficult.<sup>358</sup> What's more, at several instances the conflict surfaced between the proponents of a UK-style logic and those who militated in favour of a more limited separation between suppliers and elected politicians.

In particular, amendments were tabled to protect the interests of elected officials, such as an amendment by a Forza Italia deputy to render the authorities akin to consumer protection's bodies.<sup>359</sup> Further, the conflict between the two logics became clear when the debate in the Chamber focused on the power of appointment.<sup>360</sup> The two options before the deputies, i.e. appointment by the presidents of the two chambers or a mechanism, which would give power to the government after a binding opinion from Parliament, represented well the different sides. On the one side stood those who had in mind the UK-style logic of separation and hence preferred to see an IRA as independent as possible from elected

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<sup>356</sup> The Dini government ended with the 1996 elections, which saw a victory for the centre-left coalition. Romano Prodi became prime minister and held his post until 1998.

<sup>357</sup> See *Il sole 24 ore*, 14.3.1995, 15.3.1995 and 16.3.1995.

<sup>358</sup> One of the reasons for this delay was due to the fact that bill also concerned the powers of the telecommunications regulator, whose set up was to follow shortly after that of the energy one (already provided for by the bill), over the media. Forza Italia MPs, together with members of another centre-right party (the Centro Cristiano Democratico) requested that provisions on the media sector be carved out and dealt with separately from telecommunications (See *Il sole 24 ore*, 30.4.1995). The same request, albeit for different reasons, also came from Giorgio Napolitano, a member of the PDS party, who chaired a commission entrusted with an inquiry into the media sector.

<sup>359</sup> See *Il sole 24 ore*, 7.4.1995 and 8.4.1995.

<sup>360</sup> See *Il sole 24 ore*, 27.4.1995.

officials. On the other side were those jealous of elected politicians' powers, who sought to retain a sizeable share of those powers, thus promoting a more limited solution in contrast to the UK logic.

The latter option had the backing of the centre-left, Lega and Rifondazione Comunista and was inserted in the bill.<sup>361</sup> In contrast, appointment by the presidents of the two chambers was favoured by Alessandro Rubino and Sante Perticaro, both Forza Italia's deputies.<sup>362</sup> This further underscores that the divisions between those who pursued rejection of increasing returns and those who tried to keep powers of elected politicians were continuously shifting and sometimes varied from one deputy to another. The conflict increased and Alleanza Nazionale also joined the fray. Alleanza Nazionale MPs argued that the authorities were a useless duplication since ministries were already equipped to carry out the tasks that were supposedly to be entrusted to authorities.<sup>363</sup> Alleanza Nazionale intervention brought into the debate the other source of conflict, i.e. that of ministerial bureaucracies, and showed the full impact of the forces that militated against the rejection of increasing returns and how they could derail the institutional trajectory.

The debate continued for several months and when the bill returned to the Senate for the second reading, the Senate adopted new amendments. On balance, the Senate amendments reflected a group that was more favourable to rejection of increasing returns. For instance, an amendment proposed to extend the authorities' mandate to eight years (up from seven) in an effort to keep their life-cycle more separate from that of Parliament (five

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<sup>361</sup> See *Il sole 24 ore*, 12.5.1995.

<sup>362</sup> In any event, appointment by the government, with a binding opinion by Parliament was criticized by the Parliamentary Commission for constitutional affairs. The binding opinion of the parliament over a decision by the government was a hybrid that run contrary to the autonomy of Parliament. This argument was aired several times during the debate (See *Il sole 24 ore*, 17.5.1995).

<sup>363</sup> See *Il sole 24 ore*, 20.6.1995.

years). Moreover, the government's power to veto the authority's decision was to be subject to a stringent requirement (only for very serious reasons of national interest).<sup>364</sup>

In October 1995, the bill eventually moved forward when the government decided to ask the Senate for a vote of confidence on the bill.<sup>365</sup> The bill was thus approved by the Senate (although without the provisions relating to telecommunications and media which were enshrined in a separate act).<sup>366</sup> Moreover, to allay concerns over control of Parliament over the privatization process, the bill conceded that Parliament had the power to review and approve the government's privatization plans in the public utilities sector.<sup>367</sup>

The bill became law in November 1995.<sup>368</sup> The final provisions bore the scars of the conflict between the two logics and, on balance, showed that Italy's trajectory had failed to embrace a UK-style logic in full. Instead, Law No. 481 of 1995 represented a compromise solution. For instance, the law set out:

- a provision on the power of the Parliament to oversee privatization of public utilities (Article 1.2);

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<sup>364</sup> See *Il sole 24 ore*, 13.9.1995. See also *Il sole 24 ore*, 23.9.1995, 25.9.1995, 26.9.1995 and 27.9.1995.

<sup>365</sup> See *Il sole 24 ore*, 5.10.1995, and 7.11.1995.

<sup>366</sup> See parliamentary debate held on March 14, 1995. As a result of the compromise reached, the law provided for the set up of the energy regulator, while deferring to a separate act the creation of the telecommunications regulator.

<sup>367</sup> See *Il sole 24 ore*, 6.10.1995. See para. 1, section 2, "*Per la privatizzazione dei servizi di pubblica utilità, ivi compreso ai soli fini del presente comma l'esercizio del credito, il Governo definisce i criteri per la privatizzazione di ciascuna impresa e le relative modalità di dismissione e li trasmette al Parlamento ai fini dell'espressione del parere da parte delle competenti Commissioni parlamentari*".

<sup>368</sup> Law No. 481 of 1995, "*Norme per la concorrenza e la regolazione dei servizi di pubblica utilità. Istituzione delle Autorità di regolazione dei servizi di pubblica utilità*" (GURI n. 216, 14.9.1996).

- a provision that conferred power of appointment on the government and the Parliament (Article 2.7);<sup>369</sup>
- a provision on members' tenure (seven years) (Article 2.8); and
- a provision on eligibility requirements, forbidding those holding charges in political parties from becoming commissioners (Article 2.8).<sup>370</sup>

The approval of Law No. 481 of 1995 marked an important point in Italy's trajectory.

By providing a framework for the law on the sector specific regulator for telecommunications, it already determined the extent of delegation that could be enjoyed by this body. In other words, the conflict between the two logics not only affected Law No. 481 of 1995, but went beyond this piece of legislation and was relevant for related legislation such as the bill on the *Autorità per le Garanzie nelle Comunicazioni* (AGCOM).

In July 1996, Antonio Maccanico, announced that he would soon present a bill with a view to reform the sector, including media. The bill relied on the works of the Napolitano commission, which had been set up under the Berlusconi government and whose work ended in February 1995, at the same time as Parliament was discussing the bill on regulatory agencies. The Napolitano Commission had recommended the regulation of telecommunications and television together given the expected convergence between these two media. Furthermore, the Napolitano commission recommended the creation of an "Autorità per le garanzie nelle comunicazioni", an independent regulator.

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<sup>369</sup> *"Ciascuna Autorità è organo collegiale costituito dal presidente e da due membri, nominati con decreto del Presidente della Repubblica, previa deliberazione del Consiglio dei Ministri su proposta del Ministro competente. Le designazioni effettuate dal Governo sono previamente sottoposte al parere delle competenti Commissioni parlamentari. In nessun caso le nomine possono essere effettuate in mancanza del parere favorevole espresso dalle predette Commissioni a maggioranza dei due terzi dei componenti...."*

<sup>370</sup> See Article 2.8.

However, a bill aimed at regulating media as well was going to attract lengthy parliamentary discussions because of the peculiar situation of the sector in Italy. By contrast, the Treasury Minister (Carlo Azeglio Ciampi) pressed for a speedy approval of the rules on the independent regulator since this was a condition for privatization of Telecom Italia, whose proceeds were a very significant part of the plans to improve the budget.<sup>371</sup> In order to meet these concerns, two bills were proposed, of which one dealt only with the creation of the *Autorità per le garanzie nelle comunicazioni* in order to improve the changes of a speedier approval, while the other dealt with media and was going to be debated separately.<sup>372</sup>

The passage of the bill in Parliament shows again how the conflict between the two logics had an impact on the direction of institutional development. As was the case for Law No. 481 of 1995, the power of appointment constituted a bone of contention.<sup>373</sup> Two models were available: on the one hand, the model followed for the appointment of the head of the Competition Authority, which, by giving power to the presidents of the two chambers of Parliament, was seen as more in tune with the UK-style logic of separation and obeyed the desire towards rejection of increasing returns in so far as it provided for more independence from government. On the other hand, Law No. 481 of 1995 lent itself well to be the model of a different logic, whereby, even if an IRA was set up with powers over tariffs, the government still enjoyed the power of appointment, thus retaining a way to control the IRA and lessen its independence.

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<sup>371</sup> See *Il sole 24 ore*, 3.7.1996 and 5.7.1996, and 6.7.1996.

<sup>372</sup> See disegno di legge A. S. 1021 “Istituzione dell’Autorità per le garanzie nelle comunicazioni e norme sul sistema radiotelevisivo” (XIII Legislatura, Dossier Provvedimento, giugno 1997), concerning the creation of a regulatory authority for telecommunications. The other bill was A. S. 1138 (“Disciplina del sistema delle comunicazioni”). For more information on the passage of the bill, see <http://www.senato.it/leg/13/BGT/Schede/Ddliter/7794.htm>.

<sup>373</sup> The majority of the Parliamentary time was absorbed by debates on media ownership and the anti-concentrative measures that would have required Mediaset and Rai to each lose a channel. See Maccanico, *Il grande cambiamento*, 37-38.



The debates in Parliament underscored that the appointment of the members of AGCOM did not uphold a UK-style logic. Indeed, the complaints from the centre-right opposition did not try to extol the virtues of having a truly independent regulator, free from political direction. Instead, the opposition complained that they could not carry an equal weight, because the rules under discussion left the power to appoint the president of AGCOM to the government (hence to the ruling coalition). As a matter of fact, it is worth remembering that Antonio Maccanico, the proponent of the bill, had already stated that his personal view was that it would be up to the government to appoint the commissioners,<sup>374</sup> thus indicating that the bill took it for granted that AGCOM's independence was to be limited.

Further, during the debates in the Senate, Senator Castelli, a senator belonging to Lega Nord, complained that the political power was relinquishing too much power to AGCOM and thereby expressed concerns on behalf of his party.<sup>375</sup> Senator Baldini, a Forza Italia senator, also voiced concerns about the “enormous” powers wielded by AGCOM.<sup>376</sup> In

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<sup>374</sup> See Maccanico, *Il grande cambiamento*, 18.

<sup>375</sup> See Legislatura 13<sup>o</sup> - Aula - Resoconto stenografico della seduta n. 190, May 22, 1997 (“*È stata creata un' Authority che - a mio modesto parere - ha poteri che vanno molto al di là di quelli conferiti normalmente alle altre Autorità di questo genere. Qui infatti non siamo di fronte semplicemente ad una Autorità antitrust , sia pure importantissima anche se avesse soltanto questo compito, ma abbiamo creato un ente regolatore che però determinerà anche il mercato, visto il grandissimo potere che ha di assegnare o togliere le frequenze. Questo è un punto su cui noi esprimiamo le più grandi preoccupazioni. Dal momento che noi, come potere politico, non siamo stati in grado di risolvere e riformare questo aspetto importantissimo della materia di cui ci stiamo occupando, lo abbiamo demandato all' Authority; in sostanza, abbiamo sorvolato il problema, abbiamo però creato un ente potentissimo. Ed allora, come tutte le armi potentissime, si tratterà di capire come verrà usata. Se questa potenza e questa grande capacità di intervento saranno usate in modo virtuoso, allora tutto andrà bene; ma se ciò non accadrà allora nasceranno grandissime preoccupazioni. Per questo noi abbiamo insistito moltissimo sulle questioni delle nomine, cioè su chi sarà chiamato a comporre questo consesso*”).

<sup>376</sup> Ibid. (“*Cosa dire poi dell' Authority ? Proprio per il fatto che è un' Autorità dotata di un potere enorme nel settore delle televisioni e delle telecomunicazioni avremmo preferito, come è già stato detto da altri senatori, che il sistema di elezione fosse diverso da quello previsto dal disegno di legge. Indubbiamente, attraverso il meccanismo di elezione individuato si*

addition, Baldini questioned the ‘compromise’ solution that inspired the rules on power of appointment.

According to what would later become Article 1.3 of the Law, AGCOM is composed of eight members. The Chamber of Deputies and the Senate appoint four members each. This solution guaranteed that the majority and opposition had each half of the members. However, the President was to be appointed by the President of the Council of Ministers, on a recommendation from the Minister of Communications, and after having received a favourable opinion from the Parliamentary committee.<sup>377</sup> According to Baldini, this solution rendered AGCOM too dependent on the parliamentary majority. Similar criticism surfaced also in the debate that took place afterwards in the Chamber of Deputies. Italo Bocchino, a deputy belonging to Alleanza Nazionale, the right wing party,<sup>378</sup> stated that the appointment

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*arriverà anche qui alla composizione di un'Autorità che sarà espressione di una maggioranza politica, quindi fortemente condizionata da una maggioranza politica; un'Autorità che risentirà necessariamente dei condizionamenti della maggioranza politica di cui è espressione. Anche in questo caso avremmo dovuto trovare dei meccanismi di elezione per consentire una maggiore obiettività, una maggiore indipendenza ed autonomia di un'Autorità in un settore così importante, quale quello delle televisioni e delle telecomunicazioni?”).*

<sup>377</sup> See Art. 1.3 “[I]l Senato della Repubblica e la Camera dei deputati eleggono quattro commissari ciascuno, i quali vengono nominati con decreto del Presidente della Repubblica. Ciascun senatore e ciascun deputato esprime il voto indicando due nominativi, uno per la commissione per le infrastrutture e le reti, l'altro per la commissione per i servizi e i prodotti. ... Il presidente dell'Autorità è nominato con decreto del Presidente della Repubblica su proposta del Presidente del Consiglio dei Ministri d'intesa con il Ministro delle comunicazioni. La designazione del nominativo del presidente dell'Autorità è previamente sottoposta al parere delle competenti Commissioni parlamentari ai sensi dell'articolo 2 della legge 14 novembre 1995, n. 481”.

<sup>378</sup> See Parliamentary reports, July 9, 1997, available through the camera website (“... questa authority nasce monca perché, se nei principi generali stabiliti dall'articolo 1 è prevista la sua piena autonomia ed indipendenza di giudizio, non vengono poi stabiliti sistemi di nomina ed organizzativi, legislativamente previsti, che ne garantiscano la piena autonomia e l'indipendenza di giudizio e di valutazione. Creare una authority senza questi requisiti non ha alcun senso. Sarebbe bastato il Ministero delle poste e delle telecomunicazioni, con le sue competenze, o il garante per la radiodiffusione e l'editoria, con le sue competenze. Avevamo avanzato proposte che, a nostro giudizio, andavano verso la piena autonomia, perché tendevano a creare un sistema diverso di nomina del presidente dell'authority. Siamo convinti che oggi in Italia la nomina da parte dell'esecutivo, seppure ricalca esperienze di altri paesi, visti i precedenti di «occupazione» che il Governo Prodi ha creato in questi mesi, non offre elementi di tranquillità.”).

of AGCOM president by the government was a matter of concern, given that the Prodi government seemed bent on “occupying” strategic positions, filling the posts with loyal appointees.

