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Abstract: The existing literature on financialisation has devoted insufficient attention to how governments wield the market-based practices and technologies of financial innovation to pursue statecraft objectives. Because of this inattention, scholars have missed the opportunity to examine a crucial facet of the *financialisation of the state*. To remedy this limitation, the present article investigates how and why the Italian government designed derivatives-based strategies during the 1993-99 period. It argues that these tactics gained momentum in the context of the political struggles that developed in Italy beginning in the late 1980s. In particular, the study shows how a neoliberal-reformist alliance came to power and used financial innovation to comply with the Economic and Monetary Union (EMU) admission criteria. EMU dynamics enhanced the power position of the neoliberal-reformist coalition vis-à-vis the country's traditional political and business establishment. This work offers insights that go beyond the specificities of the Italian case. It encourages further research on how governments in other countries simultaneously exposed state institutions to financial speculation and gained access to a range of new instruments through which they could manage state affairs in a financialised manner.

Keywords: derivatives; financialisation of the state; statecraft; public debt; neoliberalism; Italy; Economic and Monetary Union (EMU).

Recently, the use of derivatives by the Italian Republic has frequently appeared in the headlines of global media. Two events attracted particular attention. First, on 3 January 2012, Morgan Stanley closed out a series of outstanding derivatives contracts with the Italian Department of Treasury (Moore 2012). This operation implied that Italy was obligated to pay $3.38 billion to cancel bets on interest rates that it had undertaken with the bank since the 1990s (Dunbar and Martinuzzi 2012). Second, on 26 June 2013, the *Financial Times* (2013; Dinmore 2013b; 2013a) and *La Repubblica* (2013; Greco 2013) published data from a confidential report of the Italian Treasury detailing the restructuring of eight other derivatives contracts. The document revealed that the Italian Republic was exposed to at least €8 billion in mark-to-market losses in derivatives markets (FT 2013).[1] Furthermore, these figures fuelled a long-standing controversy according to which the Italian government used derivatives to window dress the public deficit and join the Economic and Monetary Union (EMU) in 1999 on the basis of false accounting (Steil 2002).

Given the significance of these events, it is striking that the thriving literature on financialisation – despite substantial efforts to explore the tendency of modern finance and its market-based dynamics to permeate numerous spheres of human life – has devoted insufficient attention to how and why governments use derivatives.[2] Because of this inattention, critical scholars have missed the opportunity to examine how the governmental adoption of derivatives reflects a crucial phenomenon of present-day capitalism: governments often exercise statecraft by deploying the methods and instruments of financial innovation.[3] These activities represent a key facet of the *financialisation of the state*, that is, the restructuring of state institutions and power in line with the growing influence of finance in today's world.

To remedy this limitation, the present article investigates the case study of the Italian government and how different administrations devised derivatives-based strategies during the 1993-99 period. It argues that these practices gained momentum in the context of the power struggles that unfolded in the country starting in the late 1980s. In particular, the work investigates how an alliance of pro-market technocrats and centre-left politicians (henceforth, neoliberal reformists) enhanced its position in the domestic scenario by advocating for a market-oriented modernisation of Italian capitalism in line with the objective of participating in the EMU. The EMU project functioned as an external constraint on the country's traditional political and business establishment, the reproduction of which depended on high public debt, the growth of the state-owned sector and the highly concentrated structure of corporate ownership (Dyson and Featherstone 1996; Sbragia 2001; Bianchi 1987; Deeg 2005). Financial innovation played a central role in the statecraft strategies of neoliberal reformists. Having captured executive power, these actors exploited innovative financial methods to achieve their pivotal objective of complying with EMU admission criteria. First, they encouraged hedge funds to arbitrage the interest-rate convergence between Italian and German bonds via over-the-counter (OTC) derivatives markets (Dunbar 2000: 149–62). Second, they entered into derivatives contracts to window dress the decisive 1997 budget deficit (Piga 2001: 122–9).

Although this work examines events that are specific to Italy, it does so with the aim of fostering research on other instances of the same phenomenon elsewhere. Indeed, the Italian case reflects a general, yet uneven, evolution: starting in the 1980s, the governments of many countries abandoned their traditional practices of public-debt governance in favour of a market-oriented approach (IMF 2003; OECD 2002). They gradually transitioned away from making debt-related decisions, primarily through administrative actions, and adhered to the notion that the state should behave as any other actor in the marketplace (Giovannini 1997: 45–6). In so doing, whilst governments became more vulnerable to the crisis-prone dynamics of global financial markets, they also gained access to a range of new tools through which they could implement statecraft in a finance-mediated way and for the purpose of sustaining a neoliberal hegemonic order.

This work is structured in six parts. The first section reviews two research streams in critical studies of finance: one stream investigates the role of derivatives in modern capitalism; the other stream considers the interaction between state and finance. This review highlights the importance of problematising the governmental use of derivatives because these practices indicate the market-based transformation of statecraft in the context of financialisation. Thereafter, the section advances an agency-centred approach to interpret the specificities of the Italian case.

Drawing on this approach, the second section explores the agential conflicts and the dynamics of institutional construction unfolding in Italy beginning in the late 1980s. Specifically, focusing on the formation of a neoliberal technocratic elite and their pro-market critique of Italian capitalism, the study investigates how these actors argued for modernising government-debt markets and debt-management technology. This shift entailed the adoption of new procedures in both primary and secondary markets that were intended to save the Treasury debt-servicing costs. Derivatives were integrated within this process as risk-management tools that increased the attractiveness of government-debt securities to investors. This renovation imposed a certain degree of market discipline on ruling political parties and their dissipation of public finance.

Turning to the 1992-99 period, the third section focuses on how technocrats played a pivotal role in the Maastricht negotiations (Dyson and Featherstone 1996). These actors challenged Italy's political and business establishment by exploiting the EMU as a lever that increased their agential power in the domestic arena.

The fourth section examines how technocrats captured the executive office in 1993 and gained the necessary latitude to implement reforms. As the conflict over EMU accession intensified, these technocrats wielded financial innovation as the quintessential statecraft strategy. The Treasury and the Bank of Italy sought to influence interest-rate convergence between Italian and German bonds via OTC derivatives markets, and they particularly encouraged the Long-Term Capital Management (LTCM) hedge fund to help reduce the interest-rate spread (Dunbar 2000: 149–62). Between 1993 and 1997, these activities were crucial in shrinking government deficits by reducing interest expenditures on debt.

The fifth section focuses on the 1996-99 period, when the Olive Tree coalition was in power. The 1996 election forged an alliance between technocrats and centre-left politicians that led Italy to the EMU accession in 1999. To do so, they reinforced austerity measures, liberalisation reforms and the battle for interest-rate convergence.

The sixth section investigates how a more controversial development occurred in conjunction with the aforementioned initiatives: neoliberal reformists arranged a currency swap that was most likely part of a broader strategy intended to window dress the 1997 budget deficit (Piga 2001: 122–9).

