Italian municipalities crippled by financial speculation

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A conflict between local municipalities and banks has developed in Italian courts over municipal and regional authorities' purchases of financial derivatives. It exposes the precarious state of public finances, and the collusion between Italy's ruling elite and financial institutions—as authorities engaged in irresponsible, poorly understood transactions that have bankrupted the public purse, effectively transferring massive losses onto the backs of the working class.

In the years between 1995 and 2008, local administrators, including public health care and transportation agencies, utilized public funds to acquire derivatives and similar financial instruments, allegedly lured in by financial institutions with promises of lower costs on loans. Cases have been reported where banks concealed commissions or demanded that localities buy derivatives in order to obtain loans.

Derivatives are financial contracts or financial instruments, whose value is derived from the value of something else. Today's derivatives are increasingly exotic forms of speculation, as they are often no longer based on the exchange of commodities. In the case of credit default swaps, for example, bets can be made on the solvency or default of a firm, or even a state.

In order to guard against changes in interest rates charged by the banks on their loans, many local administrations entered in swap deals, ultimately concealing new forms of borrowing. It is estimated that more than 600 Italian municipalities engaged in such deals.

The total exposure amount is unknown, given the nature of derivatives and the many unregulated markets on which they are traded. However, estimates put the total borrowed by municipalities at €36 billion in 2008, that is, at the beginning of the financial crisis ignited by the collapse of Lehman Brothers.

Many local administrations are on the brink of bankruptcy, a situation compounded by the massive cuts the Italian government has recently adopted through the Stability Law, which slashes a total of €11.6 billion in social spending. In the more desperate cases, city councillors and mayors have resorted to the sale of property in order to maintain solvency.

Although the numbers are expected to rise considerably, so far there are at least 20 criminal investigations under way, plus some 40 complaints in which local administrators seek the cancellation of the derivative contract and all related fees. The city of Rimini, last October, won a court judgment voiding interest rate swap payments due to the Italian bank UniCredit.

However, this will not be the rule. According to ForexPros, a specialized financial web site, many municipalities are already so broke they cannot even afford an attorney—let alone a financial consultant**.**

The entire Italian establishment is implicated. The city of Milan is facing a €1.7 billion debacle, with Depfa Bank, Deutsche Bank, JPMorgan and UBS facing fraud charges. Other significant cases involve the regions of Lazio, Piedmont and Tuscany as well as the cities of Turin, Pisa, Verona, Carrara, Teramo, Fermo, Genoa, Reggio Calabria, Biella, Florence, Benevento and Pistoia. "Left" parties are as involved, as well as ones on the right.

Moreover, many lawsuits will inevitably raise the question of legal jurisdiction. Many derivatives are based on terms established by ISDA (International Swaps and Derivatives Association, Inc.), which are governed by London's court system. This applies as well to many cases in Germany and France, where local administrations are mounting similar cases.

In an article entitled "National Security and Support to Local Administrations", the Italian intelligence web site *Gnosis* noted: "The vulnerability of the current situation is very high: sudden defaults by local administrations could cause negative effects and a panic chain reaction that would compromise the stability of public finance, local as well as national." It adds, "the economic-financial interrelations generated by the mass of derivatives in existence are able to determine a systemic risk to the economic-financial security of the state."

The legal framework that allowed this development is the product of a systematic push by both right and "left" governments to eliminate the restrictions set up in the postwar period on local administrations and their involvement in banking, insurance and stock trading.

A series of bills—the Berlusconi I (1995 Budget Law) and Berlusconi II (2002 Budget Law and Decree 389/2003) governments as well as under the bourgeois "left" Prodi government (Budget Law 2007 and 2008), which included the "anti-capitalist" *Rifondazione*—allowed local administrations to resort to private capital to finance their investments, opening

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the doors to derivative instruments and speculation.