Interestingly, however, Alleanza Nazionale’s proposal was not to increase AGCOM’s independence from the government and, in general, from political oversight, as one would have expected under a logic of rejection of increasing returns. Alleanza Nazionale senators were in favour of an organizational solution that envisaged a secretary general, such role to be intended as a check against the power of the President and presumably allotted to the opposition. In other words, the opposition parties did not press for independence of AGCOM, but rather for a solution that enabled a fair representation of political forces at all levels. This can be seen also in the remarks of another AN senator, Adolfo Urso. Urso stated his preference for a system whereby the eight components appoint their president instead of the power of appointment by the government.<sup>379</sup> This solution would have produced a president acceptable to both majority and opposition, i.e. an ideal compromise solution.

Ernesto Stajano, a Forza Italia senator who was the rapporteur for the bill, defended the choice made by describing it as fine equilibrium.<sup>380</sup> But, Stajano was an isolated voice

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<sup>379</sup> Ibid. (“*Si può firmare una pace quando ci si riconosce nel proprio spazio, nel proprio territorio, nella propria comodità con pari dignità. Così non è. ... in altri paesi la nomina è tutta governativa, perché diverso è il rapporto tra la politica e l'economia: non vi è un'economia soggetta alla politica e non c'è una politica che, di fatto, occupa l'economia, la indirizza, la promuove, la utilizza ... Avremmo preferito che il presidente fosse stato anch'esso nominato dagli otto componenti oppure, in subordine, che le decisioni dell'autorità fossero prese a maggioranza dei due terzi. Questo avrebbe assicurato reciproche garanzie alle due coalizioni che si fronteggiano come in ogni democrazia occidentale ed avrebbe fatto sì che i primi passi lungo la strada della liberalizzazione e della privatizzazione di settori così determinanti per gli sviluppi economici, sociali e tecnologici del paese venissero compiuti nella reciproca fiducia tra le due coalizioni che, in quel modo sì, avrebbero siglato una vera pace, disarmando entrambi gli eserciti ed evitando che una mantenga un «deterrente nucleare» che l'altra non ha: la possibilità di determinare la propria maggioranza, anche al di là dell'esistenza di una maggioranza in Parlamento*”).

<sup>380</sup> Ibid., (“*Per quel che attiene infine alla questione relativa all'authority - ne parlo per ultimo, anche perché ne ha già parlato, come ho detto, l'onorevole Giulietti -, vorrei far presente,*

praising the bill because it showed that political parties were able to relinquish power in favor of an independent entity, thus underscoring an aspect that can be seen as interpreting a philosophy of rejection of increasing returns.<sup>381</sup>

Stajano's voice remained an exception in the ensuing debates. Complaints continued on the power left to the government and on how the Prodi government was not to be trusted to use these powers in pursuit of the common good.<sup>382</sup> Romani, a senator for Forza Italia,

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*anche per respingere molte delle critiche che sono state mosse al provvedimento nel corso delle Commissioni riunite VII e IX, che il meccanismo adottato relativamente all'indicazione dei componenti della commissione mi pare risponda ad una logica di condivisibile equilibrio. Quando ad un organismo come l'authority per le telecomunicazioni si attribuiscono competenze così vaste, è evidente che non si può non considerare, accanto alla dimensione di professionalità tecnica, anche una dimensione lato sensu politica. E in questo senso, mi pare sia perfettamente giustificato l'affidamento alle Camere della scelta degli otto componenti dell'authority, nelle sue due articolazioni. La scelta del presidente affidata al Governo ma con il parere delle Commissioni parlamentari completa questo iter di responsabilità istituzionale e caratterizza perfettamente ed in modo omogeneo e coerente la struttura di un organo che, ripeto, ha competenze vastissime, non solo amministrative, ma anche normative, sia pure a livello regolamentare, ed infine relativamente all'irrogazione di sanzioni, anch'esse amministrative. Quindi, era indubbiamente necessario ottenere un livello di qualificazione che discendesse dal massimo organo depositario della sovranità popolare e cioè dal Parlamento nella sua complessità, sia pure nell'ambito di questa articolata strutturazione").*

<sup>381</sup> Ibid. ("Il fatto che il Governo ed il Parlamento abbiano scelto di affidare ad un soggetto terzo, in qualche misura estraneo alla sfera delle determinazioni politiche in senso stretto, questi così larghi compiti rappresenta, a mio avviso, il senso ed il segno di una nuova politica, di una politica in cui coloro che sono eletti dal popolo, coloro che portano la responsabilità del governo del paese sono anche capaci di dismettere potere, di dismetterlo nei confronti delle regioni, nell'ambito di un più ampio disegno costituzionale, e di dismetterlo, in specie, nei confronti di un organismo autonomo di garanzia. Ed è bello poter constatare con soddisfazione che oggi con questa legge noi porremo un'altra valida pietra nella costruzione di una nuova immagine dello Stato: uno Stato che non è più occhiuto difensore della sua sfera di competenze ma che è in grado di valutare, volta per volta, quali sono gli strumenti più idonei per risolvere i problemi dei cittadini. In tal senso vorrei ricordare che a questa authority (e questo è un altro segno dei tempi, dei buoni tempi che viviamo pur in mezzo a tante difficoltà) potranno rivolgersi tutti i cittadini per poter vedere riconosciuti i loro interessi ...").

<sup>382</sup> Ibid., see the intervention by Mario Landolfi, an MP belonging to Alleanza Nazionale ("Si può immaginare di parlare di fine della guerra, onorevole Giuliotti e onorevole Stajano, nel momento in cui si predispose un meccanismo di nomina della presidenza dell'authority, mettendola nelle mani del Governo, dell'esecutivo, che dovrà nominare il vertice di un organismo che tutti riteniamo imparziale? E noi dovremmo credere all'imparzialità di questo futuro presidente quando i precedenti di questo Governo, anche in materia, fanno pensare il contrario? Dovremmo credere all'imparzialità del vertice dell'autorità nominata da questo Governo quando lo stesso Governo e la maggioranza hanno nominato Siciliano alla RAI, Chicco Testa all'ENEL e Guido Rossi alla STET? Un militante intellettuale e due ex

also expressed disappointment with the power granted to the government, alluding to the fact that his party would have preferred ‘a more balanced solution’, not a stronger AGCOM.<sup>383</sup>

In any event, the passage of the bill was long.<sup>384</sup> This also led to the privatization of Stet-Telecom Italia being delayed too, amidst criticism from the European Commission, which saw the sale as a chief remedy to comply with the obligation to reduce IRI’s indebtedness.<sup>385</sup> In the end, the solution chosen for the power of appointment was significantly different from the UK-style of independence.

AGCOM is composed of two Committees and a President. Each committee is a collegiate body of four members. The eight Commissioners are elected by Parliament. Each deputy and senator must designate two people, one for each Committee. Candidates are elected based on the number of votes. As a consequence, AGCOM Commissioners replicate the relative weight of political parties in Parliament, to the extent that some commentators speak of AGCOM as a “mini-Parliament”.<sup>386</sup> The President is appointed by a decree from the Prime Minister in accordance with the Minister of Communications, which has been

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*parlamentari del partito di maggioranza relativa installati prontamente al vertice di enti e di istituzioni che dovrebbero restare terze rispetto alla dialettica, al confronto ed allo scontro tra le forze politiche!”). Landolfi was also the proponent of an amendment to change the rules on appointment and entrust this power to Parliament.*

<sup>383</sup> Ibid. (“*Peccato però, signor ministro, per la disposizione sul presidente. Nella Commissione Napolitano avevamo definito un meccanismo di elezione che ci sembrava più equilibrato. Si è voluto invece prevedere un sistema che sostanzialmente delega al Governo la possibilità di nomina del presidente; quindi il consiglio è dispari: otto più uno. Ci auguriamo che la persona che verrà indicata – mi sembra che su questo vi sia un impegno del ministro Maccanico - sia equilibrata, forte, autorevole, imparziale!”).*

<sup>384</sup> See the parliamentary debate held on November 28, 1996 (Senato della Repubblica, XIII Legislatura, 90 Seduta Pubblica, Resoconto Stenografico). See also *Il sole 24 ore*, 19.9.1996, and 30.10.1996. In addition, there was criticism from the Antitrust Authority on the division of competencies in the sector, see Segnalazione AS 75, *Riforma del settore delle telecomunicazioni (Bollettino 34-35/1996)*.

<sup>385</sup> See *Il sole 24 ore*, 10.9.1996, and 11.9.1996.

<sup>386</sup> See N. Longobardi, ‘Les autorités administratives, laboratoires d’un nouveau droit administratif’, *Les Petites Affiches*, 172 (1999), 6.

approved by a parliamentary committee. Both the appointment of the Commissioners and that of the President shows that elected politicians pushing for limitation of a UK-style logic of separation obtained significant results. Indeed, Law No. 249 of 1997 has been criticized for giving too much power to elected politicians, thus leading to a “*dangerous promiscuity with politics*”.<sup>387</sup> The significance of this development for Italy’s overall trajectory, however, justifies extending the enquiry to the period after 1997. Before undertaking this task, it should not be forgotten that, when the AGCOM bill eventually became law in July 1997, Telecom Italia was privatized through a public sale. The IPO of shares held by the Treasury took place between October 20 and 24, 1997.<sup>388</sup> This marked the birth of Italy’s first public company with widespread public share ownership, although the Treasury Minister retained a 3.5% stake and a golden share.<sup>389</sup>

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<sup>387</sup> See Verdier, ‘Audiovisual and Telecommunications in Italy’, 277.

<sup>388</sup> After Telecom Italia’s floatation in November 1997, the Treasury continued to own 5.17% of the outstanding shares and 0.62% of the outstanding savings shares of Telecom Italia, but in 1999, the Treasury’s holdings had been reduced to 3.46%. In 1999, an hostile bid saw a change of control in Telecom Italia, with Olivetti becoming the leading shareholder. See *OLIVETTI/TELECOM ITALIA*, Case IV/M.1496, Commission decision of April 22, 1999 (available at [http://ec.europa.eu/comm/competition/mergers/cases/decisions/m1496\\_it.pdf](http://ec.europa.eu/comm/competition/mergers/cases/decisions/m1496_it.pdf)).

<sup>389</sup> See Telecom Italia 20F 2000, 167 (available at [http://www.telecomitalia.com/TIPortale/docs/investor/form20f\\_2000.pdf](http://www.telecomitalia.com/TIPortale/docs/investor/form20f_2000.pdf)). A decree issued on February 11, 2000 (the “Golden Share Decree”), set forth terms and conditions for the exercise by the Italian Government of special powers granted by golden shares. Pursuant to the Golden Share Decree, the Italian Government could use its special powers to protect the vital interests of the State and respond to indispensable reasons of general interest, including public law and order, public security, public health and national defense. The Italian Government is authorized to exercise such special powers in compliance with the principles of Italian and European Community laws, and in any case in line with the objectives of the privatization process, and the protection of competition and the market and having regard for non-discrimination principles. Such powers must be suitable and proportional to achieving the indispensable objectives of general interest described above. The Golden Share Decree provides that the Italian Government may exercise its special powers to prevent acquisitions of shares of privatized companies if such acquisitions (i) are not transparent and would not ensure full disclosure with respect to controlling share ownerships of the companies whose shares are being acquired and the objectives and industrial plans proposed by the buyers of the target companies; (ii) compromise the liberalization and market competition or are not in line with the company’s privatization goals, or entails situations of conflict of interests which could compromise the company’s mission with respect to the objectives of public interest; (iii) entail objective risks of being affected by criminal organizations, or involve the company

V. **THE CHANGE IN THE RULES ON COMPETITION AND INCREASING RETURNS: THE CASE OF THE AWARD OF THE GSM MOBILE LICENSES (1994-1997)**

Last but not least, this Section considers the impact of past increasing returns on the changes that took place in the rules on competition. It is important to define at the outset the institutional aspects that are of relevance. This is because the rules on competition encompass a potentially very broad number of rules, for instance the rule enshrined in the antitrust legislation, i.e. Law No. 287 of 1990.<sup>390</sup>

For the purposes of assessing the impact of increasing returns on institutional reforms, though, it is submitted that one should focus on the rules that concern access to the market and, more specifically, the rules on the award of licenses. This is due to the importance of these rules as instruments through which political parties could control suppliers.

At the beginning of the period studied in this chapter, the State retained the right to reserve for itself the provision of telecommunications services.<sup>391</sup> It could do so either directly, as it was the case for ASST, or indirectly, by the grant of a license. SIP, Italcable and Telespazio, as noted, were all operating under a license. Therefore, licenses afforded to political parties an important avenue to control suppliers. For instance, as noted for the case of the license renewal for SIP in 1984 described in the previous chapter, the definition of the scope of a license could be used as an important part of relationships binding together

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in unlawful activities; (iv) jeopardize conservation of the special powers of the State; or (v) represent a considerable risk of serious harm to the vital interests of the State described above, including the supply of essential raw materials and goods, the supply of essential public services and the security of related installations and networks and, further, the development of advanced technological sectors.

<sup>390</sup> “Norme per la tutela della concorrenza e del mercato” (GURI n. 240, 13.10.1990).

<sup>391</sup> See N. Rangone, ‘Le Telecomunicazioni’, in S. Cassese (ed.), *Diritto amministrativo Speciale*, Tomo III (Milano: Giuffrè, 2003), 2931 et seq.

suppliers and political parties. This meant that the grant of a license and its renewal formed an integral part of the increasing returns process.

Rejection of increasing returns had important consequences for license awarding procedures. It meant that political intermediation should be rejected and that licenses should be awarded based exclusively on objective criteria, i.e. that reasons of economic efficiency should be the chief rationale for awarding a tender and not the reward of 'friends'. Thus, rejection of increasing returns supported a direction of institutional change in the rules on competition based on the prevalence of market criteria.

Between 1994 and 1997, rejection of increasing returns coupled with an important exogenous factor with respect to the institutional aspect at issue, namely the EU. The case of the award of the second GSM license to Omnitel (later part of the Vodafone group) is illustrative of the role of increasing returns in shaping the direction of change and of the extent to which a broad push for reform based on domestic factors coupled with an exogenous force.

The procedure for the award of the license started in December 1993 and was concluded a year later on December 2, 1994.<sup>392</sup> Thus, the procedure spanned the Ciampi and the first Berlusconi governments, both of which were strongly influenced by rejection of increasing returns. Indeed, the tender process was carefully prepared by a group of experts (*Gruppo di Lavoro sulle Telecomunicazioni*), chaired by Maurizio Pinnarò, a professor and senior lawyer, whose mandate was to design the tender rules in a way that made them consistent with the objective of liberalization and free competition. There was no attempt to use this process as a way to gain votes or power as it would have been the case in the pre-1992 period.

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<sup>392</sup> See S. Cassese, *La crisi dello Stato* (Bari : Laterza, 2002), 102.



The tender rules, however, were criticized by the Commission because they presented a strong asymmetry in favor of the incumbent, Telecom Italia. In particular, in a decision issued in October 1995,<sup>393</sup> the Commission held that “*the competitive disadvantage in the form of the initial payment imposed on the second operator alone for its concession to operate a GSM network in Italy constitutes an infringement of Article 90 (1) of the Treaty, read in conjunction with Article 86*” and it therefore imposed on the Italian Republic an obligation to re-establish a level-playing field.