Framing derivatives and the financialisation of the state

Scholars contributing to the financialisation debate have failed to properly investigate how governments wield derivatives to pursue statecraft objectives. Consequently, they have missed the opportunity to analyse a crucial dimension of the financialisation of state institutions and power. This inattention is evident in critical studies on both derivatives and the state-finance nexus.

In essence, research on derivatives has evolved in two directions. On the one hand, a group of scholars focuses on the impact of these instruments on the nature of present-day capitalism. Most notably, Bryan and Rafferty (2006) study how derivatives shape capitalist relations in several ways. First, they argue that these tools represent a third degree of separation in the ownership of capital after the joint-stock form. Second, they contend that derivatives function as flexible monetary anchors that provide stability to a global financial system that restrains labour's living standards. Third, they argue that derivatives intensify capitalist competition by comparing all forms of capital across space and time. This process applies pressures on both capital and labour to perform in line with globally acceptable rates of return. In a subsequent study, Bryan and Rafferty (2011) advance a further proposition that derivatives expand capital accumulation by isolating the risk of numerous events occurring in our surrounding reality. These events are then commodified into instruments that are traded on financial markets.[4]

This agenda is highly innovative, and other researchers have drawn on it extensively. For example, Wigan (2009) builds on the thesis of derivatives as a third degree of separation in capital ownership. He contends that these tools represent 'artifices of indifference' that enable financialisation to disengage from the requirements of the tangible economy. However, despite providing such important insights, the studies above primarily focus on abstracting capitalism from the numerous layers of historical specificity and explaining how derivatives provide new opportunities for capital accumulation to grow. For this reason, they fall short of capturing the actual agents who adopt these practices on the ground and on the basis of the institutional context in which these actors are embedded. Ultimately, this inattention to agency and institutions hinders a proper understanding of how and why state officials would resort to derivatives as pivotal instruments of modern-day financial innovation.

On the other hand, scholars in social studies of finance focus instead on micro-level analyses of derivatives markets, actors and technologies with the aim of revealing their socio-cultural character. For instance, in their ethnography of the Chicago Board Options Exchange, MacKenzie and Millo (2003) observe that the Black-Scholes-Merton theory for pricing options was empirically validated because traders adopted it in their daily operations. In other words, the formula 'performed' the market such that it produced the phenomena that it described (Austin 1962; Callon 1998). Following a similar ethnographic approach to the subject matter, Lépinay (2011) studies the complexities of creating, trading and accounting derivatives in a leading French bank. In so doing, he uncovers the socio-cultural processes that permeate the world of derivatives, with a particular emphasis on the epistemic problem of knowledge management amongst the actors involved.

At first glance, social studies of finance appear to provide a useful conceptualisation of agential behaviour and institutional construction. Thus, this approach could be deployed to investigate a new research theme, such as the use of derivatives in public-debt management. However, social studies of finance tend to focus on actors and institutions within small-scale networks, but they do not examine how these actors and institutions are connected to broader political-economic and socio-cultural phenomena (Braun 2015; Lagna 2015: 209). Consequently, if applied to our case study, this approach would fall short of capturing how the governmental use of derivatives is inherently linked to macro-level transformations occurring outside the confined spaces of the Italian government and debt-management office.

Hence, it appears that critical scholars on derivatives are generally inattentive to the governmental adoption of such instruments, which is not to say that they do not allow for the possibility of examining this issue. Rather, they seek to investigate different processes, and their theoretical frameworks are primarily equipped for such purposes. Let us now review the research conducted on the state-finance nexus, as shown below.

Analyses exploring the interaction between state and finance are similarly inattentive to governments' use of derivatives. In this regard, scholars enhance our understanding of how the state enables financial actors to influence numerous dimensions of our reality. For instance, Engelen *et al.* (2011) examine how politicians and policymakers in the United States (US) and the United Kingdom (UK) construct a regulatory regime that favours financial expansion as a beneficial process for the broader economy. Another stream of literature explores how finance shapes the marketisation of welfare-state institutions, such as pensions, housing, education and healthcare (Aalbers 2008; Blackburn 2003; Engelen *et al.* 2014; Pollock 2004). However, despite analysing important facets of the financialisation of the state, scholars who focus on the state-finance nexus do not properly reflect on how and why public officials utilise derivatives. This inattention is particularly evident in the field of International Political Economy (IPE), especially in the work by Hardie (2011; 2012), which is highly relevant to our study because it investigates the financialisation of public-debt markets and the introduction of new trading practices, including derivatives.

Hardie examines the impact of financial globalisation on government policies by focusing on the cases of Lebanon, Turkey and Brazil. In line with previous research conducted by Mosley (2003), Hardie illustrates how investors use government-bond markets as the main arena to pressure states, thus influencing the availability and costs of debt financing. Interestingly, Hardie interprets the financialisation of public-debt markets as the development of a trading environment in which investors can enter or exit positions easily and in which they are able to execute a wide range of innovative strategies, such as short selling and risk hedging. Against the mainstream argument advanced by international financial organisations (IMF 2003; OECD 2002), he concludes that highly financialised bond markets do not allow governments to borrow on a sustainable basis (Hardie 2011: 142–3).

Thus, Hardie properly captures the financialisation of state institutions in the form of a market-based modernisation of public-debt markets. This process represents one of the most important channels whereby governments become acquainted with derivatives. However, Hardie's analysis has one shortcoming: it reveals how financial actors constrain governmental decisions, but it does not explain how governments can exploit those very same constraints to realise political-strategic goals. Specifically, Hardie treats financialisation as an independent variable that influences governmental borrowing capacities to varying degrees. In so doing, he conceptualises governments' abilities to borrow as either highly unstable, when the financialisation of debt markets and investors is high, or less unstable, when the financialisation of debt markets and participants is low. Paradoxically, this unilateral view provides governments with the latitude to act only in the event of low levels of financialisation, but it does not appreciate how the development of financialisation also multiplies opportunities for governmental action to occur via highly marketised means. In a word, Hardie's framework is not suitable for researching the construction of a tactical scenario in which financialised practices and incentives not only limit but also *enable* governments to exercise statecraft through market-based channels.

This critique suggests that we can derive significant heuristic mileage by shifting our attention from how financial markets impose constraints on governments to how governmental strategies can be devised through the expansion of market dynamics (Konings 2010b). Such an analytical shift does not imply that we should underestimate the unstable character of public borrowing in periods of financialisation. Instead, it entails abandoning the sterile state-market dichotomy to focus on the social relations constructing state and market institutions as part and parcel of a comprehensive whole that is human reality (Watson 2005: 21). In so doing, we can understand how statecraft projects can be implemented through the institutional networks of market formation and, above all, how such structures provide leverage to the agency of certain social groups vis-à-vis others. In other words, we must recognise that the growth of financial markets implies the development of new social relations of control that enhance the power of the state and particularly those dominant agents who are able to exploit its organisational complexities (Konings 2010a: 743).[5]

To operationalise this analytical shift towards the enabling character of financial expansion, this article draws on critical studies in IPE (Knafo 2010; 2013; Konings 2010b; 2011) and deploys an agency-centred approach that conceptualises human relations as an interactive field in which individuals relate to one another through the mediation of constantly renegotiated institutions.[6] In this context, key social forces shape the institutional framework to leverage their actions in a structural manner. However, these strategies and their unintended effects not only limit other actors but also allow them to experience imperatives in potentially infinite ways. This perspective provides appropriate methodological tools to explore how the speculative trends of global financial markets enabled key Italian actors to wield a financialised form of statecraft in an attempt to secure their neoliberal hegemony over the domestic political-economic arena.[7]

The next section examines the prelude to these dynamics: how a neoliberal-minded technocratic elite emerged and how it pressed for a market-oriented restructuring of public-debt governance.

