Michalis Psalidopoulos

HISTORY OF THE BANK OF GREECE 1928-2008

FROM GOVERNMENT'S BANKER TO GUARDIAN OF FINANCIAL STABILITY

BANK OF GREECE
EUROSYSTEM

CENTRE FOR CULTURE
RESEARCH AND DOCUMENTATION

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to guardian of financial stability

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To the staff of the Bank of Greece

GOVERNOR'S FOREWORD

This year marks the 86th anniversary of the Bank of Greece. The similarities and differences between the distant 1928, when the Bank began operations, and today are not only interesting but also highly instructive. The same is true of the various policies by which the Bank responded to routine problems or, at times, major crises and imminent disasters during the 80 years (up to 2008) covered by this history. One of the conclusions of this book could be – it is up to readers to decide – that these policies may have differed, but they were all governed by one constant: a commitment to serve the public interest by ensuring and safeguarding monetary and financial stability as essential conditions for fostering economic development.

The Bank of Greece has repeatedly engaged in the study of its own past and the economic history of the country. The latest comprehensive retrospect of the Bank's history, a collective work by the Economic Research Department entitled *The First Fifty Years of the Bank of Greece,* dates back to its 50th anniversary in 1978. Since then, a number of individual contributions followed: in 2003, the 75th anniversary provided an occasion to look back at the Bank's history *(Bank of Greece, 75th Anniversary, Commemorative Ceremony – 3 November 2003);* in 2005, in an homage to the late governor Xenophon Zolotas, some of his former associates shared important testimonies and perspectives *(Xenophon Zolotas, In memoriam – 25 February 2005);* in 2009, the Bank published a volume titled *The 1929 Crisis, Greek economy and the annual Reports of the Bank of Greece for the years 1928-1940* (edited by the Economic Research Department); a study by Michalis Psalidopoulos (who is also the author of the present book) titled *Monetary Management and Economic Crisis – The policy of the Bank of Greece 1929-1941* followed in 2011; the biography *Emmanuel I. Tsouderos 1882-1956: central banker and politician,* by Margarita Dritsas, was published in 2012; and the Bank has already commissioned a biography of Kyriakos Varvaressos. Moreover, together with the present book, the Bank is also launching *The Chronicle of the Great Crisis: the Bank of Greece 2008-2013,* authored by its staff.

The history of the Bank of Greece we are now introducing to the public is not intended as the last word on the subject. Its aim is quite different – and this is exactly where its value lies: using the hitherto unexploited archival material available to the Bank of Greece (General Council decisions and the Currency Committee archive, archives of former Governors), Annual Reports and interviews with former Governors or other of its executives, it seeks to provide an as far as possible comprehensive account of the events and put them in the context of the changing international environment and the perceptions on economic policy and central banking. This history falls into the category of the history of the Greek economy and could serve as a solid basis for future monographs that will delve into more specific issues.

Yet, this history is also interesting, even captivating, in its own right. Wouldn't it be fascinating to learn about a central bank that started operations in 1928 – following insistent exhortations by the Financial Committee of the League of Nations (a body strongly reminiscent of the International Monetary Fund and the Economic and Financial Committee of the European Union) – and just one year later faced the challenge of a global economic crisis and lived to tell the tale?

Soon afterwards and while its necessity as a separate institution was still debated in Greece, the fledgling central bank was admitted as an equal member to the newly-founded Bank for International Settlements (BIS) and, in 1931, participated in the financial support offered to the distressed central banks of Austria and Hungary! In 1932, under the governorship of Emmanuel Tsouderos, the Bank resorted to imaginative (unorthodox but effective) methods for drawing foreign exchange from the free market, relying on experienced brokers. Equally intriguing is the story of the Bank's international activities in the context of the pre-war clearing agreements with various countries, inevitably including Nazi Germany, Greece's major trading partner at the time, only a few years before our country entered the war.

Then came WWII, with the rescue of the country's gold reserves via a route through Crete and South Africa to London, the operation of the Bank in exile with a staff of six in London, and the heart-breaking efforts of its staff back in occupied Greece to salvage whatever could be salvaged.

From 1944 onwards, the Bank played a decisive role in the effort to reconstruct the ruined economy and monetary system (on 23 October 1944, new banknotes were issued in denominations of 10 billion and 100 billion inflationary drachmas!).

The establishment of the Currency Committee in 1946 marked a close link between the government and the Bank, with the visible presence, during these first post-war years, of foreign advisers and supervisors, partly as a result of the Marshall Plan.

The post-war period up to 1981, marked by instances of strong economic performance but also by serious structural problems emerging in the economy, is examined on the basis of – among other sources – untapped material from the archive of Xenophon Zolotas, Governor during 1955-1967 and 1974-1981. In addition, this book sheds light on certain aspects of the economic policy pursued by the dictatorial regime during 1967-1974.

In 1982, the abolition of the Currency Committee represented a first step towards disentangling the respective roles of the Bank and the government, although the Bank's independence would only formally be established in 1997-1998, ahead of EMU accession. Meanwhile, between 1975 and 2008 the monetary policy regime underwent significant changes, which could become the subject of a separate monograph. Milestone years during this period were 1998, when the drachma entered the Exchange Rate Mechanism (ERM), and 2001, when Greece entered the euro area and the Bank of Greece became a member of the Eurosystem, thereby participating in the design and implementation of the single monetary policy of the euro area.

Through the evolution of the Bank's relationship with the government/state, this history highlights the importance of its independence. Although this independence was fully established only in the last decade of the 80-year period under review, effectively, the Bank enjoyed organisational autonomy right from the start. Its 1928-2008 course clearly shows the independent critical stance typically held by the Bank, partly attributable to the strong personalities and the prestige of its successive governors, while the continuity of its analyses confirms the chronic nature of certain fundamental weaknesses of the Greek economy. Dealing with several of these weaknesses remains on the agenda in 2014.

George Provopoulos
Governor
of the Bank of Greece

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Abbreviations

ACO	Autonomous Currant Organisation
AETE	Telephone Company Limited
ASE	Athens Stock Exchange
ATE	Agricultural Bank of Greece
ATA	Automatic Wage Indexation
BIS	Bank for International Settlements
EC	European Communities
ECA	Economic Cooperation Administration
ECB	European Central Bank
EDFO	Economic Development Financing Organisation
EEC	European Economic Community
EMS	European Monetary System
EMU	Economic and Monetary Union
ERM	Exchange Rate Mechanism
ESCB	European System of Central Banks
ETBA	Hellenic Industrial Development Bank
EU	European Union
GNTO	Greek National Tourism Organisation
GSSG	General Statistical Service of Greece
IKA	Social Insurance Institute
IMF	International Monetary Fund
MFI	Monetary Financial Institutions
NBG	National Bank of Greece
NGO	non-governmental organisation
NIBID	National Investment Bank for Industrial Development
OA	Olympic Airways
OBA	Industrial Development Organisation
OEEC	Organisation for European Economic Cooperation
OTE	Hellenic Telecommunications Organisation
PPC	Public Power Corporation
SEV	Hellenic Federation of Enterprises

PREFACE

Central banks, as banking institutions pursuing particular macroeconomic objectives, such as monetary and financial stability or equilibrium in the real economy, are largely a feature of the 20th century. The increasing complexity of market economies, along with the need for implementing the economic policy and the growing role of the financial system during not just two world wars but also the Great Depression of the interwar years, highlighted central banks as necessary institutions of the highest importance, and also determined their scope of action.

The Bank of Greece was no exception to this historical process. It began operations in 1928 as an offspring of the global economic upheavals of the interwar period that led up to an international monetary system based on the gold-exchange standard. During that time, several other central banks were established across Europe. However, the Bank of Greece made its first steps under peculiar circumstances, including a League of Nations loan, a domestic banking system in which the National Bank of Greece (NBG) enjoyed a special status, and the prevailing macroeconomic conditions, all of which will be discussed in detail below. From an institutional as well as a practical viewpoint, the history of the Bank of Greece has been inextricably linked with the fortunes of the Greek economy, affecting the latter's path towards development. The Bank has experienced, co-shaped and actively participated in all the crucial phases of this path: from the gold-exchange standard to the default of 1932 and the war events of the 1940s; from post-war reconstruction, the 1953 devaluation and the subsequent regime of financial regulation and controls to the collapse of the Bretton Woods system in the early 1970s; from the oil shocks of 1973 and 1978 to the gradual liberalisation of the financial system from the late 1980s onwards; and finally, from the country's preparations, since the mid-1990s, for joining the eurozone and for integrating the Bank of Greece into the Eurosystem in the 2000s to the outbreak of the global financial crisis with the collapse of Lehman Brothers in 2008.

The admittedly few thorough analyses of Greek economic history in the 20th century typically focus on the successive governments' industrial, fiscal, or broader policies and their relations with the markets. Studies of this type have shed light on the weaknesses and structural problems of the Greek development model, but have failed to clearly depict the progress and development achieved by the Greek economy as a whole, including its institutional framework. In this sense, monetary and financial policies are only examined as peripheral or incidental to the broader government policy. This obviously does not do justice to these policies and their special role in the evolution of the Greek economy from the inter-war period to the present, all the more so since financial policy proves, now more than ever, to be equally (if not more) important for the stability and growth of market economies.

The aim of the present study is to provide a detailed account of the Bank's efforts to achieve monetary equilibrium and financial stability in the context of the developing Greek economy from 1928 to 2008.

Following a historical approach of the Bank of Greece, this book identifies six distinct periods: 1928-1941, 1941-1944, 1944-1953, 1953-1971, 1971-2001 and 2001-2008. This periodisation is not based on a single criterion and obviously does not divide the Bank's history into equal intervals. The first period (1928-1941) was the time when the Bank of Greece consolidated its influence on the Greek banking system and handled the crisis of the 1930s. The second period (1941-1944) coincides with the Axis Occupation of Greece during World War II. The third (1944-1953) refers to the Bank's efforts to restore the stability of the currency in liberated Greece, in cooperation with the successive Greek governments and the foreign allies. The fourth period (1953-1971) was one of fixed exchange rates accompanied by several years of growth, economic transformation and low inflation. The fifth period (1971-2001) starts with the changeover of the world economy to floating exchange rates, is marked by international and local disturbances, and culminates with Greece's shift to a new growth model in 1981; through banking liberalisation and the new role of central banks worldwide, this period leads to the full independence of the Bank of Greece and the entry of Greece into the euro area. For reasons associated with the handling of the archival material, this fifth period is further divided into two subperiods: 1971-1984 and 1984-2001. The sixth period (2001-2008) tells the story of the country's adjustment to the new currency, as well as the challenges posed by the new, globalised market, until the outbreak of the international crisis in 2008. This periodisation is considered to be more meaningful than one based on Governors' terms of office, and serves to highlight the Bank's continuity as an institution in a changing international and domestic environment.

By tracing the history of the Bank of Greece from 1928 to 2008, this book ultimately aims to highlight the landmarks in the history of the Greek economy and banking system during these years. The ongoing economic crisis, with the heavy toll it has taken on the euro area and the Greek economy, has led many scholars worldwide to delve into *mutatis mutandis* comparable historical events of the 1930s, 1970s and 1990s, looking for similarities and differences in the changing economic, political and international conditions. Therefore, the policy questions by which one could approach the history of the Bank of Greece are closely related to the events that have determined its course, as well as to the effectiveness of its responses in addressing the challenges of each era.

The questions this study attempts to answer include the following:

• What have been the international and, in particular, European developments of relevance to the operation of the Bank of Greece?

• How have the Bank's successive Governors contributed to analysing the problems of the Greek economy and managing monetary developments?

• How have the macroeconomic circumstances affected the Bank's monetary policy in different periods?

• Has there been policy continuity and consistency, by way of monetary discipline?

• What has been the importance of the Bank's independence from government policy, whenever – if ever - such independence existed?

• What has been the importance of the Bank's role as regulator of the financial system and how has this role changed over time?

• How has the Bank of Greece, through its qualified staff and the unique status of its Governors, driven institutional modernisation in the banking system and government policy making, in general?

• Ultimately, has the Bank of Greece contributed to monetary and financial stability, thereby also to the country's economic development, given the institutional – domestic and international – constraints of each historical period?

The above questions suggest that the history of the Bank of Greece needs to go beyond a simple narration of economic and financial events, by combining the latter with an analysis that takes account of the different contexts and constraints of exercising economic policy.

Rather than exclusively targeting an audience made up of economists or economic historians, this study aspires to provide critical readers and responsible citizens with a comprehensive account of the path followed by the country's central bank over its first 80 years, in the context of global and Greek economic developments. By so doing, it links domestic developments to international events and provides a solid starting point for future research endeavours, which will address other specific issues of the Greek banking history. As an additional objective, the study aims to demonstrate how the Bank of Greece – despite evolving through the Great Depression of the 1930s into the central bank and serving the goal of economic development coupled with monetary stability in the post-war period – gradually, and supported by the international institutional framework, emerged since 1998 as the principal guardian of financial stability in Greece. Against this background, the text below follows an analytical/descriptive method, consigning tables and charts to the Appendix. In the same spirit, references have been kept to a minimum and, as far as the Bank's actions are concerned, are almost exclusively to its own archival and other in-house material, rather than to secondary sources.

I would like to extend my warm thanks to all those from the Bank's staff who reviewed the earlier draft and helped to considerably improve it through their input, as well as to my research associates for their contribution to the documentation of this work. All errors and omissions are the responsibility of the author.

PART ONE

METHODOLOGICAL, THEORETICAL AND HISTORICAL CONSIDERATIONS

1. Writing the history of a central bank: methodological remarks

The widespread emergence of central banks is a feature of the 20th century. Central banks are institutions that serve public interest and can have various objectives, as laid down in their statutes: they control money supply in the economy, work to ensure price stability and maintain the external value of the currency, handle the primary credit discount rate, and supervise the flow of credit to the economy; they regulate the smooth operation of commercial banks; keep the government's accounts; and monitor developments in the economy, taking action to mitigate the impact of output shocks. In times of crisis they act as lenders of last resort, cooperating in this respect with the State, with which they maintain a close relationship. Over time, this relationship has become increasingly looser, so that today we can talk of a relative independence of central banks vis-à-vis the government. This independence has been enshrined in legislation.

The activities of central banks have often been the subject of historical scrutiny. Each central bank has at least one publication on its own history to show, authored either by members of its staff or by academic historians.[1] For major central banks —such as the Bank of England or the US Federal Reserve to name only a few— more studies have been prepared.[2] In the case of Greece, five such studies have so far been

1 It is characteristic that the first history of the European Central Bank was written only a few years after its establishment (see Scheller, 2006).

2 For the Bank of England, see Andréadès (1909), Sayers (1976), and Roberts and Kynaston (1995); for the Federal Reserve, see Meltzer (2001 and 2009), and Melton (1985); for the Bundesbank, see Marsh (1992), De Haan (2000), Deutsche Bundesbank (1999), and Frowen and Pringle (1998).

published, on the occasion of various anniversaries of the Bank of Greece,with the latest extensive one dating back 36 years ago.[3]

Central banking has attracted renewed scholarly interest since the 1990s, when the history of corporations in general and of banking institutions in particular emerged as a distinct field of economic history. Dedicated journals have been launched and a specialist academic society has been established, the European Association for Banking and Financial History, whose scope includes promoting research and scientific documentation of central bank activities and analysis of the practical results of such activities on a comparative basis, so as to draw lessons from the past and identify any desirable steps for the future.

But how should a history of a central bank be written, and which path should a researcher follow to glean significant insights into the subject? This is an obvious and seemingly simple question, which nevertheless conceals inherent methodological difficulties. Unsurprisingly, this question was discussed at length in an academic colloquium bringing together the world's major banking historians, who debated and illuminated various aspects of the issue.[4]

According to Barry Eichengreen (in Holtfrerich et al. 1999), histories of national central banks based on Governor reports and General Council resolutions all too frequently fail to capture what is distinctive about their subject. However essential such studies may be during the initial stages of an analysis or archival research, a way of removing the blinkers imposed by the case-study approach is to adopt a comparative perspective. One solution is to concentrate on functional comparisons: to focus on the evolution of the lender of last resort function, for example, or on the history of supervisory and regulatory responsibilities.

According to Pierre Siklos (2002), central bank behaviour can be defined by the personalities at the head of the central bank (the CEO). Bank archives themselves cannot reveal all the "secrets" of a bank's operation, especially at critical moments. Therefore, the role of central bankers has to be included and taken into account. This is also acknowledged in Holtfrerich, Reis and Toniolo (1999): ideas play an important role in monetary policy-making, which cannot be disentangled from the personalities at the head of central banks. Central banks' history bears the stamp of the personalities of their CEOs, who have their own views, ideas and principles,

3 Vouros (1938), Pyrsos (1946), Venezis (1955), and Bank of Greece (1978 and 2003). Among the studies regarding the Greek banking system as a whole, see Kyrkilitsis (1934), Andreadis (1966), Zitridis (1973), Gortsos (1998), Pagoulatos (2003 and 2009), Kostis (1997), Kostis (2008), Dritsas in Pohl and Freitag (1994), and Mirkos (2010). For the monetary and the financial system, see Papademos (1992). For development banks, see Vousvounis (2010) and Loizos (2012a).

4 Fase et al. (1995).

drawn from their study of economics and monetary and banking theory, applying them in practice while exercising their duties on a daily basis.

Rules and regulations are also of particular importance in the history of central banks. Case studies of the institutional framework, especially of good practice that has proved resilient and conducive to global coordination in a changing and interconnected world, help understand certain aspects of international cooperation and experience-sharing among countries.On the other hand, Fritz Weber (in Fase et al. 1995) argues that the author of a central bank history should start from some self-evident but occasionally overlooked facts. Familiarity with the economic history of a country, region, or even continent is essential before embarking on the study of the history of a central bank, which does not operate in a vacuum, but in a given time and within a given economic and policy setting. In particular, familiarity with both local and world economic history is necessary, as a central bank's activity is not confined in national borders, but is also affected and shaped by international events and developments. As regards central bank executives, according to Weber, one should look into their career and academic background. A central bank's track record should not only include successes, but also misjudgements and/or policy errors. The Friedman and Schwartz (1963b) criticism of the Federal Reserve's policy in 1929-1933 is a well-known example. Johan de Vries takes the same view (in Fase et al., 1995). The history of a central bank cannot be "doxographic" —to use a term coined by Richard Rorty (1984)— but should be guided by objectivity and should reconstruct decision-making in the context of the overall socio-political circumstances and the broader developments in a specific country.

The above considerations demarcate the frame of reference of this book on the history of the Bank of Greece from 1928 to 2008. The current status of research —i.e. the fact that the primary material from the Bank of Greece's Annual Reports and General Council Decisions have not yet been utilised in long-term studies— urges us to start from this material, *thus providing scholars a solid ground for further research,* in line with Eichengreen's conclusions. It also places emphasis on the views of the Bank of Greece Governors as reflected in other sources, and does not fail to discuss some of their actions and initiatives that were hotly debated in Greek society. In the absence of exhaustive biographies for some of them, this book had to rely on their publications, speeches, views and attitudes, as recorded in various sources.[5] In the third part of the book, the core of this study, this material is

5 For Tsouderos, see Venezis (1966) and Dritsas (2011); for Mantzavinos, see Stratigakis (1955); for Zolotas, see Psalidopoulos (2008). See also Zolotas (1957).

presented against the economic developments in the country that influenced the specific responses and initiatives of the Bank of Greece.

In this first part, after having clarified the methodological starting points of the study, we deal with two topics.

The first refers to the international framework for central banking, the problems of the global financial system, and the solutions given by the international community. Here the study traces how the world economy navigated through the inter-war crisis to World War II and the Bretton Woods system, and what happened in terms of worldwide understanding among central banks after the collapse of the fixed exchange rates system in 1971. As we move toward the last quarter of the 20th century, there is a sharper focus on developments in the European context, with which the Greek economy was more closely linked from 1962 onwards, leading up to Greece's accession to the EEC/EU in 1981.

The second topic refers to the major domestic economic and political developments, providing a concise account of what happened in the Greek economy, focusing not so much on quantitative outcomes but rather on events that more broadly had a bearing on the scientific debate in the country and prompted responses by the Bank of Greece. This account organically complements the preceding discussion of international developments and enables comparisons to be drawn for assessing lags, linkages and interactions between foreign and domestic factors.

The first part concludes with a brief overview of theoretical economic thought, particularly on monetary matters, in its historical evolution. The reason is once again obvious. The history of economic and, in particular, monetary and banking theories is a reflection of international —and, to the extent these were diffused to Greece, also domestic— scientific analyses that, over time, influenced and changed the principles of central banking, with central bank objectives, strategies and policies shifting as the international environment changed. This overview is not exhaustive, nor does it attempt to address all the questions raised at times in international academic journals, societies or conferences. It merely seeks to recall some seminal contributions to the relevant international academic debate, as a background necessary for understanding what will be discussed in the next sections.

The second part of the book starts with a historical analysis of the evolution of the Greek banking system up to the establishment of the Bank of Greece, showing how the practices, conventions and operations of Greek banks evolved since the establishment of the modern Greek State and until the Bank of Greece was founded in 1927. Then follows a description of how the Bank was established, with references made to its Statute and the start of its operations. This section spans the forming years of the Bank of Greece and its coming of age through its responses to the crisis of the 1930s and to the extraordinary circumstances of the war in the 1940s. It discusses how the first 15 years of the Bank shaped the key elements of its identity in the post-war period. Moving further along the time line, the successive institutional changes are examined, including the establishment of the Currency Committee in 1946, and the Bank's important role in achieving and maintaining currency stability. Also, major statutory amendments are highlighted, the most recent being the 1998 legislation enshrining the Bank's independence vis-à-vis the government.

The third part of the book is, as mentioned earlier, devoted to a discussion of yearly developments in the Greek economy, and the respective Bank of Greece policies and interventions – sometimes preventive, sometimes suppressive, but always in line with its pursuit of currency stability combined with economic growth. Thus, the individual chapters of this part follow a broadly similar structure: what happened in the economy; what the Bank's assessment of the developments was; and what its policy responses and actions were.

This enables a full-scale view of the Bank's history, which at the same time is a history of the economy of modern Greece.

The final chapter of the book contains some conclusions, followed by a statistical appendix and brief biographies of the Bank's successive Governors and Deputy Governors.

With respect to the macroeconomic data on the Greek economy, it is necessary to note the following: unfortunately, the statistical data for periods before 1953 are not very reliable. Statistics as a discipline essentially emerged in Greece only in the late 1910s and early 1920s, when the first population censuses were conducted. In the inter-war period, the General Statistical Service of Greece launched its "Statistical Yearbook" (GSSG, 1931), also including a wealth of past data. In the field of economics, 30 publications by the Supreme Economic Council between 1930 to 1940 and the "Economic Yearbook of Greece" initially published by the National Bank of Greece and then by the Bank of Greece (11 volumes from 1929 to 1939) are invaluable sources of information on the Greek economy and the overall environment of the 1930s. Official historical statistics for the period 1940-1953 are not available. The National Accounts Directorate of the Ministry of Coordination (1971) filled the data gap for the period 1953-1970 and, in later publications, the Bank of Greece (1990) and the Ministry of National Economy (1998 and 2001) released more expanded historical statistics. The above statistics are sometimes characterised by discrepancies, which are partly reflected in the data reported here. One should therefore bear in mind that the data found in this study reproduce the figures provided in the referenced sources.

Regarding the archival material on which the present study is based, it should be stressed that the main source of information is the minutes of the Bank's General Council meetings, while the Governor's Annual Reports are used as a complementary source for the years up to 1980 and as an exclusive source thereafter, as 1980 is the last year for which General Council records have been processed and archived. A selective use has also been made of other sources, namely the Currency Committee archive, the archives of Governors E. Tsouderos, K. Varvaressos, G. Mantzavinos and X. Zolotas, as well as face-to-face interviews with former Governors and other high-ranking officials of the Bank of Greece.

2. The international historical context. Major political and economic events, 1928-2008

2.1 Post-World War I imbalances[6]

The outbreak of World War I put an end to what is today called the "first globalisation" of 1870-1914, and the world economy was thrown into great trouble. The gold standard was suspended and the warring countries increasingly resorted to deficit financing of military operations. For four years, price controls, rationing schemes and various other interventions replaced the mechanisms of free market.

The war put a strain on the public finances of all the warring countries. Former lenders, such as the UK, found themselves in need of funds in 1918. For instance, taxation in this country rose from 362 million to 2,500 million pounds between 1914-1915 and 1918-1919. The British budget, always balanced in earlier times, showed a deficit of 1,690 million pounds in 1918, while the British public debt reached 7,830 million pounds.[7] The debt-to-GDP ratio rose from 24% in 1914 to 127% in 1919 (calculations based on Mitchell 1988, pp. 600-3 and 832-4). France suffered enormous losses during the war and having had —as a defeated party in 1870— to pay reparations to Prussia, now demanded reparations from Germany. With its economy in relative decline compared with that of the United States, Europe entered, with the Treaty of Versailles, a process of intra-European friction, confusion and confrontation.

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6 For the inter-war period, see Eichengreen (1992), Eichengreen and Hatton (1988), Feinstein and Watson (1995), Feinstein, Temin and Toniolo (1997), James, Lindgren and Teichova (1991).

7 Pollard (1967 and 1970).

A major cause of friction was the inter-Allied debt, long remaining unresolved as the former Allies failed to settle this matter despite its huge importance for world trade and interstate payments. According to available data, France owed US dollars 3,030 million to Great Britain and US dollars 3,991 million to the United States. Great Britain owed US dollars 4,661 million to the United States and, besides its receivables from France, had claims of US dollars 8,141 million on various other countries, which together owed US dollars 3,463 million to France and US dollars 3,209 million to the United States. Yet, instead of being settled through netting, all these reci procal debts were left to poison foreign affairs and damage world trade throughout the inter-war period, preventing mutual understanding and joint initiatives.[8]

2.2 Dissolution of monetary unions

The return to the gold standard and currency convertibility regimes proved to be a tough endeavour. The Latin Monetary Union (established in 1865) and the Scandinavian Monetary Union (formed in 1873) were dissolved, while the German Monetary Union (set up in 1873) had reached an impasse in 1923 due to German hyperinflation.[9]

The discrediting and dissolution of such monetary unions resulted in an upsurge of insecurity and a further weakening of cooperation ties, mainly among European countries. These phenomena gradually led to a rise in protectionism, by adopting a variety of laws that promoted the consumption of domestic products and imposed tariffs on imports. After all, the impact of the war on productive infrastructure, the political instability that plagued many continental European countries, and the political uprisings in countries such as Germany, Hungary and Austria, sapped confidence in the economy and led to persistent unemployment. The latter in turn triggered a surge in nationalism and —in the case of the countries defeated in World War I— revanchism.

Another result of the conditions of the time was post-war inflation. Several European countries experienced hyperinflation and monetary disasters, including Germany (Holtfrerich, 1986), Hungary, Russia after 1917, Austria, and Poland. Greece as well, experienced a great monetary turmoil between 1920 and 1924.

8 Lewis (1949) and Aldcroft (1981).

9 It should be noted, however, that the German economic and monetary (and then also political) unification process had started much earlier, with the Zollverein (customs union) in 1834.

2.3 The temporary reinstatement of the gold standard

Following the Genoa Conference in 1923 and the agreement in principle reached there, some countries readopted the gold standard after 1925, but this return to economic and financial normality soon collapsed under the coupled effects of the stock market crash of 1929 and the European banking crisis of 1931 (Drummond, 1987). Britain once again abandoned the gold standard in 1931 (Kunz, 1987) and the US followed suit in March 1933. France led the "Gold Bloc", which included Belgium, the Netherlands, Switzerland and —for a while— Italy and Poland. This Bloc lasted for three and a half years, from 3 July 1933 to 25 September 1936, when France in turn unpegged its currency from gold, following the electoral victory of the Front Populaire in May. From September 1931 to the outbreak of World War II, the countries that had their currencies pegged to the pound sterling and held their foreign exchange reserves in London constituted the (largely informal) "Sterling Bloc" or "Sterling Area": this group included a number of former British colonies (Australia, New Zealand) and the major Nordic countries (Denmark, Finland, Norway and Sweden).

2.4 The impact of the 1929 crisis on economic policy

The stock market crisis of 1929 in the USA (Galbraith 1954, Fearon 1979, Parker 2002) and the Great Depression that followed (Kindleberger 1984, Clavin 2000, James 2000, Parker, 2007)[10] pushed several European countries —Germany, Greece, Hungary, Romania, Poland, and Austria (Cassel 1932)— to formally declare a suspension of payments and ask for a restructuring of their debt. In the same period, this was also the case for the majority of Latin American and Asian states (Rothermund 1996). Unemployment rose dramatically resulting in political instability and the emergence of dictatorial governments and authoritarian regimes in a number of European countries (including Italy and Germany – see von Kruedener 1990).[11] Other countries saw changes in their economic policy mix: in post-1933 USA the Franklin Delano Roosevelt administration adopted the policy known as the "New Deal" (Barber 1985 and 1996, Bernstein 2004); in 1936 France the Front Populaire came to power; the Soviet Union launched five-year planning as from 1930; while as of 1932 Sweden

10 Among the vast literature on explanations of the crisis, see Bernanke (2000), Brunner (1982) and Temin (1991).

11 Dictatorial regimes first emerged as early as 1923. Greece had experienced the short-lived Pangalos dictatorship in 1925-1926. The specificities of the Greek case certainly include the socioeconomic and political impact of the Asia Minor Disaster of 1922.

pursued a countercyclical economic policy under the guidance of economists of the Stockholm School of Economics (Lindbeck 1975, Hansson 1982, Uhr 1977).

2.5 Wartime economy and post-war planning

World War II, which followed, was one of the greatest tragedies in human history and —at the same time— a catalyst for enormous changes in geopolitics and in the European economy and society. While a substantial part of the infrastructure of the warring countries was being destroyed, industry refocused on the war effort, which resulted in a period of intense industrial activity and technological innovation. The conscription of practically the entire male populations in all the warring countries led to the definitive and mass entry of women into the labour market, whilst the convergence between Western powers and the USSR achieved during the war, after the crush of the Axis gave way to confrontation. The Tehran and Yalta conferences laid the foundations for the post-war division of the globe into "East" and "West".

One of the first choices of the future victors of the war, even prior to the capitulation of the Axis powers, was an attempt to regulate the post-war international monetary and financial regime. The cornerstone document of this arrangement was the Atlantic Charter, signed by Franklin D. Roosevelt and Winston Churchill on 14 August 1941. With reference to the economy, the Charter stated among other things that the post-war period should see a reduction of trade restrictions, equal access to raw materials for all nations, and freedom of the seas.

2.6 The Bretton Woods conference. The post-war architecture of world economy, 1944-1971

In July 1944, delegations of the Allies met and conferred for three weeks in Bretton Woods, a resort in New Hampshire, United States, to design the post-war global economic and banking order: they decided to establish the International Monetary Fund (IMF), as well as the International Bank for Reconstruction and Development (IBRD), which today forms part of the World Bank.[12] They also adopted a system of fixed foreign exchange rates vis-à-vis the US dollar, plus the convertibility of this currency into gold. Their agreements on safeguarding free trade led to the General Agreement on Tariffs and Trade (GATT) signed in 1947, which a few decades later (in 1995) evolved into the World Trade Organisation (WTO).

12 For the system, its functioning and dysfunctions, see Eichengreen (2008), Cesarano (2006), and Bordo and Eichengreen (1993).

The reconstruction of the war-ruined economies with the help of the Marshall Plan (1948-1951), the stable environment of fixed exchange rates and convertibility of the US dollar into gold, as well as the baby boom and the ensuing rise in private consumption in the countries of the "West", resulted in the achievement, from 1945 to 1971, of a "golden triangle": growth – price stability – (nearly) full employment.

This post-war architecture lasted for approximately 25 years. Any crises that emerged during that period were short-lived competitiveness or balance-of-payments crises and led to currency devaluations in France (1959) and in the UK (1967). While Germany and Japan accumulated huge current account surpluses, the United States showed deficits, as a result of the Vietnam War, increased public spending, and capital outflows due to lower market confidence in the US administration's commitment to deficit reduction. As early as the late 1950s, Robert Triffin had pointed to these risks, which started being debated in international conferences from 1964 onwards.[13] But no reform action was taken, thus prolonging uncertainty about the future of the global economic system. A consequence of this uncertainty was the depletion of US gold reserves. The post-war architecture was at breaking point. In August 1971, President Richard Nixon announced a wage freeze and the imposition of an import tax, as well as the abolition of the convertibility of the US dollar into gold. This move, decided without any prior consultation with the international system, effectively put an end to the dollar-gold standard, and the world economy entered a period of floating exchange rates.

2.7 The path towards European integration

Another consequence of World War II and the devastation it brought about in the old continent (but also of the financial and technical assistance offered after the war by the United States) was the revival of the idea of European integration (Kotlowski 2000, James 2012). This idea, which originated in the Pan-Europa Movement of the inter-war years, led in the post-war period to the following European agreements: the Benelux customs union convention (1944), the Treaty of Brussels (1948); and the agreement establishing the Organisation for European Economic Cooperation (OEEC 1948). The OEEC, initially set up in order to coordinate issues

13 Connell (2013). According to Triffin, the Bretton Woods system relied on the provision of liquidity by the US to the rest of the world. If the United States were to stop creating deficits, liquidity would dry up; and in the event that gold prices in US dollars increased, the other countries would no longer have any desire of holding US dollars. The Belaggio Group promoted dialogue on adjustments, liquidity and confidence building in the system. Milton Friedman was the most prominent advocate of floating exchange rates, and over time many other economists endorsed his views.

related to the funds of the Marshall Plan, evolved into the Organisation for Economic Cooperation and Development (OECD) in 1961. Most European countries became members of the North Atlantic Treaty Organisation (NATO) in 1949. The same era saw the establishment of the Council of Europe (1949), the European Payments Union (EPU, 1950), the European Coal and Steel Community (ECSC, 1951), the Western European Union (WEU, 1954), and the European Atomic Energy Community (EAEC or Euratom, 1957).

The year 1957 marked the establishment of the European Economic Community (EEC), whereas the countries that refrained from joining it went ahead to form the European Free Trade Area (EFTA) in 1960. The EEC evolved into the European Union (EU) with the Maastricht Treaty in 1992, a development enshrined in, and consolidated by, the Treaties of Maastricht, Amsterdam, Nice and Lisbon. The creation of the single internal market in 1992 and the entry into force of the Maastricht Treaty in 1993 paved the road to the European Economic and Monetary Union (EMU), which culminated in the euro cash changeover on 1 January 2002.

2.8 From the Smithsonian Agreement to floating exchange rates

The collapse of the Bretton Woods system highlighted the need for a new international system of exchange rates. The first step in this direction was taken in December 1971 with the "Smithsonian Agreement", entered into by the countries of the Group of Ten (or G-10), which had been formed in 1962 after the signing of the General Arrangement to Borrow (GAB). The Smithsonian Agreement set a ±2.25% fluctuation band for the central parity of each participating currency against the US dollar. This provided a "tunnel", that is, a range within which a currency could fluctuate vis-à-vis the other currencies, and which theoretically could be up to ±9%, a band seen by some as excessive. On 10 April 1972, the six members of the EEC and the three accession countries (United Kingdom, Ireland and Denmark) decided to limit the fluctuation band to ±2.25%, thereby establishing the so-called "snake in the tunnel", which represented the first attempt at exchange rate policy coordination among the EEC member countries (and, incidentally, marked the end of the "Sterling Area").

However, capital movements remained irregular and the Smithsonian Agreement proved short-lived: it collapsed in May 1973, ushering in the modern era of floating exchange rates. Unlike the "tunnel", which collapsed in 1973 with the free float of the US dollar, the "snake" remained in place, although not without problems, until 1978. The United States entered a period of stagflation, as the energy crisis that began in 1973 greatly aggravated the situation.

The US dollar depreciated considerably during the 1970s, while the United Kingdom was forced to withdraw the pound sterling from the "snake" in 1972 (only months after joining it), without however managing to avoid a new devaluation a few years later. The Italian lira was pulled out in 1973, and France was forced twice (in 1974 and 1976) to withdraw its franc, before rejoining again. In 1975, the EEC countries agreed to adopt the European Unit of Account. On 13 March 1979, after nearly two years of negotiations, the European Monetary System (EMS) was finally launched, and the European Currency Unit (ECU) was adopted, replacing the Unit of Account at a parity of 1:1.[14]

2.9 The oil shocks

The first oil shock of 1973 led to stagflation, and western economies came to realise the need for some kind of economic policy coordination, and possibly a change in the policy mix. Thus, in 1974 the US administration called an informal meeting of senior financial officials from the United States, West Germany, Japan, the United Kingdom and France, who formed the so-called "Library Group". In 1975, Italy joined the group, which convened as an official Summit in the town of Rambouillet, France. This marked the creation of the G-6, which became the G-7 when Canada joined in 1976, the G-8 when Russia joined in 1998, and finally the way more representative internationally G-20 in 2008, when it expanded to include several other countries. Its composition also included, as from 1977, the President of the Commission of the European Communities.

2.10 The quest for international understanding

At the fourth Summit held in Bonn in 1978, the G-7 leaders made an effort to coordinate their policies in order to better manage their partly diverging priorities. It was agreed that Germany should follow a path of credit expansion, while Italy and Japan announced that they had set clear targets for real growth within the year 1979. On the other hand, the United States, Canada, the United Kingdom and France had set as their fundamental aim to rein in inflation. The United States committed to reduce its dependence on imported oil and build up strategic oil reserves. In the area of global trade, it was decided to enhance the GATT procedures, so as to prevent any weakening of the world trade system, and to set up new mechanisms.[15]

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14 James (1996). For the relationship between the EMS and the US dollar, see Giavazzi and Giovannini (1986).

15 Declaration, Bonn, 17 July 1978: http://www.g8.utoronto.ca/summit/1978bonn/communique.html

As mentioned earlier, this coordination attempt was at first not particularly successful, given that the governments of the industrialised countries were facing a multifaceted crisis, which featured high fuel prices, high inflation and stagnating output, high and persistent unemployment and growing government and current account deficits. Moreover, the second oil shock, sparked by the Iranian Revolution (1979) and the rise of an Islamic regime in power in that country and the Iran-Iraq War (1980-1988), pushed oil prices even higher, causing soaring inflation rates and a major destabilisation in the world economy. Against this background, any expansionary policy agendas were abandoned.

Elsewhere, attempts were made to boost demand along Keynesian lines, as well as to establish wage and price controls, despite objections raised by monetarists and free marketeers. Thus, in 1977 Paul McCracken and other economists argued in favour of active demand management, while the OECD too recommended policies to ensure an expansionary exit from stagflation, relying on controls and anti-inflationary interventions.[16]

2.11 A paradigm shift in economic policy

The above-mentioned Keynesian views met with a wave of opposition and triggered controversy among economists. Ultimately, Keynesianism was rejected for the neoliberal paradigm: in 1979 Margaret Thatcher became Prime Minister of the United Kingdom and in 1980 Ronald Reagan was elected President of the United States. Both these conservative leaders of the most powerful English-speaking nations fervently supported supply-side economics, came into conflict with the public sector and trade unions and pursued a policy of market liberalisation/deregulation, inspired by the theories of economists such as Friedrich A. von Hayek and Milton Friedman, exponents of the Austrian School and the Chicago School, respectively. However, their policies were not identical: Thatcher implemented drastic cuts in public spending, whereas Reagan increased public spending compared with his predecessor, Jimmy Carter. It is also worth noting that the latter had appointed Paul Volcker Chairman of the Federal Reserve, a central banker who, as a monetarist, set as his primary goal to reduce US inflation. This was achieved by raising interest rates to double digits, which led to a deep recession and, at a later phase, a "purging" of the economy.[17] Similar policy objectives were pursued in the United Kingdom.

16 OECD (1977), Economic Outlook, No. 22, and Ferguson (2010).

17 Volcker and Gyohten (1992), Feldstein (1994).

The economic policies of the Reagan administration ("Reaganomics") involved a tightening of money supply, higher government expenditure —mostly on defence— and less state intervention in the other sectors of the economy, coupled with a reduction of income and capital gains taxes. A variant of this policy, with drastic government spending cuts and a withdrawal of the State from sectors traditionally under its control, was pursued in the United Kingdom. Gradually, several other OECD countries followed suit, with their own versions of this approach adapted to fit their country-specific circumstances.

This policy had a dampening effect on inflation in the short to medium term. On the other hand, in the case of the United States, it triggered a widening of deficits, while in the case of the United Kingdom led to a drastic curtailing of the welfare state, largely dismantling the safety net that protected the more vulnerable groups of society and the unemployed. Corporate profits, however, increased significantly and many members of the middle class were able to improve their economic position, invest in the stock market and raise their incomes.

2.12 The growing importance of the financial sector

The financial liberalisation/deregulation that accompanied these changes gained momentum in the 1980s, as did financial innovation with new products such as forward contracts, structured bonds, credit default swaps, etc. The tertiary sector grew to gigantic proportions, mainly in Wall Street in New York and the City in London, but also in other financial centres, in Europe (e.g. Frankfurt), Asia (e.g. Hong Kong, Singapore) and elsewhere. Aggressive business takeovers, mergers and high leveraging marked the transition to this new era. Employment stopped being thought as a responsibility of the State and a sentiment of optimism, prosperity and confidence gradually prevailed in the business community, encouraging higher risk-taking relative to the past.

2.13 From the Plaza Accord to the crisis of 1987

In the field of international economic relations, the five most powerful countries of the (western) world, namely the United States, the United Kingdom, France, West Germany and Japan, signed the "Plaza Accord" on 22 September 1985, agreeing to devalue the US dollar against (mainly) the Deutsche Mark and the Japanese yen. This agreement initially boosted US exports to the other industrialised countries, but subsequently the depreciation of the dollar proved to be excessive and could not be halted by market forces. Thus, on 22 February 1987, a year and a half after the

Plaza Accord, the same countries plus Canada (Italy was also invited to sign the agreement but declined), reached the "Louvre Accord", which put an end to the downhill run of the US dollar rate. The signatories committed to reduce their external deficits (France, United States) or balance of payment surpluses (Japan), to reduce taxes (United Kingdom, Germany, France), to cut public spending (Germany, United States) and to keep their interest rates low (Japan, United States). As a result of these two accords, under which the yen strongly appreciated vis-à-vis all the other currencies, the Japanese currency became particularly expensive and the Japanese economy was initially led to a stock exchange and real estate bubble followed by stagnation and recession, which has broadly persisted to this day: although in essence the phenomenon originates in the Smithsonian Agreement (in 1971, when the yen had appreciated from 360 to 308 yen per dollar), it was reinforced in 1987-1988 and peaked in 1995 (when the Japanese currency reached 79 yen per dollar).

The balance struck by the Louvre Accord was put to the test eight months later, with the Wall Street crash of 19 October 1987. This crisis was attributed to various factors. The Brady Committee attributed it to the stock market's reliance on program trading (i.e. the use of automated electronic transaction systems). Another factor seen as the cause or an intensifier of the crisis was the US policy tightening, which outpaced that in Europe. However, the decisive liquidity-providing interventions of the Fed, under Alan Greenspan, prevented the crisis from spilling over to other markets and enabled the US economy to recover rather soon afterwards.

2.14 The emergence of the new globalisation. The new global architecture

The 1990s started with great expectations: the collapse of the Communist Bloc and the dissolution of COMECON provided the former socialist countries with an opportunity to gradually evolve into free market economies, while the Western European countries stepped up and deepened their integration endeavour. Meanwhile, across the Atlantic, the creation of free trade areas changed the rules of the game, and the completion of the Uruguay Round of the GATT (1986-1994) led to the establishment of the World Trade Organisation (WTO). China on the other hand, following the events in Tiananmen Square, embarked on a path of economic (though not political) liberalisation.

The disintegration of the Eastern Bloc started from Poland in April 1989 and soon spread across all the member countries. The highly symbolic demolition of the Berlin Wall took place on 9 November 1989. The US-USSR Summit in Malta (2-3 December 1989) officially marked the termination of the Cold War. Germany was reunited on 3 October 1990, while the Warsaw Pact Organisation and the USSR were dissolved on 1 July and 25 December 1991, respectively. In 1992, Poland, Hungary and Czechoslovakia (which split in two in 1993) established the Central European Free Trade Area (CEFTA), as a first coordination attempt of the economies of former socialist countries and as an antechamber to their accession to the European Union (EU). In 1995 they were joined by Slovenia. While these countries acceded to the EU in 2004, other Eastern European countries joined the CEFTA in 2006 and 2007. Also in 2004, the three Baltic States (Latvia, Lithuania and Estonia), former Soviet republics, joined the EU. Most of the remaining former Soviet republics formed the Commonwealth of Independent States, which attempted to create a free trade area from 1994 onwards. The transition from a centrally planned economy to a market economy was more successful in the countries of Central and Eastern Europe than in those of the former USSR.

In Western Europe, the twelve Member States of the EEC moved towards deeper integration, deciding to create the EU and defining its structure, which would rely on three pillars (European Communities, Common Foreign and Security Policy, Police and Judicial Cooperation in Criminal Matters). The Maastricht Treaty (signed on 7 February 1992) led to the creation of the euro and established the four convergence criteria which each member country should have fulfilled before adopting the new currency. The Maastricht criteria imposed limits on government deficits and debt, inflation rates, interest rates, and foreign exchange rate fluctuations. In 1995 the EU was enlarged with the accession of Austria, Sweden and Finland, while Norway decided again not to join. This development led to a marginalisation of the European Free Trade Association (EFTA) and the adoption (in view of the enlargement) of the Agreement on the European Economic Area in 1994.

Also, in 1994, the United States, Canada and Mexico signed the North Atlantic Free Trade Agreement (NAFTA), while in the same year, the Southern Common Market (MERCOSUR) set up in 1991 in Latin America decided to form a customs union. These developments provided impetus to expanding the scope of other regional intergovernmental agreements, with additional economic, trade or customs-related dimensions, while they also encouraged the creation of new regional unions, such as the CARICOM in the Caribbean, the Andean Community (CAN), the ASEAN in Southeast Asia, the ECOWAS in West Africa, the SAARC in the Indian subcontinent, the GCC in the Gulf region, etc. Thus, towards the end of the 20th century the future seemed to belong to regional economic alliances. Pointing in the same direction was also the impressive growth of world trade, which from 5% of global GDP in 1957 had risen to 20% by 2007.

Meanwhile, the OECD, established in 1961 reforming the OEEC, and having already expanded its membership to Japan in 1964 and Australia and New Zealand in

1971 and 1973, respectively, welcomed Mexico (1994), the former Eastern European countries (from 1995 onwards), South Korea (1996) and, more recently Chile and Israel (2010), as new members.

In the Far East, the two major economies followed dissimilar paths: while Japan was experiencing deflation and recession, China, thanks to the new policy pursued, entered a phase of strong economic expansion, with double-digit growth rates and substantial capital inflows due to its booming export sector and inward foreign direct investment. Underlying the new policy, ratified by the leaders of the Chinese Communist Party (CCP) at the 16th CCP Congress in 2002, was the theory of the "Three Represents", allowing private entrepreneurs to become members of the CCP. China was accepted into the WTO in 2001, becoming a full member in 2002. Ever since, it has been posting large current account surpluses, has managed the exchange rate of the renminbi against the US dollar within a narrow band, and has been attracting large amounts of foreign investment from OECD countries. Its foreign exchange reserves are recycled in the global market by buying US government bonds.

In the same geographical zone, during the 1980s four countries stood out as dynamic emerging economies, also known as the "four Asian tigers": South Korea, Taiwan, Singapore and Hong Kong (which was handed over to the People's Republic of China in 1997). Four other countries also saw their economies grow rapidly: Indonesia, Malaysia, the Philippines and Thailand – which were nicknamed "tiger cubs". India and Brazil shifted their economic policies, liberalised their economies and experienced high growth rates. The same happened with Turkey after 2002.

2.15 The rise of the US economy in the 1990s

World economy grew at an initially slow and then faster pace in the course of the 1990s. At first, this upward momentum was seen as a success of monetarism and market liberalisation/deregulation. In the United States, following the election of Bill Clinton as President in 1992, Reaganomics gave way to Clintonomics, i.e. a mix of a restrictive fiscal and an expansionary monetary policy. This policy, which Treasury Secretary Prof. Lawrence (Larry) Summers had developed into a theoretical model termed "stimulative austerity", aimed at economic growth through the reduction of fiscal deficits and interest rates (Summers, 1991). Clinton's term of office at the White House from 1994 to 2001 marked one of the most important boom periods in modern American history: GDP rose by roughly 30%, unemployment fell to a 40-year low, inflation was reined in and the stock exchange experienced an unprecedented boom, resulting in the emergence of a new group of small- and medium-sized investors, who amassed huge personal fortunes. This wealth, nevertheless, was not evenly distributed.

The policies of the Clinton administration were not far from the proposals of the well-known Jobs Study of the OECD (1994), which, reviewing the policies pursued since 1980, recommended that macroeconomic policy should seek to reduce unemployment by stimulating supply and should provide a framework, based on sound fiscal practices and exchange-rate stability, to ensure that economic growth and increased employment are sustainable. The individual recommendations of the Jobs Study included enhancing the creation and diffusion of technological know-how; increasing working-time, wage and labour cost flexibility; nurturing an entrepreneurial climate; reforming employment insurance provisions and unemployment and related benefit systems; improving labour force skills and competences; and reorganising/updating the tax system and business financing.

2.16 Monetary policy in the era of globalisation

During the same period, academic research focused on the balance of payments as a mechanism for balancing savings and investment on a global scale, as well as on monetary policy in a broader sense. According to the rational expectations theory, policy credibility and predictability would lead the markets to grow and prosper. According to this view, only major shocks could justify temporary deviations from the above principles.

A factor of continuity in US monetary policy throughout the 15 years of the Reagan-Bush-Clinton-Bush successive administrations was the Federal Reserve Board Chairman, Alan Greenspan, whose term started in August 1987 and was renewed four times thereafter, until he retired in January 2006.

By that time, monetary policy across the globe had become rules-based, and economic agents came to view it as unchanging. Having a medium- to long-term horizon, it was geared towards price stability. The Taylor rule, very popular in 1987-1992, helped disseminate the idea that for every percentage point increase in prices, interest rates should be raised by a little more than one percentage point.[18] Meanwhile, the question of full central bank independence was a constant topic in public debate. The discount rate, together with a communication policy aimed at anchoring market expectations, were highlighted by Jean-Claude Trichet as the key principle of monetary policy making in Europe.

18 Koenig et al. (2012).

According to the same view, financial markets were considered to be efficient and able to optimally diversify the risks of alternative financial operations.[19] Monetary policy was complemented by structural policy, which ensured resilience to shocks, through interventions in the labour market aimed at increasing productivity and labour mobility. Policies fostering human capital development and ongoing training and less regulation were the rule. Finally, fiscal policies targeted low levels of deficits and public debt. Automatic stabilisers, and rules in general, were favoured over "discretionary", ad hoc interventions.[20]

Alan Greenspan's tenure was seen as very successful at the time, but after 2008 came under severe criticism, especially with respect to the policy of market liberalisation/deregulation and weak banking and stock exchange supervision, as well as compliance with international and national accounting standards and transparency rules. It is not by chance that this period saw the formation of international NGOs such as Transparency International in 1993, striving to promote transparency in international and domestic transactions and combat corruption. This criticism was not unfounded: to a large extent, the crises and corporate accounting scandals that followed were due to the lack and/or poor implementation of supervisory rules.

2.17 Shocks and crises

While NAFTA contributed to the peso crisis in Mexico in 1994, three years later the dynamic expansion in the Far East region came to a halt with the collapse of the Thai baht in July 1997. The crisis soon spilled over to Indonesia and South Korea, while it also had considerable negative effects on Malaysia, the Philippines, Singapore, Laos and Hong Kong. In response to this crisis, the IMF offered bailout programmes for these countries in exchange for harsh fiscal adjustment measures. Further, the Asian crisis dealt a heavy blow to the Japanese economy. It was followed by the Russian fiscal crisis in 1998 and the crisis in Argentina in 1999-2002, which resulted in the unpegging of the Argentine peso from the US dollar. A major crisis was also experienced by Turkey in the same year.

The European economies, which after the EMS crisis of 1992 —which mostly hit the United Kingdom, Sweden and Finland— would adapt their monetary policies to the changing conditions, prepared for the next phase of EMU, which started on 1 January 1999 and was completed on 1 January 2002 with the cash changeover

19 For a critique of this view, see Rajan (2010).

20 Greenspan (2008).

to the euro. The Basel I and Basel II accords laid the foundations for coordination and cooperation among banking systems worldwide, including within Europe.[21]

In the Western world, the limits of the new paradigm became apparent with the burst of the so-called dot-com bubble in the New York Stock Exchange in March 2000, just a few months after the "millennium bug" panic had subsided. The Y2K problem, as it was also known, was successfully addressed without causing any adverse effects, but —combined with the 1987 crisis attributed to the widespread use of programme trading— revealed the extent of the modern economy's dependence on information technology.

As the recession that followed the burst of the dot-com bubble had triggered a shift of investors to the real estate market in search of yields, that market in turn experienced a bubble, both in the United States and in the countries of the Mediterranean south. In the United States, several banks offered loans to high-risk (subprime) borrowers and, when this bubble burst in 2008, found themselves with massive toxic assets and a large number of non-performing loans.

As these financial developments unfolded, globalisation encouraged labour migration flows, which led to lower labour costs worldwide. At the same time, the availability of low-cost raw materials, food, clothing, etc. was keeping inflation relatively low and was safeguarding the value of money in Europe, where interest rates would otherwise have increased. This is more or less how excessive leverage and risk-taking began in money markets, which was the underlying cause of the disturbances mentioned above. These crises were not so much due to macroeconomic imbalances as to the introduction of innovative financial products and the practices followed by hedge funds and investment banks. Practices that were permitted by the then applicable legal framework, such as the transfer of assets to special purpose vehicles or obfuscation or (in some cases) misleading information to investors, led many capital holders away from productive investment towards short-term, high-yield and high-risk assets.

Finally, a succession of crises and scandals —e.g. those of Long-Term Capital Management (1998), Enron/Arthur Andersen (2001), MCI-WorldCom (2002), the subprime mortgage crisis (2007), Lehman Brothers (2008) or those of BCCI (1991), Barings (1995), Fortis (2010), etc.— revealed the problems created during the previous period of market liberalisation/deregulation.

21 De Grauwe (2007) and Maes (2002). The Basel III accord followed the crisis of 2008.

2.18 The crisis of 2008 and the prospects for the future

The 2007 banking crisis in the United Kingdom (Northern Rock, Royal Bank of Scotland) led to the crisis in the US subprime mortgage market and the bankruptcy of Lehman Brothers in September 2008 and sparked contagion across several European countries which, one after the other, asked for assistance from the international community: Latvia as early as in February 2008, Iceland in September and Hungary in October of the same year, Serbia in January and March 2009, Romania also in March 2009, Greece on 23 April 2010, Ireland in November 2010, Portugal in May 2011, and Greece again in March 2011. The sovereign debt crisis threatened to spread to other countries of the European periphery, as well as to the rest of the world. In the face of this sprawling and deepening crisis, several countries (their societies and governments alike) initially put part of the blame on market liberalisation/deregulation and broader trade integration, threatening to reverse the 1990s' tendency towards regional free trade areas and customs unions. However, it soon became evident that the emerging market economies were unwilling to question their growth model and return to a more protectionist world economy.

How can the present situation be overcome, given that an exit from the 2008 crisis has been pursued relying on austerity policies?[22] As is well-known, the central banks of advanced economies have been practising quantitative easing, by purchasing government bonds with newly created money, coupled with forward guidance on the future monetary policy stance. In essence they follow a zero interest rate policy, in order to achieve the agendas of their respective governments. For other economies with strong macroeconomic imbalances, austerity policies are prescribed. The international assistance provided to them is conditional upon commitments to implement domestic reforms, which the recipient countries fulfil at varying degrees and paces. There is great uncertainty as to how policy measures affect macroeconomic conditions, after such a major shock as that of 2008. Under these circumstances, international organisations stick to their typical policy prescriptions: balanced budgets, supply-side policies and monetary stability. Central banks are called upon to serve this purpose.

22 For a discussion, see Price (2010). For the situation in Greece at the dawn of the 21st century, see Manessiotis and Reischauer (2001). For the problem of inflation in a context of globalisation, see Pain et al. (2006).

3. The Greek context. The major political and economic events, 1928-2008

3.1 The stabilisation of the drachma, 1928

The monetary upheaval in Greece in the wake of the Asia Minor Disaster and the need for a social policy placed the governments of the inter-war period before unprecedented dilemmas. With the Greek economy badly needing borrowed funds, in addition to those obtained up to 1927, the country resorted to the Financial Committee of the League of Nations in March 1927, asking for its guarantee for a new loan. The League of Nations sent a four-member delegation, headed by Joseph Avenol, to study the economic situation of the country. The delegation released a report with its findings in May of the same year. The report concluded that an essential condition for providing the loan was a reform of the Greek banking system. Special mention was made to the National Bank of Greece, which at the time, in parallel to its banknote issuance privilege, also engaged in commercial banking activities; this caused confusion between its two functions and complicated the management of currency in circulation. The delegation suggested that the National Bank should confine itself to its central bank tasks, but the National Bank opposed this plan. Under the pressure of circumstances, however, it finally agreed to waive its note-issuing privilege in favour of a new issuing bank.

Thus, on 15 September 1927, the Geneva Protocol was signed, marking the establishment of the Bank of Greece and the provision of a GBP 9 million loan to Greece. The legislation ratifying the Statute of the Bank of Greece, the Geneva Protocol, as well as the transfer of the note-issuing privilege from the National Bank to the Bank of Greece, was adopted on 7 December 1927. The establishment of the Bank of Greece brought Greece into line with the international monetary policy management standards of the time, while the Agricultural Bank of Greece and,later on, the National Mortgage Bank of Greece were added to the domestic banking landscape, as two specialised banking institutions that each had a specific mandate to fulfil.

Meanwhile, bimetallism (formally in place since 1868, when Greece joined the Latin Monetary Union) was abandoned, the gold-exchange standard was introduced, and the convertibility of the drachma was ensured via its pegging to the pound sterling at 1/15 of its pre-war value, i.e. at 375 drachmas per pound.

3.2 The establishment and the first steps of the Bank of Greece (1928-1932)

The new note-issuing bank began operations on 14 May 1928, taking up the NBG's assets associated with the note-issuing privilege, after a heated debate concerning the amount of cover in gold that had to be transferred to the Bank of Greece. Alexandros Diomidis, until then Governor of the National Bank of Greece, was appointed as first Governor of the Bank of Greece and Emmanuel Tsouderos was Deputy Governor. The primary policy instrument of the Bank of Greece, at least until World War II, was the discount rate, while the minimum reserve ratio was also used as a secondary tool. At first it was very hard to deal with the dominant market position of the NBG using the discount rate alone, with time however, under the impact of the crisis and the pressing circumstances, the Bank of Greece became the undisputed monetary policy maker in Greece.

3.3 The implementation of productive projects

The so-called "productive projects" had been launched under the Pangalos regime, but their implementation was stepped up after 1928 thanks to the impetus provided by the Venizelos government. These were infrastructure projects, partly linked to the need to resettle the Asia Minor refugees, and included land improvement projects in the plains of Thessaloniki and Serres-Drama, in the regions of Epirus, Crete, and Boeotia (at the Kifissos river basin), as well as road construction works across the country. These projects were financed by the Greek State and borrowed private funds, with the total expenditure estimated at 10% of national income.[23] They received wide publicity in the press, and provided the Technical Chamber of Greece (established in 1923) an opportunity to make its presence felt in society.

The two main views expressed at the time concerning the productive projects can be summarised as follows: the first criticised the projects because their terms and conditions had not been negotiated, sufficient funding had not been secured and the fact that the simultaneous implementation of many public works in a country characterised by poor planning and inadequate supervision of their execution would put an excessive burden on the private economy. Indeed, the government's massive demand for borrowed funds was crowding out private investors increasing the cost of money for them. The second view was that the productive projects would not only improve domestic production structures, but could also increase the farmable lands

23 Evelpidis (1950).

in northern Greece (which had received a large part of the refugee flows), thus enabling an increase of agricultural production and, therefore, a reduction of the balance of payments deficit. Moreover, these projects would help tackle the unemployment problem as well as the floods and the malaria epidemics that plagued the relevant areas. The Bank of Greece, realising the importance of these productive projects, actively supported the efforts for their completion, at a time when —due to the crisis that followed— this was no longer secured.

3.4 Managing the evolving crisis

The start of operations of the Bank of Greece coincided with an adverse domestic and international economic conjuncture. The October 1929 stock market crash in New York and the global depression that followed created a climate of insecurity in the domestic banking market and put the monetary stabilisation policy to a test. The suspension of the gold standard by the United Kingdom in September 1931 cast doubt on the gold convertibility of the drachma. The continuing depletion of the Bank of Greece's foreign exchange reserves forced the government to take action to protect the national currency in order to avoid a total collapse of the monetary system.[24] In April 1932, Greece abandoned the gold-exchange standard, and the Administration of the Bank of Greece decided to peg the drachma to the US dollar. In addition, import quotas were introduced and foreign amortisation payments were suspended until 1935. Furthermore, deposits in foreign exchange were converted into drachmas, at a parity lower than the market exchange rates. These actions helped avert the worst, in particular a banking crisis in the country. Alexandros Diomidis resigned on 28 September 1931, after falling out with Prime Minister Eleftherios Venizelos, and was replaced by Emmanuel Tsouderos, until then Deputy Governor.

3.5 Managing the default

The measures introduced by the Venizelos government helped, up to 1935, to contain the fiscal and trade deficits and stabilise the drachma, resulting in a gradual restoration of market confidence and an increase of gold and foreign exchange reserves at the Bank of Greece. Upon the default of the Greek State, the Bank of Greece took up a stabilising role, adjusting its supply of credit to meet demand, in line with the course of economic activity. The Bank sought to support economic

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24 Bank of Greece (2009).

activity in a deflationary environment, supply credit to the economy and control foreign exchange. The Bank of Greece, based on the decision of 29 June 1932 "on the conversion into drachmas of the gold liabilities of government", controlled money circulation, gradually reduced the cost of money and lowered its discount rate, while it also increased its foreign exchange reserves, taking advantage of the 1933 US dollar devaluation. In June 1933 the drachma was pegged to the Swiss franc and joined the Gold Bloc, in which it remained until 1936, when it was once again pegged to the pound sterling. A short-lived bank run in August 1939 was successfully tackled.

With the prudent policy it pursued throughout that period, the Bank of Greece played an increasingly important role in the national economy, slowly but steadily upstaging the NBG. Its tasks gradually expanded to its functioning as fiscal agent and treasurer of the government and the implementation of exchange rate policy. It also provided credit to the government, while as of 1933 it was entrusted with the management of external public debt servicing, while maintaining the exclusive right to raise foreign-currency denominated loans from abroad on behalf of the State. Finally, it contributed to the organisation and modernisation of the banking system by establishing and operating cheque clearing offices, implementing a minimum reserve system and cooperating with foreign banks. Emmanuel Tsouderos resigned in 1938 and was succeeded by Kyriakos Varvaressos, until then Deputy Governor.

3.6 Protecting domestic production – the tariff list of 1935

As was the trend worldwide at the time, Greece gradually shifted to protectionism. This shift became stronger after the failure of the international conference of the League of Nations in London in 1933 (Clavin, 1991). At first, clearing arrangements were agreed upon with a number of countries, and then in 1935 a new tariff list was introduced, classifying traded goods into eight categories (classes), from a first class that was subject to no import-export restrictions to an eighth class that was absolutely prohibited, with the classes in between being subject to various volume- or value-related restrictions.

This ensured that the deficit in the balance of payments was reined in, but at the same time introduced a bureaucratic mechanism that added much hassle to the country's post-war economic life at least until 1953. Meanwhile, up to 1936, 76.5% of exports and 51.8% of imports were carried out through clearing offices. Protectionism eased gradually after 1953, with a relaxation of restrictions and a gradual adjustment to the GATT rules.

3.7 The establishment of IKA

The Social Insurance Institute (better known by its Greek acronym, IKA) was established in 1937, after a long-lasting process. The organisation undertook to provide healthcare and pension coverage of private sector employees, and its scope was initially limited but increasingly expanded over time, despite the lack of sufficient funding.

IKA was the main pillar of social policy in the post-war period. Its establishment occurred under the Ioannis Metaxas government, but its spiritual father had been Alexandros Papanastassiou.

3.8 The Bank of Greece moves to its home

1938 was a milestone year for the Bank of Greece. On 4 April of that year, its Administration and staff were relocated to the Bank's new building on 21 Panepistimiou Str., the foundations of which had been laid five years earlier (see Bank of Greece, 1938). Until then, the Bank had been housed in premises of the NBG. Relocation to the new building, apart from its functional implications, also had a more general symbolic significance. It not only marked organisational and logistical autonomy from the NBG, in whose facilities the Bank's vaults and cashier services were formerly hosted, but also consolidated its role as a central bank, thus quashing the plans of certain political and economic circles that all this time had been entertaining the idea of a re-merger with the NBG. The Bank of Greece pursued further its building programme by constructing or acquiring properties to house its branches across Greece, as well as in Athens, so that it today boasts a sizeable real estate property.[25]

Another important decision towards ensuring greater autonomy was that of 7 June 1938, which set up the Banknote Printing Works Department (IETA), located at a building plot purchased specifically for that purpose in the Athens district of Holargos (today being part of the Municipality of Halandri). The IETA started printing the Greek banknotes in 1947, while today, thanks to its modern facilities, it prints euro banknotes for the European Central Bank (ECB).

25 For the buildings of the Bank of Greece, see Kardamitsi-Adami (2011). Today the Bank of Greece plays an important role in promoting culture and the arts. It owns a rich art and numismatic collection, part of which is on permanent display at the Museum of the Bank of Greece, located at the ground floor of its Amerikis Street building.

3.9 The rescue of the gold reserve, 1941

The upward course of the Bank of Greece came to a halt with the outbreak of World War II. In October 1940, the Bank increased the ceiling on its advance payments to the State to 1 billion drachmas and, with the start of the Greco-Italian war, restrictions were imposed on banking transactions. In parallel, negotiations were launched with the English government for the financing of the Greek war costs, and the Greek State was granted a loan to be used as cover for issuing new money.

In February 1941, the Administration of the Bank of Greece managed, by a daring act, to load the gold reserve in its possession on ships of the Hellenic Navy and secretly transport it to its branch in Heraklion, Crete. Shortly before the entry of German troops in Athens in April 1941, Bank of Greece Governor Varvaressos, along with Deputy Governor Georgios Mantzavinos and the political leadership, fled the Greek capital, headed for Crete. Thereafter, the Administration and the gold were shipped to Cairo, whereas a while later it was decided to transfer the gold reserve to Pretoria. This way, a mortgage for the recovery of the national currency once the war was over was registered. Finally, following a stopover at London, the gold reserve returned to Greece after the war. Today, according to standard international practice, the country's gold reserves are kept in more than one country, specifically 29% in the United States, 20% in the United Kingdom, 4% in Switzerland, and 47% in Greece. This ensures that the country's foreign exchange needs can always be met in any emergency situation.

3.10 Under foreign occupation

The three occupation forces (Germany, Italy, and Bulgaria) put in circulation, in parallel to the drachma, their own currencies (the "occupation" Reichsmark, the "Mediterranean" drachma and the lev, respectively) and imposed a new Administration on the Bank of Greece in Athens, appointing commissioners with full jurisdiction in monetary and exchange rate policy. Following a Bank of Greece intervention, aimed at controlling money circulation, the use of the above currencies was prohibited as of 18 July 1941, and it was agreed that the Bank of Greece would pay the costs of the occupation troops. This was in accordance with the Law of War and the Hague Conventions of 1889 and 1907. The Bank of Greece provided to the occupation authorities an indexed amount of 1,500 million drachmas per month. In addition, under the Treaty of Rome (1941), the Bank of Greece was forced to grant, over and above the agreed occupation costs, a special loan (so-called "Occupation Loan") to the German and Italian occupation authorities (for more details, see further below). These massive banknote issues caused the currency to depreciate, as hyperinflation set in and barter was increasingly used in transactions, and public trust in the drachma plummeted. Meanwhile, the Bank of Greece had increased its operating costs, following mass recruitments of personnel, motivated mostly by humanitarian reasons in a country plagued by famine and destitution.

The burden on the Greek economy from the costs of occupation and the costs of supplies to the Axis powers on other war fronts, as well as the detachment of sizeable parts of the national territory (Eastern Macedonia, Western Thrace, Ionian Islands), annexed to Bulgaria and Italy, contributed to a dramatic drop in national production and thereby in national income, which —combined with the depreciation of the national currency— led to economic collapse. Indicatively, currency in circulation rose by 36,000% between October 1939 and October 1944. The value of the gold sovereign pound, from 1,000 drachmas in 1940, soared to 1.5 billion drachmas in 1944.

3.11 Inflation and hyperinflation (1941-1944)

In July 1942, in an effort to find a solution to the problem of galloping inflation, the German government sent Hermann Neubacher to Greece. But although the occupiers approved the delivery of humanitarian aid by the Swedish Red Cross, they continued to draw funds from the Bank of Greece at increasingly frantic paces to finance the occupation costs in the context of the Occupation Loan. The gallop of inflation started in 1943 and intensified particularly in 1944. In addition, already since 1943, gold sovereigns and gold 20-franc coins had started being sold on the free market, a fact that wiped out public trust in the domestic currency and contributed to entrenching the use of gold in transactions. Thus, the end of the occupation period found the Greek economy in ruins, with its productive fabric destroyed and its monetary system critically wounded.

3.12 The Bank's Administration in exile

In September 1941 the Greek government-in-exile and the legitimate Bank of Greece Administration arrived in London. In December of the same year, on an initiative of the British government, a special inter-allied committee was set up to assess Greece's damage from the war and post-war needs, in which Greece was represented by the Governor of the Bank of Greece, Kyriakos Varvaressos. The Administration of the Bank of Greece was active on several fronts: from briefing the Allies to defending the interests of the Greek economy and from setting up a network of humanitarian aid for the population back in occupied Greece to the country's international representation. Thus, in July 1944, Governor Varvaressos represented Greece in the Bretton Woods conference in New Hampshire, which, as mentioned earlier, laid the foundations for the post-war global monetary order.

3.13 The first attempts at stabilisation, 1944

The liberation of the country and the repatriation of the Greek government and the legitimate Administration of the Bank of Greece signalled the beginning of an effort to stabilise the currency, rein in hyperinflation and revive economic activity. The Greek government appointed Xenophon Zolotas as Co-Governor of the Bank of Greece. The plan mapped out jointly by the government, the Administration of the Bank of Greece and British experts proved to be incomplete, and the new drachma, introduced in November 1944, failed to displace the gold sovereign. More specifically, the national unity government that took over in October 1944 introduced, by Law 18/11 November 1944, the new drachma, which was equal to 50 billion old drachmas and pegged to the pound sterling at a parity of 600 drachmas per 1 GBP (1 US dollar = 150 drachmas). This arrangement wiped out all the existing deposits and liabilities of the Greek State to mark a fresh start, which however was perceived by Greek citizens as an arbitrary move on the part of the State.[26] However, the tumultuous events of December 1944 and the financing of the budget through credit from the Bank of Greece triggered strong inflationary pressures, thwarting the effort to substitute the new currency for the gold sovereign in transactions.

3.14 The Varvaressos policy

The failure of the stabilisation programme led Xenophon Zolotas to resign from the post of Co-Governor in January 1945. Kyriakos Varvaressos, now the Bank's only Governor, undertook also economic policy responsibilities in June 1945 as Vice-President of the Voulgaris government. Varvaressos sought stabilisation through a number of measures mostly of an administrative character, including a ban on the use of gold in transactions and a devaluation of the drachma vis-à-vis the pound sterling (from 600 to 2,000 drachmas per pound sterling) and the US dollar (from 150 to 500 drachmas per dollar). He also introduced price controls for essential consumer goods and tried to increase the country's foreign exchange reserves. Finally, by Law 362 of 4/06/1945, he imposed an extraordinary levy on industrialists,

26 Psalidopoulos (2010), p. 267.

merchants and professionals, with a view to strengthening government revenue through high taxation of those who had excessive purchasing power and had become rich during the occupation. His endeavour met with strong opposition from the social strata concerned and was given up in September 1945. Varvaressos resigned from all his public offices, and any efforts to stabilise the currency were abandoned for a long time. He was succeeded by Georgios Mantzavinos. Under his governorship, the Bank of Greece continued to strive towards monetary orderliness and to finance the credit system and the economy in general.

3.15 The London Agreement (1946) and the establishment of the Currency Committee

The third post-war attempt at monetary reform was made in January 1946, with the London agreement between Greece and the United Kingdom, whereby the latter agreed to grant Greece a loan of 10 million pounds sterling and Greece agreed to radically restructure its fiscal management and establish a Committee to manage currency in circulation.

Thus, the Currency Committee was established in March 1946, as an independent authority within the Bank of Greece, comprising two members of the government, the Bank of Greece Governor and two foreign experts. The Currency Committee became the supreme body responsible for monetary and credit policy until 1982. All decisions concerning the currency, foreign exchange, lending, etc., were subject to its approval. Furthermore, an Industrial Credit Committee was set up at the Bank of Greece, mainly responsible for authorising loans to industry, in order to meet needs in raw materials, fuels and low-value repair works. By its decision of 14 August 1946, the Currency Committee determined, among other things, that credit to industry should be used for productive purposes and that borrowers were required to co-finance the investment projects.

Turning to the currency, the drachma was devalued by Emergency Law 879 on 25 January 1946, and its exchange rate was set at 20,000 drachmas per pound sterling and 5,000 drachmas per US dollar. Foreign exchange for imports and investment was supplied, and the restrictions on the use and circulation of gold coins were lifted, although the ban on gold coin exports remained in place. However, this effort too failed to substitute the drachma for the gold sovereign. This policy put constraints on the monetary authorities, which were forced to use a considerable part of the country's liquid resources for supporting the exchange rate of the drachma rather than for productive activities. Amid the escalation of the civil war in late 1946, speculation on gold sovereigns surged, and the Bank of Greece was forced to proceed to sales in order to maintain stability.

On 22 November 1947, the first post-war General Meeting of Shareholders of the Bank of Greece was held and was called upon to review and approve the Bank's balance sheets for the years 1941, 1944, 1945 and 1946, whereas the financial statements for the years 1942 and 1943 were not available in the legal form of balance sheet. The meeting approved the Bank's policies for all these past years and reconfirmed the policy to support the drachma through the sale of gold sovereigns.

3.16 Credit control and the Marshall plan

In 1947, the United States took over from Britain the task of providing financial aid to Greece. In April 1948, the Legislative Decree "on the control of credit", was drafted jointly by the government, the Currency Committee and the American Economic Mission, specifying in more detail the responsibilities of the Currency Committee. The main objective was to crack down on speculation, by controlling the foreign exchange market and discontinuing interventions in the market for gold sovereigns. In October 1947, another Legislative Decree, "on support to external trade", introduced foreign exchange certificates ("bons"), at a value higher than the official parity (25,000 drachmas per GBP and 3,000 drachmas per US dollar), and established a dedicated organisation to coordinate trade policy. These bons would act to boost exports, investing their owners with increased credibility in their transactions with the banking system.[27] This policy was strengthened through the aid that Greece received through the European reconstruction programme, commonly known as the Marshall Plan. However, the country's major fiscal problems and low industrial production, which in late 1948 was at 85% of its pre-war levels, were obstructing the monetary stabilisation effort and were fostering a feeling of uncertainty among the public, which continued to see the gold sovereign as the dominant currency. In August of the same year, the Currency Committee set the minimum reserve ratio in the Bank of Greece at 15% for the NBG and at 5% for the other banks, before increasing it to 22% for all commercial banks in February 1949, in order to curb the circulation of inflationary money. In the next year, in view of the continued need to control inflationary pressures, the Currency Committee raised further the minimum reserve ratio in the Bank of Greece for all banks to 25% of sight and time deposits by public entities and to 12% of all other sight and savings deposits.

27 Psalidopoulos (2013).

3.17 The path towards stabilisation, 1950-1953

Still, the troubles of the drachma continued. In September 1949, the Diomidis government decided a new devaluation of the drachma, setting its exchange rates at 42,000 drachmas per pound sterling and 15,000 drachmas per dollar, in line with those prevailing in the black market. It also reinstated, "for psychological reasons", the policy of gold sovereign sales by the Bank of Greece and abandoned the practice of setting fixed exchange rates of the drachma vis-à-vis the pound sterling and the US dollar. The Diomidis measures failed to contain the surge in demand for gold sovereigns, which intensified further in the following year with the outbreak of the Korean War, or halt the tendency for commodity hoarding. In May 1951, the Plastiras government embarked on a programme for stabilising the economy, by abolishing the "bons" and the then existing dual parity system: a single exchange rate was set for the drachma, applicable to all transactions, at 42,000 drachmas per pound sterling and 15,000 drachmas per dollar. The sales of gold sovereigns by the Bank of Greece were also discontinued, while credit policy was tightened in late 1952, by a Currency Committee decision to raise the minimum reserve ratio to 35%, on top of the requirement that at least 50% of lending to industry should be financed with lenders' own available funds. This ratio was raised further to 70% in January 1953, and a month later the Banking Supervision Department was set up within the Bank of Greece, responsible for the regulation and supervision of banks.

These measures, along with the deficit-reducing agenda of the Plastiras government, helped towards disinflation, as well as fiscal consolidation by reducing fiscal deficits, and stabilised the drachma, paving the way to a definitive solution to the problem of its exchange rate.

3.18 Regulation and supervision of the banking system

In June 1950, American expert Delos Johns, who was assigned with the task of recommending reforms to the Greek banking system in collaboration with the two foreign members of the Currency Committee, submitted to the Governor of the Bank of Greece a report that suggested a reduction of Bank of Greece credit to commercial banks and the establishment of a body for their supervision. As a follow-up, under Law 1611/1950 the management of public entity deposits was fully transferred to the Bank of Greece from the NBG and other commercial banks.[28] In 1951, banking supervision rules were introduced, along with stricter criteria for the

28 This responsibility, as modified on 1 January 1994, is still in force today.

authorisation of credit institutions. Finally, the composition of the Currency Committee was enlarged to include an economics professor, and Xenophon Zolotas was appointed by the government as the first incumbent. Control and consolidation of the banking system was completed with the mandatory merger of the NBG with the Bank of Athens in January 1953. These measures played a decisive role in the success of the drachma stabilisation effort, which in April 1953 put an end to the country's post-war monetary plights.

3.19 The devaluation of 1953

On 9 April 1953, the new government with Papagos as Prime Minister and Spy ridon Markezinis as Minister of Finance decided, with the concurrent opinion of the Currency Committee and the IMF, to devalue the drachma vis-à-vis the US dollar from 15,000 to 30,000 per US dollar and to join the fixed exchange rates system of Bretton Woods. This monetary reform was accompanied by measures aimed at a deregulation of imports, which however at the same time became subject to high tariffs, as well as the abolition of market controls, the attraction of foreign direct investment and a far-reaching public investment programme. One year later, on 1 May 1954, in an effort to address the psychological impact from the protracted monetary instability, the government introduced the "new" drachma setting its parity at 1 new drachma = 1,000 old drachmas (Eliades, 1954). This move, coupled with policy commitment to monetary stability and balanced budgets, contributed to a gradual restoration of confidence in the national currency. Growth gradually started to pick up and inflation was subdued, averaging 7.3% and 2.2%, respectively, during the 1953-1970 period.[29]

The focus of Bank of Greece actions was now on monetary equilibrium and economic development. In 1955, Professor Xenophon Zolotas became Governor of the Bank of Greece; his tenure at the Bank would be long (1955-1967 and 1974-1981) and he would exert strong influence on monetary and overall economic policy making. With Zolotas at its helm, the Bank of Greece continued to support manufacturing exports, while the Currency Committee managed the interest rates and volume of credit in line with the economic policy objectives.

29 For further details, see Gerakis and Wald (1964), as well as Iordanoglou (2004a) and Drakatos (1997).

3.20 The institutional underpinnings of economic development from 1953 onwards

Throughout the economy's course towards higher income levels, the successive Greek governments strived to transform the institutional framework with a view to encouraging private initiative, domestic and foreign, to invest in Greece.

Law 3233/1955 amended personal income tax legislation (dating back to 1918-19), followed by a corporate tax reform by Law 3843/1958, which introduced tax allowances for reinvested profits and investment expenditure.

Other significant development laws, as they were called, were the following:

- Law 2176/1952, which supported manufacturing activity in regional Greece.
- Law 2687/1953, implementing the constitutional provision (Article 112 of the Greek Constitution of 1952) on the freedom to transfer abroad the profits of foreign investment in Greece.[30]
- Law 4171/1961, which provided further incentives for large-scale investment projects.
- Laws 147/1967, 1078/1971 and 1312/1972, which subsidised manufacturing with a view to promoting exports.

Thus, manufacturing increased its share in GDP from 18% in 1960 to 30% in 1980, at the cost, however, of several distortions in the tax system, with the growth of corporate tax revenue falling short of robust GDP growth.

3.21 Agricultural development, underemployment/unemployment and migration

The Greek economy in this period remained predominantly agricultural: the agricultural sector accounted for 50% of GDP and 30% of employment. Despite the strong growth performance, there was a serious problem of unregistered unemployment and underemployment in agriculture, giving rise to a wave of migration to Belgium as from 1956 and, later on, to Germany since 1959. Especially after the Greece-EEC Association Agreement, migration to Western Europe increasingly gathered pace. Between 1956 and 1966, migration outflows came to 679 thousand, of which 185 thousand in 1957-1961, more than doubling to 494 thousand with the second wave (1962-1966).[31]

30 See the Bank's *Annual Report for the year 1953,* pp. 154-161.

31 Bank of Greece (1978), p. 511.

3.22 Association with the EEC

In the late 1950s, faced with a reduction of US financial aid and a trade deficit problem, the Greek economy sought a closer association with broader economic areas that were taking shape at the time. After the talks with the EFTA came to an impasse, Greece turned to negotiations with the EEC, applying for membership in July 1959. Ioannis Pesmazoglou, Deputy Governor of the Bank of Greece since 11 February 1960, was in charge of the strenuous negotiations that led up to the signing of an Association Agreement on 9 July 1961. This agreement envisaged the abolition of tariffs on Greek exports to the EEC countries over a period of 12 years, and a respective elimination of Greek tariffs on imports in 22 years. It also provided for coordination and consultation in the formulation of common policies and the mediation of the EEC to the European Investment Bank in order to secure financing for investment projects in Greece.

EEC association provided a fresh impetus to economic growth in Greece and encouraged a reorientation of Greek exports towards EEC countries. During the military dictatorship in Greece, the agreement was frozen and was confined to matters of day-to-day management and reciprocal reduction of tariffs, but was fully reinstated upon the restoration of democracy in 1974. In 1976, Greece applied for accession to the European Communities and joined officially on 1 January 1981.

3.23 Developments in the banking system up to the mid-1960s

During the 1960s, further steps were taken towards central coordination of economic and industrial policy through the establishment of a number of institutions such as the Investment Bank (1962) by the group of the Commercial Bank of Greece, the National Investment Bank for Industrial Development (NIBID, 1963) by the NBG group, and the Hellenic Industrial Development Bank (ETBA, 1964). The latter resulted from the merger of the Organisation for Tourism Credit (formerly "Organisation for Hotel Credit", 1946), the Economic Development Financing Organisation (EDFO, 1954) and the Industrial Development Organisation (OBA, 1959). These investment banks contributed in multiple ways to the country's industrialisation, and by 1981 industry accounted for 20% of the workforce and 30% of GDP.

3.24 Eradicating chrysophilia

Until the mid-1960s, and despite the stability of the drachma, all large-value transactions (mostly involving real estate) continued to be carried out in gold sovereigns. Amid political turbulence in the wake of the November 1963 elections, there was an upsurge in demand for gold sovereigns, which was temporarily curbed, but rebounded with the 1964 events in Cyprus. The Bank of Greece intervened with mass sales of gold sovereigns at the prevailing parity until January 1964, when its Administration proposed the discontinuation of any intervention in the relevant market. As this proposal was rejected by the political leadership, demand for gold sovereigns grew stronger in the next period, and the Bank's gold reserves fell considerably. In the context of the political crisis that culminated in the July 1965 events, demand for gold sovereigns rose even further. In December 1965, action was taken to halt this trend: the free market for gold sovereigns was abolished, price control was maintained, and the free and anonymous conversion of hoarded gold sovereigns into drachmas was adopted. These measures proved successful, contributing to the flow of large quantities of gold sovereigns back into the vaults of the Bank of Greece. By the time the measures had run their full course, and also thanks to the continued strong growth rates, the need to use gold sovereigns in transactions had faded away.

3.25 Growth and problems. Disorientation after 1967

The Greek economy continued to post high growth rates as the world economy kept growing. The economic policy mix that the Bank of Greece was called upon to support was dictated by short-term considerations, particularly after X. Zolotas resigned from the position of Governor in 1967, when dictatorship was imposed, and was replaced by Dimitrios Galanis, until then Deputy Governor. The momentum developed in the previous years enabled the Greek economy to continue its upward path well into 1967, despite slowing investment rate. However, the freeze of the EEC Association Agreement, which (as already mentioned) was confined to matters of day-to-day management, i.e. an automatic reduction of tariffs, and no longer entailed meetings for policy harmonisation and bilateral coordination, deprived Greece of much-needed credit from the European Investment Bank, and gave rise to an overall climate of uncertainty, in which the productive classes felt disoriented. The dictatorship's policies to support production activity consisted, in its initial phase, in tax allowances and exemptions and generous credit supply to the private sector, especially favouring tourism-related and construction activities. Nevertheless, emigration flows grew bigger, while a policy of large-scale public investment in infrastructure projects led to an increase in amortisation payments from 7.8% of total budget expenditure in 1966 to 12.4% in 1971. Monetary expansion caused a gradual overheating of the economy, which peaked at the time when the international system of fixed exchange rates collapsed.