Before discussing the measures of compliance and how the Commission acted in this phase, it is important to discuss the reasons for the asymmetry in favour of the incumbent. Indeed, one might be tempted to link the asymmetry to the old patterns of relationships between suppliers and political parties. In fact, as senior Vodafone representatives explained,<sup>394</sup> the origin of the asymmetry lies elsewhere, namely in a form of early ‘capture’ by the regulator.

At the time of the award of the second license, Telecom Italia supplied to the Ministry the expertise necessary to run the sector. It was not uncommon that senior ministerial posts were held by people who also occupied senior positions within Telecom Italia. On the other hand, the award of the second license for GSM telephony did not take place within a framework of rules which guaranteed equality of opportunity and access to the market. In fact, mobile telephony was a pioneering experiment in the sector. As a consequence, the only rules available to promote competition were in fact the rules of the license. Under these circumstances, Telecom Italia tried to take advantage of its position and influenced the design of the rules in a way that was favourable to itself.

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<sup>393</sup> Commission Decision of 4 October 1995 concerning the conditions imposed on the second operator of GSM radiotelephony services in Italy (OJ 1995 L 280/49).

<sup>394</sup> Interview, Director of Public and Legal Affairs.

The way in which this influence took place, though, is very different from the past increasing returns. The asymmetry was not in return for any ‘favour’ Telecom Italia had made to the ruling coalition, but can be attributed to the relative inexperience with regulating for competition and the powerful clout that Telecom Italia as the incumbent operator enjoyed.

Indeed, the attempts to redress the situation provide a broad confirmation of the extent to which (i) rejection of increasing returns was important in supporting change in the design of rules on the award of licenses; and (ii) pressure from rejection of increasing returns coupled with a powerful external source of change, the Commission.

According to senior Vodafone representatives,<sup>395</sup> after the decision by the Commission in October 1995, the Minister of Telecommunications took a very active role in defense of the new entrant. For instance, in a crucial meeting between Omnitel and Telecom Italia representatives, the Minister threatened expressly the Telecom Italia representative (Mr Gamberale) with a revocation of the license unless Telecom Italia complied with the revised terms and conditions, as they needed to be imposed to bring Italy in line with the Commission decision.

Afterwards, the Minister and the Commission worked together to ensure compliance. In particular,<sup>396</sup> on December 21, 1995 –i.e. after the meeting where the Minister threatened Telecom Italia with revocation of its GSM license – the two operators and the Minister agreed to a solution to compensate Omnitel. This solution was notified to the Commission on January 18, 1996, which, on February 9, 1996, informed that the solution was an adequate response to comply with its decision of October 1995. Nevertheless, the compliance by Telecom Italia was only partial and the Commission issued several requests for information,

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<sup>395</sup> Interview, Director of Public and Legal Affairs.

<sup>396</sup> See Cassese, *La crisi dello Stato*, 103 et seq.

urging the Italian State to remedy the asymmetry in full. In particular, the Commission wrote to the Italian government on

- July 18, 1996;
- August 7, 1996;
- September 4, 1996; and
- January 15, 1997.

On September 9, 1997, faced with continued non-compliance, the Commission threatened the opening of infringement proceedings against Italy. On October 15, 1997 the operators and the Minister reached a new agreement and on December 10, 1997 the Commission closed its proceedings.

The case of the second GSM license shows that rejection of increasing returns played a very important role in reshaping the rules on the award of licenses, hence of the rules on competition. Tendering procedures were designed in a way diametrically opposite to the one that was informed by past increasing returns. Objective criteria, not political patronage, were the criteria for adjudication. At the same time, the broad push for institutional change left open several gaps. A powerful external source of change, the Commission, stepped in to fill those gaps and Vodafone, as a regulatee, found itself in a position to benefit from the European dimension that the licensing rules had taken.

The role of the EU in fostering institutional change with respect to the rules of competition did not end with the second GSM license, either. In 1997, Presidential Decree No. 318 of 197 was passed, an act whose purpose was to transpose EC Directives and to implement re-regulation of Italian telecommunications.<sup>397</sup> Its provisions marked a complete

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<sup>397</sup> See Decree of the President of the Republic No. 318 of 1997 (*“Regolamento per l’attuazione di direttive comunitarie nel settore delle telecomunicazioni”*, GURI n. 221, 22.9.1997). Other

turnaround in the legal framework of the sector.<sup>398</sup> DPR 318 ended all exclusive and special rights in the provision of all telecommunications services and provided for full competition, also establishing guidelines for interconnection, licensing, universal service, numbering and rights of way.<sup>399</sup> In particular, as mandated by EU law,<sup>400</sup> DPR 318 provided for the abolition of all monopoly rights by January 1, 1998.

The adoption of DPR 318 shows once more that, with respect to rules on competition, the pressure for change stemming from rejection of increasing returns combined with the re-regulation of the sector at the EU level. The two factors combined to reshape the rules on

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important measures included Ministerial Decrees of July 1, 1997 and February 27, 1998 on numbering (“*Normativa tecnica sulla numerazione delle telecomunicazioni*” and “*Disciplina della numerazione nel settore delle telecomunicazioni*”, GURI n. 175, 29.7.1997 and n. 67, 21.3.1998); a Ministerial Decree of November 25, 1997 on the procedures for the granting of licenses (“*Disposizioni per il rilascio delle licenze individuali nel settore delle telecomunicazioni*”, GURI n. 283, 4.12.1997); a Ministerial Decree of March 10, 1998 on universal service (“*Finanziamento del servizio universale nel settore delle telecomunicazioni*”, GURI n. 100, 14.5.1998); and a Ministerial Decree of April 23, 1998 on interconnection (“*Disposizioni in materia di interconnessione nel settore delle telecomunicazioni*”, GURI n. 133, 10.6.1998).

<sup>398</sup> See S. Cassese, ‘La liberalizzazione delle telecomunicazioni’, in F. Bonelli and S. Cassese (eds.), *La disciplina giuridica delle telecomunicazioni* (Milano: Giuffrè, 1999).

<sup>399</sup> Article 2 further establishes the withdrawal of all exclusive and special rights, defined as follows: (i) exclusive rights: the rights that are granted by a Member State to one undertaking through any legislative, regulatory or administrative instrument, reserving it the right to provide a telecommunication service or undertake an activity within a given geographical area.; (ii) special rights means the rights that are granted by a Member State to a limited number of undertakings through any legislative, regulatory or administrative instrument which, within a given geographical area,

- limits to two or more the number of such undertakings authorized to provide a service or undertake an activity, otherwise than according to objective, proportional and non discriminatory criteria, or
- - designates, otherwise than according to such criteria, several competing undertakings as being authorized to provide a service or undertake an activity, or
- - confers on any undertaking or undertakings, otherwise than according to such criteria, legal or regulatory advantages which substantially affect the ability of any other undertaking to provide the same telecommunications service or to undertake the same activity in the same geographical area under substantially equivalent conditions.

<sup>400</sup> See Commission Directive 96/19/EC of 13 March 1996 amending Directive 90/388/EEC with regard to the implementation of full competition in telecommunications markets (OJ 1996 L 74/13), Article 1.2, which provides that “ ... Member States may maintain special and exclusive rights until 1 January 1998 for voice telephony and for the establishment and provision of public telecommunications networks ...”.

competition, but while rejection of increasing returns provided a general underlying support, EU rules gave precise and concrete meaning to it.

It is also important to realize that enforcement of national telecommunications regulation was entrusted principally to AGCOM and to note the difference between rules on competition and rules on institutional design of AGCOM. While EU rules introduced a detailed level of substantive provisions, which were then transposed into national law, the situation was the reverse with respect to institutional design. EU law largely left this aspect to national law. Thus, for instance, there were no EU provisions as to whether the regulator should be a collegial or a mono-cratic body or who should have the power of appointment. Similarly, the powers of the regulators were defined at the national level.

AGCOM's powers included the issuing of licences to telecommunications providers and adjudication of interconnection disputes. With respect to pricing decisions, following liberalization of telecommunications services, operators autonomously set prices and need only inform AGCOM of any changes therein. Only those operators named by AGCOM as having significant market power were subject to price regulation. In those cases, AGCOM could modify tariffs and interconnection fees set by the operator. Finally, AGCOM was also given powers to regulate the broadcasting sector.

The differences between rules on competition and the rules on the allocation of regulatory powers also explain the different role played by the EU and the somewhat uncertain direction of institutional change besetting AGCOM, which will be explored in the following chapter.

## VI. CONCLUSION

The empirical evidence collected in this chapter brings about important aspects of increasing returns that have the potential to refine path dependence. While the previous chapter confirmed the role of increasing returns in driving countries along a trajectory of bounded change, the present one shows that increasing returns have the ability to explain not only continuity (or ‘on-path’ change), but also radical change (or ‘off-path’ change). This is a key finding insofar as it uncovers a feature of increasing returns that has so far escaped attention, namely their ability to cause institutional reform through actors’ reaction. It adds a new dimension to increasing returns and to path dependence theory because it opens up the menu of institutional outcomes that are possible under path dependence, whilst so far the latter had been able to cater solely for bounded change.

In addition, the chapter shows that increasing returns had a different impact in shaping the direction of institutional change on different institutions. Once the old path ended because of the developments at the national level, policy-makers were confronted with the task of designing new institutions. In so doing, some of them sought to design institutions in opposition to the past increasing returns, by pushing for full separation between suppliers and elected politicians. Rejection of past increasing returns was therefore the principle behind the end of the split-supplier system in favour of the merger of all providers.

As far as the rules on competition are concerned, the chapter demonstrated that rejection of increasing returns provided a strong basis for change, but the precise institutional choices were then the result of a coupling of domestic and supranational factors, through the involvement of the Commission.

With respect to the design of the IRA, some policy-makers opposed a logic of full separation and pushed to retain a measure of control over telecommunications suppliers. The

chapter uncovered the conflict between these two logics through tracing of the legislative processes that brought about, first, the framework law on IRA (Law No. 481 of 1995), and then the law on AGCOM (Law No. 249 of 1997). It shows that, on the one hand, there were those who pushed for a UK-style logic of separation, hence delegation to IRA. On the other hand, there was pressure to adopt a logic based on limited separation between elected politicians and suppliers. In order to understand the outcome of this conflict in terms of Italy's overall institutional trajectory it is necessary to 'benchmark' Italy against the UK.

The table below shows key institutional features in the two countries at 1993 and 1997, providing comparative information on the extent of change that took place in Italy relative to the UK.

**Table 10 - British and Italian institutions 1993 - 1997**

		1993	1997
<b>No. of suppliers</b>	<b>UK</b>	Not predetermined	Not predetermined
	<b>Italy</b>	4	Not predetermined
<b>Ownership</b>	<b>UK</b>	Private/listed	Private/listed
	<b>Italy</b>	State control	Private/listed
<b>Degree of competition</b>	<b>UK</b>	Competition	Competition
	<b>Italy</b>	Monopoly/Split supply	Competition
<b>Allocation of regulatory powers</b>	<b>UK</b>	OFTEL	OFTEL
	<b>Italy</b>	Ministers	AGCOM

- ***Number of suppliers.*** First of all, it can be noted that, by opening up the sector to competition, Italy too had stopped having a pre-determined number of operators. Besides Telecom Italia, any new entrant could start to supply services after receiving a licence from AGCOM.
- ***Ownership.*** Second, the privatization of Telecom Italian in 1997 also marked a significant convergence with Britain, whereby BT had been likewise privatized through a share issue and flotation on the stock exchange.
- ***Degree of competition.*** In compliance with EU law, since January 1, 1998 all exclusive rights had to stop. There was therefore a rule of ‘full competition’ in both Italy and the UK.
- ***Allocation of regulatory powers.*** By entrusting regulatory powers to AGCOM, including price regulation and licensing, Italy managed to create an Oftel-like regulator. In fact, since AGCOM also has jurisdiction over broadcasting, the Italian design upstaged Oftel, whose powers were limited to telecommunications (later expanded with Ofcom in 2000).

The foregoing shows that by 1997 Italy and the UK had come to share key institutional features to a very significant extent. The degree of convergence bears witness to the fact that Italy’s trajectory in 1997 was a new path compared to 1992, when the two countries significantly differed.

However, it is more difficult to assess the direction of Italy’s new path. In particular, the question is whether the convergence of formal institutions also meant a convergence in terms of the respective logics of the two trajectories. The findings of the chapter have in fact



provided evidence of the opposition to a UK-style logic in Italy. The impact of such conflict on Italy's trajectory deserves a careful examination of several dimensions.

First of all, it is true that powers to set prices were removed from the hands of elected politicians. With the advent of full competition, in principle prices were set as a result of market forces by providers acting autonomously. AGCOM had price-setting powers under well-defined circumstances. Elected politicians thus lost the ability to set prices as in the past. This element is a point in common with the UK logic.

Secondly, power to affect market structure, in particular ownership and number of suppliers, was also lost to elected politicians following the privatization of Telecom Italia. In addition, it was up to AGCOM to license new suppliers that could then enter the market. This also was a point in common with the UK logic.

Thirdly, though, the rules governing the relationships between elected politicians and the regulator reflected a different position. By providing for a proportional system, whereby each major party could express an AGCOM Commissioner and the ruling party had the power to appoint the President, AGCOM remained closely linked to elected officials. In spite of the fact that important regulatory powers were allocated to the IRA, thus fostering a degree of separation between suppliers and elected politicians, this separation was at best incomplete, given that elected politicians had the power to control appointments to AGCOM. The chapter's findings about the opposition against a UK-style further show the inherent tension that beset the Italian path.

Thus, the overall logic of the Italian path in 1997 can be characterized as one of conflict between proponents of full separation between suppliers and elected politicians and those who argued for continued control over suppliers. The result was a trajectory that, although tracing closely the UK one in several respects, presented some notable elements of

difference. Further, being open to contestation, this trajectory was far from stable. In fact, in 1997 it reflected the state of play of the conflicts between the two logics. Further adjustment was likely, though, and thus justifies extending the research to the events that took place after 1997.

Before undertaking this task, a word is in order on the extent to which this complex pattern of reaction and counter-reaction to increasing returns affects path dependence. The role of increasing returns in fostering ‘off-path’ change has already been discussed. The counter-reactions confirm this important finding. After 1992, policy makers considered how to re-build the institutional architecture. The experience of past increasing returns was the common point of departure in the institutional choices that were made. But the lessons that policy makers drew from past increasing returns were different. Some were determined to cut all links between elected politicians and suppliers, others thought that elected politicians should retain a measure of control over suppliers. Both concurred, though, in taking past increasing returns as the defining element that shaped their position.

Increasing returns thus were at the origin of a complex process of reaction and counter-reaction by elected politicians, i.e. those to whom past increasing returns previously accrued. This further buttresses the point that was made earlier about the need to specify to whom increasing returns accrue as a necessary pre-condition to broaden the reach of path dependence in explaining cases of institutional change. Indeed, the findings of the chapter point towards an higher-than-expected ability of increasing returns to provide a useful lenses through which one can better understand institutional trajectories, well beyond ‘simple’ bounded change.

The fact that increasing returns discussed in this chapter were *past* increasing returns in no way affects this finding. It may be an Italian specificity that increasing returns had

ended before new institutions were designed. The fact remains that, through actors' rejection, increasing returns fostered 'off-path' change. Their ability to do so even 'after death' may only mean that, *a fortiori*, they are capable of engendering a similar reaction by actors when they are 'alive'.