Setting the stage: Technocrats, neoliberal reformism, and the renovation of public-debt markets

During the 1980s, Italian public debt grew considerably, exceeding 100 per cent of the debt-to-gross domestic product (GDP) ratio by the early 1990s (OECD 2014). Increasing debt levels were common across the Western world (Masson and Mussa 1998), but this problem assumed unique significance in Italy because of the country's political and economic trends.

Since the 1960s, the ruling parties – most notably, Christian Democracy (DC) and the Italian Socialist Party (PSI) – had controlled state resources to guarantee the reproduction of their voting base. Accordingly, these parties had patronage networks in the vast state-owned sector (Bianchi 1987; Ginsborg 2001: 139–42; Pasquino 1995) and were able to determine how and where to channel government expenditures. These conditions acquired more systemic and corrupt traits in the 1980s, when the

PSI increased its exploitation of state assets because of its ambitious plan of dominating national politics (Ginsborg 1996: 23–4). Public expenditures became an essential tool of mass consensus, as they were used to create an atmosphere of *enrichissez-vous* amongst large strata of privileged groups (Pasquino 2000: 79). Thus, Italian public debt swelled, and this increase in public debt was sustained by a market for government securities that was the world's third largest after its American and Japanese counterparts (Scobie *et al.* 1996: 75).

Despite such dimensions, both primary and secondary markets were rather undeveloped in their allocation methods and trading technologies.[8] For instance, the authorities began issuing securities through auctions during the 1980s, allowing interest rates to be set by market participants to some degree. However, the Treasury fixed a base price that limited interest rates and – in the case of short-term bills – rendered the use of the main channel of market-based monetary policy difficult for the central bank (Passacantando 2014: 44–6; Santini 1997: 289). With respect to the secondary market, this mainly consisted of bilateral interbank trading amongst few insiders. It was quite large, but it lacked transparency and suffered from illiquidity during turbulent periods. Ultimately, this simple market structure was instrumental in guaranteeing the borrowing requirements of the ruling parties, particularly because monetary authorities primarily intervened through direct policy instruments. Imposing a limit on bank lending – especially in the presence of international capital controls – entailed redirecting banks' deposit bases towards government-debt securities as the main investment vehicle (Rondelli 1994: 98). These dynamics occurred at increasingly higher costs and led to periodic public confidence crises (Alesina *et al.* 1989).

During this period, neoliberalism acquired considerable weight amongst technocrats at the Bank of Italy and the Ministry of Treasury (Ciocca 2005: 36–7).[9] These actors were haunted by the collective memory of the political, economic and social disorder that Italy experienced during the 1970s (Dyson and Featherstone 1996: 274). To their dismay, the Italian model of capitalism still lacked market discipline ten years later. With this in mind, the technocrats advanced a critique that centred on three intertwined ideas. First, public finance required restructuring to reduce the growing level of debt (Giavazzi and Spaventa 1988). Second, the vast system of state-owned enterprises was characterised by an inefficient allocation of productive resources. For this reason, it required downsizing and privatisations (Goldstein 2003: 1; Scognamiglio 1990). Third, as became clear during the 1990s, the financial system and corporate governance regime needed to be better attuned to shareholder value (Associazione Disiano-Preite 1997; Lazonick and O'Sullivan 2000).[10]

Technocrats were relegated to the role of advisers over the course of the 1980s. However, they influenced policymaking at a time when trends were gradually shifting in favour of greater market freedom. Italy had been part of the European Monetary System since 1979, and its deflationary architecture constrained to some extent the ability of the ruling parties to influence monetary policy for reasons other than defending price stability and the exchange rate (Frieden 2001; Ludlow 1982). Furthermore, European countries were liberalising capital flows, and this process pressured Italian authorities to follow suit (Abdelal 2007: 71–4), further restricting governmental control over monetary policy. Finally, the Bank of Italy – which had been legally independent since 1981 – reduced its refinancing obligations with the Treasury and began adopting indirect monetary policy instruments (Epstein and Schor 1989; Sarcinelli 1995). The adoption of such monetary policy instruments was feasible only if fixed-income and money markets were fully developed and functioning (Rondelli 1994: 99).

Thus, in the face of growing debt-servicing costs, experts at the Treasury and the Bank of Italy embraced this market-oriented course and advanced proposals for reforming Italy's public-debt practices. In 1986 and 1988, two technical committees examined the most appropriate debt-management policies, the conditions of fixed-income markets, and the linkages between debt and monetary policy (Ruffolo 1988; Italian Treasury 1987; 1989). These committees sought solutions to aid the Italian government in reducing its debt-servicing expenditures. In so doing, they also played a key role in developing a trading environment more attuned to the principles of market efficiency. The development of such an environment occurred primarily in two ways.

During the 1980s, the Treasury strove to minimise the costs of debt whilst controlling interest-rate and refinancing risks. To achieve these objectives, it became crucial to extend the average life of debt and to spread the maturity distribution evenly throughout the year (IMF 2003: 101–2). As experts suggested, the authorities decided that – in addition to diversifying the range of debt securities – the quantity of fixed-rate long-term bonds (BTPs) should be increased relative to floating-rate medium-term certificates (CCTs) and short-term bills (BOTs). A declining inflation rate would have favoured such a shift by persuading investors that holding BTPs was no longer risky. However, this strategy segmented the structure of the Italian public debt. On the one hand, households continued to invest in CCTs and BOTs as they had done since the late 1970s, and they held these instruments until maturity. On the other hand, large investors purchased most BTPs and used them for their speculative activities. These mechanisms began to impose a certain degree of external discipline on the sovereign management of interest rates (De Cecco 1994).

In addition to modifying the range of available securities, two new markets were established to facilitate investor access to Italian government-debt securities. In 1988, the authorities launched the Mercato Telematico dei Titoli di Stato (MTS), which was a screen-based environment for wholesale secondary trading. In this platform, primary dealers quoted bid-ask spreads and allowed investors to easily divest their positions (IMF 2003: 103–6). During the same period, the authorities also began to make greater use of competitive auctions – without indicating a base price – as the standard issuing procedure for short-term bills (Passacantando 2014: 79). At this point, with the renovation of government-debt markets in full swing, the practice and discourse of derivatives-based risk management reached Italy. On 18 February 1992, a ministerial decree established the Mercato Italiano Futures as an adjunct to the MTS platform (Girino 2010: 542; Rondelli 1994: 109–10). The first contracts were futures on the 10-year and 5-year BTPs (Caputo Nassetti 2011: 264–5). These instruments increased the attractiveness of government-debt securities by providing hedging solutions to fixed-income investors (La Repubblica 1992).