Behind these bills one figure played a particularly substantial role—Giulio Tremonti, the current Minister of Economy and Finance, who is being considered by sections of the bourgeoisie as Prime Minister Silvio Berlusconi's likely successor. He has occupied the same post in every Berlusconi government and has been the main proponent of these initiatives. He serves as a bridge between the right and the "left," given his past affiliation to the Socialist Party and to former Prime Minister Bettino Craxi, as well as his experience as a writer for the petty-bourgeois left radical publication *Il Manifesto*.

Tremonti has consistently depicted the Italian bank system as perfectly healthy. Last year, as Ireland was faced with a financial crisis that nearly bankrupted the country, he praised Italian banks for having limited their exposure "only to €22 billion. We are the least exposed, all others have an enormous exposure."

Last summer, the banks stress test conducted in Italy was used to further conceal the true state of financial institutions. On that occasion, he said: "As a whole, results confirm the ability of Italian banks to absorb the impact of a significant deterioration of macroeconomic conditions."

Now Tremonti, the very architect of this sand castle—who in 2008 was forced to suspend some of the provisions that enabled local administrators to trade derivatives—is spearheading an attack on what he calls "financial doping." Accusing mainly German bankers, he exclaims: "The current crisis is not just about sovereign debt, it also concerns private finance, banks (…) In the last decade some [EU] countries grew through financial drugs." Germany, he explains, "has enormous amounts of dispensation to EU rules."

The claim that the Italian establishment is uniquely immune to—or innocent of—financial speculation is utterly false. In the current debacle involving municipalities, for example, Italian banks like UniCredit and BNL-BNP are just as involved as others. There are several reasons why Tremonti is trying to popularize this absurd notion of Italian financial exceptionalism.

Firstly, it's an attempt to conceal the gravity of the crisis faced by the Italian economy. With an anemic growth rate in the fourth quarter 2010 of only 0.1 percent as reported by the OECD, Tremonti is at pains to champion the Italian bank system as a bulwark of financial orthodoxy.

Secondly, Tremonti's promotion of anti-German chauvinism is a measure of the massive international tensions building up inside the European Union. Tremonti is seeking to limit the pressure of the financial markets on the Italian state and defend the state machine's room for fiscal maneuver, but only in the interests of the financial aristocracy. His goal is to give it greater latitude to carry out massive social cuts. Cuts will be the inevitable outcome of any capitalist policy that leaves the riches of the wealthy untouched—especially given Italy's gargantuan sovereign debt, which stands at close to 120 percent of GDP.

Thirdly, Tremonti is trying to hide his own responsibility in this affair. He helped set up the very system he is now denouncing—notably with his Decree 389, written in 2003, in which he handed oversight of derivatives transactions by public entities to international credit rating agencies. These agencies, however, proved completely unreliable, as many of them ended up giving worthless mortgage assets their highest AAA ratings.

The WSWS spoke to Marco Tedone, a financial consultant based in Rome who advised several municipalities on derivatives. In his opinion, "there are derivative models that can put the client in a condition of loss. If your cap or floor are too high or too low compared to the real trend of rates and you are not familiar with these terms, without the advice of a consultant you are taking a great risk."

Tedone explains that: "derivatives are a financial mass that moves, but doesn't correspond to real economy. They are based on the notion that you are building on future buy or sell options, however you are unloading a debt on future generations, given that these are sometimes 20-year-span operations."

"It's difficult to estimate the real impact of this phenomenon on the state economy, as many local administrators take their time reacting to the situation, hoping perhaps for some solution from congress. However in my experience I see serious difficulties. They are talking about federalism, but basically they are splitting the north from the south. Speaking to the administrators, I don't see any stability in their books, on the contrary I hear suffering and difficulties."

He noted, "there are many people, including heads of state, who don't know what a derivative is. Beyond the actual instrument and the financial risks, there are substantial social implications."

This reporter contacted a number of local administrations requesting an interview. No reply was received.

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