3.26 The Greek economy after the collapse of the Bretton Woods system

The suspension of the dollar's convertibility into gold by the US government in August 1971 led to its depreciation by 8% by the end of the year. The Greek monetary authorities initially kept the drachma/dollar parity unchanged, and thus the drachma depreciated against all the European currencies by the same percentage. However, the trade deficit deteriorated and prices started to rise. The Bank of Greece tightened its monetary policy in 1972, with a view to reducing liquidity in the economy: the minimum reserve ratio in the Bank of Greece was raised and credit to construction companies was suspended. In February 1972, when the US dollar lost 10% of its value vis-à-vis gold, the drachma followed suit and depreciated again.

Amid this environment, and following the demise of Dimitrios Galanis, Konstantinos Papayiannis, until then Deputy Governor, became Governor on 7 May 1973. In May 1973, the interest rates on bank deposits, as well as the discount rate, were raised in a new effort to limit liquidity. Soon afterwards, the first oil shock occurred in October 1973, and higher oil prices were passed through to domestic inflation. The Currency Committee, in an ultimate attempt to shore up the drachma, decided to unpeg it from the US dollar and appreciate it by 10%, alongside a relaxation of price controls. In the subsequent period, amid rapid political and economic developments, domestic economic activity slowed down and growth stalled. The Greek economy experienced a hard landing, and inflation leaped to 35% year-on-year between August 1973 and August 1974. The drachma returned to its parity of 30 drachmas per US dollar in the next few months, while the Bank of Greece pursued once again a disinflationary policy as the political crisis came to a head following the events in Cyprus.

3.27 Declining growth, 1974-1981

The restoration of democracy in Greece in 1974 marked the beginning of a new era for economic policy, during which the State gradually took up a more active and generally more social role in the economy, with multifaceted initiatives and interventions (Iordanoglou, 2004b). The economic policy reorientation under the National Unity government after the transition to democracy led the real economy to a partial recovery and the drachma to a moderate depreciation vis-à-vis the major European currencies. The drachma was devalued against the pound sterling by 7.3% in 1975 and by 14.2% in 1976, before appreciating slightly by 0.8% in 1977. Against the Deutsche mark, the depreciation of the drachma was 0.7% in 1975 and 7% in 1976. The National Unity government successfully dealt with the market liquidity crisis, as the Bank of Greece lowered the discount rate. Economic activity staged a mild recovery after 1976, when Greece applied for membership in the European Communities. The drachma was definitively unpegged from the US dollar, and the Bank of Greece began to set the exchange rate of the drachma with reference to a basket of currencies. This marked a policy shift, in an effort to safeguard the Greek economy's international competitiveness. Monetary policy[32] was geared towards containing price increases, improving the balance of payments, and ensuring a recovery of domestic economic activity.

However, these efforts coincided with the second oil shock. In this adverse conjuncture, the Greek economy followed a downward path, with the GDP growth rate falling from 7.2% in 1978 to 3.3% in 1979, 0.7% in 1980 and -1.8% in 1981.

3.28 Regional development policy

Regional disparities within the country were a major source of concern for the successive post-1974 governments, also in view of the specificities of the local economies in border areas and the potential national defence risks associated with them. Law 289/1976 introduced incentives for investment in border regions. Law 849/1978 envisaged government financing for investment projects in regional Greece, up to 60% of the project costs, a subsidisation of interest rates, etc. In the same vein, Laws 1080/1981, 1262/1982, 1892/1990, 2234/1994 and 2324/1995 placed emphasis on boosting employment, on new technologies, and on other aspects of investment endeavours. Finally, Presidential Decree 456/1995 codified all the existing provisions regarding incentives for investment in regional Greece.

3.29 The nationalisations in the 1970s and "socialmania"

A development of major importance during the post-1974 period was the nationalisation (stepwise between 1975 and 1977) of three large private-sector corpo-

32 For monetary policy in general and in specific periods, see Garganas and Tavlas (2001), Lazaretou (2011), and Voridis et al. (2003).

rations, namely Olympic Airways, the Aspropyrgos Refinery and the Commercial Bank Group. At the same time, new state-run enterprises were established, such as the Hellenic Aerospace Industry. Because of these actions, the economic policy of this period was described as "socialmania". The term was coined by the Hellenic Federation of Enterprises (SEV) as an accusation against the political leadership, which in turn replied by reminding SEV's extensive interference with economic policymaking during the dictatorship.

Olympic Airways (OA) had been facing problems after the first oil shock, and its owner Aristotle Onassis requested a grant of US dollars 45 million from the government in order to continue its operation. When his request was rejected, Onassis terminated the contract between the OA and the State, and in April 1975 all of OA shares were sold to the Greek State for a price of US dollars 68 million.

The Aspropyrgos Refinery had been state-run before its concession by the dictatorship to the Niarchos Group on favourable terms, in exchange for the Group's explicit commitment to implement various investment projects. After the restoration of democracy, the Group was expected to honour this commitment, long overdue by that time. The dispute was submitted to international arbitration, and a compromise settlement was reached in the process, whereby the State took back the Refinery (for a price of US dollars 12 million) from the Group, and the Group was discharged from its other contractual obligations.

The problem with the Commercial Bank Group originated from the fact that, in breach of the applicable legislation and banking ethics, the Commercial Bank had lended more than one-fifth of its share capital to an oil company owned by Stratis Andreadis, its own board chairman. As it was not the first time that this happened, the State decided to double the bank's capital, excluding Andreadis from the capital increase. After a long-drawn international litigation, Andreadis was awarded a large compensation amount, but the Commercial Bank remained under state ownership for many years to come and was only privatised in the 2000s.

These nationalisations may have been inevitable in strict legal terms, but served to discourage the investment climate in Greece at a time when the international trend was in favour of private initiative rather than state entrepreneurship.

3.30 Greece's accession to the European Communities

Greece's EEC Accession Agreement was signed on 28 May 1979, effective from 1 January 1981. As from that date, Greece undertook to comply with the law of the European Communities, except in those cases for which a transition period had been determined. Specifically, a seven-year transition period had been set with respect to two agricultural products and for the free movement of labour. In addition, the agreement envisaged the possibility of special measures being taken should Greece face extraordinary difficulties in a sector of its economy or in any of its regions. At the same time, Greece committed to fully harmonising its national legislation with Community law, as well as to implementing necessary structural reforms to its administrative set-up in line with EEC membership. Thus, Greece had to gradually lift all tariffs on agricultural and industrial products and, with immediate effect, all import quotas, except those on 14 industrial products, which would have to be phased out gradually. In its trade with third countries, Greece was required to adapt its tariff list to the Common External Tariff of the EEC within a five-year transitional period. In the area of public finances, a transitional period of three years was allowed for the introduction of value added tax, while capital movements would be immediately liberalised, with only a few exceptions. Greece also undertook to set up a foreign exchange market in Athens, in order that the movement of the real rate of the drachma against other currencies could be followed. Moreover, during the transitional period, discussions would be held regarding the potential participation of the drachma in the European Monetary System.[33]

3.31 The new economic policy framework after 1981

The appointment of Gerasimos Arsenis as Governor of the Bank of Greece after the parliamentary election of October 1981 ushered in an era of stronger State involvement in monetary policy making. At first, topping the list of the new leadership's priorities was ensuring a more effective functioning of the banking system, which would enable to achieve the broader economic and social policy objectives. Soon, however, the policy focus shifted to the need to stabilise the economy and rein in inflation and current account deficits. Annual consumer price inflation reached 24.5% in 1981 and remained around 20% in the next five years and at double digits until the early 1990s. The general government deficit rose sharply from 2.6% of GDP in 1980 to 8.7% in 1981 and further to 11.6% in 1985. Monetary policy relaxation coincided with the abolition of the Currency Committee (Law 1266, Government Gazette A 81/2 July 1982) and the assignment of some of its tasks to bodies outside the Bank of Greece. The growth of broad money (M3) was 35.7% in 1981, 28% in 1982 and 29.6% in 1984.

33 Bank of Greece, *Annual Report 1979*, pp. 137-141. For the impact of EEC participation on Greek industry, see Giannitsis (1983 and 1988).

The tasks of the Currency Committee were transferred to other government policy bodies, most notably the Bank of Greece. Among other things, bank lending rates were unified while interest rates and credit were liberalised. To tackle the problems in the balance of payments, a stabilisation programme was launched in January 1983, accompanied by a devaluation of the drachma (by 16% against the US dollar and by 15% against the ECU). This effort failed to deliver long-term positive effects on the economy or to ensure a move to a more open and competitive environment, given that economic policy was relaxed again in the following year. On the other hand, EEC participation had worsened the trade balance (from US dollars 4,342.8 million in 1978, the trade deficit came to US dollars 6,696.8 million in 1981 and US dollars 6,267.9 million in 1985),[34] a development which, combined with higher labour costs due to an increase in minimum wages by 32% in 1982, aggravated the financial problems of many businesses and led to the emergence of the "ailing companies" phenomenon. With Law 1386/1983 an attempt was made to manage these companies in principle, succeeding in avoiding job losses, but at the cost of throwing good money after bad. In the same period, investment as a percentage of GDP fell from 19.1% in 1980 to 17.7% in 1981 and 16% in 1984.

3.32 The stabilisation programme, 1985-1987

In the face of growing fiscal deficits and high inflation, the second Andreas Papandreou government, in October 1985, introduced a stabilisation programme that was submitted to the European Commission. The programme provided for a new devaluation of the drachma by 15%, cuts in government public spending for 1986 and a legislative restriction on nominal wage increases, which had major implications for wage earners' disposable income/purchasing power. The Automatic Wage Indexation (ATA) system was now based on official inflation forecasts (instead of past inflation) and excluded imported inflation, while the value of the "green drachma", i.e. of Community aid to the agricultural sector, was set as different from the official exchange rate of the drachma. Assisted by falling international oil prices, the programme brought about a remarkable improvement in macroeconomic indicators, but was abandoned after 1987. The budget deficit, which had fallen from 11.6% of GDP in 1985 to 9.6% in 1987, rebounded to 11.4% in 1988.

34 Giannitsis (1985).

3.33 Changes in monetary policy

A significant innovation in monetary policy, already since the 1970s, was the announcement of intermediate monetary targets. Initially and until 1982 the targeted aggregate, as an anchor for policy planning and action, was narrow money (M0).

Economic policy relied on a combination of measures to control prices and interest rates, acting countercyclically in a volatile environment, which was disrupted in the wake of the second oil shock. The Bank of Greece tried to help the economy exit stagflation. In the new context of deregulated capital movements within the Community, of which gradually Greece became part, essentially from 1986-1987 onwards, competitive conditions were introduced in the banking system. Under the stabilisation programme of 1985-1987 monetary targets were set. As of May 1986, measures were adopted to limit credit expansion, all preferential interest rates were abolished, minimum lending rates were introduced, and the rates on housing loans and capital outflows for the purchase of assets abroad were deregulated.

The major concern of the monetary authorities since 1983 and throughout the following decade, in line with the international practices of the time, was to control broad money (M3). One of the results of this policy was a gradual reduction of commercial banks' compulsory investment in Greek Treasury bills (calculated as a percentage of their deposit liabilities) which, from 1986-1987 onwards, led to increased government borrowing from non-banks through T-bill issues. A direct consequence was a rise in government borrowing rates.

Meanwhile, Demetrios Halikias, until then Deputy Governor, became Governor of the Bank of Greece on 20 February 1984.

3.34 The hard drachma policy

With the growth rates of the Greek economy close to zero for a number of years, and with market deregulation measures having been decided at the European level, the Bank of Greece took corrective action. In addition to the traditional objectives —such as lowering inflation and containing the deficit in the balance of payments— the policy agenda now also included modernising and deregulating the banking system.

Measures were adopted towards greater independence of commercial banks and greater freedom in managing their asset portfolios. Restrictions on interbank borrowing/lending were abolished, and banks were free to determine their lending rates as they saw fit.

The "hard drachma" policy was introduced, whereby the drachma depreciated less than inflation using as a criterion the achievement of more than one economic policy target, in an effort to control inflation, as well as the growing —due to the depreciation of the currency— public debt. This policy prevented public debt from increasing excessively, but at the cost of a higher external deficit, which rose from 0.8% of GDP in 1987 to 4.3% in 1989. Following the change of government in 1990, efforts were resumed to reduce the fiscal deficit, as well as to restructure domestic production set-up, through a programme of gradual macroeconomic adjustment. This was in fact necessary due to developments in the context of the European Communities. Already, in accordance with the White Paper (1985) and the Single European Act (1986), work had been underway for the completion of the internal market by 31.12.1992. This entailed a full deregulation of the banking system, a process that started being gradually and consistently implemented, especially after 1994 (Garganas and Tavlas 2001, pp. 108-114). The monetary regime shift from that year onwards, as well as a broader targeting including the exchange rate in addition to monetary aggregates, forced the government to adjust its fiscal policy, and led to disinflation and a gradual adjustment of the economy to the European standards.

3.35 The Karatzas Report

In view of the strains put on the domestic banking system by the practice of financing already insolvent companies, as well as against the backdrop of international developments, a group of experts, known as the Karatzas Committee, was set up to recommend a banking reform.

The report (Karatzas, 1987) proposed the following: (a) A liberalisation of interest rates and credit in three steps, starting with a return to positive real deposit and lending rates, and releasing the credit system from the obligation to support projects for advancing the social and development policy agenda, which should normally be financed by the government budget. In a second phase, market forces should be left to operate and determine the interest rates (excluding the long-term ones) for loans to small-scale industry and agriculture. Finally, the third phase should establish the market as the main mechanism for the determination of interest rates and the allocation of resources. (b) More competition in the Greek banking system, enabling banks to cope with international competition – along with the introduction of new innovative banking products. (c) Adoption by banks of modern accounting and financial reporting practices and by the Bank of Greece of new methods of banking supervision, with a focus on ensuring capital adequacy, liquidity and asset quality. In addition to its more specific proposals for credit to agriculture and for investment banks, the Karatzas Report investigated the causes behind the underdevelopment of the capital market and suggested measures on both the supply and demand sides for securities, centred around a modern domestic stock exchange market.

It is no coincidence that both the Karatzas Report and the earlier Harissopoulos Report (prepared on the initiative of the Bank of Greece) stressed the crucial role of the Bank of Greece, which should lead the process of financial deregulation, once it became free from the burden of monetising government deficits or supporting bank balance sheets.[35]

3.36 The new economic policy, 1990-1993

On 20 February 1992, Efthymios Christodoulou became Governor of the Bank of Greece. Meanwhile, at the European level, steps were being taken towards the completion of the internal market. On 7 February 1992, the Maastricht Treaty was signed, describing the transition to Economic and Monetary Union (EMU) in three stages and specifying the fiscal and monetary criteria (known as the Maastricht criteria) which EU member states were required to meet before entering the third stage of EMU.

Greek economic policy had to adjust to these new facts, which called for immediate action in line with European developments, through a programme for deficit reduction, including privatisations. After April 1990, ATA was drastically revised and was fully abolished as from January 1991. Furthermore, those markets that were subject to price controls were deregulated. In August 1992, austerity measures were announced, along with a new convergence programme, which relied on indirect tax increases and the privatisation of ailing companies. Nevertheless, the fiscal deficit-to-GDP ratio did not fall below 10% before 1994.

The monetary policy of the Bank of Greece was geared towards supporting the broader stabilisation policy (ahead of the prospective EMU participation), in particular disinflation and improvement in the balance of payments. The Bank also undertook to foster the development of money and capital markets. Therefore, a tight monetary policy was pursued, while as from 1992 the Bank of Greece began to also monitor a broader monetary aggregate (M4) as a complementary liquidity measure.[36] January 1994 marked the start of Stage II of EMU, and a few months later the drachma came under strong speculative pressure. In response, the Bank of Greece drastically raised its lending rates. At the same time, it sought to limit the depreciation of the drachma to a rate that would not fully offset inflation differentials

35 Harissopoulos (1979), pp. 20-21 and 39; and Karatzas et al. (1987), p. 30.

36 M4 became the preeminent monetary indicator from 1999 onwards.

between Greece and its main competitors and began to set intermediate monetary targets, which in 1990 and 1991 were more than achieved. The interest rates on the credit facilities offered by the Bank of Greece to commercial banks emerged as a major instrument for controlling liquidity in the economy.

By 1993, the deregulation of bank interest rates had been completed, with the abolition of minimum interest rates on savings deposits. Medium- and long-term cross-border capital movements had also been deregulated (short-term capital movements followed suit in May 1994), and commercial banks' compulsory investment in government debt securities and all remaining foreign exchange restrictions were abolished.

3.37 A new monetary policy regime as from 1995

Ioannis Boutos became Governor of the Bank of Greece in December 1993. In October 1994, he resigned and was succeeded by Lucas Papademos, until then Deputy Governor. In 1995, the exchange rate target was for the first time expressed in quantitative terms, i.e. depreciation of the drachma vis-à-vis the ECU by 3.0%, and an explicit inflation target (below 7% by end-1995) was announced. Thus, the hard drachma policy acquired a new character, and there was a shift to a new monetary policy regime (Garganas and Tavlas 2001). The Bank of Greece repeatedly set and achieved annual quantitative targets for bringing inflation down, while using interest rates as the main tool for attaining the intermediate monetary policy targets. Monetary authorities' actions had a significant impact on other economic aggregates, which gradually improved, while Costas Simitis became Prime Minister in 1996.[37] For instance, inflation dropped to 8.9% in 1995, from 10.9% in 1994, and then followed a steady downward path, reaching 2.1% in 1999. Furthermore, growth kept strengthening throughout the second half of the 1990s, while fiscal deficits declined. The high bank interest rates in Greece, compared with the rest of Europe, encouraged capital inflows.

3.38 Towards Bank of Greece independence

In December 1995, the European Council adopted the scenario for the move to the final stage of EMU and determined the name of the currency – the "euro". The Amsterdam European Council of June 1997 adopted the Stability and Growth Pact,

37 For the economic policy dilemmas in the specific conjuncture, see Garganas (1994).

by which EU governments committed to pursuing economic stabilisation policies also after the adoption of the euro (see Papademos, 1990 and 1993; Garganas, 1999).

Meanwhile in Greece, the institutional framework governing the central bank was undergoing successive changes, with amendments to the Bank's Statute in December 1997 and continuous modernisation of the legal framework up to 2000. The key feature of this new framework was the independence of the Bank of Greece, as required by the Treaty on European Union, although as early as 1 January 1994 the central bank had ceased financing the public sector and only reserved the task of managing the government debt securities holdings of public organisations. However, the approach to monetary policy conduct was reformulated from 1999 onwards, with the central bank's primary objective defined as maintaining the stability of the general level of prices. With a view to the achievement of this primary objective, the Bank of Greece was provided with the necessary monetary policy instruments, and its institutional, personal and operational independence was safeguarded. In this context, the Monetary Policy Council was set up at the Bank of Greece as the body responsible for designing and implementing monetary policy, as well as exchange rate policy, although the latter responsibility would become obsolete after the adoption of the euro. The establishment of the Monetary Policy Council marked a major institutional change in monetary policy-making in Greece and, somehow, in an entirely different institutional and practical context, closed the cycle that had opened with the abolition of the Currency Committee in 1982.

In order to adapt to the new conditions and become an integral part of the European System of Central Banks (ESCB) led by the European Central Bank (ECB), the Bank of Greece also had to change its monetary policy instruments. This process had already begun in the period 1994-1998, after the start of Stage II of EMU. The operational framework of the Eurosystem included monetary policy instruments such as open market operations (refinancing, fine-tuning and structural operations), standing facilities (a marginal lending facility and a deposit facility) and reserve requirements aimed mainly at stabilising the financial system. The Bank of Greece implemented the necessary adjustments in a stepwise manner, attuned to the gradual pace of financial market development in Greece. An important novelty of the period was the creation of a secondary market for government securities. Following the adjustment of the Bank's monetary policy instruments to those of the Eurosystem by end-2000, the cash changeover to the single currency was also successfully completed on 1 January 2002, with the introduction of the euro banknotes and coins. This had entailed a colossal and successful effort on the part of the Bank's officials and staff to bring its operational and accounting standards into line with the principles of the Eurosystem.

3.39 The stock exchange crisis, 1999

In the meantime, and alongside the above developments, the period 1997-1999 saw a boom in stock prices, overheating the Athens Stock Exchange (ASE), and leading to an asset bubble. The ASE index, having risen by 5.4% in average annual terms between 1995 and 1996, followed a steep upward path thereafter, increasing by 58% in 1997, 72% in 1998 and 108.1% in 1999. In the summer of 1999, it increased exponentially: between end-June and mid-September 1999, stock prices rose by as much as 61.9%, and the index peaked at 6,355 points on 22 September 1999. A downward correction followed, with the index falling to 5,535.1 points by end-1999, compared with 2,737.6 one year earlier. Between December 1999 and December 2000, stock prices fell by 33.3%,[38] and the index, amid some fluctuations, remained on a strong downward path. The bubble of 1999 left many investors stranded and gave rise to debates concerning investor strategies and stock market operation in emerging market economies. Although the Bank of Greece had warned[39] investors aggressively reaching for yield against excessive risk-taking, some of them continued their speculative activity.

3.40 Joining EMU

In response to the pressures exerted on the drachma in late 1997, the Bank of Greece raised its interest rates and prepared for the entry of the national currency into the Exchange Rate Mechanism (ERM), which took place in March 1998. The drachma was devalued by 12.3% to 357 drachmas per ECU with a fluctuation band of ±15% around its ERM parity, while the Bank of Greece became part of the European Monetary System. Upon the start of Stage III of EMU, the drachma participated in ERM II at a central parity of 353.109 drachmas per euro (with a fluctuation band of ±15%). On 17 January 2000, its conversion rate to the euro was fixed at 340.75 drachmas per euro (implying an appreciation of 3.5%), a level close to its trading rate since its entry into ERM and thus presumably seen by the markets as fair. Soon afterwards, Greece applied for joining EMU. Its participation was approved in June 2000 at the Summit held in Santa Maria da Feira, Portugal and was based on the fact that the fiscal deficit had dropped to 1.9% of GDP in 1999 and inflation to 2.1%. Also, Greece was assessed positively in terms of the criteria re-

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38 Bank of Greece, *Annual Report* for the years 1996, 1997, 1998, 1999 and 2000.

39 See the statement by Governor L. Papademos in the Athens daily *Kathimerini,* 19.9.1999.

quiring a declining trend in public debt, low interest rates, fluctuation of the drachma within the narrow ERM-I band, and low inflation. The interest rates on 10-year government bonds had fallen from 17% in 1995 to 6.3% in 1999. Thus, Greece was accepted as a full member of the euro area, and the drachma would be replaced by the euro at the irrevocably fixed conversion rate. The changeover to the euro started on 1 January 2001 in scriptural form, followed by the cash changeover on 1 January 2002, when the drachma ceased to be legal tender and began to be withdrawn from circulation and was successfully replaced by euro banknotes and coins. Thus, although Greece joined the euro area as its 12th member on 1 January 2001, i.e. two years later than the other partners, it managed to catch up and implement the cash changeover simultaneously with them.[40]

3.41 Economic policy in the era of the euro, 2001-2008

In June 2002, Governor Lucas Papademos resigned in order to take up his new position as Vice-President of the ECB and was succeeded by Nicholas Garganas, until then Deputy Governor. The economy's strong performance continued until the outbreak of the global financial crisis of 2008, although growth rates gradually declined. Meanwhile, following drastic declines in lending rates, the country entered a cycle of foreign borrowing, imports and consumption; price developments were partly under control, but ample liquidity caused overheating. The Bank of Greece consistently warned of potential imbalances should inflation in Greece continue to be higher than in the euro area. Finally, towards the end of the decade, against the backdrop of the global financial crisis and as Greece's budgetary statistics figures were publicly challenged —for the second time since 2004— the country did face a problem of strong macroeconomic imbalances. A period of surveillance after 2004 and until 6 June 2007 was followed by substantial fiscal relaxation. At the same time, harbingers of the financial crisis of 2008 began to be felt in the economy. This crisis marked the end of an era and the entry of Greece, from 2009 onwards, into a phase of unprecedented economic contraction (see Stournaras and Albani, 2008). By that time, George Provopoulos had become Governor of the Bank of Greece as from 20 June 2008.

40 For the situation of the Greek economy in that period, see Bryant et al. (2001). Regarding the policy dilemmas and the country's economic strategy, see Giannitsis et al. (2004).

4. Theoretical considerations on the role of the central bank[41]

4.1 Historical background

Today, the prevailing view on central banks is that they are institutions serving the public interest, entrusted with the formulation or implementation of monetary policy, and safeguarding the stability of the banking system and of the currency. According to Goodman (1992, p. 2), the role of a central bank in an economy and its relationship with the State is in part a legacy of past political battles over the currency.

For a deeper understanding of the characteristics of central banks and the changing perceptions of central banking over time, it is important to note the following:

In the era of commercial and industrial capitalism, the banks entrusted with the operations of a central bank were private. They enjoyed privileges which had been granted by the State and which enabled them to exert influence on the economy and on the other commercial banks. The Bank of Amsterdam, the Bank of England, and other similar banks were managers of public debt in their respective countries and undertook to restabilise the currency in the event of war, fiscal deficits or rising public debt. The Prussian central bank unified the German monetary and banking system following Germany's unification in 1871, concentrating and safeguarding the reserves of the treasury and putting the monetary chaos in order. All banks of this nature made profits, among other things from seigniorage, which often caused a grudge among other commercial banks.

During the 19th century, and for as long as entry into the banking business was unrestricted, the key debates among economists referred to whether the State's special reserves should be centralised and held with a single bank or what the proportion of the currency in circulation to special reserves should be. The quantity theory of money was broadly accepted.

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41 The literature on central banks is vast. For a theoretical and historical background, see Chown (1994) and Davies (2002) on money and Wood et al. (2011) on monetary and banking history. For the historical evolution of central banks and their policies, see Morgan (1965), Holtfrerich et al. (1999) and Feiertag and Margairaz (2003). For the legislation governing central banks, see League of Nations (1932), and Aufricht (1967). For their role in developing countries, see Chandler (1962), Fry et al. (1996) and Maxfield (1997). Very interesting insights into central bank policies are provided by central bankers' speeches, as compiled in Bank for International Settlements (1972). For the more recent age of central banking, see Burstein (1991) and Giannini (2011). For central banks in the age of the euro, see Dyson and Marcussen (2009). For a comparison across the ECB, the Federal Reserve and the pre-euro Bundesbank, see Apel (2003). Finally, for central bank independence from a historical perspective, see Toniolo (1988) and Collins (1993).

The Bank of England was the most prominent banking institution in the era that followed the industrial revolution. It acted as a lender of last resort during all the banking and financial crises of the 19th century, and this despite the fact that, according to the Bank Charter Act of 1844, it had no duty to do so. This piece of legislation split the bank into two departments, an Issue Department and a Banking Department. Ultimately, its function as the banks' banker became de facto the Bank's most important feature, setting an example for other countries to follow. This function took two forms: protecting the currency and the banking system in the common interest and protecting any individual commercial bank in distress. Such protection would manifest itself by the provision of liquidity, and not by rescuing the owners of a distressed bank, as was demonstrated in the collapse of the Overend Gurney bank in 1866.

This arrangement obviously provided a solution to a problem: under the previous regime, a business competitor of other banks could not at the same time act as an arbitrator or as an accident and emergency nurse for them. The safety provided by this system created moral hazard: commercial banks could engage in speculative asset allocation, knowing that the central bank would run to their rescue if they failed. Thus, with time central banks withdrew from commercial banking, after the problems concerning shareholders' rights on profits had been resolved. Moral hazard continued to exist, but in a different form.[42] Against this background, and with a view to ensuring the safety of the banking system, the previously unrestricted banking operations became subject to regulation and supervision, and banking systems around the world moved from banking freedom to central bank regimes.

Yet, it is important to note that the idea that banking should be driven by competition instead of being supervised continued to have fervent supporters in academic theory (Hawtrey 1932; Smith 1936; De Kock 1974). For instance, Vera Smith (1936) argued that the central bank is not a "natural" phenomenon in a free economy. But she also admitted that central banks during the inter-war period had helped their respective economies in many ways, ranging from the restoration of public confidence to international understanding, even when international conferences failed to produce tangible results.

Until 1914, banking regulation and supervision was relatively simple and consisted in the choices dictated by the gold standard. However, the situation became increasingly complicated during the inter-war years, when the reinstatement of the pre-war gold standard proved impossible. At the same time, several countries faced monetary disturbances, thus the international community, through the League of

42 Bagehot (1873).

Nations, promoted the idea of creating central banks everywhere, including in countries like Greece, where the necessity of a central bank had not even featured in public debate.

After World War II and up to 1971, central bank actions were mainly geared towards keeping exchange rates stable and, in the less developed countries, strengthening economic development. Under floating exchange rates, central banks sought to maintain exchange rate and price stability. Meanwhile, traditional commercial banking operations continued, now coexisting with new financial practices and products.

Of course, monetary policy was always the primary task of a central bank, and was adequately fulfilled until the inter-war period, when high unemployment, especially after 1929, and external account imbalances in several countries rendered monetary policy powerless. Fiscal and other policies were thus called on to shoulder much of the stabilisation effort. However, from 1975 onwards, monetary policy and management became once again the key tool for central bank intervention in the economy, with some central banks (e.g. the US Federal Reserve System) having a dual mandate to promote full employment and price stability.

As already mentioned, the 1970s and 1980s were decades of transition, marked by exchange rate fluctuations, high velocity of money and interest rate volatility. Wherever monetary policy managed to reduce inflation and control money supply, high unemployment persisted. In the same period, the issue of central bank independence began to be hotly discussed, as failure to restore low inflation rates was often attributed to the influence of the State on central bank decisions. Another related issue referred to the extent of bank autonomy and discretion vis-à-vis the government's wishes. This is how the debate on central bank independence and the need to strengthen competition in the banking system started, resulting in the legal enshrining of central bank independence, which still applies to this day.

4.2 Theoretical contributions

The past two centuries saw a substantial body of theoretical research and economic (mainly monetary) policy recommendations based on theoretical analyses.

These theories can be classified into two broad categories. The first comprises virtually all 19th-century contributions, which came from doers, usually bankers or financial observers. The theories in the second category were developed by academic economists, as economic science and its individual branches had entered university curricula by the 20th century and provided a rich field for academic research. In fact, some academics moved beyond teaching and research to monetary policy making, as members of central bank governing bodies or other institutions responsible for monetary stability.

A detailed and thorough account of all these contributions is of course impossible within the scope of this chapter, although it would be very interesting to explore the history of economic thought on central banking theory and practice.

Instead, we will try to shed light on some of the theoretical contributions that had a major impact on public opinion as well as on the practice of central banking itself.

Attempts to interpret the dramatic rise in prices date back to the early modern period, in the wake of new land discoveries and the flux of precious metals from what we now call Latin America to the Kingdom of Spain. Gold and silver spread across Europe at a time of subdued economic activity, leading to inflation and to the idea that what makes a country rich is not its precious metals, but its production of goods. Accordingly, money supply had to match the value of the goods produced, and the metallic reserves had to be equal to a fixed ratio of currency in circulation.

The economic weakness observed after 1815 and for at least 15 years in England, victor of the Napoleonic Wars, led to the formulation of the "currency principle" by David Ricardo. The idea that restrictions had to be imposed on commercial banks' lending capacity, so as to prevent excessive money issuance that would lead to inflation, gained ground among experts, and this rule was ultimately established by legislation in 1844.

On the other hand, Thornton (1802) argued that a commercial bank should not be prevented from lending to any prospective borrower whose professional status and repute are positively evaluated by the bank. Credit may not constitute wealth but, according to Thornton, with time it turned into real value. At the same time, the market mechanism would ensure that excessive money issuance would not occur, and ultimately equilibrium would be restored in the banking system by the full repayment of the borrowed funds, including the accrued interest. The same author also gave practical advice to the Bank of England, if it wished to keep prices stable: gold should back the value of all paper money, thereby instilling a sense of safety and confidence, necessary for all transactions. This required a flexible policy in periods of strong propensity to borrow, letting the sum in circulation "vibrate" within certain limits (Thornton, 1802, p. 259) and never using inflexible credit rationing, which would stifle the market (Skaggs, 2012).

More than half a century later, Bagehot in his Lombard Street (1873) codified the practice of regulating money circulation, while also enriching it with insights onto banking business and the habits and customs of financial transactions of the time. For many years, this book was seen as the bible of banking, to which one would refer for authoritative views on monetary and banking matters. A similar status was accorded to the works of Robertson (1926) and Hawtrey (1932) in the inter-war period.

From the early 20th century onwards, J.M. Keynes introduced new approaches to banking. In his book *Indian Currency and Finance* (1913), focusing on the banking system of India, a still underdeveloped country, he found that the Indian currency was absolutely inelastic and that the government was not always able to manage its monetary reserve in line with the economy's seasonal needs. He concluded that in the absence of an automatic standard —regardless of the intentions and desires of the parties involved— there was a failure to deliver socially optimal results and prevent economic fluctuations. In his book *A tract on monetary reform* (1923), Keynes analysed the monetary reforms undertaken in various countries after World War I and found that in those countries where central banks existed, money issuance had been managed properly, in a way that changes in money supply were in line with the changes in money demand by businesses and the public at large. This ensured that the needs of the economy would be satisfied in a way that would not undermine economic stability. Finally, in his *General Theory of Employment, Interest and Money* (1936), Keynes argued that money should be controlled and the currency should be "managed", according to the terminology of the times. Monetary policy was not merely interest rate policy but mainly a policy for adjusting liquidity in the economy to serve broader economic policy goals such as full employment and social welfare.

The most important theoretical contribution to post-war monetary literature came with the framework developed by Jan Tinbergen (1952) and later refined by Theil (1961). Tinbergen laid the foundations of "scientific" economic policy, as opposed to earlier empirical approaches. A key notion of his model was the distinction between policy targets and instruments. The target of monetary policy was monetary stability, and the instruments for achieving this target were the discount rate, liquidity, open market operations, etc. Each of the instruments made a different contribution towards the achievement of the target, on account of time lags, economic uncertainty and unpredictability of their effects. Alternative econometric models could help in selecting the appropriate instruments that would maximise performance against the target. As a matter of importance, the model should incorporate a social welfare function – which was quite challenging, as this was not explicitly given by the State, but would have to be estimated by the central bank. So, the development of an econometric model that simulated the operation of the economy seemed to solve the problem, despite any weaknesses of this endeavour. After all, no single econometric model could be so perfect that the central bank would not need a second one or some alternative, third way for formulating its strategy.

Another significant contribution was made by William Brainard (1967), who underscored the uncertainty surrounding the money multiplier and other multipliers related to money supply. He concluded that, once a target had been set, usually some actions needed to be taken which, taken together, would not meet the target, but ultimately the market would do, through the operation of multipliers.

In the 1960s, the work by Mundell (1962 and 1963) proved to be a breakthrough as it linked domestic to external monetary equilibrium under different monetary regimes, and also analysed the role of central banks in relation to the above questions.

In the early 1970s, the focus of academic debate shifted to choosing a monetary instrument that would stand out in controlling the economy, i.e. the interest rate versus money stock (Poole, 1970). Initially, money stock seemed to be the favoured choice, as Friedman's monetary rule gained in popularity. The use of M1, M2 and M3 money as a policy instrument had its heyday for some time, and had to be adjusted to output fluctuations. Monetary policy quantification prevailed, setting the tune for various practical applications across countries. Later, however, interest rates gained prominence, in particular the discount rate at which commercial banks borrow from the central bank. This "neutral" rate echoed Wicksell's analysis on the natural rate of interest, to which the market interest should adjust.

Underlying these perceptions were, as we saw, the quests of monetarists, most notably of Milton Friedman (1960, 1963a, 1963b, 1963c, 1969, 1982). The "optimal" money stock became the aim of monetary authorities, while at the same time a rules-based economic policy was advocated, instead of the discretionary or activist policies along Keynesian lines.[43]

Against the background of the rise of monetarism, the rational expectations school came to the fore. Kydland and Prescott (1977) showed that, under a steep Phillips curve, an expansionary policy could reduce unemployment in the short run, but would cause inflation and a new shock later on. Assuming rational expectations, the policy scenario would be transparent and the government's short-term goals would be cancelled by the action of private economic agents. A practical result of this analysis was the notion that the discretion of central banks should be replaced by commitment to rules (the rules vs. discretion debate from a historical perspective is discussed by Argy, 1990). The case for rules was supported by the papers of Barro and Gordon (1983) and Barro (1986). Especially in the latter, the author identifies two types of policymakers: a "hard" one, who strives for low inflation at any cost, and a "soft" one, whose primary target refers to credit expansion and puts inflation second.

43 For the domination of international economics by monetarism and Friedman's role, see Leeson (2003).

With time, these views lost part of their appeal. It was now recognised that in the face of stagflation, although it was not of their making, central banks could not just stand and watch, but should instead drastically intervene.

Rogoff (1985) suggested that "conservatives" should be appointed to head the central banks. Taking this further, Buchanan (1984) —and others later— called for a link between remuneration and results for those at the head of central banks: in the event of high inflation, and thus failure to fulfil their mandate, according to Buchanan, bankers' salaries should be reduced. The denationalisation of money propounded by Hayek (1978) was in line with these views, as well with the incipient globalisation process.

Soon, the quest moved from absolute principles to more practical and realistic answers. The disturbances that emerged in the first decade of globalisation, when the influential positions were held by persons fitting the profile prescribed by the then prevailing view, showed that policymakers were not responsible for monetary shocks but rather faced the actions of others. Thus, the focus of academic debate shifted to the question of central bank independence (on this issue, as well as for an overview of the relevant literature, see Blinder 1998, and Goodhart 1988).

Independence can be understood as "operational" (or "instrument") independence or, alternatively, as "goal" independence (McCallum, 1996). Generally, markets respond more positively to a credible policymaker than to elected politicians who, regardless of their economic views, may make ad hoc decisions (Persson and Tabellini, 1993). Central banks may adopt transparency and accountability practices, thereby enhancing their public image as guardians of monetary stability. The Taylor rule (Taylor, 1993, see also Koenig et al., 2012) can be of relevance in this context, as it provides a mathematical formula for an independent central bank's response to changes in the real economy (reaction function). However, central bank independence has also had its critics, arguing about a possible abuse of this independence or a lack of democratic legitimacy of unelected public officials who are presumed to act as they see fit. But this argument is refutable. The people at the head of central banks are selected by and interact with governments, while also being influenced by the society within which they operate. Only they have a different mandate than the governments have. Whether their independence, which is now established in varying degrees, will continue to exist in the long run will mostly depend on the effectiveness of their actions and their ability to deliver what society expects from central banks, i.e. price stability and financial stability.

PART TWO

HISTORICAL BACKGROUND OF THE ESTABLISHMENT OF THE BANK OF GREECE

1. The banking system and the Greek economy from 1830 to the inter-war period

The economic history of Greece and, along with it, the history of the Greek currency, banking system and public finances started before the country officially gained its independence (Andreadis, 1938): with the two so-called "independence loans" in 1824 and 1825, Greece assumed a nominal debt of 2,800,000 pounds sterling, although only 1,176,000 pounds actually made it into public coffers. These funds were partly used for military expenditure (to create a national fleet) and partly spent, or rather squandered, to finance the factions fighting the two civil wars during the War of Independence, the so-called "internal struggle". On 6 April 1826, the revolutionary government, unable to repay the loans, formally declared the first Greek default, even before the country's independence![1]

Throughout the War of Independence and until the arrival of Kapodistrias, dozens of different currencies circulated across the Greek space, with various and often arbitrary parities. On 8 February 1828, Kapodistrias issued a Decree defining the exchange rates of all these currencies in terms of "grossia" (piasters), and on 14 February 1828 decided to establish in Aegina the National Finance Bank, with the help of Jean-Gabriel Eynard. This bank was effectively the national treasury. It was managed by a three-member Financial Committee, including Georgios Stavros. It is worth noting that Kapodistrias recognised the country's debt obligations arising from the independence loans, but was ultimately unable to honour them.

1 For a long-term economic history of Greece, see Kostis (2013).

On 29 July 1828, the 4th National Assembly in Argos decided to introduce a national currency (the silver phoenix) and its subdivisions ("lepta", i.e. cents). One year later, on 31 July 1829, the decision was taken to set up a mint and strike coins, which were put into circulation after only two months, on 28 September 1829. The one-phoenix coin weighed 1 and 3/8 drams (a dram is 3.2 grams) and was made of silver (90%) and copper (10%). On 25 January 1830, a resolution determined the exchange rates of foreign currencies vis-à-vis the phoenix. On 17 June 1831, the government decided to print paper bills in denominations of 5, 10, 50 and 100 phoenixes, totalling 3 million phoenixes. From 1832 onwards, the phoenix became fiat money.

Trust in the National Finance Bank was low and soon dissipated completely, as the State was not only unable to provide cover for the bank's reserves but also drew on such reserves to finance its expenditure. As a result, the bank went bankrupt.

After Kapodistrias was assassinated and the Protecting Powers brought Otto as King of Greece, the policy of the Kapodistrian period was overturned: on 8 February 1832, two days after Otto's arrival in Nafplion, a new currency was introduced, the drachma, and its exchange rates vis-à-vis foreign currencies were determined, while the circulation of Ottoman currencies was banned (Alogoskoufis and Lazaretou, 2002). One year later, along with the relocation of the capital from Nafplion toAthens, the National Finance Bank was dissolved. Negotiations started with foreign bankers on the establishment of another bank, but initially stalled.

In 1832, in view of the new king's arrival, the Protecting Powers offered as a token of good will a loan of 60 million francs, with a maturity of 36 years and an interest rate of 5%. The loan was to be disbursed in instalments, which soon started to be delayed, as Greece, unable to collect taxes from a still underdeveloped economy, fell into arrears on its debt repayments. Eleven years later, following agonised negotiations with Greece's creditors, which ended up in an extension of debt maturity, the London protocol was signed in July 1843, redefining the interest rate and the repayment profile of Greek debt, but very soon afterwards the modern Greek State unilaterally suspended payments of the 1832 loan (see Kofas, 1981). Foreign creditors and the Protecting Powers called upon Greece to honour its commitments.[2] This second default of the Greek State exacerbated public discomfort

2 In its first issue on Saturday, 2 September 1843 (or 21 August according to the old calendar applicable then in Greece), the weekly review *The Economist* featured the following brief report: "The Greek Government has suspended 25 professors of the University, in compliance, it is said, with the desire of the protecting powers, who insisted on the strictest system of economy being introduced into the finances. The crops had suffered severely in most of the provinces, and the greatest misery pervaded the whole country" (p. 11). In its issue no. 5 on 30 (old calendar: 18) September, it announced the 3 September a "revolution…in which no blood has been shed".

with the Bavarian administration, triggering the Revolution of 3 September 1843 that forced Otto to grant a Constitution (1844).

On 23 October 1839, the Ionian State Bank was founded in London as a banking institution for the Ionian Islands, then a British protectorate. Based in Corfu, the bank began operations on 1 March 1840.

On 30 March 1841, the National Bank of Greece was founded in Athens. Its founding law, published in the Government Gazette, designated the bank as a fully private société anonyme, with a total capital of five million drachmas (5,000 shares of 1,000 drachmas each) and having the privilege to issue notes (up to two fifths of its capital) and the right to establish branches across Greece; its main activities would be interest-bearing lending against real estate collateral and discount of commercial bills and promissory notes. Despite its private status, the National Bank had from the outset very close links with the State, being effectively under indirect State supervision, and was strongly connected with and dependent on the successive governments. In a way, it represented a Greek version of a "universal bank", acting as a note-issuing, commercial and investment bank at the same time. For a very long period —and at least until the establishment of the Bank of Greece to which it handed over the note-issue privilege— the National Bank was one of the strongest poles of power within the young modern Greek State. With time, it developed a peculiar relationship with government: it would provide credit to the latter in exchange for successive renewals of its note-issue privilege and was exempted from taxes until 1877 (Stasinopoulos, 2000).

The National Bank, after hard and persistent efforts, managed to impose the drachma as a means of exchange, gradually superseding the other currencies in circulation. It maintained a broad shareholders' base, including a large number of small investors. In 1843, it began accepting remunerated deposits. From 1849 onwards, it participated in insurance companies and from 1858 in industrial businesses. In 1859 it expanded into mortgage credit and in 1875 it prevented the establishment of a specialised mortgage bank. It was involved in all the major infrastructure projects implemented in the country, such as the drainage of the Kopais lake in 1876 and the opening of the Corinth canal in 1881, and in the construction of the national railway network in 1882. In general, it played a dominant role in the country's economic life.

Meanwhile, the economy continued to face problems and, in 1848, currency convertibility was suspended. Following foreign interventions (e.g. the naval blockade of Piraeus after the David Pacifico affair, so as to prevent Greek involvement in the Crimean War), Greece agreed to resume repayments on its debt. Efforts were made to secure the necessary funds through taxation, domestic borrowing and sale of public property, but after one first instalment in 1860, Greece once again suspended payments, which is considered by some scholars —in a rather exaggerated way— as a new default).[3]

In 1862 Otto was deposed, and in 1863 a new dynasty came to the Greek throne with George I. As a gesture of good will, England gave the Ionian Islands back to Greece. This introduced a new player into the banking system, the Ionian Bank, which, under the treaty of London (1864) and a law of the Greek State, maintained all its privileges, including its note-issuing privilege (up to 1920).

The entry of the drachma into the Latin Monetary Union (LMU), set up in 1865 by France, Italy, Switzerland and Belgium, was decided in 1866. By the relevant agreement, signed on 10 April 1867, Greece accepted bimetallism. Nevertheless, in the next 15 years, recurrent suspensions of convertibility rendered the country's participation in the LMU a merely formal matter of no importance. In 1874 the silver coinage of the LMU were introduced in Greece, but in the following year silver was devalued vis-à-vis gold, both in world markets and in Greece (by the National Bank). In 1877 the LMU adopted the so-called "limping bimetallism" (i.e. it prohibited the minting of silver coins but did not fully adopt the gold standard and maintained the gold/silver parity).

Between 1871 and 1873, while informal stock exchanges were operating in Ermoupolis, Piraeus and Athens, the Lavreotika events took place, the first Greek stock exchange crisis, which led to the founding of the Athens Stock Exchange in 1876.

In 1879, in the wake of the Congress of Berlin and the associated territorial changes, Greece sought and achieved a new arrangement on its foreign debt. This enabled it to embark on massive foreign borrowing, with seven foreign loans between 1879 and 1890 totalling 630 million drachmas. Professor Andreas Andreadis estimated the actual new debt at only 389 million drachmas, as a large part of these loans was used to repay older loans. Of these loans, only that of 1890 and part of the 1884 loan were channelled into productive uses, such as the construction of a railway line from the port of Piraeus to the border. All the other loans were used for military/naval expenditure, repayment of government debt to banks and repayments of earlier foreign loans. This leverage caused a short-term euphoria and an asset bubble, while problems were accumulating due to the unproductive use of the borrowed funds. On the other hand, the tax system could not possibly contribute any additional resources (Syrmaloglou, 2007).

On 1 November 1882, Greece joined the Latin Monetary Union as a full member, and the new drachma replaced the old drachma at a ratio of 1:0.89, i.e. 100 new

3 See Reinhart and Rogoff (2008 and 2009).

drachmas were equal to 112 old drachmas. The exchange rate of the new drachma vis-à-vis the French, the Swiss and the Belgian francs and the Italian lira was set at 1:1. Moreover, after Thessaly and Arta, a part of the Epirus region was given to Greece in 1881, in 1882 the Privileged Bank of Epirus and Thessaly was established in the city of Volos having the privilege to issue notes in the "new provinces", i.e. newly annexed lands. On 31 December 1884, convertibility was formally reinstated, to be suspended again nine months later (on 30 September 1885) with a return to a fiat money regime. A few weeks later, Bulgaria annexed Eastern Rumelia, triggering a Serbo-Bulgarian war, and Greece declared a state of general mobilisation. Between 14 April and 9 May 1886, a naval blockade was imposed on Greece, forcing it to revoke the mobilisation. This period was characterised by further development and consolidation in the banking system, with only one new entry into the market, the Bank of Athens, established on 30 November 1893, ten days prior to the country's default (see Kostis and Tsokopoulos, 1988).

In 1892-1893, the currant crisis peaked, depriving the country of export receipts and resulting in a new default on 9-10 December 1893. Four years of hectic negotiations with Greece's foreign creditors followed, but to no avail. In the meantime, the Greco-Turkish War broke out in 1897 and, following its "unfortunate" outcome for Greece, an agreement was reached (Law 2519, Government Gazette A28, 26 February 1898), whereby Greece was subject to International Financial Control and its creditors' claims were secured by all the revenues from the State monopolies of salt, oil, matches, playing cards, cigarette paper, and Naxos emery, tobacco tax, stamp duties and custom duties from the Piraeus Customs Office (totalling 39.6 million drachmas). Moreover, if such revenues fell short of 85% of the expected amount for two consecutive six-month periods, the gross annual revenues of the Customs Offices at Lavrio, Patras, Volos and Corfu would also be seized (making an additional amount of 7.2 million drachmas). At the same time, currency consolidation was decided, and a restrictive monetary policy was pursued until 1910.

During the 25 years between 1898 and 1923, the Greek State resumed foreign borrowing (1,465 million French francs, 10 million pounds sterling, and 64 million drachmas).

After Crete became an autonomous state, the Bank of Crete was established on 30 September 1899, with a note-issuing privilege for the island. Three months later, on 22 December, the Bank of Epirus and Thessaly merged with the National Bank of Greece, to which it transferred its note-issuing privilege as from January 1900. Also, in 1899, amid the continuing currant crisis, a Currant Bank was established to finance currant producers, but collapsed in 1904.

The three most important banks founded during that period were the Banque d'Orient (1904), the Popular Bank (1905) and the Commercial Bank of Greece (1907).

Meanwhile, the labour movement was developing and the economy was experiencing a protracted recession, which was deeper in the agricultural sector: in 1906, Marinos Antypas advocated an expropriation of large farmland holdings, but was assassinated in 1907; in 1908, farmers' unions were set up in various parts of Greece; in 1909, the first protest rallies and demonstrations were organised, culminating in the 1910 Kileler uprising in Thessaly. At about the same time, in 1909, a group of army officers, the Military League (Stratiotikos Syndesmos), staged what was called the Goudi Revolution, which brought Eleftherios Venizelos to power a few months later.

The following year marked the beginning of a new period of modernisation. The gold-exchange standard was introduced, while Law 3642 authorised the National Bank of Greece to issue banknotes for the purchase of gold or foreign exchange beyond the established ceiling.

Greece took part in the Balkan Wars of 1912-1913. As the Great War broke out in 1914, disagreement on whether the country should join the war or not evolved into a national schism, effectively putting the economy on a war footing for about ten years. At first there were no side-effects on the economy, but from 1918 onwards the drachma started to depreciate again.

In 1920 the Ionian Bank waived its note-issuing right in favour of the National Bank of Greece, whose note-issuing privilege was renewed on 31 March 1921 for a period until 1950. On 11 May 1921, a consortium of 25 banks was set up and on 28 May granted a one-year loan of 40 million francs to the State at an interest rate of 6% and backed by tax revenue to be collected from the new territories ceded to Greece under the Treaty of Sèvres. The next day, on 29 May, Law 2612 was passed, giving this bank consortium the monopoly of foreign exchange trading. This preferential treatment was heavily criticised as incompatible with a free market, and the consortium was ultimately terminated on 23 April 1923.

Greece had already become involved in the Asia Minor Campaign (1920-1922). In view of the huge military costs, debt monetisation was decided in 1921, followed by a forced loan on 22 March 1922 by literally cutting all notes in half. The front collapsed in August 1922, and some 1.5 million refugees from Asia Minor flooded the Greek territory. This caused a major shock to the national economy, which faced the cost of resettling and integrating the new population against a backdrop of a slump in production, trade deficits, unpaid debts, staggering unemployment and unstable currency. In the first months after the Asia Minor Disaster, conditions of political and economic confusion and social conflict prevailed.

Turning to the exchange rate of the drachma, the situation was out of control. In March 1923, the pound sterling peaked at 438 drachmas, from 34.2 drachmas in 1920 and 168.3 in 1922 (annual averages). In summer 1923, when Greece's application for a loan from the League of Nations was seen as likely to succeed, tensions and speculation abated and the exchange rate of the drachma declined to 170 drachmas per pound sterling.

The trade deficit increased in 1923, nearly tripling in a year, which favoured the merchant class. Through a mild protectionism, Law 2948/1922 for promoting industry helped Greek industrial firms increase its domestic market share.

The first post-1922 loan agreement was signed in 1924: Greece was given a "refugee loan" of GBP 12,300,000, to be managed by a body set up for this purpose, the Refugee Settlement Commission (RSC).[4] At the same time, under the Legislative Decree of 23 April 1923, the National Bank of Greece was granted the right to purchase foreign exchange on behalf of the State by issuing new money, a right it exercised quite extensively in 1924. This practice, although met by mistrust from foreign markets, strengthened the National Bank's foreign reserve position and enabled the banking system to generously finance the economy, something which would have otherwise been impossible.

With the pound sterling trading at between 202 and 298 drachmas in 1924, there were increasing calls for government action to stabilise the economy and the currency. The National Bank held a similar view, stressing in its reports that the drachma's fluctuations were associated more with psychological factors rather than with money supply in the economy.[5]

However, currency stabilisation was impossible given the volatile political landscape of the time. To deal with this situation, the government repeatedly borrowed from the National Bank, backtracked on the tax reform of 1919 and imposed (by the Legislative Decree of 3 March 1923) a one-off tax on all movable and immovable assets. In addition, the Legislative Decrees of 7 January 1923 and 11 May 1923 regulated the matter of the State's "gold liabilities" (i.e. government paper issued with a gold clause as additional bondholder protection): such liabilities were unilaterally converted into drachma-denominated liabilities at par va-

4 As known (see Pantelakis, 1988), the Allies (the United States, the United Kingdom and France) had promised to lend Greece to support the Venizelos government's participation in World War I, but backed out after the defeat of Venizelos at the 1920 election. Thus, the money that the National Bank of Greece had issued in anticipation of these loans remained uncovered, which was partly the cause for the high inflation and drachma depreciation seen in 1920-1924. In the face of the urgent problem of refugee rehabilitation, Greece was in desperate need of borrowing.

5 See National Bank of Greece, *Annual Report* by Governor Alexandros Diomidis for the year 1924.

lue. This, unsurprisingly, impaired the State's trustworthiness, but also alleviated government expenditure.

One last source of revenue for the State, and a cause of monetary instability until then, related to the Treasury bills of National Defence. Law 3198/1924 raised to 2.5 billion drachmas the maximum issue of National Defence T-bills in order to meet various existing liabilities, including those associated with refugee rehabilitation costs. By 23 January 1926, these T-bills pushed public debt to 1,368 milliondrachmas, of which 1,272 million represented short-term debt. Given that this floating debt was taking on threatening proportions, in 1926, the Pangalos government proceeded with two successive forced loans, similar to that of 1922, with a 50% haircut on these T-bills and conversion of the remaining 50% into long-term bonds.

The extensive public works programme launched under the Michalakopoulos government was continued by all the successive governments, with fresh impetus from 1928 onwards. Under the Pangalos dictatorship in particular, a contract with the English group Power & Traction Finance Company Ltd. was signed on 16 October 1925; water supply works began in Thessaloniki on 6 October 1925; the Autonomous Currant Organisation (ACO) was established on 13 August 1925, ultimately leading to the introduction of price floors for currants in 1928; and a free trade zone was established in Thessaloniki on 15 October 1925. More contracts followed in 1925, with Power & Traction (electricity, tram) and Ulen & Company (water supply). In 1926 the construction of the Marathon dam began, a concession agreement was signed with the New Antwerp Telephone & Electrical Works corporation (taken over by Siemens in 1930, which established the first telephone company in Greece, AETE S.A., in 1931), and the first Thessaloniki International Fair was held.

Furthermore, three new foreign loans were contracted (known as the railways loan, the water supply loan and the Swedish loan, respectively), increasing the government's debt service burden accordingly. Overall, this multifaceted investment activity was driven by the need to build national infrastructures and expand the domestic market to ensure the economic integration of the refugees.

Yet, such activity was taking place at the expense of monetary stability. Thus, when the Pangalos dictatorship was succeeded by an all-party government in late 1926, in which Georgios Kafantaris served as Minister of Finance for a year and a half, the question resurfaced about the need to bring public finances and the banking system back on track. Discussions started which ultimately led to a return to economic normality with the launch of the Bank of Greece on 14 May 1928 and the fixing of the exchange rate of the drachma at 375 drachmas per 1 pound sterling.[6]

6 Psalidopoulos (1989).

2. Events prior to the founding of the Bank of Greece

As we saw earlier, Greece's banking history has been a road full of bumps and pits, in which boom years alternated with years of upheaval and flux. The period from the Balkan Wars to 1928 was a time of restructuring and reorientation for the national economy.

On the eve of 1928, the Greek banking system was dominated by the National Bank of Greece, in its dual role as a note-issuing and a commercial bank. It also included: 37 other commercial banks, with the four major ones being the Bank of Athens, the Commercial Bank of Greece, the Banque d'Orient and the (still British-controlled) Ionian Bank; three mortgage banks, of which only one was strong; two smaller banks specialising in agricultural credit; and two specialised banking institutions, i.e. the Postal Savings Bank and the Consignment Deposits and Loans Fund.[7] In terms of deposits, the National Bank had a market share of 45%, and the top five banks together had a share of 85%.[8] This was an era of free banking, implying that banking operations were largely unregulated. The banking system was marked by an oligopolistic structure and lack of competition, while the negative aspects of the tight embrace between the State and the banks became increasingly visible and criticised, and it was realised that economic policy should build on the lessons taught by economic science and international experience.

As already pointed out, monetary stabilisation in Greece was a very challenging task. The exchange rate of the drachma vis-à-vis the pound sterling had been on a declining path: from 25 drachmas per GBP in 1919 to 168 drachmas in 1922.[9] The drachma weakened further in 1923 (GRD 309/1 GBP), partially reversed in 1924 (GRD 247/1 GBP) and deteriorated again after 1925, to over 350 drachmas.[10] Underlying this depreciation after 1922 were the weak production structure of the economy coupled with a deficit bias.

Originally, to address the problem, three different options had been suggested: (i) an upward revaluation and stabilisation of the drachma to its exchange rate prevailing in 1918; (ii) accepting the then current exchange rate as a given, and stabilising the drachma at that level; and (iii) first balancing the budget and then stabilising the currency at an exchange rate that would ensure long-term balance-of-payments and fiscal stability. Eventually, the third option was preferred, as in the

7 Bank of Greece (1978), pp. 50-51.

8 Ibid., p. 52.

9 General Statistical Service of Greece (1931).

10 Ibid.

meantime the "Savings Committee" (in 1924) and the "Experts Committee" (in 1926) had recommended large-scale cuts in government spending, especially in defence expenditure. Among academics, the Athens University professors Andreas Andreadis and Xenophon Zolotas were the leading advocates of monetary stabilisation. Andreadis, at the several committees he was member and in numerous newspaper interviews and academic papers, recommended restricting the role of the State in the economy. Zolotas did the same, with prolific publications on matters of the Greek economy in the inter-war period.

On the monetary front, the preparation for stabilisation and foreign insistence on the establishment of a separate central bank can best be understood in the light of the debate between National Bank Governor Alexandros Diomidis and *The Times* of London. *The Times,* the revered voice of the City, criticised Greece in general and the National Bank in particular for the unreasonably expansionary monetary policy pursued throughout the inter-war period, which had delayed currency stabilisation; the note-issuing policy of the National Bank had been guided by the banking principle rather than the currency principle, which since 1844 had been seen as the most appropriate guide for a stability-oriented monetary policy, in keeping with the tenets of classical political economy.[11] Diomidis, on the other hand, in numerous articles, defended the policy of the National Bank, which he headed, arguing that meeting the borrowing needs of Greek capitalists was not incompatible with monetary stability, even when it was not in conformity with standard monetary policy rules. The truth however was that the United Kingdom, as Greece's creditor, demanded that the monetary landscape in Greece be clarified and that the Greek government commit to the convertibility of the drachma to the pound.

Thus, under a pressing need for funds and under Eleftherios Venizelos's vision of an economically developed Greece, the Hellenic Republic agreed to transfer the note-issuing privilege from the National Bank to the Bank of Greece, which was founded for this purpose. Previously, the Minister of Finance, Georgios Kafantaris, in a letter to the Financial Committee of the League of Nations written on 14 June 1927 in Geneva, had informed the League that, despite the loan assistance received by then, "[i]t would be impossible to continue the refugee settlement work with any

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11 These two principles represent diametrically opposite theoretical approaches to monetary policy – see O' Brien (1975). In short, according to the Banking Principle, supported by Thomas Tooke and John Stuart Mill (Banking School), there is no such thing as too much supply of banknotes, as banknotes are issued only to cover actual transactions. By contrast, the proponents of the Currency Principle, namely Robert Torrens and Samuel Loyd (Currency School), adopting the views of David Ricardo, considered that the issued banknotes should be convertible and therefore strictly prescribed by the level of the gold reserves of the Bank of England. The Bank Charter Act of 1844, which continued to regulate several aspects of the British banking system until 1980, was based on the latter view.

hope of rapid and successful completion without concluding a supplementary loan abroad, and thus make it possible to adopt a far-reaching plan of systematic reform" (League of Nations, 14 June 1927). Kafantaris recalled that, aside from the current expenditure for the refugees, Greece also had to finance budget deficits of the past, and asked the League to ensure the generous funding of the country with a new loan (the amount asked was nine million pounds). This loan would ensure three things: rehabilitation of the refugees, stabilisation of the currency, and termination of the deficits.[12]

The League of Nations promised to assist, as well as to act as a mediator for raising the 9 million pounds, while its Financial Committee[13] decided to dispatch a group of experts to inspect the situation of the Greek economy and identify the measures that needed to be taken. The mission comprised four members, headed by the Deputy Secretary General of the League of Nations, Joseph Avenol.[14] The Avenol Committee presented in May 1927 a report that referred among other things to the position of the National Bank in the monetary system. In a relevant memo, the Financial Committee recommended that the National Bank should maintain its issuance privilege and become a central bank, shedding all of its commercial banking activities, and emphatically raised the issue of the independence of the National Bank from the government. Following a proposal made by National Bank Deputy Governor Emmanuel Tsouderos, and endorsed by the Greek government, the Financial Committee and the Council of the League of Nations, as well as the National Bank, it was decided that the latter would be confined to its role as a commercial bank and that a new, purely note-issuing bank would be founded. The relevant negotiations resulted in the Geneva Protocol, signed on 15 September 1927. On 14 May 1928, Greece adopted the gold-exchange standard —the drachma was pegged to the pound sterling— and the Bank of Greece began operations.

The demand of the League of Nations for the founding of a central bank met with strong opposition from the People's Party, which decided to pull out from the government, marking the end of the all-party coalition. The other parties passed the relevant law, and the birth of the Bank of Greece was a fact. One

12 League of Nations, Financial Committee, Report to the Council on the work of the 27th session of the Committee, 6-14.6.1927, p. 7.

13 The Financial Committee reported to the Economic and Financial Organisation (EFO) of the League of Nations. Although it had a 65-strong staff, EFO was always part of the General Secretariat of the League of Nations and never became independent (unlike the case with the International Labour Organisation, ILO). Between 1922 and 1931, EFO was headed by the Briton Arthur Salter (see Pauly, 1996).

14 See Venezis (1955) and Bank of Greece (1978).

should nevertheless note that this radical change in the country's banking system lacked support from a large part of the Greek people. The People's Party believed that taking away the issuance privilege from the National Bank and creating a central bank was contrary to the national interest and posed risks to national monetary policy.

Public opinion in the country was split, as the founding of the Bank of Greece was accompanied by a requirement on the National Bank to also transfer the capital gains on its foreign reserve assets. The matter spurred controversy among economists. These capital gains, estimated at roughly 1 billion drachmas,[15] had been generated by the revaluation of the gold and foreign exchange holdings of the National Bank since their acquisition and up to that time. The People's Party argued that the National Bank should keep the entire amount; on the other side of the political spectrum, Alexandros Papanastassiou argued instead that all of it should be transferred to the Bank of Greece. The then National Bank Governor, Alexandros Diomidis, who would become the first Governor of the Bank of Greece, believed that the National Bank was entitled to these capital gains which had resulted from its prudent policy and profitable purchases of gold and foreign exchange.[16] So, in his view, the National Bank should retain the full amount in question. The same view was later shared by Pyrsos (1940, p. 117), whereas a contemporary commentator (Raptarchis, 1927, p. 30) argued to the contrary. The issue was finally resolved by government decision: El. Venizelos, enjoying a parliamentary majority, adopted a Solomon's solution, allocating the capital gains equally between the National Bank and the Bank of Greece.

Controversy around the creation of a central bank would continue for a long time afterwards. During the first period of its operation, the Bank of Greece came under severe criticism for its actions or omissions, although in effect it was merely a weak bank within the constellation of Greek banking institutions (Kostis, 1986). As we will see below, even a merger of the Bank of Greece with the National Bank was proposed after the default, as a way of facilitating the country's exit from the crisis, but such proposals were outvoted. While currency stabilisation was an objective widely shared among economists and political forces, there was divergence of views on how to achieve it, and consensus on such a vital issue as the stability of the drachma was very hard to reach.

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15 The exact amount was 938,393,789 million drachmas (Pyrsos, 1940, p. 118).

16 Diomidis (1927).

3. The establishment and the Statute of the Bank of Greece

As already mentioned, the Bank of Greece began operations on 14 May 1928. Its Statute, which has the status of a law, comprises 75 articles divided in 16 sections.

The Bank of Greece is a banking institution governed by private law and incorporated as a société anonyme. The selection of this legal status is not without significance. The Bank of Greece has committed to the greatest possible transparency and accountability, sound management and profitability, according to private-sector standards. Thanks to this legal status, it has avoided phenomena of mismanagement and poor governance like those observed in other public enterprises, and has managed to safeguard the interests of citizens and society. The Bank of Greece had a twofold role, as it engaged in banking activities but also fulfilled a public function in relation to the currency and public finances. It exercised its note-issuing privilege on behalf of the State, i.e. it used public funds. In turn, the State had a share in its profits and controlled and supervised the Bank. In addition to its money-issuing monopoly, the Bank of Greece also engaged in purchases and sales of gold and foreign exchange. In respect of gold sales, the Bank of Greece had a monopoly too, while purchases and sales of foreign exchange could also be carried out by commercial banks, through the intermediation of the central bank.

Articles 45 to 50 of its Statute defined the relationship of the Bank of Greece with the State. Article 46 prohibited the Bank from providing loans, advances or other credit facilities to the State or to public enterprises, while Article 48 excluded government representatives from access to the Bank's books.

The Statute, which aimed at safeguarding the independence of the Bank of Greece in the fulfilment of its tasks, was of course geared towards maintaining the value of banknotes (Article 4), the gold-exchange standard and the convertibility of the currency (Article 5). From 1932 onwards, several additions and amendments to the Statute were introduced in response to international developments and the need to safeguard monetary stability in the country. In the mid-1940s, under the extraordinary circumstances of post-war reconstruction in the midst of the civil war, the Statute was amended to reflect the transfer of responsibilities to the Currency Committee (see the next section).

Furthermore, Law 5076/1931 regulated commercial banks, introducing, for the first time in Greek economic history, operational requirements for the taking up and pursuit of the business of credit institutions.

Among the numerous amendments that the Statute of the Bank of Greece underwent over time, the most fundamental ones were those of 1998 and 2000, aimed to ensure its compatibility with the Bank's membership of the Eurosystem.

4. The peculiar status of the Currency Committee between 1946 and 1982

The Currency Committee was set up by Law 1015 of 9 March 1946 "on the establishment and operation of a Currency Committee", with the aim to ensure credit policy coordination. Any issuance of new banknotes required a unanimous decision of the Committee, which was chaired by the Minister of Coordination and included as members the Minister of Finance, the Governor of the Bank of Greece and two foreign experts (one British and one American, both of whom withdrew after the 1953 devaluation).

The rationale for entrusting money issuance decisions to a new body has been explained by the future Governor X. Zolotas himself (see Zolotas, 1965 and 1977). The Currency Committee was responsible for determining money supply, the allocation of credit and the terms of lending to the real economy. Owing to its small number of members and flexibility, it could more efficiently achieve monetary policy coordination and act as a forum for a thorough preparation of policy measures in a politically and economically troubled times. Between 1946 and 1953, financial markets were non-existent, and pressure for monetary financing of all sorts of military or social expenditure was huge. After several setbacks and retractions, and thanks to Kartalis's tight fiscal policy, gradually from 1950 onwards, favourable conditions were put in place for a stabilisation of the currency. By its success in containing prices, particularly after 1953, the Bank of Greece assumed also a confidence-building role. The participation of foreign consultants in the Currency Committee reflected the country's dependence on British and American aid in the first post-war years. In the 1950s, when such aid no longer applied, the respective positions were abolished.

The Currency Committee was a peculiar body within the universe of Greek administrative structure, and the policy it pursued was undoubtedly one of control and intervention, as of course were most policies exercised at the time all over the world. Whereas it was initially intended to be in charge of banknote issuance, with time it also took up powers in the fields of liquidity in the economy and monetary stability. Effectively, the Bank of Greece would prepare and draft policy plans, which the Currency Committee would as a rule adopt. By Legislative Decree 588/1948 and Law 3074/1954, the Committee was authorised to define credit policy and impose credit allocation rules on commercial banks and, by Emergency Law 1665/1951, to also supervise banks' compliance with such rules. Law 1837/1951 further specified the tasks of the Currency Committee, while a few years later Legislative Decree 3074/1954 extensively regulated foreign exchange operations.

Due to the large volume of decisions and regulatory provisions that had built up, Currency Committee Decision 1294/1963 codified all the provisions and regulations applicable to the financing of the Greek economy. A new codification took place in 1979.[17]

By Legislative Decree 4108/1960, the mandate of the Currency Committee was extended for an indefinite period of time, while Emergency Law 1015/1964 renewed the Committee's exclusive right to authorise the issuance of banknotes. Currency Committee decisions were prepared by a special substructure, the Credit Committee, reporting to the Governor of the Bank of Greece.

As from 1978, it became a standard practice for the Currency Committee to officially announce the monetary programme for the following year, setting a monetary target, the desirable monetary and credit expansion, the sectoral allocation of credit, the level of public investment, etc.[18]

5. Control over the banking system after 1982

The Currency Committee and the Bank of Greece —along with the overall economic policy pursued by the successive governments— are credited with the conditions of high growth rates and low inflation that broadly prevailed between 1953 and 1978. However, the plethora of decisions and overly detailed guidelines to the commercial banking system have received a lot of criticism already since 1974. P. Papaligouras, who served as Bank of Greece Governor for a brief period after the restoration of democracy in 1974, once likened the decisions of the Currency Committee to a Talmudic text needing an expert to decipher, as any given decision should be interpreted in the light of earlier decisions on the same matter.[19]

The A. Papandreou government fulfilled its announced intent to abolish the Currency Committee, and the latter's tasks were shared among the Bank of Greece and other government bodies in 1982. According to the new arrangement (Article 3 of Law 1266/1982), the monetary policy framework and its incorporation into the broader economic policy planning would be a responsibility of

17 Lassados (1979).

18 Zolotas (1950, 1964 and 1977), Panagiotopoulos (1984) and Chalikias (1976).

19 See also the critique in Garganas (1992).

the government, while all tasks related to the implementation of monetary, credit and exchange rate policies were assigned to the Bank of Greece, which was also entrusted with banking supervision. Moreover, government borrowing from the Bank of Greece was subject to a ceiling, equal to 10% of government expenditure under the regular budget and the public investment budget taken together. This in effect strengthened the role of the Bank of Greece in the implementation of monetary and exchange rate policies and control over monetary aggregates according to its Statute, while the Bank through its recommendations could also influence monetary policy design. However, in this way the Bank of Greece was unavoidably more closely linked to the executive power, even more so since its Governor (appointed in November 1981) also became Minister of National Economy.

According to Zolotas (1965, pp. 63-65) the Currency Committee helped to reconcile the aims of government policy with the requirements of monetary equilibrium. With the abolition of the Currency Committee, the economy was deprived of a centralised body enabling a joint review of matters and a synthesis of the different perspectives, and the Bank of Greece assumed a role more or less complementary to government policy. However, the relative autonomy that the Bank of Greece had enjoyed since its inception was restored when Demetrios Chalikias became Governor in February 1984. On the other hand, the decision to dismantle the Currency Committee was not easy to reverse, in the context of an international trend towards deregulation and away from centralised decision-making.

In fact, the complicated scheme of controls and rules remained in place for some time afterwards. Gradually, however, from 1987 onwards, the deregulation of the financial system got underway. In the 1990s, liquidity in the economy was indirectly controlled through open market operations, the steering of interest rates and the reserve requirements of commercial banks. After the entry of the drachma into the Exchange Rate Mechanism I in 1998, the focus was on maintaining the drachma's central parity within the mechanism, as an intermediate target, along with the setting of monitoring ranges for monetary and credit aggregates. Thus, the policy pursued after 1987 —following instructions to commercial banks to purge their portfolios from unrecoverable claims on ailing companies— and particularly after 1994, was aimed at a gradual and ultimately full deregulation of the banking system, while at the same time safeguarding financial stability.

6. Enshrining full independence, 1998[20]

Following the gradual deregulation of the monetary and banking system, as well as of the banking services, and as part of preparations for EMU participation according to the goal the country had set, it was time for a new amendment to the Statute of the Bank of Greece.

By the decisions of the General Meeting of Shareholders of 22 December 1997 and 25 April 2000 (ratified by Laws 2609/11 May 1998 and 2832/13 June 2000, respectively), the Statute of the Bank of Greece was amended to ensure compatibility with the requirements of the Treaty on European Union. Price stability was explicitly defined as the Bank's primary objective, its independence was safeguarded, and its relationships with the Hellenic Parliament and the government were clearly specified.

At the same time, a new body was set up within the Bank of Greece: the Monetary Policy Council, responsible for the formulation and implementation of monetary policy and exchange rate policy, although the latter responsibility became obsolete after the adoption of the euro in 2001.

Since the replacement of the drachma by the euro, the Bank of Greece operates as an integral part of the European System of Central Banks, in the pursuit of its primary objective as well as in the fulfilment of certain other key tasks, acting in accordance with the guidelines and instructions of the European Central Bank. It contributes to the achievement of the objectives and the fulfilment of the tasks of the Eurosystem, which formulates and implements monetary policy in the euro area.

The Bank of Greece is responsible for the implementation of the Eurosystem's monetary policy in Greece and for safeguarding the stability of the Greek financial system. As mentioned above, its primary objective according to its Statute is to ensure stability of the general level of prices. The Bank of Greece is vested with wide-ranging supervisory powers over the banking system, monitoring the composition and assessing the quality of commercial bank portfolios, as well as evaluating their capital adequacy and solvency. Without prejudice to its primary objective, the Bank of Greece supports the general economic policy of the government. In the performance of its tasks, it enjoys institutional, personal and operational independence as enshrined by law, which is counterbalanced by its accountability to the Hellenic Parliament.

20 See http://www.bankofgreece.gr/Pages/en/Bank/History/historicalreview.aspx and http://www.bankofgreece.gr/Pages/en/Bank/default.aspx

On 19 May 2008, the Bank of Greece joined the Trans-European Automated Real-time Gross settlement Express Transfer (TARGET) system. Its independence was further specified by Law 4021/2011. In practical terms, independence means security of tenure for the Governor and other decision-making bodies, such as the Monetary Policy Council. This ensures stability in policy making and the unobstructed devotion of such persons to the duties assigned to them by law.

7. The Bank's staff

All along its history, the Bank of Greece has relied on its staff, constantly developing the human capital necessary for the fulfilment of its objectives. From the top officials, i.e. the Governor and Deputy Governor(s), to the lowest-ranking employees, the Bank's personnel have always prepared and/or implemented a policy for stability and growth, working for the benefit of all Greek citizens.

In attempting to reconstruct the Bank's past policies and actions, an exhaustive discussion of what the staff did all these years is not possible. Let us just mention some points that illustrate a small part of the huge human capital that the Bank possesses.

In its first year of operation, the Bank of Greece had a staff of 465, including 199 typists and office clerks. By 1930, it numbered 1,153 employees, surpassing 2,000 in 1938 and peaking at 4,192 in 1952. The vast majority (75%) were accountants and cashiers, in line with the skills the Bank of Greece needed back then. Later on, the personnel was reduced and remained below 4,000 up to 2004, gradually falling further to below 3,000 and, finally, to 2,500 by 2008. The number of accountants and cashiers declined to 50% of the total between the mid-1950s and the late 1970s, while economists first appeared in the relevant statistical tables in the Governor's *Annual Report for the year 2000* (with data dating back to 1995 and a headcount of between 30 and 51).[21] A similar number of staff has also been employed at the Bank's Legal Department, already since the 1950s.

As an employer, the Bank of Greece has always been supportive and understanding towards its staff, striving to ensure a workplace that is conducive to harmonious cooperation and high productivity. The healthcare fund and other benefits enjoyed by the staff provide them with assurance that they form part of an organisation which invests in its human resources.

21 Economists were hired at the Economic Research Department since the early 1960s (Bank of Greece, 1978, 470-471).

At the top, of course, stand the Governors, select figures who occasionally also held other public offices. Four Governors (E. Tsouderos, A. Diomidis, X. Zolotas and L. Papademos) became Prime Ministers; another eight (K. Varvaressos, G. Mantzavinos, G. Arsenis, I. Boutos, E. Christodoulou, D. Galanis, K. Papayiannis, and P. Papaligouras) served as Ministers; and some (Tsouderos, Boutos, Papaligouras, Papayiannis and Arsenis) were at some point elected as members of Parliament, while E. Christodoulou also became member of the European Parliament. All Governors and Deputy Governors had a professional background in banking and extensive scientific and managerial experience before taking up positions at the Bank of Greece. Some Governors (E. Tsouderos, K. Varvaressos, G. Mantzavinos, D. Galanis, D. Chalikias, L. Papademos, N. Garganas, and G. Provopoulos) had previously served at the Bank as Economic Advisers and/or Deputy Governors. All Deputy Governors were experienced economists having excellent knowledge of the Greek monetary and banking system. Regarding the length of term, I. Drossopoulos was the shortest-serving Governor, just 18 days before his sudden death, while X. Zolotas unquestionably stands out as the longest-serving, with his three terms of office adding up to a total of 19 years and nine months. Before or after their term of office, several Governors published studies in which they attempted to theoretically explain the policy pursued (see e.g. Zolotas, 1965; Chalikias, 1978 and 1993; Garganas, 1991).

A special place in the organisation chart of the Bank of Greece belongs to its Economic Research Department (more recently renamed Economic Analysis and Research Department). Its contribution to the evolution of economic thought in Greece has been crucial and is well documented (Psalidopoulos, 2000). As from the 1970s or even earlier, the Bank's Administration provided incentives to its staff for expanding their academic qualifications, including by postgraduate studies. Later on, the Economic Research Department was exclusively staffed through examinations. All these years, the staff of the Economic Research Department have undertaken important research, the results of which have been published in the various series of Bank of Greece publications.

Extroversion and utilisation of a broader pool of expertise beyond its in-house resources has been a salient feature of the Bank of Greece over time. Right from its inception, the Bank benefited from the expertise of a foreign adviser (Horace G.F. Finlayson) and, later on, the Currency Committee included British and American economists such as G. Patterson, D. Snider, J. Gunter, T. Gregory, A. Costanzo, etc. The Bank has also employed several university professors, Greek or foreign, for shorter or longer periods of time. These would include Andreas Papandreou (in the late 1950s) and other well-known economists.

For decades, business travels abroad required a decision of the General Council, even for senior officials. In the late 1970s, in view of the forthcoming accession to the EEC, more and more staff members were sent abroad as an opportunity to gain first-hand know-how and experience or to participate in various international committees and working groups.

In the early 1980s, following Greece's accession to the EEC, the Bank of Greece initiated the tradition of inviting and hosting famous Greek or foreign economists from abroad (such as Stephen Triantis, Edwin Kuh, etc.) for the purpose of studying matters relevant to the Greek economy, often at the request and on behalf of the Prime Minister's Office (e.g. Louis Lefeber, Miranda Xafa, etc.) Also, a number of experts initially recruited for a fixed term were ultimately included in the Bank's permanent staff, and some of them rose to high-ranking positions, such as George Tavlas, or professor Lucas Papademos, who later became Governor. Other Greek experts who have offered advisory services to the Bank of Greece include Antonios Kourakis, Vassilios Gontikas, Thanos Katsampas, Nicholas Karamouzis, Yannis Stournaras, Nicos Christodoulakis, Nicholas Economides and Apostolos Philippopoulos.

To sum up, the Bank of Greece has relied both on its own and on external human resources in order to monitor, document, analyse, plan, recommend and implement policies according to its mandate. Its success in fulfilling this mandate is not accidental: it is largely to be credited to those people who have filled its ranks over the years.

PART THREE

1 THE INTER-WAR PERIOD, 1928-1941

1.1 The macroeconomy

After a period of monetary turmoil in the wake of the Asia Minor Disaster, the Greek economy performed rather well, considering the domestic and international circumstances.

According to Evelpidis (1950), national income at constant prices grew at an average annual rate of 1.9% between 1927 and 1939, which is remarkable given that this period includes the 1929 crisis and the concomitant 1932 default. Other authors (Kostelenos, 1995) estimate an average annual growth rate of 3.4% for the period from 1922 to 1938, a truly colossal performance that can be even stronger depending on the base year (e.g. 4.35% annually for 1923-1938, 4.16% for 1927-1938). These divergences in figures warrant caution in their interpretation.

Throughout the inter-war period, the Greek economy remained predominantly agricultural. Agricultural output doubled between 1928 and 1936, from six million drachmas (at constant prices of 1914) to 12.1 million drachmas. In particular after 1932, the rise was driven by higher volumes, as prices were falling.

Industry came into play in inter-war Greece thanks to state support and cheap labour. Industrial output at constant prices of 1914 rose from 285.4 million in 1922 to 625.2 million drachmas in 1938, after temporary falling to 380.6 million in 1932 (the year of the sovereign default). The industrial production volume-weighted index increased from 100 in 1928 to 168.1 in 1938.

The country's trade balance ran deficits, not untypical in modern Greek economic history, as exports covered roughly half of imports and the country was always in need of migrant remittances, shipping receipts or, more importantly, foreign borrowing. Developments in the trade balance were positively correlated with those in economic activity until 1932, when trade regulation implied a decoupling between the two variables.

During that period, the general level of prices trended upwards, and at times very steeply so, with the exception of the years 1928 to 1931, when prices followed a declining path, falling by a total of 8.6%.[1] Particularly between 1920 and 1924, the consumer price index (1914=100) rose from 351 to 1,235. By mid-1935, it had rebounded to its 1929 levels and then kept increasing until 1940, despite the global deflationary trends.

The country's demographics changed dramatically. According to the 1928 census, 1,222,849 refugees settled permanently in the territory of Greece after 1922 (GSSG 1931, p. 41). Population thus rose sharply by 1.2 million, i.e. by some 25%, with refugees equally allocated across urban and rural areas. This influx of refugees resulted in a huge increase in labour supply, which kept wages low, while prices were increasing.

Through a mild protectionism, Law 2948/1922 sought to help Greek industry to gain ground in the domestic market. The modification of the tariff list in 1926 provided further support to the industrial sector, enabling it to remain on a steady upward path for a number of years. The monetary turmoil and the leveraging that prevailed up to 1928 gave way to a period of currency convertibility and macroeconomic stabilisation after the establishment of the Bank of Greece through to 1932.

The Venizelos government of 1928, relying on its strong parliamentary majority, continued the economic development policies of its predecessors. It went ahead with industrialisation, but the great crisis that broke out in October 1929 was soon felt in a small open economy like Greece. Growth rates declined, reaching a historic low in 1931. The government raised import tariffs on wheat and established the Agricultural Bank of Greece (ATE) to support farmers. International financial markets, on which the country relied for raising funds, remained shut to Greece. Global agricultural prices fell by around 30%, bringing Greek producers to a state of despair. On the other hand, the prices of domestic industrial products increased. Meanwhile, foreign and domestic speculation depleted the reserves of the Bank of Greece, leading the government to default on its debt on 26 April 1932.[2] The superhuman efforts of the indigenous population and the refugees suffered a strong blow, but a new beginning followed after 1 May 1932.

From the default onwards, the measures taken by K. Varvaressos implied a more introverted economic policy. Production recovered quickly, domestic output was

1 Bank of Greece (1978), Table 15.

2 For further details, see below.

protected by high tariffs, while an effort was made to ensure autarky in staple foods. Nevertheless, rural populations lived in misery. After the governmental change in 1933, the views of prominent members of the People's Party about a merger of the Bank of Greece with the National Bank could not hold sway.[3] In 1935, the last landless refugees were rehabilitated, with the completion of land reclamation projects in the Strymon valley in Northern Greece. The same year saw the introduction of a very strict tariff list that controlled the value and volume of imports and exports, drastically curtailing the freedom of trade. In 1937, the tariff list became even stricter, and the merchant class increasingly hopped across commodity classes, practicing regulatory arbitrage of some sort. Finally, the Metaxas dictatorship broadly continued along these economic policy lines, but with stronger political control and intervention in all aspects of economic life. In 1937, a noteworthy development was the establishment of a workers' insurance fund (Social Insurance Institute – IKA), which had been in the making for more than a decade and represented a breakthrough in favour of the economically weaker strata. On the eve of the Italian attack on Greece, the Greek economy was slowly yet steadily turning for the better, under a dictatorship characterised by a paradoxical mixture of a pro-British economic policy, despite the Greek-German clearing agreement, and totalitarian leanings.

1.2 Views and initiatives of the Bank of Greece

The founding act of the Bank of Greece was, as mentioned earlier, the Geneva Protocol of 15.9.27, which provided for the establishment of an independent institution, which would in particular "effect and maintain the stabilisation of the Greek currency in relation to gold and the centralisation at the Bank of all receipts and payments of the State and of the State enterprises".[4] Its creation was directly linked to the Greek government's stabilisation agenda for regaining access to international capital markets. This access was necessary after the fiscal and monetary derailment resulting from the military engagements, particularly in 1920-1922, and the problem of refugee rehabilitation.[5] The policies pursued by all inter-war governments, in particular the Venizelos government after 1928, were centred around the country's economic development. Development entailed changing the existing

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3 The idea was put forward by D. Maximos in 1931 and debated by Varvaressos, Diomidis, Drossopoulos, Koryzis and others. The issue was discussed again when the People's Party came to power (see further below). The debate was put on back burner for a while, but was revived in 1944, peaking around 1946, and closed for good soon afterwards.