Thus, the Treasury and the Bank of Italy had fully adopted market-based methods in public-debt management and trading by the early 1990s. After this period, the newly established environment exhibited high levels of financialisation in the sense given by Hardie (2011: 143). Such an environment was established on the basis that ‘private-sector-type structures or procedures [could have saved] some fractions of a per cent in debt costs’ (Giovannini 1997: 45). Under this operational framework, the government began to act as a market actor that developed benchmark portfolios capturing the optimal trade-off between the costs and the risks of debt servicing

(Cassard and Folkerts-Landau 1997). This new regime of public-debt governance imposed some degree of market rationality on the ruling parties and their dissipation of public expenditures.

The following section begins to investigate the 1992-99 period, when technocrats – joined by centre-left politicians in 1996 – captured the executive power of government and deployed financial innovation as a tool of statecraft. The study focuses first on how technocrats gained influence at the EMU negotiations and how they then applied their expertise to Italian government affairs as unelected decision makers.

Maastricht, *Tangentopoli*, and the power of technocrats

In October 1990, Treasury Director-General Mario Sarcinelli – who was soon to be succeeded by Mario Draghi in February 1991 – revealed his aversion to the ruling parties and their inability to rein in the deficit: 'we issue a colossal amount of government debt that is practically unsustainable. [...] We need constraints on our public finances' (Signoretti 1990 my translation). At that time, Italy was about to begin EMU consultations, and Sarcinelli's opinions were shared by Treasury Minister Guido Carli and by the experts who participated in the intergovernmental conference (IGC) on the EMU from December 1990 until December 1991 (Carli 1993: 435). During this IGC, the technocrats considerably increased their decision-making power and linked Italy to the neoliberal project of European integration (Dyson and Featherstone 1996; Van Apeldoorn 2002; Cafruny and Ryner 2003; 2008).

The technocrats exploited the broad consensus in favour of European unification amongst large fractions of Italian business and society (Quaglia 2011).

Interestingly, the ruling parties also held a positive opinion of the EMU, which is surprising because European integration entailed drastic changes to their way of life. As Dyson and Featherstone (1996: 274–9) explain, political leaders wished to ensure that Italy would actively participate in European affairs. Within this wider framework of ideas, a small technocratic elite consciously negotiated the EMU to limit the ability of Italian ruling parties to dissipate public finance.[11] After this point, Italy experienced a crescendo of conflicting events leading to its EMU accession in 1999. Neoliberal forces exploited the EMU accession process to enhance their agential power and to modernise the institutional parameters of Italian capitalism.

However, despite gaining influence in the EMU negotiations, the technocrats were unable to dismantle the traditional political-economic structures in Italy using these tactics. First, constructing a regime of macroeconomic austerity was insufficient to eliminate an entire political system and its dependence on high public expenditures and state resources. Furthermore, the early liberalisation measures that were introduced after the 1986 Single European Act did not involve major changes to the country's financial system and corporate governance regulation.[12] In this regard, the oligarchic structure of big business remained unchallenged. These considerations highlight one important fact: it was not the technocratic assault per se but the renowned judiciary investigation revealing the bribery networks of *Tangentopoli* that brought the traditional political system to complete collapse. *Tangentopoli* was the extensive system of kickbacks and illicit party funding that linked politicians, their patronage partners and business clientele. The *Tangentopoli* investigation began in February 1992 and lasted until 1996. Amidst widespread popular support, the probe and ensuing scandals led to the end of the so-called First Republic and its political-economic practices (Ginsborg 2001: 179–86, 249–59).[13]

Thus, the *Tangentopoli* investigation exploded and created a power vacuum that enabled technocrats to capture the executive and to unleash their neoliberal reforms in the name of EMU membership. How did these dynamics unfold? More important, how did these actors integrate financial innovation as a crucial component of their statecraft strategies? Let us first examine the 1992-96 period. During this time, a series of technocratic governments – only partly interrupted by the brief Berlusconi administration in 1994 – began the struggle to ensure Italy's compliance with the Maastricht convergence criteria whilst also implementing a substantial round of privatisation and banking reforms. During this period, the Treasury and the Bank of Italy exploited derivatives markets to manoeuvre interest-rate convergence between Italian BTPs and German Bunds (Dunbar 2000: 153).

Capturing the executive and deploying financial innovation

After the general election of April 1992, the DC and PSI formed a government, but the *Tangentopoli* investigation involved increasingly large numbers of the members of these ruling parties. Thus, the President of the Republic, Oscar Luigi Scalfaro, selected Giuliano Amato – a member of the PSI whose reputation remained intact – as the new President of the Council of Ministers in June 1992. Immediately upon entering the executive, Amato faced speculative attacks on the lira and its devaluation outside the EMS in September 1992 (Harmes 2001). This crisis dealt a blow to Italy's ambition to participate in the EMU. It further encouraged Parliament to delegate to the government executive the power of undertaking substantial cuts in public expenditures and overhauling the system of wage indexation to contain inflation (Regini and Regalia 1997: 213–4; Sbragia 2001: 90).

Amato resigned in April 1993, but his government marked a turning point in the 1990s. Public perception viewed Italy as a country at risk because of a lack of convergence with the Maastricht criteria.[14] This 'lack of fit' was viewed as a threat of Italy's exclusion from the EMU project, justifying the introduction of austerity measures and market-oriented reforms in subsequent years (Sbragia 2001: 83).

Once Amato had stepped down, *Tangentopoli* had already involved a large part of the political and business establishment. At this time, technocrats captured the executive and consolidated their agential power in the domestic scene. Instead of calling for early elections, President Scalfaro established a government led by Carlo Azeglio Ciampi, the former Governor of the Bank of Italy. This administration was the first non-elected cabinet in the history of the Italian Republic. Ciampi reasserted the objective of EMU accession by focusing on three aspects: securing the agreement of July 1993 with the trade unions (Regini and Regalia 1997: 214); giving a new impetus to privatisation (MEF 2001: 14); and reintroducing universal banking in Italy (Ciocca 2005: 10–1).