## 6. The New Italian Path 1997-2007

### I. INTRODUCTION

This chapter analyzes the development of Italy's institutional trajectory after 1997. The previous chapter showed that, when making institutional choices on the design of telecommunications institutions after 1992, some policy-makers favoured a UK-style logic of separation between suppliers and elected politicians, while others favoured a less pronounced separation. The outcome was a situation of conflict that was reflected in the charter of AGCOM. The task of this chapter is to review the empirical evidence concerning the period after 1997 to understand how this conflict played out in the subsequent years and how it shaped Italy's path between 1997 and 2007. In particular, this chapter answer the question of the direction of Italy's new path that remained ambiguous in 1997 due to the opposition to a UK-style logic in Italy.

Some clarifications are in order before undertaking this task. First, as in the previous chapter, increasing returns are *past* increasing returns (i.e. the increasing returns pre 1992 that were described in chapter 4). Conflicts after 1997 centered on the differences between the ways in which elected politicians conceived new institutions in relation to 'old' increasing returns, some of them being in favour of total rejection through complete separation between suppliers and politicians, while others had a preference for a solution that implied a degree of control in their hands. By contrast, the chapter does not argue that there are 'new' increasing returns arising in Italy's new path and therefore there is no attempt to link the developments described below to the new type of relationships between suppliers, elected politicians and the regulator. This is connected with a second clarification.

The period after 1997 is of course very rich in developments. The presence of AGCOM means that ‘regulatory games’<sup>401</sup> are being played and that the arena of telecommunications has become substantially different than the period until 1997. However, the chapter’s task focuses on institutional reform and whether and how the conflict between the two logics described earlier played out in terms of AGCOM’s institutional design. In this respect, AGCOM remains the *explanandum*, and its relationships with elected politicians and regulatees fall outside the scope of the thesis. In other words, the chapter is intended as a supplement to answer the research question to the extent the previous chapter ending at 1997 had left some ambiguity in the answer still. In trying to capture the impact of increasing returns on institutional reform, the chapter is thus written with a view to understand how past developments affected Italy’s trajectory.

The caveat on the scope of the materials covered explains how, in terms of institutional reform, in truth the period after 1997 is one of relative stability. The key empirical evidence reviewed in this chapter concerns mainly two legislative measures that were passed in 2001 by the Amato government and in 2003 by the Berlusconi government affecting institutional design. This does not mean that relationships between elected politicians and AGCOM or the approach of elected politicians to telecommunications are ignored altogether. The context in which these legislative measures were passed is described to interpret the relevance of these measures and to what extent they reveal the outcome of the conflict between the two logics. In this connection, the chapter also describes the changing nature of political intervention in Italian telecommunications.

The evidence reviewed shows that, as Sabino Cassese argued, there was a steady erosion of AGCOM’s powers and, more generally, an attempt to rein in the powers of

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<sup>401</sup> Coen, ‘Business-Regulatory Relations: Learning to Play Regulatory Games’.

IRAs.<sup>402</sup> Even earlier proponents of the adoption of a UK-style logic such as Giuliano Amato, later approved legislative measures that transferred powers to the Ministry. Based on this evidence, the chapter argues that, while Italy has adopted some formal institutions that are similar to that of Britain, there are key differences in the allocation of regulatory powers and the overall logic of the paths. As a consequence, there is a new Italian path emerging that is based on a logic of limited separation between suppliers and elected politicians.

The chapter is organized as follows. The first section deals with the law of 2001 on the transfer of licensing powers from AGCOM to the Ministry. The following section reviews the climate of open hostility towards IRA that followed, the legislative measures of 2003 to expand the Ministry's regulatory powers and developments occurred in 2007, when the Prodi government put forward a bill to strengthen regulatory agencies' independence,<sup>403</sup> which has been however halted by the fall of the Prodi government in 2008 following general elections.

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<sup>402</sup> See AGCOM Conference on "Funzionamento e organizzazione delle authorities: esperienze a confronto", Rome, May 10, 2004. "[N]ell'ordinamento italiano, le autorità indipendenti ... sono nate negli anni novanta del XX secolo e sono il frutto di quel fenomeno che lo storico Cafagna ha chiamato la «quarantena della politica». È indubbio, infatti, che in Italia le autorità indipendenti siano riuscite ad affermarsi in conseguenza della profonda crisi che, proprio in quegli anni, ha colpito i maggiori partiti politici italiani. È in questo particolare contesto che si sono potute radicare formule organizzative estranee alla tradizione del nostro paese. Quanto i due fenomeni siano legati tra loro è dimostrato dal fatto che quando il sistema fondato sui partiti si è stabilizzato, è iniziata una fase di progressiva erosione dei poteri delle autorità". ("In the Italian legal system, independent authorities ... were born in the 1990s century and they are the product of what historian Luciano Cafagna has called «the quarantine of politics ». There is no doubt that in Italy independent authorities succeeded thanks to the profound crisis that in those years struck the most important political parties. This specific context has been conducive to the establishment of administrative structures that were otherwise foreign to our legal tradition. The extent to which these two phenomena are intertwined can be showed by the circumstance that, when the system based on political parties was stabilized, independent authorities have become subject to a progressive erosion of their powers").

<sup>403</sup> See *Il sole 24 ore*, 2.2.2007 ("Energia, trasporti e tlc: via al riordino delle Authority per la tutela dei consumatori"). The bill was introduced in the Senate on March 5, 2007. See Disegno di Legge AS 1366, "Disposizioni in materia di regolazione e vigilanza sui mercati e di funzionamento delle Autorità indipendenti preposte ai medesimi". More information is available through the website of the Senate ([www.senato.it](http://www.senato.it)).

## II. “NON C’È PIÙ VOGLIA DI AUTORITÀ”: THE LAW TO TRANSFER LICENSING POWERS TO THE MINISTRY (2001)

AGCOM was born in 1997 amidst a conflict between elected officials wishing to follow the UK version of Ofcom and those who pressed for a more limited scope of delegation. In the period after 1997, conflicts continued and proponents of an Italian-style version of an IRA gained important results also due to a climate of general hostility against independent agencies, in spite of the fact that AGCOM had received praise for the work carried out in the initial phase of its operations from the European Commission in 1999<sup>404</sup> and OECD in 2001.<sup>405</sup>

The hostility towards IRAs surfaced through public statements by, for instance, the President of the Republic, Oscar Luigi Scalfaro, who launched a public debate on independent regulatory authorities in 1998,<sup>406</sup> questioning their number, their powers and their diversity and, moreover, showing concern for the fact that these authorities were not accountable to Parliament. Franco Bassanini, the minister of public administration of the centre-left coalition, also voiced concern about the proliferation of authorities in 1998.<sup>407</sup> The same attitude informed a speech by the President of the Chamber of Deputies, Luciano Violante (a deputy belonging to the Partito Democratico della Sinistra (PDS)), also raising

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<sup>404</sup> See COM (1999)537, *Fifth Report on the Implementation of the Telecommunications Regulatory Package* (November 11, 1999), Annex 3, 13 (available at <http://europa.eu.int/ISPO/infosoc/telecompolicy/5th-en.pdf>), : “the NRA has issued a number of important decisions in the telecommunications sector ... contributing to the effective implementation of the regulatory framework”. Likewise, in 2000 Commissioner Monti stated that Italy had done in one year what Ofcom had achieved in five (see *Il sole 24 ore*, 16.2.2000 “E Monti elogia l’Italia: <Tariffe liberalizzate>”).

<sup>405</sup> OECD Reviews of Regulatory Reform, ch. 6.

<sup>406</sup> See *Il sole 24 ore*, 1.5.1998.

<sup>407</sup> See *Il sole 24 ore*, 13.1.1998.

general concerns about the authorities' role and how, through the authorities, Parliament was eschewing its responsibilities.<sup>408</sup>

In 1999, the First Committee of the Chambers of Deputies started an inquiry into independent authorities,<sup>409</sup> debating whether and how regulatory authorities should have a framework law in order to better define their powers. Although the final report confined itself to limited suggestions, such as introducing specific provisions in the Constitution, passing a framework law, improving links with Parliament and cooperation with ministries, by the end of 2000 there was a general climate of hostility against IRAs.

In this context, a law in 2001 explicitly stated that the power to assign licences in the telecommunications sector, originally under AGCOM's sole responsibility under Law No. 249, was to be transferred back to the Ministry of Communications<sup>410</sup> (which had been reconstituted by Law Decree No. 217 of 2001, later confirmed by Law No. 317 of 2001,<sup>411</sup> after having been temporarily abolished by a law passed and envisaging its incorporation within the newly designed Minister of Economic Activities).<sup>412</sup>

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<sup>408</sup> See *Il sole 24 ore*, 13.5.2000.

<sup>409</sup> Available through the Italian Parliament website at [http://legislature.camera.it/chioschetto.asp?content=/\\_dati/leg13/lavori/stencomm/tabindag.htm](http://legislature.camera.it/chioschetto.asp?content=/_dati/leg13/lavori/stencomm/tabindag.htm)

<sup>410</sup> See Law No. 66 of 2001. Article 2-bis stated: "... *Le autorizzazioni e le licenze di cui agli articoli 2, comma 13, e 4, commi 1 e 3, della legge 31 luglio 1997, n. 249 [Article 4(1) referred to licenses and authorizations needed to operate in the telecoms sector] sono rilasciate dal Ministero delle comunicazioni*".

<sup>411</sup> See Law No. 317 of 2001, "Conversione in legge, con modificazioni, del decreto-legge 12 giugno 2001, n. 217, recante modificazioni al decreto legislativo 30 luglio 1999, n. 300, nonché alla legge 23 agosto 1988, n. 400, in materia di organizzazione del Governo".

<sup>412</sup> See Legislative Decree No. 300 of 1999. Article 55 stated that: "... *A decorrere dalla data del decreto di nomina del primo governo costituito a seguito delle prime elezioni politiche successive all'entrata in vigore del presente decreto legislativo e salvo che non sia diversamente disposto dalle norme del presente decreto: ... b) sono soppressi: ... - il ministero delle comunicazioni ...*".



In addition, the law of 2001 re-instating the Ministry of Communications also granted the latter new powers. These were phrased in very general terms, including the power to monitor compliance with universal service obligations, to monitor more generally compliance with sector specific regulation (“*vigilanza sulla osservanza delle normative di settore*”) and market monitoring powers (“*sorveglianza sul mercato*”).<sup>413</sup> No further indication was given in the law as to what was the scope of these powers and how they related with AGCOM’s existing powers. This confusion was deliberate, as the Ministry could later claim a broader interpretation of these provisions in furtherance of its goals.

The extent to which these provisions show that the institutional trajectory was steered towards an Italian-style logic of limited separation can be better appreciated when one thinks that in 2001 the Ministry already carried out some regulatory tasks and that this power-sharing was strongly criticized by the operators as a source of confusion. Starting from 1997, when AGCOM was formally created, but was still in its infancy, the Ministry had accepted to carry out some of AGCOM’s regulatory tasks. This undertaking had given rise to a

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<sup>413</sup> See Article 6 of Law Decree No. 217 of 2001 that stated: “1. *Il Ministero svolge in particolare le funzioni e i compiti di spettanza statale nelle seguenti aree funzionali: a) [there is no letter b, nda] comunicazioni e tecnologie dell'informazione: politiche nel settore delle comunicazioni, adeguamento periodico del servizio universale delle telecomunicazioni; piano nazionale di ripartizione delle frequenze e relativo coordinamento internazionale, radiodiffusione sonora e televisiva e telecomunicazioni, con particolare riguardo alla concessione del servizio pubblico radiotelevisivo ed ai rapporti con il concessionario, alla disciplina del settore delle telecomunicazioni, al rilascio delle concessioni, delle autorizzazioni e delle licenze, alla verifica degli obblighi di servizio universale nel settore delle telecomunicazioni, alla vigilanza sulla osservanza delle normative di settore e sulle emissioni radioelettriche ed alla emanazione delle norme di impiego dei relativi apparati, alla sorveglianza sul mercato; servizi postali e bancoposta, con particolare riferimento alla regolamentazione del settore, ai contratti di programma e di servizio con le Poste Italiane, alle concessioni ed autorizzazioni nel settore dei servizi postali, alla emissione delle carte valori, alla vigilanza sul settore e sul rispetto degli obblighi di servizio universale; produzioni multimediali, con particolare riferimento alle iniziative volte alla trasformazione su supporti innovativi e con tecniche interattive delle produzioni tradizionali, ferme restando le competenze dell'Autorità per le garanzie nelle comunicazioni; tecnologie dell'informazione, con particolare riferimento alle funzioni di normazione tecnica, standardizzazione, accreditamento, certificazione ed omologazione nel settore, coordinamento della ricerca applicata per le tecnologie innovative nel settore delle telecomunicazioni e per l'adozione e l'implementazione dei nuovi standard*”.

cooperation agreement between the two. The agreement was originally intended as a ‘one-off’ measure to help AGCOM start its own activities.<sup>414</sup>

Nevertheless, the European Commission and the Italian Antitrust Authority criticized this cooperation agreement. According to the Commission, market players had reported “*a degree of confusion as regards some specific areas (licensing, numbering and frequency). With regard to licensing, concerns can be attributed to the fact that applications were still being processed by Ministry personnel, since the NRA has not yet completely taken over this function. In relation to frequencies, while the NRA is responsible for frequency allocation and planning, the Ministry has retained responsibility for frequency assignment*”.<sup>415</sup> The Italian Antitrust Authority likewise argued that the Minister should not enjoy powers to issue regulatory measures of a general character.<sup>416</sup> In 2000, the Commission further voiced operators’ discontent and the friction between the latter and Italian authorities.<sup>417</sup> The same criticism was reported by OECD in 2001, which stated that “*this regulatory power-sharing ...*

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<sup>414</sup> See “*Accordo di collaborazione tra il Ministero delle comunicazioni e l’Autorità per le garanzie nelle comunicazioni del 2 luglio 1998*, published in the AGCOM’s bulletin of 1998 (available at [http://www.agcom.it/b\\_u\\_98/pdf/acc\\_020798.pdf](http://www.agcom.it/b_u_98/pdf/acc_020798.pdf)). The 1998 agreement was set to expire in 1999, but could be renewed.

<sup>415</sup> See COM (1999) 537, Annex 3, 13.

<sup>416</sup> See Parere AS 120, *Operatività dell’Autorità per le garanzie nelle comunicazioni*, of February 5, 1998 (*Bollettino* 4/1998) (“*al Ministero non debbano attendere compiti relativi all’emanazione di misure regolamentari generali che, in ragione della loro complessità e delicatezza, andrebbero esercitati dall’autorità settoriale, configurata dal nostro ordinamento come organismo con caratteristiche di autonomia e indipendenza*”).