4 Bank of Greece (1978), p. 3.

5 Mazower (2002), pp. 100-104.

structures and, for this to happen, funding should come, apart from domestic sources, from foreign loans for productive purposes. This in turn required monetary stability and fiscal consolidation, in order to attract the necessary funds and foreign exchange to support development.[6]

To this end, with the Treaty of Geneva, Greece undertook to reform its fiscal accounting system and introduce the single budget principle, abolishing the various existing special accounts which, although not included in the ordinary budget, ultimately affected it. Moreover, to ensure the necessary transparency in government transactions, the Bank of Greece would record State accounts.

Turning to the currency, Law 3424/1927 officially abolished bimetallism. The drachma was devalued against gold, from 0.290 grams to 0.019 grams of gold per drachma, and the banknotes of the Bank of Greece became the only legal tender. The drachma was pegged to the pound sterling, as gold-based foreign exchange, at a parity of 375 drachmas per one pound sterling. The Bank of Greece was required to hold reserves as cover, equal to not less than 40% (cover ratio) of the sum of currency in circulation and sight deposits. In exchange for these reforms, Greece would be given a "stabilisation loan" of nine million pounds to shore up the stabilisation effort.

At the time when the Bank of Greece was founded, the international monetary system was based on the gold-exchange standard (according to which currency was backed by gold and foreign exchange reserves) and was fragile due to an overvalued pound sterling, an undervalued French franc and the faltering process of exorbitant war reparations paid by Germany with funding from US loans.[7] With the New York Stock Exchange crash of 24 and 29 October 1929, this underlying fragility unravelled into a major disturbance across financial systems and real economies worldwide. For the Greek economy, and in particular its central bank that was taking its first steps amid scepticism from politicians and banking circles,[8] the new international situation represented a critical test: the Bank of Greece had to prove not only its raison d'être, but also its ability to respond to a changing economic and financial environment. Gradually, misgivings dissipated and the Bank of Greece reigned supreme in the Greek banking sector.

The Bank's policies from 1928 to 1941 can be better understood by looking at the views of its Governors and by identifying three periods. The first period lasted from 14.5.1928, when the Bank started operations, to 28.9.31, when the pound sterling abandoned the gold-exchange standard. This period marks the formative years of

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6 Ibid., pp. 152 and 154.

7 Kindleberger (1984), p. 365.

8 Kostis (1986), pp. 43-54, and Mazower (2002), pp. 145, 196-197, 223.

the fledgling Bank of Greece, in its balancing act between the different respective agendas of the government, commercial banks and the Financial Committee of the League of Nations. The second period, between 28.9.31 and 26.4.32, was a time of crisis and a prelude to the third period. In this second period, the government persisted in its gold-exchange standard policy. Runs on the drachma and speculation were everyday phenomena, and the Bank of Greece was struggling to tackle market practices that were depleting its reserves, resorting to foreign exchange controls. This period saw the introduction of the Laws of 28 September and 8 October 1931, imposing capital and foreign exchange controls, and the Legislative Decree of 1 February 1932. Finally, the third period starts with the formal suspension of payments on sovereign debt under Law 5422/1932 and the devaluation of the drachma on 26 April 1932 and ends with Greece's entry into World War II and the rescue of its gold reserve. In that period, the Bank's operational framework was radically reformed: the gold-exchange standard was abandoned, and the stabilisation and convertibility policy (inaugurated with the start of operations of the Bank of Greece in 1928) was suspended. The Bank played a dominant role in the banking sector and served as an anchor of stability for the currency and the economy in a tumultuous domestic and international environment.

Right from the start, the Bank was fortunate enough to have strong leadership. Its first Governor, Alexandros Diomidis, and Deputy Governor, Emmanuel Tsouderos, who later succeeded him as Governor, were strong personalities and men of authority. The previous experience of A. Diomidis as Governor of the National Bank and E. Tsouderos as Deputy Governor was a guarantee of their ability to steer the Greek banking system into the modern era. The third Governor was professor Kyriakos Varvaressos, another great economist. Varvaressos had previously been Adviser to the Governor at the National Bank and then the Bank of Greece, Minister of Finance in 1932 and Deputy Governor of the Bank of Greece, before succeeding Tsouderos as Governor in 1938. It is worth noting that on 28.9.31, while he was in London, he telegraphed to Prime Minister Venizelos, suggesting, to no avail, that Greece should also follow suit out of the gold standard. This makes him unique among the mainstream economists of the time.

The balance sheet position of the Bank of Greece at the time of its establishment was weak. On the asset side, its holdings of debt securities were insignificant compared with those of the National Bank or other commercial banks, too small to make its presence felt in the market, totalling 1,605 and 55,311 thousand drachmas in 1928 and 1929, respectively, compared with 1,076,143 thousand and 1,178,715 for the National Bank, 488,135 thousand and 487,369 thousand for the Commercial Bank and 321,081 thousand and 290,377 thousand for the Bank of Athens.[9] Even the smaller banks such as the Popular Bank or the National Mortgage Bank were richer in debt securities holdings than the Bank of Greece.

One of the first actions that the Bank of Greece took was to reduce its discount rate from 10% to 9%, on 30 November 1928. As Diomidis explained, this was decided in order to support lending and prevent a credit contraction. The measure, a first attempt to assert the presence of a banking institution guided by stability and prosperity goals rather than profitability considerations, triggered a storm of reactions from bankers and the academia alike.[10]

Diomidis responded to this generalised attack against the Bank of Greece by appealing to reason and moderation. In his view, 1921 had marked the start of economic dismantling, with the accumulation of deficits and excessive banknote issuance, which was not sustainable. There was a need for a clear break with the past and a fresh start. Diomidis described the current situation as one in which the State kept absorbing all Greek savings, in the absence of a legal brake, and the private sector kept asking for credit, with neither sector seeming willing to break this vicious circle. The cumulative deficits between 1921 and 1927 amounted to 8,523 million pounds, or 3,196,125 million drachmas. In the Governor's words: "we are drifting towards a total confusion between the Treasury with the National Bank".[11] Therefore, the critics were overlooking "certain characteristic phenomena of the modern social world".[12] Capital was "the most sensitive and most volatile among all commodities"[13] and needed low interest rates and currency stability. The reform ensured both, and the Bank of Greece was satisfied with maintaining the exchange rate of the drachma vis-à-vis the pound "unimpaired and undisturbed",[14] with full convertibility.

In reality, however, the commercial banks were testing the strengths of the Bank of Greece. For instance, knowing that whenever they presented any amount of foreign currency to the Bank of Greece they could take the exact drachma equivalent in exchange, since no fluctuation bands for foreign exchange buying/selling rates were in place, they were in no hurry to do so, and the Bank of Greece could not pos-

9 GSSG (1930), pp. 272-273.

10 The academic who accused the Bank's Administration of wanting to impose terms on the market instead of allowing it to freely operate was P. Christodoulopoulos (1930), professor at the Athens School of Economics and Business. He went as far as to throw at Diomidis the accusations of The Times, i.e. that he unduly adhered to the Banking Principle. Such accusations were promptly retorted by A. Tsimikalis (1931), Director at the Bank of Greece. For the arguments of the two sides, see Psalidopoulos (1989), pp. 215-219 and 378-382.

11 Bank of Greece, Report on the balance sheet of 31.12.1929.

12 Ibid.

13 Ibid.

14 Ibid.

sibly force their hand.[15] Had the Bank of Greece applied such bands, it would not have lost its reserve at the fast rates that it did.

One year later, Diomidis admitted that 1929 "was not an uneventful year for the world economy in general" [16] and stated that the mission of the Bank of Greece was "to create a favourable climate for attracting the funds floating on the international market".[17] Once again defending the Bank of Greece against criticism, he stressed that the Bank was wrongly accused, as its mission was not "to cover all the capital needs of the market". He pointed out that the cost of borrowing was high, and the Bank did its best to help, but stabilisation and convertibility should not be jeopardised. He confessed that the crisis of 1929 "initially found us, too, unprepared".[18] Despite the "exemplary order in the accounts"[19] of the Bank of Greece, the year 1930 had been one of the most turbulent years for the Greek economy. As far as the crisis was concerned, Diomidis saw only two ways of getting out of its stranglehold: "time and austerity".[20] In other words, he recommended patience and disinflation as key to exiting the crisis.

It was around the same era that action was taken for limiting the power of commercial banks. In spring 1931, a new Law on sociétés anonymes and banks was enacted, requiring banks to hold reserves equal to 12% of their deposit liabilities, up from 7% applicable since 1927. This triggered a strong reaction by the Hellenic Bank Association, which saw its members' freedom being curtailed. Despite the expert opinions provided by foreign economists (such as Frankfurt University professor Wilhelm Kalveram, but also Keynes) against this particular provision, the measure was finally passed, although it would not be fully applied in practice.[21]

The abandonment of the gold standard by the pound sterling took the Greek banking establishment by surprise. Fearing for their financial position, banks were in favour of staying with the gold standard, and the drachma was pegged to the US dollar. The Bank of Greece initially retained its reserve portfolio of pounds sterling, both due to its size and as a token of solidarity towards Great Britain (i.e. to prevent a further depreciation of the pound), but also in order to protect commercial banks, which also held pounds in their reserves.[22]

15 Pyrsos (1940), p. 82.

16 Bank of Greece, Report on the balance sheet of 31.12.1930.

17 Ibid.

18 Ibid.

19 Ibid.

20 Ibid.

21 Kostis (1997).

22 Pyrsos (1946), p. 101.

Varvaressos was the only one who, as mentioned earlier, seeing the reserve of the Bank of Greece targeted by speculation and quickly diminishing, advised Venizelos to leave the gold standard. Over the next few months, the reserve was running out, and the government was moving heaven and earth to secure a new loan. By January 1932, the reserve of the Bank of Greece had fallen below the statutory floor of 40%, whereupon the floor was suspended and efforts to find a loan continued.

Ultimately, another meeting was held on 21.4.1932, in which Venizelos, shunning the protocol in view of the extraordinary circumstances, had also invited the commercial banks along with the Bank of Greece in order to reach a common response to the situation.[23] The attendants in the meeting discussed the potential impact that a devaluation would have on commercial banks' balance sheets. Everyone (particularly Diomidis and the Deputy Governor of the National Bank, Evlampios) argued in favour of continued convertibility. National Bank Governor A. Koryzis raised the question of foreign exchange deposits, asking the government to clarify its intentions. Indeed, Venizelos was until then confident that Greece would "extraordinarily"[24] manage to secure a loan and continue its policy. Thereafter and through to early April, the government adopted a wait-and-see stance, hoping that its appeals to the League of Nations and the international markets would be positively answered.[25] The only officials to favour an immediate abandonment of the gold standard were the delegate of the League of Nations, Sir Otto Niemeyer, and, once again, Kyriakos Varvaressos. The latter must have felt particularly isolated, but he would soon be proven right by the developments that followed and brought him to the helm of the Ministry of Finance to handle the default. The default was decided due to the depletion of the reserve of the Bank of Greece (from 26,847,934 dollars on 28.9.1931, it had plummeted to 2,336,608 dollars by 26.4.1932), and following a recommendation by Niemeyer.

All in all, the criticism that the policy of the Bank of Greece came under throughout the period from its establishment to the 1932 default was definitely unfair and exaggerated. The Bank was bound by its Statute and had acted accordingly. But there has also been one decision that proved to be mistaken, although it was never criticised. Namely, in order to increase its capacity to intervene in foreign exchange markets, the Bank sold gold bullion holdings worth 985,532 pounds sterling in 1930

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23 Pyrsos comments that this composition of the meeting was "unfortunate" (1946, p. 126), as it was well-known that commercial banks were avid for profits, thus it was like a discussion "between the wolves and the sheep".

24 Vouros (1938), p. 89.

25 Speech delivered by Venizelos on 5.3.1932 at the Hellenic Parliament. See also the front cover of Psalidopoulos (1989).

in return for foreign exchange.[26] In less than a year, this move proved loss-generating, as it weakened the Bank of Greece's position following the devaluation of the pound. This must have shaken Venizelos's confidence in Diomidis and, almost as soon as the pound sterling abandoned the gold standard, Diomidis was asked (on the pretext of the "Papastratos affair") to resign – which he did on 28.9.1931. So, with the benefit of hindsight, it turns out that the Bank's Administration led by Diomidis, under pressure from the 1930 circumstances, made a wrong policy choice.

In the second period of the Bank's operation, Tsouderos was Governor. The Bank of Greece recommended on the Emergency Laws of 28 September and 8 October 1931 for the protection of the national currency, as well as another 30 or so ministerial decisions, Legislative Decrees, etc.[27] As Tsouderos stated, the abandonment of the gold standard by Great Britain had caused "the strongest possible shock"[28] to the Greek economy, and the Bank of Greece was trying to "rein in extreme panic".[29] It raised its discount rate from 9% to 12% in September 1931, to lower it again to 11% very soon, in October. The Stock Exchange closed on 19.9.1931 to avoid the worse. In the end, forsaking stabilisation was dictated by the force of circumstances and was not a policy choice of the government.

K. Varvaressos, as Minister of Finance, highlighted the "nakedness" of the Greek Treasury as a major political issue. Speaking before Parliament on 25.4.1932, he announced the compulsory re-denomination of US dollar deposit accounts into drachmas, and in fact not at the then prevailing rate of 145 drachmas per US dollar, but at 100 drachmas. In a very interesting speech, he drew a line between foreign exchange purchases for actual needs and those for speculation purposes, while inviting all sides to join forces against the speculators. According to Varvaressos, foreign exchange "cannot be the subject of private exploitation".[30] And he went on to note: "Whoever holds in his hands any currency of international value cannot possibly deny having a duty to contribute to the overall policy of the State from which he benefits", concluding that "it is socially fair to impose on them [foreign exchange holders] an obligation to contribute as well".

Among the historians of the Bank of Greece, Pyrsos assesses the above compulsory re-denomination arrangement as morally unimpeachable,[31] but unfortunate in

26 Bank of Greece, Report on the balance sheet of 31.12.1930.

27 Pyrsos (1946), p. 134.

28 Bank of Greece, Report on the balance sheet of 31.12.1931.

29 Ibid.

30 Pyrsos (1946), p. 137.

31 Ibid., p. 143.

terms of its economic results.[32] It would have been fairer, according to Pyrsos, to tax speculators' capital gains, and refrain from an arbitrary decision on the part of the government.

In response to criticism, in another speech before Parliament on 10 August 1932, Varvaressos argued that the measure operated to the benefit of the credit sector. It had saved the Bank of Greece 292,500,000 drachmas, without affecting depositors or banks, which had gained enough from speculation in the past anyway. But the times, he argued, had now changed.[33]

Coming back to Governor Tsouderos, it is important to stress his conviction that the shape of the global economy was nothing like it had been before 1918, and the world had yet to see the pre-war growth and employment rates again.[34] Autarky and fragmentation of policymaking across national borders lacking a global perspective were the root causes of the current situation, which in the case of the predominantly agricultural economy of Greece was compounded by the falling prices of agricultural products. As reported by Tsouderos, by the end of 1931 the Bank of Greece had lost reserves worth 5,300,000 pounds.[35]

Tsouderos rejected all mercantilist/protectionist theories,[36] but thought the time was "not right for a sudden substitution" of the social status quo of the credit economy. For him, the crisis of September had radically changed the conditions, and the Greek economy could no longer operate by the standards prevailing until then, as the balance of payments was deep in deficit. Greece, according to Tsouderos, presented the following paradox: a large part of its population enjoyed a high consumption level but "although employed and gaining income from their work, did not actually produce, but rather made plans for... the future production".[37] There was, in other words, a reversal of the wealth-generating process whereby, instead of the "supply-income-demand" pattern, the Greek economy operated on an "income-demand-supply" mode. Unfortunately, Tsouderos did not follow up on this analysis,[38] but moved on to argue that citizens should not expect the State to solve their

32 Ibid., p. 144.

33 Ibid., pp. 148-149.

34 For the views of Tsouderos, see further below.

35 Bank of Greece, Report on the balance sheet of 31.12.1931.

36 Ibid.

37 Ibid.

38 In his Report on the balance sheet of 31.12.1932, Tsouderos referred to an article he had published in the *Oikonomikos Tahidromos* review on 11.4.1926, in which he described a Greece in crisis due to excessive imports, credit inflation and public borrowing for productive projects. He also mentioned that following the influx of refugees the country was overpopulated, which represented "a major source of irregularity in our economic life".

problems.[39] Further, he argued that it was necessary to fanatically show confidence in Greek capital, while at the same time restraining "the extremities and insanity of panic".

The third period started, as mentioned, when the then Advisor to the Governor and subsequently Deputy Governor and Governor of the Bank of Greece, Kyriakos Varvaressos, became Minister. Further to the aforementioned Law 5422/26 April 1932 (suspension of convertibility), numerous other pieces of legislation followed, most notably the Emergency Decree of 29 July 1932, by which all of the country's liabilities in gold and US dollars were re-denominated into drachmas. This re-denomination spurred discontent from those who stood to lose from the measure, and the Bank of Greece had to defend this government initiative, invoking an opinion from law professor K. Triantafyllopoulos,[40] according to which the foreign exchange clauses agreed upon before the suspension of currency convertibility were null and void. It is worth noting that foreign exchange deposits accounted for 34% of total deposits.[41] Tsouderos, in a somewhat sarcastic tone, said that deposits in drachma "deserve every sympathy",[42] as they had suffered all the hardships of the national currency; on the other hand, foreign exchange depositors had "escaped all the national contributions imposed over time" and now it was high time they, too, contributed to the country's reconstruction.

The Bank of Greece also supported the agreement with the bondholders concluded by Varvaressos, and proposed the partial repayment of foreign creditors, initially for 30% of total debt.[43] On a different front, efforts were ongoing to support the internal purchasing power of the drachma after its devaluation.[44]

Another achievement of the Tsouderos governorship was that it managed to recover part of the foreign exchange it had been forced to sell earlier. Specifically, trusted stockbrokers would go to the Bank of Greece every morning to receive, in absolute secrecy, substantial cash amounts in drachmas with which to purchase, supposedly for their own account, foreign exchange on the informal market at rates slightly above the prevailing market rates, and then bring it back to the Bank on the same day. Several stockbrokers responded, and the practice continued until late December 1932.[45]

39 Bank of Greece, Report on the balance sheet of 31.12.1931.

40 Themis law journal, no. 35, 1932.

41 Ibid., p. xxix.

42 Ibid., p. xxx.

43 The agreement was frozen when the People's Party came to power, but after some time of confusion and uncertainty about what to do, it was finally honoured and implemented.

44 Bank of Greece, Report on the balance sheet of 31.12.1932.

45 Pyrsos (1946), p. 156.

One of the first things that the newly-elected People's Party government did, suspicious of anything the Bank of Greece was involved in, was to forbid this practice. Meanwhile, between May and December 1932, the conversion of gold deposits into deposits in drachmas had brought the equivalent of US dollars 6,533,356 to the Bank of Greece vaults.[46]

The New Deal posed new challenges to the Bank of Greece. After the devaluation of the US dollar, the Bank's Administration considered three options, i.e. to devalue or revalue the drachma or leave it unchanged.[47] Having regard to the interests of the Greek economy, it decided to peg the drachma to the Swiss franc and thus join the Gold Bloc.[48]

In the following years, the Governor repeatedly advocated a policy to support the agricultural sector.[49] The practice of foreign exchange accumulation through open market operations was resumed. By 31.12.1933, the Bank's reserve had reached 140 million Swiss francs, up from 66.5 million one year earlier. This increase subsequently led to the —expensive but necessary— conversion of part of this foreign exchange into gold.[50]

On many occasions, the Administration of the Bank of Greece made policy recommendations to the government and the productive classes. In the Report of the Administration of the Bank on the balance sheet of the year 1935, the Bank recommended an "effort to raise the deplorably low direct tax revenue".[51] In 1936, it identified a problem with industrial prices and called for their reduction, stating that: "A more pragmatic spirit must prevail among industrialists when setting the prices of their products".[52] In 1937, it highlighted the need for "vigilant attention to imports"[53] and in 1938, the Governor, in what could be seen as an act of self-criticism, called for flexible management of money supply, "not fixed and rigid".[54]

In 1939, Varvaressos, now Governor, pointed out that the international environment was shadowed by doubts about the past and worry about the future. "The imperfect tool of individual logic", he stated, "cannot fully grasp the motivations of

46 Ibid., p. 157.

47 Bank of Greece, Report on the balance sheet of 31.12.1932.

48 Ibid.

49 Bank of Greece, Report on the balance sheet of 31.12.1933, p. xxxi.

50 Bank of Greece, Report by the Governor E. I. Tsouderos on the balance sheet of the year 1934.

51 Bank of Greece, Report by the Administration of the Bank on the balance sheet of the year 1935.

52 Bank of Greece, Report by the Governor of the Bank on the balance sheet of the year 1936.

53 Bank of Greece, Report by the Governor of the Bank on the balance sheet of the year 1937.

54 Bank of Greece, Report by the Governor of the Bank on the balance sheet of the year 1938.

collective action",[55] underlining that "individualism or private motives have no place in this endeavour; personal capabilities must be harnessed to drive a common national effort".[56]

The months preceding the Greek-Italian war saw legislative initiatives to further regulate and shore up economic life in the country. Emergency Law 2476/2 August 1940 introduced extraordinary measures to regulate trade in Greek products; Emergency Law 2511/28 August 1940 allowed public organisations to buy certain categories of agricultural products and distribute them to the domestic market or export them; Emergency Law 2592/11 October 1940 established Associations of Greek Exporters; and Emergency Law 2629/7 November 1940 established a Greek Office for Supplies.

1.3 Credit and monetary policy

Every central bank, in order to impose its rules on the market and steer money supply so as to prevent disturbances in the economy, is expected to control interest rates and liquidity. The Bank of Greece was no exception. One of the first decisions of its General Council, on 14 May 1928 was to set the discount rate at 10%.[57] Six months later, on 30 November 1928, the Bank of Greece lowered this rate to 9%, triggering the reactions discussed above.

A second focus of the Bank's monetary policy was to attract deposits from commercial banks. In the absence of a required reserve system at the time, the decision of 5 June 1928 was significant, setting the interest rate on commercial banks' deposits with the Bank of Greece at 0.5%.[58] Under Article 56 paragraph 5 of the Statute, these deposits could be remunerated at an interest rate of up to 1%. Met with a tepid response from banks, the Bank of Greece raised the interest rate to 1% about eight months later.[59] Subsequently, it varied interest rates according to maturity: 0.5% for sight deposits and 1% for time deposits with a maturity of 30 days or more.[60]

55 Bank of Greece, Report by the Governor of the Bank on the balance sheet of the year 1939.

56 Ibid.

57 "Discount rate", General Council minutes, Vol. 1, meeting of 14.5.1928, p. 6.

58 "Determination of the interest rate on banks' deposits", General Council minutes, Vol. 1, meeting of 5.6.1928, p. 130.

59 "Increase of the interest rate on banks' deposits", General Council minutes, Vol. 2, meeting of 28 January 1929, p. 57.

60 "Determination of the interest rate on banks' deposits", General Council minutes, Vol. 3, meeting of 27.3.1930, pp. 79-80.

A third reform came with Law 5076/7 July 1931, whereby commercial banks were required either to redeposit with the Bank of Greece 7% of their savings deposit and sight deposit liabilities or, alternatively, to hold 12% of such deposits in their vaults, as minimum reserves.[61] In due course, the time deposit rate was lowered to 0.5%,[62] and a reduction in the sight deposit rate followed as from 1 June 1933, from 0.5% to 0.25%.[63] On 23.12.1933, the General Council decided to lower the deposit rate to 0.125% as from 1.1.1934.[64] Ultimately, the General Council decision of 15.12.1934 abolished the deposit rate altogether as from 1.1.1935,[65] indicating that by that time the Bank of Greece had consolidated its power over the Greek banking market.

Regarding liquidity, the General Council had already dealt with the issue before the NY Stock Exchange crash.[66] According to Governor Diomidis, there was no shortage of money supply, as shown by the increases in currency circulation *per capita* and in commercial bank credit between 1928 and 1929. Whenever necessary, the Bank of Greece could issue money, to the extent permitted by its cover ratio.[67] In addition, the Bank of Greece was willing to help commercial banks strengthen their reserves "through rediscounting or acceptation" of notes and bills of exchange. Using its cover as a "cushion", the Bank could transfer to it the unused foreign exchange balances of both the "Tripartite" and the "Productive" loans of 1928. Thus, shortly before the outbreak of the 1929 crisis, the Bank of Greece seemed confident that it had sufficient funds to meet the current needs of the economy, while noting that any increase in money supply to levels unjustified by the strength of economic activity would lead to inflation and flight of capital abroad.

Nevertheless, as the National Bank was accusing the Bank of Greece of failure to support liquidity and the productive classes of Greece in general, the Deputy Governor of the Bank of Greece, E. Tsouderos, in a letter to the Prime Minister dated 25 November 1929 undertook to respond, giving the central bank's version of

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61 Bank of Greece, Report on the balance sheet of 31.12.1931, Laws and Agreements Annex.

62 "Reduction of the interest rate on time deposits", General Council minutes, Vol. 4, meeting of 12.1.1933, p. 299.

63 "Reduction of the interest rate on banks' deposits", General Council minutes, Vol. 5, meeting of 29.5.1933, p. 68.

64 "Interest rate on banks' deposits", General Council minutes, Vol. 5, meeting of 23.12.1933, p. 159.

65 "Abolition of the interest rate on banks' deposits", General Council minutes, Vol. 6, meeting of 15.12.1934, pp. 68-69.

66 "Currency shortage", General Council minutes, Vol. 2, meeting of 28.10.1929, pp. 278-281.

67 The cover of banknotes in circulation referred mostly to the Bank's reserves in gold and gold-based foreign exchange. Its importance lay in the commitment made by the Bank of Greece (in the context of the efforts to stabilise the economy) to convert its banknotes into gold or foreign exchange on demand.

the facts.[68] According to Tsouderos, the data showed a decrease in the gold and foreign exchange reserve of the Bank of Greece between September and November 1929 relative to one year earlier, and this was due to the Bank's strict adherence to the convertibility of the currency under the gold-exchange standard. It was true that the Bank of Greece at the time had a cover ratio higher than the one allowed by the law, but, according to Tsouderos, it was imperative to keep the cover ratio above the level of 40% provided for by the law, so that the Bank of Greece would be able to deal with a potential bank run. Furthermore, Tsouderos attributed the decline in foreign exchange inflows to stagnation in currant and tobacco exports. Nevertheless, he continued, the Bank of Greece stood ready to extend loans and advances to banks or directly to farmers, accepting their produce as collateral, to enable them to cope with what was seen as a short-term stagnation in external trade.

Taking this opportunity, Tsouderos railed against lending to "moribund organisations that eat into the country's economic wealth". In those he included, above all, industrial companies that asked for loans to finance fixed equipment —presumably imported— unlike agricultural export companies that were seen as immediately productive and a source of foreign exchange. Moreover, he attributed the scarcity of credit to the fact that a part of banks' funds was tied up in "immobilised" loans to businesses facing repayment difficulties, while at the same time the banks were unable to meet demand for short-term working capital loans. Therefore, the Bank of Greece attributed the liquidity shortages in the market to the standard practice of industry, up to 1928, to finance its long-term needs in fixed capital by short-term borrowing, and considered options for converting these short-term loans to long-term ones, but only for viable industrial businesses. In the long run, what was necessary was to establish a new bank specialising in industrial credit, which would enjoy privileged state funding and would undertake the financing and reorganisation of industrial companies.

The next issue addressed by Tsouderos was the risk posed to the cover and currency circulation by excessive speculative demand for foreign exchange. This was contributing to a reduction of currency in circulation and was causing what was perceived as a credit crunch.

Tsouderos continued his letter by listing the tasks with which the Bank of Greece was entrusted as a central bank, i.e. ensuring the stability of the value of its banknotes, or, in his own words: "…safeguarding the stability of the gold value of its banknotes". It is obvious that the Administration of the Bank of Greece was aware of the fact

68 "Currency circulation and credit policy of the Bank", General Council minutes, Vol. 2, meeting of 27 November 1929, pp. 293-300, and Vol. 3, meeting of 27 November 1929, pp. 1-15.

that its commitment to maintain currency stability and convertibility constrained its ability to meet the financing needs of the economy. The flight of foreign exchange and the excessive "…accumulation of gold holdings abroad…" deprived the domestic economy from the funds needed for its development. For this reason, Tsouderos proposed that a part of the gold and foreign exchange cover should be substituted with a cover consisting in "...safe short-term credit to domestic businesses", by which he meant issuing banknotes backed by discounted commercial paper (inside money), as opposed to money backed by gold, foreign exchange or government paper (outside money). It thus appears that, right from the outset, the Bank of Greece was well aware of its dual role in the economy, although adherence to the gold-exchange standard rather tilted the balance towards its stabilising role.

Against this background, the Bank's view was that, if excessive demand for foreign exchange was due to speculation in the context of the monetary system of fixed exchange rates, the direct impact would be a decline in domestic money supply, along with what it implies for the economy. To corroborate his argument for a need to limit money supply, the Deputy Governor provided an extensive discussion of the quantity theory of money, which states that the general price level of goods and services is directly proportional to the amount of money in circulation, or money supply. Accordingly, Tsouderos said, for a given volume of transactions (and output), an increase in money supply would lead to higher prices and put pressure on the currency's external and internal value. Therefore, regulation of money supply —other than necessary to meet needs for transaction balances— depended on its credit policy and its discount rate decisions. It is important to note that Tsouderos linked the success of this monetary and credit policy tool to whether "…other banking institutions, voluntarily or not, keep track of the interest rate policy of the central bank…", i.e. whether commercial banks rely on central bank for maintaining their liquidity. Market conditions could be such that a higher discount rate would entail losses for producers without affecting speculators. In this case, as Tsouderos wrote, the central bank would make use of the second credit policy weapon at its disposal, i.e. direct control on both the quantity and the allocation of credit, favouring production and exports over consumption and imports, although credit rationing policies would be against contemporary economic orthodoxy.

The Bank's credit policy was not always successful in ensuring normal repayment of loans, so at times it had to write off business loans, as shown by the General Council decisions of 12.1.1931.[69] In three of the five cases considered, up to 70% of outstanding debts were written off, and only in two of them this percentage was

69 "Loan write-offs 1930", General Council minutes, Vol. 3, meeting of 12.1.1931, pp. 214-215.

below 30%. This fact highlights the Bank's commitment to help Greek businesses to recover and steer through the straits of the global crisis.

One of the most important actions taken by the General Council after the devaluation of the pound on 21.9.1931 was its decision, on 26.9.1931, to drastically increase the discount rate from 9% to 12%, the interest rate on loans backed by debt securities from 10% to 13% and the discount rate on farmer pledge certificates from 8% to 11%.[70] Underlying this decision was obviously the need to contain capital flight amid the global monetary instability triggered by the devaluation of the pound and the banking crisis in Europe. However, how the pressure of circumstances can influence decision-making can be seen from the fact that only one month later, on 29.10.1931, the General Council decided to lower the discount rate from 12% to 11%, the rate on collateralised loans from 13% to 12% and the discount rate on farmer pledge certificates from 11% to 10%. According to contemporary researchers, however, it was not at all certain that the level of the discount rate of the Bank of Greece could make a difference in the economy.[71] This erratic response indicates the Bank's attempt to strike a balance between defending the currency and its cover and averting negative effects on the real economy.

In his inaugural speech as Governor, Emmanuel Tsouderos discusses in detail the issue of the economic crisis and the policy of the Bank of Greece.[72] First of all, Tsouderos attributed the economic crisis to the dismantling, since 1914, of the international financial system that relied on free trade and a respective international division of labour. For Tsouderos, the root cause of the crisis was overinvestment. The inflationary environment that had emerged from the war and the autarky policy —coupled with relaxed monetary and credit policies and the rise of consumer demand to levels higher than production, pushing up the prices of products as well as of securities, and fuelling speculation— had eventually given way to a contraction of bank credit, the immobilisation of numerous and sizeable bank funds in inefficient businesses, a drop in industrial and agricultural product prices, and a surge in unemployment. To this one should add, as Tsouderos noted, the imbalances caused by the massive transfers of funds across countries due to war reparations and debts, but also the calculated policies of high tariffs and gold reserve accumulation followed by some countries. The consequence of all this was unemployment—his emphasis, showing the deep concern of the Bank's Administration about these

70 "Increase of the discount rate", General Council minutes, Vol. 4, meeting of 29.9.1931, p. 7.

71 Kostis (1986), pp. 89-90.

72 "Statements by Mr. Tsouderos on the economic crisis and the Bank's policy", General Council minutes, Vol. 4, meeting of 4 November 1931, pp. 27-37. See also above, Section 4.1. It is worth noting that Tsouderos provided an Austrian School interpretation of the Great Depression (see further below).

developments, unlike its detached and unemotional stance prior to 1931. For Tsouderos, three had been the factors behind the contagion of the 1929 global crisis to Greece: the proliferation of small businesses and self-employed individuals,[73] excess bank credit growth, and the poor crops of those years. A noteworthy point of the Governor's speech was also his reproach to commercial banks for their credit policies, as contrasted with the efforts made by the Bank of Greece, already since 1928, to control bank liquidity.[74]

The crisis in Greece was milder, for a number of reasons, including: (a) its unsophisticated economy; (b) the fact that its industry was oriented to the domestic market, thus not exposed to international developments, although Tsouderos alerted to the risks to its robust growth posed by protectionism; (c) a predominantly domestically-oriented agricultural sector, encouraged by moderate state protectionism; (d) the ongoing infrastructure projects, which absorbed a considerable part of the labour force and thus helped contain unemployment; and (e) the fiscal consolidation and monetary stability policies pursued, especially after 1928.

Looking ahead, the Bank's policy was expected to be shaped in this context. Its primary objective was to protect the currency; to this end, the Governor proposed foreign exchange controls of a temporary nature. The most appropriate policy for the immediate future, in his view, was a disinflationary monetary policy to sustain both the internal and external value of the currency, coupled with a tight fiscal policy. Tsouderos invited commercial banks, and the National Bank in particular, to cooperate with the Bank of Greece in defending the national currency.

On 28.3.1932, the Bank raised the ceiling on its collateralised loans in drachmas and foreign exchange from 250 million to 450 million drachmas.[75] In his statement dated 1.11.1932, the Governor revisited the issue of the central bank's policy on money supply and its correlation with the price index.[76] Tsouderos initially noted that a devaluation of the drachma alone could not restore external equilibrium, also given the restrictions on foreign exchange trading and on imports. In this regard, he dismissed as unfounded the perceptions that the only risk to the currency stemmed from excess money supply and argued that the Bank's money supply policy had been

73 Tsouderos here means the excessive number of businesses and self-employed individuals relative to the needs of the economy, probably alluding to the excess population that, after the Asia Minor Disaster, crowded the ranks of the self-employed.

74 Kostis (1986), p. 80, and Mazower (2002), pp. 196-198.

75 "Increase of the ceiling on collateralised loans", General Council minutes, Vol. 4, meeting of 28.3.1932, p. 158.

76 "Announcements of the Administration on the overall policy of the Bank", General Council minutes, Vol. 4, meeting of 1.11.1932, p. 249.

"…always within reasonable limits, despite the pressing needs faced by the government, banks and all other agents of our national economy". Comparing the evolution of the price index with money supply, he remarked that there was no clear correlation between the two aggregates; rather, the price index tended to move more in line with the exchange rate of the drachma. On the other hand, the Governor stated that the policy of issuing banknotes to purchase gold and foreign exchange had been justified by the urgent need of the country and of the Bank of Greece to replenish the respective reserves following the devaluation of the drachma. Finally, to support his argument that the post-devaluation credit policy of the Bank of Greece had been "reasonable", the Governor provided a table showing the Bank's assets, which revealed an increase in credit, in particular to the Agricultural Bank, for wheat, olive oil and tobacco, as well as to the government.

In the course of time and under the fiat money regime, the Bank of Greece, by several decisions, changed its policy regarding liquidity in the economy.

Thus, on 2 August 1934, the General Council approved a new agreement between the Bank of Greece and the Greek State, setting a ceiling on money supply.[77] The ceiling would be derived from a complicated formula, as the quarterly average sum of the following items: (a) the amount of drachmas used to purchase foreign exchange and gold, in the context of clearing agreements or otherwise; (b) the level of reserve assets; (c) total investment, up to 400 million drachmas; (d) government debt owed to the Bank of Greece; and (e) the Bank's discounts and credit during the reference quarter "…and being equal to the amount that, based on the average discount rate over that quarter, would bring about gains of twenty five million drachmas per quarter". Article 2 of the agreement stipulated that, should banknote issue exceed that ceiling, the Greek State would have an additional share in seigniorage as follows: 50% for amounts up to 50 million drachmas; 75% for amounts of between 50 and 75 million drachmas; and 100% for amounts of 75 million or more, and this share of the Greek State would be used exclusively to repay its debt to the Bank of Greece.

A subsequent agreement between the government and the Bank of Greece was signed on 4 June 1937[78] with a view to providing a credit facility to the Greek State. In particular, the Greek State would draw an advance of 486 million drachmas (12 million Deutsche marks) from its Reichsmark account with the Bank of Greece at

77 "Approval of agreement on the ceiling on circulation", General Council minutes, Vol. 5, meeting of 2.8.1934, pp. 290-292.

78 "Agreement between the Bank and the Greek State", General Council minutes, Vol. 8, meeting of 23.6.1937, pp. 116-118.

an annual interest rate of 3% —applicable on the debit balance of such account— repayable in instalments and maturing in four years, i.e. 1940. As collateral, the Bank of Greece would be free to manage the underlying funds, net of government debt repayment amounts, as it saw fit and retain the yields.

Very important for putting the fiscal house in order and for settling the pending issues of government debt to the Bank of Greece, was another agreement, signed by the two parties on 23.12.1938.[79] This addressed the total government debt to the Bank of Greece, stemming from: (a) the loans extended under Law 3642; (b) the loans dating back to the years 1920-1923 (the fiat money period); (c) the gold drachma-denominated loan under the Legislative Decree of 3 March 1923; (d) the 1.5% gold drachma loan of 1925; and (e) the 1936 and 1937 Reichsmark-denominated loans. According to the agreement, the loans referred to in (a), (b) and (d) above would be consolidated into a single amortised loan, repayable in 50 years at an interest rate of 0.3%. For the two loans referred to in (e), the agreement provided, among other things, for a 1% reduction of the interest rate on both and an extension of the repayment period for one of them. Finally, it was agreed that the loan referred to in (c) would be repaid free of interest within a period of 50 years, starting from 31.3.1945. These arrangements indicate an intention to streamline and consolidate the various debt liabilities of the Greek State in order to make them easier to monitor and manage.

In the General Council meeting discussing the annual balance sheet of 1937,[80] the Governor noted that money supply had risen relative to 1936, as also had foreign exchange inflows. Higher money supply was seen as a natural consequence of growing demand for transaction balances, on the back of a growing cover and rising prices. In this regard, the Governor made a very interesting point regarding the rise in prices and its correlation with money supply. In his own words, "it would be a fallacy to rely on one-sided theories and, reversing the actual relationships, to attribute, even if only for a part, the higher level of prices to higher money supply". In other words, the causality between money supply and prices ran the other way round than the quantity theory suggested. Higher prices were, according to Tsouderos, driven by factors relating to the real economy, disturbances in the supply-demand relationship, as well as by international conditions; they were not due to monetary factors. "Higher money supply is a necessary consequence of the change in prices, not

79 "Agreement between the Greek State and the Bank on the consolidation of the Greek State's debts to the Bank of Greece into a single amortised loan", General Council minutes, Vol. 9, meeting of 28.12.1938, pp. 156-161.

80 "Balance Sheet of 1937", General Council minutes, Vol. 8, meeting of 14.1.1938, pp. 262-280.

its cause". And to convince his audience that the monetary system must serve the needs of production and not the other way round, the Governor emphatically stated: "Fixed and inflexible money supply is an unhealthy phenomenon. Instead, adjustable money supply, in response to the volume of transactions, is a real and appropriate instrument for the economy". And he concluded that the policy of the Bank of Greece was not inflationary, but consistent with orthodox banking practices.

Discussions with foreign holders of government bonds in general were naturally a matter of concern to the Bank of Greece, especially given bondholders' demand for higher remuneration in the context of the growth of the Greek economy in the period from 1935 to 1937. The Bank of Greece suggested a settlement of the debt against the exports of tobacco and other goods to Great Britain, and argued that any debt settlement should not overstretch the country's capacity at the risk of another default, which would have devastating consequences both for Greece and for the bondholders themselves. But as the Greek side did not agree with the practice of annual settlements preferred by foreign creditors, the Bank of Greece was forced to agree to the payment of 40% of the interest on foreign currency-denominated loans for the financial year 1937-1938 as well.

In the discussion of the balance sheet of 1938,[81] the Governor reiterated his view about "healthy" banknote circulation, despite a slight decline in the cover (from 51.4% to 49.22%) in the year ending on 31 December 1938. One year later, when WWII had broken out, the discussion of the balance sheet of 1939 was shadowed by strong concern about the deteriorating international outlook.[82] Governor Varvaressos noted the adverse climate as a result of the war in Europe, adding that money circulation had developed smoothly until the end of July 1939, but had risen sharply in August and September on account of psychological reasons, fuelled also by commercial banks' reluctance to lend, triggering mass deposit withdrawals. However, the Bank's announcement that it would provide the banks with funding as necessary for fulfilling their obligations had managed to bring a turnaround, with deposits returning to banks and currency in circulation declining, although still above its former levels. The Governor considered this to be normal, as some small part of higher circulation was associated with hoarding and the remainder reflected the fact that the outbreak of the war had caused transactions on credit to dwindle and had increased demand for cash. Against this background, higher money circulation, in the Bank's view, did not reflect inflationary phenomena.

81 "Balance Sheet of 1938", General Council minutes, Vol. 9, meeting of 11.1.1939, pp. 176-192.

82 "Balance Sheet of 1939", General Council minutes, Vol. 10, meeting of 24.2.1940, pp. 37-45.

On 9.10.1940, the General Council approved a new agreement to be signed between the Bank and the Greek State.[83] The recitals of the draft agreement recalled the provisions of the Geneva Protocol and the Statute of the Bank of Greece, authorising the Bank to grant advances to the Greek State worth up to 400 million drachmas or up to 800 million drachmas including Treasury bill discounts, and in any event up to one-tenth of ordinary budget revenue. Taking into account the new needs of the Greek State and the fact that ordinary budget revenue for 1940-1941 amounted to 12,581 million drachmas, the agreement provided for an increase in the ceiling on advances to 1 billion drachmas, at an interest rate to be agreed each time between the parties. As was to be expected in view of international developments, the country by that time had fully shifted to a war footing, implying higher needs for public spending and financing.

In the discussion of the balance sheet of 1940,[84] this was vividly described in the Governor's words: "The private, the social, the public economy, all economic activity in general, has turned from a peacetime to a wartime one". And this implied not only a reorientation of the country's production base towards the needs of a country at war, but also that monetary and foreign exchange aggregates would be affected too. Thus, the increase in money circulation, which from January to October 1940 had been 2,072 million drachmas only, was mainly due to rising international prices as a result of higher risk premia, and to a lesser extent to widespread hoarding. However, between late October 1940, when the war started for Greece, and 31 December of that year, circulation had risen by another 3,844 million drachmas, i.e. 33.3% in about two months, solely due to higher, war-related government expenditure. As the Governor explained, in an effort to reassure the public, the cover for this higher circulation consisted in British wartime credit in foreign exchange, which the government had put at the Bank's disposal for the purpose of acquiring the necessary drachmas. Moreover, such foreign exchange could also be used for imports from the Sterling Area to cover the needs of production and of the population. Nevertheless, for the Governor, the resulting higher circulation did not give rise to concerns about potential inflationary pressures that could threaten the value of the drachma, thanks to the adequate foreign exchange cover and the ability of the State "…to sterilise any amount of drachmas exceeding the needs of transactions, so as to prevent the effects of higher circulation on … the price index".

83 "Authorisation by the General Council of an agreement with the Greek State", General Council minutes, Vol. 10, meeting of 9.10.1940, pp. 92-94, and "Draft amendments to Article 55 of the Statute submitted to the General Meeting for approval", General Council minutes, Vol. 10, meeting of 24.3.1941, pp. 156-157.

84 "Balance Sheet of 1940", General Council minutes, Vol. 10, meeting of 6.2.1941, pp. 131-144.

On 2.4.1941, the Bank identified[85] that money supply was not sufficient to meet demand for cash balances, which had been increasing on account of the war. Thus, given also the logistical difficulties in procuring new banknotes from abroad, it was decided to put the existing, newly delivered stock of 100-drachma notes into circulation as 1,000-drachma notes, by overstamping them with the new denomination. Accordingly, new 100-drachma banknotes would be procured from within the country. However, the collapse of the front of the Greek-Italian war and the capitulation of the Epirus Army on 21.4.1941, precipitated by the German attack across Greece's Serbo-Bulgarian border on 6.4.1941, effectively signalled also the collapse of any control over currency in circulation. Indeed, by a decision made on 25.4.1941, two days before the German troops entered Athens, the General Council approved the circulation of old-series 50-, 100-, 500- and 1,000-drachma banknotes that were about to be destructed, in order to cover the needs in money supply.[86] This decision built on the discussions during a previous meeting, on 24.4.1941,[87] in which the Bank's Directors had identified a banknote demand-supply gap, but also an excess of 400 million drachmas above the ceiling on permitted temporary advances from the Bank of Greece to the Greek State, due to the extraordinary circumstances.

To sum up, the credit and monetary policy of the Bank of Greece up to 26.4.1932 was clearly marked by its adherence to the gold-exchange standard and its commitment to defend stabilisation. The Bank's rather unsuccessful handling of the discount rate, as well as its actions with a view to luring deposits from commercial banks (prior to the establishment of reserve requirements), were aimed to control liquidity and assert the Bank's role, not as ends in themselves, but as tools for achieving economic stabilisation. On the other hand, the documents referring to monetary and credit policy, both in that period and after the suspension of stabilisation, testify to a strong effort to communicate the disinflationary policy stance of the Bank of Greece, without compromising its role in supporting the banking system and the real economy. After April 1932, a shift towards closer cooperation slowly but steadily appears in the relations between the State and the Bank of Greece, evident in the efforts to settle the State's liabilities vis-à-vis the Bank of Greece and to finance the State. This however was always done with caution, so as to avoid creating inflationary pressures, at least until shortly before the war.[88]

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85 "Circulation of new banknotes", General Council minutes, Vol. 10, meeting of 2.4.1941, pp. 160-161, and "Order of 100-drachma banknotes", General Council minutes, ibid., pp. 161-162.

86 General Council minutes, Vol. 10, meeting of 25.4.1941, p. 169.

87 "Report by the Directors of the Head Office to the General Council on the overall operations of the Bank in the latest period", General Council minutes, Vol. 10, meeting of 24.4.1941, pp. 166-168.

88 Loizos (2012b).

1.4 Banknote cover and foreign exchange policy

Currency stabilisation was inextricably linked to the very existence of the Bank of Greece, as can also be seen in the minutes of the General Council meeting of 14.5.1928,[89] in which the Governor, in addition to announcing the fixed exchange rate of the drachma vis-à-vis the pound sterling (375 drachmas per 1 GBP), focused on the Bank's cover in relation to its liabilities. Thus, the cover as a ratio of total liabilities stood at 53.67%, well above the minimum level of 40% prescribed in the Statute, and at 81.51% as a ratio of banknotes in circulation; both ratios were seen by the General Council as demonstrating the strength of the Bank of Greece. However, these figures provided no information about the composition of the Bank's assets, in particular the considerable share of "immobilised" assets, i.e. assets sunk up into legacy debt liabilities of the State to the Bank of Greece taken over from the National Bank.[90]

Just a few days into its life, the Bank of Greece conducted foreign exchange operations, mainly involving the conversion of part of its gold bullion holdings into foreign (British and US) gold-backed Treasury notes that would generate income. To refute potential criticism, the Governor argued that the Treasury notes acquired were denominated in currencies on the gold standard and the issuing countries did not restrict gold exports, suggesting there was no risk to the position of the Bank of Greece. His arguments are typical of the faith that almost all bankers of the time put in the stability of the international monetary system, which was based on precious metals and on the reserve currencies that were convertible into gold or silver. Commitment to this system and trust in its effectiveness can explain the clear statement of the Governor that, although the cover ratio was well above the statutory minimum of 40%, an increase in banknote circulation, albeit feasible, would "under no circumstances" be allowed.[91]

An important milestone in the Bank's foreign exchange policy was marked by the withdrawal of the pound from the gold standard on 21.9.1931. In response, a decision issued by the Bank's Executive Committee on 23.9.1931 and approved by the General Council in its meeting of 29.9.1931 pegged the drachma to the US dollar, at a parity of 77.05 drachmas per dollar.[92]

Indicative of the prevailing climate and of the Bank's need to reinforce its gold reserves was the decision of the General Council of 22.10.1931 to purchase

89 "Announcement on Stabilisation", General Council minutes, Vol. 1, meeting of 14.5.1928, p. 5.

90 Kostis (1986), pp. 46-48.

91 "Balance Sheet for the year 1928", General Council minutes, Vol. 2, meeting of 14.1.1929, pp. 42-55.

92 "Repegging of the drachma", General Council minutes, Vol. 3, meeting of 29.9.1931, pp. 298-299.

gold bullion bars worth one million gold sovereign pounds from the Banque de France.[93]

In the General Council meeting of 29.10.1931, the first after his appointment as Governor on 24.10.1931 and even before he was sworn in, Tsouderos discussed the level of the cover,[94] noting that the gold and foreign currency reserves had dropped to about 1.8 billion drachmas (regarding the same matter, Tsouderos would also send an aide-mémoire to the Prime Minister a couple of months later).[95] The cover consisted in: gold; foreign currency convertible into gold; the gold-denominated government bonds handed over by the National Bank along with the note issue privilege; and the part of the tripartite loan (3,000,000 pounds) that was used directly for the repayment of State debts to the Bank of Greece, making a total of $55,037,000 as at 31.12.1928. The cover had subsequently fallen to $31,330,000 as at 15.9.31, i.e. shortly before the devaluation of the pound, and to $24,592,000 (excluding $5,500,000 handed over by the National Bank) as at 15 November 1931. This implied losses of $20,130,000 in a span of 40 months (between 14.5.1928 and 15.9.1931), followed by further losses of $6,738,000 in just two months (from 15 September to 15 November 1931).[96] According to the Governor, the most recent losses were due both to foreign exchange outflows triggered by the devaluation of the pound and to the "…automatic depreciation of the pound-denominated component of the cover, as a result of the devaluation of the pound sterling".

Looking at the individual years of the period from 14.5.1928 to 23.11.1931, Tsouderos noted that capital outflows had peaked in the years prior to the pound sterling's devaluation, despite Greece's favourable interest rate differential, and this was due to the tax exemption of income from Greek government gold-backed bonds as well as mistrust in the stability of the Greek economy. For 1929-1930 alone, these outflows were estimated at no less than $22,000,000. Moreover, foreign exchange equivalent to $140,298,233 had flowed out throughout this period for meeting government needs (service of foreign loans, import of supplies, etc.), while foreign exchange inflows (coming from sources of the government, the Refugee Settlement Commission, etc.) amounted to only $75,117,353. This left a deficit of $65,180,880, covered by gains from market operations, interest income and reserves held abroad, as well as by drawing down the cover. Two key conclusions emerge from the above:

93 "Purchase of gold worth £1 million", General Council minutes, Vol. 4, meeting of 22.10.1931, p. 15.

94 "Announcements of the Governor on the cover ratios, etc.", General Council minutes, Vol. 4, meeting of 29.10.1931, p. 20.

95 "Aide-memoire to the President of the Government on the evolution of the cover", General Council minutes, Vol. 4, meeting of 4.12.1931, pp. 64-86.

96 Vouros (1938), and Pyrsos (1940).

(a) To a large extent, foreign borrowing represented borrowing of domestic funds, exported with the sole purpose of being converted into gold-convertible foreign exchange and then flowing back into the country in the form of debt financing of the Greek State. In this sense, many Greek capital holders would lend to the State, using a method that they perceived to be both profitable (due to the tax exemptions entailed) and safer (being repayable in currencies convertible into gold). However, these capital outflows took a toll on central bank reserves, and here the second conclusion comes into play, namely that (b) the burden of servicing the public debt in foreign exchange was exceptionally heavy.

Turning to the evolution of banknotes in circulation and the other liabilities of the Bank of Greece, the Governor noted that the cover had been on a steady downward path, falling from 53.7% on 14.5.1928 to 45.36% on 15.11.1931. Excluding from the cover certain amounts temporarily handed over by the National Bank, or including time deposits in the Bank of Greece's liabilities, then the cover came to 37.07% or 32.17%, respectively, in both cases below the statutory minimum of 40%.

According to the Governor, the Bank's credit policy was constrained by the fact that half of its total assets was tied up in loans to the State, which were amortised at a very slow pace. The most liquid among the Bank's assets were the gold and foreign exchange components of the cover. Yet, the Bank refrained from an active management of such assets, in order to avoid inflationary effects. Therefore, the criticism voiced by certain banking, merchant and industrial circles was unreasonable. These circles, "addicted to inflation and the expansion … of credit … beyond the country's means, now rant over a stifling shortage of liquidity and have repeatedly attempted to drag the Bank into an inflationary policy …". Moreover, Tsouderos criticised commercial banks for having pursued expansionary lending policies in 1928-1931, thereby neglecting the liquidity of their assets and pushing consumption beyond the economy's productive capacity, which resulted in growing deficits on the balance of payments. The immobilisation of banks' funds in such assets impaired their ability to adapt to the new conditions created when the pound abandoned the gold standard, and the returns on these assets fell.

The situation after September 1931 was worrying, according to the Governor, because the country was in need of foreign exchange inflows, and prospects for their continuation were deteriorating. It was thus imperative to step up efforts to save foreign exchange. In this respect, the trade balance was projected by the Bank of Greece to remain in deficit, and capital flows were likely to turn out unfavourably, despite an expected drop in imports due to lower income, higher cost of money and foreign exchange controls, as Greek exports were set to decline too, as a result of the international crisis and the devaluation of the pound. Against this background, the

Bank of Greece, the State and the private sector all had to rise to the circumstances and repatriate assets held abroad. By this, the Governor probably meant commercial banks in particular, whose foreign exchange holdings would be valuable in dealing with the global crisis. One month later, new announcements on the cover ratio followed.[97] The cover of banknotes in circulation and other sight liabilities had fallen below the statutory minimum of 40% by 12.1.1932. The Bank of Greece therefore decided to raise the interest rates on its discount facility from 11% to 12%, on its collateralised lending (Lombard) facility from 12% to 13% and on discounts of farmer pledge certificates from 10% to 11%. In addition, it notified the government that the reduction of the cover ratio below the statutory minimum was due to the Bank's increased foreign exchange advances to the State for its needs. The Governor also asked the government to suspend Article 61 of the Statute of the Bank of Greece (which set the cover ratio at 40%) for a month, as well as to temporarily exempt the Bank from tax, an option available for similar cases, given its financial condition and the immobilisation of its assets related to State debt. Over time, the discount rate was lowered again, to 11% on 20.2.1932,[98] to 10% on 8.8.1932,[99] to 9% on 17.12.1932,[100] to 7.5% on 29.5.1933,[101] to 7% on 13.10.1933[102] and to 6% on 4.1.1937.[103]

Ultimately, taking into account the drop in the cover ratio below the 40% threshold, the government agreed to exempt the Bank of Greece until end-August of the same year from any amount of tax in excess of interest payable by the State on the advances it had obtained from the Bank of Greece.[104] Indeed, in the recitals of the ministerial decision issued to this effect and published in the Government Gazette on 19.3.1932, the government acknowledged the loss incurred by the Bank of Greece from the devaluation of the pound and that the shortfall of the cover ratio had not been caused by excess Bank of Greece credit growth that would have justified levying the tax in question.[105]

97 "Ratio of the cover. Increase in the discount rate", General Council minutes, Vol. 4, meeting of 12.1.1932, pp. 110-114.

98 "Reduction of the discount rate", General Council minutes, Vol. 4, meeting of 20.2.1932, p. 143.

99 "Reduction of the discount rate", General Council minutes, Vol. 4, meeting of 8.8.1932, p. 220.

100 "Reduction of the discount rate", General Council minutes, Vol. 4, meeting of 17.12.1932, p. 263.

101 "Reduction of the discount rate and of the interest rate on other operations", General Council minutes, Vol. 5, meeting of 29.5.1933, p. 68.

102 "Reduction of the discount rate and of the interest rate on other operations", General Council minutes, Vol. 5, meeting of 13.10.1933, p. 115.

103 "Reduction of the discount rate", General Council minutes, Vol. 8, meeting of 4.1.1937, p. 13.

104 "Exemption of the Bank from the tax of Article 63 of the Statute", General Council minutes, Vol. 4, meeting of 23.3.1932, p. 153.

105 "Exemption of the Bank from the tax of Article 63 of the Statute", General Council minutes, Vol. 4, meeting of 28.3.1932, pp. 157-158.

Moreover, following the consent of the Financial Committee of the League of Nations, as confirmed by the Governor in a telegram he sent from Paris, the General Council amended Articles 61 and 62 of the Statute. Specifically, the basis for the calculation of the cover ratio would exclude the Bank's sight liabilities in respect of its silver coin holdings up to an amount of 150 million drachmas but would include —in addition to gold and foreign currency convertible into gold— gold-backed Greek government bonds up to the amount of 650 million drachmas.[106]

The minutes of the General Council make only a brief and neutral reference to the effective abandonment of the gold-exchange standard by the drachma, under Law 5422 "Suspension of the obligation of the Bank of Greece to redeem its banknotes and regulation of foreign exchange purchases and sales".[107] Actually, the minutes only announce the relevant Law and the names of the banks that would be authorised to engage in purchases/sales of gold and foreign exchange, without any comment from the Governor.

The devaluation of the drachma gave rise to another issue, referring to the allocation of the resulting revaluation gains from the cover,[108] i.e. the difference between its valuation based on the earlier exchange rate of the drachma and its new exchange rate, respectively. The government claimed these foreign exchange valuation differences, as Law 5422 stipulated that any foreign reserves in excess of the banknote circulation cover "…shall henceforth be managed on behalf of the State…". This can be seen in a letter from Finance Minister K. Varvaressos to the Governor of the Bank of Greece (28.4.1932), also asking from the Bank of Greece a detailed list of the reserve assets remaining in its hands. The Governor replied that the gold and foreign exchange holdings of the Bank of Greece were only $2,349,290.46 as at 26.4.1932. This did not include the foreign exchange surrendered by commercial banks to the central bank (mandatory redeposits of foreign exchange deposits). The Governor agreed to the government taking the revaluation gains, but argued that these should be used to pay down government debt to the Bank of Greece and should be calculated based on the drachma exchange rate prevailing prior to pound devaluation. Both points were rejected by the government, as can be seen from the Minister's letter dated 23.5.1932,[109] arguing that the exchange rate to be applied should be that prevailing before the entry into force of Law 5422 rather than prior to

106 "Amendment to the Statute", General Council minutes, Vol. 4, meeting of 23.3.1932, pp. 153-154.

107 "Announcement of Law 5422", General Council minutes, Vol. 4, meeting of 27.4.1932, pp. 169-170.

108 "Allocation of revaluation gains from the cover", General Council minutes, Vol. 4, meeting of 19.5.1932, pp. 180-185.

109 "Allocation of revaluation gains from the cover", General Council minutes, Vol. 4, meeting of 17.6.1932, pp. 199-201.

the devaluation of the pound, as the losses suffered by the Bank of Greece from the devaluation were the Bank's business and unrelated to the fiat money regime introduced by Law 5422. The government also refused to use these gains towards debt amortisation, intending to use them instead for grain supplies, by Cabinet decision.

At the same time, as shown by the minutes of 19.5.1932, the Bank of Greece embarked on an effort to replenish its gold reserves by setting up a dedicated service with the task of purchasing gold objects to be melted and refined into pure gold.[110] The Governor referred to foreign exchange policy again in a letter he sent to Prime Minister Panagis Tsaldaris on 17.12.1932, [111] trying to convince him that the purchases/sales of foreign exchange on the informal market were justified by an overriding purpose. In the Governor's own words, the Bank of Greece "…was forced to deviate…" from the law and, in an effort to increase its reserves, had resorted to the informal foreign exchange market, using brokers and offering a rate slightly above its official exchange rate quotations. This unorthodox strategy, the Governor pointed out, had enabled the Bank to build up sizeable foreign exchange reserves, although it entailed a risk of the Bank falling victim to speculation on the part of brokers and the rumours spread regarding this practice of the Bank of Greece, which ultimately dampened foreign exchange supply on the informal market. The fact remained that State control over foreign exchange movements were deemed necessary to limit foreign exchange demand to lawful uses and to stringently combat speculation. The Bank of Greece recommended tighter foreign exchange controls and argued that the most effective way to achieve this was through the banking system.

On 27.9.1936, the General Council, in agreement with the government, decided to re-peg the drachma to the pound sterling, setting a fluctuation band of between 540 and 550 drachmas for the buy rate and adjusting the selling rate accordingly, while the exchange rates of the drachma vis-à-vis other currencies would be determined by reference to the respective bilateral rates of those currencies versus the pound sterling.[112]

In the General Council discussion of the balance sheet of 1936, the Governor referred to the stricter foreign exchange controls imposed by the Metaxas regime.[113] As a result of these measures, which were aimed at cracking down on speculation,

110 "Establishment of a gold purchases service", General Council minutes, Vol. 4, meeting of 19.5.1932, pp. 185-186.

111 "Foreign exchange policy", General Council minutes, Vol. 4, meeting of 17.12.1932, pp. 274-282.

112 "Adjustment of the drachma to the pound sterling", General Council minutes, Vol. 7, meeting of 27.9.1936, p. 243.

113 "Balance Sheet of 1936", General Council minutes, Vol. 8, meeting of 9.1.1937, pp. 14-24.

the foreign exchange deficit had narrowed after August 1936, while the widening of the trade deficit suggested that foreign exchange restrictions and controls should remain in place.

In the discussion of the balance sheet of 1937, the Governor made some new remarks on the foreign exchange situation,[114] noting that the growing deficit of the balance of payments had caused gold reserves to shrink in 1935 and 1936. In 1937, however, the balance of payments had performed more satisfactorily, and the cover had increased. This increase was even more remarkable considering that it had not resulted from a lower import bill —which actually rose, reflecting higher import prices— but rather to stronger foreign exchange inflows. The purchase by the Bank of Greece of foreign exchange stemming from migrants' remittances and shipping receipts were 44,385,393 gold francs in the first ten months of 1937, up from 5,270,000 gold francs one year earlier, suggesting that foreign exchange controls had worked. One year later, the Governor would announce that the Bank's reserves in gold and "free" foreign exchange (other than under the clearing agreements) had increased by another 2,374,903 gold French francs.[115]

The foreign exchange situation was disturbed in the following year, which coincided with the outbreak of the war in Europe.[116] Thus, although Greece managed to maintain a net inflow of free foreign exchange of 218,000 pounds sterling, both inflows and outflows fell relative to 1938. The outbreak of the war definitely affected the Greek balance of payments, at least in terms of aggregate figures and their composition.

In its meeting of 13 June 1940, the General Council decided to adjust exchange rate policy[117] in line with the decision of the British government on 9 June 1940 to suspend the convertibility of the pound. In this context, the Bank's pound-denominated reserves could only be used for payments to the UK and/or to countries within the Sterling Area, implying that the pound was now effectively treated similarly as the currencies that were subject to clearing agreements. The drachma was pegged to the US dollar, the only remaining freely exchangeable currency, at a parity of 150 drachmas per dollar. The other currencies, including the pound sterling, would retain their fixed exchange rates versus the drachma, but would exclusively be used as clearing currencies. Accordingly, a "Payments Agreement" between the Bank of

114 "Balance Sheet of 1937", General Council minutes, Vol. 8, meeting of 14.1.1938, pp. 262-280.

115 "Balance Sheet of 1938", General Council minutes, Vol. 9, meeting of 11.1.1939, pp. 176-192.

116 "Balance Sheet of 1939", General Council minutes, Vol. 10, meeting of 24.2.1940, pp. 37-45.

117 "Adjustment of the drachma to the dollar", General Council minutes, Vol. 10, meeting of 13.6.1940, pp. 72-73.

Greece and the Bank of England[118] stipulated that the sterling reserves held by the Bank of Greece with the Bank of England, as well as any further amounts to be acquired from transactions with the sterling area, would be pooled in a dedicated "Special Account" and would be used for payments within this area. All the other Greek banks could open similar accounts for their transactions within the sterling area. Respectively, payments to Greece by sterling area countries —including shipping receipts— would be carried out only through this "Special Account", and the balances of this account could not be used for payments outside the sterling area. Moreover, it was agreed that the value in gold of the reserves included in the "Special Account" would remain unchanged, even if the sterling/gold parity were to change in the future, implying that the value of the sterling reserves would increase commensurately with a potential depreciation of the pound sterling. However, any accounts held by Greek citizens in the UK were not protected against depreciation of the sterling, unless they became subject to the abovementioned "Special Accounts" regime.

Greece's entry into the war does not seem to have had a negative impact on its foreign exchange reserves. As pointed out in the discussion of the balance sheet of 1940,[119] despite the higher import needs and costs as a result of higher freight rates and insurance premia, the country's foreign exchange reserves had actually increased, even without taking British war credit into account.

The chapter in the Bank's foreign exchange policy that had opened with its inception in 1928 would effectively close in April 1941, when the Bank undertook to rescue the gold reserve and transport it abroad, out of the reach of the occupation forces. Governor G. Mantzavinos, in his Report on the balance sheets of the years 1941, 1944, 1945 and 1946,[120] mentioned that the gold reserve (610,796.431 ounces) was first transported to Heraklion, Crete. Then, on board HMS Dido it was brought to Alexandria, Egypt, then via an English cargo ship to Durban, South Africa, to end up in Pretoria by railway. The Administration of the Bank of Greece itself accompanied the gold reserve all along its journey to South Africa, staying for two months in Johannesburg and then Cape Town, before finally moving to London, where the Bank's headquarters were relocated on 22.9.1941.

The policy of the Bank of Greece that best reflects the three periods mentioned in the introduction to this chapter was its foreign exchange policy. And, of course,

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118 "Approval of an agreement between the Bank of Greece and the Bank of England. Transactions with England and the countries of the sterling area", General Council minutes, Vol. 10, meeting of 2.10.1940, pp. 90-91.

119 "Balance Sheet of 1940", General Council minutes, Vol. 10, meeting of 6.2.1941, pp. 131-144.

120 Bank of Greece, Annual Report on the balance sheets of the years 1941, 1944, 1945 and 1946, pp. 11-13.

the history of its foreign exchange policy is the history of the cover. The rapid depletion of the cover marks a watershed between two subperiods, before and after the devaluation of the pound. In effect, the fall in the cover below the statutory minimum of 40% already since January 1932 foreshadowed the drachma's subsequent abandonment of the gold-exchange standard and its devaluation. However, it is important to note that the new conditions did not affect the Bank of Greece's firm commitment to a balanced and internationally oriented foreign exchange policy, as can be seen in its efforts to replenish the gold reserves it had lost, coupled with the use of foreign exchange controls to maintain adequate foreign exchange reserves, as well as in the re-pegging of the drachma to the pound in 1936 and for as long as the latter remained a freely exchangeable currency, i.e. until 1940. Meanwhile, although inflation showed fluctuations, prices on average fell over the three-year period 1930-1933 and remained at relatively low levels compared to the 1920s. One could therefore conclude that the policy of the Bank of Greece had a favourable effect on the level of prices, considering the circumstances of the economy in that period.

1.5 The international relations of the Bank of Greece: League of Nations and Bank for International Settlements

From its inception to the outbreak of World War II, the Bank of Greece maintained a close link to the Financial Committee of the League of Nations through the presence and involvement in its operations of a foreign expert, Horace C. F. Finlayson, up to 1937. The relevant agreement between Governor Alexandros Diomidis and Finlayson, Adviser to the Bank, was signed on 14.5.1928 and submitted to the General Council of 26.5.1928 for approval, accompanied by the correspondence between the two men.[121] As envisaged in this documentation, Finlayson served as a liaison between the Financial Committee of the League of Nations and the Administration of the Bank of Greece. The agreement provided for close cooperation between Finlayson and the Bank's Governor and Deputy Governor and required the personnel to provide any assistance necessary for the fulfilment of his tasks. Finlayson was authorised to attend the meetings of the General Council in his capacity as Adviser of the Bank of Greece on behalf of the Financial Committee of the League of Nations. Finally, based on the terms set out in a letter from Tsouderos to the

121 "Approval of the agreement with Adviser H. C. F. Finlayson", General Council minutes, Vol. 1, meeting of 26.5.1928, pp. 47-51. It is surprising that Finlayson's actions and views have not as yet become the subject of a dedicated monograph. He was born in Aberdeen in 1885 and died in 1969. He was Professor of Politics and Public Administration at the Chinese Imperial University, Peking, since 1910, and after the end of his assignment in Greece he worked at the Intelligence Branch of the British War Ministry from 1939 to 1945.

Financial Committee dated 15 June 1927, Finlayson was expected to accompany the Bank's delegates in their visits to Geneva for discussions with the Financial Committee. Apparently, the only commitment undertaken by the appointed foreign Adviser, according to a "Statement" he signed, was to perform his duties in the best interests of the Bank of Greece and to observe confidentiality with respect to the Bank's dealings with its customers. However, as these duties were not clearly defined, the exact scope of Finlayson's work as technical adviser remained vague. His compensation was determined by the budget for 1928[122] at 613,500 drachmas annually, compared with 487,500 drachmas for the Governor and Deputy Governor combined. This was only partly reversed in the following years. In 1931, Finlayson's salary was set at 937,500 drachmas, compared with 1,579,920 drachmas for the Governor and Deputy Governor combined.[123] However, by a decision made on 4.12.1931, i.e. after the outbreak of the banking crisis, the General Council refused to pay Finlayson's salary in gold sovereigns or dollars instead of pounds sterling, as had been agreed before the devaluation of the pound, invoking the Bank's losses as a result of such devaluation, although at the same time it recognised the fruitful cooperation between the Bank and the Adviser.[124] It should be noted that this was a time when the Bank of Greece was making efforts to cut costs, including the representation costs of the Managers and Deputy Managers of its branches, and even introduced a cash reward for any employee who submitted a practicable proposal for improving the cost efficiency of operations.[125] In 1932, the foreign Adviser's salary was lower than in the previous year, i.e. 750,000 drachmas, while the sum of the salaries of the Governor and Deputy Governor remained unchanged at 1,579,920 drachmas.[126]

The presence of a foreign expert also established a more permanent contact between the Bank and the international community, as can be seen in the Bank's proposal to the Financial Committee of the League of Nations to extend Finlayson's term of office, ending in May 1931, for another two years.[127] His term of office was

122 "Budget of management expenses for the year 1928", General Council minutes, Vol. 1, meeting of 12.11.1928, pp. 273-276.

123 "Budget of management expenses for the year 1929", General Council minutes, Vol. 2, meeting of 24.4.1929, pp. 94-98, and "Budget of management expenses for the year 1931", General Council minutes, Vol. 3, meeting of 6.3.1931, pp. 230-233.

124 "Technical Adviser H.C.F. Finlayson", General Council minutes, Vol. 4, meeting of 4.12.1931, pp. 60-61.

125 "Cost-saving Committee. Decisions on its proposals", General Council minutes, Vol. 4, meeting of 4.12.1931, pp. 61-62.

126 "Budget of management expenses for the year 1932", General Council minutes, Vol. 4, meeting of 29.1.1932, pp. 120-123.

127 "Extension of the term of office of the Technical Adviser, Mr. Finlayson, for two years", General Council minutes, Vol. 3, meeting of 22.1.1931, pp. 219-221.

renewed on 08.3.1933 for another year, until 14.5.1934,[128] with the possibility of an early unilateral termination on his part, should he be offered a more advantageous position elsewhere.[129] New extensions for one year each, ending on 14.5.1935, 14.5.1936 and 14.5.1937, respectively, were approved by the General Council decisions of 17.4.1934,[130] 29.3.1935[131] and 18.5.1936.[132] It is characteristic that the Adviser's monthly earnings on these last occasions of successive annual extensions remained unchanged at 2,500 pounds, plus 6,000 drachmas per month as travel allowance. Still, it is interesting that on 12.8.1936 the Governor needed to argue for an extension of Finlayson's term of office, stressing that this was the "…opinion and wish of the Government, expressed orally…". The Government's consent was confirmed in writing, by a document dated 25 June 1936 and signed by Finance Minister G. Mantzavinos.[133]

As can be deduced,[134] the newly established Metaxas regime was eager to tighten the government's grip on the central bank, in order to better control the state apparatus. It therefore proposed or rather imposed the establishment of the position of a second Deputy Governor, entrusted to G. Mantzavinos. The overall feeling was that the Bank of Greece's relationship with the Financial Committee of the League of Nations increasingly weakened as the international crisis deepened. In May of the following year (1937), Finlayson's term of office ended for good.[135]

It should be noted that the close links of the Financial Committee with the Greek economy had started as early as 1923, when the League of Nations received Greece's request for assistance in rehabilitating the refugees. Since then, the minutes of the Financial Committee of the League of Nations constantly referred to the refugees in Greece and the progress made in addressing their problems (see League of Nations:

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128 "Extension of the term of office of the Technical Adviser, Mr. Finlayson", General Council minutes, Vol. 5, meeting of 8.3.1933, p. 33.

129 "Extension of the term of office of the Technical Adviser, Mr. Finlayson", General Council minutes, Vol. 5, meeting of 30.3.1933, pp. 46-47.

130 "Extension of the term of office of the Technical Adviser, Mr. Finlayson", General Council minutes, Vol. 5, meeting of 17.4.1934, p. 223.

131 "Extension of the term of office of the Technical Adviser, Mr. Finlayson", General Council minutes, Vol. 6, meeting of 29.3.1935, p. 154.

132 "Extension of the term of office of the Technical Adviser, Mr. Finlayson", General Council minutes, Vol. 7, meeting of 18.5.1936, p. 138.

133 "Term of office of the Technical Adviser of the Bank, Mr. H. Finlayson", General Council minutes, Vol. 7, meeting of 12.8.1936, p. 199.

134 "Proposal to the government for an amendment to the Statute. Appointment of a Second Deputy Governor", General Council minutes, Vol. 7, meeting of 14.8.1936, p. 211.

135 "Expiry of the term of office of the Technical Adviser, Mr. H. Finlayson", General Council minutes, Vol. 8, meeting of 10.5.1937, p. 98.

21.6.1923, 2.9.1925, 3.12.1925, 10.6.1926, 2.12.1926, 9.12.1926 and 2.3.1927). On 8.6.1927, reference was made for the first time to the need for a comprehensive solution to the problem of the Greek budget (in view of Greece's high indebtedness) and to the need to stabilise the currency. A letter from Kafantaris followed (as mentioned earlier), and by 1.9.1927 the lending scheme had already been drawn up, along with the agreements to be signed between the Greek government and the League of Nations and between the Greek government and the National Bank. This was the background of the close relationship of the Bank of Greece with the Financial Committee and the role the former assumed after 1928 as an interlocutor of the international community in the consultations and contacts with Greece.

In this context, the Financial Committee continued to closely monitor the financial position of the Bank of Greece (see League of Nations, 30.5.1928, 30.8.1929, 20.1.1930, 8.5.1930, 4.9.1930, 15.1.1931 (noting that the financial statement of the Bank of Greece was satisfactory), 14.9.1931 (when the Financial Committee decided to set up a group of experts to study the phenomenon of depression and 28.1.1931 (noting the Bank's request for an on-site enquiry into the country's financial situation by the League of Nations, p. 6).

On 3.3.1932, the Financial Committee, unable to satisfy Greece's request for a new loan, agreed to a twelve-month suspension of payments on the country's public debt to international organisations such as the League of Nations and the International Financial Commission (IFC), in order to facilitate Greece's recovery. Greece would in exchange commit to honour its other contractual obligations (pp. 14-15). When the Financial Committee met again on 27.7.1932, it criticised Greece's unilateral actions and noted the protests of bondholders voiced by the British delegate, adding that it regarded Greek actions as "gravely prejudicial to Greece's credit" (p. 3).

The cooling of relationships between Greece and the League of Nations, as the tap turned off on international loans to sustain convertibility in Greece, did not put an end to the bilateral dialogue. On 9.1.1933, the Financial Committee expressed its "gravest apprehensions" regarding the financial and monetary situation in Greece (p. 7). On 24.4.1933, the People's Party asked for a new on-site enquiry into the Greek economy, which was swiftly completed and recorded in the minutes of the League of Nations on 6.6.1933. The resulting report, in more than 48 pages, rather long by the Financial Committee's standards, exhaustively examined all the aggregates of the economy, with detailed statistical tables, and recommended: (a) greater reliance of the government on domestic savings rather than on foreign loans; (b) cuts in public spending; (c) a balancing of the budget; and (d) prudent completion of public works, to be exclusively financed by tax revenues. These recommendations, in other words, reiterated past disinflationary prescriptions, which were now even harder to implement in the prevailing conditions. On 18.9.1933, the Financial Committee turned its focus on a resumption of payments to bondholders, and on 7.5.1934 it noted an improvement in the financial situation of Greece.

The close links of the Bank of Greece with the League of Nations are also evidenced by the travels of its senior officials, as recorded in the minutes of the General Council. Starting from 1929, the Governor regularly visited the headquarters of the League of Nations for exchanges of views and information.[136] On 5.12.1931, the new Governor, Emmanuel Tsouderos, embarked on a tour of the major financial centres of the time, namely London, Paris and Basel (location of the Bank for International Settlements), for a series of contacts with other central bankers and leading economists to discuss the turbulent international economic situation.[137]

In turn, in January 1932 the Bank of Greece welcomed Sir Otto Niemeyer, a delegate of the Financial Committee who came to study the impact of the economic crisis on Greece and recommend actions to address it.[138] The conclusions of his report were discussed extensively by the General Council.[139] As mentioned earlier, the Financial Committee agreed to a suspension of payments on government debt to the Bank of Greece and the National Bank for one year, on condition that part of the debt would be repaid from the State's participation in the profits of the Bank of Greece and that the Statute of the Bank of Greece would be amended, including an increase in the proportion of the cover. However, the Financial Committee also recalled the importance of the Geneva Protocol of 1927 with regard to maintaining the Bank of Greece as a separate central bank. This was meant as an answer to those economic and political circles in Greece which favoured a merger between the Bank of Greece and the National Bank. Such a move, continued the Financial Committee's report, would not only infringe the Protocol, but would also hold back the Greek banking system, which needed an impartial and reputable central bank. The report included two very important points concerning the Bank of Greece. First, it recommended that the Greek authorities should not change the status of the Bank of Greece as laid down in the Geneva Protocol and its Statute. Second, it commended the Bank's policy regarding foreign exchange and banknote circulation, given that,

136 "Departure of Governor A. Diomidis for Paris", General Council minutes, Vol. 2, meeting of 29.5.1929, p. 136.

137 "Departure of the Governor", General Council minutes, Vol. 4, meeting of 4.12.1931, p. 63.

138 "Visit of Mr. Niemeyer to Greece", General Council minutes, Vol. 4, meeting of 29.1.1932, p. 123.

139 "Mission of the Governor to the Financial Committee of the League of Nations", General Council minutes, Vol. 4, meeting of 30.3.1932, pp. 159-161.

despite the reduction of the discount rate, no excess money supply had emerged, therefore the internal value of the drachma and the stability of the exchange rate had been preserved. Both these points are important weapons against the criticism that the Bank of Greece was facing in the country, as much for its policy as for the very reason of its existence, especially during the time of the suspension of stabilisation efforts.

The issue of the Bank's continued existence as a separate issuing institution or merger with the National Bank was discussed again by the General Council on account of a letter from the Bank for International Settlements (BIS), dated 12.12.1932.[140] Having heard of a statement by Dimitrios Maximos at the Hellenic Parliament, as reproduced in the European press, in favour of a merger between the two banks, the BIS requested the Bank of Greece to confirm these rumours, suggesting that such a move would challenge the new institution's status as a central bank, hence its eligibility as a BIS shareholder, or even partner. In his response, the Governor stated that the government was indeed contemplating the merger of certain commercial banks and a closer cooperation between the Bank of Greece and the National Bank, but without questioning the autonomy of the issuing institution, although no final decision had been made thus far.

On 31.5.1933, Governor Tsouderos travelled to London to attend the International Economic Conference and negotiate the country's external debt.[141] Upon his return, the Governor briefed the other General Council members on the outcome of his visit.[142] Also, on 24.2.1934 the General Council was informed of a decision by the Executive Board of 20.2.1934 regarding a planned visit of E. Tsouderos to Switzerland, England and France for talks with the BIS, the Bank of England and the Banque de France on monetary and other matters.[143] Travels abroad continued: the Bank of Greece was represented at the Annual General Meeting of the BIS on 14.5.1934 by technical adviser H.C.F. Finlayson and economic expert G. Charitakis; this followed Finlayson's visit to Geneva, to represent the Bank of Greece at the Financial Committee meeting.[144] In addition, the General Council approved on

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140 "Merger of banks", General Council minutes, Vol. 4, meeting of 29.12.1932, pp. 286-287.

141 "Calculation of the remuneration and other travel expenses of the Governor and of those accompanying him to the Economic Conference in London", General Council minutes, Vol. 5, meeting of 8.5.1933, p. 66.

142 "Decisions of the Financial Committee of the League of Nations", General Council minutes, Vol. 5, meeting of 10.7.1933, p. 85.

143 "Departure of Governor E. Tsouderos for Europe", General Council minutes, Vol. 5, meeting of 24.2.1934, p. 204.

144 "Departure of Economics Adviser G. Charitakis and Technical Adviser H. Finlayson in order to represent the Bank, and calculation of their travel expenses", General Council minutes, Vol. 5, meeting of 7.5.1934, p. 230.

23.10.1934 a travel of the Governor to Basel in order to participate in the meeting of the Annual General Meeting of the BIS.[145] A little later, on 1.12.1934, the General Council was briefed by the Governor of the outcome of his travel to Vienna, Basel and Paris. In Basel in particular, Tsouderos had met with the central bank governors of the UK, France, Germany, Italy, Belgium and the Netherlands, and the President of the BIS. The view prevailing in Europe at the time was that the crisis would continue for another two to three years. Central bankers did not expect that the US would devalue the dollar further, but there were risks to the economic outlook and the US dollar, associated with a surge in unemployment, credit inflation and political developments. On the positive side, however, the countries on the gold standard appeared well-anchored to that regime, implying that the monetary situation was likely to remain stable, save in case of political upsets.

Another aspect of the Bank's international bonds emerges from its positive response to a letter dated 17.5.1930 from the President of the newly-established BIS, inviting the Bank of Greece to participate in the BIS's capital.[146] The invitation is evidence of the repute that the Bank of Greece enjoyed abroad. Indeed, as stated in the BIS letter, eligible to participate in its capital were only central banks interested in the settlement of the debts and reparations from the Great War, or having a currency of satisfactory value based on the principles of the gold standard or the gold-exchange standard. Therefore, both the Greek economy, which followed the gold-exchange standard, and the Bank of Greece, which supported it with its policy, were in line with the accepted principles of the time, which, it should be recalled, was the period after the 1929 New York Stock Exchange crash but before the devaluation of the pound and the banking crisis of 1931.

With the incipient signs of the banking crisis in Europe, the Bank of Greece stood ready to assist foreign central banks in distress. Thus, in the General Council meeting of 22.6.1931 it was decided to join other central banks and the BIS in providing financial support to the Oesterreichische Nationalbank (National Bank of Austria).[147] In fact, the Bank's willingness to contribute to a second loan to that central bank indicated not only its wish to take part in an effort spearheaded by the BIS, but also the confidence of its Administration in the soundness of monetary management in Greece, as well as to its optimism that the country and its banking

145 "Invitation by the Bank for International Settlements", General Council minutes, Vol. 6, meeting of 23.10.1934, p. 29.

146 "Participation in the capital of the Bank for International Settlements", General Council minutes, Vol. 3, meeting of 26.5.1930, pp. 119-120, and Meeting of 23.6.1930, p. 130.

147 "Participation in the Financial Support to the National Bank of Austria", General Council minutes, Vol. 3, meeting of 22.6.1931, pp. 288-290.

system were able to overcome the crisis, which seemed to increasingly spread across Europe.

It is indicative that on 12.1.1932, the same day when the dramatic announcements about the fall of the cover ratio below the statutory minimum took place, the Governor had to propose to the General Council the renewal of the credit lines granted to the central banks of Austria and Hungary.[148] It seems that the Bank of Greece was initially reluctant to agree on this renewal, due also to the circumstances it faced on the domestic front, but finally agreed after repeated pressures by the BIS and after the latter refused to mediate for the full repayment of the loans by the two borrower central banks. On the part of the Bank of Greece, this was an act of international banking solidarity, which raised its international profile.

In addition, on 16 November 1933, the General Council endorsed a decision of the Executive Board of 6 November 1933 to freeze for three years, until 18.10.1936, the repayment of credit in gold dollars extended by the Bank of Greece to the National Bank of Hungary, on the grounds that repayment was impossible, due to the adverse economic conditions in Hungary.[149] The debt of the National Bank of Hungary was finally settled in August 1940.[150] This bank had already paid 5% of its debt in three instalments between 1937 and 1939, and before paying the instalment for 1940, asked for a new settlement, proposing, among other things the conversion of the outstanding amount from gold dollars into Federal Reserve note fiat currency and repayment by end-1940. This proposal was accepted by the Bank of Greece.

Right from the start, the policy of the Bank of Greece had a strong international dimension. This is confirmed not only by its close relationship with the Financial Committee of the League of Nations during the first years of its life, but also by its eagerness to be part of international banking and economic developments through numerous initiatives, such as its participation in the capital and interventions of the BIS, support to foreign central banks and the frequent visits of its senior officials to international economic centres for face-to-face contacts and to gain first-hand knowledge of the changing international environment. In addition, among the benefits of the Bank's international relations, one should certainly include the support that the Bank consistently received from international organisations whenever its role or its autonomous existence as a central bank in Greece were challenged.