More important, the Treasury developed an aggressive strategy for reducing the costs of debt servicing during the last period of the Ciampi government. This manoeuvre – which lasted until 1997 – was undertaken on OTC derivatives markets and involved the highly leveraged LTCM hedge fund. In 1994, Alberto Giovannini – co-chairman of the council of experts, who answered directly to the Director-General Draghi – was responsible for the coordination of foreign debt at the Italian Treasury.[15] Although Giovannini asserted that his role was marginal, someone clearly gave LTCM – and, indirectly, other arbitrage desks – privileged information. The objective was to encourage these actors to purchase huge amounts of Italian bonds to inflate bond prices and thus drive down interest rates. This strategy dealt a blow to domestic banks that until then had purchased bonds at low prices and earned high interest. In return for this favour, the Treasury and the Bank of Italy invested $100 million in LTCM via the Italian foreign-exchange office in October 1994 (Dunbar 2000: 152–4; Partnoy 2009: 252–3).

Derivatives entered the picture through the arbitrage strategies of LTCM and the other actors following its approach. For instance, as Dunbar (2000: 155–6) demonstrates, one of the profitable trades that Victor Haghani – the head of LTCM's London office – and his team were able to implement was a typical swap-spread arbitrage.[16] The opportunity for this operation was signalled by the swap spread, which is the difference between the fixed-rate leg of a swap and the yield on a government bond of the same maturity. In 1994, receiving Italian lire swap-rate payments was considered less risky than purchasing Italy's government bonds and receiving their coupons. In visual terms, the swap yield curve stood below that of Italian BTPs, as the swap rate declined due to the anticipation of Italy's participation in the EMU. However, investors remained wary of Italian government bonds and thus required a higher interest rate. In this context, Haghani's trade would operate as follows. His team would purchase BTPs on the market for repurchase agreements through Morgan Stanley. In so doing, they would receive fixed-rate coupons from their BTP position whilst paying lira-London Interbank Offered Rate (LIBOR) to Morgan Stanley. At this point, traders would hedge their floating LIBOR payment to Morgan Stanley through a floating-to-fixed interest rate swap. In other words, they would enter into a swap with another bank, such as Deutsche Bank, whereby the latter would pay lira-LIBOR to LTCM, which would cancel out the LIBOR payment to Morgan Stanley. Haghani's team would instead pay the fixed swap rate that, as mentioned above, was lower than the BTP's fixed rate. This arbitrage strategy would allow LTCM to profit from the difference between the BTP and the swap rates until the two converged. Such trades by LTCM and other arbitrage desks resulted in a huge amount of capital flowing into the Italian bond market. These tactics were crucial in supporting Italy's qualification for EMU membership (MacKenzie 2003: 357).

Whilst arbitrageurs inflated prices and caused substantial losses to Italian banks (Dunbar 2000: 159), media entrepreneur Silvio Berlusconi won the national election in May 1994. His coalition was rather hesitant towards European economic and monetary integration (Ginsborg 2001: 297). However, as a sign of continuity with the previous technocratic government, Lamberto Dini – former Director-General of the Bank of Italy – was selected as the unelected Treasury Minister.[17]

Berlusconi remained in office until January 1995. At this point, with the traditional party system of the First Republic entirely dismantled (Gundle and Parker 1996), President Scalfaro again refused to call for new elections and selected Dini to form a new government that included only unelected technocrats. The Dini administration overhauled the pension system and implemented drastic cuts in public expenditures (Sbragia 2001: 93). Eventually, the national elections of April 1996 brought the Olive Tree coalition to power under the leadership of Romano Prodi.

The Olive Tree coalition and the politics of interest-rate convergence

The previous sections have described how technocrats increased their agential power and eventually captured the executive office. Amidst the pro-European consensus of Italian elites and the broader public, they claimed to fight for Europe through austerity measures in public finance, privatisations and banking reform. In addition, technocrats utilised the available derivatives technology, directing their efforts towards breaking the vicious cycle of low-price/high-interest bonds (Dunbar 2000: 152). However, despite these efforts, Italy was still far from meeting the Maastricht criteria when the Olive Tree coalition won the elections.[18] Furthermore, important reforms had been implemented during the previous years in line with the European single market, but these reforms did not yet challenge business oligarchies. Thus, whilst technocratic governments laid the foundations for the modernisation of Italian capitalism, it was only after Prodi came into power that a neoliberal-reformist alliance consolidated and reinforced the initiative to transform Italy in the name of European integration. We focus first on the efforts to join the EMU in 1999. In the subsequent section, we examine the unique currency swap.

The centre-left coalition of the Olive Tree was established when former communist leader Massimo D'Alema opened up to part of the post-DC forces after Prodi announced his intention of running against Berlusconi in the 1996 elections (Ginsborg 2001: 300).[19] As Favretto (2002: 403) explains, the centre-left portrayed itself as a political force capable of solving the long-lasting problems of Italian capitalism. It sought to do so by dismantling the old regime and by constructing a modern, normalised and Europeanised market democracy in its place. For this reason, these politicians embraced the neoliberal tenets that had hitherto been espoused only by technocratic elites (Ginsborg 2001: 303). In other words, technocrats showed the newly elected Olive Tree coalition the areas in which to intervene to modernise Italy. Crucial in this regard was the appointment of Ciampi as Treasury Minister, again as an unelected policymaker.

With Ciampi in this position, the Prodi administration was determined to join the EMU. However, as already mentioned, Italy's macroeconomic condition in 1996 was far from satisfying the Maastricht criteria. In June 1996, the government planned to reduce the deficit to 4.4 per cent in 1997 and then to three per cent in 1998. In brief, Italy would have been one year late on the reference period agreed for EMU membership.[20] The government hoped that other member states – primarily France and Germany – would have flexibly interpreted the convergence criteria (Quaglia 2002: 256–8).

This course of action changed after Prodi met with Spanish Prime Minister José María Aznar in September 1996. Prodi advanced the possibility of reinterpreting the Maastricht criteria, but Aznar was not 'interested in holding hands' with Italy (White and Burns 1996). Prodi hence realised that Italy was isolated at the European level (Battocchi 2011). Both German Chancellor Helmut Kohl and French President Jacques Chirac did not intend to postpone the beginning of the EMU any later than 1999 and rejected the possibility of flexibly interpreting the convergence criteria (Quaglia 2002: 249–53). At this point, Aznar had also eliminated the possibility of forging a common Southern-European front and lobbying for a loosening of the criteria. Given this external scepticism, Italy's only option was to demonstrate that it was fit for Europe on the basis of sound macroeconomic data.

Thus, Prodi turned to the domestic scenario and depicted EMU membership as an issue of national interest that justified drastic measures (Ginsborg 2001: 305–6). The government presented a budget law in October 1996 that targeted a three per cent deficit-to-GDP ratio for 1997. This manoeuvre involved drastic spending cuts and increased taxation, including a one-off 'tax for Europe' (Radaelli 2002: 223–4). Simultaneously, Ciampi engineered the re-entry of the lira into the EMS in November 1996. The new parity was overvalued, as the Bundesbank suggested (Quaglia 2002: 247–8).

The decision to join the EMU on time caused intense controversy. Whereas trade union leaders and even the radical left went along with the plan, centre-right forces opposed the government's objective. Business elites and Antonio Fazio – the new Governor of the Bank of Italy – were also sceptical (Ginsborg 2001: 306–7; Quaglia 2002: 271–2). Ultimately, the austere budget law was passed on 23 December 1996 (Italian Parliament 1996).