<sup>417</sup> See COM(2000)814, *Sixth Report on the Implementation of the Telecommunications Regulatory Package* (December 7, 2000), Annex 2, (available at <http://europa.eu.int/ISPO/infosoc/telecompolicy/implrep6/Annex2-en.pdf>). According to the Commission: “[O]perators say that the NRA is not yet fully operational in all its functions, and it is not clear which functions have not yet been transferred from the Ministry to the NRA. The Italian authorities contend, however, that the distribution of tasks between the two is clearly defined by the relevant agreement, and that cooperation between the two authorities works well (as in the case of 3G systems) ...” (176).

created confusion for market players in trying to determine which is the relevant regulatory body ...”.<sup>418</sup>

The cooperation agreement was nonetheless tolerated because of its temporary nature.<sup>419</sup> However, at the end of 1998 the agreement was renewed for 1999<sup>420</sup> and in March 1999, Law No. 78 enabled the continuation of power sharing until AGCOM’s recruitment process had been completed.<sup>421</sup> Thus, the law of 2001 on the transfer of licensing powers from AGCOM to the Ministry exacerbated a situation of discontent and sub-optimal

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<sup>418</sup> See OCED, *Reviews of Regulatory Reform*, ch. 6, at 92. See also COM(2001) 706, *Seventh Report on the Implementation of the Telecommunications Regulatory Package* (November 28, 2001), Annex 3, (available at [http://europa.eu.int/information\\_society/topics/telecoms/implementation/annual\\_report/7report/documents/finalannex2.pdf](http://europa.eu.int/information_society/topics/telecoms/implementation/annual_report/7report/documents/finalannex2.pdf)), “[T]he distribution of tasks between the NRA (AGCOM) and the Ministry of Communications as regards licensing is not entirely clear following the adoption of legislation” (207).

<sup>419</sup> See COM (539) 1999, “[T]he concerns expressed ... arise mainly from a lack of human resources in the NRA, according to market players. Recruitment is ongoing and fewer than half of the total staff have been hired so far (113 out of 260). However, about half of the existing staff are involved in regulatory work (50 people) and, according to the NRA, the majority of its future staff should also be assigned to regulatory issues. The major difficulty with regard to recruitment concerns the selection of personnel who have been working for the Ministry (approximately 1500 applications for about 100 jobs), which is expected to be completed by December 1999. The NRA plans to complete recruiting by the beginning of 2000, by which time it is expected to have 320 staff members - including both permanent and temporary contracts - and should be sufficiently resourced”.

<sup>420</sup> See *Relazione Annuale 1999 sull'attività svolta e sui programmi di lavoro*, para. 5 “[A]lla naturale scadenza del 31 dicembre 1998, l'accordo è stato prorogato fino al 30 giugno 1999, con le modificazioni ritenute utili per massimizzare i significativi risultati già conseguiti nella prima fase attuativa”.

<sup>421</sup> See Article 3-bis of Law No. 78 of 1999, which stated: “L'Autorità per le garanzie nelle comunicazioni, per lo svolgimento delle funzioni di propria competenza, continua ad avvalersi, in conformità agli accordi stipulati con il Ministero delle comunicazioni, delle strutture centrali e periferiche del Ministero stesso fino alla data di effettiva immissione in servizio del personale indicato nell'articolo 1, comma 17, della legge 31 luglio 1997, n. 249 [a provision which concerned AGCOM’s staff, set at 260 officers]. Restano validi gli atti e i provvedimenti adottati, nonché le attività poste in essere, dal Ministero delle comunicazioni sulla base di intese e accordi di collaborazione stipulati anche ai sensi degli articoli 11 e 15 della legge 7 agosto 1990, n. 241, e successive modificazioni” (emphasis added).

institutional arrangements (for competition) that had already prompted operators to raise their voice and demanded a swift solution in light of the delays the confusion was causing.<sup>422</sup>

The transfer of regulatory powers to the Ministry in 2001 marked a first step towards the consolidation of an Italian path, whereby elected politicians enjoyed a degree of control over suppliers. In other words, after the creation of AGCOM as an IRA had seen already conflicts between a UK-style logic of separation and a different understanding of the relationships between elected politicians and suppliers, in 2001 the proponents of an Italian-style regulation emerged as strong contestants. It is noteworthy that the 2001 law was passed under a government held by Giuliano Amato. This indicates that even one of the leading figures in favour of ‘cutting off’ the links between political parties and suppliers was not able to resist pressures to change course.

Furthermore, by AGCOM Resolution No. 61 of 2001, its structure was modified to include a Secretary General.<sup>423</sup> As can be recalled, during the passage of the bill, the opposition had demanded that a Secretary General post be created to counter-balance the pre-eminent position of AGCOM’s president, whose appointment was decided by the Prime Minister. On February 14, 2001, Antonio Catricalà was appointed as Secretary General,<sup>424</sup> whom Silvio Berlusconi would later appoint as Secretary General of the office of the Prime Minister. This further confirms that, at the same time when AGCOM was losing powers in favour of the Ministry, its independence from elected politicians was further weakened by the creation of a new post that should further enhance the ability of politicians to control AGCOM’s actions. Later developments would confirm that this trend was indeed going to

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<sup>422</sup> See *Il sole 24 ore*, 7.4.2001, “Licenze tv, lite Ministero-Authority – Tlc- Per il conflitto di competenze sospesa la gara sul <wireless local loop>”.

<sup>423</sup> See Gazzetta Ufficiale del 23 marzo 2001, n. 69.

<sup>424</sup> See press release ([http://www.agcom.it/comunicati/cs\\_140201.htm](http://www.agcom.it/comunicati/cs_140201.htm)).

become well-settled, giving rise to a new Italian path of limited separation between elected politicians and suppliers.

### **III. THE NEW ITALIAN PATH 2001-2007**

The transfer of licensing powers from AGCOM to the Ministry was followed by a string of episodes where the Italian-style logic of incomplete delegation to AGCOM saw important advances. Legislative initiatives to reduce the power of independent regulators, including AGCOM, started in 2001, when the Minister for the Public Administration, Franco Frattini, formed a commission of experts to study a reform of independent agencies. The main goal of the reform was to reduce the powers of regulatory authorities, including the abolition of the energy authority and the transfer of its powers to the Industry Ministry.<sup>425</sup>

The opposition denounced the government intention to ‘re-ministerialize’ regulation.<sup>426</sup> Enrico Letta, former minister of Industry, and Giuliano Amato put forward a bill to oppose the government attempt. Franco Frattini reacted by calling on the opposition to act for the common good.<sup>427</sup> The ruling coalition split and by 2002, there were several bills already in Parliament to reform independent agencies, including a bill by Forza Italia deputy Raffaele Costa which called for the outright abolition of all authorities and a bill by Bruno Tabacci, a CCD deputy acting as the head of the Committee for Industry in the Chamber of Deputies, and Pietro Armani, of Alleanza Nazionale, that was in support of the authorities’ independence.

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<sup>425</sup> See *Il sole 24 ore*, 23.11.2001.

<sup>426</sup> See *Il sole 24 ore*, 25.11.2001.

<sup>427</sup> See *Il sole 24 ore*, 11.12.2001 (“[S]arebbe auspicabile che un tema così delicato venisse affrontato in base al senso dello Stato e del bene comune e non come una battaglia politica qualsiasi di inizio legislatura, o, peggio, come confronto tra chi vuole migliorare l’assetto dell’ordinamento e chi vuole conservare qualche spazio che, colpevolmente, la politica ed i governi avevano abbandonato negli scorsi anni”).

The conflicts within the ruling coalition continued in 2002, when the commission set up by Franco Frattini presented a study on the reform of independent agencies, which called for a framework law,<sup>428</sup> whereas Bruno Tabacci was rather supportive of leaving independent agencies' role intact.<sup>429</sup> Franco Frattini announced that he aimed at presenting a version of the bill for approval by the government by October 2002.<sup>430</sup> In November 2002, Franco Frattini was appointed as a Minister of Foreign Affairs and Luigi Mazzella took over as minister of the public administration.

Luigi Mazzella continued in the footsteps of his predecessor and in March 2003 announced that the bill on the reform of the authorities was ready to be presented at the council of ministers.<sup>431</sup> The bill envisaged that AGCOM should lose powers over price controls. Moreover, it placed the energy authority under the direct control of the government. Finally, authorities' heads were to be appointed by Parliament, acting upon a choice made by the government.<sup>432</sup>

The ruling coalition split again over this version of the bill. Luigi Mazzella's under secretary, Learco Saporito, a deputy of Alleanza Nazionale, was against the plan to abolish the energy authority and so was his fellow party member Stefano Saglia.<sup>433</sup> Gianfranco Fini, the leader of the Alleanza Nazionale's party, was also against. Luigi Mazzella decided to

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<sup>428</sup> See *Il sole 24 ore*, 24.1.2002.

<sup>429</sup> See *Il sole 24 ore*, 3.5.2002.

<sup>430</sup> See *Il sole 24 ore*, 21.9.2002, 7.10.2002. The bill concerned a framework law, aimed at laying down uniform provisions on the appointment of the authorities' heads as well as their powers. The bill distinguished between authorities that were created to guarantee constitutional rights ("authority di primo livello") from those, which had monitoring powers, the latter category notably including the energy authority, which, the Minister argued, should become a simple office of regulation within the Industry Ministry.

<sup>431</sup> See *Il sole 24 ore*, 11.3.2003.

<sup>432</sup> See *Il sole 24 ore*, 12.3.2004.

<sup>433</sup> See *Il sole 24 ore*, 13.3.2003.

write a letter to the newspapers with the aim of clarifying matters.<sup>434</sup> Furthermore, in an effort to stave off criticism, a new version of the bill was prepared. This new version envisaged that the Presidents of the authorities were to be appointed by the government and the energy authority was not been abolished.<sup>435</sup> Other differences in the ruling coalition also ensued, following the issue of a decree to freeze tariffs, including electricity tariffs, which were under the control of the energy authority.<sup>436</sup>

Perhaps even more serious criticism attracted the choices over the appointments at the helm of the Antitrust Authority of Giorgio Guazzaloca and Antonio Pilati, against which consumer associations threatened legal action, while the opposition argued that their only merit was party affiliation and that their choice was a serious blow to the Antitrust Authority's prestige.<sup>437</sup> According to Mario Monti, former EU Competition Commissioner, the new Antitrust Authority Commissioners "*did not seem the result of an effort aimed at identifying the best the country can offer in terms of competence and independence*".<sup>438</sup> With respect to AGCOM, at the end of its mandate, Enzo Cheli, AGCOM's first president, stated that AGCOM needed "*more resources, more powers and more independence from vested interests*".<sup>439</sup>

Legal changes to further limit AGCOM's independence took place when Italy had to implement the EU legislative package approved to replace the first generation of liberalization directive and, in particular, Directive 2002/21 that set out certain provisions

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<sup>434</sup> See *Il sole 24 ore*, 26.3.2003.

<sup>435</sup> See *Il sole 24 ore*, 16.4.2003.

<sup>436</sup> See Law Decree of September 4, 2002, No. 193 and *Il sole 24 ore*, 4.9.2002.

<sup>437</sup> See *Il sole 24 ore*, 31.12.2004.

<sup>438</sup> See *Il sole 24 ore*, 4.1.2005 and 19.2.2005.

<sup>439</sup> See *Il sole 24 ore*, 4.12.2004.

concerning the role of independent regulators.<sup>440</sup> In the preparatory works,<sup>441</sup> the Commission criticized the split of competences between regulatory authorities and Ministries and urged Member States to grant more powers to the former.<sup>442</sup> Moreover, the rules on the

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<sup>440</sup> See Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive) (OJ 2002, L 108/33), Article 3, according to which “... *Member States shall guarantee the independence of national regulatory authorities by ensuring that they are legally distinct from and functionally independent of all organisations providing electronic communications networks, equipment or services. Member States that retain ownership or control of undertakings providing electronic communications networks and/or services shall ensure effective structural separation of the regulatory function from activities associated with ownership or control. Member States shall ensure that national regulatory authorities exercise their powers impartially and transparently. Member States shall publish the tasks to be undertaken by national regulatory authorities in an easily accessible form, in particular where those tasks are assigned to more than one body. Member States shall ensure, where appropriate, consultation and cooperation between those authorities, and between those authorities and national authorities entrusted with the implementation of competition law and national authorities entrusted with the implementation of consumer law, on matters of common interest. Where more than one authority has competence to address such matters, Member States shall ensure that the respective tasks of each authority are published in an easily accessible form. National regulatory authorities and national competition authorities shall provide each other with the information necessary for the application of the provisions of this Directive and the Specific Directives. In respect of the information exchanged, the receiving authority shall ensure the same level of confidentiality as the originating authority. Member States shall notify to the Commission all national regulatory authorities assigned tasks under this Directive and the Specific Directives, and their respective responsibilities*”.

<sup>441</sup> See COM (1999) 539, *Towards a new framework for Electronic Communications infrastructure and associated services - The 1999 Communications Review*.

<sup>442</sup> See COM (1999) 539, cit., “*Community legislation recognises that the functions of a national regulatory authority may be undertaken by more than one body, and in most Member States these functions are shared between the independent national regulator and the relevant Ministry, and in some cases a separate body for spectrum aspects. The Commission continues to have a number of concerns with regard to the effectiveness of some of these arrangements, and will strengthen existing legal provisions to ensure that:*

*the independent national regulator can undertake its role of supervision of the market free from political interference, without prejudice to the government’s responsibility for national policy;*

*allocation of NRA responsibilities to different bodies does not lead to delays and duplication of decision making;*

*where sector-specific regulators and national competition authorities are both involved in issues related to communications infrastructure and associated services, there is effective co-operation between the two bodies and that NRAs ensure that their decisions are compatible with Community competition law;*

*the decision-making procedures at national level are transparent” (para. 4.8.2; emphasis added).*



strengthening of regulators' independence and the definition of 'regulatory body' provided in the decision to set up a regulators' group as part of its drive to improve coordination between national regulators and the Commission,<sup>443</sup> show that EU legislation favoured an independent regulatory agency over a ministerial department.<sup>444</sup>

In spite of these EU directives, the implementation of the EU law provisions led to a further loss of AGCOM's powers and a corresponding accretion in the role of the Ministry. The implementation of these provisions took place in two stages: in 2002 the Parliament approved a law containing general principles of implementation and delegating to the government the adoption of a legislative decree; in 2003 the government then adopted a legislative decree in order to comply with the deadline for implementation, i.e. July 24, 2003.<sup>445</sup> In particular, Law No. 166 of 2002,<sup>446</sup> containing general principles of implementation, stated that the AGCOM and the Ministry should maintain the same

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<sup>443</sup> See Commission Decision of July 29, 2002 establishing the European Regulators Group for Electronic Communications Networks and Services (OJ 2002, L 200/38). Article 2 states: "*‘relevant national regulatory authority’ means the public authority established in each Member State to oversee the day-to-day interpretation and application of the provisions of the Directives relating to electronic communications network and services ...*".

<sup>444</sup> See S. Cassese, 'Il concerto regolamentare europeo delle telecomunicazioni', *Giornale di diritto amministrativo*, 2002, 689 ss. ("*L'apposita decisione della Commissione ... preso atto che in tutti gli Stati membri vi sono Autorità indipendenti dai governi ... istituisce il Gruppo ...*" (emphasis added)). See also R. Perez, *Telecomunicazioni e concorrenza* (Milano: Giuffrè, 2002), 131. "*L'allargamento [of the Ministry's competences] è in contrasto con la normativa comunitaria. E' vero che la normativa comunitaria ... vuole stringere i controlli sull'attività di regolazione degli Stati, ma si tratta, comunque, di una 'stretta' da esercitare su di un organo neutrale ed indipendente*".