148 "Renewal of credit to the National Banks of Austria and Hungary", General Council minutes, Vol. 4, meeting of 12.1.1932, pp. 115-116.

149 "Freezing of our loan of 87,647.42 gold dollars to the National Bank of Hungary for a three-year period", General Council minutes, Vol. 5, meeting of 16.11.1933, p. 130.

150 "Settlement of the outstanding debt of the National Bank of Hungary in gold dollars", General Council minutes, Vol. 10, meeting of 14.8.1940, pp. 79-80.

In the long run, such support may have been the most important positive consequence of the Bank's international activity.

1.6 The Bank of Greece and the clearing agreements

The 1930s ushered in a new chapter of economic policymaking, i.e. protectionism. After the United States put up tariff walls, all countries followed suit. In an environment of foreign exchange controls, any means to facilitate trade was welcome. This is how bilateral clearing agreements emerged. Given that they ultimately involved the transfer of foreign exchange, the Bank of Greece undertook to oversee the process on the Greek side.

A characteristic clearing agreement was concluded with the government and the central bank of Yugoslavia. Under this agreement, for 35% of the value of imported Yugoslav products, the price would be paid in drachmas to the Bank of Greece. The Bank would in turn issue to the Yugoslav exporter transferable bonds payable on demand (bons de caisse), which would be exclusively used to pay for the value of Greek exports to Yugoslavia.[151] The same General Council minutes stated that the Governor informed the General Council that similar clearing agreements had also been signed by other countries, such as Austria, France, Germany, Sweden and Czechoslovakia.

In September 1933, the General Council approved the payment of a monthly salary to the trade attaché at the Embassy of Greece in Belgrade, on the grounds that he would undertake not only to promote Greek exports to Yugoslavia, but also to monitor the clearing trade with that country.[152] Moreover, on 17.4.1934 it approved the travel expenses of two Bank of Greece officials, Director Giannakopoulos and Head of Section Dimopoulos, who would go to Bucharest and Berlin, respectively, in order to negotiate matters relating to the Greek-Romanian and the Greek-German clearing agreements.[153] An announcement on 30 June 1934 informed of the positive outcomes of the trip of Deputy Governor Varvaressos to Germany in relation to the Greek-German clearing agreement.[154] Specifically, the Bank of Greece had obtained

151 "Clearing agreements with various countries", General Council minutes, Vol. 4, meeting of 3.9.1932, pp. 230-231.

152 "Contribution of the Bank for the development of the Greek-Yugoslav trade", General Council minutes, Vol. 5, meeting of 18.9.1933, p. 108.

153 "Calculation of travel expenses for Director Giannakopoulos and Head of Section A. Dimopoulos", General Council minutes, Vol. 5, meeting of 17.4.1934, p. 225.

154 "Receivables of the Bank from the Greek-German Clearing", General Council minutes, Vol. 5, meeting of 30.6.1934, p. 271.

the consent of the Reichsbank for the conversion of 4 million Reichmarks into drachmas, at a parity of 40 drachmas per RM, while negotiations were also underway for the allocation of 5 million marks to offset debts of the Greek Telephone Company and of 900 thousand marks for the procurement of railway rolling stock. The importance of the Greek-German clearing is also testified by the Deputy Governor's new trip to Germany on 29.3.1935.[155] The outcome of this visit[156] was encouraging as regards both the implementation of the previous agreement concerning the transfer of 4 million marks into a guaranteed account in drachmas, as well as the lifting of various impediments that made the import of some Greek products in Germany particularly difficult, hampering the operation of the clearing agreement. In the context of the Greek-German clearing agreement, the Railways of the Greek State were financed with an amount of up to 150 million drachmas, at a rate of 4%, for the supply of equipment and materials from Germany.[157]

The Greek-German clearing agreement drew attention once again in February 1936.[158] By then, clearing trade with Germany had left a net balance of 32 million marks in favour of Greece. However, as the Bank of Greece paid to Greek exporters the value of their commodities in drachmas, it had a claim on this amount of marks. And this balance kept growing and could not possibly be offset against the value of imports from Germany. On the other hand, the practice followed by the Bank of Greece, consisting in "[…] the unconditional purchase of the marks representing the value of the products exported to Germany", which had led to an "[…] excessive […] increase […] of the credit balance on its mark account, exceeding RM 32,000,000 already – and the fact that this account mirrored the drachmas issued by the Bank of Greece to pay out the exporters" imposed on the Bank of Greece "[…] the obligation to also formally hedge this account…". Apparently, by paying drachmas to the exporters without having the corresponding marks in its vaults (which were blocked at the Reichsbank), the Bank of Greece effectively granted interest-free credit to exporters, without any guarantee that its clearing claims would be satisfied. Instead, the common international practice would involve extending credit to exporters in the relevant foreign currency (in this case, marks), to be settled in the domestic currency (in this case, drachmas) after equal imports of German products.

155 "Travel of the Deputy Governor to Germany", General Council minutes, Vol. 6, meeting of 29.3.1935, p. 153.

156 "Travel of the Deputy Governor", General Council minutes, Vol. 6, meeting of 10.4.1935, pp. 168-169.

157 "Financing to the Railways of the Greek State", General Council minutes, Vol. 7, meeting of 21.12.1935, p. 41.

158 "German Clearing", General Council minutes, Vol. 7, meeting of 21.2.1936, p. 92.

As a way out of this impasse, the Bank of Greece proposed a set of actions: (a) the State would purchase the amount of marks in question (up to 15 million), which would be settled against imports of military supplies from Germany; (b) from then on, the Bank of Greece would be authorised to purchase on behalf of the central government the marks corresponding to the value of the products exported to Germany beyond the existing balance of 32 million marks; and (c) the amount of marks remaining after subtraction of the 15 million would be settled through imports from Germany. The minutes of the Supreme Command of Economic Defence, on 22.2.1936, reported suspicions that Germany's mass imports of Greek products were intended for resale to Italy, while the rising prices of Greek products made them unattractive to other countries which had to pay for them in free foreign exchange. This implied that Germany had practically a monopsony on Greek exports, hence the high credit balance of the Bank of Greece with the Reichsbank. As the government failed to arrive at any decision on the proposals, the Bank of Greece decided to stop purchasing marks and took the following steps: (a) it would no longer pay to the exporters the value of their commodities in drachmas, but would instead credit them with the respective value in marks; (b) against this amount, which would serve as collateral, it would grant them an interest-free loan in drachmas for up to 60% of the invoice in marks. By so doing, the Bank of Greece believed that it had done its part and it was now the turn of the State to settle the matter that had arisen.

Indeed, the minutes of 3.3.1936[159] refer to an announcement by the Deputy Governor, according to which, after the Bank took these steps, the council of political leaders had convened to discuss the German clearing situation. This council recognised the difficult position in which the Bank had been put and the fact that it took all the risk, but decided to suspend the recent steps of the Bank of Greece and reinstate the previous system (advance in drachmas to the exporters for the value of their exports to Germany). However, it also specified that the marks would be purchased on behalf and at the risk of the State rather than of the Bank of Greece. Also, the State would purchase 22 million marks out of the Bank's credit balance in Germany for the procurement of military equipment. To this end, the State would obtain a 15-year loan from the Bank of Greece, at an interest rate of 3% per annum.

The negotiations regarding the German clearing were probably the context for a visit from Reichsbank Governor H. Schacht to Athens between 13-17 June 1936, requesting a meeting with the Bank's Administration.[160] In turn, the minutes of 26

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159 "German Clearing", General Council minutes, Vol. 7, meeting of 3.3.1936, p. 109.

160 "Travel of the Governor of Reichsbank, Dr. Hjalmar Schacht, to Athens", General Council minutes, Vol. 7, meeting of 12.6.1936, p. 160.

June 1936 mention an upcoming visit of a delegation of Greek government officials to Germany to discuss the procurement of military equipment and supplies.[161] The delegation was accompanied by the Head of the Foreign Exchange Control Section, Dimopoulos, who would expect Deputy Governor Varvaressos to join him in Germany for talks on the clearing. In this connection, on 23.12.1936 Governor Tsouderos informed the General Council of the outcome of his tour in Europe.[162] Regarding the talks he had had in London, Paris and Basel, his conclusion was that monetary instability would persist for long. However, the point of focus —judging from the greater detail in the minutes— was the matter of the prolongation of the trip as negotiations in Germany on a loan to the Greek State for completing its armament programme took 20 full days. The loan, amounting to 30 million marks, was finally granted by the Golddiskontbank in the form of discounts on Greek Treasury bills, with which Greece would pay the German suppliers. The agreement was deemed to be advantageous from the Bank's perspective, not least because the servicing cost of these state procurements would not encumber the Bank of Greece and its monetary policy. Visits to Germany in connection to the clearing agreement between the two countries continued in the next few years, as seen from references in the General Council minutes to a travel by Head of Section Dimopoulos in May 1938[163] and Deputy Governor Varvaressos in the summer of the same year.[164]

This attachment of Greece to the interests of the Axis did not go unnoticed by Great Britain. The Governor visited London in the summer of 1938, where he was surprised by the cordial reception of the local political and economic circles. His impression from the contacts he had there was that "…it will not be long before British trade policy shifts in favour of Greece".[165] To understand his enthusiasm at the news, one should consider Greece's effort to diversify its external trade, as well as the promise carried by the possibility of closer trade relations with Great Britain, which was the home country of the foreign holders of Greek government bonds. Governor Varvaressos returned satisfied from another trip to London in early 1940.[166]

161 "Travel of the Head of Section Dimopoulos to Germany", General Council minutes, Vol. 7, meeting of 26.6.1936, p. 179.

162 "Travel of the Governor to Europe", General Council minutes, Vol. 7, meeting of 23.12.1936, pp. 296-297.

163 "Travel of Head of Section A. Dimopoulos to Germany", General Council minutes, Vol. 9, meeting of 5.5.1938, p. 35.

164 "Travel of Deputy Governor K. Varvaressos to Germany", General Council minutes, Vol. 9, meeting of 12.7.1938, p. 72.

165 "Travel of the Governor to London", General Council minutes, Vol. 9, meeting of 12.7.1938, p. 56.

166 "Travel of the Governor to London", General Council minutes, Vol. 10, meeting of 24.2.1940, pp. 36-37.

Negotiations had been "…conducted in a most friendly atmosphere and a spirit of mutual understanding, and he [the Governor] thinks that the achieved public debt settlement is a very happy development".

The importance of Germany as Greece's trading partner is also confirmed by the General Council minutes of 12.11.1937, mentioning that the Governor proposed that the Bank pay a monthly remuneration to the trade attaché at the Greek Embassy in Berlin,[167] on the grounds of the special significance of Germany for the Greek economy, given the size of trade between the two countries, and of the importance attached by the Bank of Greece to monitoring the Greek-German clearing.

In December 1936, the Bank of Greece hosted the central bank governors of the Balkan Pact countries,[168] who met up in Athens to jointly review the international economic and monetary situation and discuss matters regarding their cooperation.[169] In this context, on 22.11.1937[170] the Governor went to Ankara for the second meeting of Balkan Pact governors.

The problems associated with the clearing agreements were highlighted in the discussion of 23.6.1937, concerning the Greek-French clearing trade.[171] This was based on the principle that payment to French exporters would be subject to an inflow of an equal amount of foreign exchange to Greece as a result of Greek exports to France. But as Greece's trade balance with France was deeply in the red, the above principle was holding back imports from France. Thus, some Greek banks, in order to better serve their customers, paid in advance French exporters in francs, expecting to recover the relevant amounts in the future through the clearing process. But the persistent trade deficit was a drag on Greek importers, who, although they had paid for their imports in drachmas, were charged with interest and commission fees for the francs already paid by their bank. To relieve importers from such costs, the Bank of Greece proposed to pay to the banks interest-free the drachma equivalent of the francs they had paid, so that banks would keep the amount of francs to arise from the clearing process and refund the drachmas to the Bank of Greece.

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167 "Determination of remuneration payable by the Bank to the Trade Attaché at the Greek Embassy in Berlin", General Council minutes, Vol. 8, meeting of 12.11.1937, p. 206. It should be noted that the German market was the key destination of Greek tobacco products, absorbing a large share of domestic output and playing a pivotal role in their marketing.

168 Yugoslavia, Romania, Turkey and Greece.

169 "Conference of central bank governors of Balkan Pact countries. Hospitality costs", General Council minutes, Vol. 7, meeting of 23.12.1936, pp. 292-293.

170 "Travel of the Governor to Ankara", General Council minutes, Vol. 8, meeting of 12.11.1937, pp. 208-209.

171 "Greek-French Clearing", General Council minutes, Vol. 8, meeting of 23.6.1937, pp. 106-107.

A similar problem, but in the opposite direction, was mentioned in the minutes of 18.4.1938 with respect to the Greek-Italian clearing.[172] In more detail, as the trade with Italy showed a positive balance of 18 million Italian liras in favour of Greece, payment to Greek exporters was delayed until the creation of an equivalent debit balance through imports from Italy. Thus, the General Council approved a proposal according to which the Bank of Greece would pay in advance to the exporters 60% of their receivables, charging a rate 1% higher than the discount rate, in exchange taking over their total claim in Italian liras.

Clearing agreements were a major chapter in the international and foreign exchange policy of the Bank of Greece after the suspension of the stabilisation effort. Apart from the distortions they caused in pricing and the distribution of trade across countries, what is particularly interesting is how the Bank of Greece managed to strike a balance between having foreign exchange holdings tied up abroad and paying domestic exporters, as in the case of the Greek-German clearing, or between advance foreign exchange payments to foreign exporters in anticipation of a clearing of the remainder from the positive balance of Greek exports, as in the case of the Greek-French clearing. The way the Bank handled these matters reveals its flexibility in responding to the challenges posed by the prevailing regime of trade arrangements of the era, a flexibility that the Bank had to accept in order to facilitate domestic business activity and Greek exporters and importers. This handling also helped Greece to prepare for the imminent war, securing resources for the Greek State that otherwise would simply not have existed.

1.7 Financial stability in practice

As part of its efforts to modernise the Greek financial system, the Bank of Greece also decided to set up a Clearing Office.[173] The agreement establishing the Athens Clearing Office was signed on 5.12.1928 between the Bank of Greece and the six larger Greek banks of the time: the National Bank, the Bank of Athens, the Ionian Bank, the Popular Bank, the Commercial Bank, and the Banque d'Orient. The Clearing Office would be seen as a crucial institution that would reduce cash transfers in interbank transactions. This, along with the fact that the Bank, as manager of the Athens Clearing Office, operated the accounts held by the clearing banks, suggests that the importance of the Clearing Office was much greater and associated both with the goal of controlling bank liquidity and consolidating the Bank's position

172 "Greco-Italian clearing", General Council minutes, Vol. 9, meeting of 18.4.1938, p. 26.

173 "Establishment of a Clearing Office", General Council minutes, Vol. 1, meeting of 10.12.1928, pp. 291-295.

within the Greek banking system and with the role the Bank intended to play in currency stabilisation.

The interventions of the Bank of Greece aimed at ensuring the smooth functioning of the banking system included its participation in the liquidation of failed banks. Even before the economic crisis of 1929 or the banking crisis of 1931, the Bank of Greece took part in initiatives such as the Syndicat de Garantie that undertook to liquidate the Bank of Thessaly.[174] The reason behind the Bank of Greece's involvement, as mentioned in the relevant General Council minutes, was that in its capacity as the country's issuing institution the Bank could not remain outside a government initiative aimed at restoring confidence in the country's banking system, even more so when it saw itself as regulator of this system. However, indicative of the banking reality in 1929 and of the Bank's minor role in developments at the time was the fact that it participated with a share of 10%, equal to that of the Bank of Athens, but clearly lower than the National Bank's share of 20%.

Furthermore, the Bank of Greece took initiatives in connection with the valuation of assets and the mergers between banking institutions, such as that of the Bank of Industry with the Bank of Laconia and the Bank of Greek Commercial Credit shortly before the New York Stock Exchange crash.[175] In this context, the Bank of Greece stepped in, jointly with the National Bank, to prop up the Bank of Industry, which was facing liquidity problems. The Bank of Greece had assessed the asset portfolio of the Bank of Industry as healthy overall, although its was burdened by troubled assets. Still, it saw it as its duty to support that bank amid the prevailing unstable market conditions, given the broader repercussions of a potential bank failure. The importance attached by the Bank of Greece to rescuing the Bank of Industry is evidenced by the fact that the General Council was called to approve a loan to that bank that exceeded one-tenth of the paid-up capital of the Bank of Greece.[176]

On 31.1.1932, the Kosmadopoulos Bank formally declared inability to meet its obligations to depositors, and thus the Ministry of National Economy requested the Bank of Greece to undertake, jointly with the National Bank, its liquidation.[177] The Kosmadopoulos Bank attributed its default to mass deposit withdrawals in early 1932 and the illiquidity of a considerable part of its assets. The same minutes report that the Bank of Trikala, as well, declared inability to meet its obligations.

174 "Liquidation of the Bank of Thessaly", General Council minutes, Vol. 2, meeting of 21.6.1929, pp. 140-142.

175 "Merger of banks", General Council minutes, Vol. 2, meeting of 28.10.1929, p. 277.

176 "Bank of Industry", General Council minutes, Vol. 3, meeting of 15.1.1930, pp. 28-29.

177 "Kosmadopoulos Bank", General Council minutes, Vol. 4, meeting of 3.2.1932, pp. 126-131.

In addition, the failure of the Kosmadopoulos Bank worsened the overall economic situation in the cities of Volos and Larissa, as the General Council revoked a previous decision to raise the credit extended to the I. Cholevas & G. Markaras Sons Bank from 300,000 to 4,000,000 drachmas.[178] Ultimately, following a new refusal by the Bank of Greece to grant the requested loan, the Cholevas & Markaras private bank was placed in liquidation, which the Bank's Agency in Larissa was tasked to conduct.[179]

On 24.5.1932, yet another bank, the Central Bank of Greece, announced its inability to repay depositors.[180] This bank had for long been facing serious problems, due to mass deposit withdrawals. Despite the efforts of the Bank of Greece to support the Central Bank of Greece in meeting its short-term liabilities, in the end the bank formally declared a suspension of payments. Once again, the liquidation of this bank was entrusted to the Bank of Greece.

On 17.6.1932, the General Council approved two new loans to banks: one for 150,000,000 drachmas to the Agricultural Bank against collateral of assets from its farmer portfolio, amounting to at least 200 million drachmas,[181] and one for 20 million drachmas (topped by 5 million drachmas from the National Bank) to the under liquidation Kosmadopoulos Bank, against collateral of the bank's total assets.[182]

On the other hand, in August 1932 the Bank of Greece refused to reduce the interest rate on a loan granted to the Postal Saving Offices, on the grounds that they engaged in banking operations and should therefore be treated like any other bank.[183]

The situation of the banking system and the Bank's role in it can be best understood by looking at the decision made by the General Council on 11.9.35 to increase credit to banks.[184] The relevant General Council discussion started with the announcement by the Deputy Governor that banks' deposits with the Bank of Greece had declined from 1,767 million drachmas on 7.1.1935 to 160 million, indicating reduced bank liquidity, which impaired their lending capacity and caused them to charge higher lending rates. The banks themselves, including the National

178 "Larissa Agency – Suspension of credit to the I. Cholevas & G. Markaras Sons Bank", General Council minutes, Vol. 4, meeting of 13.2.1932, p. 137.

179 "Liquidation of the I. Cholevas & G. Markaras Sons Bank", General Council minutes, Vol. 4, meeting of 4.3.1932, p. 148.

180 "Central Bank", General Council minutes, Vol. 4, meeting of 26.5.1932, pp. 193-195.

181 "Loan of 150,000,000 drachmas to the Agricultural Bank of Greece", General Council minutes, Vol. 4, meeting of 17.6.1932, p. 206.

182 "Loan of 20,000,000 drachmas to the Kosmadopoulos Bank", General Council minutes, ibid.

183 "Interest rate on collateralised loan to Postal Saving Offices", General Council minutes, Vol. 4, meeting of 8.8.1932, p. 217.

184 "Credit to banks", General Council minutes, Vol. 6, meeting of 11.9.1935, pp. 275-277.

Bank, had turned to the Bank of Greece for support, and the National Bank, in particular, had asked for an urgent injection of 275 million drachmas, which was approved by the Executive Board as the matter could not wait for the General Council to convene.[185] The Deputy Governor expressed the view that the discount rate, which stood at 7%, should be lowered, especially for banks. However, this was not permitted by the Statute, so he suggested instead that in the future, provided that the circumstances allowed, the hitherto non-interest-bearing deposits of banks should be remunerated at a rate of 1% until an amount equal to 1% of credit extended to banks was reached.

A similar issue regarding credit to commercial banks is mentioned in the minutes of 31 August 1939.[186] The Governor invited bank representatives to jointly address the crisis,[187] as there had been instances of refusal by banks to lend to their customers, which gave rise to insecurity and triggered deposit withdrawals. He assured bank managements that neither the Bank of Greece nor the government approved of any sort of restriction to the repayment of deposits and that, if necessary, the Bank of Greece could strengthen banks' liquidity. Indeed,[188] the banks facing mass deposit withdrawals drew down their deposits with the Bank of Greece and made use of rediscount or credit line facilities. Such phenomena emerged on 24 August 1939 and lasted until the end of September 1939, when deposits returned to banks and liquidity was restored.

Interesting insights into the economic climate of the era are provided by the parts of the minutes referring to settlement of debts of the Bank's customers. In the case of tobacco merchants Papadatos Bros, half of their debt would be recovered through the sale of the tobacco products they had pledged as collateral and the other half would be repaid in ten biannual interest-free instalments.[189] Another case was that of the Greek Enamelware Industrial Company SA, where the Bank of Greece decided to accept avalised promissory notes of the company and waive the interest accrued on a part of the debt.[190] The minutes of 1.11.1932 mention a new debt settlement with respect to Diamantopoulos & Co. SA, through discount of bills of

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185 "Credit to the National Bank", General Council minutes, ibid., p. 277.

186 "Credit to banks", General Council minutes, Vol. 9, meeting of 31.8.1939, p. 290.

187 By "the crisis" he means the international situation on the eve of World War II that officially started in September 1939 with the German invasion of Poland.

188 "Determination of an interest rate on overdrafts from banks' deposit accounts", General Council minutes, Vol. 10, meeting of 20.12.1939, p. 26.

189 "Settlement of arrears of Papadatos Bros", General Council minutes, Vol. 4, meeting of 8.8.1932, p. 217.

190 "Settlement of arrears of the Greek Enamelware Industrial Company SA", General Council minutes, ibid., 218.

exchange against collateral of the company's claims on the Municipality of Thessaloniki.[191] The minutes of 6.2.1935 refer to a settlement of interest owed by the cotton wholesaler A. Andritsakis.[192] The General Council, accepting the borrower's request, applied a single interest rate of 7% on all debts, given that the current discount rate ranged between 12% and 7%. On 24.2.1937, the General Council granted another request by the Agricultural Providence Cooperative of Aspropyrgos to reduce the default interest on loans dating back to the years 1928 and 1929,[193] reasoning its decision to do so by the fact that this was a long overdue agricultural debt that could be fully recovered only by harsh measures – which the Bank of Greece obviously did not want to take, given the nature of the debtor entity.

To sum up, from the first years of its operation, the Bank of Greece introduced significant institutional innovations in the Greek banking system, such as the Clearing Office, and above all, unfailingly took steps to support banks and the system as a whole. This became vital especially from 1935 onwards, when commercial banks came to acknowledge this role of the Bank of Greece and increasingly resorted to it for funding. This consolidated the Bank's presence in the Greek banking system and provided tangible proof of its necessity and the important role of central banks in financial stability.

191 "Settlement of arrears of Diamantopoulos & Co. SA", General Council minutes, Vol. 4, meeting of 1.11.1932, p. 257.

192 "Settlement of interest arrears of Athanasios Andritsakis", General Council minutes, Vol. 6, meeting of 6.2.1935, p. 105.

193 "Determination of the default interest rate of agricultural debt in arrears", General Council minutes, Vol. 8, meeting of 24.2.1937, p. 44.

2 THE OCCUPATION PERIOD, 1941-1944

2.1 Economic developments

The period of Axis Occupation was devastating for the Greek economy and its currency. The economic improvements achieved after the default of 1932 were wiped out, giving way to chaos and absolute disorder on the eve of the country's liberation (Mazower, 1994). Against this background, to describe the situation in the country's economy during the war, we cannot even talk of macroeconomic developments, but rather of a road to the abyss.

Starting with demographics, the population, from around 7,336,000 according to the 1940 census, plummeted by 415,300 during the Occupation. Of these losses, about 260,000 were civilians who died of starvation or violence. The average daily calorie intake in 1941 was 900 per person and never exceeded 1,400 throughout the Occupation period. Between 1940 and 1944, agricultural production fell by 70% and industrial production by 82%, 60% of livestock was lost, shipping lost 78% of its capacity, 72% of vehicles (trucks and lorries) vanished, and 25% of the country's forests were destroyed. Although Greece (Konstantinos Doxiadis) calculated its losses at about 15 billion pre-war US dollars, the Economic and Social Council of the United Nations estimated a more conservative 1-2 billion.[1]

The production engine was ruined, and so was commerce. Food shortages plagued the poorer social strata of the urban population, while the middle and upper classes lost accumulated wealth to hyperinflation and the black market. Hyperinflation wiped out any previous savings and the black market reigned supreme.[2]

1 Psalidopoulos (2013), p. 19.

2 Thomadakis (1984).

The worst of all evils, however, was the country's monetary disaster. It started with the partition of the territory into three occupation zones, in each of which a different currency was introduced, co-existing with the drachma, by the occupation authorities: the Occupation mark (Reichskreditkassen – RKK), the Mediterranean drachma, and the lev, in the German, Italian and Bulgarian zones, respectively. These remained in circulation for a few months until 18.7.1941, when the drachma was declared sole legal tender, following persistent requests by the Bank of Greece, in an aim to regain at least some control over money circulation.

Right from the start, the occupation authorities, in collaboration with the Tsolakoglou government, confiscated agricultural products (tobacco, olive oil, etc.) and mineral ores (bauxite, chromium, etc.), and shipped to Germany whatever goods they had found stored. The Greek industrial firms that were relevant for the war economy of Germany were purchased, rented or commandeered to supply the German market with any volumes of pyrite, iron ore, chromium, nickel, manganese and granite they could produce. The Italians asked for a share in the loot and managed to secure some privileges after the spring of 1942, without however reversing the flow of trade to Germany. Around 76% of Greek exports were channelled to Germany and 17% to Italy.

The above clearly show that the occupying forces came with the worst of intentions for the Greek economy, stopping at nothing, systematically destroying its physical basis and its currency, and more fiercely so as the resistance of the Greek people gained ground. It is not by chance that a short while before the beginning of hostilities between Greece and the Axis forces, the German government had commissioned and received from the Kiel Institute for the World Economy six studies on Greece's natural resources and industrial sector.

As regards the value of the drachma, total currency in circulation rose by 36,000% between October 1939 and January 1944. The Bank of Greece was unable to influence the decisions of the occupation authorities. In the last ten months of the occupation period, the currency was totally ruined. The value of the gold sovereign, from 1,000 drachmas in 1940, reached 1.5 billion drachmas in 1944.

According to available data, currency in circulation evolved as follows:

- 11.2 billion drachmas in 1940;
- 19.4 billion on 30.4.1941;
- 79.1 billion on 30.4.1942;
- 560 billion on 30.4.1943;
- 18,100 billion on 30.4.1944; and
- 604,570,000 billion on 31.12.1944.

As the situation was spiralling out of control, the occupiers were alarmed. In November 1942, the Germans appointed Hermann Neubacher as Special Plenipotentiary of the Reich for Economic and Financial Affairs in Greece (the Italians followed suit by dispatching D'Agostino as special emissary). Following the high number of deaths of starvation in the winter of 1942, the occupiers consented to shipments of food through the International Red Cross, while, later on, the Germans also sold gold sovereigns and francs through the Bank of Greece and the Athens Stock Exchange, in order to halt the freefall of the drachma and thus contain the occupation costs. This proved impossible. The loads of gold sovereigns sent by the Allies to the mountain-based Greek guerrilla bands also contributed to a complete loss of confidence in the currency and its de facto substitution with gold in transactions, as inflation started galloping from winter 1943 onwards.

The liberation of Athens on 12.10.1944 found the Greek economy and currency in a critical state. However, the common experience of deprivation, starvation and death, as well as the Resistance, united the Greek people and inspired some optimism that wounds could quickly heal and the Greek economy would soon get back on track.

2.2 The Occupation Loan

The monetary disorder described above came about because Germany and Italy, under the Treaty of Rome of 14.3.1942, forced Greece to grant them a loan, over and above the agreed amount of occupation costs, to be disbursed by the Bank of Greece to the local German and Italian occupation authorities.[3]

The data explaining the collapse of the Greek currency, as reported by Bank of Greece Governor G. Mantzavinos in 1947, are the following: under the 1907 Hague Convention Respecting the Laws and Customs of War on Land, Greece paid to Germany and Italy 87,811,216,671,480 drachmas, or 3,381,001 gold sovereigns as occupation costs (on the basis of the average price of the pound on the Athens Stock Exchange during the Occupation period). In addition, it extended a loan totalling 1,530,190,356,165,819 drachmas, or 4,506,226 gold sovereigns, in the form of advances. Thus, the total sum of occupation costs and advances had come to 1,618,001,572,837,299 drachmas, or 7,887,227 gold sovereigns.[4]

In other words, the occupation authorities, judging that the occupation costs extorted from Greece (1,500 million drachmas per month) were not enough, signed

3 Gotzamanis (1954) and Hahn (1957).

4 Bank of Greece, Governor's Report for the years 1941, 1944, 1945 and 1946, Athens 1947, Table 11.

the Treaty of Rome requiring the occupied country to pay them on a monthly basis additional amounts to meet their needs, in the form of advances. The Treaty of Rome did not explicitly provide for any interest rate or amortisation arrangements, but did include a clear reference to a future repayment of the loan. According to the collaborationist "Minister" of Finance, S. Gotzamanis (1954, p. 8), there was a controversy between the German government and the German occupation authorities in Greece on how to manage the finances of the occupied country; and although the latter, continuously pressing for unlimited funds, eventually prevailed, the German government decided, as mentioned earlier, to appoint a special plenipotentiary for economic affairs (Neubacher) in Athens (the Italians appointed D'Agostino). The two plenipotentiaries instructed the military authorities in the country to notify the Greek Ministry of Finance the detailed amounts of money they paid to which Greek citizens. This practice was relaxed in the course of 1943.

On 1.12.1942, following intense pressure by the occupation authorities, the Greek government was forced to inflation-adjust the occupation costs to a new figure, to be decided by a Greek-Italian-German committee, based on the evolution of the price index after 14.3.1942 (the date when the Treaty of Rome was signed). By this fresh extortion of Greece, the occupation authorities sought to retroactively increase the monthly occupation cost amounts, as they realised that their debt was rising by leaps and bounds and had to be reduced. Under this new arrangement, the extension of new advances stopped for a while, occupation costs were capped at 8 billion drachmas per month, and the occupation authorities undertook to start, as of 1.4.1943, repaying the credit already received, in monthly instalments equal to 10% of the outstanding debt as at 31.3.1943. Neither this arrangement referred explicitly to any interest rate, but indirectly yet clearly implied an indexation of the amount being repaid. Still, on that day (1.4.1943), to avoid fulfilling their undertaken obligation, the occupiers sacked "Prime Minister" K. Logothetopoulos, replacing him with Ioannis Rallis, and so the whole matter was postponed indefinitely. On 18.5.1943, with retroactive effect as of 1.4.1943, the 8 billion drachma cap on monthly occupation costs was removed, while the price index used in their calculation became more broad-based, so as to better serve the purposes of the occupation authorities. From then to October 1944, the drachma plummeted. As the free Greeks and the Allied troops were advancing, the occupation troops retreated, but not without drawing off drachmas from the Bank of Greece, thus dealing even heavier blows to the country's currency.

Under these circumstances, the Bank of Greece acted on behalf of the Greek State. Consequently, it is an indisputable fact that a loan was indeed granted and disbursed and, therefore, a legal obligation to repay it exists, although the whole process, as well as the overall conditions governing the relationship between the conquered and the conqueror at the time of conclusion of legal agreements, raise a number of questions. These would relate, in the event of any claims to a repayment of such loans, to the debts' conversion into present values, the methodology that should be followed, the interest rate that must be applied (regardless of the fact that it was not agreed at the time), the inflation recorded in the meantime that must be factored in, as well as several other parameters.

The Bank of Greece has always provided assistance to all Greek post-liberation governments that have explored legal, financial, as well as political aspects of the issue. As a matter of fact, the issue of the Occupation Loan was first brought up in the Treaty of Paris in 1945, although for procedural reasons its resolution stalled. In the early 1960s, the Federal Republic of Germany acknowledged the occupation loans the Third Reich had concluded with Yugoslavia and Poland, and proceeded to a settlement with these countries. In 1963, by a rigorous study, the Bank of Greece informed the political authorities of Greece on the historical background and the then existing estimates of the value of the loans. The same was repeated in 1991, after the "Two plus Four" Agreement, and again in 1995, 2000, and every year throughout the first decade of the 21st century, up to 2012-2013.

Consequently, whenever the Greek authorities deem it appropriate, the Bank of Greece will once again be ready to assist in a legal claim to the Occupation Loan, with several alternative economic analyses and recovery scenarios based on studies and calculations already carried out by its staff in the years mentioned above.

2.3 Initiatives of the Bank of Greece in occupied Greece, 1941-1944

Already since late October 1940, with the outbreak of war on the Albanian front, and until the eve of the German invasion on 6 April 1941, the Bank of Greece stood as a key buttress of the Greek government in managing the country's war economy. A typical example is its agreement with the British Military Base in Greece, under which the Base would hold in the Bank of Greece a non-interest bearing open deposit account, built up by remittances from Great Britain.[5]

More specifically, the Bank's relationship with the State had officially entered a new phase, as evidenced by the amendments to Article 55 of its Statute. These changes were effected in order to ratify the agreement signed between the Bank of Greece and the Greek State on 9.10.1940, i.e. just before the outbreak of the Greek-

5 "Agreement with the British Military Base in Greece", General Council minutes, Vol. 10, meeting of 16.1.1941, pp. 129-130.

Italian war. In essence, the amendments to Article 55 allowed the Bank to finance more generously the State's expenditure, by: (a) removing the ceiling on total discounts, guarantees and advances that the Bank was allowed to grant to the Greek State (originally capped at one-tenth of total estimated revenue of the ordinary budget for a given year); and (b) raising from 400 million drachmas to 1 billion drachmas the limit on its temporary advances to the Greek State.[6] However, even this limit finally proved to be insufficient following the dramatic rise in the State's financing needs in the context of the war. Indeed, days before the German troops entered Athens, the State had already exceeded the advances limit by 400 million drachmas, while the General Council had authorised a continuation of disbursements, effectively unlimited, in order to help the State succeed in its war effort and continue its operation.[7]

At the same time, the Greek economy, by now on a war footing, was increasingly in need of money. Banknotes commissioned and delivered before the war were not enough to cover the circulation needs. In addition, the procurement of banknotes from abroad was too risky in terms of timely delivery, due to the disruption of transportation caused by the war. The solution given by the Bank of Greece was to issue as 1,000-drachma bills the 100-drachma bills that had already been ordered from the UK, by deleting the original denomination and overstamping them with the new one.[8] Furthermore, it commissioned new 100-drachma banknotes in Greece to replace those converted into 1,000-drachma notes as described above.[9] In the meantime, part of the Bank's cash stocks was lost due to the ongoing hostilities and air bombardments, as was the case at the Larissa Branch, where a banknote stock of 185 million drachmas was buried under the debris of the bombed-out building.[10] However, the increase in circulation was so large and the demand for banknotes so strong that in late April 1941 it was suggested to put back into circulation banknotes that had been withdrawn, although some of them had already been marked as "cancelled" or punched.[11] The proposal was accepted in view of the extraordinary

6 "Draft amendments to Article 55 of the Statute to be submitted, having been approved by the General Meeting", General Council minutes, Vol. 10, meeting of 24.3.1941, pp. 156-157.

7 "Report by the Directors of the Head Office to the General Council on the overall recent operations of the Bank", General Council minutes, Vol. 10, meeting of 24.4.1941, pp. 167-168.

8 "Launch of new banknotes", General Council minutes, Vol. 10, meeting of 2.4.1941, pp. 160-161.

9 "Commissioning of 100-drachma banknotes", General Council minutes, ibid., pp. 161-162, and "Commissioning of 100-drachma banknotes", General Council minutes, Vol. 10, meeting of 8.5.1941, pp. 176-177.

10 "Report by the Directors of the Head Office to the General Council on the overall recent operations of the Bank", General Council minutes, Vol. 10, meeting of 24.4.1941, p. 167.

11 "Report by the Directors of the Head Office to the General Council on the overall recent operations of the Bank", General Council minutes, ibid., p. 168.

circumstances, and all of the cancelled banknotes of 50, 100, 500 and 1,000 drachmas that were to be destroyed were instead put back into circulation.[12]

Commercial banks, also facing considerable problems in their transactions with customers, asked the Bank of Greece to help by cutting its discount rate. As a result, the Bank lowered its discount rate from 7% to 5%, as of 7.4.1941.[13] However, this decision was suspended two months later, on the grounds that the reasons that had made it necessary no longer applied.[14] In July 1941, while discussing the reduction of the Bank's discount rate, the General Council returned to the matter of the stressed condition of commercial banks, which evidently could not cover their expenses by the existing net interest margins.[15]

April 1941 was an important milestone for the next four years in the history of the Bank of Greece, as the Bank was split in two: on the one hand, Governor K. Varvaressos and Deputy Governor G. Mantzavinos fled with the gold reserve initially to Crete and then, on an odyssey, via Johannesburg to London, and on the other hand, the rest of the Bank's staff was stranded in Greece and suffered the hardships of foreign occupation. Thus, the General Council appointed M. Negrepontis as Acting Governor, awarding him a monthly remuneration equal to the Deputy Governor's salary,[16] and P. Dekazos as his alternate.[17]

The Bank of Greece kept on acting as the government's banker, even during the occupation period. Indeed, the agreement of 3.7.1931 between the Greek State and the Bank of Greece, designating the latter as fiscal agent of the Greek State, was renewed in June 1941 for another ten years.[18] But although until then the relationship of the Bank of Greece with the Greek State focused on the former's contribution to the management of the latter's needs, this framework changed as of May 1941 due to the war and the country's conquest by the Axis powers. The country's occupation suddenly redefined the State's needs. Thenceforth, the Bank was effectively compelled to satisfy the needs of the occupation authorities, which, on a practically permanent basis, took the form of demands of payments on the Greek State.

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12 General Council minutes, Vol. 10, meeting of 25.4.1941, p. 169.

13 "Interest rate on loans to banks", General Council minutes, Vol. 10, meeting of 26.4.1941, p. 171.

14 "Suspension of the decision of the General Council on the interest rate on loans to banks", General Council minutes, Vol. 10, meeting of 26.6.1941, pp. 194-195.

15 "Reduction of the discount interest of the Bank", General Council minutes, Vol. 10, meeting of 14.7.1941, pp. 203-204.

16 "Remuneration of Acting Governor Mr. M. Negrepontis", General Council minutes, Vol. 10, meeting of 8.5.1941, p. 176.

17 General Council minutes, Vol. 10, meeting of 25.4.1941, p. 169.

18 "Authorisation to sign an agreement between the Greek State and the Bank", General Council minutes, Vol. 10, meeting of 14.6.1941, pp. 190-191.

An indicative example is the agreement signed between the Bank of Greece and the Greek State concerning a one-off discount of Treasury bills, amounting to 500 million drachmas, overrunning the 400-million-drachma limit provided for under Article 55 of the Statute, in order to pay suppliers of the Greek State in Germany, namely German tobacco industries.[19] Such overruns were enshrined in an amendment to Article 55 (paragraph 11) of the Statute removing the restrictions under this article until the end of the war, so as to cope with the needs of both the Greek State and the occupation authorities.[20] The amendment to Article 55, paragraph 11, and the inclusion of a new paragraph, 11a, were ratified by Legislative Decree 1991/1.12.1942, authorising the Minister of Finance to draw unlimited funds from the Bank of Greece for the needs of the occupation authorities and the Greek State, while also providing for the conclusion of a relevant agreement between the Greek State and the Bank of Greece that would regulate the status of the relevant loans. However, the collaborationist government was delaying the signing of the draft agreement prepared by the Bank of Greece, so the General Council authorised the Administration to proceed to such lending operations in the absence of a signed agreement on their settlement.[21]

Another aspect of the activity of the Bank of Greece, closely linked to its forced relationship with the government of the time, is the financing of the Agricultural Bank of Greece (ATE) with a view to concentrating agricultural products. Although the justification used was the need to prop up "national production" amidst adverse social and economic conditions, it became evident in the winter of 1942 that feeding the population was not among the priorities of the occupation authorities. Thus, a new amendment to Article 55 of the Statute of the Bank of Greece was introduced, adding a paragraph that authorised the Bank of Greece to finance ATE with credit up to an amount of 3 billion drachmas "by way of derogation from the provisions of the present article and Article 56 below, and without being subject to the restrictions provided for thereunder…".[22] However, the collaborationist government revisited the matter, insisting on a new amendment that would require, rather than simply authorise, the Bank of Greece to finance ATE, along with setting a particularly low interest rate, no higher than 3%.

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19 "Authorisation of the Administration by the General Council to sign an agreement with the Greek State", General Council minutes, Vol. 10, meeting of 27.5.1941, pp. 180-181.

20 "Proposed amendment to Article 55, paragraphs 11 and 18, of the Statute", General Council minutes, Vol. 10, meeting of 18.9.1942, pp. 278-280.

21 "Authorisation of the Administration to carry out the orders of the Minister of Finance", General Council minutes, Vol. 11, meeting of 30.6.1943, pp. 78-80.

22 "Financing of the Agricultural Bank. Proposed amendment to the Statute", General Council minutes, Vol. 10, meeting of 26.6.1941, pp. 195-196.

The General Council, which had right from the start expressed reservations regarding the amendment to Article 55,[23] opposed this, considering that the Bank's Statute should neither require it to lend ATE nor set an upper limit on the lending rate.[24,25] In the face of the occupation authorities' intransigence, in the end not only was the Statute changed to require the Bank of Greece to finance ATE, but also the 3 billion drachma cap was scrapped, leaving the collaborationist Ministers of Finance and Agriculture free to determine the amount of loans at will.[26] The financing of ATE continued throughout the occupation period, as evidenced by the relevant decisions of the General Council,[27] and intensified in the course of its final year, among other things due to hyperinflation, despite the fact that the relevant guarantees asked by the Bank of Greece from the Greek government were not provided.[28,29,30,31,32,33,34,35,36,37,38,39,40,41,42] Due to the enormity of these credits, the Bank of Greece had to establish a new Section for "Monitoring and Control of Special Credits", in order to retain some control over the management of these loans by ATE (and the

23 Ibid.

24 "Draft amendment to Article 55 of the Statute for the financing of the Agricultural Bank", General Council minutes, Vol. 10, meeting of 1.7.1941, pp. 201-202.

25 It is worth noting that, with the start of the occupation period, discussions at General Council meetings began to be recorded in the minutes. It is unclear, and could be investigated, whether this practice was introduced by demand of the occupation authorities or on the initiative of the members themselves for the purpose of ensuring that any differences of opinion in matters related to the Bank's management were put on record, precisely in the context of foreign occupation.

26 "Proposed amendment to Article 55, paragraphs11 and 18, of the Statute", General Council minutes, Vol. 10, meeting of 18.9.1942, pp. 280-281.

27 "Extension of credit in excess of 1/10 of the paid-up capital", General Council minutes, Vol. 11, meeting of 29.1.1943, pp. 10-11.

28 "Loans to the Agricultural Bank", General Council minutes, Vol. 11, meeting of 23.12.1943, 130-131.

29 Ibid., meeting of 22.1.1944, pp. 134-135.

30 Ibid., meeting of 12.2.1944, p. 149.

31 Ibid., meeting of 13.3.1944, p. 154.

32 Ibid., meeting of 29.3.1944, pp. 156-157.

33 Ibid., meeting of 4.5.1944, pp. 166-169.

34 Ibid., meeting of 30.5.1944, pp. 178-179.

35 Ibid., meeting of 16.6.1944, pp. 182-183.

36 Ibid., pp. 186-188.

37 Ibid., meeting of 28.7.1944, pp. 202-204.

38 Ibid., meeting of 11.8.1944, pp. 209-211.

39 Ibid., meeting of 23.8.1944, pp. 213-214.

40 "Advances against approved credit to the Agricultural Bank – financing in excess of approved credit", General Council minutes, Vol. 11, meeting of 1.9.1944, pp. 220-222.

41 "Loans to the Agricultural Bank", General Council minutes, ibid., pp. 228-229.

42 "Loans to the Agricultural Bank", General Council minutes, Vol. 11, meeting of 7.10.1944, pp. 244-245.

organisations it financed using the funds concerned).[43] This great interest in the financing projects of ATE is explained by the need to support agricultural production for the reasons described earlier. In parallel, the Bank of Greece also extended discount credit to the National Bank that could be used to rediscount promissory notes issued by sociétés anonymes such as the Power Company of Athens-Piraeus,[44] the Electric Transport Company,[45,46] and the Greek Telephone Company.[47]

Dealing with inflation and its impact on the cost of living was a permanent concern of the Bank of Greece; this time, however, not in the context of a policy to limit money supply (as would be the case in normal periods), but through defensive measures taken to relieve wage-earners. This problem was also recognised by commercial banks when they discussed rises in their employees' salaries, despite their own dire financial position.[48] The Bank of Greece granted a "monthly cost-of-living allowance" to its personnel, which was inversely proportional to an employee's rank in the hierarchy.[49] Moreover, in autumn 1943 the Administration of the Bank of Greece, recognising the stretched financial condition of its staff members, especially of those that had to work overtime because they sat on councils and/or committees, suggested paying them a compensation, in line with a similar practice followed in the public sector.[50] Another measure taken by the Bank of Greece for the protection of its employees, this time from disease and infections, was the establishment of a Healthcare Service headed by a chief medical officer.[51]

In a move to tighten their grip on the Bank of Greece, in September 1941 the occupation authorities appointed commissioners of the German and the Italian governments. The relevant announcements stated that all payments by Greece to third countries would be processed by the Italian Clearing Office and be subject to the authority of the Italian commissioner. In contrast, payments to Germany and the countries it controlled would be subject to the authority of the German

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43 "Establishment of a new Department", General Council minutes, Vol. 11, meeting of 16.6.1944, p. 182.

44 "Increase of discount credit to the National Bank", General Council minutes, ibid., p. 183.

45 "Increase of discount credit", General Council minutes, Vol. 11, meeting of 28.7.1944, p. 204.

46 Ibid., meeting of 11.8.1944, p. 211.

47 Ibid., meeting of 23.8.1944, p. 214.

48 "Reduction of the discount interest of the Bank", General Council minutes, Vol. 10, meeting of 14.7.1941, p. 203.

49 "Proposal to the General Council for a rise in the wages of the employees", General Council minutes, Vol. 10, meeting of 14.7.1941, p. 204.

50 "Compensation to employees for their participation in Councils", General Council minutes, Vol. 11, meeting of 6.10.1943, pp. 111-113.

51 "Establishment of a Healthcare Service at the Bank", General Council minutes, Vol. 11, meeting of 22.1.1944, p. 139.

commissioner.[52] However, the two commissioners' authority was much broader. They had the right to control the operation of the accounts of the Bank of Greece, the documents of its Administration, the expenses it made, as well as the circulation of its banknotes. They were authorised to demand the implementation of any instruction regarding monetary and/or banking policy they deemed necessary. Although the orders of the commissioners were formally addressed to the Administration of the Bank of Greece, in extraordinary cases they could also be given directly to the Bank's Departments. In addition, the Administration had to submit a monthly report to the commissioners, while all new staff hirings were subject to their approval. The commissioners also had the right to demand the cancellation of an employee's hiring due to incompetence, as well as the right to participate in the General Meetings of Shareholders and the meetings of the General Council and the Board of Directors, while the relevant Minutes had to be submitted to them, as they had the right to annul any decisions made. Moreover, even the decisions of the Executive Board were subject to the commissioners' approval. Finally, they had the right to unilaterally change the above principles that governed their role in the Bank of Greece, while the Bank of Greece would in turn have to amend its Statute to bring these principles in line with the legal framework.[53] It is also interesting to note that the Bank of Greece at the time wanted to set up an "Economic-political Research Service", by hiring experts fluent in German and Italian.[54] Furthermore, in October 1943 it established a committee of experts "to study the country's agro-economic problem".[55]

On 3.7.1941, D. Santis, until then government commissioner, was appointed Governor of the Bank of Greece, and Director A. Papadimitriou was made Deputy Governor.[56] Santis was succeeded by S. Hatzikyriakos on 20.1.1943. [57], while from 19.4.1943 until 13.4.1944 Th. Tourkovassilis was served as Governor of the Bank.[58]

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52 "Announcements of the Governor regarding the appointment of Commissioners of the German and the Italian governments at the Bank", General Council minutes, Vol. 10, meeting of 19.9.1941, pp. 219-220.

53 "Announcement of notes of the Commissioners of the German Reich and Italy at the Bank", General Council minutes, Vol. 10, meeting of 23.9.1941, pp. 231-233.

54 "Organisation of Services. Recruitment of employees under contract", General Council minutes, Vol. 10, meeting of 14.7.1941, p. 204.

55 "Committee for the study of the agro-economic problem of the country", General Council minutes, Vol. 11, meeting of 6.10.1943, p. 114.

56 "Appointment of Governor and Deputy Governor", General Council minutes, Vol. 10, meeting of 14.7.1941, pp. 202-203.

57 General Council minutes, Vol. 11, meeting of 23.12.1943, p. 130.

58 "Announcement of acceptance of the resignation of the Governor of the Bank, Mr. Th. Tourkovassilis", General Council minutes, Vol. 11, meeting of 4.5.1944, p. 166.

As already mentioned, the occupation authorities demanded the Greek government to pay occupation costs in accordance with the Hague Convention Respecting the Laws and Customs of War on Land. The Bank of Greece inevitably became involved, as the Greek government was unable to raise enough revenue through taxation or borrowing to cover these costs. Thus, the only option that the Bank of Greece had was to grant "temporary advances" to the government by resorting to the printing press, also in order to replace all the banknotes issued by the occupation authorities, such as the Germans' Occupation marks (RKK) and the Italians' Mediterranean drachmas.[59] The withdrawal of these "currencies" was carried out following persistent requests by the Bank of Greece, in an effort to achieve a minimum of control over money supply and put an end to parallel circulation. In addition, the Ordinary General Meeting of Shareholders, which would discuss the balance sheet of 31 December 1941 and had to be held no later than April 1942, was postponed, initially for six months[60] and then for a further two-month period, until late December 1942.[61] However, the balance sheet of 1941 was submitted to the General Council and was included in its Minutes of 18.9.1942.[62] The practice of postponing the General Meetings of Shareholders was systematically followed throughout the occupation period. As a result, the Ordinary General Meetings of Shareholders for the years 1942-1943 were postponed anew, initially until September 1943,[63] and then until April 1944.[64] In the end, the convocation of these meetings, along with the one regarding the year 1944, was deferred until December 1944 by a decision made in March of that year.[65]

In an effort to contain the inflation generated by the incessant printing of banknotes for payments to the occupation authorities, the Bank of Greece was granted, pursuant to Legislative Decree 1984/24.11.1942, the right to issue IOUs, which would be used to pay 75% of the price of the agricultural products purchased by the

59 "Exceptional temporary advances to the Greek State", General Council minutes, Vol. 10, meeting of 19.9.1941, p. 222.

60 "Decision to postpone the convocation of the Ordinary General Meeting of Shareholders", General Council minutes, Vol. 10, meeting of 23.5.1942, p. 270.

61 "Extension of the postponement of the convocation of the Ordinary General Meeting of Shareholders of the current year", General Council minutes, Vol. 10, meeting of 3.9.1942, p. 272.

62 "Balance Sheet for the year 1941", General Council minutes, Vol. 10, meeting of 18.9.1942, pp. 273-275.

63 "Decision to postpone the convocation of the Ordinary General Meetings of Shareholders for the years 1942-1943", General Council minutes, Vol. 11, meeting of 17.5.1943, p. 75.

64 "Decision to postpone the convocation of the Ordinary General Meetings of Shareholders of the Bank for the years 1942 and 1943", General Council minutes, Vol. 11, meeting of 6.10.1943, p. 114.

65 "Decision to postpone the convocation of the Ordinary General Meetings of Shareholders of the Bank for the years 1942, 1943 and 1944", General Council minutes, Vol. 11, meeting of 29.3.1944, p. 159.

government. These would have a maturity of four months, ending on 31 March 1943. They were issued in the hope that the government by that time would have managed to raise enough revenue by selling these products to deposit the relevant funds with the Bank of Greece, so as to avoid new banknote issuance.[66] Later on, in October 1943, ATE itself was authorised to issue IOUs on behalf of the Bank of Greece, in order to pay for agricultural products.[67] The minimal effectiveness of this measure in limiting inflationary circulation becomes evident from the fact that, hard on the heels of the launch of new 1,000-drachma banknotes (fourth series) in September 1942,[68] the General Council authorised the issuance of 10,000-drachma banknotes in December of that same year.[69] At the same time, the Bank of Greece temporarily suspended its Banknote Register due to the costs associated with keeping it, staff shortages and, predominantly, the difficulties of monitoring banknotes in circulation due to their rapid proliferation. As a result, new series of banknotes put into circulation were not recorded.[70] On the other hand, the procedures for destroying worn-out banknotes were expedited, as the presence of General Council Members sitting on the relevant Committee was no longer required, and the task was delegated to the competent heads of sections.[71]

Finally, the practice of prolonging the circulation of older-series banknotes was also used in this period.[72] October 1943 saw the approval of the circulation of a 25,000-drachma banknote,[73] while February 1944 saw the launch of denominations of 50,000 and 100,000 drachmas.[74] The Bank of Greece, keeping track of the surge in inflation, just one month later, in March 1944, issued 500,000-drachma

66 "Authorisation of the Administration to sign a contract on the issuance of IOUs", General Council minutes, Vol. 10, meeting of 28.11.1942, pp. 285-288, and "Extension of credit to the Greek State and issuance of IOUs for the financing of the purchase of the tobacco crop of 1941-1942", General Council minutes, Vol. 11, meeting of 25.1.1943, pp. 2-4.

67 "Authorisation of the Agricultural Bank to issue IOUs", General Council minutes, Vol. 11, meeting of 6.10.1943, p. 109.

68 "Approval of new-style 1,000-drachma banknotes, fourth series", General Council minutes, Vol. 10, meeting of 18.9.1942, pp. 276-277.

69 "Approval of new-style 10,000-drachma banknote", General Council minutes, Vol. 10, meeting of 19.12.1942, pp. 290-291.

70 "Suspension of the Banknote Register", General Council minutes, Vol. 11, meeting of 26.2.1943, p. 44.

71 "Authorisation for destruction of banknotes withdrawn from circulation", General Council minutes, ibid.

72 "Prolongation of the circulation of older-series banknotes", General Council minutes, Vol. 11, meeting of 26.2.1943, p. 45.

73 "Approval of new-style 25,000-drachma banknote, first series", General Council minutes, Vol. 11, meeting of 6.10.1943, pp. 100-101.

74 "Approval of new-style 50,000-drachma and 100,000-drachma banknotes of the Bank", General Council minutes, Vol. 11, meeting of 12.2.1944, p. 146.

banknotes.[75] Amidst rampant inflation in the last few months of the occupation period, on 10 July 1944 the issuance of 1,000,000-drachma banknotes was authorised,[76] while on 28 July of the same year, i.e. only a few days later, 5,000,000-drachma banknotes were issued.[77] New banknote denominations were launched on 23 August, of 10,000,000 and 25,000,000 drachmas,[78] and on 9 September, of 200,000,000 drachmas.[79] Upon the departure of the Germans from Athens in October 1944, accompanied by the German commissioner Paul Hahn and the Governor S. Hatzikyriakos, the Bank of Greece discovered that its vaults were empty and had to issue new banknotes, first of 500,000,000 drachmas[80] and then of 2,000,000,000 drachmas.[81]

The Bank financed the country's trade with Germany and Italy by extending credit to German and Italian companies, such as a loan of 50 million drachmas (exceeding 1/10 of the paid-up capital of the Bank of Greece) to the Italian company "Compagnia Italiana per l' Oriente Mediterraneo".[82] Another example was the extension of credit of 600 million drachmas to the government for purchasing tobacco from the Italian Tobacco Company in order to cover the needs of the Greek Tobacco Industry.[83] Along the same lines, in March 1944 it was decided to raise the discount credit to the "Banca Commerciale Italiana e Greca" from 25 million to 2 billion drachmas (a huge increase, obviously explained by hyperinflation), so as to allow the said bank to rediscount promissory notes of ETMA industry,[84] while in May 1944

75 "Approval of new-style 500,000-drachma banknote of the Bank", General Council minutes, Vol. 11, meeting of 29.3.1944, pp. 162-163.

76 "Approval of new-style 1,000,000-drachma banknote of the Bank", General Council minutes, Vol. 11, meeting of 10.7.1944, pp. 193-194.

77 "Approval of new-style 5,000,000-drachma banknote of the Bank", General Council minutes, Vol. 11, meeting of 28.7.1944, p. 201.

78 "Approval of new-style 10,000,000-drachma and 25,000,000-drachma banknotes of the Bank", General Council minutes, Vol. 11, meeting of 23.8.1944, p. 214.

79 "New-style 200,000,000-drachma banknote", General Council minutes, Vol. 11, meeting of 9.9.1944, pp. 226-228.

80 "Announcement of the resignation of Mr. S. Hatzikyriakos. Approval of new-style banknote", General Council minutes, Vol. 11, meeting of 7.10.1944, pp. 242-244.

81 "New-style 2,000,000,000-drachma banknote", General Council minutes, Vol. 11, meeting of 18.10.1944, pp. 246-248.

82 "Extension of credit in excess of 1/10 of the paid-up capital of the Bank. Decision made by the General Council in accordance with Article 56, paragraph 10, of the Statute", General Council minutes, Vol. 10, meeting of 19.12.1942, p. 293.

83 "Extension of credit of 600,000,000 drachmas to the Greek State for the financing of the purchase of the tobacco crop of 1941", General Council minutes, Vol. 11, meeting of 13.3.1943, pp. 53-54.

84 "Increase of discount credit to the Banca Commerciale Italiana e Greca", General Council minutes, Vol. 11, meeting of 29.3.1944, p. 159.

the Bank of Greece increased its discount credit to a distillery based in Chania, Crete (which worked for the occupation authorities), from 3 million to 300 million drachmas, by personal approval from the German commissioner at the Bank of Greece.[85]

Indicative of the living conditions faced by the Bank's staff of all ranks was the General Council's decision to distribute food to General Council members, as it did with lower-ranking employees, and to include its unsalaried Legal Advisers in this scheme.[86] Another example was the "common list of foods" for the personnel of the three major banks (the Bank of Greece, the National Bank and ATE), defining monthly rations of various types of food to be allotted individually to each employee and to each member of their families.[87] Special care was taken for tenured employees' children according to their age, from one month to 16 years old, while each employee was entitled to food rations for no more than two children.[88]

2.4 Activities of the legitimate Administration

As regards the activity of the legitimate Administration of the Bank of Greece in London, first of all it is worth mentioning that it remained in contact with certain members of the Bank's Administration and senior staff in Greece, which transmitted news, statistics and other input from Athens, despite the existing official prohibition. Including the Governor and Deputy Governor, the Bank-in-exile operated with a team of six people, who, using this input, kept the Allies informed and promoted Greek interests abroad. The Bank of Greece was instrumental in overcoming British objections to the supply of food to the starving people of Athens through the Swedish Red Cross. Of particular importance was also the effort to acquire foreign exchange by taxing the profits of Greek shipowners whose ships were time-chartered to the British government, without precluding private operation of ships. Revenue from the taxation of requisitioned ships in the first years of the implementation of this measure (1941 and 1942) was around 350 thousand pounds sterling per year and 1.2 million pounds overall. In the subsequent years, as part of the fleet was lost, shipping tax revenue fell.[89]

85 "Increase of discount credit. Special decision", General Council minutes, Vol. 11, meeting of 8.5.1944, p. 169.

86 "Provision of food to the Members of the General Council and the unsalaried Legal Advisers of branches", General Council minutes, Vol. 11, meeting of 6.10.1943, p. 109.

87 "Common diet list of the three major banks", General Council minutes, Vol. 11, meeting of 8.12.1943, pp. 126-127.

88 "Provision of food to the children of the tenured employees of the Bank", General Council minutes, Vol. 11, meeting of 8.5.1944, pp. 172-173.

89 Bank of Greece (1978), p. 217.

K. Varvaressos, in addition to his position as legitimate Governor of the Bank of Greece, also served as Minister of Finance of the government-in-exile. However, he resigned from the latter position in December 1943 to become ambassador in charge of Greece's economic affairs abroad. In this capacity he took part in both the preparatory and the main sessions that laid the foundations of the post-war economic architecture, in Hot Springs, Atlantic City, and most importantly, Bretton Woods. There, Governor Varvaressos played an important role, earning a seat in the five-member committee responsible for settling any disputes arising between member countries of the IMF and the World Bank in connection with provisions in the Statutes of these two organisations. Regarding the new international architecture, Varvaressos backed the Keynes plan, which —as known— was not adopted. In these discussions Varvaressos voiced the concerns of a number of countries with "scarce" currencies, which were barred from world trade due to lack of adequate foreign exchange. In this context, he achieved the inclusion of the "scarce currency clause" and the possibility of loans to such countries for supporting their international trade.

3 THE PERIOD OF RECONSTRUCTION, 1944-1953

3.1 Macroeconomic developments

From the country's liberation to the monetary reform of April 1953, the Greek economy followed an upward path. On the downside, this period was marked by the Civil War and failure to take full advantage of the foreign aid made available to Greece to support its reconstruction and economic development.

The years 1944-1946 saw high inflation, despite efforts to the contrary. Thereafter, inflation gradually declined, to 47.9% in 1947, 23.1% in 1948, 6.4% in 1949, 14.5% in 1950, 9.9% in 1951 and 0.6% in 1952 (Bank of Greece, 1978, p. 290). Economic activity also increased and, by 1950, the standard of living had almost rebounded to close to pre-war levels. The national income index (1938=100), from 31 in 1945, rose to 51 in 1946, 68 in 1947 and 72 in 1948 (ibid., p. 238). The index of GDP at constant prices (1970=100) was 58.5 in 1948, 70.2 in 1949, 74.7 in 1950, 81.1 in 1951 and 81.5 in 1952 (ibid, p. 283).

Key developments during that period included the sales of gold sovereigns by the Bank, aimed to contain post-war inflation, and the introduction of the "new drachma" in November 1944. The policy of selling gold sovereigns, initiated in 1944 when Zolotas was Co-Governor, was subsequently discontinued and resumed three times. This outflow of gold sovereigns definitely weakened the asset position of the Bank of Greece, but on the other hand provided vital liquidity to the economy, which with time enabled a rebuilding of capital stock and house purchases or was used as collateral for investment or, ultimately, flowed back into the vaults of the Bank of Greece 20 years later.

For commercial banks, the major problem during that period was their inability to attract savings. Any savings that existed were siphoned off onto the black market for gold sovereigns, amid public mistrust in bank deposits due to the risk of losing their value. Gradually, under the steering of the Currency Committee, confidence in the banking system was restored, with a credit policy based on centralised allocation of credit to productive purposes (Bank of Greece, 1978, pp. 263-264).

Meanwhile, the country was totally dependent on foreign assistance. The aid in kind from the UNRRA up to 1947 and British loans (GBP 10 million) provided some relief until US aid came into play. The latter, which initially aimed to address Greece's external imbalance, soon (in 1948) became part of the Marshall Plan for Greece and continued, although diminishing, until after the 1953 devaluation of the drachma. This aid was managed by various agencies and bodies, including the Central Loans Committee, and amid growing nervousness on the US side, which, once the Greek civil war was over and the Korean War had broken out, was more preoccupied with Greece's defence rather than with its economic development.

Unlike shipping, which with a sizeable fleet of Liberty ships recovered quickly after the country's liberation and benefited from the Korean War, the other sectors of the economy managed to recover only after the end of the Civil War in 1949. Thus, reconstruction took long, but, in the process, economic policy makers gained invaluable experience with extraordinary situations and built the capacities that enabled Greece's path to prosperity and progress from 1953 onwards.

3.2 Credit and monetary policy in the first years after liberation, 1944-1945

The withdrawal of the German occupation forces and the liberation of Athens in October 1944 found the Bank of Greece in a pressing need to replete its vaults, which had been emptied by the departing Germans, and to cater for the increased transactional needs due to rampant inflation. On 7 October, even before Athens was liberated, the General Council had authorised the printing of a 500 million drachma banknote,[1] while a few days later, on 12 October, a new banknote was launched, denominated at 2 billion drachmas.[2] Finally, on 23.10.1944, new banknotes in denominations of 10 billion and 100 billion drachmas were issued.

The new, post-liberation General Council of the Bank of Greece, including Co-Governor X. Zolotas and Deputy Governor G. Mantzavinos, was sworn in on 30/11/1944.[3] Varvaressos, annoyed at the appointment of a Co-Governor without his

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1 "Announcement of the resignation of Mr. S. Hatzikyriakos. Approval of new-style banknote", General Council minutes, Vol. 11, meeting of 7.10.1944, pp. 242-244.

2 "New 2,000,000,000-drachma banknote", General Council minutes, Vol. 11, meeting of 18.10.1944, pp. 246-248.

3 "Swearing-in of General Council members", General Council minutes, Vol. 11, meeting of 30.11.1944, pp. 248-249.

knowing or consent, abstained from his duties until Zolotas resigned on 3.1.1945. The dire situation that the General Council had to address is reflected in its first decisions, envisaging the supply of emergency credit to commercial banks to help them cover their working capital needs.[4] At the same time, the first attempt at monetary stabilisation was made, as reflected in the decisions to print and put into circulation banknotes of “new” drachmas in denominations of 50, 100 and 1,000 drachmas.[5] According to the General Council minutes,[6] X. Zolotas reviewed the economic situation, noting a shortage of funds in the money market and a total lack of income for banks, including the Bank of Greece. Commercial banks had to resort to the Bank of Greece for liquidity, which inevitably entailed increased currency in circulation. For this reason, the Co-Governor’s view was that a high discount rate of at least 11% should be set as from 1.12.1944, given that the one-month money market rate was 10%.

Another important concern, according to Zolotas, was the supply of bank credit to the various sectors of production. Under government decisions, only industry and small-scale manufacturing were eligible to credit, which was to be extended by commercial banks based on funding from the Bank of Greece. For managing the allocation of credit and determining the applicable terms and conditions, it was proposed to set up a Credit Committee, bringing together the Governor of the Bank of Greece, the Director General of the Ministry of National Economy, the Director for Industry of the same ministry, three General Council members of the Bank of Greece, the Governor of the National Bank, and two Directors of the Bank of Greece. The Head of the Bank of Greece’s Discount and Credit Section would serve as Secretary to this Committee. The Bank of Greece would provide the necessary funds, while the responsibility for assessing the creditworthiness of potential borrowers would lie with the relevant lending bank. Moreover, an 11% ceiling was set on lending rates, and the Bank of Greece would refund to commercial banks 2%-3% of the interest accrued on its credit to banks, against their operating costs and the risks they assumed.

The hiatus in the series of General Council minutes between 30.11.1944 and 24.1.1945 can be explained by the events of December 1944. Thus, the review of the Bank’s activity during the Occupation only took place in the first meeting of the General Council in 1945.[7] Looking back on these years, Deputy Governor

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4 “Credit to banks”, General Council minutes, ibid., pp. 249-250, and “Credit to the Agricultural Bank”, General Council minutes, ibid., pp. 250-251.

5 “Approval of new-style banknotes”, General Council minutes, ibid., pp. 251-256

6 “Discount rate of the Bank of Greece. Establishment of a Credit Committee”, General Council minutes, ibid., pp. 259-261.

7 General Council minutes, Vol. 11, meeting of 24.1.1945, pp. 262-268.

G. Mantzavinos described how, in April 1941, it had become necessary for the Administration of the Bank of Greece to follow the government in exile, in order to assist in wartime fiscal management and in preparing for the aftermath of the war. Mantzavinos provided a detailed account of the Bank's actions, which are worth repeating here, although they have broadly been discussed above.

The Bank's Administration moved to Crete and then to Alexandria, Cairo and finally London, where it stayed until Greece's liberation. In effect, the Bank-in-exile operated with a staff of six, who served the needs of both the Bank itself and the Treasury-in-exile.

Back in occupied Greece, General Council member Miltiadis Negrepontis became Acting Governor for about three months, until he and the other members of the General Council, some of whom were persecuted and imprisoned, were replaced by persons appointed by the occupation authorities. Despite a virtual standstill in the Bank's operations, its staff grew by 51%, from 2,200 to 3,325 during the occupation period.

Meanwhile, the Bank-in-exile, with its small team of officials and staff, had an important role to play. The Governor and Deputy Governor formed part of the governments-in-exile, as Minister and Deputy Minister of Finance, respectively, while Governor K. Varvaressos also represented the government and the Bank of Greece in international conferences during the war. The Treasury-in-exile relied on funding from the Allies and on the only remaining source of revenue, taxation of merchant shipping. When the Allies' funding ran out and two-thirds of the Greek-owned merchant fleet were sunk, the Bank of Greece had to extend advances to the Greek State, amounting to 2,150,000 pounds sterling by September 1944.

While the Greek government, on its way back home, was in Cava dei Tirreni, Italy, Law 3325/1.10.1944 was issued, establishing the position of a Co-Governor at the Bank of Greece, cancelling that of a second Deputy Governor, and modifying the composition of the General Council. As already mentioned, Professor X. Zolotas was appointed Co-Governor. The position of Co-Governor was ultimately abolished by Law 82/7 January 1945, which also re-established the position of second Deputy Governor and reinstated the General Council that existed on 27.4.1941. Finally, the government invited Governor Varvaressos to return to his post in Athens, and he accepted. Varvaressos himself explained his former stance as follows:[8] although he had no problem working with Zolotas, he had seen it as "improper and indecorous" towards both himself and the Deputy Governor to establish a Co-Governor's position for a young professor who had no previous

8 General Council minutes, ibid., pp. 279-280.

experience in the management of organisations or of the Bank of Greece. Moreover, he had thought that the government at the time did not want him to come back to Greece, and this had been why he had submitted his resignation, which had however been rejected.

The top priority after the liberation was to secure food supplies for the population and restore essential functions in the economy. Thus, as mentioned by Co-Governor Zolotas, following an appeal to the Allies, he had secured a doubling of food aid and had also tried to lay the foundations for the country's economic reconstruction. The main obstacle to this attempt was the huge monetary instability, in response to which the new drachma was introduced by Law 18/11.11.1944, corresponding to 50 billion old drachmas. Currency in circulation on that date amounted to 125 million new drachmas, but about two and a half months later it came close to 3,400 million drachmas, without including the circulation of 2,776,000 BMA (British Military Administration pounds), equivalent to about 1,665 million drachmas. Against this background, efforts were made to release and repatriate deposits from abroad. However, despite the December 1944 civil conflict in Athens (the so-called *Dekemvriana*) and their economic, not to mention other, repercussions as reflected in the above figures, Zolotas noted that the new drachma had weathered rather well, and for that reason he thought its introduction had been a major achievement. The policy pursued in these first post-liberation months was criticised by K. Varvaressos,[9] who instead thought that the government's primary concern should be to drastically tackle chrysophilia and bolster confidence in the drachma as the national currency. Regarding the exchange rate of the drachma, Zolotas continued, this should be determined taking into account the needs of the market and of the Greek State, as well as the levels of wages and prices, which, as it seems, could not be done in an effective manner.

High on the new Administration's agenda was the determination of terms and conditions of credit.[10] At a first stage, only industrial and handicraft enterprises would be eligible for credit, extended mostly by commercial banks and by only one bank for each borrower, excluding businesses with stocks of finished products. Lending would be accompanied by control over the prices charged by the borrower. Any businesses found to have used the funds for purposes other than those intended would be disqualified from further credit and would be liable to a financial penalty in favour of the Greek State of three times the misused funds.

9 General Council minutes, ibid., pp. 281-282.

10 "Credit to industrial companies, etc.", General Council minutes, ibid., pp. 271-276.

The extension of a loan was subject to the prior approval of the Credit Committee, prioritising industries that produced essential goods or goods in high demand, to enable them to immediately resume their production, using raw materials that they already had or would receive from the Allies. Priority would also be given to industries producing essential inputs for other industries, or to the sectors of transportation, food, public health and clothing. Credit would be disbursed in three 10-day tranches and according to the progress of the financed project, as verified by the creditor bank or, as appropriate, by Bank of Greece inspectors and the relevant ministries. Loan applications would be forwarded by the relevant commercial bank to the Credit Committee for review. In making its final decision, the Committee would consult a recommending body, comprising representatives of the local Chambers of Industry or Handicrafts, as appropriate, and of the relevant ministries, and determine the maximum amount for the loans approved, without obliging the bank to actually extend the loan. Funding to banks would be provided through discount of bills of exchange or promissory notes with a 3-month maturity or through credit lines backed by such securities. The banks that were originally granted access to Bank of Greece funding for on-lending were the National Bank, the Bank of Athens, the Ionian Bank, the Commercial Bank, the Popular Bank, and the Banque Anglo-Française, with the maximum amount of funding specified on a case-by-case basis by the Bank's Administration and approved by its General Council. The same procedure also applied for loans extended directly by the Bank of Greece to businesses.

As the productivity of the prospective borrower was one of the criteria underlying loan decisions, industrialists were often required to commit to cutting their production costs. This was intended to encourage savings on raw material costs. On the other hand, lending to industrial firms that had survived the Occupation and emerged cash-rich from the war should be avoided, in order to discourage speculation. The Credit Committee should have the discretion to decide on a case by case basis.[11]

Funding to banks for on-lending to industrial firms began to be provided in February 1945, subject to bank-specific ceilings,[12] along with funding to all banks for meeting their payroll needs,[13] a practice that continued throughout the 1940s. Moreover, the Bank of Greece extended its first direct loans to industrial corpo-

11 "Credit to industrial companies", General Council minutes, Vol. 12, meeting of 22.3.1945, pp. 7-8.

12 "Funding to banks for on-lending to industrial companies", General Council minutes, Vol. 11, meeting of 10.2.1945, pp. 284-285.

13 "Credit to banks for meeting payroll needs", General Council minutes, ibid., pp. 286-288.

rations and funding to the Agricultural Bank for on-lending to farmers according to Credit Committee decisions.[14]

In February 1945, following a proposal by Governor Varvaressos, the discount rate was lowered to 7% and the rate on funding to commercial banks was set at 3.5%, with the exception of the Agricultural Bank for which it was set at 3%. The real interest rate of the time is hard to estimate, given the prevailing high inflation, but was definitely negative. The same General Council decision imposed a 7% ceiling on banks' lending rates, except in the case of current accounts overdrafts where an additional 1% was justified by the higher administrative costs involved.[15] The interest rate on Bank of Greece funding for banks' payroll needs was set at a lower level of 1.5%.[16] Meanwhile, with a view to supporting liquidity in the economy, a new article (numbered 56a) was added to the Bank's Statute, authorising the Bank to extend loans to other banks and to enterprises on terms and conditions to be determined by the General Council. The effect of the article started retroactively from 11.11.1944 and would end on 31.12.1946.[17] For the same purpose, a draft law on "Bank of Greece financing to businesses" was prepared and submitted by the Governor to the General Council for approval, which regulated Bank of Greece credit to industrial, agricultural, banking and other enterprises, as defined from time to time in General Council decisions.[18]

Credit to commerce was addressed separately, by a new decision of the Governor, approved by the General Council.[19] Such credit would be extended directly by the Bank of Greece or, alternatively, through commercial banks using own-sourced funds. Eligible for financing would be exclusively growth-enhancing activities relating to the transportation and distribution of goods, prohibiting the use of the borrowed funds for speculation in gold or foreign exchange, for stockpiling aimed at price manipulation. Once again, banks should refrain from lending to businesses that had continued their operations during the Occupation and had built up sufficient cash reserves. Loans to businesses trading in luxury items or having sufficient stocks of finished products were explicitly prohibited, as were also multiple credi-

14 "Direct lending to industrial companies", General Council minutes, ibid., 285, and "Agricultural credit", General Council minutes, ibid., pp. 285-286.

15 "Determining the Bank's lending rates", General Council minutes, Vol. 11, meeting of 10.2.1945, p. 283.

16 "Credit to banks", General Council minutes, Vol. 11, meeting of 15.3.1945, pp. 302-303.

17 "Amendment to the Statute", General Council minutes, Vol. 11, meeting of 10.2.1945, pp. 288-289.

18 "Law on the financing of undertakings by the Bank of Greece", General Council minutes, Vol. 11, meeting of 10.3.1945, pp. 290-291.

19 "Funding to banks to facilitate their transactions and provide credit to trade", General Council minutes, Vol. 11, meeting of 15.3.1945, p. 304.

tors for any given borrower. Funding to banks for this purpose would be provided by the Bank of Greece, at an interest rate of 3.5% per annum, and bank lending rates would be 7% in the case of discounts of 3-month promissory notes or bills of exchange or 8% in the case of current account overdrafts backed by such securities. The lending bank would be responsible for verifying compliance by the borrower with the terms of the loan agreement and, in the event of non-compliance, would discontinue financing and call in the entire outstanding amount. Also, a penal clause would be activated in the event that the loan amounts were found to have been used for purposes other than the intended use.

The requirements for the activation of this penal clause were laid down by a General Council in July 1945:[20] borrowers that were found to have used the funds for other purposes would, in addition to any other consequences under the loan agreement, be liable to pay a financial penalty in favour of the Greek State equal to up to three times the amount misused, or equal to the entire amount of the loan, should they refuse inspection of the company's books by the competent officials of the Bank of Greece.

In August 1945, the Bank of Greece set up a new business unit, the Banks and Enterprises Inspection Section,[21] with the task of carrying out wide-ranging inspections at banks to verify: (a) compliance with the applicable legislation on the protection of the national currency; (b) compliance with the reserve requirements; (c) compliance with the rules on the sectoral allocation of credit and the intended use of the borrowed funds; and (d) the collection of commission fees and interest. Moreover, it would also carry out inspections of industrial, handicraft and commercial firms and natural persons in order to verify compliance with the terms of the loan agreement.

Recognising the special role of industry and commerce as key drivers of economic growth and signalling its commitment to support these sectors, the Bank of Greece decided to reinstate the position of trade and economic adviser, to oversee both the Economic Research Section and the newly-established Commercial and Industrial Affairs Service.[22]

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20 "Responsibility for the activation of a penal clause", General Council minutes, Vol. 12, meeting of 28.7.1945, p. 92.

21 "Establishment of a new Section for 'Banks and Enterprises Inspections'", General Council minutes, Vol. 12, meeting of 21.8.1945, pp. 109-111.

22 "Re-establishment of the position of Commercial and Economic Adviser. Establishment of a position of Alternate Commercial and Economic Adviser. Establishment of a Commercial and Industrial Affairs Service at the Bank", General Council minutes, Vol. 12, meeting of 31.3.1945, pp. 10-11.

The General Council minutes that record the sectors and activities targeted from time to time by credit decisions vividly illustrate the changing needs of the Greek economy and the respective priorities of the Bank's credit allocation policy. For instance, tobacco trade was one of the first industries to be targeted, as early as April 1945.[23] Tobacco traders faced severe strain, not least because they were unable to export. The Bank of Greece therefore decided to extend limited credit to them, following approval by the Credit Files Committee. The regular flow of credit to tobacco trade from then onwards attests to the Bank's keen interest in this export-oriented sector, as well as its intention to address the so-called "tobacco issue" in the context of the effort to revive the economy of northern Greece and the overall reconstruction endeavour. This policy was hardly new: it had been followed in the four years prior to the Occupation and it was only natural to be resumed now that the country was free and in desperate need to recover its heavy losses. And this time the terms and conditions were more favourable: the loan-to-collateral ratio was 100%, compared with 80% previously, and the amount of the loan was not strictly limited by the value of available collateral (pledged unmanufactured tobacco), but qualitative characteristics also mattered, such as the integrity and professional competence of the entrepreneur.[24]

Another industry featuring in credit decisions of the time was that of livestock trade. Livestock merchants, through their association, asked for short-term loans enabling them to supply the Athens and Piraeus market.[25] At any rate, the country still faced severe shortages in food and other essential goods, as indicated by the fact that the Bank of Greece was commissioned by the Ministry of Supply to print (at its Banknote Printing Works at Holargos) ration cards for bread, food, clothing, etc.[26]

As part of its overall regulatory role in the banking system, the Bank of Greece set the commission fees to be charged by commercial banks on their various operations with customers. This responsibility previously lay with the Hellenic Bank Association, until it was dissolved by the occupation authorities. Now the Bank of Greece stepped in, emerging as the key regulator of the domestic financial system.[27]

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23 "Credit to tobacco merchants", General Council minutes, Vol. 12, meeting of 3.4.1945, p. 26.

24 "Credit to tobacco merchants", General Council minutes, Vol. 12, meeting of 28.7.1945, pp. 100-103.

25 "Funding to banks for on-lending to livestock dealers", General Council minutes, Vol. 12, meeting of 21.4.1945, p. 28, and meeting of 21.8.1945, pp. 104-105.

26 "Printing of ration cards on behalf of the Ministry of Supply", General Council minutes, Vol. 12, meeting of 23.10.1945, p. 143.

27 "Terms and conditions of banking operations", General Council minutes, Vol. 12, meeting of 16.6.1945, p. 54.

Moreover, to assert itself as a responsible regulator, it sought to become subject to the scope of Emergency Law 431/1945,[28] which imposed an extraordinary monthly levy on banks, at 25% of their June 1945 wage bill, for a temporary period from 1.7.1945 to 31.3.1946. Although the law had exempted the Bank of Greece from this obligation, its Administration considered that the Bank, too, should voluntarily pay the levy, as a token of its active contribution to the national effort for reconstruction and currency stability.

On 19.9.1945, the General Council was informed that Governor Varvaressos had tendered his resignation to Prime Minister Petros Voulgaris.[29] Explaining the reasons for his decision to resign, K. Varvaressos recalled the key principles of the programme he had announced in June 1945, when he became, in addition to Bank of Greece Governor, Vice-President of the Government and Minister of Supply, for addressing the country's economic and fiscal problem. These principles were: (a) state-led price and supply controls to combat hoarding and speculation; (b) imposition of a levy (so-called "special contribution") on enterprises with a view to income redistribution, as the rich had profited from the country's plights and the poor were struck by high inflation and indirect taxes; (c) achieving a fair distribution of goods, including foreign aid deliveries, based on the population's needs and not on their purchasing power, along with preventing any speculative activities. The success of this programme in the first two and a half months of its implementation, Varvaressos continued, had contributed to a turnaround in public sentiment. However, its implementation had met with reactions from vested interests. This reaction took the form of artificial shortages of goods in the market, even of the most essential. Eventually, K. Varvaressos resigned from Vice-President of the Government and Minister of Supply. And given the close interaction of the Bank of Greece with the government in economic and fiscal policy making and the status of its governor as natural adviser to the government, he could not but resign from his position as governor, too. Ultimately, Varvaressos left for England on 7.10.1945,[30] before moving to the US when he was elected executive director of the World Bank. In February 1946, the long-serving Deputy Governor G. Mantzavinos was appointed new Governor of the Bank of Greece.[31]

28 "Payment of mandatory levy under Law 431/1945", General Council minutes, Vol. 12, meeting of 9.7.1945, pp. 68-69.

29 "Resignation of Governor K. Ch. Varvaressos", General Council minutes, Vol. 12, meeting of 19.9.1945, pp. 135-139.

30 General Council minutes, Vol. 12, meeting of 23.10.1945, p. 140.

31 "Proposal of the General Council for the appointment of new Governor", General Council minutes, Vol. 12, meeting of 11.2.1946, pp. 246-248, and meeting of 18.2.1946, pp. 248-250.

Amid a succession of short-lived governments, the Bank's powers in the field of credit policy were jeopardised for a moment, given that the law ("Control on credit") envisaged that credit policy would be regulated by a decree recommended by the Minister of Finance. However, the Administration of the Bank of Greece reacted and obtained assurances from the new government that a new law would be adopted fully respecting the Bank's credit policy competence.[32]

Characteristic of the extraordinary situation in which the economy was in 1946 and which inevitably affected the functioning of the Bank of Greece was the long postponement of Annual General Meetings of Shareholders. During the Occupation, such meetings to discuss the balance sheets for the years 1941, 1942 and 1943 had been deferred to the end of December 1944. This was postponed too, by decision of the General Council, until July 1946.[33]

The credit policy of the Bank of Greece continued, intensified and became more broadly based across recipient sectors and activities, from provincial electricity companies[34] to Privileged Company of General Warehouses of Greece S.A.[35] and from tobacco manufacturers [36] to chemical industries.[37] General Council Minutes make a specific reference to funding to banks enabling them to extend export credit,[38] but also import credit, for which Bank of Greece funding would be in foreign currency.[39] The Bank of Greece also appointed inspectors to supervise its borrowers on an ongoing basis, reporting to the Bank's Administration on (a) receipts from sales and other sources of income of the businesses concerned; (b) absorption and use of available financing; (c) expenditure for raw materials, working capital, fuel, wages and other costs; (d) volume and value of output; and (e) volume and value of sales, and share of exports in total sales.[40] With regard to import credit, the problem was that

32 General Council minutes, Vol. 12, meeting of 26.11.1945, p. 172.

33 "Postponement of Ordinary General Meetings of Shareholders of the Bank", General Council minutes, ibid., p. 180.

34 "Repayment of credit to provincial electricity companies", General Council minutes, Vol. 12, meeting of 23.10.1945, p. 146.

35 "Credit to the Privileged Company of General Warehouses of Greece S.A.", General Council minutes, Vol. 12, meeting of 9.1.1946, p. 221.

36 "Approval of loans to tobacco manufacturers 'Papastratos' and 'Ethnos'", General Council minutes, ibid., p. 222.