Domestic opposition was a minor concern compared with the opposition that Prodi faced abroad. Germany and France exhibited a clear preference for a two-tier Europe in which Italy would be a member of the second class (Quaglia 2002: 250). The most interesting aspect of this foreign scepticism was the transmission of signals to financial markets, in which arbitrageurs bet on the convergence of Italian and German bonds. Financial markets represented the main field in which Italy fought for its right to join the EMU in 1999. As Quaglia (2002: 66) explains, '[t]he key element in the Italian fiscal adjustment [...] was the reduction of the interest payments on the Italian public debt'. In other words, reducing Italy's debt to bondholders would have allowed the Treasury to deduct a large sum of money from the total deficit. This element was so crucial that convergence between Italian and German rates could have reduced the deficit 'by up to 1 per cent of GDP without the Italian government lifting a finger' (Barber 1997b). Clearly, this strategy was a top priority for the Treasury, and the spread between Italian and German bonds had already declined substantially by the end of 1996 (Quaglia 2002: 253).

Given the rapid decline in the spread, it became imperative for governments opposing Italy's participation in the EMU to shift market expectations. The most emblematic moment was the media attack against Italy that was launched in the *Financial Times* on 5 February 1997. According to the article, Italy received an offer that would postpone its EMU accession until 2000 or 2001. Specifically, Rome would miss the first wave of EMU accession but would join the single currency before the actual adoption of euro notes and coins on 1 January 2002 (Barber 1997a). Irrespective of whether this offer was actually made, financial markets received the message and the spread widened between January and March 1997 (Quaglia 2002: 254).

Coincidentally, events in Bonn and Paris shifted Italy's position for the better. In Germany, unemployment figures soared and cast doubt on the solidity of Europe's major economy (Atkins 1997, Wolf 1997). In this context, it was difficult for German elites to oppose Italy's participation in the EMU on the basis of a lack of convergence with the Maastricht criteria. In France, Socialist Prime Minister Lionel Jospin won the election and supported Italy's participation in the EMU (Quaglia 2002: 252–3). Thus, as of mid-1997, financial markets allowed the spread between Italian and German rates to converge again, with the gap falling to a mere 97 basis points by July 1997 (Guha and Luce 1997). Financial actors became confident of Italy's entry into the EMU (Quaglia 2002: 255), and this confidence remained unchanged even during the brief crisis of late 1997, when radical-left politicians opposed the 1998 budget law and temporarily withdrew their support of Prodi.

In February 1998, Ciampi visited Germany, where political and business elites applauded Italy's achievements (Schmid 1998), indicating that relations between the two governments were smooth and that Italy deserved a place in Europe. In this favourable atmosphere, the European Commission, the European Monetary Institute and the Bundesbank published their convergence reports in March 1998. In all, eleven countries – including Italy – were recommended to adopt the euro as of 1999 (Barber *et al.* 1998).[21]

LIBOR minus 16.77 per cent: an unusual currency swap

As described above, France and Germany initially opposed Italy's entry into the EMU. In this hostile environment, Prodi expressed the following thoughts during an interview with the *Financial Times* in October 1996: 'if others carry out window-dressing we can do the same […] If the French get away with it, then we can show them a trick or two as well' (Graham 1996).[22] Prodi did not explain what his 'trick or two' implied, but as the fight for Europe intensified, it became clear that the Italian government was prepared to deploy all available resources to join the EMU. It is important to recall that the accession to the EMU was a crucial point in the statecraft strategies of neoliberal reformists. For neoliberal reformists to dominate the national political scene, Italy needed to be transformed into a modern market economy in line with European directives.

In this state of unease, the Prodi administration adopted financial innovation in the most controversial manner imaginable. Evidence reveals that the Italian Treasury developed a derivatives-based strategy intended to window dress the decisive 1997 budget deficit. Before we proceed, two caveats must be noted. First, whether other European actors were aware of these tactics is unclear. Recent authoritative newspaper sources indicate that the German government knew of and condoned these tactics once it became confident that the Prodi administration was on the right path to implementing neoliberal reforms (Böll *et al.* 2012; Dinmore 2013a; Norris 2013). Second, it is unknown how many contracts this strategy included and to what extent such artifice helped Italy's macroeconomic data satisfy the convergence criteria. Certainly, the largest portion of deficit reduction was due to cuts in public expenditures and the convergence battle of the BTP-Bund spread. However, ten swaps transactions, such as the one reported below, could have easily saved 0.2 per cent at a time when the deficit-to-GDP forecast for the year 1997 was nearly 3 per cent (Piga 2001: 128). For the purpose of this study, it is clear that this episode demonstrates how Italian neoliberal reformists adopted derivatives as statecraft instruments that were essential to their highly politicised struggle. According to Piga (2001: 122–9), the Italian Treasury executed an unorthodox currency-swap transaction in this way.[23]

In early June 1995, Italy borrowed by issuing a three-year and three-month yen-denominated bond. Its par value was ¥200 billion; the annual coupon was 2.3 per cent; and the maturity was set for 25 September 1998 (La Repubblica 1995).[24] Moreover, the bond was sold at par – ¥200 billion. The exchange rate on the day that the bond was issued was 193.44 Italian lire for one yen. The choice of issuing a foreign-currency bond was justified by the higher domestic interest rate for this maturity compare with the Japanese equivalent. However, despite its convenience in terms of interest rate differentials, the bond presented an exchange-rate risk between the yen and the lira. Fortunately, the yen experienced considerable depreciation against the lira by late 1996. At the time, it was possible to purchase one yen for 134.1 lire. Nevertheless, the Italian Treasury was exposed to exchange-rate risk in the remaining period until the bond's maturity on 25 September 1998. At this point, active debt management through the use of derivatives entered the story in a rather unconventional manner. Instead of using a normal currency swap to hedge the risk of the yen appreciating against the lira, the Italian Treasury designed a strategy through which it managed to reduce interest expenditures in 1997 and 1998, despite disbursing a larger amount of money at the maturity of the swap contract.[25] In colloquial terms, the Treasury shot itself in the foot to join Europe. What did this scheme entail?

Italy entered into a currency swap with its counterpart in December 1996. The swap matured on 25 September 1998, which is the same date as the yen-denominated bond. Here, the financial intermediary paid a 2.3 per cent annual fixed rate on a notional principal amount of ¥200 billion to the Italian treasury and the entire notional amount (again ¥200 billion) at the expiration of the contract. In so doing, the Treasury was perfectly hedged against the exchange-rate risk of its yen-denominated bond. Thus far, the contract included no irregular details. The crucial element emerged in the yen-to-lira exchange rate at which the Italian Treasury had to return the notional principal amount of ¥200 billion. This exchange rate was not 134.1 lire for one yen – that is, the prevailing exchange rate on the day that the swap was agreed upon. Against common practice, the two parties used the exchange rate from the date when the bond was issued: 193.44 lire for one yen. Thus, the Treasury had to pay a much larger sum. However, the surprise did not end there. Every six months, Italy had to pay an unusual interest rate of LIBOR minus 16.77 per cent on the lira-denominated notional amount of ¥200 billion times the off-market exchange rate of 193.44 lire for one yen. In other words, LIBOR minus 16.77 per cent was a negative interest rate that allowed Italy to receive interest payments on both legs of the swap until maturity.

