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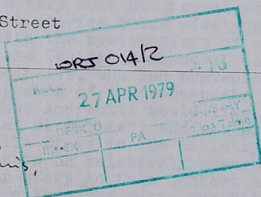
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C J Baker Esq
HM Treasury
IFI
Parliament Street
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Your reference

Our reference

Date 19 April 1979



Dear Chris,

SCANDAL AT THE BANK OF ITALY

- (3)
- Many thanks for your letter of 6 April. Although the situation continues to develop daily, I thought that since we have a bag leaving this evening I would take the opportunity to bring you up to date.
 - After 12 days in prison Sarcinelli was eventually released on bail, but not before Baffi had agreed to suspend him temporarily from his office, which seems to have been the immediate purpose of the investigating judge.
 - Following his release, the managing Council of the Bank of Italy, in Baffi's convenient absence in Basle, passed a resolution requesting the Government to reinstate Sarcinelli in his position: the Government have the power to do this, since he is one of the directors of the Bank. The Council of Ministers was due to meet today to discuss this request, and it was widely expected that they would indeed have reinstated Sarcinelli. However this possibility has now been pre-empted since the investigating judge yesterday took action by direct order to suspend Sarcinelli from his job pending the outcome of the case, in what was clearly a deliberate move to forestall a decision by Ministers. The magistrates have the power to do this under an Article of the penal code which permits the suspension of public officials where charges against them are particularly serious: but this is in fact a provision which has rarely been invoked in the past. Since the charges so far made against Sarcinelli are not regarded as all that serious the whole affair is beginning to look more and more like a plot designed specifically to keep him out of office. The case could in fact drag on for years. It has been widely pointed out that the only people who have really suffered so far in the 18 months judicial enquiry into the SIR financing have been Sarcinelli and a lawyer who was accused of reluctance to provide evidence, neither of whom could possibly have been central figures in the affair.
 - Meanwhile there has been growing press criticism of Andreotti for failing to make his position clear, although the 11 members of the Government who belong to the Ministerial Committee for Credit and Saving did so in unequivocal terms in the Bank of Italy's favour (I was wrong in suggesting in the last paragraph of my letter of



26 March that Andreotti had endorsed their resolution). Andreotti's office were in fact belatedly putting it about earlier this week that he was in favour of the reinstatement of Sarcinelli. The most probable explanation of Andreotti's equivocal behaviour is that in order to resolve what is fast becoming a serious clash between Government and magistrature he needs to avoid being drawn in decisively on either side. This is very much his normal style. There are however some less attractive stories being widely publicised concerning Andreotti's involvement with the protagonists of a number of financial scandals, particularly the Italcasse scandal, and his alleged determination to be rid of Sarcinelli, who had prevented senior Christian Democrats from resolving some of these scandals by dubious financial means. It is rumoured that Andreotti would like to replace Baffi with Milazzo, who is his Chef di Cabinet, and was previously the Head of the Ragioneria della Stato in the Ministry of the Treasury, or by Ciampi who is thought to be relatively amenable to the Christian Democrats. One particular story in this context seems to be based on rather firmer evidence than the rest: the Milan magistrate charged with investigating the Sindona case, who evidently has a high opinion of Sarcinelli, released two weeks ago a deposition made by Sarcinelli to him in which Sarcinelli alleged that not long ago he had been pressed by Evangelisti, who is a junior Minister at the Presidency of the Council and Andreotti's right hand man, to agree to the use of 150 billion Lire of public money to bail out some of Sindona's debt-ridden companies, and thus enable Sindona's name to be cleared. It is very difficult to distinguish truth from fiction in all these stories, with which the political weeklies have been having a whale of a time, but they do show quite convincing evidence of considerable friction between the Bank of Italy, and particularly Baffi and Sarcinelli, and certain members of the Christian Democrat Party. Some of the dirt being thrown around may well rub off on Andreotti, particularly since, whatever his real relationship with these shady financiers, he apparently did have some social connections with them, though those who have observed Andreotti over a longer period say that his ability to extricate himself from compromising situations is unrivalled.

5. We received some interesting background on the whole story from the economic spokesman of the Italian Communist Party, Barca, last week. He said that some two years ago, following the imposition of new exchange control legislation, the Italian financial police had conducted a series of investigations which had led them eventually to request documents from the Bank of Italy. After initial reluctance these documents had been provided and had gone to the magistracy. The latter had then been unable, since they lacked the technical expertise, to complete the investigation, and had entrusted the matter to a number of "experts" appointed by themselves. Among these experts, by chance or otherwise, were the lawyers of the Caltagirone brothers, protagonists in the Italcasse scandal. A number of Bank of Italy documents had gone missing, and copies of these had in fact formed the basis for the magistrates' recent assault against the Bank of Italy. There is a certain ring of truth in this story.

6. It is very difficult to see the way ahead. Clearly the magistrates' action to force the suspension of Sarcinelli puts Baffi, who faces the same charges, in an extremely difficult position. There are rumours in the press today that he and the other directors of the Bank will resign this week. This is not the first time that this



as been said. He is however under considerable pressure from Pandolfi to remain on at the Bank, and before the latest developments, we were told that it was unlikely that he would resign, if he did resign at all, before the annual general meeting of the Bank on 31 May. (This was the occasion at which Carli announced his surprise resignation in 1975). If Baffi does not receive any sign of support from Andreotti, he will clearly have to consider offering his resignation: but the only effective support Andreotti could give would be to refer the magistrates' decision to suspend Sarcinelli to the constitutional court. Unofficial press briefing from Andreotti's office suggests that he is unwilling to do this while heading a caretaker government. And we have just heard that today's meeting of the Council of Ministers on the case has been postponed sine die. It is in fact becoming increasingly difficult to foresee how a change in the leadership of the Bank can be avoided.

7. Meanwhile there are some quite serious economic implications. Not surprisingly, we understand that the banking supervision activities of the Bank of Italy are practically at a standstill. This means that the Bank of Italy's traditional moderating role in the shady world of Italian high finance is not being exercised at all. The persistence of such a situation would be extremely unhealthy. We also believe that practically no agreements for assisted interest rate loans available in one form or another under Italian legislation are at present being granted, since nobody is willing to risk having his decision investigated by the magistrates. Clearly this tendency, if allowed to develop, is going to cause even more paralysis than is normal!

8. I will write again when the situation develops further. I am sorry there appear to be so many diffuse strands in the story - but that is the nature of Italian politics.

*Yours ever,
Tung*

A C Galsworthy

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6 April 1979

SCANDAL OF THE BANK OF ITALY

I was compelled to pen to paper to say how tremendously informative, as well as hugely diverting, we have found your letters on the above topic. It really is a quite extraordinary state of affairs, and we very much look forward to the further episodes promised in your fifth paragraph.

C J BAKER

cc: D Gore-Booth Esq, FRD, FCO
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