37 "Industrial credit to the Hellenic Chemical Products and Fertilisers Company S.A.", General Council minutes, ibid., p. 223.

38 "Funding to banks for advance payments against shipping documents, letters of credit and export trade finance", General Council minutes, Vol. 12, meeting of 5.12.1945, pp. 187-188.

39 "Foreign exchange funding to banks", General Council minutes, Vol. 12, meeting of 16.1.1946, p. 230.

40 "Credit to Fertilisers Company – Appointment and mandate of inspector", General Council minutes, Vol. 12, meeting of 30.1.1946, pp. 238-239.

the pre-war credit files were obsolete, while there were creditworthy importers that needed confirmed letters of credit for free imports. To address this problem, the General Council authorised the Administration of the Bank of Greece to extend credit to such importers at its discretion, against adequate collateral.[41]

3.3 The establishment of the Currency Committee, and American aid, 1946-1951

The establishment of the Currency Committee, in accordance with the London agreement signed between the British and Greek governments on 24 January 1946, ushered in a new era, although it effectively continued the Bank's credit control regime in place since late 1944. The Bank of Greece would host the Committee at its premises and make offices available to the foreign (British and American) members of the Committee.[42]

One of the first industries to be financed after the Currency Committee was set up was that of dairy products. The relevant loans were extended by commercial banks at an interest rate of 8%, while the underlying Bank of Greece funding to banks carried an interest rate of 3.5%. The amount of the loan could not exceed 60% of the value of current dairy production to be financed or, if the purpose of the credit was to support future production, a credit line would be established against collateral of cheese stored in the facilities of the General Warehouses. Excluded from financing were firms that had remained active during the Occupation, which were seen as already possessing funds of their own.[43] Another industry that was targeted was that of tourism, in particular hotels.[44] The loans granted to the various companies often required approval by the General Council, as they involved high amounts, in excess of one-tenth of the paid-up capital of the Bank of Greece, for each borrower.[45] A large part of the Bank's credit activities were geared to enhancing the country's infrastructures, e.g. by financing the Thessaly Railways Company S.A.,[46] while the tobacco industry remained a constant recipient, as exemplified

41 "Credit to importers for 'crédits confirmés'", General Council minutes, Vol. 12, meeting of 8.4.1946, p. 295.

42 "Appointment of Currency Committee members – Recruitment of staff", General Council minutes, Vol. 12, meeting of 18.2.1946, pp. 255-256.

43 "Credit to dairy manufacturers", General Council minutes, Vol. 13, meeting of 7.5.1946, pp. 55-57.

44 "Funding to the National Bank for the extension of hotel credit", General Council minutes, Vol. 13, meeting of 26.6.1946, pp. 125-126.

45 "Approval of various loans in excess of one-tenth of share capital", General Council minutes, Vol. 13, meeting of 10.7.1946, p. 142, and "Approval of various loans in excess of one-tenth of share capital", General Council minutes, Vol. 13, meeting of 24.7.1946, p. 168.

46 "Loan to Thessaly Railways S.A.", General Council minutes, Vol. 13, meeting of 10.7.1946, p. 147.

in a State-guaranteed loan to Kavala Tobacco Manufacturing Company for the purchase of tobacco inputs.[47]

The Bank's relations with the State at the time can be approached by looking at how it responded to the latter's occasional requests for financial assistance in the face of a distressed budget. One such request was discussed when Prime Minister Konstantinos Tsaldaris asked for a loan in pounds sterling to finance the government and the Greek diplomatic missions in London, Washington, Paris, Bern and Cairo. The rationale was that the Bank should support the government in its fight for the nation's rights and for reconstruction, thereby also contributing to economic recovery. Technically, the loan would be part of the advances to the State and would be settled in due time along with the other government debts to the Bank. Moreover, a draft law was submitted to the Fourth Revisory Parliament, expanding the scope of Bank of Greece credit to include (apart from industrial) agricultural, banking and other enterprises until 1947 and authorising the Bank to extend foreign-currency-denominated loans to the State.[48]

However, the problem of currency instability persisted, and so did the associated gold hoarding trend, as can be seen by a reference in General Council minutes to the unsuccessful attempt to contain the price of the gold sovereign.

The Administration suggested that an "invisible" market intervention of the Bank of Greece would have been more effective than using the official stock exchange market as the British Economic Mission insisted. However, under pressure from the latter, the Bank of Greece followed the second course of action, but failed to contain the price of the gold sovereign, despite the high volume of sales. Thus sales through the Stock Exchange were suspended and substituted with over-the-counter sales of gold sovereigns, subject to a ceiling per customer. Meanwhile, the Bank carried out "invisible" sales in the free market, along with visible ones via stockbrokers selected by the Bank. The former lasted from 11.6.1946 until 19.6.1946, while visible sales ended on 27.6.1946. By these operations, the Bank managed to rein in the price of the gold sovereign at 135,000 drachmas by end-June 1946, with minor fluctuations, compared with a black market price of 136,000 drachmas as at 1.6.1946 and occasionally even 155,000 drachmas.[49] To replenish its gold reserves, the Bank of Greece purchased gold

47 "Extension of a loan by way of derogation from the Statute", General Council minutes, Vol. 13, meeting of 17.7.1946, p. 157.

48 General Council minutes, Vol. 13, meeting of 21.6.1946, pp. 122-125.

49 "Containing the price of the gold sovereign", General Council minutes, Vol. 13, meeting of 31.7.1946, pp. 192-195.

from the Bank of England and the Banque de France, the US Federal Reserve and investors in Athens.[50]

The Currency Committee decision of 7 August 1946 laid down the requirements for financing the various sectors of the economy.[51] For industry and handicraft, eligible for financing, either directly from the Bank of Greece or through commercial banks, were only working capital needs or expenditure aimed to restore production capacity, i.e. purchase of machinery spare parts and repair of machinery and buildings, excluding expansion of existing fixed equipment or acquisition of new machinery. Working capital needs referred only to the purchase of raw materials and fuel and, exceptionally for mining firms, compensation of employees.

The procedure was as follows: prospective borrowers applied to their bank, which reviewed the application, also from a risk perspective, and referred the matter to the Bank of Greece for approval. A new review followed by the Industrial Credit Committee, comprising the Governor and Deputy Governor of the Bank of Greece, two members of its General Council, two high-ranking officials from the Ministry of National Economy (the Director General for Commerce and Industry and the Director for Industry), one official from the Ministry of Supply, the Governor of the National Bank, the Directors of the Banking Supervision and Credit Departments of the Bank of Greece, representatives of the Bank of Athens, the Ionian Bank, the Popular Bank and the Commercial Bank, and the Presidents of the Hellenic Federation of Enterprises (SEV) and the Athens Chamber of Commerce and Industry. This committee evaluated the advisability of the loan and its terms and conditions. Loans to the Hellenic Chemicals and Fertilisers Company, to the Greek Gunpowder and Cartridge Company S.A., and to tobacco manufacturers, given "…their special nature and their scope…", were governed by specific provisions set each time by decision of the Currency Committee. Private educational institutions or hospitals were treated the same as industrial corporations, whereas public transport and hotel enterprises were subject to specific decisions of the Currency Committee.

For credit to commerce, different arrangements applied to import, export and domestic trade, respectively. Currency Committee decisions were required for credit to consumer cooperatives, tobacco and currant exporters, livestock dealers and dairy manufacturers. While allocation of industrial and handicraft loans among

50 "Containing the price of the gold sovereign", General Council minutes, Vol. 13, meeting of 7.8.1946, pp. 215-217.

51 "Financing of commerce and industry. Increase of the Bank's discount rate", General Council minutes, ibid., pp. 219-233.

commercial banks would be driven by bank-specific demand, the allocation for credit to commerce was fixed in advance, i.e. 58% for the National Bank, distantly followed by the Bank of Athens with only 14%, the Commercial Bank and the Ionian Bank with about 8% each, and less than 2% for most of the other commercial banks. This allocation was determined on the basis of banks' loan market shares for 1939.

Payroll funding to banks was standard practice for a couple of years after the war, but was phased out over the period of September 1946 through to August 1947, by monthly reductions equal to one-twelfth of monthly compensation of employees.

The discount rate and the lending rate of the Bank of Greece were set at 10%, with the exception of (a) funding to other banks for on-lending to industry and commerce, for which the interest rate was set at 3.5%; (b) loans to the Agricultural Bank (3%); and (c) payroll funding to commercial banks (1.5%). The ceiling on bank lending rates was set at 10%.

The Currency Committee prohibited banks from allocating funds to assets other than those it designated. Thus, banks were not allowed to invest in real estate, debt and other transferable securities, foreign exchange, gold and valuables.

In the summer of 1946, the Currency Committee approved credit to, among other agricultural associations, the Co-Operative Sultanas Associations – KSOS S.A., aimed at financing the centralised marketing and export of sultana raisins. These loans were guaranteed by the Greek State, did not entail collateral of commercial paper and enjoyed a favourable interest rate of 3%.[52] Soon afterwards, the Committee approved credit for infrastructure projects, including the tramway of Thessaloniki, operated by the newly set up Autonomous State Organisation of Electric Transport of Thessaloniki and financed by a State-guaranteed Bank of Greece loan at an interest rate of 3%.[53]

Reflecting the Bank's focus on credit matters, credit to industry in particular, a new business unit was created, the Industrial Credit Section. Its tasks were to review loan applications; recommend to the Credit Committee; keep records of Committee meetings; follow up on Credit Committee decisions; verify borrowers' compliance with the terms of loan agreements; and collect data on the activities of industrial companies across the country.[54]

52 "Financing to the Co-Operative Sultanas Associations", General Council minutes, Vol. 13, meeting of 28.8.1946, pp. 255-256.

53 "Credit of 1,000,000,000 drachmas in favour of the Autonomous State Organisation of Electric Transport of Thessaloniki", General Council minutes, Vol. 13, meeting of 4.9.1946, p. 271.

54 "Establishment of a new Section – Increase of Head of Section positions", General Council minutes, Vol. 14, meeting of 23.10.1946, p. 32.

Nevertheless, normal working order had yet to be restored in the country and its economy. The convening of a General Meeting of Shareholders, which had been postponed anew for October 1946 because the "…economic situation of the country…" was not "…opportune for a review of the various matters that need to be discussed at the forthcoming General Meeting…", was eventually approved by the General Council in May 1946[55] and by the Minister of National Economy in June 1946.[56] However, in October 1946 the meeting was postponed again for April 1947, which was not judged to compromise central bank communication, as the Bank regularly published its financial statements every two weeks.[57] In the meantime, amid renewed currency instability between late August and early September 1946, the Bank sold gold sovereigns on the market and managed to contain the price of the gold sovereign to 136,000 drachmas and prevent its rise in the context of a surge in all other prices.[58]

Financing to consumer cooperatives was one of the credit policy priorities at the time and was regulated by a Currency Committee decision, allowing banks to extend loans to consumer cooperatives with a maturity of 12 months or, in exceptional cases, 15 months, at an interest rate of 3%, with funding from the Bank of Greece at an interest rate of 1.5%.[59]

The sectoral allocation of credit for the year 1946 was outlined at the March 1947 meeting of the General Council discussing the balance sheet of the years 1945 and 1946.[60] The bulk (60%) was accounted for by agricultural production, compared with only 6% for industry, 15% for tobacco trade and 10% for other trade. At current prices, the Bank's lending rose from 29 billion drachmas at end-1945 to 643 billion at end-1946, while the outstanding amount of Bank of Greece advances to the Greek State rose from 85 billion drachmas to 510 billion during the same period. Both increases are huge, even factoring in inflation.

On the other hand, the Bank's gold and foreign exchange reserves had declined by end-1946, due to the sales of foreign exchange to finance imports of food and

55 "Postponement of the Ordinary General Meeting of Shareholders of the Bank", General Council minutes, Vol. 13, meeting of 29.5.1946, pp. 88-89.

56 "Postponement of General Meeting", General Council minutes, Vol. 13, meeting of 10.7.1946, p. 148.

57 "Postponement of General Meeting until April 1947", General Council minutes, Vol. 14, meeting of 23.10.1946, p. 38.

58 "Sale by the Bank of gold sovereigns on the free market", General Council minutes, Vol. 14, meeting of 13.11.1946, p. 68.

59 "Financing of consumer cooperatives", General Council minutes, Vol. 14, meeting of 23.12.1946, pp. 122-123.

60 "Balance sheet for years 1945 and 1946", General Council minutes, Vol. 14, meeting of 5.3.1947, pp. 241-255.

raw materials and of gold sovereigns with a view to containing their price. However, this policy of sales was seen as essential for preventing economic collapse; in particular gold sovereign sales were a necessary but temporary measure in the face of widespread gold sovereign hoarding and speculation, which were a major obstacle to economic recovery and deprived the economy of resources for productive investment. The sales of gold sovereigns by the Bank of Greece were aimed precisely at cracking down on the phenomenon of chrysophilia, or gold thirst.[61]

On the inflation front, the Bank's policy had been successful: after the parity of the drachma's exchange rate to the pound sterling and the US dollar had been adjusted in February 1946, prices had remained broadly stable, providing favourable conditions for a pick-up in agriculture and industry and continued adequacy of supplies and imports. By December 1946, industrial production had rebounded to 60% of its pre-war level, while agricultural production had performed satisfactorily, considering the conditions prevailing in rural Greece. Foreign aid was deemed absolutely necessary for the country's reconstruction, but the success of the endeavour necessitated a domestic effort, hard work, expenditure cuts, savings and discipline to government policy guidelines.

Thus, the Bank of Greece, despite the adverse environment within which it had to contribute to economic recovery, carried through its efforts towards a turnaround in economic and social sentiment. While continuing to finance the tobacco industry,[62] it also provided loans for the development of tourism. Specifically, in March 1947, following a Currency Committee decision, the General Council approved a loan to the Organisation for Hotel Credit, to support a number of hotels with a total capacity of 1,300 beds so that they could restart business. The loan was guaranteed by the Greek State, had a maturity of two years and an annual interest rate of 10%.[63] The same period also saw the first cases of penal clauses in favour of the Greek State called in, because loans for productive purposes (namely the operation of manufacturing plants or purchase of raw materials) had been used for the financing of trade or the production of goods other than those designated.[64] Finally, in July 1947, following a decision by the Currency Committee, the Bank of Greece also financed the Greek Carpet Organisation

61 Psalidopoulos (2013).

62 "Credit to the Xanthi Tobacco Manufacturing", General Council minutes, Vol. 14, meeting of 19.3.1947, pp. 268-269, "Financing to the Rhodes Tobacco Manufacturing", General Council minutes, Vol. 15, meeting of 28.5.1947, p. 74, and "Credit to the Kavala Tobacco Manufacturing", General Council minutes, Vol. 14, meeting of 19.3.1947, p. 271.

63 "Financing to the Organisation for Hotel Credit", General Council minutes, ibid., pp. 270-271.

64 "Activation of a penal clause in favour of the Greek State against Hellenic Iron Industry of Piraeus S.A.", General Council minutes, Vol. 15, meeting of 28.5.1947, pp. 74-76; and "Activation of a penal clause in favour of the Greek State against Andreas E. Aliprantis S.A.", General Council minutes, ibid., p. 76.

(Office Hellenique de Tapis) with a State-guaranteed three-year loan at an annual interest rate of 3%, to enable it to resume operations.[65]

As part of its responsibilities, the Bank of Greece also covered the salaries and living costs of the foreign members of the Currency Committee. Thus, the General Council approved in July 1947 the relevant outlays for American adviser Gardner Patterson, following the extension of his term until 30.6.1948. His salary was set at US dollars 12,000 per annum plus a monthly allowance of 400 dollars for representation, travel and other expenses, as well as house rent. At the end of his tenure he would take one extra monthly salary, US dollars 1,400 for relocation costs and his fare back home.[66] A similar arrangement was made for the British member of the Currency Committee, Theodore Gregory, and his assistants.[67] Moreover, the Bank of Greece covered the living and accommodation expenses of the three foreign members of the External Trade Directorate, given the entity's relevance to monetary and credit policy making by the Bank of Greece.[68]

As another line of credit activity, the Bank extended loans to the Ministry of Finance, to build up a "Providence reserve" for extraordinary social transfers, such as to workers of tobacco industries. These loans carried a favourable annual interest rate of 1%.[69] In other cases, credit decisions sought to support specific regional activities under favourable conditions. Thus, the Agricultural Bank was financed at a rate of 2%, instead of the standard 3%, for on-lending to Dodecanese grape growers charging the borrowers with a total cost of no more than 5% per annum.[70] Also, given the harsh conditions in rural areas, the Currency Committee approved loans (by the Bank of Greece and commercial banks) to support domestic distributional trade and transport of goods.[71]

The introduction of "bons" was announced at the General Council meeting of 13.10.1947 by the Governor of the Bank of Greece. The measure had been agreed

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65 "Credit to the Greek Carpet Organisation", General Council minutes, Vol. 15, meeting of 23.7.1947, p. 192.

66 "Remuneration of Mr. Patterson, US delegate at the Currency Committee", General Council minutes, Vol. 15, meeting of 30.7.1947, pp. 202-203.

67 "Remuneration of Mr. Gregory, UK delegate at the Currency Committee, and of the staff of his office", General Council minutes, Vol. 15, meeting of 8.10.1947, pp. 285-287.

68 "Participation of the Bank in the remuneration of foreign members of the External Trade Organisation", General Council minutes, Vol. 16, meeting of 4.2.1948, p. 139.

69 "Setting the interest rate on a loan of 375,000,000 drachmas to the Ministry of Finance", General Council minutes, Vol. 15, meeting of 3.9.1947, p. 240.

70 "Setting a reduced interest rate for the Agricultural Bank of Greece for the provision of loans to grape growers in the Dodecanese", General Council minutes, ibid., p. 240.

71 "Financing to domestic trade", General Council minutes, Vol. 15, meeting of 17.9.1947, pp. 255-256.

between the government and the American Mission, and the Bank of Greece had been assigned to print the securities in utmost secrecy before their launch was publicly announced.[72]

The new credit policy of the Bank of Greece was made official with the inclusion of a new Article 75 in its Statute, allowing the Bank, by way of derogation from its Statute and with a view to supporting the national economy, to extend credit to industrial, agricultural, banking or other enterprises until the end of 1948, on terms to be specified by the General Council. The Bank was also allowed to introduce to contracts a penal clause in favour of the Greek State, as well as to extend advances (until end-1948) to the Greek State against bills of exchange or promissory notes issued or endorsed by the latter, on terms to be bilaterally agreed upon.[73]

A category of loans that became standard practice as from early 1948 were those to the National Mortgage Bank of Greece, which provided long-term financing to various entities, such as the National and Kapodistrian University of Athens,[74] the Aristotle University of Thessaloniki[75] and the Panteios School of Political Sciences,[76] the Piraeus Port Authority,[77] the Athens-Piraeus Power Company, etc.[78] These loans had a maturity of ten years and carried an interest rate of 2%. Credit to exporters also continued, e.g. with loans to olive oil exporters,[79] approved by the Currency Committee following a recommendation of the Ministry of National Economy, to help them export the bumper crop of 1948.

An overview of the economic situation as at the end of 1947 was provided by Governor G. Mantzavinos at the General Council meeting discussing the balance sheet for that year.[80] Banknotes in circulation had almost doubled between 31.12.1946

72 General Council minutes, Vol. 15, meeting of 13.10.1947, p. 289.

73 "Amendments to the Statute", General Council minutes, Vol. 16, meeting of 19.11.1947, pp. 25-28.

74 "Credit to the National Mortgage Bank for financing the National and Kapodistrian University of Athens", General Council minutes, Vol. 16, meeting of 24.3.1948, pp. 224-225.

75 "Credit to the National Mortgage Bank for financing the University of Thessaloniki", General Council minutes, ibid., pp. 225-226.

76 "Credit to the National Mortgage Bank for financing the Panteios School of Political Sciences", General Council minutes, ibid., pp. 226-227.

77 "Credit to the National Mortgage Bank for financing the Piraeus Port Authority", General Council minutes, ibid., pp. 227-228.

78 "Credit to the National Mortgage Bank for financing the Athens-Piraeus Power Company", General Council minutes, ibid., pp. 228-229.

79 "Financing of olive oil exporters", General Council minutes, Vol. 16, meeting of 7.4.1948, pp. 270-271.

80 "Announcements of Governor G. Mantzavinos on the Balance Sheet of the year 1947", General Council minutes, ibid., pp. 279-287.

and 31.12.1947 to 973.6 billion drachmas, but were more than offset by the Bank's "productive investment", which stood at 1,168 billion drachmas. This indicated that the Bank of Greece was right to not see itself as responsible for the inflationary phenomena of the time.

However, acting in line with the instructions of the Currency Committee and the government, the Bank of Greece did not let monetary policy constrain its growth-enhancing credit policy. This credit policy seemed to work: industry and agriculture recovered, with their output indices rising to 72% and 65% of their respective pre-war levels. On the other hand, foreign exchange reserves dropped and, but for American aid and UNRRA relief, the consequences for the economy would have been devastating. At the same time, the Bank of Greece pursued a strong disinflationary policy, including sales of gold sovereigns in order to contain their price and ensure that the prices of goods remain unaffected. Advances to the Greek State also increased, by about 35%, but, insofar as they were used for the management of supplies, they were in effect no different from productive credit to trade and therefore did not contribute to inflation. The Bank of Greece welcomed the improvement in public finances, although associated with high and broad-based taxation; still, this was preferable to creating deficits that would in turn necessitate increased banknote issuance. The Bank's view was that taxation should optimally leave such after-tax disposable income as to sustain the development effort.

The declining purchasing power of the drachma remained a source of concern, as about one-third of this power had been lost by the end of 1947 relative to one year earlier. The Bank of Greece attributed the rise in prices to the high import prices, higher indirect taxation, continuing difficulties in international trade exchanges, as well as to the civil war that had disrupted the transportation of goods across the country. Most importantly however, higher prices were due to the decline in imports during 1947, which had impaired the adequate supply of goods, and the delayed introduction of an effective price control system.[81] The Bank of Greece believed that by addressing these problems, and mainly by utilising American aid to support industrial and agricultural production, it would be possible to overcome the economic crisis and move on to development and a brighter future for the country.

In the next period, financing continued apace. Recipients included iron industries that needed imports of raw materials;[82] the National Bank for financing the purchase of 1,000 vehicles from Greek Gunpowder and Cartridge Company S.A.

81 Ibid.

82 "Financing to iron industries", General Council minutes, Vol. 17, meeting of 5.5.1948, pp. 32-33.

for professional motorists;[83] and the National Mortgage Bank for long-term loans to construction firms enabling them to restore their equipment.[84]

In July 1948 the Bank of Greece changed its interest rate policy: it raised the ceiling on its lending rate to 12% and specified that banks could not charge borrowers with more than 15% per annum (increased to 16% by a later decision), including commission fees and other costs.[85] Also, it raised from 3.5% to 5% the annual interest rate on funding to commercial banks for on-lending to commerce and industry, leaving unchanged the interest rates on the Bank's loans to tobacco trade and the favourable interest rates applying to public utilities, consumer cooperatives, the Agricultural Bank and the National Mortgage Bank.[86] In addition, the Bank of Greece required commercial banks to provide the Currency Committee with any financial and accounting data upon request; any institutions that failed to comply would face an increase in their required reserves with the Bank of Greece and, in case of repeated breaches, exclusion from central bank funding.[87] At the same time, the Currency Committee introduced the compulsory use of cheques in the disbursement and repayment of loans, with a view to reducing the need for cash, encouraging bank intermediation and exercising more effective control on the relevant transactions.[88]

The Bank's delegate at the Annual General Meeting of the Bank for International Settlements in June 1948, Kosmetos Kosmetatos, reported to the General Council on the international economic and banking state of affairs.[89] The meeting brought together central bank governors from across Europe and, for the first time, American delegates of the World Bank and the International Monetary Fund. Participants commended the stance of the Bank of Greece during the war and its efforts to resume its role in international cooperation based on its pre-war experience. One

83 "Funding to the National Bank for on-lending to members of the Panhellenic Federation of War-stricken Professional Motorists", General Council minutes, Vol. 17, meeting of 2.6.1948, pp. 70.

84 "Funding to the National Mortgage Bank for on-lending to construction firms", General Council minutes, ibid., pp. 70-71.

85 "Determination of interest rates and commission fees on bank lending", General Council minutes, Vol. 17, meeting of 1.9.1948, pp. 206-207.

86 "Determination of the interest rate and commission fees on bank lending. Increase of the Bank's discount rate", General Council minutes, Vol. 17, meeting of 14.7.1948, pp. 134-137.

87 "Decisions of the Economic Policy Committee", General Council minutes, ibid., pp. 140-142.

88 "Special terms for the extension of industrial loans. Decision of the Currency Committee", General Council minutes, Vol. 17, meeting of 28.7.1948, pp. 161-163.

89 "Representation of the Bank at the 18th annual General Meeting of Shareholders of the Bank for International Settlements. Submission of report", General Council minutes, Vol. 17, meeting of 16.10.1948, pp. 254-258.

of the issues discussed referred to payment agreements among European countries and multilateral monetary compensation, enabling to economise the use of foreign exchange, mainly dollars of American aid. The BIS had undertaken the technical management of these multilateral monetary compensation schemes. However, a problem that could not be addressed by these payment agreements was the existence of a majority of countries with a permanent debtor position and a minority of countries with a permanent creditor position on the relevant accounts. Thus, to cover intra-European transactions, it was proposed to use part of the aid available under the Marshall Plan. Kosmetatos argued that, in his view, the BIS's effort to rehabilitate the European economy was motivated by its aspiration to become, with the help of the United States, the central bank of Europe.

As a follow-up to the Economic Cooperation Agreement signed between the governments of the United States and Greece in July 1948, an agreement on industrial and agricultural loans was signed and was announced to the General Council in November 1948.[90] The rationale behind this agreement was that economic recovery necessitated a more effective utilisation of Greece's natural resources and the development of agriculture and industry; this effort required funding that could not possibly come from domestic sources alone. The amounts of dollars and pounds available under the agreement would be used to finance imports for supporting industry and agriculture. Moreover, a Central Loans Committee was set up, comprising representatives of the Greek government, the Bank of Greece, the American Mission and the banks participating in the programme. The Central Loans Committee would decide by majority vote on loan applications forwarded by the participating banks, following an assessment of their compatibility with Greek law, the requirements of the aforementioned agreement, the government's credit policy orientations, the Greek Recovery Programme and the specific lending policy of the Central Loans Committee. The Currency Committee would prepare a list of the banks eligible to participate in the programme, and the terms and conditions for such participation would be agreed between banks and the Greek government. Participating banks would receive the relevant loan applications and undertake to monitor and execute the loan agreements in accordance with the instructions of the Central Loans Committee. The maximum maturity of these loans was 12 years and the maximum lending rate 8%. The agreement would expire on 30.6.1952, although the United States reserved the right of early termination.

90 "Agreement regarding agricultural and industrial loans", General Council minutes, Vol. 17, meeting of 10.11.1948, pp. 288-299.

Another agreement addressed the supply of capital goods in the context of the Greek Recovery Programme.[91] Specifically, the ministries involved in the recovery programme needed to import certain goods. Financing for these imports would come from (a) the Economic Cooperation Administration (ECA), which would provide loans in US dollars; (b) the relevant bodies of European Economic Cooperation, which would provide multilateral monetary compensation; and (c) the Bank of Greece, which would supply foreign exchange in pounds sterling, as well as drachmas for the domestic part of import payments under clearing arrangements. Based on this agreement, the Greek State was required to deposit with the Bank of Greece the drachma equivalent of American aid, of which 95% would be blocked and offset against the outstanding debt of the Greek State vis-à-vis the Bank of Greece in the context of these supplies.

Under the Greek-American trade cooperation agreement, several financing operations took place: loans for the import of automobiles, approved by the Currency Committee following a relevant decision by the Hellenic-American Automobile Committee;[92] funding to the National Mortgage Bank for a 10-year loan to support the import and installation of US-manufactured machinery by Hellenic Steel Sheet and Tin S.A.;[93] a loan to Attica Lignite Mines S.A., which ultimately benefited from a favourable repayment arrangement taking into account the firm's financial condition and importance for the Greek State.[94] The management of these operations as well as of all American aid loans was entrusted to a newly established Section of the Bank of Greece.[95]

To facilitate import trade, especially imports of essential inputs to industry, the Currency Committee, following a proposal by its representative at the Ministry of National Economy, Charles Terrell, specified that importers could be financed for up to 50% of the value of their foreign exchange vouchers (or bons) upon the opening of the letter of credit. Also, upon arrival of the imported goods at the customs they could be financed for 50% of the invoice in foreign exchange (having to pay the

91 "Agreement on the procurement of capital goods under the Greek Recovery Programme", General Council minutes, Vol. 17, meeting of 10.11.1948, pp. 299-300, and General Council minutes, Vol. 18, meeting of 10.11.1948, pp. 1-7.

92 "Financing of importers of automobile accessories", General Council minutes, Vol. 18, meeting of 17.11.1948, pp. 17-18.

93 "Funding to the National Mortgage Bank for financing the Hellenic Steel Sheet and Tin S.A.", General Council minutes, Vol. 18, meeting of 23.12.1948, pp. 71-72.

94 "Industrial loan of 70,000,000 drachmas to the Attica Lignite Mines S.A.", General Council minutes, Vol. 18, meeting of 13.4.1949, pp. 232-233.

95 "Establishment of a new Section responsible for American aid industrial loans. Increase of Head of Section positions", General Council minutes, ibid., pp. 236-237.

remaining 50% on their own). Imports by industrial or handicraft enterprises would again be financed up to 50% of the value of foreign exchange vouchers, but in the case of imports of raw materials and fuel, the financing upon arrival would be up to 70%.[96] These percentages were changed by a new decision in July 1949, envisaging the financing of up to 40% of foreign exchange vouchers and the invoice price upon arrival, with the exception of raw materials and fuel for industry and handicraft in which case financing was up to 60%.[97] Finally, by a new decision in August 1949, financing to import trade via letters of credit upon arrival of the goods was increased to 70%, or 90% for raw materials and fuel to industry and handicraft.[98]

At the 19th Annual General Meeting of the Bank for International Settlements in Basel on 13.6.1949, the Bank of Greece was represented by its adviser K. Kosmetatos.[99] Participants also included representatives of the US State Department, the US Treasury, the Economic Cooperation Administration, the Organisation for European Economic Cooperation (OEEC), the US Federal Reserve, the International Bank for Reconstruction and Development and the International Monetary Fund, as well as central banks, including those of Egypt, Turkey, Portugal, Ireland and the Eastern European countries.

The BIS provided technical assistance to the OEEC for the settlement of transactions in the context of bilateral agreements and indirect aid. According to Kosmetatos, although the BIS's report revealed its adherence to economic orthodoxy, which, in his view, could not fit the specific circumstances of Greece, still he saw it as useful to mention the key points of the report. He went on to note that the BIS had assessed the year 1948 as one of "…economic and monetary rehabilitation". Whereas the first post-war years had rightly been marked by disinflationary policies alongside measures to bolster output, thereafter less control was warranted. Thus, according to the orthodox view, higher investment could not contribute to economic stability unless it was matched by sufficient savings, with government expenditure financed by additional taxation. A country would not be able to stand back on its feet through "excessive" investment in capital goods, if it lacked a sound credit policy and had an overvalued currency and high output prices, all of which would lead to a

96 "Financing of import trade, as well as industry and handicraft", General Council minutes, Vol. 18, meeting of 11.5.1949, pp. 258-261.

97 "Financing of import trade, as well as industry and handicraft", General Council minutes, Vol. 19, meeting of 27.7.1949, pp. 120-124.

98 "Financing of import trade, as well as industry and handicraft", General Council minutes, Vol. 19, meeting of 10.8.1949, pp. 156-160.

99 "Representation of the Bank at the 19th Annual General Meeting of the Bank for International Settlements – Submission of report", General Council minutes, Vol. 19, meeting of 29.7.1949, pp. 130-137.

deficit in the balance of payments, a drain on foreign exchange holdings and a "…squandering of foreign credit…", thereby perpetuating economic imbalances.

Continuing his discussion of the BIS report, Kosmetatos noted that according to the BIS "…the advocates of controls should not forget that these, although they help to save foreign exchange, on the other hand cause, or at least greatly contribute to, higher domestic consumption to the detriment of exports". Therefore, all forms of prohibitions and restrictions imposed for monetary or other reasons had to be abolished. At the national level, each country should take care to maintain its internal and external stability, without creating excessive domestic purchasing power. In concluding his account, K. Kosmetatos remarked that, although these views were not relevant for Greece at the time, they could become so in a future different context of the Greek economy and thus deserved the attention of the Bank of Greece.

On 22.9.1949, the Governor of the Bank of Greece announced an adjustment of the exchange rate of the drachma vis-à-vis the pound sterling,[100] necessitated by the devaluation of the pound, which affected most of the currencies of Marshall Plan countries. The new parities of the drachma against the US dollar and the pound sterling reflected Greece's economic reality. To prevent a pass-through to domestic prices, the Greek government took a number of measures, such as: (a) maintaining at pre-devaluation levels the administered prices of essential foodstuffs, as well as the prices of all other food and clothing items, fuel and certain raw materials for industry; and (b) strict price controls for all other goods. At the same time, legislation was adopted to ensure a corresponding adjustment of foreign exchange and credit policy, as well as of the policy to boost production and exports, in line with the economic development agenda.

With respect to export trade, in October 1949 the Currency Committee decided that exporters could obtain financing for up to 70% of confirmed letters of credit, to be disbursed two months prior to the execution of the credit, at the latest.[101]

In January 1950, Deputy Governor S. Grigoriou announced to the General Council that Governor G. Mantzavinos had been appointed Minister of Finance[102] and had been sworn in as a member of the government at the Greek Embassy in Washington, D.C. on 9.1.1950.

At around the same time, a new Currency Committee decision introduced even stricter penalties for non-compliance by banks with Currency Committee's credit

100 "Announcement of the Governor on the adjustment of the drachma following the devaluation of the pound sterling", General Council minutes, Vol. 19, meeting of 22.9.1949, pp. 222-224.

101 "Financing of export trade", General Council minutes, Vol. 19, meeting of 19.10.1949, pp. 254-255.

102 "Announcement of the appointment of Governor G. Mantzavinos as Minister of Finance", General Council minutes, Vol. 20, meeting of 11.1.1950, pp. 154-155.

control guidelines. Sanctions included a higher minimum reserve ratio, a higher interest rate on Bank of Greece funding, as well as criminal liability for the natural persons involved, whether employees or board members of the bank concerned.[103]

In March 1950, the General Council was informed that the Governor, on a visit to the United States together with Theodore Gregory, had requested the Federal Reserve Board in Washington to send a banking expert to Greece to assist the Currency Committee in its enquiry into the Greek banking system. The Fed appointed Delos C. Johns, general counsel and secretary (and later vice president) of the Federal Reserve Bank of Kansas City.[104] Johns joined the Bank of Greece and, in April 1950, a General Council decision defined his remuneration and the costs of his three-month stay in Greece, which would be paid by the Federal Reserve Bank of Kansas City and debited to the account of the Bank of Greece.[105,106]

In view of the growing financing needs of domestic trade businesses, the Bank of Greece decided to raise the loan amount threshold that could be approved by a number of its branches, as well as by its Head Office.[107] Moreover, the Bank of Greece extended credit to HELLAS Hellenic Airlines for the purchase of an aircraft for its Athens-London flight connection,[108] as well as to National Greek Airlines (TAE) for working capital, due to a deterioration of its financial condition.[109] Meanwhile, arrears on past loans had been accumulating; to address this problem, a Currency Committee decision was issued, as announced to the General Council in August 1950.[110] The decision called for banks' best efforts to ensure the settlement of such arrears. Subject to prior approval by the Currency Committee or the Industrial Credit Committee, banks were authorised to lengthen the repayment period only for

103 "Announcement of the Emergency Law of 4.1.1950 complementing the provisions of Legislative Decree 588/1948 regarding control on credit", General Council minutes, ibid., p. 157.

104 "Announcement by the Deputy Governor on the Governor's request to the Federal Reserve Board for an expert to assist the Currency Committee in an enquiry into the Greek banking system", General Council minutes, Vol. 20, meeting of 1.3.1950, p. 250.

105 "Determination of the remuneration of Mr. Delos C. Johns, expert assigned to assist in an enquiry into the Greek banking system", General Council minutes, Vol. 21, meeting of 19.4.1950, p. 62. As already mentioned, the report he submitted was of decisive importance.

106 For the Johns Report, see Part 1, 3.18 above.

107 "Increase of the ceiling on the financing of domestic trade", General Council minutes, Vol. 21, meeting of 17.5.1950, pp. 128-130.

108 "Loan of 3,750,000,000 drachmas to HELLAS Hellenic Airlines", General Council minutes, Vol. 21, meeting of 26.5.1950, pp. 161-163.

109 "Loan of 160,000,000 drachmas to National Greek Airlines (TAE)", General Council minutes, Vol. 22, meeting of 30.8.1950, p. 130.

110 "Adoption of measures for the recovery of bank loan arrears", General Council minutes, Vol. 22, meeting of 23.8.1950, pp. 116-117.

borrowers that had repaid a considerable part of their debt. For every month in arrears, borrowers would face an additional charge of 0.5%. Commercial banks were not allowed to extend credit to borrowers with outstanding debts to the same or any other bank without prior approval of the Currency Committee.

By a new amendment to the regulations on the financing of domestic trade, the Currency Committee decided that financing should not exceed 40% of the value of goods, except for building materials and other inputs to construction activity. Also, along with the loan application, prospective borrowers had to submit a statutory declaration regarding any existing debts to other banks. Those whose loan applications were rejected had the right to appeal before a review committee to be set up at the Bank of Greece and bringing together the Director of the relevant Department of the Bank of Greece, a representative of commercial banks and a representative of the local Chamber of Commerce and Industry or Merchant Association.[111]

In late 1950, the Bank of Greece began to extend loans, repayable in 30 monthly instalments at an annual interest rate of 3%, to its employees for repurchasing their homes that had been sold under duress during the Occupation.[112] Also, in the context of the effort to ensure the adequacy of supplies, working capital financing was extended to oil companies for imports of oil products; the loans covered 100% of import invoices or foreign exchange vouchers and were repayable in two years.[113]

The financing of the Thessaloniki International Trade Fair was announced for the first time in May 1951. After a suspension of 10 years, the Fair would open again in September of that year and was in need of financing to repair war damages and restore its pillaged facilities. The loan, which would top up the Marshall Plan aid, was guaranteed by the Greek State and was repayable by 30.11.1951.[114]

In June 1951, the Governor reported to the General Council on his visit to the United States and the talks he had there with Federal Reserve, IMF and IBRD officials. The discussions focused on problems arising from the abolition of bons and matters relating to the introduction of a rationing system in Greece, mostly for olive oil. Also, the Governor informed the General Council that one of the main recommendations of the Johns Report was the establishment of a new Banking Supervision unit, reporting to the Currency Committee. Thus, the Governor suggested that

111 "Financing of domestic trade and ceiling on its financing from banks' own available funds", General Council minutes, Vol. 22, meeting of 18.10.1950, pp. 230-232.

112 "Loans to employees for repurchasing their homes sold during the Occupation", General Council minutes, Vol. 22, meeting of 22.11.1950, p. 47.

113 "Financing to oil companies", General Council minutes, Vol. 24, meeting of 23.4.1951, pp. 132-133.

114 "Financing of the Thessaloniki International Trade Fair with 500,000,000 drachmas", General Council minutes, Vol. 24, meeting of 9.5.1951, pp. 167-168.

an American expert should be assigned to organise such a unit. Federal Reserve auditor W.H. Dillistin was chosen for the task, and his recruitment by the Bank of Greece under a one-year contract was proposed.[115]

At the Annual General Meeting of the BIS in Basel on 11.6.1951, the Bank of Greece was once again represented by its adviser K. Kosmetatos. The meeting reviewed the global economic situation and recommended policies in line with economic orthodoxy. The BIS report focused on possible ways to avoid inflation as a result of increased armament expenditure in Europe. All countries had to reexamine their tax policies, curtailing non-essential expenditure, and address the decline in investment. As rephrased by Kosmetatos, the report also noted that balance-of-payments equilibrium had broadly been restored in the dollar area, thus the only reasons why foreign exchange restrictions remained in place were associated with vested interests or foreign exchange shortages. Disagreeing with "those which adhere to a collectivist type of economy", the BIS argued that the wartime credit controls could not be usefully employed in time of peace, even if it were an "armed peace". The great risk lay in a relapse to inflation as a result of re-armament, which would weaken economic and social structures, especially in "countries with a relatively free system". Other proposed ways to finance the increased military expenditure, apart from higher taxation and cuts in other types of spending, included borrowing and a restrictive credit policy through interest rate increases. Furthermore, in order to maintain monetary equilibrium, which would also contribute to higher saving levels, there should be no recourse by governments to money issuance through the central bank for financing their expenditure. Economic growth would also be supported by a gradual relaxation of import restrictions and by restoring free scope for foreign competition. Overall, the BIS considered that international competition would keep prices down, boost production and —coupled with a prudent credit policy at the national level— enhance confidence in the currency, thus generating savings that could be used to finance armaments without causing inflation.

Kosmetatos believed that these views could not be fully applied in the case of Greece, which, saddled with the devastating impact of the civil war, balance-of-payments and fiscal deficits and unemployment, lagged behind the recovery underway in Western European countries. Under the prism of the orthodox stance of the BIS, the effort of the Bank of Greece to stabilise the currency by selling gold sovereigns, as well as its credit policy aimed at strengthening productive capacity, were seen as

115 "Announcements of the Governor regarding his actions in the USA, as well as proposal for the appointment of an American expert as Technical Adviser to the Bank", General Council minutes, Vol. 25, meeting of 20.6.1951, pp. 9-10.

positive. What was inconsistent with that orthodoxy was only the growing government spending financed by the Bank of Greece, which along with the rising world prices of raw materials and the psychological factors associated with Greece's bordering on the Eastern Bloc, caused the domestic purchasing power of the drachma to decline. Therefore, the sound policy of the Bank of Greece was distorted by factors beyond its control.[116]

At the International Credit Conference held in Rome in 1951, the Bank was represented by its Deputy Governor and, on behalf of the Currency Committee, T. Gregory. Discussions focused on bank liquidity and control on money circulation and credit. The conference brought together representatives of the major European and US banks and academics. T. Gregory talked about bank liquidity, while the Deputy Governor of the Bank of Greece focused on the issue of inflation in Greece. After presenting an overview of the policy of the Bank of Greece, in particular its policy with respect to gold, the Deputy Governor described the situation of the Greek economy, highlighting the psychological factor, while also stressing the need for a well-functioning banking system and for the operational autonomy of central banks.[117]

In November 1951 the General Council was officially informed of a Currency Committee decision regulating credit to import trade.[118] The decision identified three classes of imports and specified the percentage of import value that could be financed, as follows: 60% for Class A, comprising basic foodstuffs and livestock; 50% for Class B, encompassing all consumer goods and raw materials under the current needs plan other than those included in Class A; finally, Class C goods, to be specified by joint decision of the Ministers of Finance and Commerce, were not eligible for financing. Loans would be extended by commercial banks, with the possibility of recourse to the Bank of Greece for funding only where their own available funds were insufficient.

As the problem of arrears on bank loans persisted, the Currency Committee issued a new decision,[119] whereby banks were not allowed to grant any loan repayment extension without the approval of the Currency Committee. Banks were authorised to use any means, including legal action, to recover loan amounts, while the

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116 "Representation of the Bank at the 21st Annual General Meeting of the Bank for International Settlements – Submission of report", General Council minutes, Vol. 25, meeting of 17.8.1951, pp. 137-142.

117 "Announcement by Deputy Governor Mr. Grigoriou on the International Credit Conference held in Rome", General Council minutes, Vol. 26, meeting of 7.11.1951, pp. 20-21.

118 "Financing of import trade", General Council minutes, Vol. 26, meeting of 10.11.1951, pp. 34-37.

119 "Adoption of measures for the timely repayment of bank loans", General Council minutes, ibid., pp. 49-51.

Currency Committee also urged the government to take the necessary steps for a faster enforcement of court rulings.

In December 1951, the General Council was informed of the return of K. Varvaressos to Athens from Washington. K. Varvaressos, serving at the International Bank for Reconstruction and Development, had been invited by the government to review the economic situation of the country and recommend measures for its reconstruction.[120]

The Currency Committee decision of 20 December 1951 laid down the provisions on banking supervision, in line with the recommendations of American expert W.H. Dillistin. A dedicated Section for Banking Supervision would be set up at the Bank of Greece, divided into a Secretariat Service and an Inspection Service. The former would determine the type of data banks that would be required to report and collect such data. The latter would conduct on-site inspections at banks and, if necessary, at their customers, to verify compliance with Currency Committee decisions.[121]

3.4 Credit and monetary policy until the 1953 devaluation

A new Currency Committee decision on 16 January 1952 reformed the import credit framework.[122] Imports were now classified in four classes: Class A included food, draught and breeding animals, chemicals, fuel, metals, textiles, raw materials for industry, timber, paper and finished paper products, leathers and skins, rubber, minerals and mineral products, (road, railway and air) transport equipment, machinery and parts of machinery. These items could be financed up to 50% of their import value. Class B referred to goods that could be financed up to 25% of their value and included, in addition to specific items under the above categories, pharmaceuticals, medical supplies, electrical appliances, scientific instruments and office supplies. Class C included fuels, which could be financed up to 100% of their value based on relevant decisions by the Currency Committee, while Class D related to items excluded from financing. The lists of Classes A and B were revised in August 1952 by decision of the Currency Committee,[123] although the respective financing percentages were kept unchanged.

120 "Arrival of Mr. Kyriakos Varvaressos", General Council minutes, Vol. 26, meeting of 5.12.1951, p. 106.

121 "Banking supervision", General Council minutes, Vol. 26, meeting of 28.12.1951, pp. 193-195.

122 "Financing of import trade", General Council minutes, Vol. 26, meeting of 16.1.1952, pp. 229-240.

123 "Modification of the terms of financing of import trade", General Council minutes, Vol. 28, meeting of 8.8.1952, pp. 138-145.

“The emblem of the Bank”, drawing by Michael Axelos, 1928

Top: "The Administration and the Members of the General Council convening on 23 November 1933", painting by Michael Axelos, 1947

Bottom: The 1st General Council of the Bank of Greece convening on the plot of its Head Office on 20 November 1933 (according to the handwritten inscription at the bottom of the picture)

Top left: Ceremonial laying of the foundation stone of the Head Office (20.11.1933). Consecration by Archbishop Chrystostomos of Athens; next to him, Emm. Tsouderos delivers a speech

Top right: Construction of the Head Office, 3.8.1934

Bottom: The General Council of the Bank of Greece, session of 4.4.1938, the same day that the Head Office was inaugurated. At the head: on the left Deputy Governor K. Varvaressos, in the middle Governor Emm. Tsouderos and on the right Deputy Governor G. Mantzavinos

Top: Perspective design of the Main Hall of Bank of Greece's Head Office by Dimitrios Tripodakis, 1933
Bottom: View of the Main Hall

Top: Celebration of 50 years from the establishment of the Bank and commemorative coin
Bottom: Celebration of 75 years of operation and commemorative coin

General Council minutes

Banknotes issued by the Bank of Greece

Bank of Greece publications

The minutes of the General Council of 6 February 1952 recorded for the first time a divergence of views among its members, following the announcement of a Currency Committee decision regarding the collection of debt arrears, whereby the additional charge for every month in arrears would be increased from 0.5% to 1%, payable to the Greek State. General Council member A. Fix asked the Governor whether this decision was binding on the Bank of Greece. The Governor replied that indeed it was, and this was simply about its announcement to the General Council. Then, members M. Finopoulos and G. Mamais protested, arguing that such mea sures "…will bring about no benefit to the economy of the country, on the contrary … they are … damaging". Nevertheless, the General Council finally endorsed the decision of the Currency Committee.[124]

The economy had not yet been stabilised, as was evident also by the urgent funding requested by the National Bank in February 1952.[125] Specifically, the National Bank, through its Governor, attributed its illiquidity to: (a) the penalties it had incurred for exceeding the ceiling on lending to domestic trade; (b) exceptionally high deposit withdrawals; and (c) the delays in loan repayment by borrowers. Taking these points into consideration, the Currency Committee decided to "…exceptionally and strictly temporarily…" approve emergency credit from the Bank of Greece to the National Bank, at an interest rate to be set by the General Council, and subject to a regular reporting to the Currency Committee on the daily debit balance of the National Bank's account with the Bank of Greece.

In July 1952, the Bank of Greece extended a State-guaranteed loan to the Greek National Tourism Organisation for the needs of its programme.[126] Also, by government decision, the Bank of Greece transferred to the Athens Stock Exchange, as temporary support, 0.5% of the drachma equivalent of banks' foreign exchange purchases and sales. By a new decision, this percentage was reduced by one-fifth to 0.4%, with retroactive effect as from 1.1.1952, and became subject to the requirement that such transactions should have generated gains for the Bank of Greece.[127]

124 "Adoption of measures for the timely repayment of bank loans – Amendment to the decision of the Currency Committee", General Council minutes, Vol. 26, meeting of 6.2.1952, pp. 284-285.

125 "Emergency funding to the National Bank of Greece", General Council minutes, Vol. 27, meeting of 13.2.1952, pp. 3-4.

126 "Loan of 750,000,000 drachmas to the Greek National Tourism Organisation for the implementation of its programme for the current year", General Council minutes, Vol. 27, meeting of 11.6.1952, pp. 294-295.

127 "Determination of a contribution in favour of the Athens Stock Exchange based on the drachma equivalent of the Bank's purchases and sales of foreign exchange", General Council minutes, Vol. 28, meeting of 26.7.1952, pp. 103-104.

In late July 1952, the Currency Committee revisited the matter of bank loan arrears.[128] A list was prepared with all borrowers having overdue bank debts of more than 1 billion drachmas. Named in the list were manufacturers producing machinery (6 companies), building materials (4), textiles (29), food (7), chemicals (9), leather (1) paper (1) and tobacco (2 companies), one mining company, three construction firms, 14 retailers and nine other organisations and enterprises, including the Hellenic Telecommunications Organisation (OTE), hospitals and agricultural enterprises. Under the new Currency Committee decision, 40% of industrial corporations' debt would be refinanced against collateral of 3-month promissory notes, while the remaining 60% would be exempted from the additional charge of 1% for every month in arrears. The Currency Committee had the power to remove from the list a debtor enterprise whose total outstanding debt had fallen to less than 1 billion drachmas, including favourable repayment arrangements for enterprises normally continuing their activity. In the event that the above enterprises failed to settle their debts as prescribed by the decision of the Currency Committee, the lending bank would initiate judicial enforcement proceedings. These favourable provisions would not apply to trade companies, which faced immediate legal enforcement proceedings and could only avoid the sanctions for overdue debts by repaying 80% of these debts.

A challenge for the Bank of Greece was ensuring co-financing by banks with their own available funds, where required. The Credit Files Committee examined the issue and concluded that: (a) it was absolutely necessary to continue the financing programme in the cases where banks did not have sufficient funds to contribute; (b) it was impossible, both in theory and in practice, to verify the accuracy of banks' reported lack of funds; (c) therefore, for ensuring continued financing in such cases, the only option was for the Bank of Greece to provide funding assistance.

Of course, this would only be done for the part that banks were unable to contribute and at interest rates less favourable than their respective retail deposit rates, which would act as a disincentive to misrepresent their lending capacity. For that part, banks would obtain funding in the form of rediscounts of (at most) three-month promissory notes out of their commercial paper portfolio, at an interest rate of 10%. Failing this, the Bank of Greece would extend the loan directly and for the entire amount.[129]

128 "Arrangements for debts in arrears as at 30.6.1952", General Council minutes, ibid., pp. 116-123.

129 "Ensuring the participation of banks in financing operations with their own resources", General Council minutes, Vol. 28, meeting of 8.8.1952, pp. 133-135.

In September 1952, with a view to ensuring the viability of social security funds, the Currency Committee prohibited them from forbearing social security arrears of debtor enterprises, and introduced, with retroactive effect as from 1.8.1952, a requirement on all businesses to submit a social security clearance certificate as a precondition for their loan applications to be considered.[130] Also in September 1952, the Currency Committee abolished the established co-financing rates between the Bank of Greece and commercial banks for loans to trade and industry, excluding tobacco trade, export trade in general, handicraft and consumer cooperatives. Financing projects would be provided exclusively by commercial banks out of their own resources, indicating that banks had strengthened their balance sheets. Of course, banks could also use funding they obtained from the Bank of Greece in the form of commercial bill discounts. The interest rate was set at 5% per annum. To monitor compliance with the terms specified by the Currency Committee in respect of loans to trade and industry, a new committee (the Credit Committee) was set up within the Bank of Greece, composed of the Governor and Deputy Governor of the Bank of Greece, the two foreign members of the Currency Committee, one Currency Committee member in their capacity as University of Athens professor and, without the right to vote, the Directors of the relevant Departments of the Bank of Greece.[131]

Yet another step towards assigning greater responsibility to commercial banks, which also shows improved confidence in their ability to effectively implement the defined credit policy, was the decision on the allocation of responsibilities between commercial banks and the Industrial Credit Committee.[132] First of all, the terms of financing to industry were modified. Industrial companies would be financed for their imports of raw materials and other inputs and, exceptionally, for domestic supplies, only if they lacked own resources or commercial bill portfolios to discount. Also exceptionally, lignite and ore mines would be financed to pay extraction workers. Costs related to expansion of facilities, repair of buildings and/or machinery or the purchase of new machinery and parts were in principle ineligible for financing. As from 1.10.1952, prior approval of the Industrial Credit Committee for the financing of industry would not be required in the following cases: (a) imports of raw materials; and (b) purchases of raw materials from the domestic market, although a long list of exceptions applied. An upper limit to credit per industrial

130 "Cash surpluses of Public Organisations", General Council minutes, Vol. 28, meeting of 10.9.1952, pp. 221-222.

131 "Financing of trade and industry", General Council minutes, Vol. 28, meeting of 17.9.1952,pp. 231-233.

132 "Allocation of responsibilities between intermediating banks and the Industrial Credit Committee in respect of industrial credit. Financing of import and export trade", General Council minutes, Vol. 28, meeting of 20.9.1952, pp. 249-258.

plant was also introduced. The Industrial Credit Committee would decide on applications by lignite and ore mining firms for loans to finance extraction costs and exports of manufactured products and ores. Credit to commerce, related to either import or domestic trade, was brought under the responsibility of commercial banks.

In November 1952, it was announced to the General Council that the Currency Committee had decided to set up a permanent Industrial Companies Audit Service within the Bank of Greece, as recommended by British certified auditors. Its staff would include auditors and supporting personnel, including translators, as its tasks would involve contact and consultation with British experts.[133] Furthermore, by a decision adopted in December 1952, the additional charge of 1% per month in arrears imposed on enterprises was also extended to banks with overdue debts to the Bank of Greece,[134] although a subsequent decision[135] allowed for exemptions in the following cases: (a) loans of less than 30 million drachmas; (b) arrears settled within one month; (c) arrears settled within four months, for which the additional charge was set at 0.5%; and (d) arrears for which the Currency Committee had approved a repayment time extension.

In early February 1953, the Bank began to consider ways of cutting its operating costs, [136] and on 20.2.1953 it was announced to the General Council that, owing to the decline in its gross income that had been observed in 1952 and was projected to continue at a faster pace in 1953, it was necessary to reduce administrative costs. This led to the abolition of overtime pay, travel allowances to Directors, rent allowances to employees, the 15% bonus to staff in northern Greece, all sorts of remunerations for participation in committees and councils, as well as the adoption of a number of other drastic cost-cutting measures. Furthermore, the decision to establish branches in the towns of Trikala and Livadia was cancelled, a number of Director positions were abolished, and a target was set to downsize staff by 350 persons.[137]

In March 1953, under Legislative Decree 2176/1952 "Measures to protect provincial industry", the Currency Committee introduced a framework to govern cre-

133 "Establishment of an Industrial Companies Audit Service", General Council minutes, Vol. 29, meeting of 4.10.1952, p. 89.

134 "Imposition of an additional charge of 1% per month to intermediating banks in arrears on their debt to the Bank of Greece", General Council minutes, Vol. 29, meeting of 3.12.1952, pp. 216-217.

135 "Application of the measure of additional charge in favour of the Greek State on debt arrears. Approval of exemptions from the measure", General Council minutes, Vol. 29, meeting of 30.12.1952, pp. 293-294.

136 "Announcement by the Chairman of a cost-saving plan", General Council minutes, Vol. 30, meeting of 6.2.1953, pp. 57-58.

137 "Reduction of the Bank's expenditure", General Council minutes, Vol. 30, meeting of 2.2.1953, pp. 79-83.

dit to industrial companies located outside large urban centres.[138] These companies enjoyed a favourable interest rate, 20% lower than the one applicable on other industries. In addition, banks were obliged to allocate to provincial industry at least 30% of their total lending to industry.

On 9.4.1953, the Governor of the Bank of Greece announced to the General Council the government's decision to adjust the exchange rate of the drachma to the US dollar to 30,000 drachmas per dollar. The Governor explained to the General Council that the nature of the measure and the need for absolute secrecy to ensure its success had prevented him from announcing it to the General Council sooner. Then, the Governor explained the reasons behind this devaluation and why the prevailing conditions were favourable for its success.[139]

On 22.4.1953, announcement was made of the settlement of the issue of withdrawals by the former National Bank and Bank of Athens after they had merged into National Bank of Greece and Athens S.A. The settlement concerned the continuation of the right of the former National Bank to withdraw funds from Bank of Greece deposits at its branches up to a fixed monthly amount and without any commission fee, in exchange for the services it provided to the Bank of Greece free of charge through its local branches.[140]

On the occasion of the Bank's 25th anniversary on 14/05/1953, Governor G. Mantzavinos conveyed a greeting message to the General Council, the staff and the Bank of Greece Employees' Union.[141] Commenting on this, Deputy Governor S. Grigoriou stressed that the Bank's 25-year-long history had been inextricably linked to the country's economic development, while he also recalled the conditions in which the Bank of Greece had been founded as a separate institution and the efforts it had made to support the currency and credit. In all these years, the Bank of Greece had not been guided by a profit-making motive, but rather by its commitment to serve society at large and the productive classes.

138 "Special terms for financing to provincial industry", General Council minutes, Vol. 30, meeting of 20.3.1953, pp. 158-161.

139 "Announcement by the Governor regarding the adjustment of the drachma to the dollar", General Council minutes, Vol. 30, meeting of 9.4.1953, pp. 217-218.

140 "Ceiling on weekly withdrawals by the National Bank of Greece and Athens, establishment of a guarantee in favour of the Bank and exemption from any commission on capital movements in general", General Council minutes, Vol. 30, meeting of 22.4.1953, pp. 255-258.

141 "Greeting message by Governor Mr. G. Mantzavinos, from the United States, on the Bank's 25th anniversary", General Council minutes, Vol. 31, meeting of 20.5.1953, pp. 8-9.

4 THE PERIOD OF FIXED EXCHANGE RATES, 1953-1971

4.1 Introduction

The 1950s found Greece with still open wounds from the Occupation and the Civil War in all aspects of the nation's life. The need to quickly increase production and raise the standard of living was pressing and guided the economic policies pursued during that period, particularly in its first years.

The actions of the Bank of Greece, whose role as bank of issue and monetary and credit policymaker was strengthened further during the period 1950-1956, were geared towards ensuring both currency stability, amid ongoing efforts for economic reconstruction, and adequate supply of credit to the productive sectors of the Greek economy. At the same time, efforts were made by the Bank of Greece and the Currency Committee, in cooperation with the successive governments, to ensure a strong and healthy banking system and to address chronic weaknesses that were reflected, among other things, in persistent external and fiscal imbalances until 1952.

As mentioned earlier, the monetary reform of 9.4.1953 was a milestone in Greek post-war economic history.[1] This adjustment of the exchange rate of the drachma, implying its devaluation by 50% vis-à-vis the US dollar and the other foreign currencies, was the result of long-term planning.[2] The reform was introduced by Law 2360/30 March 1953 "Emergency measures for balancing the budget and for reconstruction" and Law 2366/7 April 1953 "Abolition of tax exemptions and deroga-

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1 "Announcement by the Governor regarding the adjustment of the drachma to the dollar", General Council minutes, Vol. 30, meeting 16, 9.4.1953, pp. 217-218. For the monetary reform of 9.4.1953 "Adjustment of the exchange rate of the drachma", ratified by Law 2415/9 May 1953, see also *Annual Report for 1953*.

2 Bank of Greece (1978), pp. 393-394. Also, Varvaressos (2002), pp. 375-406, and Psalidopoulos (2013).

tions". Also, for the first time in more than 30 years, the government was able to issue a domestic drachma-denominated loan of an "entirely voluntary character".[3]

Before long, the monetary reform started to work as a driver of economic development, confirming the expectations of its architects. In 1957, the then Governor of the Bank of Greece, Xenophon Zolotas, was happy to announce to the General Meeting of Shareholders of the Bank of Greece that "the material improvement in public finances and the relative credit relaxation provide for the first time the opportunity to mobilise, on a large and increasing scale, the country's national resources towards the modernisation and development of agriculture and industry, as well as the swift promotion of smaller projects of more immediate yield and investments with a far-reaching impact on output growth".[4]

The international environment, directly or indirectly, had a bearing on the path of the Greek economy. The Korean War (1950-1953) benefited Greek shipping, but also caused strong inflationary pressures on both sides of the Atlantic, first affecting raw materials. Consumer inflation came close to 12% in the United Kingdom and 22% in France. In industrialised countries, employment rose by between 1% and 5%, unemployment declined and industrial output grew, in particular the production of military equipment.

Global inflationary pressures began to abate after the end of the Korean War, largely thanks to declining raw material prices, which fell by about 11% on average. Still, it was obvious that the world economy was poised for a downturn, as evidenced in a slight decline in economic activity and its low responsiveness to active demand. The trade balance of Europe had improved, and so had its foreign exchange reserves, but payments in hard currency remained a problem, as US dollars were hard to find. The European Payments Union operated in the right direction, but had yet to produce satisfactory results.

According to data from the Organisation for European Economic Cooperation (OEEC), annual real GDP growth in OEEC member countries averaged 4% in the period 1951-1954 and 6% in 1954-1955. Private consumption rose by 5% in European countries and by 6% in the United States, whereas government consumption remained broadly unchanged or trended downwards. The rise in output from mid-1954 onwards was accompanied by a wave of mergers in the industrial and banking sectors. Private investment increased, with a shift from construction and public works in 1953-1954 towards investment in industry and productive equipment in 1955. World trade in value terms grew by 5%. However, Western European coun-

3 *Annual Report for 1953.*

4 *Annual Report for 1956.*

tries still faced a shortage of US dollar funds, and American aid continued to bridge the gap.

Amid conditions of strong demand, inflationary pressures resurfaced, while in several economies —mainly in the United Kingdom and the Scandinavian countries— wage growth in industry outpaced the respective increase in productivity. These countries responded by various measures, such as increases in the discount rate and/or interest rates in general, credit restrictions on purchases of durable consumer goods and construction loans, higher indirect taxes and a curtailment of subsidies.

The initiatives aimed to create a European Common Market (or European Economic Community (EEC) as it was officially named) and a European Free Trade Area (EFTA) reflected a broader trend towards economic integration worldwide. According to the Bank of Greece, the country's political leadership should reconsider its economic development agenda in the light of these international developments. The negotiations for EEC association lasted from 1958 to 1961, with the Greek delegation led by Ioannis (Yangos) Pesmazoglou, Economic Advisor to the Bank of Greece, close associate of X. Zolotas since 1955, and Deputy Governor as from 1960.

Following the Association Agreement of Greece with the EEC, which came into effect on 1.11.1962, the Bank of Greece emphatically pointed out a need for structural changes that would gradually —over the next decade— make the Greek economy competitive vis-à-vis the advanced economies of the EEC. According to X. Zolotas, the benefits of economic integration and trade liberalisation could be reaped only when participating countries were "of an approximately equal economic strength".[5]

The Bank's assessment was that Greece should use the transitional period (1962-1972) to broaden export opportunities for its fast-growing output, concentrating "on a smaller number of products, for which to achieve internationally competitive conditions of supply".[6] On the other hand, Zolotas warned against a protectionist policy of high tariffs such as the one pursued in inter-war years. In his own words, "the mentality of closed space and increased protection should be replaced by awareness of the need for constantly better performance with a view to increasing and improving production and introducing modern methods of production organisation and marketing".[7]

5 *Annual Report for 1959.*

6 *Annual Report for 1962.*

7 *Annual Report for 1960.*

This implied a need to develop new and modern entrepreneurial units that, in cooperation with foreign enterprises, could ensure the transfer of know-how, hence a faster promotion of their exports. Greece's success within the newly-established Community depended on "a radical change in the attitude of the Greek business community, which was formulated under the influence of protectionism".[8]

From the Treaty of Rome in 1957 through to 1962, average annual GDP growth in the EEC as a whole was 5.4%, and industrial production growth was 8%. Equally remarkable was the trade performance of the EEC, as the combined trade of its six countries rose by 132% between 1958 and 1963, having a significant contribution to global trade.

In the eleven years from 1956 to 1966, the Bank of Greece continued to recommend to the successive governments a prudent policy, aimed at ensuring that the economy's available credit resources were channelled into productive investment. As asserted by I. Pesmazoglou (in a biographical note forming part of his archive), monetary and credit policy planning and credible implementation by the Bank of Greece had a major contribution to the country's positive economic performance in that period. The Bank of Greece placed emphasis on qualitative controls on the domestic financial system, while at the same time working towards the fast development of the secondary sector and the modernisation of the agricultural sector. It is worth noting that its advisory role was not limited to the area of monetary and credit policy, but spanned the entire spectrum of economic policy. Nevertheless, currency stability always remained the central objective that guided the credit policy measures taken by the Bank of Greece in cooperation with the Currency Committee. Monetary equilibrium, coupled with fiscal discipline, was seen by the Bank as a *sine qua non* for economic development.

Between 1967 and 1971, the military dictatorship radically changed these objectives, aiming for faster economic growth at any cost. Growth rates were satisfactory in that period as well, but were mainly driven by higher public investment and credit relaxation. The growth path was lopsided: the primary sector was neglected, in favour of construction and tourism. In that period, the Bank of Greece and the Currency Committee had a rather redistributive role, focused on allocating the available credit resources. And although active support by the banking system was necessary for the fulfilment of this role, this was not the case. The relaxation of credit rules and the shift of credit policy away from qualitative control towards quantitative credit rationing led to overindebtedness in certain sectors of the economy, complicating the Bank's job in controlling money circulation.

8 *Annual Report for 1962.*

During the seven years of the dictatorship (1967-1974), the Association Agreement of Greece with the EEC was frozen. That period was marked by the international monetary crisis of 1971 and the enlargement of the European Community with the accession of the United Kingdom, Ireland and Denmark in 1973.

The first signs of the monetary crisis emerged as early as the 1960s, when it became obvious that the international monetary system of Bretton Woods —with its fixed exchange rates, the gold convertibility of the US dollar and the gradual liberalisation of trade and foreign exchange— needed a drastic reform if it were to respond to the new conditions being created by the rapid growth of the German and Japanese economies, ongoing industrialisation, the dynamic expansion of the EEC and the weakening of the dominant role of the United States in the world economy.

In the view of the Bank of Greece, the crisis of 1971 created favourable conditions for improving Greece's trade balance and more generally its foreign exchange position within the international environment. However, it also implied a need to refocus economic policy on currency stability, which had been sidelined in the context of the Five-Year Economic Development Plan (1968-1972). The overheating of the economy and the inflationary pressures that started building up in early 1972 called for a reorientation of credit policy towards a disinflationary management of active demand.

4.2 Macroeconomic developments

In the first couple of years after the Civil War, Greece's key social and economic structures were broadly the same as in the pre-war period. From the early 1950s through to the late 1970s, however, the Greek economy followed an upward path. Between 1953 and 1971, annual GDP growth averaged about 7%, with considerable fluctuations.[9]

Overall, with the exception of the two years of economic stabilisation (1951-1952), real GDP recorded positive growth, rising by 4% from 1953 to 1954 and by 6% in the next two years, driven by manufacturing and services.[10]

The supply of credit to the economy had an upward effect on currency in circulation, which rose by 11% in 1954, whereas higher deposits held by public entities with the Bank of Greece dampened money growth.[11] Banknote circulation increased

9 Psalidopoulos (2008), p. 62, and Psalidopoulos (2010), p. 282.

10 *Annual Report for 1955.*

11 *Annual Report for 1954.* Since 1951, deposits by public entities had come under the control of the Currency Committee and the Bank of Greece. In September 1954, further measures were taken (Legislative Decree 2999) to regulate bank lending using balances on public entities' deposit accounts. See Bank of Greece, ibid., p. 16.

by 27% in 1955 and by 24% in 1956, though without disturbing monetary equilibrium. By the mid-1950s, currency in circulation and sight deposits (together making up narrow money, M1) had been 39% and 11% higher, respectively, relative to 1938, the last "normal" pre-war year.[12] During that period (1954-1955), the rising indices of producer prices, retail prices and cost of living were a source of concern for the Bank of Greece.[13] To a large extent, these rises stemmed from the supply of credit to the economy, in particular to tobacco trade using Bank of Greece funds.[14]

The disinflationary policy pursued since early 1952 and the monetary reform of April 1953, with the introduction of the new drachma and the elimination of the zeros as from 1.5.1955, helped to contain inflation and restore public confidence in the national currency.[15] By 1955, the staggering inflation of the 1940s had been reined in. In the latter half of the 1950s, the rise in prices averaged 2.3% annually and, with a slight upward trend, hovered around 2.5%-3% up to 1971.[16]

The standard of living improved markedly in the period 1949-1974 and, mainly from 1963 onwards, wages evolved in line with rising productivity, without however weighing on corporate profitability or investment.[17]

Unemployment and underemployment were two of the major social problems faced by the country, which were expected to be addressed by the anticipated economic growth. One-third to one-fourth of total labour force were unemployed, which explains the continued migration outflows until 1972.[18]

The primary sector, in particular agriculture, performed satisfactorily, but the structural reforms that would ensure its modernisation lagged behind. The introduction of support prices in 1952 failed to bring about the desired restructuring of

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12 *Annual Report for 1955.*

13 Ibid.

14 Some examples are: "Financing of 1949 tobacco crop", General Council minutes, Vol. 20, meeting 50, 7.12.1949, pp. 59-60; "Loan of 3,000 million drachmas to Greek Tobacco Industry V. Karavassilis S.A.", General Council minutes, Vol. 21, meeting 15, 29.3.1950, p. 25; "Loan of 200,000,000 drachmas to Kavala Tobacco Manufacturing", General Council minutes, Vol. 21, meeting 28, 21.6.1950, p. 246; "Financing of a tobacco manufacturing company", General Council minutes, Vol. 22, meeting 33, 26.7.1950, pp. 43-46; "Financing of the Tobacco Workers' Insurance Fund (TAK)", General Council minutes, Vol. 23, meeting 54, 22.11.1950, pp. 39-41; "Financing of tobacco trade", General Council minutes, Vol. 32, meeting 41, 9.9.1953, p. 34; "Additional 5% financing to tobacco traders for the payment of the levy under Law 2348/1953", General Council minutes, Vol. 32, meeting 45, 25.9.1953, pp. 109-111. See also General Council minutes, Vol. 35, meeting 30, 9.7.1954, for financing to tobacco manufacturers Matsangos, Vlachopoulos and Papastratos.

15 Psalidopoulos (2008), p. 51.

16 Iordanoglou (2004a), p. 84.

17 The salaries of civil servants were regulated by Emergency Laws 1502 and 1537 of October 1950, followed by Emergency Law 1538/1950 on salaries in public entities, all of which took retroactive effect as from 1.7.1950. See Iordanoglou (2004a), p. 74.

18 Psalidopoulos (2008), p. 47.

crops that would make Greek agriculture competitive. Thus, although output of certain products rose considerably, overall agricultural output lost part of its momentum, due to delays in adopting new and advanced cultivation methods.[19]

The Bank of Greece, with its direct lending or loans intermediated by the Agricultural Bank and the National Mortgage Bank, was the main source of financing for the primary sector, offering preferential interest rates and supporting efforts and initiatives aimed at a qualitative and quantitative improvement of agricultural production.[20]

The secondary sector, mainly light industry, experienced robust growth from the late 1950s onwards. Between 1959 and 1971, the general index of industrial production rose by 179%, while investment in industry represented roughly 30% of GDP in the period 1960-1975.[21]

Despite the strong performance of the primary and secondary sectors, imports kept rising faster than exports, leading to growing deficits in the balance of payments and the trade balance in particular. The 1950s saw several bilateral trade and payment agreements between Greece and other countries (mainly European), with a view to expanding the markets for Greek exports.[22] Nevertheless, during most of the period under review, exports corresponded to only 30%-35% of imports, half the pre-war (1938) percentage, and mainly concerned certain agricultural products such as tobacco and cotton. Imports were dominated by finished manufacturing products and, starting from the 1960s, private passenger cars.

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19 Ibid.

20 See, indicatively: "Funding to the National Mortgage Bank for the extension of loan of 250,000,000 drachmas", General Council minutes, Vol. 20, meeting 47, 23.11.1949, pp. 11-12; "Funding to the Agricultural Bank for 50,000,000,000 drachmas", General Council minutes, Vol. 20, meeting 47, 23.11.1949, p. 12; "Rejection of the Agricultural Bank's request for an interest rate reduction on its 10,000,000,000 drachma funding", General Council minutes, Vol. 24, meeting 15, 28.3.1951, p. 58; "Amendment to the decision on medium- and long-term loans to the Agricultural Bank", General Council minutes, Vol. 31, meeting 22, 13.5.1953, p. 1; "Funding to the Agricultural Bank for its agricultural programme", General Council minutes, Vol. 31, meeting 28, 24.6.1953, p. 95; "Funding to the Agricultural Bank in September 1953 for its agricultural programme", General Council minutes, Vol. 32, meeting 43, 18.9.1953, pp. 87-89; "Financing of government programme for the reorganisation of fishing", General Council minutes, Vol. 33, meeting 1, 7.1.1954, pp. 88-91; "Funding to the Agricultural Bank in March 1954 for its agricultural programme", General Council minutes, Vol. 34, meeting 15, 27.3.1954, p. 10; "Announcement by the Chairman regarding the endowment of the Agricultural Bank", General Council minutes, Vol. 36, meeting 43, 6.10.1954, pp. 1-2; "Reduction of the interest rate on funding to the Agricultural Bank", General Council minutes, Vol. 36, meeting 50, 3.12.1954, pp. 184-185.

21 Psalidopoulos (2008), p. 63, and Iordanoglou (2004a), p. 78.

22 After a trade agreement with Portugal on 31.12.1949, more trade agreements followed with Austria, Belgium, France, Denmark, Spain, Italy, Norway and Sweden in 1950 and with Egypt, Austria, Bulgaria, Brazil, East and West Germany, Yugoslavia, Italy, the Netherlands, Hungary, Uruguay, Russia (USSR), Sweden, Turkey and Finland in 1953.

Invisible receipts rose rapidly in the 1950s, steadily covering a considerable part of the balance of payments deficit. This increase continued at an accelerating pace throughout the 1960s, driven both by migrant remittances and foreign exchange inflows from shipping and tourism, two sectors that had received particular attention under the reconstruction programme.[23]

From 1959 onwards, the emigration wave grew increasingly stronger. In the short term, emigration helped to export unemployment and, through migrant remittances, provided some relief to the balance of payments. In the long term, however, it entailed a loss of human capital, which held back domestic economic development. Between 1959 and 1965, the total number of Greek emigrants was some 538 thousand, 6.4% of total population. In 1961-1965, emigration flows rose at an ave rage annual rate of 20.3%.

Handicraft, industry, agriculture and export trade were the priority sectors for bank credit and benefited from favourable lending terms and conditions. In the 1950s, agriculture absorbed 55%-56% of bank credit (this share included credit to export trade and tobacco trade), while manufacturing had a share of 33%-35% and domestic trade accounted for a mere 11%. For the systematic supply of long-term credit to support development, specialised state-run institutions were established, such as the Economic Development Financing Organisation (OXOA) that undertook to promote productive investment, mainly in industry.[24]

The period 1957-1971 saw an investment boom, which up to 1966 was financed by 87% through domestic resources, with the remainder covered through foreign funds. Foreign borrowing rose after April 1967, to serve the goals of the Five-Year Economic Development Plan (1968-1972) of the military dictatorship; as a result, foreign debt service payments increased sharply, to US dollars 76 million in 1969, US dollars 80.8 million in 1970 and US dollars 106.6 million in 1971. Building activity also flourished, supporting growth in the secondary sector. Against the background of growing housing needs in urban centres, residential investment soared, rising by more than 10% on average between 1963 and 1973.[25]

Law 2687/1953 "Foreign investment and protection of foreign capital", implementing Article 112 of the 1952 Constitution, enshrined the legal protection of profits arising from inward foreign direct investment, prompting the first capital inflows into the country, which boosted investment and foreign exchange deposits. Attrac-

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23 It is worth noting that migrant remittances accounted for roughly one-third of total invisible receipts in the 1960s.

24 For this organisation, see *Annual Report for 1954*.

25 Iordanoglou (2004a), pp. 78-80.

ting investors hinged crucially on addressing the problem of Greece's outstanding foreign debt liabilities – in fact, this had been the rationale behind the adoption of Emergency Law 1529/1950 "Settlement of recognised foreign exchange liabilities" and Law 1586/1950 "Ratification and supplementation of Law 1318/1949".[26] However, the inflow of foreign private capital was rather sluggish during most of the period under review.

In specific, foreign capital inflows picked up between 1956 and 1971, but still represented only a small fraction of foreign exchange receipts. This period saw the launch of important investment projects, such as the extraction of asbestos in the area of Kozani, new shipyards, takeover and operation of air transport companies, etc. Private investment rose sharply in the 1960s, and new major industrial plants were put into operation, including the Nitrogen Industry, the Aluminium of Greece (Pechiney), Esso-Pappas, Larco – General Mining and Metallurgical Company, Pirelli Hellas, the Chemical Industries of Northern Greece, the Hellenic Steel Industry – Halyvourgiki, and GoodYear Hellas, often involving foreign direct investment.

In the area of monetary policy, the Bank of Greece and the Currency Committee continued to play a dominant role and are credited with the stability of the drachma in 1953-1971. During most of that period, the Currency Committee exercised tight control on the banking system, which benefited from a return of saving deposits, marking an end to the gold sovereign craze of the past decades.

The upward trend in bank deposits that started in the 1950s was temporarily interrupted due to the Korean War (1950-1953). Thereafter, between 1953 and 1956, saving deposits rose substantially, and so did the number of depositors, rising by 80% for the National Bank and Bank of Athens and tripling for the Postal Savings Bank. The increase in saving deposits outpaced the growth of banknotes in circulation, attesting to improved public confidence in the national currency. As in the case of the Korean War, the Suez crisis of 1956 also triggered a temporary drop in deposits. Among positive developments, under Emergency Law 1611/1950, deposits held by public entities with the Bank of Greece increased, and banks became less dependent on central bank funding.[27]

Between 1956 and 1973, propensity to save was strong —not that households had large surpluses to save at the time— and saving accounts were the most profitable choice. That period saw a mass inflow of deposits into commercial banks and the Postal Savings Bank. By 1960, the total amount of saving deposits with commercial

26 By Law 1318/1949, Greece had suspended payments on its foreign currency-denominated loans until June 1952.

27 *Annual Report for 1956.*

banks and specialised credit institutions had increased by 75% relative to 1958, reaching 18 billion drachmas.[28] Also, savings per capita more than doubled, from 513 drachmas in 1957 to 1,088 in 1959 and 1,285 in 1960.[29] According to the then Governor of the National Bank, Dimitrios Helmis, these figures indicated that the Greek credit system had fully recovered, boding well for the future of the Greek economy.[30]

Private deposits by natural and legal persons rose by 62.5% in 1962 relative to the previous year, with nearly 97% of this rise stemming from household deposits. Private saving deposits increased by 52.9%, and time deposits by 41.1%.[31] In nominal terms, the volume of private deposits rose 41 times between 1956 and 1973.[32] Short-lived episodes of mass deposit withdrawals were occasionally triggered by the Cuban crisis of 1962; domestic political developments in 1963-1965 (which coincided with the Cyprus crisis and a deterioration in Greek-Turkish relations); the Arab-Israeli War of June 1967; and a new Cyprus crisis in November 1957. With the memories of World War II still alive, it was only natural that depositors panicked at the mere thought of a new global conflict.[33]

In the area of public finances, the successive governments (led by the National Radical Union and the Centre Union parties) more or less respected the fiscal rules, thus the ordinary budget (which by definition does not include public investment) was balanced or in surplus throughout the period 1957-1974. On the other hand, the public investment budget, weighed down by the infrastructure projects of the 1950s and 1960s, recorded deficits, which were partly covered by ordinary budget surpluses, bond issues or borrowing from commercial banks through Treasury bill issues.[34]

4.3 The Bank's policy stance through the views of its Governors

The Governor's Annual Reports presented to the General Meeting of Shareholders of the Bank of Greece provide information on the annual accounts of the

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28 National Bank of Greece (1960), p. 11. Prominent among the specialised credit institutions in that period were the Postal Savings Bank, the Agricultural Bank and (as of 1964) the Hellenic Industrial Development Bank (ETBA).

29 Ibid., pp. 11-12.

30 Ibid., p. 12.

31 Postal Savings Bank (1963), pp. 1-5.

32 Iordanoglou (2004a), p. 77.

33 Bank of Greece (1978), pp. 622 and 664.

34 For the contribution of American aid to covering the public investment budget deficit, see Stathakis (2004), p. 187; for the economic growth model, see Psalidopoulos (2011).

Bank and review the monetary and credit policies pursued in the reported year. They also provide an overview of the economic situation, challenges and prospects, put in the context of international economic developments, and offer relevant policy recommendations.

Throughout the period of the Zolotas governorship, Annual Reports warned about the risks to the economic outlook and to monetary stability arising from a potential rise in inflation and/or fiscal deficits. They also expressed concerns about occasional surges in demand for gold sovereigns, which depleted the foreign exchange reserves of the Bank of Greece. In the period 1953-1966, the Bank of Greece fervently advocated a restructuring in the primary sector, which it continued to support with financing (either by direct loans or by loans intermediated by the Agricultural Bank). Permanent features on the policy agenda of that period were two issues: the deficit in the balance of payments and the pressing need for a shift of Greek production towards greater extroversion, i.e. from a domestic demand-led model to export market penetration.[35]

The pursuit of economic development —which, as the Bank of Greece strongly argued in the 1960s, should be elevated to a "national and social ideal"— was closely associated with a number of requirements, such as large-scale productive investment, modernisation of the banking system, an increase in long-term lending, capital market reform and securities offering. For achieving this economic goal, which was seen as very important also from a social point of view, the government needed to ensure favourable conditions for attracting entrepreneurial capital and borrowed funds. The implementation of public infrastructure projects and the provision of (mainly tax-related) incentives were only some of the necessary government actions for the economy to embark on a path of development and growth.

Between 1957 and 1964, education reform stirred controversy in Greek society. For the Bank of Greece, a reorientation towards technical education and vocational training was an issue of high relevance for the country's social and economic progress and an answer to the acute problem of unemployment and the resulting emigration.[36]

As already mentioned, starting from the mid-1950s, bank deposits grew strongly and commercial banks became less and less dependent on Bank of Greece funding. The Bank of Greece, in cooperation with the Currency Committee, relaxed its quantitative and qualitative control over commercial banks, allowing them greater freedom of action. Nevertheless, the diversion of bank funds to

35 Chalikias (1958).

36 Zolotas (1959).

non-productive investment revealed the banking system's weaknesses, which exacerbated in 1967-1971.

The following sections discuss some of the major challenges facing the Greek society and economy in the period 1953-1971, along with the respective views and responses of the Bank of Greece. The views of Bank of Greece Governors Georgios Mantzavinos (1946-1955), Xenophon Zolotas (1955-1967) and Dimitrios Galanis (1967-1973) provide insights into the Greek economy's capabilities and prospects in the context of a changing international environment; they also confirm the role of the Bank of Greece as an adviser to the government in terms of economic policy strategy, design and implementation. During the dictatorship, this role was significantly undercut. Given the overall climate that prevailed in this period, all the Reports for the years 1968-1970 refrain from any criticism on the design and objectives of the Five-Year Economic Development Plan (1968-1972), instead of extolling the strong growth of national income, which however had been achieved through an overheating in certain branches of the secondary (manufacturing, construction) and tertiary sectors (tourism).

4.3.1 Inflation and "chrysophilia"

In the early 1950s, high inflation represented a key challenge for the Bank of Greece. Governor Georgios Mantzavinos stressed that "…we started and we continue unceasingly our efforts against inflation",[37] since "the specter of inflation is still haunting the restless world and... widespread efforts are being made to curtail the creeping inflationary pressures".[38]

In the face of the inflationary pressures triggered by the outbreak of the Korean War in the summer of 1950, the Bank of Greece called for measures to control production, prices and wages, combined with higher taxation and a moderation in bank credit. This latter measure risked creating conditions of recession that would jeopardise the reconstruction and development programme: "On the contrary, the tightening of note-circulation and the decrease of credits below the essential limits may bring about non-recommended anti-inflationary [: deflationary] consequences and such a policy we reject altogether".[39] Thus, disinflationary measures were deemed necessary, and their successful implementation required international cooperation. In the case of Greece, delicate handling was needed to ensure that

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37 *Annual Report for 1951.*

38 Ibid.

39 *Annual Report for 1952.*

disinflation would not harm growth.[40] According to the Bank of Greece, the monetary policy pursued at the time could not be characterised as purely disinflationary, but rather as a "policy for economic stability".[41]

According to G. Mantzavinos, in the two-year period 1950-1951 the rise in prices would have been steeper, had not production increased by 10%, while the inflationary pressures observed were largely attributable to the negative impact of the Korean War rather than higher money supply.[42] They were, in other words, a conjunctural phenomenon, unrelated to the monetary and credit policies of the Bank of Greece, and bound to fade away once the hostilities ended.