In summary, Italy promised to pay the intermediary a substantially larger amount of lire at the maturity of the swap contract because of the higher exchange rate of 193.44 lire for one yen. In the meantime, the intermediary paid Italy LIBOR minus 16.77 per cent in four semi-annual instalments. In practice, Italy received four loans that were used to reduce its interest expenditures in 1997 and 1998.

Conclusions

This article has suggested that the financialisation literature should explore how and why public officials use derivatives, as these practices indicate a crucial phenomenon of modern capitalism: governments implement statecraft strategies by exploiting the market-based methods and technologies of financial innovation. These activities are a key aspect of the financialisation of the state, that is, the reshaping of state institutions and power in the context of financial expansion.

To explicate this proposition, the present study has examined how the Italian government implemented derivatives-based strategies during the 1993-99 period. It has argued that these tactics became significant in relation to the power struggles that unfolded in Italy from the late 1980s onwards. Specifically, the work has investigated how Italian neoliberal reformists – after capturing the executive power – deployed financial innovation to participate in the EMU, a project that enhanced their agential power vis-à-vis the country's traditional political and business establishment.

This article offers insights that go beyond the specificities of the Italian case, thus encouraging further research on how governments in other countries might use innovative financial instruments to pursue statecraft objectives. Italy certainly stands out for its extensive and Machiavellian adoption of derivatives. However, similar practices are also in use elsewhere. Most notably, Greece – during the Simitis administration (1996-2004) – took advantage of currency-swap accounting rules to ensure its national deficit and debt ratios met the Maastricht criteria (Dunbar 2003). As in the Italian case, Simitis intended to join EMU as a catalyst for domestic reform and political empowerment (Featherstone 2011: 198). In addition to Greece, many other governments implement derivatives-based programmes (OECD 2002; 2008; Piga 2001), the statecraft purposes of which are likely to vary in intensity and magnitude depending on the distinct institutional environment and power relations that influence governmental actions. Hence, given the widespread nature of the phenomenon in question, the present study should be seen as the first step towards a wider research project that aims to explore the role of derivatives in statecraft strategies worldwide.[26]

In this regard, at least four dimensions should be investigated. First, it is necessary to evaluate the extent to which governments deploy derivatives in public-debt management and determine which accounting practices they use. This task would entail mapping quantitatively the use of derivatives on two different levels: the national (e.g., central governments) and the local (e.g., municipalities, provinces, and regions). Second, it is important to analyse how the governmental adoption of derivatives differs according to each country's institutional trajectory. This analysis is useful in grasping how agents, their power struggles and the dynamics of institutional construction create context-specific modes of understanding and deploying derivatives in state affairs. Third, it is essential to examine how the governments' use of derivatives changed historically since its emergence in the 1980s. For example, in the case of Italy, derivatives-based techniques played a major role in the run-up to the EMU during the 1990s. Given such a critical juncture, it is important to understand how the Italian Republic performed in derivatives markets before and after this period. Fourth, it is crucial to study how public officials use derivatives on the ground. Particularly, it is worth addressing how debt-management officers portray market forces visually and give them meaning; how this process of creating meaning leads debt-management officers to an institutionalised interpretation of market dynamics; and how both visual representations and institutionalised interpretations influence debt-management officers in their daily operations.

Exploring these four dimensions would provide a comprehensive picture of modern statecraft and its relation to derivatives as key tools of financial innovation. This research project faces great hurdles due to the scarcity of available data and governments' well-known reticence to discuss their derivatives activities (Piga 2001: 17-8). Nonetheless, the project is highly relevant and should be pursued. It opens up the 'black box' (MacKenzie 2005) of public-debt governance and captures how political-economic, socio-cultural and cognitive elements shape its supposedly depoliticised and expert-led procedures. More important, it encourages public accountability in state affairs at a time when neoliberal-minded forces have captured state power and are exposing the fabric of democratic life to global financial speculation.

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[1] Mark-to-market losses during the second quarter of 2014 were approximately €42 billion (MEF 2015).

[2] Scholars from different disciplines and theoretical backgrounds employ the concept of financialisation to describe – and in most cases denounce – 'the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies' (Epstein 2005: 3). For a recent review of this literature, see Van der Zwan (2014). Derivatives markets represent a pivotal dimension of financialisation in both quantitative and qualitative terms. First, the global notional value of OTC derivatives markets stood at $710 trillion in December 2013 (BIS 2014). This astonishing figure represents approximately ten times the gross world

product (IMF 2014: 184). Second, derivatives-based techniques are a powerful form of financial innovation, as they provide solutions to marketise human relations and to stretch the limits of finance-led accumulation (Bryan and Rafferty 2006, 2011; Bryan *et al.* 2009; Wigan 2009).

[3] Statecraft refers to the management of state power in domestic and foreign affairs (Baldwin 1985). Financial innovation indicates the emergence and popularisation of new financial markets, actors and instruments (Allen and Gale 1994; Tufano 2003). In recent years, several scholars have devoted attention to the use of monetary and financial tools to achieve statecraft objectives (Armijo and Katada 2014; Steil and Litan 2006). However, these studies focus on traditional monetary and financial assets – see, for example, the cases of currency wars or capital controls – but do not investigate the governmental adoption of more innovative practices, such as derivatives or securitisation. Furthermore, these scholars do not contextualise the development of 'financial statecraft' – to differentiate their work from other studies on 'economic statecraft' (Baldwin 1985) – within the broader dynamics of financialisation that are unfolding differentially across the globe.

[4] In other words, derivatives epitomise the vision of a complete market in the sense given by Arrow and Debreu (1954) – a theoretical scenario in which all future risks can be efficiently hedged (Greenspan 2003; Sandor 2012; Shiller 2003; Wigan 2009).

[5] Indirectly, this article builds on the Gramscian notion of the 'integral state' and understands state institutions and power as constructed through 'a virtually endless network of connections […] that organically ties formal [state] institutions and organizational actors to lower-level institutions and practices, travelling all the way down to social relations as people experience them in their daily lives' (Panitch and Konings 2008: 8). The origins and nature of the state – especially which social groups influence its material and discursive production to the partial exclusion of others – are highly debated issues that lead to competing theories. A complete theoretical investigation of the social construction of state institutions and power is beyond the scope of this article. For a review of the state debate, see Hay *et al.* (2006).

[6] Institutions are understood as the formal rules and informal habits structuring the political-economic, socio-cultural and cognitive relations amongst individuals or groups.