<sup>445</sup> See Article 28, "*Member States shall adopt and publish the laws, regulations and administrative provisions necessary to comply with this Directive not later than 24 July 2003. They shall forthwith inform the Commission thereof. They shall apply those measures from 25 July 2003*".

<sup>446</sup> See "Disposizioni in materia di infrastrutture e trasporti" (GURI 2002, 3.8.2002, n. 181).

competencies as provided by existing legislation, which was tantamount to perpetuating the situation of confusion then existing.<sup>447</sup>

Based on these principles, in 2003 AGCOM and the Ministry entered into a new bilateral agreement,<sup>448</sup> which provided for the creation of a joint committee to handle the allocation of tasks. For instance, this meant that AGCOM and the Ministry had to coordinate in their relationships with the European Commission. It was indeed an elementary requirement that the European Commission be met with a single position coming from Italian authorities. Nevertheless, AGCOM and the Ministry often failed to do so and submitted documents independent of each other, sometimes expressing conflicting views.

In August 2003, Legislative Decree No. 259 reiterated the same provisions as Law No. 166 of 2002.<sup>449</sup> Moreover, a new law adopted in December 2003 also granted to the

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<sup>447</sup> See art. 41, para.2, n. 6) (“*affidamento all’Autorità per le garanzie nelle comunicazioni delle funzioni di vigilanza, controllo e garanzia sull’attuazione delle politiche di regolamentazione del Ministero delle comunicazioni, fatte salve le competenze di cui alla legge 31 luglio 1997, n. 249, e successive modificazioni, al decreto-legge 23 gennaio 2001, n. 5, convertito, con modificazioni, dalla legge 20 marzo 2001, n. 66, ed al decreto-legge 12 giugno 2001, n. 217, convertito, con modificazioni, dalla legge 3 agosto 2001, n. 317*”).

<sup>448</sup> See 2003 AGCOM Report, “*Il nuovo accordo di collaborazione fra il Ministero delle comunicazioni e l’Autorità, sottoscritto in data 28 gennaio 2003, discende dalla comune sensibilità verso le importanti innovazioni che gli interventi normativi in itinere produrranno: essi, infatti, investendo l’intero quadro normativo sia del settore audiovisivo che del settore delle telecomunicazioni influenzeranno significativamente l’attività di cooperazione e di raccordo tra Ministero ed Autorità. In particolare, l’accordo prevede l’istituzione di un comitato permanente, coordinato alternativamente dai componenti appositamente designati, quali componenti del comitato stesso, dal Ministro e dal Presidente dell’Autorità. Il Comitato si riunisce, di norma, con cadenza bimestrale ed ha il compito di risolvere eventuali problemi sorti in sede di applicazioni dell’accordo stesso, nonché di valutare questioni attinenti la coerente azione dei due organismi in materie di interesse comune che coinvolgono le rispettive competenze, al fine di individuare ed avanzare proposte anche di tipo organizzativo. Anche nel corso di quest’anno, infine, l’attività consultiva svolta dall’Autorità, su richiesta del Ministero, è stata considerevole ed ha riguardato, tra l’altro, il decreto di recepimento del nuovo quadro regolamentare europeo*” (available at [http://www.agcom.it/rel\\_03/index.htm](http://www.agcom.it/rel_03/index.htm)).

<sup>449</sup> See Article 7: “*1. Il Ministero esercita le competenze derivanti dal decreto legislativo 30 luglio 1999, n. 300 come modificato dal decreto legge 12 giugno 2001, n. 217, convertito con modificazioni dalla legge 3 agosto 2001, n. 317, dal decreto legge 2 gennaio 2001, n. 5, convertito con modificazioni dalla legge 20 marzo 2001, n. 66, e dalla legge 16 gennaio*

Ministry the powers to issues sanctions when deciding whether an infringement had been committed in one of its areas of competences,<sup>450</sup> as listed in the law itself. Besides licences and authorizations, the catalogue comprised, among others, market monitoring powers including the power to issue fines (*l) controllo del mercato, vigilanza sul rispetto delle normative di settore e applicazione delle sanzioni*); and update of universal service obligation and powers to monitor compliance (*m) adeguamento periodico del servizio universale nel campo delle comunicazioni; n) verifica degli obblighi di servizio universale nei settori delle comunicazioni*).<sup>451</sup> Again, these powers were described in very general terms, without

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*2003, n. 3. 2. L'Autorità è Autorità nazionale di regolamentazione ed esercita le competenze derivanti dalla legge 14 novembre 1995, n. 481, non derogate da leggi successive, dalla legge 31 luglio 1997, n. 249, come modificata dal decreto legge 2 gennaio 2001, n. 5, convertito con modificazioni dalla legge 20 marzo 2001, n. 66, e dalla legge 16 gennaio 2003, n. 3. 3. L'Autorità, in quanto Autorità nazionale di regolamentazione, ed il Ministero, per la parte di propria competenza, adottano le misure espressamente previste dal Codice intese a conseguire gli obiettivi di cui agli articoli 4 e 13, nel rispetto dei principi di ragionevolezza e proporzionalità. Le competenze del Ministero, così come quelle dell'Autorità, sono notificate alla Commissione europea e sono rese pubbliche sui rispettivi Bollettini ufficiali e siti Internet”.*

<sup>450</sup> See Legislative Decree No. 366 of 2003 (*Modifiche ed integrazioni al decreto legislativo 30 luglio 1999, n. 300, concernenti le funzioni e la struttura organizzativa del Ministero delle comunicazioni, a norma dell'articolo 1 della legge 6 luglio 2002, n. 137*). Article 2, (2) “*Nelle materie proprie del Ministero delle comunicazioni l'accertamento delle violazioni e l'applicazione delle relative sanzioni amministrative sono espletati dagli uffici centrali e periferici del Ministero stesso, nell'ambito delle rispettive competenze, ferme restando le funzioni spettanti agli organi di polizia. L'ordinanza - ingiunzione, di cui al secondo comma dell'articolo 18 della legge 24 novembre 1981, n. 689, e' adottata nel termine di 180 giorni dalla scadenza del termine indicato nel primo comma dell'articolo 16 della medesima legge”.*

<sup>451</sup> See Article 2(1) of Legislative Decree No. 366 of 2003 (“*L'articolo 32-ter del decreto legislativo 30 luglio 1999, n. 300, come introdotto dall'articolo 6, comma 2, del decreto-legge 12 giugno 2001, n. 217, convertito, con modificazioni, dalla legge 3 agosto 2001, n. 317, e' sostituito dal seguente: «Art. 32-ter (Funzioni). - 1. Il Ministero svolge in particolare funzioni e compiti di spettanza statale nelle seguenti aree funzionali, tramite gli organi centrali e gli Ispettorati territoriali: a) politiche nel settore delle comunicazioni; b) rapporti con l'Unione europea e con le organizzazioni e le agenzie internazionali nel settore delle comunicazioni, ferme restando le competenze del Presidente del Consiglio dei Ministri di cui al decreto legislativo 30 luglio 1999, n. 303, e del Ministro degli affari esteri; c) disciplina del settore delle comunicazioni elettroniche; d) gestione nazionale di programmi comunitari in materia di comunicazioni elettroniche; e) radiodiffusione sonora e televisiva pubblica e privata anche nelle forme evolutive; f) regolamentazione dei servizi postali, con particolare riferimento al contratto di programma con il fornitore del servizio universale; g) emissione delle carte valori postali; h) formazione e addestramento professionale anche tramite la Scuola superiore di specializzazione in telecomunicazioni; i) concessioni, licenze e autorizzazioni nei settori delle comunicazioni; l) controllo del mercato, vigilanza sul rispetto delle normative di*

providing any further clarification of their scope and possible coordination with AGCOM's powers with a view to giving the Ministry the maximum possible latitude in interpreting these provisions. The allocation of competences between AGCOM and Ministry was published on the AGCOM website, pursuant to Legislative Decree No. 259.<sup>452</sup>

However, in 2004 AGCOM and Ministry still operated through a bilateral agreement and a joint committee.<sup>453</sup> In 2006, AGCOM annual report mentioned that the two bodies continued their cooperation with a view to dispel the uncertainty surrounding the allocation of tasks.<sup>454</sup> Similarly, in 2007 AGCOM annual report stated that “è *proseguita l'attività di*

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*settore e applicazione delle sanzioni; m) adeguamento periodico del servizio universale nel campo delle comunicazioni; n) verifica degli obblighi di servizio universale nei settori delle comunicazioni; o) tutela delle comunicazioni; p) piano nazionale di ripartizione delle frequenze e relativa attività internazionale; q) gestione degli accordi internazionali in materia di assegnazione dei diritti d'uso delle frequenze e delle reti ed orbite dei sistemi satellitari e notifica all'Unione internazionale delle telecomunicazioni; r) assegnazione dei diritti d'uso delle frequenze e delle numerazioni; s) controllo delle emissioni radioelettriche e delle interferenze; t) tecnologie dell'informazione; sicurezza delle reti; studi e ricerca scientifica nei settori delle comunicazioni e delle tecnologie dell'informazione (ICT); normazione tecnica, ivi compresi gli aspetti inerenti alla numerazione, standardizzazione, anche quale organismo nazionale di standardizzazione (NSO), accreditamento, certificazione ed omologazione nei settori dell'ICT; definizione degli standard di qualità dei servizi nei settori dell'ICT; coordinamento della ricerca applicata per le tecnologie innovative nei settori dell'ICT e per l'adozione e l'implementazione di nuovi standard. Restano ferme le competenze e le funzioni attribuite al Presidente del Consiglio dei Ministri e al Ministro per l'innovazione e le tecnologie; u) servizi multimediali, con particolare riferimento alle iniziative volte alla trasformazione su supporti innovativi e con tecniche interattive delle produzioni tradizionali; v) certificazione per i prodotti e i sistemi informatici commerciali; z) adozione delle regole di impiego degli apparati radioelettrici; aa) espletamento di prestazioni per conto terzi; bb) rilascio dei titoli di abilitazione all'esercizio delle stazioni radioelettriche; cc) attività di collaudo ed ispezione delle apparecchiature radioelettriche di bordo; dd) vigilanza e controllo sugli enti operanti nell'ambito delle comunicazioni; ee) agevolazioni all'editoria, ferme restando le competenze del Dipartimento per l'informazione e l'editoria della Presidenza del Consiglio dei Ministri e del Ministero delle attività produttive”).*

<sup>452</sup> See [http://www.agcom.it/operatori/operatori\\_competenze.htm](http://www.agcom.it/operatori/operatori_competenze.htm), last accessed on December 10, 2007.

<sup>453</sup> See [http://www.rna.it/doc/agcom/20040630\\_accordo\\_MINCOM\\_AGCOM.pdf](http://www.rna.it/doc/agcom/20040630_accordo_MINCOM_AGCOM.pdf)

<sup>454</sup> See 2006 Annual Report, para. 3.3 (“*La collaborazione con il Ministero delle comunicazioni, che la complessità del quadro normativo del sistema delle comunicazioni rende necessaria e opportuna, ha proseguito nel corso dell'ultimo anno, al fine di assicurare coerenza e continuità nell'azione dei due organismi e anche di dissipare le incertezze nei confronti dei consumatori e degli utenti relativamente all'attribuzione delle specifiche e differenti*

*collaborazione istituzionale e di confronto tra l’Autorità e il Ministero delle comunicazioni nell’ambito delle rispettive competenze e del rispetto del complesso sistema normativo”*.<sup>455</sup>

New developments occurred under the Prodi government that indicate the limited separation existing between elected politicians and suppliers. First of all, in September 2006, the government openly condemned Telecom Italia decision to re-organize its business, including the sale of its mobile telephony business.<sup>456</sup> Romano Prodi stated that he would consider action to keep the company in Italian hands. Later, when disagreements ensued with Telecom Italia chairman, Marco Tronchetti Provera, the government disclosed that Romano Prodi had requested that control over Telecom Italia should remain in Italian hands.<sup>457</sup> Opposition leader Gianfranco Fini also agreed on this position.<sup>458</sup>

Secondly, in February 2007 the government recognized in a bill to reform independent agencies that the current regulatory system in Italy is weak because powers originally entrusted to authorities have been transferred back to Ministries.<sup>459</sup> The bill therefore aimed to strengthen the regulatory system by reinforcing their powers.<sup>460</sup>

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*competenze”* – emphasis added). See also F. Bruno and G. Nava (eds.), *Il nuovo ordinamento delle comunicazioni* (Milano: Giuffrè, 2006), ch. I.1.3.3, “I rischi per l’indipendenza delle Autorità” (88).

<sup>455</sup> See 2007 Annual Report, para. 3.3.

<sup>456</sup> See *Il sole 24 ore*, 11.9.2006, 14.9.2006 and 19.9.2006. See also *Financial Times*, 13.9.2006.

<sup>457</sup> See the press release published on the government website on September 13, 2006 (<http://www.governo.it/Presidente/Comunicati/dettaglio.asp?d=29118>).

<sup>458</sup> See *Il sole 24 ore*, 14.9.2007.

<sup>459</sup> See Relazione al disegno di legge (“... *il sistema è debole; alcune prerogative originariamente attribuite alle Autorità istituite sono state ritrasferite, nel corso della scorsa legislatura, ad organismi governativi, riducendone così l’ambito di intervento e i poteri, e sono stati introdotti poteri abnormi di ingerenza che minacciano l’indipendenza delle Autorità; altre competenze, invece, sono risultate poco efficaci per mancanza o insufficienza di risorse o di strumenti, in particolare, sanzionatori*”).

<sup>460</sup> Ibidem (“... *risulta improcrastinabile un intervento in materia di Autorità di regolazione e di vigilanza dei mercati, volto a rafforzarne funzioni, poteri e capacità d’azione ... il disegno di legge interviene in materia di Autorità di regolazione dei servizi di pubblica utilità rafforzando i poteri di regolazione ...*”).

Furthermore, the bill sought to change the rules on appointments of authorities' members in order to end appointment criteria based on political party allegiance.<sup>461</sup> This would have important consequences for AGCOM.

The bill envisaged that AGCOM (like all other authorities) would have four commissioners only. The proposed rules on appointments envisaged appointment by a decree of the President of the Republic, upon a resolution from the Council of Ministers. More precisely, Article 16 of the bill provided that the Council of Minister would adopt a resolution to designate the appointees.<sup>462</sup> The resolution is adopted on the basis of a proposal

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<sup>461</sup> Ibidem (“... Innanzitutto, il numero dei componenti è fissato a cinque per ciascuna Autorità, così rendendo più efficiente il processo decisionale e abbandonando criteri di rappresentanza politica”).