In the mid-1950s, the rising level of prices was still a cause of concern for the Bank of Greece, which argued that all possible efforts should be made to stabilise prices. In this context, the Bank recommended credit facilities to certain branches of import trade so as to speed up imports of basic goods; distribution of certain imported goods by the State, keeping them in sizeable stocks to ensure effective control on the market; better organisation of the domestic market; and a compression of transportation and intermediation costs.[43]

What was most urgently needed, according to G. Mantzavinos, was the completion of the armament programme, which would put an end to the increase in defence spending.[44] The continued armament programme caused strong inflationary pressures, which were compounded by the abolition of import subsidies, wage growth and the rise in support prices for certain agricultural products in fiscal year 1950-1951.[45]

Nevertheless, between 1955 and 1972 average annual inflation hovered around 2.5%, one of the lowest worldwide at the time.[46] Thus, throughout the period under review, inflationary trends were broadly contained, with the exception of the years 1964 and 1965, when a pick-up in inflation threatened the monetary stability achieved by then. In his Report for the year 1964, Governor Xenophon Zolotas warned: "No economic phenomenon is more dangerous to social welfare and democracy than rapid inflation".[47]

The assessment of the Bank of Greece was that there were two factors that could endanger monetary stability in Greece. First, the psychological after-effects of the wartime

40 *Annual Report for 1950.*

41 *Annual Report for 1952.*

42 *Annual Report for 1950* and *Annual Report for 1951.*

43 *Annual Report for 1955.*

44 *Annual Report for 1951.*

45 *Annual Report for 1950.*

46 Bank of Greece (1978), p. 768.

47 *Annual Report for 1964.*

and post-war inflation had not disappeared completely. The fear of inflation affected the economic behaviour of individuals, as well as the composition of national expenditure. The second factor had to do with continuous demands on behalf of various social groups for increases in money incomes in excess of productivity increases.[48]

The inflationary phenomena of the two-year period 1964-1965 were accompanied by a resurgence in demand for gold sovereigns, with serious repercussions on foreign exchange reserves. Initially, the Cuban crisis in October 1962 triggered private deposit withdrawals, which however did not exceed 1% of total deposits, while private hoarding of gold was limited. Tension in Greek-Turkish relations on account of the Cypriot issue in the period 1963-1964 and the political upheaval in July 1965 led to a considerable drop in the rate of increase in deposits and to stronger gold sovereign hoarding, phenomena that persisted until the end of that year. From December 1963 to December 1965, the gold and foreign exchange reserves of the Bank of Greece fell by the equivalent of some 2 billion drachmas.[49] At the same time, there was a shift of savers away from bank deposits towards investment in land.

In the 1953-1966 period, both the Bank of Greece and the successive governments looked into drastic measures to curb the widespread chrysophilia. In 1955, following a recommendation by the Bank of Greece, the government allowed the Bank of Greece flexibility in pricing its sales and purchases of gold sovereigns, which introduced an element of uncertainty and risk that discouraged speculators. The measure met with relative success until late 1963; the occasional bouts of chrysophilia during 1955-1963 were short-lived and did not disturb monetary equilibrium or the buffer stock of the central bank. The advantage of this policy, as opposed to an outright ban on gold coin transactions that was the most common practice internationally, was that it did not undermine public confidence in the currency and, above all, kept a channel open for gold sovereigns to flow back into the Bank of Greece. The practice continued for years, enabling the Bank of Greece to amass several millions of gold sovereigns.

In January 1964, demand for gold sovereigns returned with a vengeance. Following much vacillation and lengthy discussions between the Bank of Greece and the government, as from 27.1.1964, sales of gold sovereigns were subject to a regulated procedure entailing buyer identification, but at the same time the Bank of Greece recommended stopping any intervention in gold sovereign market altogether. Although this recommendation was not acted on, the introduction of the regulated

48 Ibid.

49 From about 8.8 billion drachmas, it fell to 7.1 billion drachmas. See *Annual Report for 1964* and *Annual Report for 1965*.

procedure itself had an immediate impact, dampening excessive demand for gold sovereigns. About three months later, however, excessive demand returned, and the method of intervention in the gold sovereign market was reconsidered. The Bank of Greece recommended a reintroduction of flexible pricing, which was rejected by the government,[50] thus it continued to intervene in the market, with large quantities, to keep the price of the gold sovereign stable.

The Bank of Greece argued that a stable or broadly stable gold sovereign price, instead of reducing demand, actually strengthened it. Indeed, mass sales of gold sovereigns followed, urging the Bank to call once again, by a memo dated 19.2.1965, for a more flexible pricing.[51] This was ultimately adopted in July 1965, at first without any effect on the market. In fact, November 1965 saw a renewed wave of chrysophilia. Against this background, the policy long advocated by the Bank of Greece, i.e. abolishing the free (unofficial) market for gold sovereigns, maintaining the regulated market and establishing a procedure of free conversion of gold hoardings into drachmas, became unavoidable. This policy, introduced on 23.12.1965, exerted a dampening effect on excessive demand and, by end-1966, had delivered successful results, drastically reducing gold hoarding and eliminating the unofficial gold market, this "source of perverse psychological influences" as Zolotas stated.[52] This was largely due to the continuous and systematic follow up by the Bank of Greece over the gold market.

4.3.2 Fiscal policy

The years 1952-1953 marked a turning point in the reconstruction effort. Up to 1949, the Greek economy effectively continued to operate in war mode, with defence spending absorbing about 50% of American financial aid, also in view of the impact of the Korean War. Unlike government debt to the Bank of Greece, which the Bank assessed as not posing monetary risks as long as American aid continued to flow in, government deficits, which were covered by American aid, were a serious problem and their reduction was urgently necessary.[53]

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50 *Annual Report for 1965.*

51 Ibid.

52 *Annual Report for 1966.*

53 During most of the period under review, defence spending remained too high for the country's financial capacity. Thus, in 1949-1953, about 9%-9.5% of the national resources were channelled into defence expenses, and these accounted for 41%-43% of total expenditure while absorbing 47%-53% of total budget revenue, compared with 10.5%-23% in developed countries. Particularly increased was also social expenditure, which in the same period absorbed 20.5% of revenue. See the *Annual Reports* of the Bank of Greece for the years 1949-1953.

With exorbitant defence spending and higher social expenditure, fiscal deficits were unavoidable. In addition, the tax burden at the time was quite heavy, corresponding to 27% of national income. According to the Bank of Greece, there was still "room for the reduction of State expenditure, attainable by the reorganisation of the whole administrative system and by the strict application of the principle of the Budget's unity. The latter should be applied by abolishing all special funds or head[ing]s of expenditure. These should be included either in the General Budget of the State or in the budgets of municipalities and communities, according to whether general or local interests are being served".[54]

Despite high defence spending, the State budgets for fiscal years 1952-1953 and 1953-1954 anticipated a balanced outcome without the use of US aid. In the view of the Bank of Greece, both the policy for increasing public revenue and cracking down on tax evasion and the policy of "cutting down all expenditure which is not absolutely essential for the normal continuation of State activity"[55] had to remain in place and be intensified.

Higher-income classes, which had benefited the most from post-war economic growth, were now called on to shoulder a greater tax burden. It was at these classes that the government should target direct taxation in its effort to raise revenue. However, as the tax burden was already about 23-25% of net national income,[56] fiscal consolidation could only be pursued by combating tax evasion, "taxing fully all tax evaders" and by improving tax administration.[57]

After the tax reform of 1955 (Law 3323) and further measures adopted in 1957-1958, the tax burden fell to 17%. These measures were aimed at simplifying the tax system, improving tax efficiency and curbing tax evasion.[58] According to the Bank of Greece and Governor Zolotas, the cuts in income tax rates introduced by Legislative Decree 3765/1957 were bound to reduce further the low share of direct taxes

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54 *Annual Report for 1950.*

55 *Annual Report for 1951.*

56 Towards the end of the 1950s, the tax burden, measured by the share of tax revenue in net national income, was around 17%.

57 *Annual Report for 1952.*

58 Among the measures adopted in this period were: Legislative Decree 3765/1957, which cut income tax rates; Legislative Decree 3746/1957, which allowed for certain security clauses and tax exemptions for bond issues; Legislative Decree 3846/1958, which reduced (from 75% to 62.5%) the percentage of income tax collected in advance; Legislative Decree 3843/1958, which unified the tax system by bringing legal persons under the legislation applicable to natural persons regarding the calculation of gross income and net profits and abolished the fixed charge and the 10% surcharge tax on sociétés anonymes' retained profits; and Legislative Decree 3842/1958, which increased the tax-free amounts on inheritances, donations and dowries and decreased tax rates per income bracket.

in total revenue, which was inconsistent with the principles of tax equality and social justice.[59]

In addition to tax evasion, another source of concern for the Bank of Greece was rising government consumption, which had to be contained, always on the basis of a clear planning. In particular, in case of extraordinary needs in the primary sector, agricultural subsidies should be covered by the state budget.

To prevent demand from growing in excess of the available resources, it was necessary to take counterbalancing measures: "The principal and most healthy counterbalancing measure, under the conditions prevailing in Greece at present, would be the restriction of funds used by the government for current expenditure in excess of current receipts, so that the rate of expansion in the financing of the economy from Bank of Greece funds may be maintained".[60] Therefore, an improvement in the cash position of the Greek State would have a beneficial effect on the financing of the economy by the Bank of Greece.

The Bank of Greece always evaluated carefully its financing to the government, thereby avoiding over-financing which would jeopardise monetary equilibrium. Subject to a maximum ceiling as specified in agreements between the Greek State and the Bank of Greece from 1949 onwards, the government received finance mainly through the Centralised Receipts and Payments account and (as from 1955) the Consumer Goods account, as well as in the form of advances against expected receipts (e.g. from NATO).

The increase in Bank of Greece advances to the government was driven by two main factors: the purchase by the Greek State and pooling of agricultural products (chiefly wheat and tobacco) and the financing of public investment. The Bank of Greece had long called for a crop reform and a modernisation of agricultural production. Excessive storage of agricultural products was leading to fiscal problems, which in turn threatened monetary stability.

In view of this risk, Zolotas stressed that: "Experience has shown that fiscal deficits constitute a main factor upsetting monetary equilibrium in developing countries".[61] The country's development path at the time allowed no deviation from a policy of cutting fiscal expenditure other than envisaged in the ordinary or the public investment budget. It also dictated a measured increase in taxation and an intensification of efforts to combat tax evasion. A lowering of tax rates could instead

59 *Annual Report for 1958*. In the period 1955-1967, the share of direct taxes in total tax revenue was about 20% (22.8% in 1956, 20.2% in 1960, 19.4% in 1963, 18.6% in 1966, and 19.2% in 1967).

60 *Annual Report for 1955.*

61 *Annual Report for 1965.*

prove counter-productive, leading to higher consumer spending at the expense of saving, hence investment.

It is worth noting that the Administration of the Bank of Greece itself practised the cost-saving policy it preached. Thus, in the twelve years from 1954 to 1966, it downsized its staff by 383 members, at a time when the volume of its operations had more than doubled.[62]

4.3.3 Public and private investment

By 1950, the reconstruction programme had been reduced to the absolutely necessary projects, without helping to address the country's economic problem, which clearly required investment of a larger scale. Against this background, it was necessary to attract funds from international organisations or private investors. The first step in this direction was taken on 10.11.1953 with Law 2687 "Foreign investment and protection of foreign capital", which concerned both long- and short-term investment, but also included measures encouraging a repatriation of Greek ships and attracting foreign ships to the Greek flag.[63]

In the Bank's view, the low-income level in Greece created conditions for fast production growth, making investment the primary focus of the economic effort. Unemployment, widespread underemployment, cheap labour and, since 1953, currency stability created favourable conditions for foreign investment in Greece, at a time when industrial production growth in developed countries had weakened due to shortages in labour and basic materials (mostly steel). If supported by a more stable tax system and less cumbersome bureaucratic procedures for starting a business in an environment of exchange rate stability, the country would become suited for foreign investment and would attract international entrepreneurship.[64]

Investment by the Greek State and public organisations and enterprises would play an important role and could, according to the Bank of Greece, be divided into

62 Increases in the productivity of the Bank of Greece's employees were not always accompanied by corresponding wage increases, triggering industrial action. See, indicatively: "Staff strike", General Council minutes, Vol. 22, meeting 45, 11.10.1950, p. 227; "Staff strike", General Council minutes, Vol. 25, meeting 39, 29.8.1951, p. 191; and also "Reduction of the Bank's expenditure", General Council minutes, Vol. 30, meeting 6, 20.2.1953, pp. 79-83.

63 *Annual Report for 1953*. In the same year (1953), the revival of Greece's credit relations with France, Germany and Italy for the financing of the government's long-term investment programme started to attract private capital from these countries. In addition, the Greek government turned to the International Bank for Reconstruction and Development (IBRD) for a loan to support productive investment, in particular in the energy, agricultural and manufacturing sectors.

64 *Annual Report for 1956*.

large infrastructure projects and minor agricultural projects of rapid return. The projects of the first category would be chiefly concerned with electrification, industrialisation and expansion of the possibilities of agricultural production, while the small-scale projects would make possible the rapid increase in production, mainly of foodstuffs and basic raw materials. These small-scale projects could be carried out in cooperation with the Army, which possessed appropriate technical equipment and thus less expenditure would be required. However, despite the progress achieved, the economic and investment effort was not sufficiently geared towards directions that would deliver high rates of increase in national product and employment. It was necessary to create attractive opportunities for productive investment, scaling down the pressure for investing public entities' funds in construction and real estate investment. The already strong tendency towards higher consumption should not be encouraged, and all non-productive or less productive expenditure should be curtailed. Mainly, public expenditure should be restricted, in particular investment in construction projects of low economic benefit and of minor importance to the majority of the population.[65]

Public investment projects were for the most part financed by healthy sources, including the state budget, Treasury bill issues (particularly from 1958 onwards) and US aid loans. Investment projects focused on the areas of irrigation and land reclamation, road construction, energy and tourism. On the other hand, non-productive investment showed persistently high growth. In 1959, construction (mostly of houses) continued to represent 45% of total fixed capital formation, which was seen as incompatible with the pressing problems for the economic development of the country. Still, with small fluctuations, residential investment remained buoyant throughout the period under review.[66]

As from the late 1950s, the execution of purely productive investment projects was no longer hindered by shortage of funds. In the early 1960s, public investment increased substantially, and private investment followed suit. To encourage private productive investment, Legislative Decree 4256/1962 "Establishment and expansion of industrial and handicraft companies" relaxed state control on private initiative and simplified the procedures for the licencing and operation of businesses. In the same year, new loans for fixed industrial investment (mainly from the Economic Development Financing Organisation – OXOA) more than doubled as a percentage of industrial investments, to 32.4% from 14.4% in 1961. This development

65 *Annual Report for 1955.*

66 *Annual Report for 1959.*

clearly indicated that private initiative had started responding to the need for intensified investment activity.[67]

In the mid-1960s, the launch of new large industrial plants, such as the Nitrogen Industry, Aluminium of Greece (Pechiney), Esso-Pappas, Larco S.A. and the Chemical Industries of Northern Greece was accompanied by a fast rise in private investment (25.4% in 1964 and 18.8% in 1965) and strong capital inflows, which doubled relative to 1963 and hit a post-war high.

That period also saw the establishment of investment banks,[68] such as the Investment Bank (1962), the National Investment Bank for Industrial Development–ETEBA (1963) and the Hellenic Industrial Development Bank – ETBA (1964). In the view of the Bank of Greece, investment banks would only be able to operate efficiently if they became channels through which foreign capital could flow into the country.[69] That said, the Bank of Greece had advocated the establishment of a single investment bank, with the participation of the major Greek commercial banks and possibly of other Greek credit institutions. An investment bank of this type would enjoy greater independence from the parent organisations and would be able to undertake bolder reforms.

In Zolotas' words, the Bank of Greece had also taken various steps in support of the establishment of investment banks, "although it has always been of the opinion that the banks should cooperate in setting up a major investment bank that would be able to play a decisive role in promoting economic and industrial development". Also, capital market deepening and wider stock ownership were necessary, with a broader risk-sharing by the government or government agencies.[70]

Among the Bank's recommendations for attracting funds directly into the execution of major developmental projects was the formation of joint-stock companies with State participation and rights of control. At first, the government and public organisations would hold all the shares until such time as the conditions were created for making them available to private individuals. It was necessary to attract private capital and mobilise private resources. In this respect, the Bank argued that "the idea of the appropriation of profits by the individual but the sharing, by the entire community, of losses must definitively be abandoned".[71] Moreover, a permanent

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67 *Annual Report for 1962.*

68 Vousvounis (2010) and Loizos (2012a).

69 *Annual Report for 1963.*

70 *Annual Report for 1966.*

71 *Annual Report for 1954.*

settlement on foreign public debt and a national, non-partisan, economic policy were key prerequisites for the inflow of investment capital.[72]

Throughout the 1960s, the Bank of Greece stressed the need for the country's credit institutions to take, prudently but also boldly, more initiative. According to the Bank of Greece, in a free market economy based on private initiative, it was inconceivable to expect everything from the State. After all, the potential of the state budget for investment was not unlimited, and the State was not an "all-powerful economic entity".[73] At the same time, consumption absorbed a growing share of national resources, and the rise in investment was largely financed by external borrowing.

Under the Five-Year Economic Development Plan (1968-1972), public investment expenditure more than doubled, reaching 61 billion drachmas, from 30 billion drachmas in the previous five-year period (1963-1967). By 1971, fixed capital investment as a percentage of total expenditure had reached 24.7%, up from 19.7% in 1965. Investment also improved as a percentage of gross national product, to 27% in 1971, from 22% in 1965.[74]

As the Bank of Greece had already warned in the period 1966-1967, the expansion of government investment for its own sake and regardless of the general conditions prevailing in the economy could have very adverse effects on monetary equilibrium and economic development. This was more so if such an expansion of public investment was financed by foreign borrowing. [75]

4.3.4 The banking system and credit to the economy

In 1950, Governor Georgios Mantzavinos pointed out the need to strengthen "by all means the tendency towards placing savings with banks because it constitutes the basic prerequisite for the monetary and credit healthiness of our economy, since the increase in the volume of deposits shall render possible the extension of financing, not, however, by the use of means of payments created by the bank of issue, but by the means which will come from the normal channels, i.e. the healthy savings effected out of the national income".[76]

72 *Annual Report for 1955.*

73 *Annual Report for 1964.*

74 *Annual Report for 1971.*

75 *Annual Report for 1966.*

76 *Annual Report for 1950.*

The rise in bank deposits that had started in 1949 enabled the Bank of Greece to reduce banknote issuance: "In this direction, we think, lies the solution to our credit problems, i.e. in the financing of the productive branches on a continuously increasing scale, from private savings flowing into the commercial banks".[77] According to G. Mantzavinos, this would allow the Bank of Greece to return to its main function, which was "to supplement the money for the economy by issuing banknotes and not, as it happens with us, out of dire necessity to supply the biggest percentage of the economy's financial requirements through the note-issuing privilege".[78] In other words, the accumulation of savings at commercial banks was key to solving the economy's credit problem.

On the other hand, an expansion of financing, as a result of higher bank liquidity created by deposits, was not free of inflationary risks.[79] It was therefore necessary to introduce effective means of controlling the size and impact of the total money supply in the country. In the Bank's view, the most appropriate line of action in this respect would be to contain any expansion in banknote circulation and absorb part of the increased liquidity to meet the needs of the population and to strengthen the balance of payments.[80] It was equally essential, according to G. Mantzavinos, to make clear to economic agents, financial institutions in particular, that the scarcity of resources allowed no room for inefficient or non-productive investment. As the Governor said, "The fact that credit means are drawn from a common pool and that, therefore, the use of finite resources for specific purposes necessarily restricts the margins for the satisfaction of others, is usually disregarded".[81]

Credit had to be allocated (in 1955) mainly to handicraft and, through the Agricultural Bank, to agriculture. Short-term loans to handicraft firms aimed to support these businesses as well as employment. Handicraftsmen were seen as "a very sympathetic class constituting one of the main pillars of the Greek economic structure".[82] Also, it was necessary to support agricultural production, through the Agricultural Bank and US aid loans financing small-scale investment projects and the acquisition of mechanical equipment. However, finding the means of endowing the Agricultu-

77 *Annual Report for 1951.*

78 Ibid.

79 *Annual Report for 1956.*

80 Ibid.

81 *Annual Report for 1955.*

82 *Annual Report for 1950*. In 1956, credit to handicraft industry increased by about 80%. See also *Annual Report for 1956.*

ral Bank of Greece with cheap capital, enabling it to extend short-term agricultural credit, was a matter still pending.

The financing of industry required a programme of medium- and long-term loans, along with the introduction and use of Treasury bill and bond issues. T-bills and bonds with security clauses and bank guarantees along with tax exemptions for issuing securities represented, according to the Bank of Greece, desired and feasible measures for financing productive investment.[83]

The Bank of Greece had good reason to question the effective and efficient channelling of bank credit to the economy: in 1956, financing to industry had increased by 11%, while industrial production had not increased more than 2%-3%.[84] Sizeable amounts had been directed to export trade as well, but had failed to bring about a proportionate increase in exports.[85] It was thus a mistake to keep supporting enterprises which, despite ample financing, showed little or no improvement at all in their condition. "It is, therefore, suggested that preferential assistance be given to those enterprises which show ability and progressive spirit".[86] Nevertheless, the higher supply of bank credit had considerably reduced firms' reliance on costly non-bank borrowing.

The reform of the banking system and the development of the capital market —which would have a crucial role to play in the sale of Treasury bills and bonds in times of increased liquidity— represented major challenges in that period. In 1950, on the initiative of the Bank of Greece, Delos C. Johns (Vice-President, Federal Reserve Bank of Kansas City), Theodore Gregory and John W. Gunter (the British and American members, respectively, of the Currency Committee) were assigned to study the Greek banking system.[87] The conclusions of their report highlighted, among other things, two fundamental problems of the Greek financial system: first, a serious insufficiency of savings and, by consequence, the very high interest rates offered in order to attract depositors; and second, the fact that two thirds of bank credit to commerce, industry and agriculture were funded by the Bank of Greece.[88]

Based on the recommendations of the three experts, Emergency Law 1611 "Deposits by Legal Persons Governed by Public Law and Insurance Funds" ("Public Entities", as they are collectively called in the report) was adopted on 31.12.1950, under

83 *Annual Report for 1956.*

84 Ibid.

85 Ibid.

86 *Annual Report for 1955.*

87 *Annual Report for 1950.*

88 Ibid.

which a "Special Account for the Management of Funds of Public Organisations" was established at the Bank of Greece. Thus, Public Entities' funds in excess of day-to-day operating needs would be deposited in a centralised manner with the Bank of Greece, rather than being scattered among commercial banks as was previously the case. Emergency Law 1665 "Operation and control of banks" followed on 27.1.1951, further enhancing the role of the Bank of Greece in the domestic banking system.[89]

In that period, consolidation in the banking sector was in the best interest of the national economy, according to the Bank of Greece.[90] Under Law 2292 "Merger of Banking Sociétés Anonymes", adopted on 18.2.1953, a decree was issued regarding the merger between the National Bank and the Bank of Athens.[91] This merger was a result of the new policy for ensuring a healthier domestic banking system, expected to bring about "a substantial reduction in bank expenditure and consequently in the cost of bank money and the rate of bank interest".[92]

A new policy was also required with respect to interest rates. In the Bank's view, a liberalisation of bank interest rates was preferable to the policy of successive interest-rate reductions pursued until then. This new policy however depended on a number of prerequisites, including a gradual shift towards a uniform system of interest rates, through coordination among banks and under the supervision and full control of the Currency Committee and the Bank of Greece; relative price stability; and a change in banking practices, with bank credit directed to strictly productive investment. But as these prerequisites were not yet in place, banks were encouraged to offer attractive deposit rates of interest according to maturity.[93]

Another problem was the fact that short-term credit was often extended for long-term purposes.[94] Thus, in 1957, when saving deposits had more than doubled relative to the previous year and long-term financing represented only one fifth of total bank credit, the Currency Committee decided that commercial banks should channel up to 10% of their deposit liabilities into long-term loans.[95] Furthermore, it was decided that the Bank of Greece would no longer make its own funds available for long-term lending, as it used to do after the war due to scarcity of funds,

89 Ibid.

90 *Annual Report for 1952.*

91 *Annual Report for 1953.*

92 *Annual Report for 1952.*

93 *Annual Report for 1955.*

94 *Annual Report for 1954.*

95 See Currency Committee Decision no. 1010/1957.

but instead all long-term credit should be funded from public entities' deposits with the Bank.[96]

The large increase in deposits, which took place within a short period of time, changed the relationship of commercial banks with the Bank of Greece: "The adequacy of banks' own available funds has resulted in a decisive reduction of the quantitative and qualitative control which was exercised by the Bank of Greece while advancing funds to commercial banks".[97] In 1958, deposit and lending interest rates declined. Deposit rates in particular stood at 8% for saving deposits, 9% for time and 5% for sight deposits. In the Bank's view, interest rates should gradually be reduced and set at "more normal" levels, given that confidence in the currency had been restored and the propensity to save had increased considerably. Although bank profits had risen, the cost of bank borrowing, i.e. lending rates, had not declined, at least for some loan categories. Thus, the Bank of Greece, through its direct lending to the economy, had to set the tune for new interest rate reductions.[98]

Among the banking reforms introduced during that period were also the compulsory increase in bank funds to be channelled into long-term loans for the modernisation or expansion of businesses, and the abolition of the preventive qualitative control exercised by the Bank of Greece and the Currency Committee on most bank credit with a maturity of up to three years. In addition, it was decided to set up a "Central Service for Monitoring Bank Lending". According to the Bank of Greece, the present-day mission of banks in a developing country like Greece required them to play a more active role in the economy: "In a country of small business enterprises, such as Greece, where the need for economic development and modernisation of technical equipment is pressing, the active contribution and assistance of the banks towards this need is an essential prerequisite together with government policy and activity".[99]

Lending rates fell in 1958, by 0.5-1 percentage point. The Bank of Greece decided to further reduce its interest rates on lending to industry (in particular for certain short-term industrial loans) from 9% to 8%, and those on loans to export trade and tobacco trade from 8% to 7%.[100] In that period, long-term lending accounted for

96 *Annual Report for 1957.*

97 Ibid.

98 *Annual Report for 1957.*

99 Ibid.

100 *Annual Report for 1958.*

one fourth of total bank credit, but long-term loans to industry had quadrupled between 1956 and 1958.[101]

In the late 1950s, the problem of qualitative control on bank lending persisted, and the Currency Committee took a number of decisions in response. Other decisions sought to boost long-term credit, as well as the participation of banks and OXOA in the share capital of enterprises, serving the dual goal of supporting new productive investment and providing technical advice and assistance. Meanwhile, activity in the Athens Stock Exchange was very weak compared with pre-war levels and insufficient to meet the long-term financing needs of economic development.

The early 1960s saw strong credit expansion to industry, handicraft and domestic trade, 60% of which was accounted for by commercial banks. This credit expansion was a combined result of higher bank liquidity and of Currency Committee decisions that markedly eased restrictions on credit to industry and handicraft. Nevertheless, according to the Bank of Greece, "Commercial bank policies in this respect have often diverged from the principles established by monetary authorities. The essence and the objectives of the decisions of the Currency Committee were not to abolish all controls and selective processes in the allocation of credit, [...] but rather to transfer the authority of control to commercial banks in order to simplify the credit mechanism".[102] In other words, the credit policy followed by commercial banks at the time effectively annulled the monetary authorities' decisions that were intended to reassign the responsibility for, rather than cancel, control on bank credit.

A consequence of this policy of commercial banks was the excessive short-term indebtedness of many enterprises, posing serious risks to the economy due to overborrowing/overlending. Thus, it was necessary to exercise tighter control on bank liquidity. To this end, a decision of the Currency Committee and the Bank of Greece in early 1961 raised the ratio of commercial banks' compulsory investment in Treasury bills from 10% to 18% of all their sight and saving deposit liabilities. In addition, it was deemed necessary to increase the share capital of banks and raise the interest rates on time deposits.[103] According to Zolotas, the business world failed to understand that these measures helped to rationalise business operation, while avoiding to increase share capital, in order to maintain the family character of corporations, as well as relying on bank credit alone were "not compatible with the creation and development of sound, dynamic and competi-

101 Ibid.

102 *Annual Report for 1960.*

103 In October 1961, the interest rate on time deposits was increased by 0.5%.

tive enterprises".[104] In other words, businesses had to evolve into sociétés anonymes owned by "a large number of shareholders", in order to secure ampler and lower-cost funding.

In the two-year period 1963-1964, credit policy reforms were introduced by Currency Committee and Bank of Greece decisions, marking a "substantial liberalisation of credit".[105] Still, the diversion of bank credit to non-productive purposes remained a concern for the Bank of Greece. Thus, by the measures taken in September 1964 "to contain credit expansion" commercial banks were instructed to accord top priority, and satisfy in full, the credit requirements of handicraft enterprises and demand for short-term credit related to actual needs of enterprises for their production and transactions; apply more conservative policies in respect of other forms of loans; and extend without restriction long-term credit to finance the investment activity of domestic enterprises.[106]

4.3.5 Balance of payments

One of the crucial structural problems of the Greek economy throughout the period under review was the deficit on the trade balance and, by extension, on the overall balance of payments (Chalikias, 1958). In the early 1950s, G. Mantzavinos remarked that the country's foreign exchange position "continues to be weak, owing to the deficiency of our balance of trade, creating for this country, which is deprived of other sufficient resources, an equally great deficiency in its balance of payments". He also stressed that, since the launch of the Marshall Plan in April 1948, the foreign exchange policy of the Bank of Greece consisted, on the one hand, in "the strict application of restrictive measures in the disposal of foreign exchange", and on the other hand, in helping and ensuring "the greatest possible volume of exports by granting a subsidy on certain products whose export is becoming difficult under cost of production conditions prevailing in Greece and owing to international prices".[107]

The Greek economy therefore had to become more competitive, and measures needed to be taken to reduce the production costs of Greek exports and at the same time broaden their destination markets. The policy imposed by circumstances accordingly consisted in handling the foreign exchange available for imports with the

104 *Annual Report for 1960.*

105 *Annual Report for 1963.*

106 *Annual Report for 1964.*

107 *Annual Report for 1951.*

greatest economy, vigorously excluding the import of any item which was not indispensable for basic needs. The imports restriction policy was, in the Bank's view, a tool facilitating negotiations for trade agreements, bringing greater benefits to the country. Overall, efforts to reduce the trade deficit had to intensify, and priority had to be given, among other things, to the problem of Greek tobacco exports to Germany, which had deteriorated.[108]

To support export trade, and tobacco trade in particular, the Bank of Greece recommended a three percentage point reduction (from 8% to 5%) in the interest rate on credit to tobacco trade, in order to reduce the cost of tobacco. In agreement with the Currency Committee, this rate was lowered from 8% to 6%, and the maturity of tobacco-related loans was increased from six months to two years.[109]

The trade deficit declined in 1952, as exports increased, but the balance-of-payments problem remained acute. The 1953 devaluation represented a decisive step towards addressing this problem: "With a view to creating the most favourable conditions for the equilibrium of the balance of payments, the government centred its full attention on the solution of this basic problem of exports and on the attraction of foreign exchange. Through the recent devaluation of the drachma, the government aims at the decisive solution of these problems". According to the Bank of Greece, this measure was long overdue, but the necessary political and economic conditions for its effective and successful implementation had not been in place.[110]

In the Bank's view, the adjustment of the exchange rate of the drachma would immediately act as a driver of economic development. The former exchange rate hindered export growth, the inflow of invisible receipts and the attraction of capital and, more generally, prevented the consolidation of the balance of payments. "The reason for Greece's unhealthy economic state of affairs had been revealed and it was only a question of time, suitable conditions and favourable outlook for the application of a measure which would definitely purge the Greek economy both for the present and the future".[111]

However, a permanent consolidation of the balance of payments was inextricably linked to the completion of the key projects of the public investment programme. This would strengthen national production and stabilise the sources of foreign ex-

108 "Financing of exports to Germany", General Council minutes, Vol. 20, meeting 53, 21.12.1949, pp. 111-112; "Purchases of tobacco by the German company Reemtsma", General Council minutes, Vol. 21, meeting 17, 19.4.1950, p. 56.

109 "Measures to reduce the cost of tobacco", General Council minutes, Vol. 21, meeting 31, 12.7.1950, pp. 301-304.

110 *Annual Report for 1952.*

111 *Annual Report for 1953.*

change inflows in the country. Moreover, higher production of foodstuffs would make a crucial contribution towards reducing imports.

According to the Bank of Greece, in order to check the rate of imports, under conditions of free trade, it was essential that the rise in money incomes be restrained.[112] On the other hand, as long as the tariff policy did not protect domestic production, import quotas were deemed necessary in the case of Greece: "It is not possible to allow the unrestricted undertaking of foreign obligations for goods of non-basic importance, even more so the financing and encouraging of such imports by loans from our banking system".[113] The freedom of imports, i.e. the absence of import quotas, presupposed credit, tariff and taxation policy measures.[114]

In the economic circumstances of the time, domestic production had to be sheltered from international competition, i.e. foreign enterprises which operated within a more favourable technical, economic and credit environment. In the Bank's view, the benefits from unlimited free trade had "no meaning when the weaker countries, which are supposed to enjoy these benefits, are doomed to reduced levels of production, income and employment".[115]

More specifically, Greek industry was in need of protection until it "matured" and became autonomous. In this respect, tariffs were seen as a more effective tool compared with import quotas. But a new tariff policy would be to no avail unless businesses were modernised. Higher productivity could be achieved through a modernisation of equipment and administrative reorganisation: "Credit and other measures should, by positive assistance, induce and support enterprises to direct their productive efforts towards these aims".[116]

Furthermore, healthy competition among enterprises and against imported goods should not rely on longer-term credit, but rather on lower prices and improved quality. The artificial maintenance, through subsidies, of prices below their normal levels was anti-economic and dangerous. Subsidies should therefore be entirely provisional. The price support policy should always be formulated in accordance with the conditions and trends prevailing in international markets and with the prices of

112 *Annual Report for 1956.*

113 *Annual Report for 1954.*

114 In 1953, a revision of the tariff list started and freedom of imports was established. Legislative Decree 2415/1953 "Adjustment of the exchange rate of the drachma" provided, among other things, for a full or partial suspension of restrictions on imports, effectively repealing Law 5426/1932 limiting commodity imports.

115 *Annual Report for 1954.*

116 *Annual Report for 1955.*

the respective products so that the position of Greek foreign products would be safeguarded and improved.[117]

To avert a negative impact on exports, “irregularities in financing” should be addressed, by a qualitative structure of credit and a careful selection of the enterprises to be financed. The privileged assistance to handicraft industry, for instance, should be continued, as this industry provided a productive outlet for thousands of persons who would otherwise have remained unemployed.[118] Investment was also required in directly productive sectors —agriculture, manufacturing, electric power and transportation— which in the mid-1950s accounted for a relatively low share of aggregate investment: 50% in 1956, compared with 47% in 1955.[119]

In 1956, despite the progress made in the Greek economy, the balance of payments showed persistent deficits, partly financed by American aid. By that time, American aid was provided in the form of long-term loans (rather than grants), repayable in drachmas with a maturity of 40 years and an interest rate of 4%. The Bank of Greece argued that “aid” in the form of loans was not justified in the case of Greece. Irrespective of its form, however, this aid should be used for the economic development of the country and particularly for basic productive projects “which cannot be undertaken by private initiative”.[120]

The steady increase in the import bill was offset by the strong increase in invisible current receipts, of which one third were migrants’ remittances, while shipping and tourism earnings were also strong. Nevertheless, invisible receipts should be considered “a sensitive item of the balance of payments”, that could not substitute exports, and “it must be generally realised that large-scale import and consumption of many commodities is not as yet in keeping with the possibilities of the Greek economy, even though such goods may be considered as essential […] in other countries”.[121] In the Bank’s view, the country’s growing dependence on unilateral transfers of shipping and migrant remittances, which did not emanate from the domestic production process, was neither healthy nor encouraging.

In the latter part of the 1950s, exports tended to stagnate. On the other hand, the Bank of Greece expected that until the mid-1960s the Greek economy would heavily rely on agricultural exports: “It is certain that for a long time to come

117 *Annual Report for 1956.*

118 *Annual Report for 1954.*

119 *Annual Report for 1956.*

120 Ibid.

121 *Annual Report for 1957.*

Greece will depend on its agricultural exports and the effort to increase and organise these exports is necessary".[122] The need for more extroversion was encouraged at the time by commercial banks' proclaimed initiatives aiming to support exports, which signalled an incipient reorientation towards a healthy direction.

A leitmotif in the Reports of the Bank of Greece in the 1960s was the need for the country's rapid industrialisation and, by extension, an increase in industrial exports. Wage moderation in line with productivity growth and agricultural prices that would not exceed the respective international prices were seen as *sine qua non* conditions for improving the country's balance of payments and foreign exchange position. In contrast, subsidies to strengthen exports could not provide a solution to the problem: there was also a need to establish favourable conditions for attracting long-term entrepreneurial capital and debt financing, mainly for industrial investment, and to provide incentives to industrial exporters. Finally, it was considered necessary to use modern methods for advertising Greek products abroad.[123]

4.4 Credit and monetary policy, 1953-1966

In the 1950s, the crucial challenge for the Bank of Greece and a steady preoccupation of the General Council was the financing of the productive sectors of the Greek economy. In particular, "funding to banks for on-lending to industry and handicraft" was the most frequent agenda item during that period.[124]

In the two-year period 1949-1950, credit was extended for the first time since 1944 to handicraft industry, while at the same time credit to agriculture increased.[125] Credit to agriculture was extended either directly by the Bank of Greece to agricultural organisations/cooperatives or with the intermediation of the Agricultural Bank. In that period, sizeable funding was provided to the National Mortgage Bank and the Agricultural Bank for their agricultural development programmes.[126]

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122 Ibid.

123 See, indicatively, the *Annual Reports* by the Governor of the Bank of Greece for the years 1958-1966.

124 See, indicatively: General Council minutes, Vol. 20, meeting 49, 30.11.1949, pp. 32-33; General Council minutes, Vol. 21, meeting 26, 7.6.1950, p. 195; General Council minutes, Vol. 23, meeting 53, 17.11.1950, pp. 17-18; General Council minutes, Vol. 30, meeting 1, 7.1.1953, pp. 11-12; General Council minutes, Vol. 34, meeting 15, 27.3.1954, pp. 8-10; and General Council minutes, Vol. 36, meeting 52, 15.12.1954, pp. 226-228.

125 *Annual Report for 1950.*

126 "Credit of 50,000,000,000 drachmas to the Agricultural Bank" and "Funding to the National Mortgage Bank for extending a loan of 250,000,000 drachmas", General Council minutes, Vol. 20, meeting 47, 23.11.1949, pp. 11-12.

In the Bank of Greece's opinion, the rising prices of agricultural products called for larger-scale credit support to the agricultural sector.[127] The development of agriculture and mortgage credit had implications for the entire economy. Thus, the Agricultural Bank had to reshape its relationship with cooperatives, support a policy of medium-term credit, and mobilise and attract farmers' small savings.[128]

The need for more and more credit was pressing during most of the 1950s and was mainly covered by Bank of Greece funds. However, the main pursuit of the Bank, acting in accord with the Currency Committee, was "to secure through the selection of the most eligible enterprises, the most advantageous channelling of available funds".[129] At the same time, financing should be provided in a timely manner, without any setbacks or delays in disbursements. On the other hand, credit expansion through the creation of new money was permissible to the extent that economic activity in general expanded.[130]

In the two-year period 1949-1950, total bank credit to the economy rose by 34.5%, with the share of the Bank of Greece in total bank credit increasing to 74.4%, from 62.5% in 1948-1949. The share of commercial banks fell, accordingly, from 37.5% in 1949 to 25.6% in 1950.[131] By contrast, in the next two years (1951-1952), total bank credit rose by about 23%, but the share of the Bank of Greece remained very high, at 73.3%.[132]

Bank credit growth remained very strong, at 35% in 1954. From a sectoral perspective, credit to agriculture grew by 30%, while credit to trade and to industry both rose by 36%. The Bank of Greece considered this credit as sufficient for that year's production and distribution of the country's increased output. On the other hand, credit developments were marked by commercial banks' reduced reliance on central bank funding as a result of higher private deposits. The share of commercial banks' own-funded credit in total credit rose considerably between 1951 and 1954, from 30% to 42.7%.[133]

Total bank credit increased only by 6.5% in 1955. In fact, total credit declined by 350 million drachmas in December 1955 relative to the previous month, but this reflected the policy to decrease funds to the tobacco industry.[134]

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127 *Annual Report for 1950.*

128 *Annual Report for 1954.*

129 *Annual Report for 1950.*

130 *Annual Report for 1955.*

131 *Annual Report for 1950.*

132 *Annual Report for 1951.*

133 *Annual Report for 1954.*

134 *Annual Report for 1955.*

The rise in private deposits in the mid-1950s, coupled with the wider use of such deposits together with public entities' deposits, allowed the Bank of Greece to reduce its share in credit growth.[135] This reduced reliance of banks on central bank funding largely stemmed from the systematic control, by the Bank of Greece, on the concentration of public entities' deposits, as well as on the advances made from these deposits through commercial banks.[136]

During the 1950s, credit policy was fundamentally revised, in line with the changing economic conditions. Jointly with the Currency Committee, the Bank of Greece revised the terms and conditions for the financing of the various sectors, increasing the credit allocated to industry and export and import trade, lengthening loan maturities and, where necessary, exceeding the defined percentages of financing. In addition, it lowered the interest rate on specific types of lending and, in the case of export trade, reduced the commission fee to 9%.

The revision of credit policy was guided by the need to support the development of industry and export trade. According to Governor G. Mantzavinos, "every care was taken so as not to negatively affect the industrial sector", while for the trade sector the Governor stated that "it is necessary to take all measures that will ensure the ability of Greek products to compete in foreign markets".[137] Nevertheless, the policy for boosting export trade only began to bear fruit after the monetary reform of 1953.[138]

Credit policy was in keeping with the "orthodox principles", avoiding any practices that could endanger the much sought after currency stability. In this regard, the expansion of credit limits and the granting of credit facilities (loan extensions or renewals) were to be avoided.[139] Accordingly, a tightening of credit policy, whereby total credit fell by 3.3% in 1952, was aimed, among other things, at curbing product stock-piling tendencies that had in the past created artificial supply shortages and inflationary pressures.[140]

During the Korean War, the Bank of Greece continued its policy of gold sovereign sales to avoid monetary disturbances. Still, the Bank's Administration continued to be concerned about the occasional bouts of "chrysophilia" and, as Governor G. Mantzavinos stated, "it is indeed not understood that the investment of the very

135 Ibid.

136 *Annual Report for 1954.*

137 *Annual Report for 1950.*

138 *Annual Report for 1953.*

139 *Annual Report for 1951.*

140 *Annual Report for 1952.*

substantial amount of almost 560 billion drachmas in gold sovereigns deprives the economy of means of payment for the purchase of other goods".[141]

A significant development in the context of credit policy was the establishment, as from 1952, of commercial promissory notes as the main instrument for the provision of credit by the Bank of Greece or commercial banks.[142] Also, a Currency Committee decision of 1953 laid down rules on the use of private cheques in banking operations.[143]

The "credit arrhythmia", as it was called, and a broader credit gap arising from the shortage of medium- and long-term loans to support the primary sector, as well as a growing number of new handicraft and industrial enterprises, were major handicaps to the development path, often necessitating Bank of Greece funding to commercial banks and specialised credit institutions, such as the Agricultural Bank.[144]

To help bridge this credit gap, the Bank of Greece required banks to allocate 10% of their total deposit liabilities to medium- and long-term loans. According to the Bank of Greece, this measure would not compromise bank liquidity, while, for heavily indebted undertakings, the new long-term loan agreements could envisage an option to convert debt into equity.[145]

In 1956, medium- and long-term credit by the Agricultural Bank rose considerably; among other long-term loans, only those to the ore mining industry recorded an increase. The already identified "serious gap" obviously persisted.[146] It is worth noting that in 1955 a new category of loans was introduced, those to professionals, which was tantamount to a rise in the level of financing to domestic trade.[147]

By the Currency Committee decision of 30.9.1949, the Handicraft Loans Committee was set up, but only became operative in 1950. By a later decision, on 26.7.1950, the Currency Committee decided to allocate Bank of Greece funds for

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141 *Annual Report for 1950.*

142 *Annual Report for 1952.*

143 *Annual Report for 1953.*

144 *Annual Report for 1954* and *Annual Report for 1956.*

145 *Annual Report for 1956.*

146 *Annual Report for 1951.*

147 *Annual Report for 1955*. Increases of the maximum level of financing to domestic trade continued throughout the 1950s, in particular in the first years of that decade. See, indicatively: "Increase of the ceiling on financing to domestic trade", General Council minutes, Vol. 21, meeting 23, 17.5.1950, p. 128; "Increase of the ceiling on financing to domestic trade by the Bank of Greece", General Council minutes, Vol. 22, meeting 32, 22.7.1950, pp. 17-18; "Increase of the ceiling on financing to domestic trade", General Council minutes, Vol. 22, meeting 38, 30.8.1950, p. 129; and "Financing to domestic trade", General Council minutes, Vol. 23, meeting 5, 7.2.1951, pp. 209-212.

the purpose of credit support to handicraft industry, at an interest rate of 6%-8% depending on the maturity of the loan.[148] Meanwhile, in 1950, credit continued to be provided to enterprises coming under the "special financing" category, including the Hellenic Chemical Products and Fertilisers Company,[149] provincial electrical power companies[150] and large agricultural enterprises.[151] As from 10.11.1951, eligible for financing were only enterprises that had fulfilled their tax obligations.[152]

Legislative Decree 588/1948 "Control of credit", supplemented by Emergency Law 1387/1950, raised the ratio of banks' compulsory deposits (required reserves) with the Bank of Greece and the interest rate on their financing from the central bank.[153] Specifically, according to a Currency Committee decision, the percentages of deposit liabilities that banks were required to deposit with the Bank of Greece were set at 25% for sight and time deposits held by public entities and 12% for all other sight and saving deposits.[154]

In early 1952, further measures were taken regarding the organisation and control of the banking system, heavily influenced by the recommendations of William H. Dillistin: a Credit Committee was set up within the Bank Inspection Section, and a position of General Inspector was established.[155]

In the mid-1950s, the rediscounting of commercial bills as a method for Bank of Greece funding to banks was "flexible and suitable for the rapid restoration of banking liquidity in periods of falls or only minor rises in their deposits". In addition, the ability of banks to overdraw their accounts with the central bank in order to meet temporary cash shortages was, in the Bank's view, a considerable step towards

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148 "Composition of the Industrial Credit Committee", General Council minutes, Vol. 23, meeting 1, 3.1.1951, pp. 150-151. See also *Annual Report for 1950,* p. 41.

149 "Financing of the Hellenic Chemical Products and Fertilisers Company for the production of fertilisers", General Council minutes, Vol. 33, meeting 2, 16.1.1954, pp. 106-110.

150 "Credit to provincial electrical power companies", General Council minutes, Vol. 20, meeting 49, 30.11.1949, pp. 34-35.

151 *Annual Report for 1950.*

152 "Announcement of Currency Committee decision whereby the financing of enterprises is subject to prior fulfilment of their tax obligations", General Council minutes, Vol. 26, meeting 49, 10.11.1951, pp. 37-39.

153 *Annual Report for 1950.*

154 Ibid.

155 Meanwhile, Law 1665 "Operation and control of banks" had been adopted on 27.1.1951. For a description of the tasks of General Inspector, see *Annual Report for 1952*. For Dillistin's influence, see ibid. Although not cited, the work on which the design of the banking system control measures had drawn was obviously his monograph "Bank note reporters and counterfeit detectors, 1826-1866: with a discourse on wildcat banks and wildcat bank notes, American Numismatic Society, 1949.

securing more flexibility in the banking mechanism and greater stability in the financing of the economy.[156]

The decisions introducing discounting and allowing overdrafts (i.e. debit balances on the accounts held by commercial banks with the Bank of Greece), as well as the new arrangements for desirable allocation of bank credit, helped to put the banking system on more healthy foundations and fostered its further development.[157] In particular, 33% of private deposits with the four major commercial banks, together with the aggregate deposits of public organisations allotted among them, should be directed to financing activities of major productive importance. Should the banks be unable to meet these percentages, the amount of the shortfall had to be invested in Treasury bills and, until such bills were issued, deposited in a special account with the Bank of Greece, remunerated at an interest rate of 5%. According to X. Zolotas, despite the initial reactions, the new system was conducive to the development effort.[158]

By Cabinet Act 1272/30.10.1953 "Setting bank lending rates", the maximum interest rate on bank loans was lowered from 12% to 10%, effective from 1.1.1954, and to 9%, effective from 1.1.1955. The same legislation reduced the commission charged on loans from 4% to 2% (and to 1% as from 1.1.1955)[159] and the default interest rate from 16% to 13% for the first quarter in arrears and from 17% to 14% for each subsequent quarter. The rates on short-, medium- and long-term loans to farmers, cooperatives and associations of cooperatives were set at 7%, 6.25% and 6%, respectively. For collateralised loans the respective rates were 8.5%, 7.5% and 7%.[160] In addition, the Bank of Greece lowered to 1.5% the rate on its lending to the Agricultural Bank, while three years later (1956) reduced it further, to 1%.[161] Meanwhile, interest rate differentiation across categories of loans to commerce and industry had been abolished as from 1954.[162]

The average annual interest rate of the Bank of Greece, i.e. the cost of its loans to the economy and banks, followed a downward trend during the 1950s, falling from 3.54% in 1953 to 2.17% in 1960. In the three-year period 1961-1963, it rose to

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156 *Annual Report for 1955.*

157 *Annual Report for 1956.*

158 Ibid.

159 "Fixing commission fees on bank loans", General Council minutes, Vol. 23, meeting 58, 15.12.1950, pp. 104-106.

160 *Annual Report for 1953,* pp. 169-170. For the interest rate on collateralised loans, see also: "Setting the interest rate on collateralised loans", General Council minutes, Vol. 22, meeting 40, 9.9.1950, p. 160.

161 *Annual Report for 1956.*

162 *Annual Report for 1954.*

2.82%, before falling again to a low of 2.08% and to 1.97% in 1967 and 1968, respectively. The successive reductions of the Bank's average lending rate reflected a shift of its lending policy towards low-interest-rate loans, the bulk of which was absorbed by the agricultural sector.[163] Thus, the percentage of total Bank of Greece credit that was channelled to agriculture, through the Agricultural Bank, was 67.2% in 1954, rising further to 85% by 1959.

In the 1960s, the Agricultural Bank remained dependent on Bank of Greece credit. Commercial banks and the Postal Savings Bank had benefited from the contemporary higher propensity to save, but the Agricultural Bank failed to attract private savings. Its deposit-to-loan ratio stood at a mere 16% in 1963, compared with 75% before the war. The Agricultural Bank's inability to attract private deposits and its consequent dependence on Bank of Greece funding, apart from potential inflationary effects, posed a risk to the adequate supply of credit to the agricultural sector in the future.[164]

Against this background, a reform of agricultural credit was deemed necessary, and a set of measures were adopted in late 1963 to this end. A review of the methods and procedures for lending to agriculture, a lowering of the applicable interest rates and a settlement of agricultural debts in arrears were among the key recommendations of the Bank of Greece, which the Centre Union government took into consideration in December 1963: "the Bank of Greece has always advocated the retroactive cancellation of the interest on delayed repayments as well as the settlement of debt on an individual basis".[165]

The policy of increasing credit to the Agricultural Bank and, more generally, to the public sector, had a direct impact on money supply. Between 1954 and 1964, money supply grew at an average annual rate of 18%, and currency circulation at about 19%.[166] Meanwhile, an average money supply growth of between 3% and 10% was observed in most countries of the world, developed or not. Money growth had therefore to be contained, although —as already mentioned— this strong monetary dynamics did not significantly affect prices or the balance of payments.

Towards the late 1950s, the Bank's Administration confirmed the need to keep credit controls in place, arguing that "in a country such as Greece, where it is vitally important to raise productive investment… consumer expenditure or non-

163 During most of the period under review, the rate on Bank of Greece credit to the Agricultural Bank ranged between 1.5% and 2%.

164 It is worth noting that 60% of the funds of the Agricultural Bank at the time stemmed from credit by the Bank of Greece.

165 *Annual Report for 1963*.

166 In the eight-year period 1956-1963, the average annual rate of increase in money supply was 16.2%.

productive investment should be kept under strict control". Any easing of credit controls would increase expenditure, particularly on building or durable consumer goods, crowding out productive investment. "The suggestions, therefore, which are occasionally put forward advocating credit liberalisation" were "irresponsible and dangerous".[167]

As mentioned earlier, in the early 1960s the easing of credit rules led to widespread overborrowing and overfinancing phenomena, which had begun to emerge in 1957-1958. A careful qualitative selection and monitoring of loans was therefore warranted, and the Central Service for Monitoring Bank Loans was established precisely for this purpose.

On the other hand, the decline in deposit rates implied a need to adjust lending rates accordingly.[168] The Bank of Greece decided to lower further, by another percentage point, its rates for lending to industry (in particular for certain short-term industrial loans) to 8% and for export and tobacco trade to 7%, down from the levels of 9% and 8% respectively set on 1.4.1959. Significant cuts in bank lending rates followed: from 9% to 6% for export trade (as from 1.4.1960); from 10% to 8% for short-term credit to industry; and to 7% for medium- and long-term loans (as from 1.10.1959). For loans to handicraft industry, interest rates fell by 2.5 percentage points, from 10% in March 1959 to 7.5% in April 1960.

New credit policy measures were taken in 1962 and 1963. These included a reduction of the cost of bank borrowing (3 to 5 percentage points lower rates on loans to industrial and handicraft exporters), a raising of the credit ceiling for working capital, a reduction in the interest rates on long-term bank loans for fixed investment, coupled with an extension of the maximum maturity of these loans from seven to ten years. By decision of the Currency Committee, commercial banks were allowed to extend long-term loans for up to 15% of their total deposit liabilities. The largest commercial banks were also allowed to invest up to 5% of their total deposit liabilities in shares of newly-established or expanding enterprises.[169]

In 1964, measures were taken to contain credit expansion in response to a reduction in commercial bank liquidity and with a view to a more rational allocation of credit according to businesses' actual financing needs. More specifically, to relieve the temporary shortage in commercial bank liquidity, the Bank of Greece

167 *Annual Report for 1959.*

168 The interest rates on saving deposits were lowered by 0.5%: from 8% to 7.5% for amounts up to 100,000 drachmas, and from 6% to 5.5% for amounts between 100,000 and 200,000 drachmas. The interest rates on sight and time deposits were lowered by 1 percentage point, from 5% to 4% and from 9% to 8%, respectively.

169 *Annual Report for 1962.*

permitted a substantial increase in the rediscounting of bank portfolios. Thus, total rediscounting and other advances extended by the Bank of Greece to commercial banks rose by 900 million drachmas between July and September 1964. In addition, credit regulations were amended: (a) the discount period for bills delivered by handicraft and industrial firms was reduced by one month (half a month in the case of trade); (b) financing of domestic trade through overdrafts was reduced from 7% of the previous year's sales to 6% of the previous year's purchases; (c) minimum downpayments for instalment sales were raised by 5% and the maturity of rediscountable bills signed by purchasers was shortened, in order to curtail the excessive expansion of sales on instalment credit. In addition, commercial banks were instructed to accord top priority to, and satisfy in full, the credit requirements of handicraft enterprises and demands for short-term credit related to actual needs of enterprises for their production and transactions, and to apply more conservative policies in respect of other forms of loans, but extend without restriction long-term credit to finance the investment activity of domestic enterprises.[170]

Some steps towards credit liberalisation were taken in 1966: restrictions on the financing of industrial and handicraft firms through overdrafts were abolished, and the margins within which commercial banks were allowed to grant long-term investment loans were widened.[171]

At the end of 1959, direct advances by the Bank of Greece accounted for 6% of aggregate bank financing, down from 12% in 1939. Central bank financing was necessary for as long as the capital market was still underdeveloped. Despite a nascent shift of the general public towards investment in stocks in 1960, the utilisation of the capital market as a source of long-term financing to support economic development remained a challenge until the early years of the next decade. In the meantime, legislation was adopted to foster a well-functioning capital market, such as Law 4237/1962 amending the legal framework for sociétés anonymes, and regulatory bodies were established, notably the Capital Market Commission in 1965.[172]

The Bank of Greece was actively involved in the effort to secure funds for productive investment and often —via its Governors and/or Deputy Governors— negotiated foreign loans on behalf of the Greek government. In 1964, Deputy Governor Dimitrios Galanis travelled for this purpose to the United States and, on behalf of

170 *Annual Report for 1964.*

171 *Annual Report for 1966.*

172 For the reduction in the share of the Bank's direct financing in the period 1939-1959, see *Annual Report for 1959.* For the reform efforts aimed at the development and tapping of the capital market in the 1960s, see, indicatively, *Annual Report for 1962.*

the Greek State, successfully negotiated loan agreements with US commercial banks for a total amount of US dollars 27 million.[173]

In the period 1953-1966, the Bank of Greece stood ready to support commercial banks whenever their liquidity fell to levels insufficient to meet financing needs. The banking system at the time was unable to cope with higher demand for long-term credit.

To sum up, in 1953-1966, and especially in the 1956-1966 eleven-year period, the Bank of Greece consistently advocated policies in line with the economy's productive capacity. In its recommendations to the governments of the time, the Bank invariably pointed out that a rise in money incomes faster than in production and real national product could disturb the domestic and external stability of the currency. Accordingly, it was necessary to contain wage growth within the increase in productivity, as well as to keep the prices of agricultural products in line with world prices.[174]

In other words, an increase in money incomes that was not accompanied by a corresponding rise in productive investment and in the country's productive capacity was certain to disturb monetary equilibrium, aggravate the deficit in the balance of payments, interrupt the economic development process and, ultimately, lead to a deterioration in the employment situation and the standard of living of the population. According to Zolotas, "the rate of economic growth cannot be accelerated by simple interventions strengthening demand which is nearly always the aim of the various irresponsibly proposed measures".[175]

In the early 1960s, developed European countries pursued policies of monetary stability and austerity, which, according to the Bank of Greece, showed the way to go as far as Greece's economic policy was concerned: "It is characteristic that some of the richest countries in Europe have recently adopted austerity programmes to maintain monetary stability and safeguard their economic and social progress".[176]

According to Zolotas, all social groups had to carefully weigh their income demands against the economy's actual capacities. A risk to monetary equilibrium stemmed from the continuous demands made by various social groups for increases in money incomes in excess of productivity increases.[177]

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173 In 1964, the amount of government foreign borrowing totalled US dollars 50.1 million. See *Annual Report for 1964.*

174 See, indicatively, *Annual Report for 1957,* p. 13, and *Annual Report for 1958.*

175 *Annual Report for 1959.*

176 *Annual Report for 1963.*

177 *Annual Report for 1964.*

As mentioned above, throughout the eleven-year period 1956-1966 the Bank of Greece argued in favour of a reasonable increase in taxation and called for an improvement in tax collection in order to combat tax evasion, also given that tax-evading incomes were largely used for conspicuous consumption, with adverse effects on the balance of payments. In addition, the Bank welcomed the financing of investment in public infrastructure projects through the government budget, Treasury bill issues and American aid loans. In the field of credit policy, the Bank —in collaboration with the Currency Committee— emphasised qualitative control on credit, in order to prevent overlending to businesses and a diversion of funds to non-productive investment.

4.5 Policy changes, 1967-1971

The orientations of economic policy, in particular credit policy, as described in the previous section, were drastically changed during the military dictatorship. As the keystone of the policy that it intended to pursue, the dictatorial regime promised to free the economy of controls and restrictions and reduce state intervention. Emphasis was placed on galvanising the economy by increasing public investment expenditure, supporting the construction and tourism industries, repealing tax provisions such as those regarding taxation of capital gains on immovable property, lowering tax rates and raising tax-free thresholds.[178]

In early August 1967, Governor X. Zolotas and Second Deputy Governor I. Pesmazoglou resigned, and Dimitrios Galanis, until then First Deputy Governor, was appointed Governor. Emergency Law 278/1968 amended Article 71 of the Statute of the Bank of Greece, doubling the percentage of the Bank's net profit to be distributed as first dividend, from 4% to 8%, which, together with an additional dividend of 4%, made a total of 12%, up from 8% previously. Law 151/1969 amended Article 55 (paragraphs 6 and 11) of the Statute, raising the ceiling on the Bank's temporary facilities to the Greek State (from the level last set in 1955), including the ceilings on Treasury bill discounts and temporary advances to the Greek State for expenditure authorised in the annual state budget. Legislative Decree 513/1970 increased the share capital of the Bank of Greece by 25%, with a view to strengthening the Bank's capital position but also stimulating the capital market through the public offering of the new shares.[179] The amount of the dividend per share almost doubled (from

178 *Annual Report for 1967*.

179 See also Legislative Decree 889/1971 "Share capital increase of the Bank of Greece".

252 to 489 drachmas) between 1969 and 1970, while in 1971 the total distributable dividend was increased to 15% of net profit.

The monetary and credit policy of that period was expansionary and geared towards the goals of the Five-Year Economic Development Plan (1968-1972), while also having "a redistributive character" in terms of reallocation of the available credit resources.[180] According to the *Annual Report for 1968,* "the credit policy pursued in 1967 and 1968 aimed primarily at counterbalancing the deflationary pressures of 1966".[181]

The second half of 1967 saw an increase in commercial bank liquidity and improved central bank funding conditions, as the discount rate of the Bank of Greece was lowered from 5.5% to 4.5%, whereas bank lending rates remained unchanged. For the first time, the Bank of Greece was allowed to discount medium-term loans extended by banks for investment in industry, construction, tourism and shipyards; to this end, the Bank would mainly use public organisations' funds under Emergency Law 1611/1951. This measure was intended to encourage certain investment activities in the above four sectors on a more permanent basis. Furthermore, special low-cost credit in the form of discounts was granted for new categories of short-term financing, inter alia, to wheat merchants and public works contractors, while the long-term funding programmes for the specialised financial institutions, such as the Agricultural Bank, the Postal Savings Bank, the National Mortgage Bank and the Consignment and Loan Fund, were expanded. A large-scale agricultural housing programme and an affordable workers' housing programme were launched, along with an expansion of the existing housing loan schemes of mortgage banks. In the tourism sector, a special programme for the financing of tourism facilities was launched, and the Greek National Tourism Organisation was supported by Bank of Greece funds for extending loans to tourism enterprises.

Credit regulations underwent fundamental changes: commercial banks were allowed to extend medium-term financing for residential construction (high-rises) and investment in tourism. Credit to shipyards was expanded, the procedure for the financing of domestic trade was simplified, and a scheme was introduced for the short-term financing of wheat trade by commercial banks.

According to Governor Dimitrios Galanis, some of these changes were connected with "countercyclical policy" and other changes were aimed at establishing "a more liberal credit system" and restore banks' functional role in managing the available credit instruments.[182] The changes represented "a transition from specific

180 *Annual Report for 1970.*

181 *Annual Report for 1968.*

182 *Annual Report for 1967.*

to general regulations" and to a "more flexible" credit control system, marking a first step towards a full abolition of qualitative controls on credit.[183]

Between June 1968 and February 1969, the discount rate was gradually increased to 5.5%. Bank deposit rates remained unchanged, whereas lending rates were lowered by 1 percentage point. Among the credit policy measures taken in 1968, the ceiling on credit to domestic trade and professionals was raised by 15%. On the other hand, the requirement on prospective borrowers to submit tax and social security contribution clearance certificates was abolished. Commercial banks were given a free hand to carry out lending operations at their own discretion, with almost no restriction as to the type of lending.[184] This marked a shift from qualitative to quantitative credit controls, within the credit ceilings and general guidelines established by the Bank of Greece.

During 1969, bank credit to private and public investment grew rapidly. According to Governor Galanis, there was no objective criterion by which to determine the limits for a safe monetary and credit expansion. It was, therefore, natural that the policy pursued in this respect was sometimes criticised, especially when the measures taken affected individual interests.[185]

The discount rate of the Bank of Greece applicable to funding to commercial banks was also raised, reaching a relatively high level of 6.5%, compared with lending rates of between 1.5% and 4% applicable on bank funding for special categories of loans (wheat trade, shipyards). For investment banks, the discount rate stood at 5.5%, while for shipyard and tourism loans at 3%-4%.

In the context of the policy of quantitative credit controls, banks' compulsory investment in Treasury bills and government bonds, as a ratio of their drachma-denominated sight and saving deposit liabilities, was raised from 27% to 29.5% in 1969 and further to 31.5% in February 1970. This measure was deemed necessary due to the strong acceleration of the government's infrastructure works programme. Other credit policy measures taken in 1969 included: credit expansion to domestic trade was contained; commercial banks' compulsory deposits with the Bank of Greece in connection with credit to domestic and import trade were increased from 30% to 35%; it was permitted to extend credit for the purchase of ships flying the Greek flag; and the facility to finance importers for unspecified needs was abolished. It is worth noting that the general guidelines provided by the Bank of Greece to commercial banks did not include restrictions, but only recommendations, e.g. to avoid the

183 Ibid.

184 *Annual Report for 1968.*

185 *Annual Report for 1969.*

overfinancing of enterprises. Thus, banks were "absolutely free to make decisions on the best part of their financial operations".[186]

In the period 1967-1970, the primary objective of currency stability was superseded by the pursuit of fast economic growth. In an attempt to comply with the instructions of the military dictatorship, D. Galanis noted that monetary equilibrium was not an end in itself and that the role of the Bank of Greece was to promote the development process and implement the Five-Year Economic Development Plan. As he stated, "monetary stability is not viewed by the Bank of Greece as an exclusive and independent goal. On the contrary, the central bank regards as its basic objective, mainly through its redistributive role, the rapid promotion of the country's economic development", adding that economic policy should be prepared for any adjustments needed to maintain monetary equilibrium and continue the economic development process without any interruption, which represented a national target and the point on which the efforts of the Greek people were focused.[187]

During the same period, the Bank of Greece extolled economic policy achievements, which overshot the targets of the Five-Year Plan. This stance in support of the dictatorial regime's choices began to gradually change from 1971 onwards, against the backdrop of the international monetary crisis and, subsequently, the emergence of strong inflationary pressures in early 1972. Thus, in the Report for 1971, Governor Galanis called attention to the overexpansion of building activity, underscoring both the negative and positive effects of the phenomenon. In his own words, this expansion "cannot be beneficial for the economy, as it leads to development-inhibiting asymmetry in the structure of production and the allocation of available resources. Nevertheless, there can be no doubt as to the importance of building activity from the standpoint of its repercussions on overall economic activity".[188]

According to the then Administration of the Bank of Greece, monetary developments in 1970 vindicated the pursued expansionary, although it was equally true that since the last quarter of 1970 there had been signs of a self-sustained acceleration in effective demand, especially in private consumer spending, which seemed to continue into 1971. Consumption growth rate (6.7% at current prices) outpaced the growth rate of gross national income (5.6%). This trend, according to Galanis, should be properly evaluated so as to readjust credit policy accordingly. Potential steps in this connection "would be aimed at preventing any further excessive incre-

186 *Annual Report for 1970.*

187 Ibid. As suggested by personal interviews with former Bank of Greece officials, Galanis had worked with Zolotas for years and did not share these views, but he was forced to toe the line of the military regime.

188 *Annual Report for 1971.*

ase in credit and at a stricter application of credit allocation criteria based on development priorities".[189]

The international monetary crisis coincided with strong growth performance in Greece. There was an increase in invisible receipts and a rise in total liquidity, which however made the Greek economy more vulnerable to changes in sentiment and less responsive to monetary steering.

Galanis defended the policy choice to keep the drachma pegged to the devalued US dollar by invoking the country's long-term orientations, the expected beneficial effects of this peg on the Greek economy's competitiveness, and the certainty that the international monetary system would rebalance with a new exchange rate arrangement.

Between 1953 and 1971, the exchange rate of the drachma remained stable at 30 drachmas per US dollar, whereas the exchange rates of most foreign currencies were adjusted (e.g. the French franc was devalued in 1957), and Greece's competitive position gradually weakened, as reflected in its balance of payments. Thus, according to Galanis, it was "evidently necessary to regain the advantages and secure the conditions for improving the competitive position of the Greek economy internationally". The streamlining of the production structure, which is sought as a basic condition for accelerated and self-sustained economic growth in the long run, required that Greece should keep up a steady and increasing inflow of capital equipment, raw materials and machinery from abroad. To this end, the economy should increase its foreign exchange reserves by expanding export trade, speeding up the import substitution process, increasing invisible receipts and encouraging the inflow of foreign venture capital. These aims would certainly be promoted in the best possible way thanks to "the country's improved position in the international structure of exchange rates and the advantages secured thereby". In other words, the realignment of exchange rates had created favourable conditions for improving Greece's trade balance and for stimulating inflows from abroad, as reflected in the tourism sector, which had gained striking advantages. Thus, "Greece's decision not to change the long-established dollar-drachma parity was the best of all available alternatives. In fact, the solution chosen may be said to be in line with the economy's current needs and its long-range targets in terms of structural readjustments and sustained growth, besides serving to strengthen its foreign sector".[190]

According to Galanis, the Smithsonian Agreement (Washington, December 1971) had not introduced an organic reform in the international monetary system,

189 *Annual Report for 1970.*

190 *Annual Report for 1971.*

but was able to restabilise the existing system at a new level of equilibrium. Although the Agreement provided no final solution, yet it ensured the conditions needed, in terms of time and psychological climate, for a more systematic and effective tackling of the problem in the future. Greece's handling of the situation had placed the economy in a position "reasonably in line with its present phase of development and the prospects of further growth".[191]

The international monetary crisis brought monetary stability back into policy focus, while at the same time prompting a revision of credit policy to deal with problems in the financing of economic development. According to Galanis, the existing monetary conditions had favoured the implementation of an eased credit policy, which had served the economic development process satisfactorily. The rapid growth of all types of bank deposits had provided healthy resources for strong credit expansion. However, after August 1971, "credit measures were dictated… by international monetary developments and by the concomitant need to strengthen the country's balance of payments position".[192]

The discount rate of the Bank of Greece was kept at the high level of 6.5%, while bank deposit and lending rates remained unchanged. Changes were recorded in the following categories of interest rates: the interest rate on foreign exchange deposits under the Housing Loan Deposit Scheme, which was raised from 6.25% to 6.75%-7.25% depending on the amount and maturity of the deposit; interest rates on deposits in drachmas from converted foreign currency (a new category introduced in 1971) were made equal to the interest rates on deposits in foreign exchange, which were higher than those on drachma deposits (savings deposits: 6.25%, compared with 4.5%-5.5%; time deposits: 6.75%-8%, compared with 5.75%-7%); a new category of sight deposits was introduced, for exclusive use by private individuals, up to a maximum amount of 200,000 drachmas, remunerated at a rate of 4% instead of the standard 0.75%; the interest rate on loans to depositors under the Housing Loan Deposit Scheme was reduced by 1 percentage point; the interest rate on loans for shipbuilding at Greek yards was raised by 0.25 percentage point (from 7% to 7.25%) and that on loans for working capital of shipping enterprises was also raised, by one percentage point (from 10% to 11%). Finally, the interest rates for prefinancing and financing exports of minerals were reduced.

These interest rate changes were mainly aimed at attracting saving deposits in foreign currency by Greeks working abroad. According to Galanis, it should be noted "that the interest rate policy has not, up to now, been used to any considerable

191 Ibid.

192 Ibid.

extent as an instrument of monetary control; changing or maintaining interest rates is not, therefore, sufficiently suggestive of the short-term policy followed".[193] When fixing interest rates on deposits, the requirements for a balanced development in the credit market in the long run were given primary consideration, whereas, when determining the structure of interest rates on loans, criteria related to economic development prevailed. The period 1970-1971 had seen, in the Governor's view, changes aimed at enhancing the importance of interest rates as a means of credit allocation. Still, it was necessary to reinstate the qualitative and quantitative control measures that had been lifted or eased during the four-year period 1967-1970. "The part played by interest rates in monetary policy was taken over mostly by quantitative and qualitative credit controls, which became necessary in the first post-year decade because of a marked shortage of loanable funds and, in the following years, because of the extensive recourse to credit policy as a means of influencing the allocation of available savings".[194] As more savings flowed into bank deposits and, accordingly, bank credit flows grew, as the financing mechanism was increasingly connected to foreign markets and, finally, as the capital market developed, the effectiveness of direct credit controls as a tool to influence liquidity was reduced. Against this background, it was time to reconsider the whole structure of interest rate policy, with a view to introducing more flexibility, which would enhance the role of interest rates as a standard means of influencing demand trends, capital movements and the allocation of savings.[195]

Quantitative and qualitative controls on credit in Greece were the principal instrument for influencing total bank credit volume and allocation, as well as liquidity. Among the credit control measures adopted in 1971, the percentages of commercial banks' primary reserve requirements (compulsory interest-free deposits with the Bank of Greece) were increased; banks were required to maintain interest-bearing seasonal deposits with the Bank of Greece, during the period from October 1971 to January 1972; the percentages of commercial banks' secondary reserve requirements (compulsory investment in Treasury bills and government and public enterprises' bonds) were raised from 34.5% to 36.5%; credit out of funds controlled by the Bank of Greece, which was granted through specialised credit institutions, to finance productive investment, increased at a high rate; credit regulations were also revised: the percentage increase in the average amount of credit provided by commercial banks to individual enterprises for working capital had to be kept within limits

193 Ibid.

194 Ibid.

195 Ibid.

determined by the growth rate of borrowers' productive activity; bank credit for fixed capital formation was subject to a ceiling of 70% of total cost; the terms on loans to importers of foreign exchange for the purchase or construction of real estate in Greece were improved; and the terms on loans to depositors under the Housing Loan Deposit Scheme were also improved, both for deposits in foreign exchange and drachma deposits.[196]

According to Galanis, the quantitative and qualitative credit control exercised in 1971 had been mainly of a "redistributive nature", given that interest rates were not extensively used in Greece as a credit allocation instrument. It was therefore necessary to use direct credit rules for that purpose. Thus, rather than the "free hand" that had been given to banks according to his Report for 1969, the Governor noted that an expansionary credit policy going beyond the limits of safety risked disturbing monetary equilibrium: "credit measures that are seemingly restrictive are often no more than a means of shifting available funds to other activities of higher priority in the process of economic development. It is evident, of course, that at the same time the authorities attempt to contain overall credit expansion within limits not liable to upset monetary stability, which is the basic prerequisite for economic development".[197] Putting this differently, the Governor stressed that "an expansionary monetary and credit policy can only be stretched to the limits imposed by the need to safeguard monetary stability".[198]

The problems with financing economic development involved the financing triangle: banks, enterprises and the capital market. Excessive bank credit to businesses in the period 1967-1970 had not only reduced the funds available for new productive activities and investment, but had also slowed down, according to Galanis, "the transition from family businesses to genuine sociétés anonymes, which offer business activity a wider and firmer basis for growth".[199]

The rapid rise in deposits during that period reflected the underdevelopment of the capital market, with the result that Greek industrial enterprises heavily depended on bank credit. Thus, the functioning of the banking system was key to tackling the financing problem: "Therefore, it is ultimately up to the banking system itself to make full use of the opportunities offered by the new credit regulations for improving existing conditions".[200]

196 Ibid.

197 Ibid.

198 Ibid.

199 Ibid.

200 Ibid.

Banks were called on to play an active role in the development of the stock market, since the measures taken earlier (including Emergency Laws 148 and 149 of October 1967) had yet to deliver visible results, due to insufficient supply of securities "from healthy sources".[201] This supply could not be increased as long as banks continued to accommodate at a low cost the financing needs of enterprises, including those with access to the capital market: "The required institutional and organisational framework has been provided. The missing factor is the business world's interest and boldness and, mainly, the active cooperation of the banking system, which must develop vigorous activity to this end".[202]

201 For the measures to support the capital market, see *Annual Report for 1968*. Legislative Decree 608/1970 "Investment Trusts and Mutual Funds" aimed to promote a shareholder society.

202 *Annual Report for 1970,* p. 27. By Legislative Decree 827/1971 "Amending and supplementing the provisions on the Athens Stock Exchange, and regulating other relevant matters", the Athens Stock Exchange Rulebook was amended, and a special account was opened at the Bank of Greece for increasing the joint guarantee fund.

5 DESTABILISATION, OIL SHOCKS, STAGFLATION: 1971-1984

5.1 The 1971-1973 period: monetary policy in crisis

In May 1971, the term of Dimitrios Galanis as Governor was renewed.[1] When he died in spring 1973,[2] Konstantinos Papayiannis became Governor,[3] while E. Panas remained Deputy Governor.[4]

As far as the Bank of Greece is concerned, the main developments during that period included new trends in financing and credit, the Bank's position within the international banking environment, and its activities as government's banker. All these occurred against the backdrop of the monetary turmoil triggered by the suspension of the gold convertibility of the US dollar on 15 August 1971.

As early as May 1971, the Bank of Greece noted the developments in the international monetary system and their impact on its foreign exchange reserves. The Bank had taken positions in Swiss francs and Deutsche marks, converting into the latter currency part of the 60 million US dollars syndicated loan. As a result, it gained from the appreciation of the Swiss franc and the floating of the Deutsche mark as from 10.5.1971.[5] The Bank of Greece responded to the events of 15.8.1971 by a brief announcement by its Governor on 18.8.1971, mentioning that, despite

1 "Renewal of the term of office of Governor D. Galanis", General Council minutes, Vol. 75, meeting of 24.5.1971, pp. 257-258, and "Announcement of swearing-in of D. N. Galanis as Governor of the Bank upon renewal of his term", General Council minutes, Vol. 76, meeting of 9.6.1971, pp. 1-2.

2 "Resolution of the General Council of the Bank of Greece following the demise of Governor Dimitrios N. Galanis", General Council minutes, Vol. 82, meeting of 3.5.1973, pp. 198-199.

3 "Announcement of the appointment of Mr. Konstantinos E. Papayiannis as Governor of the Bank", General Council minutes, Vol. 82, meeting of 7.5.1973, pp. 201-202.

4 "Expiry of the term of office of Deputy Governor E.G. Panas, and proposal for his reappointment", General Council minutes, Vol. 83, meeting of 11.7.1973, p. 44.

5 "Announcements by the Governor", General Council minutes, Vol. 75, meeting of 13.5.1971, pp. 195-196.

exchange market developments, the Currency Committee had decided on 16.8.1971 to keep the exchange rate of the drachma vis-à-vis the US dollar unchanged at 30 drachmas per dollar and retain the fluctuation bands as determined by the International Monetary Fund.[6] About two years later, in October 1973, it was announced that the Bank of Greece had been authorised to set a different exchange rate by an Act of its Governor. Thus, Governor's Act 965/19 October 1973 established a new parity of 27 drachmas per dollar.[7]

5.2 Financing operations

In that period, the bulk of credit to the real economy was provided through development banks, i.e. the Hellenic Industrial Development Bank – ETBA (state-owned), the National Investment Bank for Industrial Development (ETEBA/NIBID) and the Investment Bank (subsidiaries of the National Bank and the Commercial Bank, respectively). These banks extended medium-to-long-term loans to large corporations, with a view to supporting industrial development. Their main sources of funding were the Bank of Greece and loans from foreign banks.

Loan approvals by the Bank of Greece often included specific provisions, such as that the fiduciary assignment by the lending bank of its receivables to the Bank of Greece would not be notified to the borrowers or annotated in Mortgage Registries, where applicable. The rationale was that these claims concerned "serious" banks, with investments considered to be safe to the extent that they relied on detailed studies.[8,9] In some cases, the Bank of Greece also granted a cost-free extension of the repayment period for development banks' claims (although often the original maturity was ten years), at a favourable interest rate and with a grace period of a few years.[10] The Bank

6 "Announcements by the Governor", General Council minutes, Vol. 76, meeting of 18.8.1971, p. 189.

7 "Announcement by the Governor regarding the exchange rate of the drachma vis-à-vis the dollar", General Council minutes, Vol. 83, meeting of 24.10.1973, p. 257.

8 "Approved funding of up to 300 million drachmas to the National Investment Bank for Industrial Development (ETEBA) for supporting its lending capacity. Approval of non-notification to borrowers of the fiduciary assignment to the Bank of Greece of the lending bank's receivables from long-term loans by it, and of non-annotation in Mortgage Registries, where applicable", General Council minutes, Vol. 75, meeting of 17.3.1971, pp. 39-41.

9 "Approved funding of 100,000,000 drachmas to Investment Bank S.A. for its investment programme. Approval of non-notification to borrowers of the fiduciary assignment to the Bank of Greece of the lending bank's receivables from long-term loans by it, and of non-annotation in Mortgage Registries, where applicable", General Council minutes, Vol. 77, meeting of 15.12.1971, pp. 240-242.

10 "Modification of repayment period for approved funding of 300,000,000 drachmas to the National Investment Bank for Industrial Development (ETEBA) from Public Organisations' funds, for supporting its lending capacity", General Council minutes, Vol. 75, meeting of 14.4.1971, pp. 133-134.

of Greece operated both as direct lender and as banker of public organisations, whose funds it channelled towards supporting the investment programmes of development banks.[11,12,13,14,15]

Moreover, the Bank of Greece continued to extend credit to the National Mortgage Bank for supporting its investment programme.[16] Particularly for loans to hotel and tourism enterprises by the Hellenic Industrial Development Bank (ETBA), the National Mortgage Bank and the National Bank, special terms applied, namely: (a) a share of Bank of Greece funds of up to 100% of the loan amount; (b) a grace period of three to five years; (c) an annual interest rate of 4% for the grace period, free of any commission fees; and (d) repayment of the loans upon expiry of the grace period and rollover of principal, using public organisations' funds at an annual interest rate of 5.5%, without any commission fees. Other development banks could also be subject to this arrangement upon request.[17]

Loans to the tourism industry were channelled via the Greek National Tourism Organisation, which allocated the relevant funds to cover the working capital needs of hoteliers and other tourism-related firms, such as travel agencies.[18]

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11 "Extension of supplementary advance of 100 million drachmas to the Hellenic Industrial Development Bank (ETBA) pending the approval of funding for its 1971 programme, of which (a) 80,140,030 drachmas from Public Organisations' funds for the investment programme of 1971; and (b) 19,859,970 drachmas from Bank of Greece funds for the financing of tourism and hotel enterprises, with a grace period", General Council minutes, Vol. 75, meeting of 17.3.1971, pp. 42-43.

12 "Extension of supplementary advance to the Hellenic Industrial Development Bank (ETBA) of 100 million drachmas pending the approval of funding for its 1971 programme, of which 55,737,530 drachmas from Public Organisations' funds for the investment programme of 1971 and 44,262,470 drachmas from Bank of Greece funds for the financing of tourism and hotel enterprises, with a grace period", General Council minutes, Vol. 76, meeting of 23.6.1971, pp. 40-41.

13 "Approval of funding of up to 350,000,000 drachmas to the National Investment Bank for Industrial Development (ETEBA), from Public Organisations' funds, for supporting its lending capacity in 1972", General Council minutes, Vol. 78, meeting of 22.3.1972, pp. 236-237.

14 "Funding to the National Investment Bank for Industrial Development (ETEBA) with an amount of up to 500,000,000 drachmas, from Public Organisations' funds, for the support of its financing capacity in the year 1973", General Council minutes, Vol. 82, meeting of 14.2.1973, pp. 7-8.

15 "Funding of up to 150,000,000 drachmas to Investment Bank S.A. for its 1973 investment programme", General Council minutes, Vol. 82, meeting of 28.2.1973, pp. 46-47.

16 "Approval of funding of 100 million drachmas to the National Mortgage Bank in April 1971, pending the approval of its lending programme for 1971", General Council minutes, Vol. 75, meeting of 13.5.1971, p. 201.

17 "Funding to the National Investment Bank for Industrial Development (ETEBA), on the terms applicable to the Hellenic Industrial Development Bank (ETBA), the National Mortgage Bank and the National Bank, for on-lending to hotel and tourism-related enterprises", General Council minutes, Vol. 76, meeting of 7.7.1971, pp. 97-98.

18 "Loan of 190,000,000 drachmas to the Greek National Tourism Organisation (EOT/GNTO). EOT credit lines to hotel and tourism enterprises and travel agencies for working capital", General Council minutes, Vol. 77, meeting of 29.9.1971, pp. 8-9.

Meanwhile, agricultural credit remained a constant concern for the Bank of Greece in the form of funding to the Agricultural Bank[19,20,21,22] or financing to organisations such as the Autonomous Currant Organisation for the pooling of crops[23] or to exporters of agricultural products such as currants,[24] tobacco,[25,26] olive oil and cotton,[27,28,29] or even to industries relevant for agricultural development, such as fertilisers manufacturing.[30]

Furthermore, the Bank of Greece provided guarantees on behalf of the Greek State to foreign banks for loans to Greek construction firms,[31,32] while another and quite interesting aspect of its activities was the financing of the construction of a high-rise

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19 "Supplementary funding of 50,000,000 drachmas to the Agricultural Bank of Greece in March for its short-term lending programme", General Council minutes, Vol. 75, meeting of 14.4.1971, p. 134.

20 "Funding of 900,000,000 drachmas to the Agricultural Bank of Greece in August 1971 for its short-term lending programme", General Council minutes, Vol. 76, meeting of 18.8.1971, pp. 190-191.

21 "Funding of 330,000,000 drachmas to the Agricultural Bank of Greece, for financing 1971 tobacco crop", General Council minutes, Vol. 76, meeting of 18.8.1971, pp. 193-194.

22 "Extension until 31.12.1973 of the maturity of agreements for State-guaranteed funding to the Agricultural Bank of Greece for the pooling of tobacco crops of the years 1963-1969", General Council minutes, Vol. 82, meeting of 14.2.1973, p. 6.

23 "Extension until 30.6.1971 of the maturity of loans to the Autonomous Currant Organisation for the pooling of the 1967 currant crop", General Council minutes, Vol. 75, meeting of 14.4.1971, p. 135.

24 "Limits to Bank of Greece financing of exporters of dried grapes and figs", General Council minutes, Vol. 76, meeting of 18.8.1971, pp. 195-197.

25 "Shipments of tobacco to be delivered to the tobacco industry Roth-Händle in exporting period 1971-1972", General Council minutes, Vol. 77, meeting of 29.9.1971, pp. 11-13.