[7] The notion of global finance is used to bracket off an extended analysis of how the American state is able to command the global trajectories of financialisation (Gowan 1999; Seabrooke 2001; Panitch and Gindin 2012). The present study could be regarded as an 'inside-out' perspective (Panitch 1996) on

how Italian neoliberal actors strove to transform the country's traditional model of 'dysfunctional state capitalism' (Della Sala 2004) by exposing the domestic economy to US financial power and its market-oriented dynamics. Unfortunately, a full enquiry into the evolution of American financial hegemony in relation to European economies is beyond the scope of this article. On this theme, see Konings (2008), Cafruny and Ryner (2008).

[8] Note that the simple traits of domestic government-debt markets did not prevent Italian authorities from resorting to existing financial innovation in global markets. For instance, in 1963 Autostrade – the then state-owned company in charge of national motorways – engaged with the Eurodollar market by issuing the world's first Eurobond (Atkins and Stothard 2013).

[9] Neoliberalism commonly refers to the ideology according to which 'human well-being can best be advanced by liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by strong private property rights, free markets, and free trade' (Harvey 2005: 2). For in-depth research on neoliberalism, see Mirowski and Plehwe (2009) and Peck (2010).

[10] Italian blockholders dominated private corporations against the interests of minority shareholders. Introducing shareholder value implied subverting the status quo by guaranteeing equal rights amongst shareholders (McCann 2000: 49). A study of how neoliberal reformists challenged Italian business oligarchies through the modernisation of Italian finance is beyond the scope of this work. On this theme, see Deeg (2005) and Lagna (2015).

[11] The total number of Italian personnel involved in the EMU negotiations was no more than sixteen. Amongst these personnel, Mario Draghi and Tommaso Padoa-Schioppa played the most important roles in the economic negotiations. Draghi was Director-General of the Treasury after Sarcinelli resigned. Padoa-Schioppa was Deputy Director-General of the Bank of Italy (Dyson and Featherstone 1996: 277–9).

[12] See Ciocca (2005) for a review of early reforms. These reforms included the liberalisation of capital movements; the transformation of state-owned banks into joint-stock companies; the implementation of anti-trust regulation; the implementation of insider trading regulations; and the end of stockbrokers' monopoly over equity trading. More radical changes concerning Italian finance and corporate governance occurred starting in the mid-1990s, only within the broader process of European financial market integration (Van Apeldoorn and Horn 2007; Bieling 2003).

[13] According to Berselli (2001: 4–7), *Tangentopoli* represented the key emotional element that demolished the First Republic. However, this major event occurred only because Italian politics had already reached a dead end. For a long time, the DC and PSI managed to conceal structural problems, such as the huge public debt and the lack of modernisation in the institutional establishment. However, by the early 1990s, both external and internal phenomena had turned against them. First, the collapse of the Soviet Union removed the communist threat over which DC had constructed its legitimacy since the 1950s. Second, the Northern League emerged as a secessionist political force and gained substantial support in Italy's northern regions. Finally, Italians supported a referendum that proposed transforming the proportional electoral system into one based on majoritarian representation.

[14] In brief, these criteria were as follows: the inflation rate must be no more than 1.5 per cent higher than the average of the three best-performing member states; the government deficit-to-GDP ratio must not exceed 3 per cent at the end of the previous fiscal year; the debt-to-GDP ratio must not exceed 60 per cent at the end of the previous fiscal year; member states must not devalue their currencies for two consecutive years as part of the EMS; and the nominal long-term interest rate must not be higher than 2 per cent relative to the three lowest inflation members (ECB 2014).

[15] Sarcinelli established the council of experts in 1985 as a group of economic advisors (Quaglia 2002: 93–5). When Draghi replaced Sarcinelli as the new Treasury Director-General, he brought in a group of young and influential academics: Francesco Giavazzi, Vittorio Grilli, and the aforementioned Giovannini (La Repubblica 1994a). Both Giovannini and Giavazzi left the council in August 1994 (La Repubblica 1994b). Thereafter, Giovannini began working for LTCM (Partnoy 2009: 252).

[16] For a full description of Haghani's strategies, see Dunbar (2000:156–62). For a study on LTCM and arbitrage, see also MacKenzie (2003).

[17] In line with this continuum, the Berlusconi government passed the law on privatisation (Italian Parliament 1994). This regulatory framework was designed to dismantle long-established patronage relations between political parties and public managers. Furthermore, privatisation increased stock-market capitalisation and encouraged the creation of shareholder value (McCann 2000).

[18] At that time, the deficit-to-GDP ratio was 6.7 per cent, whilst the debt-to-GDP ratio was 123.8 per cent. The level of inflation was 3.9 per cent, which was 1.3 per cent higher than the average level of the three best-performing EU countries (Ginsborg 2001:304). Interest rates were considerably higher in

Italy than in Germany, whereas the lira widely floated outside the EMS until November 1996, when it re-entered the system (Quaglia 2004: 1104).

[19] This move signalled a profound transformation in the Italian left that – after the collapse of the Soviet Union and the dissolution of the Italian Communist Party in 1991 – abandoned its Gramscian legacy in favour of an ill-defined liberal socialism. See Ginsborg (2001) and Favretto (2002).

[20] European member states decided which countries could join the first round of the EMU on the basis of macroeconomic data for the year 1997. The level of the budget deficit came to play a pivotal role amongst all the other convergence criteria.

[21] Italy was part of this group despite its high level of public debt. According to the final report by the European Monetary Institute (EMI 1998), Italy's macroeconomic figures for 1997 were as follows: inflation (1.9 per cent); interest rate (6.9 per cent); budget deficit (2.7 per cent of GDP); and public debt (121.6 per cent of GDP).

[22] Prodi referred to the French plan of transferring 37.5 billion francs from France Telecom's pension funds to the Treasury to window dress the budget deficit in line with the Maastricht criteria (Friedman 1996).

[23] Piga (2001: 123, 147) provides evidence of such a scheme through a copy of the swap contract agreed upon by the sovereign state and provided to him by a public official. He keeps the identities of the country and the financial counterpart confidential. However, Steil (2002) – who wrote the foreword to Piga's report – explains that the country in question is Italy. Furthermore, the details of the yen-denominated bond issued by the sovereign actor are consistent with Italy's bond issuance in 1995 (La Repubblica 1995). Regarding the identity of the counterpart, ZeroHedge (2010) believes that it was Goldman Sachs. However, other sources instead point to J.P. Morgan (Alloway 2010). This article keeps the financial counterpart undisclosed.

[24] The bond was the first of a three-tranche issuance of ¥550 billion. The maturities of the other two tranches were 8 June 2005 and 8 June 2015 (La Repubblica 1995).

[25] Regarding the issue of how swaps affect interest expenditures and budget-deficit accounting under the European System of Accounts (ESA 95), see Piga (2001: 95–116). Current accounting rules are supposedly more transparent (Dinmore 2013b).

[26] For an outline of such project, see http://www.andrealagna.net/#finstate

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