<sup>462</sup> Article 16 states: “1. Ogni Autorità di cui alla presente legge è organo collegiale composto dal Presidente e da quattro membri. 2. Il Presidente e i membri sono nominati con decreto del Presidente della Repubblica, previa deliberazione del Consiglio dei Ministri, su proposta del Presidente del Consiglio dei ministri, al termine della procedura di cui al comma 3. 3. Possono essere designati con deliberazione del Consiglio dei Ministri, su proposta dei Ministri competenti per materia, nel rispetto dell’equilibrio di genere, soltanto soggetti che abbiano presentato la loro candidatura nell’ambito di una apposita procedura di sollecitazione pubblica avviata con la pubblicazione nella Gazzetta Ufficiale di un apposito bando predisposto dalla Presidenza del Consiglio. Le designazioni del Governo sono sottoposte al parere vincolante della Commissione parlamentare di cui all’articolo 21, espresso a maggioranza di due terzi dei componenti, previa pubblicazione del curriculum vitae e audizione delle persone designate. La procedura di nomina dei componenti delle Autorità è avviata centoventi giorni prima della scadenza del mandato dei componenti delle Autorità in carica con la pubblicazione del bando di cui al presente comma. 4. I componenti delle Autorità sono scelti tra persone di indiscussa moralità e indipendenza e di comprovata professionalità e competenza nei settori in cui operano le medesime Autorità. Non possono essere nominati componenti coloro che nell’anno precedente alla nomina hanno ricoperto incarichi elettivi politici o che, in relazione alle cariche assunte nell’anno precedente alla nomina nelle imprese regolate o vigilate, permangono portatori di interessi in conflitto con l’esercizio della funzione di regolazione o di vigilanza, nonché coloro che sono stati componenti del Collegio di altra Autorità indipendente. Restano ferme altresì le incompatibilità per i titolari di cariche di Governo previste dalla normativa vigente. I componenti delle Autorità sono nominati per un periodo di sette anni e non possono essere confermati nella carica. In caso di dimissioni o impedimento del Presidente o di un membro delle Autorità, si procede alla sostituzione secondo le regole ordinarie previste per la nomina dei componenti dell’Autorità, la loro durata in carica e la non rinnovabilità del mandato. Per le Autorità di nuova istituzione, due dei componenti sono nominati per un periodo di cinque anni, così da evitare il rinnovo contestuale dell’intero collegio. 5. In caso di gravi e persistenti violazioni della legge istitutiva, di impossibilità di funzionamento o di prolungata inattività, il Consiglio dei Ministri, su proposta del Presidente del Consiglio dei ministri, può deliberare, previo parere favorevole espresso a maggioranza di due terzi dei componenti

from the Ministers who have the competence by subject matter (e.g., the Minister of Communications will make a proposal for AGCOM). The appointees must receive approvals from a special committee that is formed by members of the Chamber of Deputies and the Senate (the *Commissione parlamentare per le politiche della concorrenza e i rapporti con le Autorità di regolazione, vigilanza e garanzia dei mercati*).<sup>463</sup> This Committee will vote and

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*dalla Commissione parlamentare di cui all'articolo 21, la revoca motivata del Collegio, che viene disposta con decreto del Presidente della Repubblica. 6. Per l'intera durata dell'incarico i componenti delle Autorità non possono esercitare, a pena di decadenza, alcuna attività professionale o di consulenza, essere amministratori o dipendenti di soggetti pubblici o privati, né ricoprire altri uffici pubblici di qualsiasi natura, compresi gli incarichi elettivi o di rappresentanza nei partiti politici, né avere interessi nelle imprese operanti nei settori di competenza delle Autorità. All'atto di accettazione della nomina, i componenti delle Autorità sono collocati fuori ruolo o in posizioni analoghe, se dipendenti di pubbliche amministrazioni. Nell'anno successivo alla cessazione dall'incarico, i componenti delle Autorità non possono intrattenere, direttamente o indirettamente, rapporti di collaborazione, di consulenza o di impiego con imprese nei cui confronti sono state adottate misure regolatorie specifiche o aperte istruttorie di vigilanza dell'Autorità presso cui hanno svolto il mandato, né esercitarvi funzioni societarie. La violazione di tale divieto è punita, ferma restando la responsabilità penale ove il fatto costituisca reato, con una sanzione pecuniaria pari nel minimo a 25.000 euro e nel massimo alla maggiore somma tra 250.000 euro e l'importo del corrispettivo percepito. Ferme restando le altre disposizioni previste dagli ordinamenti di settore, all'imprenditore che abbia violato tale divieto si applicano le sanzioni previste dall'articolo 2, comma 9, della legge 14 novembre 1995, n. 481. I valori delle predette sanzioni sono rivalutati, ogni due anni, in base alla variazione dell'indice dei prezzi al consumo per le famiglie di operai e impiegati calcolato dall'Istituto nazionale di statistica. 7. I componenti e i funzionari delle Autorità, nell'esercizio delle proprie funzioni, sono pubblici ufficiali e sono tenuti al segreto d'ufficio. Restano ferme le disposizioni in materia di segreto d'ufficio e di scambio di informazioni previste dalle leggi speciali per le Autorità di cui al Capo III. Con apposito regolamento, le Autorità adottano il proprio codice deontologico, che stabilisce le regole di condotta dei componenti, dei dirigenti e del personale, anche con previsioni relative al biennio successivo alla cessazione del mandato o del rapporto di impiego. 8. Le disposizioni dei commi 1, 2, 3, 4 e 5 non si applicano alla Banca d'Italia. 9. In via transitoria, fino a quando le funzioni in materia di conflitto di interessi dei titolari di incarichi di Governo non siano trasferite ad altro ente o organo, la nomina del Presidente e dei componenti dell'Autorità garante della concorrenza e del mercato è effettuata dai Presidenti delle Camere nell'ambito di una rosa pari ad almeno al doppio dei soggetti nominandi, selezionata dalla Commissione bicamerale di cui all'articolo 21, secondo le procedure di candidatura di cui al comma 3. In via transitoria, fino a quando le funzioni in materia di conflitto di interessi dei titolari di incarichi di Governo non siano trasferite ad altro ente o organo, la disposizione di cui al comma 5 non si applica all'Autorità garante della concorrenza e del mercato. 10. Le disposizioni del presente articolo trovano applicazione alle nomine successive alla data di entrata in vigore della presente legge. La riduzione a cinque del numero dei componenti dell'Autorità Garante della concorrenza e del mercato opera a partire dalla scadenza del mandato dell'attuale consiliatura”.*

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See Article 21 (“1. È istituita la Commissione parlamentare bicamerale per le politiche della concorrenza e i rapporti con le Autorità indipendenti di regolazione, vigilanza e garanzia dei mercati. 2. La Commissione: a) esprime il parere vincolante sulle nomine di cui all'articolo

candidates will need a two third majority. The Committee vote is binding on the Council of Ministers. Eligibility rules exclude people who have obtained electoral charges in the year prior to the appointment. The appointees need to respond to a public tender, published in the official journal. In any event, the bill did not proceed forward because the Prodi government fell in 2008 and lost the ensuing general elections.

Finally, in April 2007, America Movil, a Mexican telecommunications carrier, and AT&T, the US telecommunications provider, started negotiations to acquire control over Telecom Italia.<sup>464</sup> The government put pressure to stop the deal, threatening regulatory action, such as a measure to oblige Telecom Italia to sell its network.<sup>465</sup> This wasn't the first time that, after its privatization, the government took an active stance in ownership over Telecom Italia. In 1999, when Telecom Italia was the object of a hostile takeover in 1999, the government had used its rights as a shareholder to facilitate the success of the offer.<sup>466</sup>

#### **IV. THE RE-POLITICIZATION OF ITALIAN TELECOMMUNICATIONS AFTER 1997**

The evidence described above shows how elected politicians used their law making powers to pass measures with a view to limit the powers of AGCOM. This can lead one to conclude that, in the contest between the UK-style logic and its opponents, the latter had

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*16; b) esamina la relazione annuale presentata da ciascuna Autorità di cui alla presente legge; c) si esprime sui pareri e sulle segnalazioni formulate dalle Autorità e sulle iniziative legislative e regolamentari di rilevanza strategica sull'assetto concorrenziale dei mercati e sulla tutela dei consumatori e degli utenti. 3. La Commissione non si occupa di singoli casi sottoposti all'esame delle Autorità e non esprime giudizi tecnici sulle singole questioni. 4. Restano ferme le competenze delle Commissioni permanenti delle due Camere, che concorrono all'attività della Commissione con modalità stabilite dai regolamenti parlamentari?").*

<sup>464</sup> See *Il sole 24 ore*, 10.4.2007.

<sup>465</sup> See *Il sole 24 ore*, 18.4.2007

<sup>466</sup> See *Il sole 24 ore*, 11.4.1999. For a journalistic account, see D. Giacalone, *Razza corsara : i mercati mal controllati e la politica in fuga : il caso Telecom e la mala privatizzazione* (Soveria Mannelli : Rubbettino, 2004).



prevailed, as it is borne by the changes in the institutional design of AGCOM. Further evidence of this can be traced by observing the other ways in which elected politicians have intervened in the sector after 1997. Note that the discussion is limited to the formal resources available to elected politicians because this can be more easily traced (whereas a review of informal relationships would clearly exceed the scope of this work).

It is useful to remark at the outset that elected politicians stopped using law making powers to regulate the sector almost completely.

- The works carried out by the 8<sup>th</sup> Senate Standing Committee, a permanent committee with powers to review and approve all legislative proposals in the field of telecoms, show that, between 2001 and 2006, the only law concerning regulation of telecommunications concerned Internet Service Providers' interconnection rates.<sup>467</sup>
- The official directory of legislation supplied by the Parliament for the period after 1996 again lists no other legislative measure concerning regulation of telecommunication but the law on ISPs, i.e. Law No. 59 of 2002.<sup>468</sup>

Instead of law making powers, elected politicians turned to powers over appointment of AGCOM members. With respect to the latter, Thatcher has provided evidence about the 'politicisation' of appointments in Italy through a comparison with IRA appointments in

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<sup>467</sup> See *Riepilogo Attività Svolta dalla 8<sup>a</sup> Commissione Lavori Pubblici, Comunicazioni* (Ufficio di Segreteria della 8a Commissione permanente, Aprile 2006), available at [http://www.senato.it/documenti/repository/commissioni/comm08/Documenti/attivita\\_XIV.pdf](http://www.senato.it/documenti/repository/commissioni/comm08/Documenti/attivita_XIV.pdf).

<sup>468</sup> Law No. 59 of 2002, 'Disciplina relativa alla fornitura di servizi di accesso ad INTERNET' (GURI n. 86, 12.4.2002).

other countries.<sup>469</sup> The table below reproduces the information concerning the degree of politicisation of IRA appointments in four countries, Britain, France, Germany and Italy.

**Politicisation of appointments 1997-2001**

	<b>Britain</b>	<b>France</b>	<b>Germany</b>	<b>Italy</b>
% holding or standing for public office	3%	9%	15%	23%
% publicly affiliated with party	0	46%	36%	77%

The table uses two measures: holding of office in government or standing for elections; and publicly known party affiliation. The results are based on appointments to all IRAs in Italy, including the competition authority and the energy authority, besides AGCOM. Since data span the period between 1990 and 2001, they cover only the first term of AGCOM (which was set up in 1997).

The data shows that Italy is “*the most politicized of the four countries*” and “*almost all members of AGCOM ... have clear party political affiliations and a high proportion have stood or held public office*”, whereas “*Britain is the most depoliticised of the four countries*”.

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<sup>469</sup> See Thatcher, ‘Independent Regulatory Agencies and Elected Politicians in Europe’, 47-66.

<sup>470</sup> Thatcher, Independent regulatory agencies, 52-53.

The above is confirmed by primary sources:<sup>471</sup>

- Since 1997, industry representatives have equipped themselves with a department to handle public and regulatory affairs. Their task is no longer to seek to establish contact with elected politicians, but to have regular contacts with AGCOM commissioners.
- Vodafone has adopted a code of conduct that provides for serious limitations on contacts with political parties and similar rules have been adopted by Telecom Italia.
- The way in which AGCOM Commissioners carry out their mandate is strongly linked to their political affiliation. Regulatory decisions are thus turned into a strongly politicized arena, where technical advice is often sidestepped by political goals.
- There are indications that the modernization of telecommunications networks and the investment needed to deliver New Generation Networks may give to political parties an even stronger leverage since they could use both influence over AGCOM Commissioners and direct powers through the Minister to influence investments decisions by suppliers in ways that match their political goals.

The above brings about a confirmation of the earlier findings of the chapter and, at the same time, enables some further observations.

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<sup>471</sup> Interview, Director of Public and Legal Affairs.

First of all, the relationships between elected politicians and AGCOM confirm that Italy has indeed embarked on a new path. Even in a very politicized environment, there is no suggestion of a return to direct control by elected politicians over suppliers. Elected politicians recognize their limited means to affect suppliers and use indirect means, such as their powers over appointment of AGCOM commissioners.

Second, the way in which elected politicians use their powers in the sector confirms that, in the contest between the two logics, a distinct Italian logic has emerged, which is indeed based on a limited degree of separation between elected politicians and suppliers. Compared to the UK logic of complete de-politicisation, one could describe Italy's overall trajectory as going from elected politicians' control over suppliers to limited separation. This epitomizes change and continuity in Italian telecommunications. On the one hand, there is indeed change, since Italy moved from a logic of control to one of separation between elected politicians and suppliers. On the other hand, separation is limited, which means that, in making choices about new institutions, policy makers have preferred not to break away from the past completely. This is discussed further in the conclusion below.

## V. CONCLUSION

The findings of the chapter provide evidence of the existence of a new Italian path, emerging after the conflicts that accompanied the creation of new institutions, notably AGCOM. The logic of this path is based on limited separation between elected politicians and suppliers. This can be shown once again through benchmarking with Britain.

**Table 11 - UK and Italy 1997 -2007**

		1997	2007
<b>No. of suppliers</b>	UK	Not predetermined	Not predetermined
	Italy	Not predetermined	Not predetermined
<b>Ownership</b>	UK	Private/listed	Private/listed
	Italy	Private/listed	Private/listed
<b>Degree of competition</b>	UK	Competition	Competition
	Italy	Competition	Competition
<b>Allocation of regulatory powers</b>	UK	OFTEL	OFCOM
	Italy	AGCOM	AGCOM/Ministry

The above table shows that, after a brief convergence, Italian and British telecommunications institutions have started to diverge again in a crucial aspect, namely the allocation of regulatory powers. The legislative measures of 2001 and 2003 have transferred to the Ministry regulatory powers previously granted to AGCOM.

In contrast with Britain, where the Secretary of State and the IRA have well defined areas of competence and coordinate their actions, the Ministry has been entrusted with the very same regulatory powers that belonged to AGCOM, namely licensing in 2001 and general and yet unspecified powers in 2003. This shows that regulatory powers in Italy are exercised by two bodies concurrently, with very little coordination, as denounced by operators and public institutions (including the OECD, the European Commission and the Italian Antitrust Authority).



This already shows that the Italian path is a distinct path from the British one, in spite of several similarities. If one tries to understand its logic, the following is worth considering.

- First of all, the government has taken over the role of the regulator and acted to set tariffs in pursuance of its economic policies.
- Secondly, elected politicians have been very actively involved in crucial episodes concerning the ownership of Telecom Italia, by favouring a suitor or discouraging an unwanted buyer through the threat of using regulatory powers.
- Thirdly, AGCOM's independence, already limited due to the rules on the appointment of its Commissioners and President, has been further reduced by legislative measures and the creation of a post of Secretary General.
- Fourthly, elected politicians have used rules on appointment to fill AGCOM posts with individuals with clear party political affiliation.