26 "Shipments of tobacco to be delivered to tobacco manufacturer H. F. and PH. F. Reemtsma in exporting period 1971-1972", General Council minutes, ibid., pp. 13-14.

27 "Financing of export trade. Provisional increase, until end-May 1972, of the 16,000,000 drachmas discount credit to Thessaloniki Oil and Cotton Industry S.A., borrower of the Thessaloniki Branch, by 16,000,000 drachmas", General Council minutes, Vol. 77, meeting of 29.9.1971, pp. 19-20.

28 "Financing of export trade. Provisional increase, until end-May 1972, of the discount credit of 2,000,000 drachmas to Cotton Grins of Macedonia S.A., borrower of the Thessaloniki branch, by 5,000,000 drachmas", General Council minutes, ibid., pp. 20-21.

29 "Financing of export trade. Provisional, until end-May 1972, increase of the discount credit of 6,500,000 drachmas to the borrower of the Thessaloniki Branch Antoniadis-Athanasiadis Cotton Industry S.A., by 6,500,000 drachmas", General Council minutes, ibid., pp. 22-23.

30 "Funding of 50,000,000 drachmas to the Agricultural Bank of Greece for credit to Chemical Industries of Northern Greece S.A. for the production of fertilisers in the period 1971-1972", General Council minutes, ibid., pp. 9-10.

31 "Provision of a guarantee for up to US dollars 1,035,000 dollars by the Bank of Greece to Hambros Bank Ltd, London, on behalf of the Greek State, for a loan to the construction firm Skapanefs S.A.", General Council minutes, Vol. 76, meeting of 18.8.1971, pp. 191-192.

32 "Provision of guarantee by the Bank of Greece to the Hessische Landesbank Girozentrale, Frankfurt, for an amount of up to 1,000,000 DM on behalf of the Greek State, for the extension of a loan to Elliniki Techniki S.A.", General Council minutes, ibid., pp. 192-193.

office and retail building by the Municipality of Piraeus. The latter obtained a State-guaranteed loan (at an annual interest rate of 6% and repayable in 15 years in 30 biannual instalments) from the National Mortgage Bank, funded by the Bank of Greece.[33]

A considerable part of total allocated credit was absorbed by the shipping sector,[34] in the form of bank loans to shipping companies for building and/or converting vessels at Greek shipyards. All types of vessels were eligible (cargo, passenger, fishing, etc.); the loans covered 80% of total costs and were repayable in 18 equal biannual instalments, starting six months after the delivery of the ship. More specifically, loans for the building of all types of smaller-tonnage Mediterranean ships were repayable in 12.5 years, with a grace period of two and a half years. The lenders (commercial banks and the Hellenic Industrial Development Bank) would in turn have their receivables discounted by the Bank of Greece at an annual interest rate of 4.2% for Bank of Greece funds and of 5.2% for public organisations' funds managed by the Bank of Greece.[35] Such loans continued to be extended in the following years, mostly but not exclusively intermediated by the State-owned Hellenic Industrial Development Bank,[36,37,38] and in certain cases with a cost-free lengthening of the repayment period.[39,40,41]

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33 "Funding of 25 million drachmas to the National Mortgage Bank, from Public Organisations' funds, for extending a State-guaranteed loan to the Municipality of Piraeus, for the construction of an office and retail building", General Council minutes, Vol. 77, meeting of 13.10.1971, pp. 49-50.

34 "Codification of Currency Committee decisions on the financing of shipping", General Council minutes, ibid., p. 193.

35 "Funding to commercial banks and the Hellenic Industrial Development Bank (ETBA) for on-lending to shipping companies, for building and conversion of vessels at Greek shipyards", General Council minutes, Vol. 76, meeting of 1.9.1971, pp. 211-213.

36 "Determination of the level of Bank of Greece funding to the Hellenic Industrial Development Bank (ETBA) in 1971 at up to 1,150,000,000 drachmas, for on-lending to shipping companies for building and conversion of vessels in Greece, based on the applicable specific decisions of the Currency Committee", General Council minutes, Vol. 78, meeting of 26.1.1972, pp. 69-70.

37 "Approval of refinancing of the Hellenic Industrial Development Bank (ETBA) with 669,600,000 drachmas – i.e. 90% of its loan to Constant Shipping Company, for the building of 5 product carriers", General Council minutes, Vol. 80, meeting of 4.10.1972, pp. 201-202.

38 "Funding to commercial banks and the Hellenic Industrial Development Bank (ETBA) for extending supplementary loans related to building and conversion of vessels at Greek shipyards", General Council minutes, Vol. 81, meeting of 6.12.1972, pp. 62-63.

39 "Approval of further postponement of the start of repayment of funding to the Hellenic Industrial Development Bank (ETBA) to finance the building of two bulk carriers", General Council minutes, Vol. 79, meeting of 24.5.1972, pp. 80-82.

40 "Extension by two months of the maturity of the fifth tranche, amounting to 133.95 million drachmas, out of total 669.6 million drachmas funding to the Hellenic Industrial Development Bank (ETBA) to finance the building of a bulk carrier by Constant Shipping Company at Hellenic Shipyards S.A.", General Council minutes, Vol. 81, meeting of 20.12.1972, p. 133.

41 "Extension of the maturity of funding to Hellenic Industrial Development Bank (ETBA) S.A. to finance the building of an oil tanker in Greece by Symianos Bros Shipping Enterprises S.A.", General Council minutes, Vol. 83, meeting of 7.11.1973, pp. 295-296.

Other recipients of intermediated loans were export companies, specifically Greek Exports S.A.,[42,43,44] handicraft enterprises,[45] as well as the film industry for domestic productions.[46] Finally, the Bank of Greece also participated in the financing of large-scale international projects, such as the Suez-Alexandria oil pipeline.[47]

5.3 Foreign borrowing

The Bank of Greece was involved as a party or agent in major foreign borrowing operations between the Greek State, Greek banks and foreign financial institutions. In 1971, negotiations were concluded for a 60 million US dollars loan by a syndicate of foreign banks (Bank of America, First National Bank of Chicago, Continental Illinois National Bank & Trust Company Chicago, The Chase Manhattan Bank, Bank of Nova Scotia, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Co, Bankers Trust Company and American Express International Banking Corporation) led by First National City Bank. The loan had a maturity of six years, with a grace period of three years, during which only interest would be payable. The interest rate would be the Eurodollar Libor plus one percentage point. The Bank's Administration welcomed the loan as a great success, not only for its favourable terms, but also because the participation of major foreign private banks was evidence of confidence in the outlook of the Greek economy.[48] A new deal in January 1972 concerned a loan of US dollars 30 million to the Bank of Greece from Bankers Trust Company, Continental Illinois National Bank & Trust Company of Chicago and Goldman Sachs International Corporation, Canadian Imperial Bank

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42 "Funding of 100,000,000 drachmas to the Hellenic Industrial Development Bank, for lending to Greek Exports S.A. prior to the issuance of a Greek State guarantee", General Council minutes, Vol. 81, meeting of 6.12.1972, pp. 64-65.

43 "Revision of the 1973 funding programme for the Hellenic Industrial Development Bank (ETBA)", General Council minutes, Vol. 83, meeting of 22.8.1973, pp. 129-130.

44 "Revision of the 1973 funding programme for the Hellenic Industrial Development Bank (ETBA)", General Council minutes, Vol. 83, meeting of 7.11.1973, pp. 294-295.

45 "Funding of up to 6,000,000 drachmas to Traders' Credit Bank from Public Organisations' funds, for on-lending to handicraft enterprises", General Council minutes, ibid., p. 298.

46 "Refinancing by the Bank of Greece of loans extended by commercial banks, investment banks and the Hellenic Industrial Development Bank (ETBA) to Greek and foreign film enterprises for domestic productions", General Council minutes, Vol. 81, meeting of 6.12.1972, pp. 63-64.

47 "Announcement of the Government Political Council decision on Greece's participation in the financing of the Suez-Alexandria oil pipeline project, and authorisation of negotiations with Egypt on Bank of Greece financing", General Council minutes, Vol. 80, meeting of 19.7.1972, pp. 16-18.

48 General Council minutes, Vol. 74, meeting of 4.2.1971, pp. 285-287.

and Toronto Dominion Bank; Barclays Bank International, Bank of Tokyo Trust, Sumitomo Bank, Associated Japanese Bank, Japan International Bank, Sanwa Bank and Dai-Ichi Kangyo Bank. The loan had a maturity of ten years, with a three-year grace period and an interest rate equal to that of the Eurodollar Libor, plus 1.05 percentage points on average. This loan was also seen as a success, particularly in view of its rather long maturity by the market standards of the time (5-6 years),[49] and was greatly praised by the dictatorial government,[50] to which the loan was handed over by the Bank of Greece.[51]

In April 1972, a new loan for US dollars 70 million was obtained from Goldman Sachs International Corporation, Continental Illinois National Bank and Trust Company, Japan International Bank and Orion Banking Group, with the same maturity (ten years) and the same average interest rate as in the previous loan.[52] In May 1972, the Greek State received a 25 million US dollar loan from First National City Bank N.Y., with the Bank of Greece acting as agent of the State, to finance the procurement of military equipment and services from the United States. The loan had a maturity of at least ten years and an interest rate equal to the base rate of First National City Bank plus 0.5%.[53]

In October 1972, the Bank of Greece obtained a loan of US dollars 70 million from a syndicate of banks led by Crocker National Bank of San Francisco, California, the terms of which were even more favourable than for earlier loans, as they provided for an interest rate of only one percentage point over the Eurodollar Libor and a longer grace period of five years.[54] These exceptionally favourable terms also received positive comments from the international financial press such as *The Financial Times, The Wall Street Journal* and *The International Herald Tribune.*[55] Finally, in July 1973

49 "Announcements of the Governor on a 30,000,000 US dollar loan from a syndicate of foreign credit institutions", General Council minutes, Vol. 78, meeting of 29.12.1971, pp. 18-21.

50 "Announcement of a letter from Mr. N. Makarezos, Vice-President of the Government, to the Governor regarding the 30,000,000 US dollar loan", General Council minutes, Vol. 78, meeting of 9.2.1972, p. 131.

51 "Approval of the transfer to the Greek State of the 30,000,000 US dollar loan contracted by the Bank of Greece, under Currency Committee Decision no. 3056/9/22.12.1971, with London-based credit institutions", General Council minutes, ibid., pp. 132-133.

52 "Announcements by the Governor regarding the 70,000,000 US dollar loan from a syndicate of foreign credit institutions", General Council minutes, Vol. 79, meeting of 19.4.1972, pp. 20-23.

53 "Announcements by the Governor regarding the 25,000,000 US dollar loan from First National City Bank N.Y. to the Greek State via the Bank of Greece acting as an Agent of the Greek State", General Council minutes, Vol. 79, meeting of 24.5.1972, pp. 69-70.

54 "Loan of US dollars 70 million to the Bank of Greece", General Council minutes, Vol. 80, meeting of 4.10.1972, pp. 224-227.

55 "Loan of US dollars 70,000,000 from a syndicate of international banks led by Crocker National Bank of San Francisco", General Council minutes, Vol. 81, meeting of 6.12.1972, p. 60.

the Bank of Greece was granted a credit line of US dollars 200 million by a syndicate of foreign banks led by First Boston (Europe) Limited, London, with a 12-year maturity and an interest rate 0.75% above the Eurodollar Libor applicable on three-month or six-month deposits in US dollars.[56] This loan was also handed over to the Greek State in December 1973.[57]

Throughout that period, along with the temporary advances it continued to extend to the Greek State,[58] the Bank of Greece was also involved in the management of Greek government bond issues on the domestic market (the so-called development bonds).[59, 60, 61]

5.4 International relations and interventions of the Bank of Greece

In the period under review, the Administration of the Bank of Greece sought to strengthen the Bank's presence within the international banking and economic research community, as well as to make the achievements and the upward path of the Greek economy known. This was a practice followed also by other central banks, at a time of information dissemination and worldwide quest for credit. In this context, the Governor of the Bank of Greece joined international research institutes and organisations, such as the Stanford Research Institute[62] and the Organisation for International Economic Relations,[63] and summaries of the *Annual Report* and articles on Greek economic developments were frequently published in prominent foreign journals and newspapers, such as *The American*

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56 "Announcements by the Governor regarding a 200,000,000 US dollar loan agreement concluded by the Bank of Greece with foreign credit institutions", General Council minutes, Vol. 83, meeting of 11.7.1973, pp. 45-46.

57 "Transfer to the Greek State of the 200,000,000 US dollar loan concluded by the Bank of Greece under the agreement of 24.7.1973, with foreign credit institutions", General Council minutes, Vol. 84, meeting of 20.12.1973, pp. 116-117.

58 "Extension of temporary advance to the Greek State", General Council minutes, Vol. 76, meeting of 18.8.1971, p. 198.

59 "Domestic Economic Development Lottery Loan for 2,350,000,000 drachmas at 6.5%, 1971", General Council minutes, ibid., pp. 201-202.

60 "Extension of loans using as collateral bonds of the 1972 6.5% 3,000,000,000 drachmas Lottery Loan", General Council minutes, Vol. 81, meeting of 1.11.1972, p. 5.

61 "Appointment of the Bank of Greece as underwriter of a 260,000,000 drachmas tranche of the 6.5% 1972 Domestic Lottery Economic Development Bond Issue to be launched under Legislative Decree 1183/72", General Council minutes, ibid., pp. 6-9.

62 "Registration of the Governor of the Bank of Greece as member of the Stanford Research Institute, California", General Council minutes, Vol. 76, meeting of 23.6.1971, p. 82.

63 "Registration of the Bank of Greece as member of the Organisation for International Economic Relations, Vienna", General Council minutes, Vol. 83, meeting of 27.6.1973, p. 43.

Banker,[64,65] *The Economist,*[66,67,68] *Corriere della Sera,*[69] *Libre Belgique,*[70] *Journal of Commerce,*[71,72] *The Wall Street Journal,*[73,74,75,76] *The Financial Times,*[77,78, 9] *Al-Ahram,*[80] *Die Presse,*[81] *The Times of London,*[82] *Le Figaro, Frankfurter Allgemeine Zeitung, Washington Post,*[83] and *The New York Times.*[84] At the same time, by demand of

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64 "Publication of the *Annual Report* in the New York newspaper *The American Banker*", General Council minutes, Vol. 76, meeting of 23.6.1971, p. 82.

65 "Publication of a summary of the *Annual Report* in the New York newspaper *The American Banker*", General Council minutes, Vol. 79, meeting of 28.4.1972, p. 44.

66 "Publication of an article in the London newspaper *The Economist*", General Council minutes, Vol. 76, meeting of 23.6.1971, pp. 82-83.

67 "Publication of an article by the Governor in *The Economist* and *The American Banker*", General Council minutes, Vol. 77, meeting of 20.10.1971, pp. 98-99.

68 "Publication of a summary of the *Annual Report* in the London newspaper *The Economist*", General Council minutes, Vol. 79, meeting of 28.4.1972, p. 45.

69 "Publication of an article by the Governor in *Corriere della Sera*", General Council minutes, Vol. 77, meeting of 13.10.1971, p. 78.

70 "Publication of an article by the Governor in *Libre Belgique*", General Council minutes, ibid., pp. 78-79.

71 "Publication of an article by the Governor in the *Journal of Commerce*", General Council minutes, ibid., p. 79.

72 "Publication of a summary of the *Annual Report* in the *Journal of Commerce*", General Council minutes, Vol. 79, meeting of 28.4.1972, p. 45.

73 "Publication of an article by the Governor in *The Wall Street Journal*", General Council minutes, Vol. 77, meeting of 13.10.1971, pp. 79-80.

74 "Publication of article in *The Wall Street Journal*", General Council minutes, Vol. 77, meeting of 17.11.1971, pp. 176-177.

75 "Publication of a summary of the *Annual Report* in *The Wall Street Journal*", General Council minutes, Vol. 79, meeting of 28.4.1972, pp. 44-45.

76 "Publication of an article entitled 'The economy of Greece in 1972' in *The Wall Street Journal*", General Council minutes, Vol. 81, meeting of 20.12.1972, pp. 154-155.

77 "Publication of an article by the Governor in *The Financial Times*", General Council minutes, Vol. 77, meeting of 13.10.1971, p. 80.

78 "Publication of the *Annual Report* (summary) in *The Financial Times*", General Council minutes, Vol. 79, meeting of 28.4.1972, p. 46.

79 "Publication of an article in *The Financial Times*", General Council minutes, Vol. 82, meeting of 14.3.1973, pp. 101-102.

80 "Publication of an article in the Cairo newspaper *Al-Ahram*", General Council minutes, Vol. 78, meeting of 8.3.1972, p. 226.

81 "Publication of the summary of the *Annual Report* in the Vienna newspaper *Die Presse*", General Council minutes, Vol. 79, meeting of 28.4.1972, p. 45.

82 "Publication of an article in *The Times of London*", General Council minutes, Vol. 79, meeting of 24.5.1972, pp. 127-128.

83 "Publication of the *Annual Report* in *Le Figaro, Frankfurter Allgemeine Zeitung* and *Washington Post*", General Council minutes, ibid., p. 128.

84 "Publication of article entitled 'The Economy of Greece in 1972' in the annual Economic Review of Europe and the Middle East of *The New York Times*", General Council minutes, Vol. 81, meeting of 20.12.1972, p. 155.

the dictatorial government, the Bank of Greece sponsored propaganda publications, targeted at domestic and international audiences, on the dictatorship's economic achievements.[85]

As part of its international contacts, the Bank regularly invited foreign academics, bankers and other prominent figures to give lectures in Greece and exchange views with the Administration of the Bank of Greece on economic and financial matters, also as a way of promoting Greek interests. This programme was launched before the dictatorship, by the General Council decision of 2.11.1966. Among others, Gottfried Haberler visited Greece in October 1971[86] and Gordon F. Boreham, professor at the University of Ottawa, in July 1972.[87]

In the context of its international relations, the Bank participated in the Annual General Meetings of the International Monetary Fund (IMF)[88] and the Bank for International Settlements (BIS). The 41st Annual Meeting of the BIS, held in Basel on 14.6.1971, brought together the Bank's Administration with its peers from the BIS, the Nederlandsche Bank, the Bank of England, the Bundesbank, the Federal Reserve Bank of New York, as well as certain Swiss banks.[89] The meeting focused on international instability, marked by an increase of nominal income above productivity gains and the emergence of cost inflation, although demand inflation had been reined in through restrictive monetary policies. The result had been economic stagnation and higher unemployment. These domestic imbalances had affected external economic relations, with adverse repercussions on the international monetary system, mainly via the persistent payments deficit of the United States and the abundant supply of Eurodollars since 1970. The appreciation of major European currencies (such as the Deutsche mark, the Dutch guilder and the Swiss franc) vis-à-vis the US dollar and gold triggered chain reactions across the international monetary system. The Bank of Greece had predicted, already in June 1970, that an appreciation of the hard European currencies was more probable than a depreciation of the US dollar vis-à-vis gold.

85 "Approval of expenditure as the contribution of the Bank in the costs of a publication on the Greek economy", General Council minutes, Vol. 77, meeting of 17.11.1971, pp. 171-172.

86 "Invitation to Professor Gottfried Haberler to deliver a lecture", General Council minutes, Vol. 76, meeting of 1.9.1971, pp. 259-260.

87 "Prolongation of stay in Greece of invited foreign academics, bankers and other distinguished guests", General Council minutes, Vol. 79, meeting of 5.7.1972, pp. 267-268.

88 "Travel of Governor D. Galanis and Deputy Governor E. Panas abroad for official business", General Council minutes, Vol. 76, meeting of 15.9.1971, pp. 261-262.

89 "Announcements of the Governor following his travel to Basel and Zurich", General Council minutes, Vol. 76, meeting of 7.7.1971, pp. 85-92.

In the view of the BIS, which was shared by the Bank of Greece, although a correction of exchange rates was necessary, it was of the utmost importance to restore domestic stability, not only through appropriate monetary and fiscal policies, but also through a restrictive incomes policy that would ensure wage growth in line with the increase in productivity. Moreover, monetary policy coordination was necessary, especially with respect to the Euro-dollar market.

In June 1972, the Bank of Greece attended the 42nd Annual General Meeting of the BIS, along with other central banks and international organisations. The meeting confirmed once again that inflation was the major problem of the world economy, having a serious impact on the international monetary system and foreign exchange markets. This time, however, the upsurge in inflation was attributed to excess demand, and the focus shifted to policies for containing demand. The Smithsonian Agreement of 18.12.1971 in Washington that introduced a new exchange rate regime was welcomed, but its successful implementation crucially hinged on national policies. In parallel, the meeting called for monetary policy coordination across countries, noting the destabilising role of short-term capital movements.[90]

In the next Annual Meeting of the BIS, on 18.6.1973, the assessment was that no progress had been made on the inflation front internationally. This was attributed to the failure of governments and central banks to curb the demands made by various social groups for higher incomes and prices. The direct controls on prices and incomes implemented by some governments had not been successful either, in the absence of public support to disinflationary policies. At the same time, also due to the lack of coordination of economic policies across countries, the Smithsonian Agreement collapsed and the Bretton Woods system was abandoned in early 1973. However, despite the shift to floating exchange rates, outflows from the US dollar continued, mainly on account of the lack of a systematic disinflationary policy in the United States. It is interesting that the policy of *de facto* devaluation of the dollar was seen as being supported by both the United States, seeking to improve its balance of payments, and West Germany, which saw the strong mark as a bulwark against inflation. The Bank of Greece pointed out the risk of monetary instability leading to competitive devaluations, protectionism and controls reminiscent of those prevailing in the 1930s. Still, it believed that there was scope for establishing a new international system that would retain the basic characteristics of the Bretton Woods system, which had

90 "Announcements by the Governor following his travel to Basel and Zürich", General Council minutes, Vol. 79, meeting of 21.6.1972, pp. 172-177.

significantly contributed to international prosperity during a quarter of a century after the end of World War II.[91]

Finally, the Bank of Greece entered into agreements with American banks active in the international Eurodollar market, to open time deposits in US dollars by such banks. One such agreement was signed on 25.11.1970 (and renewed twice, in December 1971 and February 1973) with The Chase Manhattan Bank, for a deposit of one million US dollars, with a facility of overdrafts in drachmas up to the amount of 30 million.[92,93] Similar agreements were signed with the Bank of Nova Scotia on 9.9.1970 (renewed in September 1972) for a time deposit of two million US dollars;[94] First National Bank of Chicago, Athens for a time deposit of one million US dollars, renewed on 13 February 1973 for an additional year;[95] and First National City Bank for a deposit of 5 million US dollars, effective from January 1973.[96]

5.5 The collapse of the Bretton Woods system and its consequences for exchange rate policy

The year 1971, the second to last of the dictatorship's Five-Year Economic Development Plan 1968-1972, was characterised by rapid economic growth in Greece, in spite of strong inflationary pressures abroad in the wake of the international monetary crisis. According to the *Annual Report* of the Bank of Greece, the balance of payments was in surplus —partly thanks to higher invisible inflows— that led to a substantial increase in the country's foreign exchange reserves. The impact of the international monetary crisis manifested itself through abrupt and strong fluctuations in the trade balance, mainly imports. The decision to maintain the drachma/dollar exchange rate at the level last set in 1953 (30 drachmas per dollar) implied that the drachma was less expensive than the currencies of the EEC countries and Japan and contributed to a rise of inflation in Greece. Regarding the structure of the Greek economy, a slowdown was observed in the rate of growth in

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91 "Announcement by Governor K. Papayiannis to the General Council following his travel to Basel and Zürich", General Council minutes, Vol. 82, meeting of 27.6.1973, pp. 292-297.

92 "Approval of an agreement with The Chase Manhattan Bank", General Council minutes, Vol. 77, meeting of 1.12.1971, pp. 199-200.

93 "Approval of an agreement with The Chase Manhattan Bank", General Council minutes, Vol. 82, meeting of 14.2.1973, pp. 17-18.

94 "Approval of agreement with the Bank of Nova Scotia", General Council minutes, Vol. 80, meeting of 20.9.1972, pp. 174-176.

95 "Approval of agreement with First National Bank of Chicago, Athens", General Council minutes, Vol. 82, meeting of 14.2.1973, pp. 16-17.

96 "Approval of agreement with First National City Bank", General Council minutes, ibid., pp. 18-19.

agricultural income growth in favour of manufacturing, which from 1969 onwards had exceeded the agricultural sector in terms of relative size.

Developments in 1972 were marked by an overheating in certain sectors of the economy, most notably construction, along with a pick-up in inflation and import prices. In the labour market, conditions of nearly full employment prevailed. Industrial production increased, driven by buoyant building activity and higher public expenditure. The share of manufacturing in GDP rose from 16.5% in 1962 to 22.9% in 1972 (at 1958 prices), and that of the secondary sector as a whole was 33.5% of GDP in 1972. The Bank's *Annual Report* noted that "Rapid industrial expansion is coupled with a commensurate increase in social cost owing to the strong and multiform incentives given to promote industrial development", and "industrial development and production are being promoted through disproportionately large and growing support from the banking system".[97] Moreover, after a long period of relative stagnation, prices were rising at accelerating rates (on average 6.5% in 1972, while the wholesale price index increased by 10.5%).

The economy faced much more adverse conditions in 1973, against the backdrop of the first oil shock: between the beginning and the end of the year, the Consumer Price Index (CPI) increased by 30.6%, being on average 15.5% higher than in 1972, and the rise in the wholesale price index (which is directly affected by international prices) came to 44.2%. At the same time, a slowdown in agricultural production was a cause of concern. The Bank of Greece pointed out a need for a review of agricultural policy and the relevant objectives, recalling that agriculture employed and secured income for 40% of the population and contributed about 15% to GDP. The slowdown in agricultural production was associated with urbanisation and the excessive growth of the construction sector: during the 1969-1973 period, residential investment as a percentage of total gross fixed capital formation was 30%, much higher than in comparable economies (Turkey 22%, Spain 18%, Portugal 17%). The Report stressed that "the overexpansion of the building sector cannot be considered to be a favourable development in the long run, since it entails a lopsided structure of the productive mechanism".[98]

After several decades of a fixed exchange rate between the drachma and the US dollar (and the dictatorship's successive decisions to maintain this exchange rate), in October 1973 it was decided to unpeg the drachma from the US dollar and revalue it upwards by 11.1%. With subsequent developments, most notably the recovery of the dollar, the drachma-US dollar parity broadly returned to about 30 drachmas per

97 *Annual Report for the year 1972.*

98 *Annual Report for the year 1973.*

one dollar; still, the lasting impact of the measure was that the peg was abandoned and, as the Report mentioned, "a controlled float was maintained, which makes for more elastic arrangements".[99]

In conclusion, the exchange rate policy of the Bank of Greece after the collapse of the Bretton Woods system, as well as the overall policy of the military dictatorship, were erratic, complicated and often contradictory. While the economic development process continued, the Bank of Greece, lacking Zolotas' steady hand and commitment to monetary stability, put up with an overheating of the economy, only taking comfort in the attainment of full employment. Pressures on the drachma became unsustainable, and no alternative strategy was in sight, as the dictatorial regime was by its nature averse to plurality of views. Even though the country's European prospect appeared too remote at the time, it was a fact that Europe was the chief destination for Greek exports, and this should normally not have been forgotten in exchange rate policy making. The —albeit short-lived— pegging of the drachma to the US dollar perhaps reflected contemporary political priorities, but these were not in line with the long-term interests of the Greek economy.

5.6. The Bank of Greece following the restoration of democracy

A few months after the General Meeting of Shareholders of the Bank of Greece on 29.4.1974, a number of major developments took place: a coup against Archbishop and President Makarios in Cyprus (15.7.1974); the Turkish invasion of Cyprus (20.7.1974); and the fall of the dictatorship in Athens (23-24.7.1974), followed by the Attila II operation in Cyprus on 14.8.1974. In September, new political parties were formed in Greece, including the Panhellenic Socialist Movement (PASOK) on 3.9.1974 and New Democracy on 29.9.1974, while some older parties were reactivated and/or legalised: the Centre Union – New Forces party on 20.9.1974, the Communist Party of Greece (KKE) on 23.9.1974, the KKE Interior, and the United Democratic Left (EDA). A national election was held on 17.11.1974, followed by a referendum on the form of government on 8.12.1974.

Meanwhile, the acting Governor of the Bank of Greece, Panayis Papaligouras, addressed the extraordinary General Meeting of Shareholders held on 23.9.1974 with the following statement: "We are called: first, to assist the government in dealing with the direct economic consequences of the Cypriot crisis; second, to contribute to a rationalisation of the operating conditions of the disorganised banking system; and third, to restore within this national institution staff order and legality".

99 Ibid.

The situation of the economy was improving, as Papaligouras assured the Bank's shareholders: "…the rate of increase in price indexes is declining. It is also projected that in the second half of the current year the total increase will not exceed 4% for the Consumer Price Index and 5%, at most, for the wholesale price index". These developments had strengthened depositor confidence: "Between 1 and 18 September, private deposits rose by 3,636 million drachmas, while banknote circulation fell by 3,180 million drachmas".[100]

At the next Ordinary General Meeting of the Bank of Greece held on 24.4.1975, Xenophon Zolotas, reinstated as Governor, presented his first post-1974 Report, noting among other things the following: "When the Government of National Unity came to power on 24 July 1974, the economy was marked by recession, a high rate of inflation and a large deficit in the balance of payments", adding that "the decline in economic activity was halted during the last months of 1974",[101] although it was not clear whether the economy had started recovering. Despite a significant weakening in imports, the balance of payments remained in deficit, which was due to an almost fourfold increase in oil prices, as well as exceptional imports of defence equipment in the context of the Cyprus crisis. The Report went on to note that "the state budget is burdened by the legacy of the period of the dictatorship, which is characterised by an unplanned swelling of public spending, both consumer and investment, in directions of low productivity".[102] By this, the Governor implied that the dictatorial regime had focused on providing liquidity for consumption and low-yield investment in order to generate consumer affluence and thereby raise its popularity, making up for its lack of legitimacy. This policy, according to Zolotas, had been unacceptable and against the long-term interests of the Greek economy.

With regard to the unpegging of the drachma from the US dollar, the Report explained the rationale behind the decision of 8.3.1975, as well as the functioning of the new system of setting exchange rates based on a basket of currencies. This choice, along with a number of other government decisions in the areas of incomes, credit and fiscal policies, had brought the Greek economy out of recession and onto a path of recovery, with GDP growing by 3.7% in 1975, compared with a decline of 2.5% for the OECD's European members as a whole. Inflation was still high, at double-digit levels (15.2% in 1975, up from 13.5% in 1974), which was partly attributed by the Bank of Greece to higher indirect taxes. According to the Bank of Greece, the authorities should take steps to prevent an excessive increase in profits, especially

100 Papaligouras (1996), p. 470.

101 *Annual Report for the year 1974.*

102 Ibid.

those arising through the abuse of monopoly power, in order to bring inflation under control in the period ahead, during which further recovery and higher demand were expected. The Bank also called for effective measures to reduce the high cost of marketing of agricultural products and the unjustifiably high profits of middlemen. An important problem was the lower level of savings (from about 23% of GDP in 1973 to 15.7% in 1975), as a result of inflation and recession. Moreover, it was stressed that "the substantial credit expansion that took place in the second half of 1974 and continued for the best part of 1975 was aimed at helping the economy out of the recession".[103] This credit expansion had been allocated unevenly across the private and the public sector, almost 58% and 42% respectively, in 1975. The goal was to support industry and export trade, but this policy had inflationary side-effects. The Report for 1975 featured, for the first time, a section on "Accession to the EEC and economic development". In this context, the Bank of Greece pointed out that "the process of tariff elimination will be speeded up during the next few years and [....] other forms of protection against foreign competition will be gradually abandoned".[104]

5.7 Between an energy shock and inflation

In the next two years (1976-1977), the Bank of Greece noted an increase in disposable income and a decline in inflation. However, the oligopolistic structure of the domestic market and the resulting weak competition remained a source of concern. The Bank of Greece also continued to monitor monetary policy developments, particularly in EEC member countries, "looking into the possibility of setting target rates for the expansion of the money supply. These targets will vary in accordance with the unique conditions prevailing in each country. They will, however, be binding on the other EEC member countries".[105] Also, "the rapidly rising and highly liquid nature of private savings in the banking system is by itself a potential source of inflation". As stated in the Report, "the most effective means of curtailing excessive credit expansion is to control commercial bank liquidity". Other significant goals were also the development of a capital market and the familiarisation of the general public with other forms of savings, such as bank and corporate bonds.

Turning to the structure of the economy, it was proposed to "place under control the increase of profit margins and other incomes, mainly derived from intermediary

103 *Annual Report for the year 1975.*

104 Ibid.

105 *Annual Report for the year 1976.*

professions, services and other profiteering parasitic-type activities. In addition, effective measures had to be adopted to bring these incomes under taxation. Significantly, incomes from these categories were numerous, comparatively high and rapidly rising. These incomes were, therefore, a significant source of overconsumption and strong demand for luxury goods imports. At the same time, the consumption patterns of these social groups influenced the consumer behaviour of the population at large".[106] This was a view consistently supported by X. Zolotas throughout the post-1974 period.

Energy self-sufficiency was a major matter for the Bank of Greece: the Report for 1976 noted that "aside from traditional energy sources (petroleum, lignite) Greece also seems to have some possibilities of developing geothermic energy sources. In the absence of rapid utilisation of these resources the country's growing dependence of fuel imports becomes inevitable".

The following year, the Bank of Greece ascertained a slowdown in the growth rate, accompanied by a deterioration in the composition of growth: the share of the primary sector had shrank by almost 5%, manufacturing output had also slowed down, and GDP growth was exclusively driven by services and building activity, further aggravating a problem identified in the past. Throughout that period, the Administration of the Bank of Greece was deeply concerned about developments in the Agricultural Bank, its borrowing from the Bank of Greece, as well as its lending to farmers. Another cause of concern was the weakness of industrial production, which was attributed to the decline in exports as a result of higher protectionism that affected mainly textile and clothing/footwear manufacturing. On the other hand, both the agricultural and the industrial sectors seemed to be inadequately adjusted to the requirements of the EEC.

5.8 The path towards EEC participation

After a year of stagnation, exports of goods and services increased by a substantial 19% at constant prices in 1978. Given a slight deceleration in the growth rate of the respective imports (to 7% from 8%), the deficit in the real external balance narrowed considerably. In addition, the assessment of the Bank of Greece was that, unlike most other OECD countries, Greece was among the few OECD countries that were not faced with unemployment problems. On the contrary, the economy was operating near full employment, despite the repatriation of considerable numbers of Greek workers from Western Europe. The shortages in the labour market were also evidenced by the

106 Ibid.

change in the composition of crews of ships under the Greek flag, about one-third of which consisted of foreigners. On the inflation front, the government implemented a strict disinflationary programme, aimed at limiting the growth of commercial bank credit to 18% in 1979, compared with 24.5% in 1978 and 26.5% in 1977.

However, the economic targets set by the government had proved to be unattainable, due to the second oil shock and the economic slowdown in OECD member countries. These events had resulted in a considerable deceleration of the rates of increase in disposable private income and private consumption, as well as in GDP, in addition to a dramatic upsurge in inflation: consumer prices rose by 24.8% during 1979, while on an average annual basis the increase was 19%. The situation worsened the following year, with a persistent rise in oil prices: between end-1978 and end-1980, oil prices in US dollars rose by 150%. Most OECD countries entered recession, which affected the Greek economy via exports. Gross fixed capital formation fell by 8.3% in 1980 (compared with a 7.9% increase in 1979). Inflation kept on rising.

The Governor's Report presented at the Annual General Meeting of 30.4.1981, five months before the national election that brought PASOK to power, seemed to contain a subtle criticism against the current government: "In past annual reports as well as at the joint annual meetings of the International Monetary Fund and the World Bank, the Governor of the Bank of Greece has pointed out that the effective combatting of inflation, adjustment of balance of payments and achievement of self-sustained economic development require a policy that will encourage productive investment."[107] Governor Zolotas went on to recall the recommendations that the Bank of Greece had made in 1976, concluding that "it is along these lines —which we think are the basic elements of an efficient development and anti-inflationary strategy— that the government has orientated its policies, and progress has already been achieved over the past few years". Lastly, he added: "as has already been mentioned, the country's economic development is adversely affected by complex bureaucratic procedures and various disincentives, which must be eliminated as soon as possible". In other words, Zolotas pointed out that certain chronic policy weaknesses, of which he had repeatedly warned the political leadership, hampered the country's efforts to catch up with European standards.

5.9 A Governor's correspondence with a political leader and two governments

During his (second) seven-year term as Governor of the Bank of Greece, between 1974 and 1981, Xenophon Zolotas used to regularly send memos to the

107 Bank of Greece, *Annual Report for the year 1980.*

government, in particular to the Prime Minister (and subsequently President of the Republic) Constantinos Karamanlis, with whom he had long ties of friendship and mutual respect. In these reports, memos, or even simple notes, Zolotas never left their personal relationship show and always addressed Karamanlis as "Dear Mr. President". Only once, in January 1981, did Zolotas express his concern about the future in somewhat more emotional terms, but nevertheless his style remained meticulously formal.

5.9.1 Tax reform considerations

During the transitional phase between the restoration of democracy in 1974 and the formation of an elected government to succeed the National Unity government after the 17.11.1974 vote, two public figures who enjoyed Constantinos Karamanlis's absolute trust, Panayis Papaligouras and Xenophon Zolotas, switched positions as Minister of Coordination and Governor of the Bank of Greece: Zolotas took up the Ministry on 24.7.1974 (under the National Unity government), handing it over on 21.11.1974 to Papaligouras, who had been Bank of Greece Governor from 9.8.1974 to 24.10.1974, and Zolotas moved to the Bank of Greece on 26.11.1974.[108]

This was a very challenging period for the new government. The state apparatus had been disorganised during the seven years of the dictatorship, especially in the aftermath of its downfall. As noted by Papaligouras —although the adoption of a relevant law would enable the rehiring of civil servants who had been fired by the military junta— "incomparably more difficult […] will be the enactment and implementation of procedures that, little by little, will eventually restore the staff hierarchical order that has been upset as a result of gratuitous actions or impermissible omissions by the responsible bodies".[109] Zolotas, on the other hand, closed one of his memos to Karamanlis, dated 30.12.1974, with the remark: "During the seven years of the dictatorship, the most competent employees of the government and public organisations left their posts […]. As a result, there is scarcity […] of competent personnel. All these services should be restaffed by qualified and experienced employees, and the government should spare no expense to ensure this".[110] Moreover, the dictatorship had brought about changes in the composition of society. Papaligouras noted: "the seven-year dictatorship has created many newly rich, but few

108 See www.ggk.gov.gr/?page_id=776, www.bankofgreece.gr/BoGDocuments/Governors.pdf

109 Papaligouras (1996), p. 479.

110 X. Zolotas Archive, document A2S1Y2F4/4, p. 9.

responsible and assertive young people and internationally competitive entrepreneurs".[111] A few months later, Zolotas noted that "it is known that there is sizeable tax-evasion in the higher income brackets, whereby direct taxation, rather than corrective of the distribution of income, becomes supportive of inequality and unfairness". From a longer-term perspective, he added that "the large real estate properties have been created mainly during the last 25 years, as a result of the country's economic growth, tax-evasion by the high income brackets and the automatic colossal overvaluation of land".[112]

Furthermore, the later phase of the dictatorship had been marked by a slump in economic activity, a surge in inflation and a shortfall in tax revenue. After becoming Governor of the Bank of Greece, Zolotas wrote two policy memos, recommending an effective and cohesive tax policy.

In a note dated 27.5.1974 (obviously serving as a draft for his later policy memo), X. Zolotas reviewed the real estate tax systems of developing countries and identified rental income taxation and capital taxation as the most common types of non-agricultural property taxation. He remarked that "Greece follows property taxation based on the value of the building plot", along with a few Third World countries.[113]

In the election of 17.11.1974, the first in almost 11 years, New Democracy (the party founded by Constantinos Karamanlis) won 54.37% of the vote, a landslide victory unprecedented in modern Greek parliamentary history. The new government was sworn in on 21 November.

In the first of his two policy memos (dated 23.12.1974 and not addressed to any particular person), Zolotas recommended a set of measures, including:

• A higher tax-free threshold for low incomes, taxation of dividends, and aggregation of dividends with incomes from other sources.

• Taxation of the retained profits of listed sociétés anonymes and expansion of its scope to include limited liability companies and joint ventures.

• Reinstatement of the law of 1951 on the taxation of shipping companies, and abolition of the junta law whereby "Greece [...] has become a tax haven for ships under the Greek flag".

• Establishment of objective values for the taxation of real estate —since it was impossible to annually calculate the associated capital gains— according to a progressive tax scale. Zolotas recommended a tax-free threshold of two or three million drachmas.

111 Papaligouras (1996), p. 478.

112 X. Zolotas Archive, document A2S1Y2F4/4, p. 5.

113 X. Zolotas Archive, document A2S1Y2F4/1, p. 1.

• Introduction of an annual tax on the net worth of sociétés anonymes (which he defined as the "difference between the company's assets and liabilities").

• Updated market valuation for fixed assets in the balance sheets of sociétés anonymes, given that "the latest such valuation took place on 1 January 1957, thus the relevant balance sheet entries are quite unmeaningful".[114]

It is worth noting that Zolotas envisaged an exemption of public sector property from these measures: "It goes without saying that the scope of this tax property system should exclude any real estate owned by central government, local authorities, legal persons in public law, public organisations, institutions and enterprises".[115]

Following up on a meeting he had had earlier with Karamanlis, Zolotas revisited the matter on 3.12.1974 in an official policy memo, whereby he assured the Prime Minister that "our cooperation with the Ministers of Coordination and Finance is excellent, and this will be very helpful in dealing with the various problems".[116] In that document, Zolotas argued that "if we keep attempting to cover the deficit by new burdensome loans, we will contribute to a further deterioration in the situation" and provided specific recommendations on tax policy: certain —inevitable, as he wrote— indirect taxes; higher tax breaks for low incomes; higher tax rates for high income brackets, even above the currently applicable 49% ("perhaps 54% for the part of the income in excess of 2.5 or three million drachmas"); and a property tax with a high tax-free amount "so as to fully exempt the lower social strata". In fact, Zolotas recommended "avoiding labyrinthine procedures […] even if this could entail some loss of revenue".

The memo also addressed other policy areas, such as prices and incomes. In this regard, Governor Zolotas noted that "in the Ministry of Coordination [headed by himself in the previous period], over the last four months the Prices and Incomes Department has undergone a reform", in order to ensure a constant monitoring of prices, productivity, incomes and corporate profits. He also recommended a reform in arbitration courts —under Law 3239/1955, these were competent to resolve labour disputes (mainly with respect to wages)— with a view to improving their expertise, capacities, as well as prestige and authority, which Zolotas saw as a deterrent to industrial action.

In concluding his memo, the Governor alerted to the fact that foreign investment projects had long been stalling at the Ministry of Coordination, as the committee responsible for their approval had been inactive during the dictatorship. He recom-

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114 X. Zolotas Archive, document A2S1Y2F4/3, passim.

115 X. Zolotas Archive, document A2S1Y2F4/3, p. 6.

116 X. Zolotas Archive, document A2S1Y2F4/4, p. 1. For the excerpts that follow, passim.

mended that an incentives policy should be studied and planned, using Ireland as a model. The comparison of our country with the Celtic tiger, as it later came to be called, in terms of foreign investment and more generally of growth, would come again to the fore 30 years later.

5.9.2 Economic policy concerns

The new government under Constantinos Karamanlis, winner of the 17.11.1974 election, was confronted with two major challenges: consolidating democracy (and bringing the junta leaders to justice), and healing the wounds that the Greek economy had suffered from a cascade of events during the previous two years.[117]

In his capacity as Governor, Zolotas provided input and advice in a number of policy areas. With two memos, both dated 8.1.1975, he formulated "Recommendations for reducing the deficit in the balance of payments of 1975" and "Recommendations for strengthening economic activity".

In the former document, Zolotas expressed the mainstream views of the time: state monopoly in fuel and refining; administrative measures to contain oil consumption; protectionism and import substitution; reduced consumption of goods produced using imported raw materials; additional taxation of selected imported and domestically produced goods, which in the case of domestic producers could be compensated by a covert subsidisation; and expansion of the scope of import tariffs to include hitherto exempted enterprises. At the same time, however, he emphatically noted that "neither general import quotas nor a general burden on the cost of imported products are recommended".[118] In an economy exposed to rising international commodity prices, it was only natural that the Bank of Greece fervently advocated the largest possible expenditure cuts.

Turning to exchange rate policy, Zolotas argued that a "devaluation of the currency is not appropriate". Instead, he recommended "the unpegging of the drachma from the dollar and a free and uncommitted tracking of a stable leading currency (e.g. the Deutsche Mark)". This, in his view, would enable the country, on the one hand, to avoid an appreciation of the drachma in the event of a strengthening of the

117 The international environment in 1973 was marked by an international foreign exchange crisis (January) and an oil shock (October). In the Greek context, the most important developments in 1973 were: the destroyer Velos mutiny (June); the rigged referendum (July); student uprisings at the Athens Law School (February) and Technical University (November); and a second military coup (November). The year 1974 saw the first and second Turkish invasions of Cyprus (July and August, respectively), the collapse of the dictatorship and the restoration of democracy (July), a general election (November) and a referendum on the form of government (December).

118 X. Zolotas Archive, document A2S1Y2F5/1, p. 2.

US dollar, and on the other hand to implement a crawling peg policy (with "small imperceptible depreciations [...] since all currencies float in various directions and in various proportions"), in order to counterbalance any pressures.[119] Indeed, as already mentioned, the drachma was unpegged from the US dollar on 8.3.1975.

This point in Zolotas' recommendations essentially heralded the future crucial policy choice of the Karamanlis government, and indeed the most fundamental shift in Greek post-war foreign policy: amid conditions of widespread monetary instability (after the abandonment of the Bretton Woods system in 1971), the drachma gravitated towards European currencies (mainly the Deutsche mark), just as Greece was moving closer to the EEC ahead of its accession to the European Communities on 1.1.1981.

The second set of recommendations, with a view to strengthening economic activity, was informed by the same adherence to a state-steered economy: they involved expanded funding programmes for specialised credit institutions (the Agricultural Bank, the National Mortgage Bank, the Hellenic Industrial Development Bank, the National Investment Bank for Industrial Development, the Postal Savings Bank, and the Consignment Deposits and Loans Fund), with an emphasis on housing and agricultural loans (from the National Mortgage Bank and the Agricultural Bank, respectively), as well as on investment financing. One interesting point was the proposed re-engagement of the Hellenic Industrial Development Bank (ETBA) in private business initiatives (to "take up business initiatives preferably in cooperation with domestic or foreign entrepreneurial capital").[120]

In mid-August, Zolotas returned to this matter, addressing in particular investment in industry, a very relevant topic at the time given the international context and the Greek economy's lagging behind. This followed a nine-page-long memo, dated 12.8.1975, sent to the Prime Minister by Konstantinos Nevros, a well-known chemist and industrialist,[121] who outlined plans for the development of key chemical industry plants.[122] Four days later (on 16.8.1975), Zolotas sent to Karamanlis an 18-page "preliminary study on the urgent matter of establishing industries in the mining and chemical sectors".[123] The document enumerated 16 industrial plants, which would take some one and a half billion dollars and three to five years to

119 Ibid., p. 3.

120 X. Zolotas Archive, document A2S1Y2F5/2, p. 3.

121 Konstantinos Nevros was President of the Association of Greek Chemists and a member of the Supreme Economic Council in the 1930s.

122 X. Zolotas Archive, document A2S1Y2F5/3.

123 X. Zolotas Archive, document A2S1Y2F5/4, p. 1.

develop and, once they became operative, would deliver "net foreign exchange gains of about 800 million dollars per year", reproducing in an attachment a table with Nevros's initial estimations and figures. It should however be noted that in the course of time these plans were revised, and specifically the investment regarding the development of a petrochemical plant was never implemented.

5.9.3 In the run-up to a snap election – Accession negotiations with the EEC

In mid-1976, by which time Constantinos Karamanlis had started to consider a snap election, measures were agreed between the government and the Bank of Greece, as summarised by Zolotas in a note entitled "Decisions of the meeting of 14 July 1976 chaired by the Prime Minister".[124] These measures included "A balanced people-friendly budget for 1977 [where the words "people-friendly" have been crossed out by hand], of about 200 billion drachmas, without imposition of new taxes, through limiting tax evasion, organisational changes and other tax reform measures" (point 4); "exploring the possibility of implementing a wage indexation system" (point 6);[125] and "improving the structure and performance of the Public Investment Programme for 1977, focusing on a small number of projects of high and immediate yield".

One year later, on 12.7.1977, by which time Karamanlis had decided to call a snap election, a new meeting took place at the Prime Minister's office. Ahead of that meeting, Zolotas had sent to Karamanlis a six-page review of recent developments in money supply, noting that between 1975 and 1977 banknote circulation had increased from 15.6% to more than 20%, liquid assets (M3) had risen from 22.5% to 27%, and total credit to the private sector had increased by 25%, 22% and 24% in these three years. Zolotas concluded that "credit expansion more than covers the economy's actual needs in working capital. This inevitably implied a diversion of funds to the financing of unnecessary imports, speculative or parasitic activities or other undesirable purposes".[126] Further below, adopting a monetarist approach, Zolotas noted: "A view that has been gaining ground among OECD countries is that setting medium-term monetary and fiscal targets, which would diminish year after year, is an effective tool for combating inflation. […] These would serve to anchor infla-

124 X. Zolotas Archive, document A2S1Y2F6/3.

125 Automatic Wage Indexation (ATA) was first announced in November 1981 with the policy statement of the Andreas Papandreou government and implemented from 1982 onwards, during the term of Gerassimos Arsenis as Governor of the Bank of Greece (from 3.11.1981 to 20.2.1984) and Minister of National Economy (from 5.7.1982 to 5.6.1985). Arsenis also served as Minister of Finance (from 27.3.1984 to 26.7.1985).

126 X. Zolotas Archive, document A2S1Y2F7/2, p. 3.

tion expectations".[127] Finally, he stated that "the ample credit supply in Greece over the past three years ultimately finances a relatively fast growth of production costs".

At the meeting itself, it was decided to contain money supply to about 20%; to refrain, for the time being, from a drachma devaluation ("should the international competitiveness of Greek products be put at risk, the Prime Minister shall be promptly notified so that appropriate actions can be taken"); to make an effort to contain the prices of vegetables, tuition fees, and livestock produce, with a view to reducing the rise in the price index; and "to have the Minister of Coordination examine the possibility of purchasing electricity from Bulgaria at affordable prices, on a short-term basis".

In the run-up to the election, a major economic event took place beyond the Greek borders: the partial suspension of external payments by Turkey. Soon afterwards, in a document dated 2.9.1977,[128] Michalis Vranopoulos (then Economic Advisor at the Bank of Greece) described Ankara's choices in an effort to avoid a default, concluding that: "The assessment of the Turkish authorities is that the problem is temporary […]. On the other hand, foreign banking circles think that a normalisation of the situation is unlikely without generous support from international organisations and/or adoption of unpopular measures in the country". Eventually, as known, Turkey received assistance from the international community.

The second post-1974 parliamentary elections were held one year before the expiry of the government's four-year term of office, on 20.11.1977. The new government was sworn in on 28.11.1977 and, four days later, on 2.12.1977, a "meeting at the Ministry of Coordination chaired by the new Minister, Mr. G. Rallis" took place.[129] On that occasion, Zolotas had sent to Karamanlis two reports entitled "Problems and recommendations", focusing on economic policy (18 pages) and monetary and credit policy (21 pages), respectively.

In the former report,[130] Zolotas reviewed the negative developments in inflation, GDP growth and agricultural and industrial production (arguing that "a shift of domestic demand towards imported goods is likely to have an adverse effect on domestic industrial production"). He went on to note that "Greece's economic policy is considered [by the OECD and the IMF] to be expansionary", pointing out that "the deficit of central government is close to 6% [of GDP]" and that "currency in cir-

127 Ibid., p. 4.

128 X. Zolotas Archive, document A2S1Y2F7/4.

129 X. Zolotas Archive, document A2S1Y2F7/5, p. 1.

130 Ibid., pp. 2-19 (for the excerpts, passim).

culation is growing at an annual rate of more than 20%, far exceeding the targeted level of below 15%".

With regard to incomes policy, Zolotas recommended an increase of only 2-3% in real incomes, which would be hard to achieve "particularly after the pick-up in inflation […] and the expectations created during the pre-election period". Zolotas here seems to be indirectly criticising the generous spending policies associated with the electoral cycle.

As the process of Greece's accession to the EEC was ongoing, the Governor of the Bank of Greece recommended to the Prime Minister that an information campaign be organised, which would also promote the overall policy of the government. The campaign should "also address the long-standing structural problems of the Greek economy and the more general economic orientations of the country, including EEC participation. […] Public communication of policy is key and urgently necessary. […] Whenever economic policy measures are taken, their impact, purpose and rationale will thus be explained to the public. This is the only way to counter misinformation and self-interested or ill-advised criticism that cause unwarranted reactions by the public".[131]

For Zolotas, accession to the EEC provided a prime opportunity for modernising the economy, helping it to break with obsolete mentalities and practices: "in view of the country's accession to the EEC, the creation of a favourable business environment is the most effective, as well as the only possible method for making Greece an attractive place for industrial activity"; "[...] a reform of the overall system of incentives is anyway necessitated by EEC membership"; "[…] it is urgently necessary to introduce a stable tax regime, preferably one that would be more favourable than those in place in other industrialised countries, in EEC countries in particular". As a follow-up on this recommendation, an *ad hoc* working group was set up to prepare a report on "counter-incentives", which was published by the Bank of Greece during the term of Zolotas (Harissopoulos, 1979).

In his latter report to Karamanlis,[132] Zolotas discussed recent monetary and credit developments and provided policy recommendations. Arguing that "reducing inflation should be the central goal", he suggested that "a slowdown in credit expansion must be combined with a stricter selection of bank credit allocation", before elaborating on how to achieve this. He also reiterated the need to "strictly contain

131 Of this ambitious plan, only one information campaign was implemented; it ran during 1980, was limited in scope and its key slogan was "You are in the EEC, learn about the EEC".

132 Ibid., pp. 20-41 (for the excerpts, passim).

money supply (M1) growth to 13-14% and total credit expansion to the private sector to 16-17%"; according to his "ambitious" calculations, these rates could support GDP growth of 5%.

Zolotas in effect suggested greater independence and a stronger supervisory role for the central bank: "Commercial banks should stop taking for granted their access to central bank funding, at their discretion, through their current accounts or rediscounting operations, even for financing a credit expansion in excess of the level determined by the monetary authorities [...]. To support the effectiveness of monetary policy, it is necessary for the central bank to consider whether and to what extent it has to inject liquidity to commercial banks, always in line with the targets set by the Currency Committee. For the same purpose, the penalty rates on commercial bank overdrafts on their current accounts with the Bank of Greece must be strictly imposed". Reading between the lines, what the Governor was actually telling the government was "let me do my job".

This message should be seen in the context of Zolotas' call for tighter procedures in the Greek banking system. Regarding the commercial banks' practice of repaying time deposits before maturity "virtually at no cost to depositors", Zolotas stated: "It should be noted that this is largely a result of a mentality and conviction, shared at least by certain banks, that ensuring their profitability is not their own task but a task of the monetary authorities, which have indeed been accommodating in the last few years in order to secure sufficient profits to banks".

In another point, Zolotas observed that "foreign currency-denominated time deposits have, in effect, often turned into sight deposits, insofar as banks assume in advance an obligation to repay them on demand, virtually at no cost to depositors. [...] The share of foreign-currency denominated time deposits in total deposits rose from 44% in March 1973 (when the penalty for early withdrawal was abolished) to 68% in September 1977".

With respect to foreign currency-denominated deposits, the Governor's recommendations included the following: an across-the-board cut in interest rates; a ceiling per depositor (US dollars 100,000 for new deposits by workers and seamen and US dollars 200,000 for the renewal of existing deposits); a compulsory discount at a rate of 2% in the event of withdrawal before the agreed maturity; free negotiation of the interest rate between banks and expatriates; and discontinuation of interest rate subsidisation by the Bank of Greece. These recommendations in essence reflected the shift in the social and economic profile of the holders of such deposits, from Gastarbeiter in the 1960s to the petit-bourgeois and middle-class depositors in the late 1970s.

5.9.4 Concerns about overconsumption and lower productive investment

On 8.5.1978, Xenophon Zolotas took part in meeting no. 78/70 of the Executive Board of the International Monetary Fund, which discussed, among other things, the situation and prospects of the Greek economy. Four days later, on 12 May, he sent to C. Karamanlis a "note on the evolution of deposits and a draft comprehensive plan for dealing with the economic situation".[133] In the cover letter, Zolotas indicated that "This note, sent earlier to the former Minister of Coordination, Mr. G. Rallis, is being forwarded today to the new Minister, Mr. K. Mitsotakis".

This note was soon followed by two memos focusing on the same matters, one entitled "Consumption expenditure" (16.5.1978) and one (sent to Karamanlis on 19.5.1978) with an official briefing on the IMF Executive Board's comments on the Greek economy.

These documents clearly indicate that both the Bank of Greece and the IMF were concerned about the negative developments in the Greek economy. These included a number of phenomena that together threatened fiscal stability: higher consumer spending, with a shift towards imported durables and luxury goods; declines in savings and deposits; higher demand for real estate and a sharp increase in apartment prices at the high end of the market; and a rise in inflation.

These phenomena reflected a fundamental change in the Greek society and economy post-1974, which was even more pronounced after 1981, due both to Greece's entry into the EEC and the income policies of the first PASOK governments, as well as a change in perceptions of the social role of the State.

Zolotas came back to the topic of overconsumption four days later (on 16.5.1978) with a two-page note, drawing a sketchy picture of the growing consumerism during the eight-year period 1970-1977: "private cars have tripled"; "the number of telephone connections has doubled" (and "has come close to the levels of France […] or Italy", countries with much higher per capita incomes); "the number of Greeks travelling abroad [has risen] from 652 thousand to 1,265 thousand"; "the number of boutiques has more than tripled". As Zolotas indicated, the strongest rise in living standards was recorded in the area of Athens: "Characteristic is also a proliferation of night clubs, tavernas, etc., which have reached 3,243 in the Athens-Piraeus area". Zolotas also often mentioned the higher consumption of meat.

The increase in consumption was not at pace with the increase in production. In addition, "investment in manufacturing dropped significantly […], repre-

133 A handwritten note on the margin of this document refers to a "Meeting at the President's Office, 19.4.78", while copies were sent to "Mr. Rallis", "Mr. Paleokr[assas]", and "Mr. Drakos".

senting a mere 2.8% of GDP. "By contrast, housing investment [...] in 1977 accounted for about 39% of total private investment expenditure, one of the highest percentages worldwide".[134]

This view seems to have been shared by international organisations. The IMF Executive Board had wondered whether "Greece was approaching an income level at which demand for imported industrial goods would start increasing at a fast pace".[135]

The recommendations of the IMF are reproduced in the memos that Zolotas subsequently sent to the government. Thus, "although wage moderation could help small enterprises, particularly in the export sector, some speakers observed that controls alone would not enable the authorities to achieve their objectives. Greater reliance on market discipline was required, especially in connection with the interest rate policy. Financing the budget exclusively through note issuance was equally imprudent".[136] Echoing remarks by IMF experts, Zolotas sounded the alarm to the government: the Bank of Greece could not possibly keep on printing money and causing inflation to accommodate the government's expansionary policy.

In his nine-page memo dated 12.5.1978, Zolotas (following a detailed discussion of sectoral developments) recommended concrete actions, adding that these should be seen as a package of mutually complementary measures. Piecemeal implementation could prove counterproductive".[137] The eight "Stabilisation Policy Measures" he recommended were: a drastic curtailing of the public investment programme by 5 billion drachmas; increases in lending and deposit rates; stricter control on the credit expansion of commercial banks; measures for addressing loan repayment arrears; a reduction of subsidies in general, and subsidisation of luxury consumption in particular; a tighter incomes policy; control and stabilisation of prices of broad consumption goods; and containment of the prices of luxury goods and services.

Another concern for the government at the time (and all Greek governments over time, for that matter) was tax evasion. Following the announcement of tax measures by Finance Minister Athanasios Kanellopoulos, Zolotas sent a four-page memo to Karamanlis (carbon copied to Konstantinos Mitsotakis), with comments and remarks on the new policy.[138]

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134 X. Zolotas Archive, document A2S1Y2F8/2, p. 1.

135 X. Zolotas Archive, document A2S1Y2F8/3, p. 2.

136 Ibid., p. 3.

137 X. Zolotas Archive, document A2S1Y2F8/1, pp. 8-9.

138 X. Zolotas Archive, document A2S1Y2F8/4.

5.9.5 Greece in the maelstrom of the second oil shock

In 1979, Greece and the entire industrialised world suffered the dramatic consequences of the second oil shock.[139] Although the first oil shock had been more important from a geopolitical point of view, the second one had a much stronger and lasting impact on the world economy. It effectively started on 7.11.1978 when, amid the Islamic Revolution, 37,000 workers at the state-run oil refineries of Iran went on a protracted strike, causing Iranian oil supply to drop from 6 million barrels to 1.5 million barrels per day,[140] directly affecting international oil prices. After two months, on 16.1.1979, the Shah fled Iran, leaving Prime Minister Shapour Bakhtiar in charge.[141] Just four days later (on 20.1.1979), Saudi Arabia decided to drastically reduce its oil production to nine and a half million barrels per day. As a result, the price of crude oil soared by 36%.

Already since 11.1.1979, Zolotas, in a document sent to the Prime Minister and six more members of the government,[142] had warned that one of the factors likely to drive inflation higher in 1979 was "the impact of the recent oil price increase, which will affect, directly or indirectly, the cost of a large number of goods and services included in the price index".[143]

In that memo, entitled "Prices and Incomes Policy in 1979", Zolotas noted that, although the CPI had risen by 11.6% in 1978, compared with 12.8% in 1977, this slowdown was due to individual administrative measures without which inflation would have been much higher, and pointed to a need to develop and implement a consistent disinflationary programme. After stating that "in the past few years, the effect of import prices on the domestic level of prices has weakened considerably, implying that inflation in Greece today is mostly of a domestic origin",[144] he recommended measures for reducing annual inflation to 10%. "The implementation in 1979 of a wage policy aimed at a substantial reduction of the increase in labour income is, as already mentioned, a key prerequisite for combating inflation".[145]

139 The first oil shock (the OPEC's oil embargo) lasted from 6.10.1973 to 14.3.1974.

140 In the metric system, this corresponds to a reduction from 950,000 cubic metres to 240,000 cubic metres per day.

141 The Bakhtiar government lasted only four weeks before being replaced by the Islamic regime.

142 X. Zolotas Archive, document A2S1Y2F9/1, p. 10.

143 Ibid., p. 2.

144 Ibid., p. 4.

145 Ibid., p. 5. On page 6 (footnote 1), Zolotas compared nominal wage increases and price levels across Greece and major EEC countries: 8.8% in 1977 and 9.4% in 1978 in Greece, compared with, respectively: 3.7% and 2.8% in Germany; 0.5% and 3.8% in the Netherlands; -4.4% and 6.5% in the United Kingdom; 2% and 9% in Ireland; and finally 10.9% and 2% in Italy.

Eleven months later (on 26.11.1979), Zolotas returned to the matter with a new document entitled: "Proposed measures for combating inflation and improving the balance of payments". This document —addressed to Coordination Minister Konstantinos Mitsotakis, Finance Minister Athanassios Kanellopoulos and Deputy Coordination Minister Ioannis Paleokrassas— came at a very sensitive time: 1980 was the final year of the term of office of Konstantinos Tsatsos as President of the Hellenic Republic, and there was widespread speculation both in political circles and in the press that Constantinos Karamanlis intended to move from his post as Prime Minister to the Presidency. The problem was that the New Democracy party numbered a total of 173 seats in Parliament, while the election of Karamanlis as President of the Republic required at least 180 at the third and final voting round. This meant that the candidacy of Karamanlis needed to be supported by MPs outside the New Democracy party,[146] otherwise new parliamentary elections would have to be held. For the government it was equally important to rein in inflation as well as not to displease a large part of Greek voters ahead of a potential early election, at a perhaps high political cost.

Right from the introduction, Zolotas warned: "the economic situation is worsening and the outlook for 1980 does not appear, at least for the time being, favourable". He attributed this situation "to the prevailing strong inflationary psychology", as well as to the "high uncertainty about the imminent oil price increases, which could possibly come close, even if only gradually, to the increases recorded this year".[147] Zolotas found that "the adverse outlook for the level of oil prices in 1980 leaves no room for optimism that the current account deficit will narrow in the next year. Thus, the problem of the balance of payments is reaching critical proportions". He also predicted that "the rise in prices will likely be close to 19%".

The effect of oil prices, according to Zolotas, was compounding the problems caused by strong credit and fiscal expansion, as well as by the incomes policies of the preceding years, which had resulted in "a redistribution of income in favour of large categories of self-employed and small-business owners who earn income outside the formal economy". The informal economy, according to the Governor, was a typical source of income for the newly rich and "very harmful for the economy, because such incomes are as a rule used for conspicuous consumption and, above all, fuel demand for imported goods". Further below, Zolotas reiterated one of his earlier recommendations,[148] i.e. "the imposition of a special levy on self-employed pro-

146 This was actually the case, as Karamanlis took 183 votes at the third voting and was elected President of the Republic.

147 X. Zolotas Archive, document A2S1Y2F9/5, 1 ff.

148 X. Zolotas Archive, document A2S1Y2F9/4, p. 4 (16.8.1978).

fessionals, who would be required to be listed in appropriate professional registers and classified for tax purposes on the basis of certain objective criteria (a study on the organisation and implementation of this new levy has been carried out by the Bank of Greece). This special taxation scheme can capture, even if only in part, incomes created on the margins of the economy". Zolotas believed that "this measure offers the significant advantage that the resulting tax burden is extremely hard to pass on to prices" and that "its acceptance by the tax subjects will not meet with any difficulties, because upon its announcement it will become known that tax services will have no involvement in determining and collecting this tax".

Another measure recommended by Zolotas was a reorganisation of public utility enterprises, through zero-based budgeting; a rationalisation of their operation; increased productivity; a reduction of their deficits; gradual rises in their rates; and lower recourse to borrowing. Turning to efforts towards reducing imports, he recommended a set of nine (mostly administrative) measures, including one "emergency", as he called it, measure that consisted in the imposition of a temporary universal tariff of 10% on all imported goods, with the exception of certain basic foodstuffs.

However, the main part of the Governor's recommendations referred to measures to control energy consumption. As he noted, "the net oil import bill in 1979 is estimated at 1,600 million US dollars and, according to available evidence, could reach 2,100 million US dollars in 1980. […] A key target for 1980 must be a reduction of energy consumption by 10%". In order to achieve this target, Zolotas recommended increasing the prices of fuel oil and electricity for industrial use; expanding the measure of alternate-day car circulation in the centre of Athens; increasing roadduties and car-ownership imputed incomes; and increasing the price of diesel oil.[149]

Fully aware of the political situation and the sensitive conjuncture, Zolotas concluded as follows: "the effectiveness of this policy will crucially hinge on the strict and systematic implementation of the recommended measures. Unless the measures are implemented in a resolute and rigorous manner, they would be counterproductive".

5.9.6 Inadequate adjustment to the conditions of the EEC

After Constantinos Karamanlis became President of the Republic, Georgios Rallis was elected by New Democracy MPs as president of the party on 8.5.1980 and

149 Ibid., pp. 13-15. With specific regard to diesel, he noted the following: "A positive difference of the price of diesel oil over that of heating oil, as is the standard practice abroad, is not at present technically feasible in Greece. It is therefore necessary to overcome this technical difficulty, thereby enabling a more rational pricing of the product".

was sworn in as Prime Minister on 9 May. The newly-formed New Democracy government, without the active involvement of the party's founder, was faced with a major challenge: Greece's adjustment to the *acquis communautaire* and its accession to the EEC on 1.1.1981.

This heavy duty fell onto Georgios Rallis. On 27.5.1980, three weeks after the appointment of Ioannis Boutos as Minister of Coordination (and *ex officio* chairman of the Currency Committtee), Zolotas sent him a note and, on the next day, 28.5.1980, a detailed nine-page memo focused on foreign exchange deposit rates, a burning issue at the time: "the main cause of the crisis was staggering inflation and profiteering importers who proceeded with mass imports from abroad, withdrawing deposits from the banking system".[150]

In another note dated 27.5.1980, Zolotas stressed that "by decision no. 269/2/180 of the Currency Committee, the interest rates on dollar and pound deposits were deregulated effective from 1.5.1980. Consequently, as of that date, the banks are free to determine their respective rates, in line with international money market rates", and assured that "to prevent unfair competition […], banks were informed by telex that their rates may not exceed the respective rates in the London market".[151]

Moreover, he observed that "the definite elimination […] of the deposit rate differential in favour of domestic deposits has removed the associated incentive for depositors, which used to be attracted to Greek banks offering higher rates than the international ones" and suggested "exploring the possibility of establishing a one percentage point differential in favour of deposits with Greek banks, although this would entail […] a risk of attracting hot money".

In his document dated 28.5.1980, Zolotas provided an overview of current developments: "inflationary pressures in the economy continue unabated, and their disturbing effects on currency in circulation (both internal and external money supply), as well as on the behaviour of private economic agents, remain acute".[152] He concluded that it was absolutely necessary to raise both deposit and lending interest rates. To this end, two proposals had been submitted: one by an *ad hoc* committee, recommending a partial or total deregulation of deposit and lending rates, and one by the Bank of Greece, recommending a managed increase in all interest rates, grouped in broad categories.

150 X. Zolotas Archive, document A2S1Y2F10/22.

151 X. Zolotas Archive, document A2S1Y2F10/23, p. 1.

152 X. Zolotas Archive, document A2S1Y2F10/24, p. 2.

The latter proposal, which Zolotas explained in detail, entailed increases of four percentage points in deposit rates, three percentage points in Treasury bill rates and five percentage points in investment bank bond rates. Lending rates would be raised, to 25% for loans (not subject to prior Bank of Greece approval) to trade, handicraft and manufacturing; to 20% for loans to agricultural manufacturing and tourism; and to 15% for loans to tobacco trade and mining. Finally, the interest rates on loans to tobacco manufacturers would be raised by four percentage points and those for housing loans by two percentage points. The interest rates of the Bank of Greece would also be increased by 4 percentage points (bringing the discount rate to 23%).

Six months prior to the country's accession to the EEC, in a note dated 7.7.1980, to which a table marked "confidential" was attached, Zolotas provided "Exchange rate policy directions", stating that "in the first half of 1980 the drachma depreciated by 12.7% vis-à-vis the US dollar, by 10.51% vis-à-vis the Deutsche mark and by 10.59% and 10.65% vis-à-vis the two baskets of currencies used by the Bank of Greece (the currencies of denomination of trade inflows and outflows, respectively). Therefore, a further significant devaluation is not deemed necessary, but instead, given the persistent inflation, a further sliding depreciation".[153]

The Governor noted that, in the future, "in addition to the currency basket, account should also be taken of the currency unit of the European Monetary System, in which we will eventually have to participate", although a peg to the ECU was in his view "at present impossible and disadvantageous". According to Zolotas, what was necessary was a "skilful management of the external parity of the drachma, always taking into account the parity between the US dollar and the Deutsche mark as the representative currency of the EEC". However, he warned that "nevertheless, under no circumstances should we repeg the drachma to the dollar, which floats erratically and is exogenous to the Greek economy, nor should we peg it to the mark, which is on a constant appreciating trend vis-à-vis all other currencies".

Ahead of a meeting at the Prime Minister's office on Thursday, 9.10.1980 (as is stated on a handwritten attached card note), which took place just one day before Ioannis Boutos resigned from Minister of Coordination, Zolotas prepared a five-page memo dated 8.10.1980.[154] Entitled "Preliminary forecasts as input to the preparation of the state budget for 1981", the document mentioned that the budget balance for 1980 "will turn out in deficit of about 20 billion drachmas, compared with a surplus of six billion drachmas anticipated at the time when the budget was enacted".

153 X. Zolotas Archive, document A2S1Y2F10/25, p. 2.

154 X. Zolotas Archive, document A2S1Y2F10/28, pp. 1-5.

To a large extent, this was due to revenue shortfalls, mainly from road duties, tariffs and taxes on imports and transaction taxes. On the expenditure side, there was an overrun of more than ten billion drachmas. For 1981, he projected a deficit of 45 billion drachmas in the ordinary budget. For the public investment budget, the expenditure overrun was 25 billion drachmas (an outcome of 85 billion versus a budgeted 60 billion). In closing, Zolotas predicted that: "the negative fiscal position in 1981 will reach 169 billion drachmas, up from 126 billion drachmas in 1980 and 93.4 billion drachmas in 1979". Subtracting 5 billion drachmas representing net transfers from the EEC, he calculated the net borrowing requirement at 163 billion drachmas.

Three weeks later (on 29.10.1980), Zolotas sent a note (addressed to Messrs Kontogeorgis, Paleokrassas and Oikonomou) on "exchange rate developments in 1980": between 2.1.1980 and 3.6.1980 the drachma depreciated by 13.69% against the US dollar and by 11.79% against the ECU. On 3.6.1980, a decision was made to stabilise the drachma vis-à-vis the US dollar at the level of 43-44 drachmas per dollar, which led to a 4.39% appreciation of the drachma against the ECU. Zolotas sounded the alarm, given that "the ECU/drachma exchange rate of 1 January 1981 will also be the value of the green drachma", and proposed an adjustment to around 62 drachmas per ECU.

On 27.11.1980, one month before accession to EEC, Zolotas sent a note to G. Rallis, observing that "in the four-year period 1975-1978, the Greek economy recorded relatively high growth rates, while inflation hovered around 12%. […] The expansion of the public sector and fast growing borrowing requirements resulted in an overheating of the economy and […] contributed to a doubling of inflation in 1979 and 1980".[155]

As a result, since 1980 the Greek economy had faced a "serious problem of stagflation, an exit from which will be difficult unless coordinated and systematic efforts are made and decisive measures are taken". Zolotas went on to forecast strong inflationary pressures, a contraction of credit to the private sector, higher supply and lower demand. And he warned Rallis against issuing new money, because "due to inflation, the public avoids holding large quantities of money, and thus monetary expansion ends in (and is absorbed by) a widening of the balance-of-payments deficit".

On the other hand, he warned that "temporary import-dampening measures, such as those used in the past, will be very hard to apply following full accession to the EEC". This sentence implicitly indicates how long back goes the political

155 X. Zolotas Archive, document A2S1Y2F10/30, p. 2.

system's failure to understand —or accept— the changes in attitudes needed for Greece to adapt to the conditions of the common market and, later on, the single currency area.

Zolotas went on to note: "The above adverse developments and risks must be prevented. The most appropriate means to this end would be a substantial curtailment of public sector expenditure". As seen from a later document by Zolotas,[156] the Rallis government had engaged in an electioneering spending spree after spring 1981, when the defeat of New Democracy was clearly in sight.

"Releasing financial resources from the public sector", Zolotas continued, would strengthen private initiative and in particular the building sector, to the reactivation of which "the Government and especially the Ministry of Coordination[157] have rightly shifted their focus".

In closing, Zolotas recommended: "We should also seek to attract investment from EEC countries. This can bring us know-how and organisational expertise. [...] So far, foreign investment, instead of being encouraged, has been obstructed and an unfavourable climate has been created both by the relevant government agencies and by the press. This should be a matter of concern for the Government, and an information campaign could be considered in this regard".

As judged ex post, almost 35 years on, the failure of economic policy on several of these fronts has been huge. Despite the above analyses and recommendations, the Greek political system failed to implement major reforms in the areas of tax evasion by self-employed professionals, real estate taxation and overvaluation, as well as to contain public expenditure and deficits. In fact, the exactly opposite happened: since its accession to the European Communities, the country pursued policies that tolerated inflation and a growing public debt and utilised the resources and the opportunities afforded by EEC participation not to modernise itself, but to preserve an ineffective and inefficient growth model. Despite some occasional reforms that gave the impression of a change, Zolotas' recommendations turn out to be prophetic and still remain extremely relevant.

5.9.7 Nervousness due to the accession to the EEC and in view of a political change

By early 1981, it had become obvious that PASOK held a clear lead and that the autumn elections, for the first time in Greek history, would bring a majority socia-

156 X. Zolotas Archive, document A2S1Y2F11/6, 20/10/1981.

157 On 11.10.1980, following the resignation of I. Boutos, the Ministry of Coordination was taken up by the Prime Minister himself, with I. Paleokrassas as Alternate Minister, and then (as from 29.6.1981) by the latter as Minister.

list government to power. Constantinos Karamanlis had moved on to the Presidency of the Republic since the spring of 1980. Despite the presence of Karamanlis at the Presidency (which under the Constitution of 1975 was vested with certain overarching powers), those in the bourgeois political spectrum were quite nervous about the prospect of Andreas Papandreou becoming Prime Minister.

This can be seen from the cover letter of a memo dated 8.1.1981 on developments and prospects of the Greek economy. In that letter, addressed to Karamanlis personally, Zolotas wrote: "from the position you hold, you are the only real guarantee for our democratic institutions and peace in the country".[158]

In the memo itself, Zolotas stated that the country had been in a protracted period of stagflation, "exit from which [...] requires delicate handling, perseverance and consistency",[159] and provided Bank of Greece forecasts, somewhat more pessimistic than those of the OECD, as he said: following inflation rates of 24.8% in 1979 and 26% in 1980, inflation would be about 24% in 1981, more than double the average of the EEC countries (the latter, as well as those of the OECD more generally, were also facing economic stagnation, "following modest growth in 1980"). Adding that this outlook was subject to risks associated with labour cost developments, he warned against introducing a wage indexation scheme, which would make it harder to combat inflation.

Of particular interest is the Governor's remark that "central government has been absorbing, for the second consecutive year, more than 90% of funding capacity gains from healthy domestic resources (deposits and public organisations' funds)". This finding encapsulates the cause of the country's economic predicament during the period that followed.

As a follow-up to the Accession Agreement of 29.5.1979, Greece joined the European Economic Community on 1.1.1981, with a transitional period of five years (or seven years in respect of certain matters such as the free movement of labour). This occurred a few months before the electoral victory of PASOK, whose stance towards Greece's European orientation was unclear: initially abstaining from the vote on accession, gradually, as it moved closer to power, it supported a renegotiation of the terms of the Accession Agreement.[160]

The conditions under which the country was joining the Community, as well as the consequences of its accession, were reasonably seen as key issues of high concern

158 X. Zolotas Archive, document A2S1Y2F11/1, p. 1.

159 Ibid., p. 2.

160 In March 1982, the government submitted a memorandum entitled "*Position of the Greek Government on Greece's relations with the European Communities*" (*Bulletin of the European Communities, No. 3, 1982*, pp. 90-93).

for Greek policymakers. In January 1981, Zolotas expected the trade deficit to rise to 7.9 billion US dollars during the year, recalling that EEC participation would imply greater freedom of imports. Moreover, he argued that various factors, including the "urgent need to curb inflation, for the purpose of supporting growth as well as ensuring a seamless integration into the monetary setup of the EEC [...], warrant continued disinflation policy".[161]

The Bank of Greece forecasts were for nominal GDP growth of 25% in 1981, of which 1% would be real growth and the remainder would be the effect of inflation. Stressing that combating inflation was "a paramount social cause", Zolotas argued that "the prevailing view is that a policy of stimulating demand to achieve recovery through a supposedly concomitant increase in supply is wrong, because it ultimately leads to stronger inflationary pressures and expectations and a new cycle of stagflation".

Six months later, on 6.7.1981, Zolotas wrote a note entitled "Reassessment of foreign borrowing requirements", which was communicated to Ioannis Paleokrassas, newly appointed (as from 29.6.1981) Minister of Coordination. In this note, Zolotas identified a "risk of foreign exchange outflows", resulting in a larger-than-projected current account deficit.[162] With weaker private capital inflows and with the private sector crowded out of the credit market, "foreign exchange reserves should be some 400 million US dollars lower at the end of 1981" relative to 1980. Against this background, "additional borrowing of 400-500 million US dollars, bringing up total public sector borrowing […] to 1,900 million US dollars, […] was deemed absolutely necessary". Given that the Public Power Corporation (PPC/DEH) was currently looking for market-based borrowing of 425 million US dollars and the Hellenic Telecommunications Organisation (OTE) for another 200 million US dollars, Zolotas argued that it would "not be advisable for the Bank of Greece to tap the market again, only a few months after the latest loan of 400 million US dollars, because this could be seen as an indication of a sharp deterioration in the country's external transactions". Instead he recommended raising "several loans […] outside the market (directly from banks)". Due to the pre-electoral spending spree of the Rallis government, coupled with fears among economic agents and market participants about the upcoming victory of the socialists, the economic situation went off track, as Zolotas would point out to the newly-elected PASOK government several months later.

On 27 August, Zolotas sent to Demetrios Chalikias (then Economic Advisor at the Bank of Greece and later appointed Deputy Governor as from 16.11.1981) a

161 X. Zolotas Archive, document A2S1Y2F11/1, p. 8.

162 X. Zolotas Archive, document A2S1Y2F11/2, p. 2.

note regarding the curtailed investment programmes of several public enterprises, with detailed data on their operating budgets.[163]

On 18.10.1981, a broadly anticipated change of the political tide brought PASOK to government. Two days later, Zolotas sent to Apostolos Lazaris (newly-appointed Minister of Coordination and second highest-ranking official in the Cabinet) a memo with an overview of economic developments and policy recommendations.[164]

Zolotas noted that "the country's economic situation is critical" and that monetary and fiscal policies had become expansionary since spring 1981 (ahead of the election), leading to higher credit expansion and excessive growth of liquidity. The economy had entered recession, stabilisation was urgently needed, and any recovery would be slow.

The competitiveness of the Greek economy had been declining. Labour cost growth in the first quarter of the year was estimated at 31% (of which 26.2% was attributed to higher average hourly wage and 3.7% to lower productivity), and expectations of a drachma devaluation had built up. The Governor alerted to the fact that foreign exchange reserves had fallen below the safety level and developments in the balance of payments were worrying, while also pointing out that borrowing posed a serious threat to stability.

Obviously, by this note Zolotas attempted (or at least hoped) to influence the economic policy being formulated and about to be announced by the new government, and to mitigate what he saw as populist and economically unsustainable policies.

Credit expansion was to him a crucial matter: the growth of bank credit to the private sector was 30%, against a targeted 18%, while low-cost subsidised loans to private enterprises returned to banks in the form of deposits, leading to increased bank liquidity and so on. In an uncertain political environment, businessmen were risk-averse and, rather than investing, preferred to park their borrowed funds in deposits, benefiting from a negative interest rate margin; this pattern epitomised the Greek economy's distortions.

Among other things, Zolotas recommended an economic stabilisation programme (without which "recovery does not seem to be possible"); strengthening productive investment; containing the increase in the fiscal deficit; and reducing the central government's borrowing requirements. He was not optimistic: "…an eventual economic recovery will be slow", he wrote. On the controversial matter of public organisations and enterprises (whose employees formed a key pillar of PASOK's

163 X. Zolotas Archive, document A2S1Y2F11/7.

164 X. Zolotas Archive, document A2S1Y2F11/6. For the excerpts that follow, passim.

base), Zolotas argued that these entities needed restructuring and suggested that they should issue corporate bonds, "as a first step" with a five-year maturity and a floating coupon. With respect to interest rate policy, the note expressed seemingly contradictory views, on the one hand recommending an interest rate increase and unification, "if not immediate liberalisation", and "some proportionality" to foreign interest rates (taking into account the inflation differential) and, on the other, arguing that high interest rates would dampen investment, and therefore suggesting interest rate subsidisation for certain loan categories, i.e. those financing "desirable expenditure (productive investment, exports, housing)". Meanwhile, Zolotas called for price controls, but only for consumer staples.

As a stable exchange rate reduced not only inflationary pressures, but also competitiveness, Zolotas believed that a drachma parity adjustment was inevitable, but this should be done preferably through a sliding depreciation, given its less negative inflationary effects, rather than a devaluation.

In this regard, he made specific proposals: although he admitted that "it is very difficult to determine an appropriate level for the parity of the drachma", he suggested that depreciation should "cover a fraction (e.g. half to two thirds) of the inflation differential between Greece and the countries of Western Europe in the last 15 months", noting that France and Italy stood out among Greece's main competitor countries, with inflation rates above the EEC average. Finally, he suggested that depreciation "should lag monetary and credit policy tightening by at least two or three months".

5.10 The Bank of Greece after the rise of PASOK to power

On 3.11.1981, X. Zolotas resigned and was succeeded by Gerassimos Arsenis.

In the *Annual Report for 1981* (the first signed by Arsenis), the style and content were very different from those of Xenophon Zolotas: the *Report* started with the remark that "Since 1979 the Greek economy has been going through a new and critical phase, characterised by a decelerating growth rate —which in 1981 became negative— by rapidly accelerating inflation and a widening balance-of-payments deficit". In essence, the new Governor pointed out the legacy problems facing the new government. Continuing his criticism against the previous government, Arsenis noted that "it was sought to combat inflation not by removing its causes but by eliminating its symptoms, mainly by freezing public utility rates and by increasing state subsidies".[165] The conclusion was that "provided inflation can be kept down at

165 *Annual Report for the year 1981.*

the targeted level, real incomes, particularly of lower income groups […] will increase",[166] which should strengthen domestic demand.

Of course, by that time, the new government had introduced a huge increase in minimum wages and an average increase of 35% in low wages through the so-called "corrective amounts". These income policies would ultimately add to the current account deficit. Moreover, it should be noted that a little later, on 5.7.1982, the Governor of the Bank of Greece was also appointed Minister of National Economy, thus holding two offices which were seen as incompatible in other countries. This signalled the Bank's alignment with the government in conducting economic policy in line with the Greek people's vote for a shift to a new economic model (Psalidopoulos, 2011).