Taken together, these aspects show that the Italian path of institutional development after 1997 is based on a logic of limited separation between elected politicians and suppliers, that stands in contrast with the UK logic. One can thus conclude that, after conflicts over institutional choices between proponents of a UK-style logic of rejection of increasing returns and those who drew a different lesson from the collapse of increasing returns and wished to follow an Italian path, starting from 1997 Italy has steadily embarked on a distinct path where the separation between elected politicians and suppliers is limited, leading again the two countries along diverging trajectories.

The foregoing provides a more critical reading of the Italian trajectory than can be appreciated through a snap-shot study focusing exclusively on the reforms that took place in

1997. Faced with decisive institutional choices after 1992, policymakers had two options, namely either to break away completely from the past trajectory of elected officials' involvement with telecommunications providers, or to opt for a compromise solution whereby elected officials could retain a degree of control. The two options clearly involved a different degree of change relative to the past trajectory as it can be gathered through the benchmarking exercise. By choosing an Italian-style logic, the convergence with Britain proved short lived for when Italy created AGCOM, it already showed that independent agencies' mandate was the subject of a political fight and was being renegotiated with a view to reduce it, not to enlarge it. The subsequent developments show that Italy and Britain have resumed their divergent trajectories, since the Italian path is based on a logic of limited separation between elected politicians and suppliers.

## **7. Path Dependence and Institutional Reform: Friends or Foes?**

### **I. INTRODUCTION**

In keeping with the inductive methodology of the thesis, the task of this final chapter is to assess the empirical evidence described in the previous chapters and to provide an answer to the research question, i.e. whether increasing returns affected institutional reform in the case of Italian telecommunications and, if so, how and why. As set out in chapter one, the salience of this question stems from the fact that path dependence currently has a limited ability to explain 'off-path' change and thus it is ill equipped to explain institutional reforms. A perhaps simplistic way to portray this limitation is to characterize path dependence and institutional reform as foes at the moment. As happens often in real life, the best way to maintain the hostility is to refuse to know your enemy. Thus, the thesis aims to provide empirical evidence precisely on the role of increasing returns in processes of institutional reform.

This chapter presents below the findings of each of the previous chapters with a view to show how each contributed to answering the research question and then offers concluding overall remarks on the contribution of the thesis to path dependence.

### **II. THE ROOTS OF THE PATH: ITALIAN AND BRITISH TELECOMMUNICATIONS INSTITUTIONS BEFORE 1979**

Chapter 2 provided a short history of telecommunications institutions before 1979. From its inception, the provision of telecommunications services was provided by multiple suppliers. A tender that took place in 1925 awarded area licences to five private operators, while a sixth licence for inter-area telecommunications was awarded to a Ministerial body, ASST, for lack of bidders. In the aftermath of the 1929 economic crisis, the private suppliers



became indirectly owned by the state through IRI and its sub-holding company STET. The number of suppliers was reduced in 1964, when SIP acquired the other area licensees. In any event, provision of telecommunications services remained fragmented as, besides ASST, there were other two licensees active in the provisions of intercontinental and satellite telecommunications services.

This fragmentation had been judged negatively already in 1925, when the Mussolini government received an unfavourable advice on the split between different area providers. Nevertheless, the split was upheld for political reasons. Thereafter, the split-supplier system became progressively untenable from an economic and technological point of view. In particular, the survival of ASST appeared devoid of economic or technical reasons. Yet, ASST enjoyed backing from political parties and so it managed not only to avoid abolition, but to steadily expand its sphere of business, including new services such as data transmission.

In contrast to the Italian situation, provision of telecommunications services in Britain was entrusted to a single entity, the Post Office. Moreover, and again in contrast to Italy, there was no private ownership after 1911, as the Post Office was originally a government department and later became a public corporation in 1969. By 1979, therefore, the two countries had already almost a century of different histories.

### **III. THE BENCHMARK COUNTRY: THE UK LOGIC OF SEPARATION BETWEEN SUPPLIERS AND ELECTED POLITICIANS**

Chapter 3 presents the changes in British telecommunications institutions that took place in 1984 and argues that the trajectory followed by Britain thereafter was inspired by a stable logic, namely the separation of elected politicians from suppliers. More specifically, pursuant to the 1984 Telecommunications Act, the sector was gradually open to competition and, as a consequence, there was no longer a pre-defined number of operators. Moreover,

regulatory tasks were attributed to Oftel, a newly-established IRA. In the same year, BT was privatized through a share offer. These changes brought about a significant break with the past and gave to Britain a leadership in regulatory change. In the following years, Britain's institutional trajectory remained stable, thus offering an ideal benchmark against which one can assess the development of the Italian path.

To this end, it is also important to take into account the defining elements of the British logic, which is based on separation between elected politicians and suppliers. This logic has several dimensions. First of all, elected politicians have no ability to set prices. Pricing decisions are left to suppliers acting autonomously. Under well-specified circumstances, the IRA may have the power to set prices for some services and suppliers. Secondly, elected politicians have little ability to affect market structure as they have no power to veto change of ownership, entry/exit by firms and/or other sale of assets. If provided by law, IRAs and competition authorities can have the power to issue decisions on such matters. Thirdly, elected politicians do not interfere with IRA's powers and responsibilities. It is against this benchmark that Italy's trajectory will be assessed.

#### **IV. THE FAILED REFORMS OF 1979-1992: CONFIRMING PATH DEPENDENCE**

Chapter 4 presents key findings with respect to empirical evidence on increasing returns in Italian telecommunications and how they affected the institutional trajectory. The chapter lends support to path dependence's current claims by showing that increasing returns led Italy onto a trajectory of bounded change, dominated by a logic based on elected politicians' control over suppliers, i.e. the opposite of the UK logic.

Empirical evidence concerning increasing returns shows that telecommunications providers and political parties were entangled in a self-reinforcing relationship based on the 'political' use of the former resources by the latter, due to the fact, that during this period,

weak coalition governments exercised powers through political patronage and thus used state-controlled companies such as the licensees and ASST to foster their goals. In order to do so, political parties appointed 'loyal' managers in proportion to their electoral weight and then expected managers to carry out their instructions so that they could divide between themselves the spoils (*'lottizzazione'*). Furthermore, elected politicians used their powers over tariff approval (for the licensees) and budget (for ASST). The self-reinforcing character of the relationship was linked to the fact that investment decisions driven by political goals resulted in inefficient choices, which damaged the providers, thus making them even more dependent on political parties for fresh funds.

Political parties needed to apportion the resources available between themselves. The split-supplier system was highly conducive to such apportionment, by offering several opportunities to divide resources between the multiple political parties that formed the various coalition governments and between the factions of the leading party, the Christian Democrat Party. Each party and faction thus had its own appointees and could draw on them to boost its power base. It was common, for instance, for each new Minister of Posts and Telecommunications to recruit ASST staff from his/her own electoral district on being appointed. The Christian Democrat Party was 'entitled' to appoint the top managers at STET, SIP and ASST, but the Socialist Party contested its leadership and strove to increase its influence. The other parties split between themselves the remaining posts available and the resources thereof.

The foregoing shows that the split-supplier system was strongly supported by increasing returns, which kept Italy's trajectory of institutional development on a bounded change course, with the split supplier system remaining firmly at the heart of the organization of the sector. In particular, during this period there was first a long period of inertia when no

legislative initiative was proposed in spite of pressures to do so due to the hindrance that the system of split-supply represented for a modern telecommunications sector. When EU law required separation of regulatory functions from operations in 1987, the bill that was proposed in 1989 to wind up ASST envisaged the continuation of the split-supplier system. The law that was eventually passed in 1992 to wind up ASST equally permitted several suppliers and the plans that were conceived in May 1992 envisaged a three-company structure, with ASST being in essence reincarnated in the guise of one of the three licensees.

Chapter 4 thus provides empirical evidence as to the existence of increasing returns in Italian telecommunications institutions. It further links these increasing returns to the institutional trajectory and argues that increasing returns were responsible for bounded change, thus upholding path dependence theory. Through benchmarking with the UK, the chapter argues that the two countries were on two diverging trajectories due to the very significant differences in formal institutional arrangements. Moreover, the two countries had opposing logics of institutional development. Whereas the British logic was based on separation between elected politicians and suppliers, in Italy the former enjoyed control over the latter and this relationship was made progressively stronger by its self-reinforcing character.

#### **V. THE UNEXPECTED REFORMS OF 1992-1997: NEW DYNAMICS OF INCREASING RETURNS**

The fundamental purpose of chapter 5 was to show that increasing returns, i.e. increasing returns as observed in the previous chapter, were at the origin of a process of rejection by actors, which in turn caused a counter-reaction by other actors affected by the loss of power that rejection of increasing returns would have meant for them. The chapter shows how these reactions and counter-reactions affected the institutional trajectory, leading Italy onto a new path. The findings of the chapter are important because they show a so far

unnoticed feature of increasing returns relative to institutional development, namely that increasing returns may be responsible for 'off-path' change through a process of rejection by actors.

Indeed, after the Law of 1992, one should have expected the continuation of the split-supplier system. Quite to the contrary, in 1993 a CIPE resolution passed under the first Amato government called for the unification of all existing providers into Telecom Italia, with a view to terminate the process of increasing returns. In 1995, a law was passed to set up independent regulatory authorities, including an authority to regulate the telecommunications sector, whose fundamental charter was approved in July 1997. Re-regulation of the sector and new rules on competition were passed in the same year.

Independent regulatory authorities were meant as another device to prevent increasing returns to arise and are thus part of the process of rejection of increasing returns. At the same time, rejection of increasing returns elicited a counter reaction by other actors whose powers were threatened, i.e. ministerial bureaucracies and elected politicians. The latter acted to reduce the extent to which independent agencies could take away powers from them. These counter reactions emerged in the passage of the laws on independent agencies in 1995 and on AGCOM in 1997 and they raise the issue as to the true direction of Italy's path.

By 1997, Italy and Britain had come to share key institutional arrangements. In both countries the number of operators was no longer fixed by law, opening the sector to full competition. Moreover, in both countries the incumbent had been privatized. Finally, regulatory powers were entrusted to an IRA. However, there were conflicts in Italy as to whether new institutions were to follow a UK-style logic of separation between suppliers and elected politicians or whether some degree of control over suppliers by elected politicians should still remain. Both positions were linked to past increasing returns, which can thus be

traced as the origin of Italy's new path. The direction towards which the path was going was still unclear, though, due to the aforementioned conflict between two logics. This justifies extending the inquiry to the period after 1997.

## **VI. THE NEW ITALIAN PATH 1997-2007**

Chapter 6 shows a steady erosion of AGCOM's powers to the advantage of the Communications Ministry. In particular, regulatory powers previously entrusted to AGCOM, notably licensing, were assigned to the Ministry by a law passed in 2001 under a government held by Giuliano Amato. This was strongly criticized by operators and by the Italian Antitrust Authority, the OECD, and the European Commission. In addition, it was in contrast with the 2002 EU framework, which recommended a clear division of tasks and strengthened IRAs.

In 2003, new legislation granted to the Ministry new and unspecified regulatory powers. During these years, there was a general climate of hostility against IRAs, with the energy authority risking abolition and the government stepping in to freeze energy tariffs in 2002. In a bill adopted in 2007, the government held by Romano Prodi explicitly admitted that the IRA had been weakened in the previous years and sought to pass a reform to boost their powers. However, in 2006 the same government strongly criticized Telecom Italia for its decision to sell off its mobile telephony arm, putting pressure on the chairman to resign. In 2007, when foreign carriers started negotiations to acquire control over Telecom Italia, the government threatened regulatory action, thus favouring an "Italian" solution. This was not the first time the government influenced ownership matters, as in 1999 it had also played an important role in the success of a hostile takeover on Telecom Italia. Finally, the chapter showed that elected politicians have used rules on appointment to fill AGCOM posts with

individuals with clear party political affiliation, thus making Italy “the most politicised” country in terms of relationships between elected politicians and IRAs.

The foregoing shows that, after a temporary convergence with Britain, Italy was on a distinctive path. The two countries differed crucially in that the allocation of regulatory powers was split between the Ministry and AGCOM. Moreover, elected politicians enjoyed a power of appointment that weakened its independence and exercised it to re-politicise the sector. The logics of the two countries were therefore different.

While the British logic was based on separation between suppliers and elected politicians, in Italy elected politicians enjoyed a considerable degree of control over suppliers. Indeed, during the period studied elected politicians in Italy had been able to pass price setting measures, to affect ownership decisions and, moreover, to acquire regulatory powers, while rules on appointment of AGCOM Commissioners and President made it a “*mini-Parlamento*”. This distinctive logic marks the Italian path.

## **VII. CONCLUSION: THE CONTRIBUTION OF THE THESIS TO PATH DEPENDENCE AS A THEORY TO STUDY INSTITUTIONAL REFORM**

Taking as its starting point path dependence current shortcomings in dealing with institutional change other than ‘bounded change’, the thesis asked whether increasing returns affect institutional reform and, if so, how and why. In response to this question, the thesis puts forward two findings that represent its contribution to path dependence.

First of all, the thesis provides ‘an anatomy’ of increasing returns by an empirical analysis of how increasing returns worked in Italian telecommunications. It shows that increasing returns can arise from interactions between different levels, i.e. a sector of the economy and national politics. This underscores the importance of carrying out studies of path dependence by looking at the links between different levels.

Secondly, the thesis showed that increasing returns can be responsible for 'off-path' change. This was made possible in Italy by reactions and counter-reactions by actors. This finding has a potential far-reaching impact for path dependence because it answers directly its critics. It suggests that increasing returns are a valid explanatory tool for the whole gamut of institutional life. However, this demands careful specification of the identity of those to whom increasing returns accrue. Sometimes path dependence seems like a face-less mechanism that, once set in motion, becomes unstoppable until a non-specified meteorite-like event happens. The thesis argues that there is no need to have recourse to *deus ex machina* explanations. Nevertheless, it is required that a more sustained attention be paid to beneficiaries of increasing returns, identifying potential conflicts and following up on their development over an extended time-horizon. Increasing returns impact on institutional reform may play out for over a decade, as in the Italian case where still in 2007 one is able to trace the institutional trajectory to increasing returns dating back to 1992.

These findings are not confined to Italy or telecommunications. The form that increasing returns took in Italy through the special link between elected politicians and telecommunications providers may be unique. But interactions between different levels certainly is not and, moreover, reactions to increasing returns by actors are bound to be common in other sectors and countries. Once again, they may not be as forceful as rejection, but it would be difficult to believe that actors in other countries or sectors remain completely passive spectators in the presence of increasing returns.

Finally, the thesis also contributes to a more balanced view on the implications of increasing returns for countries' ability to reform. Whereas increasing returns have so far been conceived exclusively as a factor explaining undesirable lock-in, the thesis shows that lock-in can be the breeding ground for reform as past increasing returns are then met with



rejection and later reform. This shows that institutional change under path dependence does not require exogenous shocks, as actors within a path keep the ability to start 'off-path' change.

## **Appendix**

### **Persons Interviewed**

Giuliano Graziosi, STET CEO

Franco Sircana, IRI official

Giuliano Amato, Prime Minister

Francesco Chirichigno, Telecom Italia CEO

Luigi Prosperetti, Senior Economic Advisor and Professor

Maurizio Mensi, AGCOM senior counsel

Bianca Maria Martinelli, Vodafone, Director of Public and Legal Affairs

Giulio Masselli, Vodafone, Head of Spectrum & Mobile Payments, Public and Legal Affairs

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