Noting that the problems were only partly attributable to the actions of recent governments or to the international conjuncture, the Governor pointed the finger of blame at "the pattern and process of economic development during the post-war period", which had led to the structural weaknesses of the Greek economy, including the overexpansion of the services sector at the expense of the goods sectors.[167] It was therefore necessary that "all available human and material resources are sufficiently mobilised", a strategy embodied in the five-year development plan 1983-1987 being prepared by the government. Regarding credit policy, the Report announced that credit expansion would be 580 billion drachmas in 1982, up from 458 billion in 1981 but lower as a percentage of GDP.

Turning to exchange rate policy, the Governor argued that "the continuous devaluation of the drachma over the past eight or ten years is considered to have been larger than what is justified on economic grounds", adding that "it is our belief that [...] a policy of continuous devaluations provides no solution", but rather "the solution to the balance-of-payments problem lies in improving productivity".[168]

In his next *Annual Report,* Gerassimos Arsenis recalled that "since 3 July 1982, when Law 1266/1982 came into effect,[169] the Bank of Greece is solely responsible to decide, by Acts of its Governor or bodies authorised thereby, on monetary, credit and exchange rate matters, within the framework of the [...] policy determined by the Cabinet". The Report went on to note that "foreign exchange policy in 1982 aimed at maintaining the competitiveness of Greece products", a policy that "led to the depreciation of the effective exchange rate of the drachma by 9.5%, against 11.2% in 1981", with the largest part of this change estimated to have reflected the appre-

166 Ibid.

167 Ibid.

168 Ibid.

169 Article 1 of that law abolished the Currency Committee and its sub-committees.

ciation of the dollar. Without explaining the government's change of mind in this respect, the Report mentioned that "At the beginning of January 1983 the drachma was devalued by 15.5%, to restore the competitiveness of Greek products",[170] adding that "for the purpose of stepping up exports […] an active and coordinated participation of the public sector was needed". In connection with this latter point, agencies had been set up for export promotion and insurance and for setting standards for production and packaging.

In other respects, PASOK's first full year in government was marked by economic stagnation, with GDP growing by 0.2%, compared with a 0.2% decline in 1981, while inflation remained above 20% (at 21%, down from 24.5% in 1981, which was characterised as "significant progress"). In response, the government had taken a number of actions, including an investment programme that focused on technological upgrading with a view to ensuring Greece's international competitiveness, as well as a higher education reform by Law 1268/1982. Nevertheless, the Governor admitted that "although significant progress was made in 1982 [...], not all of the problems identified in last year's Report have been adequately solved", as this endeavour had been hampered by the structural nature of the problems and the adverse international environment. One cannot but notice the belief (or hope) shared between the new government and the Bank of Greece that the problems facing the Greek economy could be solved rather soon and, once the problems were over, economic growth would kick in.

The new Administration of the Bank of Greece endorsed the government's view that "Greece's accession to the EEC has removed all barriers to imports from the Community and has rendered effective the productivity differentials existing between Greece and the other member countries", noting that it had been decided to take measures, within the framework of the Accession Agreement, to protect those domestic industries that had run into serious difficulties owing to sharp competition from other EEC countries. This was "being done by means of temporary import restrictions on the respective products".[171]

Regarding monetary and credit policies, Gerassimos Arsenis argued that "even though interest rate differentiation is sometimes justified for economic or social reasons, it is often doubtful whether the existing range of lending rates really serves the economic and social aims for which it was introduced" and stated that "the monetary authorities believe that the existing interest rate subsidisation system should gradually be replaced by a system of direct subsidisation out of the budget".

170 Bank of Greece, *Annual Report* for the year 1982.

171 Bank of Greece, *Annual Report* for the year 1982.

5.11 Financing to banks and enterprises

General Council decisions reflect quite accurately the contemporary economic and political conditions, as well as the major policy challenges faced by the Bank of Greece and the government alike.[172] Furthermore, they provide insights into the structure of the Greek economy and state intervention mechanisms. The minutes of General Council meetings refer to Governor's Acts, decisions of the Currency Committee (until 1982, thereafter Acts of the Monetary and Credit Matters Committee), decisions of the Loans and Foreign Exchange Sub-Committee and decisions of the Credit Files Committee.

In the early 1980s, the Bank of Greece continued the same policy as in the recent past, which involved decisions on:

1. Refinancing operations, repayment period extensions and credit to state-owned banks: the largest recipient of refinancing was the Agricultural Bank,[173] followed by the National Mortgage Bank,[174] the Mortgage Bank, the Investment Bank and the National Investment Bank of Industrial Development (ETEBA); the General Bank of

172 It should, however, be noted that General C ouncil decisions cover a broad range of matters, from the most important to the most trivial: for example, in the minutes of General Council meeting no. 13/82 of 20.5.1982 we can find a decision to transfer to the Greek State a loan of 550 million US dollars concluded by the Bank of Greece and, in another paragraph just a few lines above, a decision approving the "purchase of a cable for connecting machines".

173 Indicatively: 6.3 billion on 10.1.1980 (General Council meeting no. 1/80); 5 billion + 4.6 billion on 12/03/1980 (no. 5/80); 2.2 billion + 700 million on 16.4.1980 (no. 7/80); 1 billion + 5.75 billion on 26.4.1980 (no. 9/80); 4.35 billion on 28.5.1980 (no. 11/80); 2.9 billion on 11.6.1980 (no. 12/80), etc. On 23.7.1980 (no. 15/80) it was decided to provide the Agricultural Bank of Greece with: credit guaranteed by the Greek State amounting to 4 billion; financing amounting to 3.1 billion; refinancing of almost 2 billion and credit of 2.8 billion to be made available to KYDEP (in total: 11.9 billion drachmas). On 21.1.1981 (no. 2/81) it was decided to finance the Agricultural Bank of Greece with 23.3 billion drachmas. On 14.10.1981 (four days prior to the election), the General Council no. 19/81 decided, among other things, to provide the Agricultural Bank of Greece with: financing of 6 billion; supplementary financing of 3 billion; supplementary financing (guaranteed by the Greek State) of 1,275 billion; financing of 14 billion for the extension of a loan to KYDEP; credit of 3.025 billion plus 300 million (in total: 27.6 billion plus another 3 billion to the KSOS). On 1.7.1982 (General Council no. 15/82) it was decided to finance the Agricultural Bank of Greece with at least 21.34 billion drachmas – in more detail: 7 billion + 5.6 billion + 1.84 billion (for KYDEP) + 2.5 billion (for Agricultural Exports S.A.) + 1.9 billion + 2.5 billion + an unspecified sum for loans to professionals – while it was also decided to increase from 1 billion to 1.2 billion drachmas the limit approved for weekly withdrawals by the Agricultural Bank of Greece. It should be noted that the previous increase, from 900 million to 1 billion drachmas, had been decided by the General Council no. 13/81 of 1.7.1981. On the same day, i.e. 1.7.1982, it was decided to refinance the National Mortgage Bank with 25.62 billion drachmas "from Public Organisations' funds". In the next meeting (no. 16/82 of 20.7.1982), i.e. just three weeks later, it was decided to refinance the National Mortgage Bank with 36 billion.

174 Indicatively: 600 million on 12.3.1980 (General Council meeting no. 5/80); 8.96 billion on 26.3.1980 (General Council no. 6/80); 700 million on 26.4.1980 (General Council no. 9/80).

Greece is very rarely mentioned.[175] Whereas refinancing decisions typically took the form of Acts of the Monetary and Credit Matters Committee, as we can see from General Council no. 11/84 of 29.6.1984, a Governor's Act was issued in the case of funding to the National Mortgage Bank and the Agricultural Bank "for financing the Central Agency for the Management of Domestic Products (KYDEP) and agricultural coope-ratives with an amount of up to 28 billion drachmas for the purchase of wheat and barley harvested in 1984". Moreover, the General Council, in its meeting no. 9/86 of 27.5.1986 approved funding to the Hellenic Industrial Development Bank (ETBA) for covering its participation in the capital of the Hellenic Arms Industry.

2. Repayment period extensions for loans to government-owned enterprises and organisations: Ethnoktimatiki Active Urban Planning S.A. (EKTENEPOL), subsidiary of the National Mortgage Bank; Greek Gunpowder and Cartridge Company S.A. (PYRKAL); Hellenic Water Company S.A. (EEY);[176] Central Agency for the Management of Domestic Products (KYDEP); Association of Sultana Raisin Co-operatives (KSOS); Autonomous Currant Organisation (ACO); Hellenic Sugar Industry (HSI), etc.[177]

3. Financing to agricultural enterprises: in the early 1980s, the most frequent recipients of financing —by decisions of the Credit Files Committee— financing were Thrace Mills – I. Ouzounopoulos S.A. and Macedonian Ginning Mills S.A. as well as the Kapetanakis and the Melisseidis currant manufacturing companies.[178] In the mid-1980s, we can often see tobacco manufacturers Allamanis S.A. (Volos) and Petridis S.A. (Kavala), and currant manufacturers Petropoulos S.A. (Kalamata) and Melisseidis (Heraklion).[179] After 1985, this type of decisions became less frequent (only two in each of the years 1986, 1987, 1988 and 1989) and concerned fewer enterprises, exclusively in the tobacco industry. In the last two years of PASOK government (1988-1989), financing was provided to Reemtsma S.A. and only two other companies, one each year. In 1990, as recorded in the General Council minutes, meeting no. 11/90 (of 30.7.1990), "on the occasion of the discussion of 'Reports

175 Special financing of the General Bank of Greece amounting to 85 million drachmas on 11.6.1980 (General Council no. 11/80).

176 Indicatively: modification of the Bank of Greece's financing or refinancing of the National Bank for the extension of loans of 500 million on 14.5.1980 (General Council meeting no. 10/80) and 500 million on 17.9.1980 (General Council meeting no.19/80) to Hellenic Water Company S.A., plus of 500 million on 19.11.1980 (General Council meeting no. 23/80) to the Athens Water Supply and Sewerage Company (EYDAP S.A.).

177 At least once (in General Council meeting no. 11/82 of 28.4.1982) it was decided to finance through the Agricultural Bank of Greece a private enterprise (namely Nestlé), with 1.5 billion drachmas.

178 For instance, General Council minutes, meeting no. 17/80 (of 20.8.1980).

179 See General Council decisions in 1984 and, most importantly, in 1985, a peak year in this regard (meetings no. 4/85 of 11.2.1985; no. 15/85 of 24.6.1985; no. 19/85 of 2.10.1985; and no. 23/85 of 20.12.1985).

on the operations of the Credit Department', and following a relevant proposal by the Governor, the Council decides that as of 1.9.1990 the Bank of Greece shall stop financing the private sector of the economy".[180] Five years later[181] decisions were made on "Resuming operations for the financing of tobacco trade by the Bank of Greece", "Setting up a Credit Files Committee at Thessaloniki Branch", while "other related matters" were also discussed.[182] Decisions made in 1996 addressed matters such as the following:

• renaming and expanding the scope of the Credit Files Committee at the Thessaloniki Branch;

• remuneration of tobacco appraisers; and

• an amendment to paragraph 446 of the Regulation on Discount and Credit Operations of the Head Office and Branches.[183]

In early 1980, following arsons that destroyed several department stores in Athens and Piraeus (Minion and Katrantzos Sport on 19/12/1980; Atheneé and Klaoudatos on 3.6.1981; Dragonas and the Piraeus branch of Lambropoulos Bros on 4.7.1981), the Bank of Greece decided to provide successive funding to commercial banks for financing these enterprises, to help them survive and recover.[184]

Private banks were less frequent recipients of Bank of Greece credit, often for the purpose of on-lending to businesses.[185] Other decisions concerned the payment of contributions to mass media, cultural and other organisations and NGOs.[186] One 1981 decision concerns the "adjustment of the interest rate on the amount of 17.3 million drachmas provided by the Bank of Greece to the Hellenic Industrial Development Bank (ETBA) for the financing of TeleVision Enterprises S.A.".[187] In 1991 it was also decided for the Bank of Greece to establish an annual ex-

180 General Council minutes, meeting no. 11/30 July 1990.

181 Although, earlier, items 9-10 of the Agenda of meeting no. 8/92 (of 28.4.1992) refer to a "Financing of the tobacco trader A. Christidis for the purchase and processing of oriental tobacco harvested in 1991, intended for exports – Kavala".

182 General Council meeting no. 2/95 (of 27.1.1995).

183 General Council meeting no. 2/96 (of 15.3.1996).

184 For example, the decision of General Council meeting no. 6/81 (of 23.3.1981), regarding Katrantzos Sport, refers to Currency Committee decision no. 298/13/22.1.1981, specifying the annual interest rates as follows: 3% for overdue debts, 5% for working capital, and 6% for the purchase or building of premises. A similar decision followed for Minion (General Council meeting no. 7/81 of 8.4.1981), approving credit of 700 million drachmas.

185 For example, to the Ionian and Popular Bank for covering up to 50% of its loan to D.A.N.E. S.A. Sea Lines, by decision of General Council no. 12/1980 (of 11.6.1980), and to Credit Bank for covering up to 50% of its loan to the same company, by decision of General Council meeting no. 14/1980 on 9.7.1980.

186 For example: short-term financing of Athens daily newspapers (with 80 million drachmas) "for covering urgent needs in working capital" (due to a strike of press workers), by decision of General Council no. 14/80

cellence prize for Economics graduates.[188] In some cases, there is a discernible effort towards an even-handed and balanced approach: thus, in a single meeting, no. 3/95 on 24.3.1995, the General Council approved grants to the Foundation for Economic and Industrial Research (IOBE), to the Communist Party of Greece (KKE), for the restoration of its historical archives, and to the Sakis Karagiorgas Foundation.[189]

In addition to the direct financing provided to private enterprises, decisions were also made for the continued refinancing of the Agricultural Bank for on-lending to businesses within its scope, such as in the tobacco, cotton, grape, currant and potato industries.

In one case, the refinancing of the National Mortgage Bank and the Agricultural Bank was approved by a Governor's Act, rather than by a Decision of the Monetary and Credit Committee, as was the rule: this unusual practice was discussed and decided on 11.2.1984 (General Council meeting no. 11/84). This decision was accompanied by two more Governor's Acts, determining the level and sources of funding for the 1984 financing programmes of the Agricultural Bank (no. 7/84 of 14.4.1984) and the National Mortgage Bank (no. 13/84 of 7.9.1984).

(of 9.7.1980); contribution in favour of the Foreign Press Association of Greece, by decision of General Council no. 16/80 (of 6.8.1980); refinancing of the National Bank for the financing of the Athens Newspapers Agency (with 12 million drachmas) and the New Newspapers and Magazines Agency (with 8 million drachmas), by decision of General Council no. 19/80 (of 17.9.1980); refinancing "of the financing of the daily political newspapers of Athens and Thessaloniki by commercial banks against the return of newsprint paper of 1980", by decision of General Council no. 13/81 (of 1.7.1981); refinancing of commercial banks for the financing of weekly political newspapers of Athens against the return of newsprint paper of the period 1.1.1981-31.10.1981, by decision of General Council no. 10/81 (of 14.4.1981); and (in the following month) refinancing of the National Bank (with 6.57 million drachmas) for the financing of weekly political newspapers of Athens against the return of newsprint paper of the period 1.1.1981-31.10.1981, by decision of General Council meeting no. 13/81 (of 20.5.1981), etc. In addition, as part of the Bank's policy of grants to cultural organisations and publications, the General Council often decided to extend grants to journals and magazines. These included, more frequently, the *Diavazo* and *Nea Estia literary reviews* and the *Greek Economic Review*, while a grant was also provided to the Foreign Press Association of Greece. Rather regular recipients of grants among cultural organisations were the Athenaeum International Arts Centre and the Dora Stratou folk dance theatre, and, outside the area of culture, the Foundation for Economic and Industial Research (IOBE) and the Hellenic Red Cross.

187 General Council meeting no. 25/81 (of 25.11.1981). "TeleVision Enterprises S.A", or TVE, is an audiovisual productions company that was founded in 1975, started operating in 1977, and since 1989 has an exclusive technical management contract with Mega Channel (see http://www.tve.gr/about-us/).

188 General Council meeting no. 5/91 (of 15.2.1991), paragraph 31.

189 General Council meeting no. 3/95 (of 24.3.1995), paragraphs 39, 40 and 41, respectively.

5.12 The Bank of Greece and state-owned enterprises: the case of the Aspropyrgos Refinery

During the 1980s and in the context of the economic policies then pursued, the Bank of Greece was often called upon to support state-owned enterprises. The relevant decisions are too many to list here. We could instead look at General Council decisions on Hellenic Aspropyrgos Refinery S.A. (ELDA) as an example of the relationship of the Bank of Greece with state-owned companies. This company was established in 1955 by government decision, founded by shipowner Stavros Niarchos. In 1976, it was purchased by the Greek State and in 1985 became part of the group of Public Petroleum Corporation S.A. (DEP). In 1998, DEP was renamed Hellenic Petroleum S.A, absorbed EKO-Hellenic Refineries & Chemicals of Macedonia S.A.; the manufacturing branch of EKO S.A.; ELDA; and DEP-EKY, and was listed on the Athens and London stock exchanges.[190]

In July 1983, the General Council, alongside a decision to reduce the exchange rate applicable on the drachma conversion of foreign loan disbursements to the Public Power Corporation (DEH), also decided to reduce the commission fee on transactions with ELDA.[191] In September 1984, it authorised a loan agreement between Citibank (Channel Islands) Ltd. and ELDA for an amount in yen equivalent to 200 million US dollars, guaranteed by the Bank of Greece.[192] This was followed by another General Council decision in December 1988, whereby the Bank of Greece would issue a guarantee in favour of a syndicate of foreign banks for an interest rate swap to be conducted in future by ELDA.[193] The swap operation was later cancelled, as we can see from a General Council decision, in September 1990, granting the Bank's consent, in its capacity as guarantor, to the cancellation of the swap agreement.[194] In the following month, it decided the provision of a Bank of Greece guarantee for a 100 million US dollars loan from a syndicate of banks to ELDA.

190 https://www.helpe.gr/en/the-group/from-past-to-present/,https://www.eko.gr/i-etairia-mas/istoriko/, https://www.csrhellas.net/about-us/timeline/

191 General Council meeting no. 14/83 (of 6.7.1983), paragraphs 12-13.

192 General Council meeting no. 13/84 (of 7.9.1984).

193 General Council meeting no. 17/88 (of 22.12.1988), paragraphs 5-6.

194 General Council meeting no. 13/90 (of 4.9.1990), paragraph 6.

5.13 The armament programmes

During the 1980s, the Bank of Greece, as part of the responsibilities it had back then, was involved in finance operations regarding the procurement of defence equipment for Greece's armed forces. Some examples are the following operations:

General Council meeting no. 8/81 (of 22.4.1981) decided to issue an irrevocable documentary credit for DEM 370 million concerning the purchase of military equipment by the Hellenic Army General Staff.

Under General Council no. 3/82 (of 4.2.1982), the Bank of Greece provided an aval for promissory notes issued by the Hellenic Air Force General Staff that covered price adjustment, plus interest, of helicopters purchased from the Costruzioni Aeronautiche G. Augusta SpA under contract no. 3/1980.

In the same year (General Council meeting no. 27/82 of 22.12.1982, paragraph 8) it approved an amount as Greece's contribution to the operation and maintenance costs of the NATO FORACS Station in Crete.

By decision of the General Council (meeting no. 7/85 of 26 March 1985), paragraph 29, it was decided for the Bank of Greece to open an irrevocable documentary credit for 356,671,500 French francs for an advance payment to the French companies Marcel Dassault, Snecma and Thomson/CSF, against the value of forty Mirage-2000 aircraft to be supplied to the Ministry of National Defence/Hellenic Air Force General Staff, while in General Council no. 16/85 (of 18 July 1985), paragraphs 3-4, a decision was made to increase, by 119,809,520 French francs, irrevocable documentary credit no. 1855333 opened by the Bank of Greece as a guarantee for the financing, by the French bank Banque Nationale de Paris, of the advance payment to the above French companies.

In 1986, General Council meeting no. 8/86 (of 21 May 1986) approved the conclusion of a short-term credit facility loan with the RBC Finance B.V., amounting to US dollars 25 million, which on 25 July 1986, by decision of the next General Council (no. 9/86), was to be used for the opening by the Bank of Greece, without a deposit of the corresponding coverage in drachmas, of an irrevocable letter of credit up to the amount of US dollars 25,000,000 in favour of the American supplier company General Dynamics for covering any expenses that would emerge from a cancellation by the Ministry of National Defence/Hellenic Air Force General Staff of the contract for the procurement of forty F16 fighter aircraft. On 22.12.1986 (General Council meeting no. 23/86, paragraphs 4-5), a decision was made for a new stand-by letter of credit to General Dynamics, amounting to US dollars 81 million.

Finally, General Council meeting no. 7/88 (of 9.6.1988) approved the opening by the Bank of Greece of an irrevocable divisible letter of credit for DEM 33,432,793 and GBP 6,452,049, without deposit of a coverage in drachmas, in favour of the German supplier company Siemens AG Radio and Radar Systems Division, Munich, on behalf of the Hellenic Army General Staff/731 Military Works Division, through the German Bank Bayerische Vereinsbank AG, Muenchen.

6 THE LONG ROAD TO STABILISATION AND EURO AREA ENTRY, 1984-2001

6.1 Introduction

The 1984-2001 period can be divided into two sub-periods. The first, from 1984 to 1994, saw the Bank of Greece gradually regain its past relative autonomy within the domestic financial system and the first steps towards a new era, free from restrictions and tight controls. In 1984, there were about 80 administered interest rates and tight credit allocation rules. The banking system was also weighed down by exposures to the so-called ailing firms, which obscured banks' balance sheets and did not ensure the necessary transparency. On the other hand, the path to financial liberalisation, which was seen as indispensable by experts, had to be gradual and cautious, so as not to disturb economic activity. The governments of the 1970s and 1980s had social policy mandates. It was against this backdrop, and amid fiscal deficits, that Greece's adaptation to the new era was undertaken. This adaptation was not painless, nor did it follow a straight upward path until 1994. But the important thing is that the process was not reversed and that the way was paved for the next phase of financial liberalisation.

In the second sub-period, from 1994 to 2001, Greece faced two interrelated challenges: the institutional modernisation of its financial system and adaptation with a view to joining the European monetary union. The main feature of that period was therefore an effort to ensure economic stabilisation, along with the necessary fiscal consolidation, in an economy like Greece vexed by chronic inflation and high deficit and debt levels. Throughout that period, the Maastricht criteria served as benchmarks for the Bank of Greece too, in its effort to achieve the monetary and exchange rate policy targets towards the fulfilment of the criteria for the adoption of the single currency. Monetary policy shifted to a new regime, entailing changes in strategies and targets that, over time, proved to be effective.

With perseverance and constant vigilance, the Bank of Greece reinforced policy credibility and achieved gradual disinflation until 1998, which made possible the entry of the drachma into ERM I in March 1998 and ERM II in January 1999 and, subsequently, entry into the euro area and the adoption of the euro in 2001, which was a watershed in Greek economic and monetary history. In the same vein, the institutional modernisation of the Greek banking sector and of the financial system in general was completed during that period, in line with broader developments in Europe.

6.2 The beginning of the turnaround in economic policy

The state of the economy did not improve, despite a shift from the sizeable wage increases of 1982 towards the devaluation of 1983 and deferred wage indexation. Against this background, in the *Annual Report for 1983,* the new Governor, Demetrios Chalikias —appointed just two months before the Annual General Meeting of Shareholders held on 27.4.1984— noted that "a limited economic recovery is anticipated […]. Nevertheless, the prerequisites for a substantial and sustained expansion of the economy have not yet been ensured".[1]

The two major concerns of the new Administration of the Bank of Greece were inflation and the deficit in the balance of payments. Public debt, which had risen from 10.5% of GDP in 1978 to 23.8% of GDP (US dollars 8.1 billion) in 1983, was yet another crucial aggregate, which, according to D. Chalikias, was due to the fiscal deficit that "led to a substantial increase in foreign borrowing". Notably, the Report mentioned that foreign debt service as a percentage of exports of goods and services had risen from 8 per cent in 1978 to 16 per cent in 1983.[2]

Two important initiatives in 1983 and early 1984 (when Gerassimos Arsenis was both Governor and Minister) were a tightening of the incomes policy, leading to a reduction in the growth rate of average nominal earnings from 26% in 1982 to 17% in 1983 (falling short of inflation by an estimated 3%), and an increase in interest rates on bank deposits and Treasury bills as of 15.2.1984. Nevertheless, D. Chalikias acknowledged in his Report that, although the changes had been substantial, they had not as yet had a significant effect on the course of the economy, which he attributed to the policies pursued during the 1975-1982 period. In other words, his criticism included the first year of PASOK government.

1 *Annual Report for the year 1983.*

2 Ibid.

The Report argued that Greece's accession to the EEC had adversely affected the trade balance in the short run, as the balance of trade in agricultural products with the Community had turned negative after accession (the agricultural sector accounted for 16% of GDP). At the same time, domestic industrial goods had been increasingly displaced by imports from the Community, while the implementation of policies designed to support the industrial sector of Greece's EEC trading partners created serious difficulties for Greek exports to the Community.

The Report indirectly criticised the exchange rate policy pursued after the devaluation of the drachma, implying that it was a missed opportunity. The Bank of Greece "intervened in the foreign exchange market to maintain the dollar/drachma parity stable up to early August 1983. This policy resulted in a significant appreciation of the drachma and consequently in a loss of part of the competitiveness gained by the devaluation [...]".[3] The decision to devalue the Greek currency was in line with the government initiatives and policy choices of the time. The pegging of the drachma to the US currency could not be maintained (especially in view of the dollar's continuing appreciation), thus the drachma was unpegged from the US dollar in August 1983. By the end of 1983, the exchange rate of the drachma vis-à-vis the ECU had returned to its pre-devaluation levels, but it was still higher relative to several other European currencies.

The next *Annual Report*, reviewing the year 1984, noted that the economy had entered a phase of recovery. Part of this recovery stemmed from the agricultural sector, thanks to higher yields per hectare, crop restructuring, increased investment in agricultural machinery and improved processing and marketing of agricultural products. Industrial production grew slightly, mainly driven by consumer non-durables and capital goods, and partly offset by an increase in imported consumer goods, reflecting a consumer preference "in many cases not justified by differences in price or quality".[4] The Bank of Greece noted that the competitiveness of the Greek economy remained low and highlighted the need to raise competitiveness through investment for modernisation and expansion of productive capacity. At the same time, fixed investment in manufacturing had declined in the past few years, with only a slight recovery in 1984, while residential investment had also weakened. A reversal in the downward trend of employment and a slight increase in productivity had been observed in the manufacturing sector. The relatively high rate of youth unemployment was seen as a serious problem. Pressures on the labour market were exerted by the supply side, owing to the natural

3 Ibid.

4 *Annual Report for the year 1984.*

growth of population, the increased participation of women in the urban labour force and the repatriation of emigrants. The increase in the consumer price index (CPI) had averaged 18.5% in 1984, consistent with government forecasts; as a result, "inflation continues at a high rate [...] and inflationary pressures on the cost side remain strong".[5]

The Governor described the high balance-of-payments deficit as a serious problem and criticised the policy that had been pursued over the past few years, stressing that "the current account deficit remains at a high level, probably the requisite measures had been delayed and the imbalances and structural weaknesses of the economy had worsened, before the stance of economic policy changed in the spring of 1982".[6] According to Governor D. Chalikias, the most critical structural weakness referred to the difficulties faced by manufacturing, largely resulting "from excessive protection and subsidisation", while it was only "after Greece's accession to the EEC" that Greek manufacturing firms "were exposed to market pressure".[7] As mentioned in the Report, "during the entire post-war period the large manufacturing firm was regarded as the lever of industrialisation [...], whereas the small- or medium-size productive unit was all but neglected". This policy "did not promote the development of new and dynamic small- and medium-size firms and thereby discouraged the necessary changes in the structure of Greek industry". This attitude was deeply rooted: "Even today, despite the fact that the stance of industrial policy has changed, there is still widespread acceptance of the view that the large manufacturing firm is the lever of industrialisation". The Report underscored the significant role of large, technologically advanced enterprises, although some of them were facing difficulties, usually reflecting poor capital structure as a result of over-dependence on bank credit.[8]

6.3 The stabilisation programme 1985-1987

The political landscape in Greece changed in 1985, after a new President of the Republic was elected and PASOK once again formed a majority government. A cabinet reshuffle followed a few months later, accompanied by a radical change in the stance of economic policy with the launch of a two-year stabilisation programme on 11.10.1985.

5 Ibid.
6 Ibid.
7 Ibid.
8 Ibid.

At the Annual General Meeting of Shareholders on 28.4.1986, D. Chalikias opened his Report by stating that "the main feature of economic developments in 1985 was the significant deterioration of the internal and external balances. At the same time, however, 1985 was the year in which the stance of economic policy changed radically. The new policy aims at stabilising the economy". Furthermore, he conceded that "practically all macroeconomic magnitudes in 1985 deviated from targets or forecasts." The balance of payments had also deteriorated considerably. "The current account deficit amounted to [...] 10 per cent of GDP, whereas in the previous five years it had ranged between 5 per cent and 6.4 per cent of GDP. The trade deficit was [...] higher [...]. The surplus on invisibles decreased again [...]. The rise in invisible payments was mainly due to higher interest payments, reflecting the increase in the country's foreign debt. [...] Finally, autonomous net inflow of private capital has slowed down considerably over the past few years".[9]

It is worth noting that Chalikias extended his severe criticism to the overall economic policy pursued during the first four-year term of the PASOK government, pointing out that "net invisible receipts have declined steadily in recent years and since 1983 they have fallen below earnings from non-oil commodity exports. Between 1980 and 1985, net invisible receipts decreased by US dollars 1.6 billion, which largely accounts for the deterioration of the balance of payments".[10]

According to the Governor of the Bank of Greece, the policy package introduced in October 1985, chiefly including a 15% devaluation of the drachma and a six-month advance deposit requirement (corresponding to 40% or 80% of import value) on a wide range of imports, had failed to halt the sharp rise in inflation, despite a modification of the wage indexation mechanism and the prohibition of any other wage increases. The inflation rate was thus projected to reach 25% for 1986 as a whole.

A considerable destabilising factor identified by the Governor was "expansionary fiscal policy [which] was a major cause of adverse economic developments [in 1985]. The public sector's borrowing requirement (PSBR) rose to 18.1 per cent of GDP, up from 15.6 per cent in 1984. [...] The rising PSBR contributed to domestic credit expansion and money growth at rates higher than the targets. Domestic growth rose by 26.4 per cent in 1985, substantially above the target of 21.3 per cent", while "the increase in public and private expenditure did not contribute to a corresponding increase in domestic production, but was largely reflected in a widening of the balance of payments deficit", as a result of greater

9 *Annual Report for the year 1985.*

10 Ibid.

import penetration.[11] These developments "should also be seen in the light of the steady loss of competitiveness [...] of Greek products between 1980 and 1984, by 30.6 per cent in relation to Greece's 15 major trading partners and by 38.4 per cent in relation to other member states of the European Economic Community".[12] Moreover, the country's external debt had more than tripled in seven years, soaring from US dollars 4,489 billion in 1978 to US dollars 14,775 billion in 1985.[13]

A very interesting observation by Governor Chalikias was that 74% of the increase in GDP had stemmed from the services sector: "The tendency of this sector to expand at a higher rate than the rest of the economy was observed after the first energy crisis and has become more pronounced since 1979. The 7.5 per cent increase in GDP over the last six years derived exclusively from the growth of services", the aim of which was "largely to satisfy collective needs", combined with a decrease in exports of services. These developments indicated a need to raise productive investment and productivity.[14]

The Report concluded that "a new economic policy was adopted [...]. The gradualist approach to economic adjustment pursued over the past few years had been abandoned. This new policy, provided that it is supplemented with appropriate structural measures, represents a break from post-war economic policy, and will have a major impact on the course of the Greek economy". The new policy was pragmatic, as it had been based on the correct assessment that the difficulties were to a large extent associated with structural imbalances, while at the same time it had been designed to make up for the wrong macro- and micro-economic policies of the past.[15] This juxtaposition with the economic policies pursued before the stabilisation programme of October 1985 is perhaps one of the harshest criticisms ever expressed in a Bank of Greece *Annual Report*.

In his Report for 1986, D. Chalikias began by reiterating the main targets of the two-year stabilisation programme: to bring inflation down from 25% to 16% in 1986 and 10% in 1987, as well as to reduce the current account deficit from US dollars 3.3 billion to US dollars 1.7 billion in 1986 and US dollars 1.25 billion in 1987. He went on to assess that the targets had been broadly achieved: inflation stood at 16.9% and the current account deficit came to US dollars 1,704 million. The net public sector borrowing requirement declined by 3.9%, against a target of 4%, while real earnings decreased by 8%. However, he also detected an indirect and lagged

11 Ibid.

12 Ibid.

13 Ibid.

14 Ibid.

15 Ibid.

adjustment of the economy to the stabilisation programme: "the decline in the real disposable income of wage earners was partly offset by an increase in [business] profits and the incomes of the self-employed".[16]

Furthermore, several external factors, including a sharp drop in international oil prices, the depreciation of the US dollar and the continuing decline of interest rates in international markets, had a positive effect on the Greek economy. As a consequence, "favourable conditions have thus been created which ensure that inflation will continue to decelerate in the ensuing months and that the balance of payments will improve further". In 1986, GDP grew by 1.4%, real disposable income shrank by 5%, and private consumption rose by 0.8%. This suggested that private savings had declined, "unless there was an increase in income in the underground economy".[17] The public sector had not contributed to a reduction of consumption expenditure. On the other hand, public investment had contracted by 20%, unlike private investment that had expanded by 5%, although "this recovery […] may be transitory". Business investment had not yet shown a clear trend, largely as a result of time lags between an improvement in the rate of return on investment and the planning and implementation of new investment. Still, some optimism was expressed, particularly for medium-sized firms.

According to D. Chalikias, the stabilisation programme had worked well: "the devaluation of the drachma and the modification of the wage indexation scheme have substantially strengthened the competitiveness of Greek products since the last quarter of 1985. In addition, the imposition (from November 1985 through April 1987) of advance deposit requirements on a wide range of imported goods was aimed at curtailing demand for imports".[18] Yet, the volume of imports kept rising, mainly as a result of the failure of domestic supply to meet domestic aggregate demand, in terms of both quantity and quality.

With respect to the other main target of the programme, the Report noted a decline in the net PSBR as a percentage of GDP from 17.6% in 1985 to 13.7% in 1986. This drop resulted from the lower borrowing requirements of both central government and public enterprises. The Report also noted that "by contrast, the deficits of public organisations, especially social insurance agencies, continued to widen" in 1986,[19] adding that "the net PSBR target in 1987", i.e. a reduction by another four percentage points, "appears to be ambitious".

16 *Annual Report for the year 1986.*

17 Ibid.

18 Ibid.

19 Ibid.

Turning to monetary and credit developments, the Report noted a substantial slowdown in the growth rates of monetary and credit aggregates, as well as the significant progress achieved in interest rate unification and in controlling the credit expansion of the Agricultural Bank of Greece and the National Mortgage Bank: "Today, the Bank of Greece treats these [specialised credit] institutions in virtually the same way as commercial banks". With regard to money supply, M3 growth declined from 29.6% in 1984 to 27.3% in 1985 and 19.2% in 1986, while M1 (comprising currency in circulation and private sight deposits) grew by only 9.7% in 1986, compared with an increase of 24.4% in 1985. Specifically, the growth of currency in circulation (M0) slowed down considerably, from 26.1% in 1985 to 7.5% in 1986 (in average annual terms: 15.5%), while a weaker slowdown was seen in the growth rate of sight deposits, from 19.8% in 1985 to 16.2% in 1986.[20] Meanwhile, the growth rates of bank credit to the private sector had been diminishing: 20.5% in 1984, 19.9% in 1985 and 15.4% in 1986. In particular, commercial bank credit to the private sector grew in 1986 by 14.8%, compared with an increase of 17.7% in 1985. "Credit expansion decelerated after the Bank of Greece took certain measures in June 1986 which drastically curtailed bank liquidity".[21]

The measures adopted in June 1986 included the establishment of a minimum interest rate of 15% on medium- and long-term bank loans, the abolition of the subsidised interest rate on "ordinary" housing loans, the imposition of a maximum interest rate of 21.5% on loans to governmental agencies which intervened in the markets of agricultural products, and an increase in the interest rate on short-term loans to small and medium-sized handicraft firms.[22]

One year later, by which time the stabilisation programme had been completed, the Governor stated: "Following the stabilisation programme implemented over the period 1986-1987, the Greek economy has entered a new phase characterised by an easing of economic imbalances" and "thus in 1987 external equilibrium was achieved and the country's external position was strengthened", adding that "the implementation of the stabilisation programme had a limited negative impact on economic activity. In 1987, GDP decreased by only 0.6 per cent".[23]

According to the Bank of Greece, "irrespective [...] of the costs entailed [mostly affecting wage earners], it seems that the economic stabilisation programme has created favourable conditions which, if exploited, can ensure a further deceleration

20 Ibid.

21 Ibid.

22 Ibid.

23 *Annual Report for the year 1987.*

of inflation".[24] The wording further below is clear, showing Chalikias' concerns about the policy that would be pursued after the stabilisation programme (P. Roumeliotis had already replaced C. Simitis in the Ministry of National Economy on 27.11.1987): "The implementation of prudent economic policies is an essential prerequisite for maintaining stable economic conditions. Of crucial importance in this respect is to continue the efforts for a drastic reduction of public sector deficits".[25]

According to the Governor, some signs were alarming: "The decline in private consumer expenditure was smaller than in real private disposable income. As a result, the share of private saving in private disposable income decreased for the second consecutive year. [...] Total fixed asset formation declined by 2.3 per cent, as the sharp decrease in public investment was not offset by the increase in private investment".[26] On some other fronts, however, developments had been encouraging: "There are indications that a steadily growing number of firms, mainly of medium size, are adapting to the new competitive environment. [...] Developments in the Greek balance of payments were particularly favourable [...]. The improvement in the current account was accompanied by a rise in net private capital inflows, which increased by 81.8 per cent in 1987 [...] the country's net foreign exchange position improved by US dollars 541 million in 1987".[27]

The Governor argued that a central aim of economic policy should be to bring about a permanent improvement in the balance of payments, which called for the promotion of structural changes and the implementation of appropriate fiscal and monetary policies, as "it is significant that it has now become widely accepted that, in a small and open economy like Greece, the conduct of an autonomous monetary policy is not feasible".[28]

It was crucial to strengthen the export orientation of the Greek economy, given that the opening of the domestic market to foreign competition following EEC accession had led to an increase in import penetration of manufactured goods from 23.6% in 1980 to 34.7% in 1987, and this trend was expected to continue in the following years, "even though at a slower pace". Nevertheless, the non-oil trade deficit as a percentage of GDP had not widened over the same period and averaged 10.4% in the first seven years after EEC accession (under PASOK governments), compared with 10.9% in the seven years before 1981 (under New Democracy governments).[29]

24 Ibid.
25 Ibid.
26 Ibid.
27 Ibid.
28 Ibid.
29 Ibid.

With regard to the public sector, D. Chalikias was strict in his judgment: "Efforts to reduce the public sector deficit continued into 1987, but the outcome was less satisfactory, compared with the progress made in 1986 and the targets set by the Government". He pointed out that the net PSBR as a percentage of GDP had declined by only half percentage point in 1987, against four percentage points in 1986. "The improvement in 1987 was limited because of the widening of the central government deficit", which was due to a shortfall in tax collection (partly on account of a strike of tax office cashiers), the inadequate adjustment of domestic oil prices and increased government transfers to the Social Insurance Institute (IKA) and public transport organisations. Conversely, the net borrowing requirements of social security funds, local authorities and other public organisations had decreased visibly. D. Chalikias went on to note that: "The containment of public sector expenditure comes up against certain difficulties, considering that the high deficits of recent years have increased the inelasticity of expenditure […] expenditure for interest payments more than doubled between 1982 and 1987".[30]

On the other hand, "in 1987, major steps were taken towards the liberalisation of bank interest rates and the abolition of a host of credit rules and regulations restricting the management of banks' portfolios. As a result of a series of measures taken by the Bank of Greece, only a few interest rates are still administratively determined. These are mainly interest rates on savings deposits, the special interest rates on loans to small and medium-size manufacturing firms, and the interest rates on loans under some categories of social housing programmes. In particular, commercial bank loans with market determined interest rates account for more than 80 per cent of commercial bank credit to the private sector".[31]

More specifically, "liberalisation of bank lending rates started towards the end of June 1987 with the abolition of the maximum rate of 21.5 per cent on short-term credit and other categories of bank loans, accounting for about 55 per cent of commercial bank lending to the private sector. The minimum interest rate on these loans was set at 21 per cent and banks were permitted to set lending rates above this minimum".[32]

30 Ibid.

31 Ibid.

32 Ibid.

6.4 The Bank of Greece and the Greek banking system in 1987

Greece's bank-centric and "traditional" financial system was among the main preoccupations of governments and the Bank of Greece, but also of the banking system itself.

The relevant discussion dates back to the second Karamanlis government, when the Minister of Coordination, Georgios Rallis, decided (22.2.1978) to set up a group of eleven experts, led by Bank of Greece Deputy Governor Nikolaos Harissopoulos,[33] for the purpose of preparing a study of the Greek banking system. The "Harissopoulos committee", as it became known, assigned eight working groups to prepare individual reports. The final comprehensive report, including 17 specific recommendations, was released in 1979. As mentioned by N. Harissopoulos in the introduction to the report, "The common thrust of the recommendations that follow is the phasing out of administrative restrictions and a smooth transition to a system where market mechanisms play a more important role, irrespective of whether the State will maintain a strong presence through direct or indirect control on various credit institutions. Such transition is seen as a necessary condition for eliminating several structural weaknesses".[34] The release of the Harissopoulos report took place shortly before Constantinos Karamanlis moved from premiership to the Presidency of the Hellenic Republic and the political developments that followed. This timing was the reason why the report did not have a direct effect on current economic policy.

Six years later, in a separate section of his *Annual Report for 1984* (April 1985), Demetrios Chalikias discussed in detail the need for banks to adapt to the new conditions. He noted that the past three years had seen important changes to the system of credit rules and controls, giving a freer hand to banks in their lending decisions and loan repayment arrangements. However, the adaptation of banks to the new conditions was slow, due to a lack of appropriate mechanisms and specialised staff, as well as to a long-entrenched mentality among part of their staff.[35]

Further below, it was stressed that the Bank of Greece had opened up the banking system to new loan categories and to the financing of economic activities that

33 Harissopoulos served as Deputy Governor from 21.10.1975 to 6.11.1981.

34 Harissopoulos, N. V. (1979a), p. 38.

35 *Annual Report for the year 1984.*

had previously been regarded as less productive, if not undesirable.[36] Among other concluding remarks, the section stressed that a shift of focus to an assessment of the prospects and financial condition of prospective borrowers was in the best interests of both the economy and banks, as experience had shown that real estate collateral did not adequately secure the repayment of loans.[37]

Ten months later, during the second premiership of Andreas Papandreou, and while the stabilisation programme launched on 11.10.1985 was already underway, the Minister of National Economy – and the main champion of stabilisation – C. Simitis set up a committee on 18.2.1986, with the task of designing the reform and modernisation of the Greek banking system ahead of the completion of the European Single Market in 1992. The committee, bringing together the Deputy Governor of the Bank of Greece, Efstathios Papageorgiou,[38] as well as Georgios Kasmas, Fotios Panagiotopoulos, Efstratios Papaefstratiou and Panayiotis Poulis, became known as the Karatzas Committee, after the name of its chairman, Theodoros Karatzas. Between 1982 and 1985, Karatzas had been Managing Director of the National Investment Bank for Industrial Development (ETEBA) and president of the Banque Franco-Hellénique de Commerce International et Maritime, and would later serve as Secretary General of the Ministry of National Economy (1985-1987), Deputy Minister of National Economy (24.6.1987-22.12.1988) and Governor of the National Bank of Greece (1996-2004).[39]

The report of the Karatzas committee, released on 13.2.1987, provided a clear overview of the Greek banking system in 1985-1987. Banks dominated the Greek economy almost entirely: in 1985, around 90% of saving resources (other than those channelled into bank bonds) were held in bank deposits – nearly 70% with commercial banks.[40] It should be noted that bank bonds were introduced in 1975.[41] In more detail, in May 1986, the breakdown of deposits was as follows:[42]

36 Ibid.

37 Ibid.

38 Deputy Governor from 17.9.1985 to 17.9.1989.

39 In the same period, he was also Chairman of the Board of the Hellenic Bank Association. Sources: General Secretariat of the Government (http://www.ggk.gov.gr/?p=1291); National Bank of Greece 1841-2006/History Timeline (https://ha.nbg.gr/el/pdf_library/XRONOLOGIO.pdf) [in Greek].

40 Karatzas et al. (1987), p. 21.

41 Ibid., p. 59.

42 Ibid., p. 39.

Greek commercial banks[43]	63.80%
Foreign commercial banks	1.60%
Total commercial banks	65.40%
Agricultural Bank of Greece	13.00%
Investment banks[44]	4.60%
Mortgage banks[45]	2.50%
Postal Savings Bank	13.50%
Consignment Deposits and Loans Fund	0.90%

On the other hand, the breakdown of loans was as follows:[46]

National Bank of Greece	28.50%
Commercial Bank of Greece	8.20%
Ionian Bank	3.80%
Credit Bank	5.30%
Agricultural Bank of Greece	25.45%
Investment banks	7.20%
Mortgage banks	10.70%
Postal Savings Bank	2.00%

The Committee concluded that "the banking system cannot be modernised as long as it remains the exclusive manager of the credit resources of the economy. The capital market should become the main mechanism for raising and allocating the long-term funds of the economy.[47] The problem became more obvious with the prospect of the completion of the Single Market in 1992. The Single European Act, signed in Luxembourg on 17.2.1986 by nine member states and on 28.2.1986 by Denmark, Italy and Greece,[48] came into effect on 1.7.1987.

The *Annual Report for 1987* was an implicit response to the Karatzas Report. The standard overview of "Economic developments and monetary policy" in

43 Including, most notably, the National Bank of Greece, the Commercial Bank of Greece, the Ionian Bank and Credit Bank and a number of smaller banks, i.e. General Bank of Greece, Traders' Credit Bank, Piraeus Bank, Attica Bank, Ergasias Bank, Bank of Crete, Bank of Macedonia-Thrace and Bank of Central Greece.

44 Investment Bank, National Investment Bank for Industrial Development (ETEBA) and Hellenic Industrial Development Bank (ETBA).

45 National Mortgage Bank and National Housing Bank.

46 Karatzas et al. (1987), p. 40.

47 Ibid., p. 11.

48 http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=LEGISSUM:xy0027&from=EN

Chapter II featured, for the first time, sections focusing on "Liberalisation of interest rates and of the banking system" and "Supervision of the banking system",[49] emphatically noting that, in view of the integration of European financial markets by 1992, Greek banks would face competition from foreign banks in the provision of banking products and services in which they had limited experience, as their business was still concentrated on the "traditional" activity of lending. The problem would exacerbate to the extent that the government, other public bodies and private enterprises increasingly resorted to domestic and international money and capital markets for fund raising.[50]

Although C. Simitis resigned from Minister of National Economy on 27.11.1987,[51] and the stabilisation programme was abandoned, a large part of the recommendations of the Karatzas Committee was adopted in the following years, marking a significant shift in economic policy, with a far-reaching impact on economic and political developments.

6.5 Balance of payments and foreign borrowing

Throughout the 1980s, Greece faced problems with its balance of payments, leading to increased foreign borrowing and hence a burgeoning public debt, which would eventually take on dramatic proportions.

On at least one occasion, the General Council (which usually met once a month) convened for an extraordinary meeting in order to approve a new large loan: the new meeting was held on 6.5.1982, eight days after the previous regular meeting of 28.4.1982, and the only agenda item referred to a loan of US dollars 550 million from foreign banks. The urgent character of the matter can be seen from a handwritten note at the bottom of the page: "Approval [of the minutes] on the same day".

The early 1980s had seen a change of practice with regard to the extension of loans to the Greek State: whereas a period of a few months (corresponding to two or even three meetings of the General Council) would typically elapse between the signing of a loan and its assignment to the Greek State, this period was at first gradually reduced to only a few weeks (signing of a loan amounting to US dollars 500 million on 14 April and assignment on 27 April) to be further shortened to the same day of the General Council's meeting (e.g. General Council no. 25/82 of 28.12.1982: the decision on the conclusion of a loan agreement amounting to 500

49 All subsequent Annual Reports include similar sections, under varying titles.

50 *Annual Report for the year 1987.*

51 He was replaced by Panayiotis Roumeliotis (27.11.1987-2.7.1989).

million Dutch guilder was referred to in paragraph 21, while the decision on the assignment of the same loan was mentioned in Paragraph 22).

In some cases, it was decided to grant —some form of— advance payment to the government; by way of illustration, according to the agenda of General Council meeting no. 24/82 of 2.12.1982, it was decided (under paragraph 10) that the Bank of Greece would issue a bond amounting to 15 million Deutsche marks, while at the same time (under paragraph 17a) it was decided that a bond issue denominated in foreign currency, amounting to 15 million Deutsche marks, would be assigned to the Greek State [by the Bank of Greece], brokered by County Bank Ltd., London. Similarly, according to the agenda of General Council meeting no. 19/85 of 14.6.1985, it was decided (paragraphs 2-4) to issue floating rate notes in foreign currency, amounting to 500 million Deutsche marks, and (paragraph 5) to assign to the Greek State the notes that would be issued on the Euromarket.

Successive loan agreements were concluded with foreign banks in the first months of 1983 and again in the last months of 1984.[52] A short-lived turn to Arab banks was also observed (e.g. Commercial Bank of Kuwait on 17.10.1985; Arab Banking Corporation on 27.5.1986, together with Western banks and one Japanese bank). In the late 1980s, bond issues in the large German and Japanese markets were decided (namely, General Council meeting no. 10/87 of 1.6.1987: two series of fixed-coupon bonds of a total nominal value of DEM 300 million; and General Council meeting no. 11/88 of 17.8.1988: bond issue of JPY 20 billion). At the same time, the Euromarket was also being explored (General Council meeting no. 4/89 of 20.1.1989: floating-rate bond issue of US dollars 250 million; General Council meeting no. 2/91 of 22.1.1991: loan in foreign currency, amounting to 10 billion Italian liras and 60 million XEU – the ISO code for the ECU).

The gradual shift towards Japan as from the mid-1980s peaked in the early 1990s when a large part of the loans originated from the Japanese market. Some indicative cases are the following:

At its meeting in February 1992, the General Council approved a bond issue of JPY 70 billion in the Japanese market, and interest rate and foreign exchange swap operations between the Bank of Greece and two Japanese banks, Sumitomo Bank Capital Markets Inc. and Mitsubishi Bank Ltd., for JPY 20 billion and JPY 10 billion, respectively.[53]

52 For example, within five months in early 1983, standby credit lines in foreign currency were decided and loans amounting to US dollars 125 million + US dollars 200 million + LUF 250 million + JPY 10 billion yen + US dollars 150 million + US dollars 70 million + US dollars 100 million + US dollars 500 million + US dollars 105 million + JPY 10 billion + DEM 50 million Deutsche marks + US dollars 25 million + DEM 15 million + US dollars 100 million were concluded.

53 General Council agenda no. 2/92 of 4.2.1992, paragraphs 2-4 and 5-6, respectively.

Ten months later, in late December, the General Council decided to renew the request made to the Japanese Ministry of Finance regarding the issuance of bond loans by public offering in the Japanese capital market, to transfer to the Greek State the Bank of Greece's obligation to pay the fee (amounting to JPY 500,000) plus expenses of the law firm Nishimura & Sanada, and to issue a floating-rate bond loan of JPY 100 billion in the Euromarket.[54]

This trend of high foreign borrowing continued through 1993, but it was abruptly brought to a halt when the Bank of Greece was banned from engaging in monetary financing. The last relevant decision was made at General Council meeting no. 22/93 (of 6.12.1993) regarding the issuance of floating rate notes, amounting to US dollars 500 million, by public offering. This abrupt halt was directly associated with the launch of Stage II of EMU (from 1.1.1994 to 31.12.1998), which provided for a prohibition of monetary financing. Thereafter, the Greek State had to directly tap the capital markets (through the Greek Public Debt Management Agency since 1998) in order to meet its borrowing requirements.

In the light of the above, the Bank of Greece had to resort to foreign borrowing, in an effort to address a worsening balance of payments. The factors behind this deterioration were the high borrowing requirement of the public sector[55] and the manner in which it was financed, which drove inflation up to double-digit levels for 16 years in a row (1979-1994), which exceeded 20% in seven of those years. In turn, double-digit inflation levels, compounded by the incomes policy pursued from 1982 to early October 1985 (with the exception of 1983), led to a sharp increase in production costs and a loss of competitiveness for the Greek economy.[56] This development brought about a decline in exports and a rise in imports, although this rise was temporarily interrupted by the two devaluations of the drachma (in January 1983 and in October 1985). However, from 1988 onwards, the ratio of exports of goods to imports of goods continuously deteriorated (from 39.8% in the period 1975-1979 to 31.3% in the period 1990-1994, on average). Especially in 1981-1982, private capital inflows plummeted, mainly for

54 General Council agenda no. 23/92 of 22.12.1992, paragraphs 2-3 and 4-5, respectively.

55 It should be noted that the net public sector borrowing requirement (i.e. the cash deficit) was more than double the general government deficit, as measured today by ELSTAT. For instance, the net PSBR stood at 8.4% of GDP in 1980 and 14.8% of GDP in 1981, whereas on an accrual basis the deficit was only 2.6% of GDP in 1980 and 8.7% of GDP, and so on. This difference is due to the fact that public enterprises were included in the public sector, but excluded from general government.

56 With respect to higher wage costs, it should be noted that unit labour costs in industry rose by 37.6% in 1982 (*Annual Report for the year 1982*). Besides, "annual pre-tax earnings… in real terms… rose by 5.2 per cent [in 1982]" (ibid.). Higher purchasing power led to a further increase in demand for imported goods ("income effect").

political reasons (-17.9% in 1981 and -39.7% in 1982), thereby increasing the need for foreign borrowing.[57] In this context, the balance of payments was under continuous and severe strain.

In conclusion, to offset negative developments in the balance of payments, the Bank of Greece had to turn to foreign borrowing. Besides, it is no coincidence that most of the abovementioned cases of foreign borrowing refer to the years 1982 and 1985, just a few months before the respective devaluations of the drachma. Finally, the shift to Japan (for borrowing in yen) was explained by the particularly low interest rates of the yen that prevailed at the time, as well as by Japanese banks' ample liquidity.

In addition, it should be noted that over the same period domestic borrowing increased as well. The result was a rapid accumulation of public debt, which considerably limited the options of economic policy in the run-up to EMU.

6.6 The aftermath of the stabilisation programme and the path towards the Single Market

The *Annual Report for 1988* featured a new section entitled "The Single European Market and the Greek economy", indicating the Bank's and the Greek government's attention to developments leading up to the completion of the Single Market in 1992. The Report noted that the process of European economic unification had accelerated and deepened, a development that would be to the benefit of consumers, but at the same time entailed risks "for countries like Greece, which [were] experiencing serious economic imbalances. […] Moreover, the establishment of a single European market by the end of 1992 represents a challenge for the less developed members of the Community", given that "all trade barriers set up to protect domestic markets against foreign competition [would] have been abolished".[58] The Report identified a need for closer cooperation and coordination of economic and monetary policies among Member States, while special mention was made to the (Delors) Committee for the Study of Economic and Monetary Union. Its proposals would "be discussed at the European Council's meeting next June [...] however … there are limited possibilities for conducting an independent monetary policy [especially as regards interest rates], even in countries like Greece which do not yet participate in the exchange rate mechanism of the European Monetary System".[59]

57 *Annual Report for the year 1982.*

58 *Annual Report for the year 1988.*

59 Ibid.

Further below, D. Chalikias referred to the North-South divide in Europe, the opportunities opened up by EMU participation, but also the risks entailed if the country failed to seize these opportunities. As he pointed out, "it would be incorrect to assume that potential risks [...] can be dealt with by the transfer of resources from the richer to the less developed countries", while "if Community resources were used mainly to sustain a higher level of consumption [rather than to complement domestic savings], the country would fail to reap the benefits from the integration of the European market".[60] This far-sighted warning went rather unheeded by Greek governments in the next decades.

In the meantime, the relatively successful implementation of the stabilisation programme in 1985-1987 had started to bear fruit: GDP growth had been 3.5% in 1988, which "set a new record for the eighties, [while] as a proportion of GDP, the current account deficit in 1988 fell to its lowest level in the last twenty-five years and was financed by autonomous private capital flows". Output grew by 6% in the primary sector and by 5% in the secondary sector (manufacturing 5%, construction 7.3%), compared with a mere 2.1% in the tertiary sector. Moreover, private consumption increased by 6.4% (as a result of a 4.4% increase in real wages, following a cumulative contraction of 11.4% during the period 1986-1987) and private investment picked up by 10.5%, while private savings came to 12.8% of GDP (up from 11% year-on-year).[61]

The Governor concluded that "developments in production and investment are generally satisfactory", while "progress is being made towards the necessary structural adjustments, [...] "though not at the pace needed if the country is to weather the keener competition that is bound to develop as the Community advances towards economic integration". On the other hand, the faster increase in wages had been pushing up production costs, leading to discouraging developments in inflation, which decelerated at a much slower pace than the targets set. Another factor that contributed to this development was low and stagnant productivity.

Moreover, after two years of contraction, the public sector borrowing requirement had shown an upward trend, standing "at a level which could prove to be a source of economic instability": following the replacement of C. Simitis by P. Roumeliotis, the stabilisation programme was seen as completed and economic policy relaxed. The Report stressed that "if the economy was led into a new phase of instability, it would run a serious risk of entering a prolonged period of stagflation [similar to that experienced after the second oil crisis]; hence the imperative need for

60 Ibid.

61 Ibid.

fiscal discipline and prudent monetary and incomes policies". In other words, a relaxation of discipline would cancel the efforts and sacrifices made in 1986-1987, and the economy would backtrack to the situation prevailing before the devaluations.

6.7 The collapse of the Bank of Crete

Meanwhile, the country had plunged into a deep political crisis due to the Prime Minister's illness and absence abroad. During this power vacuum, the Bank of Crete collapsed: on 8.7.1988 the Governor of the Bank of Greece, D. Chalikias, sent a letter to the Minister of National Economy, P. Roumeliotis, requesting the lifting of banking secrecy on the accounts of the Bank of Crete. On 19.10.1988, by Governor's Act no. 1375, Spyros Papadatos, a senior Bank of Greece official, was appointed Temporary Commissioner at the bank. After his sudden death on 23.12.1988, he was succeeded by another Bank of Greece official, Ioannis Kamaras, under Governor's Act 1416/23.12.1988. The president of the Bank of Crete, Georgios Koskotas, who had been indicted on 20.10.1988, fled abroad, was arrested one month later in the Unites States and was extradited to Greece.

On that matter, D. Chalikias stated in his Report for 1988: "For being able to effectively supervise the country's banking system, the Bank of Greece must have full freedom of action. Most importantly, it is necessary to lift the secrecy of deposits against the Bank of Greece and its inspectors [...]. This gap is being addressed by a recent[62] draft amendment to legislation,[63] to the effect that deposit secrecy shall no longer apply to the Bank of Greece in the performance of its tasks". Next, defending the Bank against those who had accused it of inadequate banking supervision, particularly in the case of the Bank of Crete in the 1985-1988 period, he pointed out that: "the regular inspections at the Bank of Crete in 1987 did not identify, and actually could not have identified, any embezzlement or other unlawful acts, as our inspectors were not granted access to the personal bank accounts in drachmas and in foreign currency of the then President of that credit institution or to the sight accounts of the companies controlled by the Bank of Crete and its President at the time. Similar insurmountable obstacles had been encountered during the extraordinary on-site inspection at the Bank of Crete carried out by our inspectors during the four months from 20.6.1988 to 19.10.1988, when a Temporary Commissioner was appointed. Once again, the

62 The Report was presented at the Annual General Meeting of Shareholders on 26.4.1989.

63 The amendment was submitted on 13.4.1989 by the Ministers of National Economy, Finance, Justice, and Trade, and modified Article 40 of Law 1806/1988 (Government Gazette A 207/20.9.1988), which had been enacted by Parliament in early August of the same year.

embezzlements that had been committed were not identified, nor could have been identified, due to deposit secrecy". The Governor then set out the proposals of the Bank of Greece for enhancing its supervisory tasks, in line with practices followed by "countries with developed financial systems" and, putting the blame for the Bank of Crete crisis on the government, added that: "The Bank of Greece had recommended to the Government these legislative measures as early as in early 1988".

While the Bank of Crete case continued to make the headlines, the Bank of Greece, given its role as banking supervisor, was taking steps to ensure a smooth winding-up process. At General Council meeting no. 11/89 of 28.6.1989, two decisions were made. First, to provide credit of 25 billion drachmas to the Bank of Crete. As stated in the decision,[64] "Under Law 1858/1989 [...], Article 11(8), an amount of 25,000,000,000 drachmas out of the total credit granted by the Bank of Greece to the Bank of Crete pursuant to earlier legislation (Article 39 of Law 1828/1989) shall be converted into a loan with a maturity of 12 years at an interest rate of 5% per annum and a 5-year grace period, during which no interest shall accrue. It should be noted that the above financing to the Bank of Crete exceeds one-tenth of the paid-up capital of the Bank of Greece (Article 56 paragraph 10 of the Statute)".

The second decision concerned the Bank of Crete's request for a modification of an earlier credit agreement. Specifically, as stated in the decision of the General Council,[65] by "document no. 507/26.6.1989 of the Bank of Crete, [...] the bank in question, with reference to the credit it had received from the Bank of Greece on 1.6.1989 under Law 1858/1989, for an amount of 25 billion [drachmas] at an interest rate of 5% per annum, requested that the same rate (5%) be also applied to the period prior to the entry into force of that credit agreement, i.e. until 31.5.1989. It should be noted that, for the period between the appointment of a Temporary Commissioner at the Bank of Crete on 19.10.1988 and the entry into force of Law 1858/1989, the debit balance of the Bank of Crete's current account with the Bank of Greece (part of which is being converted into a loan) is not subject to the high interest rates applicable on current account debit balances, but instead to an interest rate of 14.5% per annum as determined by the Administration of the Bank of Greece, and that interest accrued in the period up to 31.12.1988 has already been collected".

The Bank of Crete case was closed six and a half years later (see Section 6.15 below).

64 Decision of the General Council, 11th meeting, 28.6.1989, paragraph 8.

65 Ibid., paragraph 9.

6.8 Political instability and economic uncertainty

The general election held on 18.6.1989, in a polarised political climate, removed PASOK from power and led to a hung parliament. Previously, in anticipation of an election as its four-year term was coming to a close, the government had relaxed further its incomes policy and promised even more generous spending. At a pre-election rally at Peristeri, Attica, Prime Minister Andreas Papandreou came up with a phrase that caught up as a slogan, urging his Finance Minister Dimitris Tsovolas to dole everything out.

With the formation of a government still pending, at the crucial EEC Summit in Madrid in June 1989 Greece was represented by the President of the Republic, Christos Sartzetakis. The Madrid Summit, "accepting the 'Delors Report' as a useful basis for further work on EMU, decided in June 1989 to begin the process of creating a single currency with the first stage starting on 1 July 1990".[66] While in Eastern Europe the communist regimes were collapsing one after another,[67] a coalition government under Tzannis Tzannetakis was formed in Greece on 2.7.1989, by New Democracy and the Coalition of the Left and Progress (Synaspismos, comprising the Communist Party of Greece (KKE), and the Greek Left (EAR), and pledged a purge against corruption. A new election was held on 5.11.1989, again resulting in a hung parliament. Eighteen days after the election, the three largest parties formed an all-party government under the premiership of Xenophon Zolotas, former Governor of the Bank of Greece. The Zolotas government, after a radical cabinet reshuffle on 13.2.1990 (turning it into a caretaker government), held a third election on 8.4.1990, which brought New Democracy to power.

At the Annual Meeting of Shareholders on 30.4.1990, D. Chalikias presented his Report for the year 1989, starting with a harsh, aphoristic assessment: "The main feature of economic developments in 1989 was a reversal of the improvement in economic fundamentals which followed the 1986-1987 stabilisation programme, while economic imbalances worsened sharply. A particularly unfavourable development was the further increase in the public sector deficit and the public debt. At the same time, the balance of payments deteriorated".

66 European Commission, "The third attempt to create EMU (1989)" (http://ec.europa.eu/economy_finance/emu_history/history/part_a_2_c.htm)

67 On 7.10.1989, the Communist Party of Hungary was renamed Socialist Party; on 16-20.10.1989, the Hungarian Parliament adopted a multi-party system; on 9.11.1989, the authorities of the German Democratic Republic lifted border controls across the Berlin Wall; on 28.11.1989, the Czechoslovak Communist Party stepped down and the one-party regime ended.

Regarding the factors behind these developments, the Governor noted: "To a significant extent, the worsening of economic imbalances was due to the expansionary fiscal and incomes policies pursued since the beginning of 1988. In particular, increasing public expenditure and tax evasion, tax reliefs and rapidly rising real incomes led to an overheated economy and, through it, to an increase in inflationary pressures as well as a widening of the current account deficit".[68]

According to the Governor, the outlook was gloomy: "The economy is again entering a phase of stagflation. This time, however, the public sector deficit is larger. The public debt —both domestic and foreign— is also greater, and obligations for servicing it will be heavier. [...] Fiscal policy contributed to a sharp increase in the public sector deficit as a proportion of GDP in 1988-1989, while in the previous two years it had helped reduce it". Specifically, the net PSBR, on a cash basis, after declining from 18% of GDP to 13.5% of GDP between 1985 and 1987, had risen again to 16% of GDP in 1988 and to 18.1% of GDP in 1989 – and could actually have been one percentage point higher than that, taking into account that sizeable budget outlays were deferred to 1990 and Community fund transfers for 1989 were disbursed in 1990.[69] Moreover, in 1988 and 1989, real wages rose by 6.4% and 5.3%, while labour productivity increased by only 3% and 2%, respectively. In the same two years, aggregate consumer spending grew by 4.6% and 5.1%, leading to an increase in the current account deficit, i.e. a rise in imports rather than in domestic output. Obviously, the stabilisation gains had been wiped out, and the economy was back to the state it was five years earlier.

Moreover, inflation, which had started to pick up since mid-1988, increased further, with the consumer price index (CPI) rising by 14% and 14.5% in 1988 and 1989, respectively. As mentioned in the Report: "The government that took office after last November's elections [i.e. the Zolotas government] raised the prices of certain goods and services supplied by public enterprises, abolished some state subsidies, and increased a number of indirect taxes. Inevitably, the consumer price index rose faster". Yet, the Governor added that those decisions "have positive effects to the extent that they help contain inflationary pressures by reducing the public sector deficit".[70]

68 *Annual Report for the year 1989.*

69 Ibid.

70 Ibid.

6.9 Trading with Eastern Europe

The Bank of Greece had long supported Greek exports to the USSR and other Eastern Bloc countries that were under communist rule until 1989. The minutes of the General Council of the Bank of Greece include many decisions related to the extension of credit for trade with those countries. Two examples, although not very typical, are the following.

The first decision, referred to in the agenda of the General Council meeting no. 15/91 of 29.8.1991 (paragraph 4), concerns a deposit of US dollars 100 million by the Bank of Greece with the National Bank of Greece for the extension of trade credit in foreign currency to the Soviet Union. Such credit would have a maturity of six months, renewable for up to three years, and would be LIBOR-based and disbursable as a lump sum or in tranches within the six-month period. The decision was taken one week after the failed Soviet coup of 19-21.8.1991 that led to the dissolution of the Soviet Union just four months later, on 25.12.1991.

Under the second decision, referred to in the agenda of General Council meeting no. 8/93 of 18.5.1993 (paragraphs 5-6), US.dollars 40 million would be deposited by the Bank of Greece with the National Bank of Greece to finance a credit facility to the Bank of Foreign Economic Affairs of the USSR, Moscow (Vneshekonombank or VEB). This decision, which was amended two months later[71] reducing the amount to US dollars 37,404,237.43, confirmed that, after the dismantling of the USSR, Greece's trade relations with the successor states were not discontinued, as well as that trade relations remained under the management of traditional Soviet-era institutions such as the VEB, which later evolved into a Russian government-owned bank. These decisions of the General Council were made in the wake of the dissolution of the USSR. As part of the Bank's effort to mitigate its negative consequences, the General Council adopted decision no. 24/93 of 28.12.1993 (paragraph 37) regarding the provision of "financial support to ethnic Greeks repatriated from the former Soviet Union".

6.10 Adverse trends and deterioration

The economic situation was getting worse and worse: in the *Annual Report for 1990,* D. Chalikias noted that "the unfavourable trends [...] continued into 1990, causing a further deterioration of macroeconomic imbalances. The dominant features of economic developments were a high public deficit combined with an upsurge

71 General Council agenda no. 15/93 of 22.7.1993, paragraphs 6-7.

of inflation, a further widening of the current account deficit and a decline in GDP". The Governor considered that exogenous factors were "only partly" responsible for these adverse developments, which he clearly ascribed to endogenous factors: "The unfavourable economic developments were mainly due to serious structural weaknesses, inflationary pressures built up over a number of years as a result of the large public deficits and the increase in liquidity and nominal income, as well as the substantial deterioration of competitiveness".[72]

D. Chalikias gave credit to the New Democracy government ("in April 1990, economic policy started becoming progressively tighter"), but thought that this tightening had not been bold enough ("adjustments were insufficient to reverse the deterioration").[73] He was more specific: the net PSBR on a cash basis rose from 18.3% to 19% of GDP, inflation rose sharply from 14.8% to 17.9% (which was partly attributable to higher taxes and public utility rates), while unit labour costs in manufacturing increased by about 21% (i.e. same as in 1988 and 1989). The current account deficit widened considerably, from US dollars 2.57 billion in 1989 to US dollars 3.56 billion in 1990. Against this background, the Greek economy entered a phase of economic downturn: "The rate of economic growth began to decelerate in the first half of 1989 and became negative in the course of 1990. GDP at constant prices declined by 0.4 per cent in 1990".[74] Consumption growth slowed: from 3.6% to 2% for the private sector and from 4.3% to 0.4% for the public sector. By contrast, the growth of private investment, including residential investment, remained strong and broadly unchanged from the past two years, mainly on account of inflationary expectations and households' efforts to hedge against inflation. It should be noted that the previous twelve months had seen mounting expectations of a currency devaluation: "There are signs that, since the second half of 1990, a number of firms have been trying to get rid of the large stocks of goods accumulated in 1989 and early 1990, when speculation about a drachma devaluation was widespread".[75]

Furthermore, "the deterioration of the balance of payments, which had started in the spring of 1989, continued at a faster pace […]. The current account deficit had already reached US dollars 2,502 million in the first four months of 1990, compared with US dollars 884 million in the corresponding period of 1989", while for the year as a whole it was 38% higher than in 1989.[76]

72 *Annual Report for the year 1990.* Regarding competitiveness, see Leventakis (1995), as well as Moschos and Stournaras (1993).

73 *Annual Report for the year 1990.*

74 Ibid.

75 Ibid.

76 Ibid.

While the services sector continued to expand, the output of goods fell considerably behind, accompanied by declines in the output of the primary sector and of manufacturing. These developments were a cause of concern for the Bank of Greece, which pointed out that "for the most part, it reflects the growing difficulties faced by the manufacturing sector in coping [with foreign competition and import penetration]" and that "the substantial improvement in agricultural income in the last ten years has been largely due to subsidies".[77]

The Governor sounded the alarm with regard to the stabilisation programme announced by the New Democracy government in April 1990, noting that "the public deficit remains at a level without precedent in peacetime", and reminded that "the state budget includes additional revenue of 300 billion drachmas from the sale of ailing firms, mortgage bonds and public utility shares", while "the budget provides for a reduction in the deficits of public enterprises and organisations". According to budget forecasts, if all measures were fully implemented, the net PSBR would fall from 19% of GDP in 1990 to 13% of GDP in 1991.[78]

D. Chalikias concluded that "the implementation of the economic stabilisation programme and the unfavourable international economic environment are expected to have a strong impact on economic activity [in 1991 as well]". This would be the last *Annual Report* submitted by D. Chalikias, before he was succeeded by Efthymios Christodoulou on 20.2.1992.

6.11 New tasks, organisational structure and adjustment to European standards: General Council decisions in 1982-1995

The Bank of Greece has repeatedly revised its internal structure and reallocated or expanded the tasks of its units, often renaming them accordingly. The changes are far too many to list in an exhaustive manner, but we could selectively mention some General Council decisions.

Decision no. 13/82 of 20.5.1982: abolition of the Administration Offices Department and transfer of its responsibilities to the Administration Department;

Decision no. 7/88 of 9.6.1988: establishment of an Art Conservation and Greek Numismatic Collection Service;

Decision no. 17/92 of 16.9.1992: abolition of the Credit Department and establishment of a Studies Office within the Government Financial Operations and Accounts Department;

77 Ibid.

78 Ibid.

Decision no. 4/94 of 16.3.1994: restructuring of the Economic Research Department, establishment of a Balance of Payments Statistics Division, establishment of a new Book-Entry Securities Management Section within the Public Sector Accounts Department, and restructuring of the Banking Supervision Department;

Decision no. 13/94 of 2.12.1994: installation of an IT interconnection at the Banking Supervision Department and linking of the Legal Department with the NOMOS Database;

Decision no. 8/95 of 24.5.1995: execution by the Bank of Greece of operations under Law 2198/1994 on book-entry securities;

Decision no. 9/95 of 27.6.1995: participation of the Bank of Greece in the interbank payment system DIAS S.A.

Moreover, the accession of Greece to the European Communities, the transformation of these Communities into the European Union, the deepening of the Union, and the process for the establishment of the euro area are key developments which are reflected in the General Council meeting agendas.[79]

On 24.1.1986 the General Council decided to open accounts in Spanish pesetas and Portuguese escudos, following the accession of the two Iberian countries to the EC, while on 7.10.1988 it approved the costs for a meeting entitled 'Coordination of economic policies and the prospects of the European Monetary Union', to be held in Athens in the context of the Greek Presidency of the EEC".[80]

6.12 The long road to Economic and Monetary Union

In his first Report, Governor Efthymios Christodoulou criticised in strong terms PASOK's economic governance: "The 1980s were characterised by high inflation, which averaged 19.4 per cent, and a low average [GDP] growth rate of 1.7 per cent. During the same period, the country faced serious balance of payments problems that brought it to the brink of a foreign exchange crisis in 1985, and again at the end of 1989 and the beginning of 1990. The economy's performance was largely due to

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79 In this respect, it is also worth noting the interest-free loans extended by the Bank of Greece to the Greek State to finance its participation in European institutions. For instance: General Council agenda no. 4/85 of 11.2.1985: for the European Investment Bank (EIB), the European Coal and Steel Community (ECSC) and the European Atomic Energy Community (Euratom), a total amount of almost ECU 40 million for the period 1981-1984; General Council agenda no. 2/87 of 4.2.1987: for the EIB, 1.364 billion drachmas (or roughly ECU 10.974 million) for 1985 and 1986; General Council agenda no. 3/88 of 4.3.1988: for the EIB, ECU 4.734 million for 1987, and so on.

80 This was the second time that Greece took over the presidency of the Council of the European Communities, during the second half (July-December) of that year, which culminated with the European Council held in Rhodes (2-3.12.1988).

the economic policies pursued over most of the period. The efforts made from time to time, and especially during the 1986-1987 economic stabilisation programme, were short-lived and inadequate [...]. As a result of the economic policies pursued, the economy's performance diverged instead of converging towards that of our EC partners".[81] Furthermore, E. Christodoulou pointed out the sharp rise in public debt from 32.8% of GDP in 1981 to 98.3% in 1991.

The Report extensively discussed the stages of Economic and Monetary Union and the steps that Greece was required to take in order to participate in EMU, detailing the so-called Maastricht criteria. On the one hand, Governor Christodoulou concluded that "the extent of the fiscal adjustment needed in our country is still considerable and time is running out". On the other hand, he warned that "in an economy like Greece the process of reversing trends and establishing the preconditions for a move in the desired direction is initially slow, but accelerates when the structural adjustment measures already taken, such as those designed to improve the tax system and promote privatisation, begin to yield results".[82]

One year later, in the *Annual Report for 1992*, the Governor's assessment was that "three years of concerted efforts to stabilise the economy have resulted in encouraging signs of recovery and have opened up positive prospects […], despite adverse conditions in the world economy. [...] The deregulation of the banking system […] and the liberalisation of capital movements are gaining momentum. Major infrastructure projects are under way, partly with the help of financial resources supplied by the European Community, which are expected to increase substantially over the coming years. [...] Nevertheless, the central goals of economic policy —a drastic reduction in inflation and a satisfactory and sustainable rate of economic growth— are still out of reach. Serious problems associated with the structure of production, the lack of modern infrastructure, the educational system, the social security system, the labour market and the inefficiencies of public administration remain unresolved".[83]

Furthermore, the Governor referred to the EMS crisis in 1992, "the worst in the system's history, with the withdrawal of two national currencies from the exchange rate mechanism (ERM) in September 1992 and with four central rate realignments over a period of five months. Uncertainty regarding progress towards EMU [...] released underlying pressures in the markets which, as a result of favourable expectations […], had been contained earlier". The crisis affected Greece as well:

81 *Annual Report for the year 1991.*

82 Ibid.

83 *Annual Report for the year 1992.*

"It has had a direct and strong impact on the balance of payments, particularly on capital movements, and it has also had indirect consequences due to the need to adjust monetary policy so that it can cope with pressures in the foreign exchange market".[84] The attacks against the drachma, similar to those that would follow in May 1994, were decisively addressed by the Bank of Greece under Christodoulou's governorship.

As far as Greece was concerned, the Report admitted that the targets had been missed: "The mitigation of the economic imbalances […] was not consistent with initial forecasts", while "the curtailment of fiscal deficits was only partly the outcome of measures to consolidate the public sector" and had largely been achieved "by means of additional taxes and higher contributions to social insurance funds. This, however, caused an acceleration of the rise in the consumer price index, [...] with the result that inflation was eventually not reduced to the initially forecast level".[85]

According to data provided further below in the Report, the consumer price index declined from 22.9% in 1990 and 18% in 1991 to 14.4% in 1992, while the rate of increase in unit labour costs in the non-agricultural sector moderated, respectively, from 19.2% and 13.6% to 11.9%. Still, annual consumer price inflation remained almost four times the Community average (15.8% compared with 4.3%). The Report underlined that "if Greece is to participate in EMU, however, domestic inflation must not exceed by more than 1.5 percentage points the average rate in the three EC countries with the lowest inflation, which was 2.4 per cent in 1992", adding the assessment and warning that "prospects are favourable, provided that the economic policy announced by the government is implemented".[86]

The Governor discussed developments in the current account deficit, which "widened significantly and reached US dollars 2,081 million from US dollars 1,520 million in 1991. Half of this increase (US dollars 234 million), however, concerned arrears of interest on Ministry of National Defence loans [...]. If these interest payments are spread over the years in which they should have been made, the current account deficit falls to US dollars 1,847 million in 1992 and rises to US dollars 1,622 million in 1991".[87] Further below, the Report stated that "the Bank of Greece has started the restructuring of the balance of payments collection system, in order to improve both the coverage and reliability of statistical information in this field,

84 Ibid.

85 Ibid.

86 Ibid.

87 Ibid.

which has been adversely affected by the completion of the single market and the liberalisation of capital movements".[88]

Regarding Greece's transition to Stage III of EMU, the Bank of Greece noted: "A major question concerning the balance of payments is whether the current account deficit is likely to be restrained in the medium and long run at roughly 2 per cent of GDP and be financed by inflows of non-debt-creating private capital, in order to prevent a further rise in the country's foreign debt. Experience gained during the last two and earlier years has shown that, under normal circumstances, the financing of a deficit of this size is feasible. Doubts arise, however, as to whether it is possible in the medium and long run to contain the current account deficit at this level, given that the growth of the Greek economy must be both faster than at present as well as relative to the other EC economies, if the required convergence of living standards is to be achieved".[89] The appropriate policy would be to raise investment in infrastructure, although the trade deficit would increase during the period of adjustment of the economy's production base, as capital goods would be predominantly imported and export performance was not expected to improve soon. The solution seen by the Administration of the Bank of Greece lay in the absorption of transfers from the European Community over the next five years, when "the contribution of the EC structural funds in the context of the second Delors package is expected to be particularly large".[90]

On a positive note, "the government budget for 1992 left a primary surplus of 253 billion drachmas", mainly as a result of the containment of primary expenditure under the ordinary budget and a fast increase in revenue (which, despite the positive effect of proceeds from the sale of the Heracles Cement Company and the mobile telephone concession, still fell 130 billion drachmas short of the budgeted amount).[91]

Six months later, the Mitsotakis government resigned, having lost its parliamentary majority. The election that followed on 10.10.1993 was won by PASOK, which again formed a government under Andreas Papandreou. On 1.12.1993, the new government appointed Ioannis Boutos as Governor of the Bank of Greece and Lucas Papademos and Evangelos Kourakos as Deputy Governors (the latter was reinstated as Deputy Governor after approximately eight years).

88 Ibid.

89 Ibid.

90 Ibid.

91 Ibid.

6.13 Strengthening the balance sheet of the Bank of Greece and safeguarding its financial independence

The last meeting of the General Council for 1993, held on 28 December, was of particular importance. The main agenda item was the "Settlement of claims by the Bank of Greece on the Greek State ahead of the start of Stage II of EMU". As evidenced by the relevant decision of General Council meeting no. 24/93: "In view of the start of Stage II of EMU on 1.1.1994, certain claims of the Bank of Greece on the Greek State must be settled, such as those arising from the current accounts of the Greek State with the Bank of Greece. Such claims must be converted into long-term loans or bonds, subject to specific terms as to the applicable interest rate and repayment schedule". As clarified, "the settlement must be carried out in accordance with Articles 104 and 109e of the Treaty on European Union and the Council Regulation specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(1) of the Treaty establishing the European Community".[92]

This settlement referred to the balances of three accounts held by the Greek State with the Bank of Greece (the oil products account, the foreign exchange valuation differences account and the centralised receipts and payments account), totalling 3.1 trillion drachmas. As a result of this settlement, public debt rose from 87.8% of GDP at the end of 1992 to 110.1% of GDP on 31.12.1993, or from 93.3% to 119.6% according to data available at the time (see Table 1.3 in Annex 1, as well as Section 6.14 below). The importance of the settlement lay in the fact that it increased transparency about the level of public debt, while at the same time it helped to strengthen the Bank's balance sheet and safeguard its financial independence, as required for the country's path towards EMU. For the Bank of Greece in particular, the settlement was necessary to ensure compliance with the prohibition of any measure establishing privileged access by the Greek State to financial institutions from 1.1.1994, as required by Article 104a of the Maastricht Treaty for all EU Member States.

This General Council decision was made after about one-year-long negotiations with the Ministry of Finance.

6.14 Gradual recovery of lost ground, and the attack against the drachma

On 27.4.1994, the new Governor, Ioannis Boutos, presented his first *Annual Report for the year 1993* (which would be also his last *Annual Report*), in which he

92 General Council agenda no. 24/93 of 28.12.1993, paragraphs 5-5a.

expressed strong criticism in all directions: "In 1993, […] some basic economic aggregates deviated from the targets set at the beginning of the year. Deviations from targets occurred in public sector deficits and the public debt, the deceleration of inflation and the rate of economic growth, resulting in a worsening of the overall economic situation". Elaborating on this, the Governor noted that "the substantial widening of the PSBR is mainly due to the shortfall in tax revenue", which "for 1993 is estimated at 980 billion drachmas. [...] These deviations are partly due to the general elections, which had an unfavourable effect on public revenue and contributed to the increase in outlays [which overshot forecasts by 325 billion drachmas], owing to the rise in pre-election grants".[93]

The most dramatic developments referred to public debt: "The public debt rose to 119.6 per cent of GDP at the end of 1993 (from 93.3 per cent in 1992), also because the following extra items are included in its definition: (a) Claims of the Bank of Greece on the government, regarding the total balance of the three government accounts with the bank: i) the current receipts and payments account, ii) the oil products account, and iii) foreign exchange valuation differences, which were converted on 31st December 1993 into 30-year loans to the government; (b) Bond issues through which the government rescheduled the accumulated debts of the Agricultural Bank and the National Mortgage Bank and increased the capital of the Hellenic Industrial Development Bank (ETBA). Under the prevailing economic conditions of high real interest rates and slow rate of growth, the worsening of fiscal deficits and the increase in public debt in 1993 make particularly difficult the stabilisation of the public debt as a percentage of GDP and disrupt the implementation of the convergence programme of the Greek economy towards the economies of the EU member states".[94]

As a result of these developments, total credit expansion had accelerated, reaching 13.2% in 1993, compared with a targeted 6%-8% (and an outcome of 11.6% in 1992). Broad money (M3) grew by 15.2% in 1993, compared with a targeted rate of 9%-12% (and an outcome of 14.4% in 1992). GDP at constant prices declined by 1.6% in 1993, against a targeted increase of 2% (and a small increase of 0.9% in 1992).

The Governor's assessment was that "the efforts made to stabilise and adjust the Greek economy in recent years had limited and —as regards certain aggregates— only temporary results. The progress made [...] not only proved inadequate [...], but was also reversed in the crucial field of fiscal adjustment, which was the central goal

93 *Annual Report for the year 1993.*

94 Ibid.

of the 1990-1993 economic stabilisation programme. As a result, Greece's participation in the process of European economic and monetary unification is becoming increasingly difficult". Noting that all those factors fed each other into a vicious circle, which could only be broken by drastically reducing public deficits, the Governor warned that "without such a drastic reduction, economic stabilisation, which is a prerequisite for the country to get out of the economic crisis, is impossible".

Turning to the goals of the new PASOK government, as reflected in its budget for 1994, namely disinflation and deficit-to-GDP ratio reduction, I. Boutos noted that a stabilisation of the deficit ratio would require large primary surpluses, which in turn necessitated a long-term policy effort. In view of the severity of accumulated structural problems, only a new and credible medium-term fiscal consolidation programme would serve the purpose. The measures taken by the new government were "merely a first step", according to Governor Boutos.[95]

Six months later, on 26.10.1994, Lucas Papademos was appointed Governor. In his first *Annual Report,* in April 1995, he noted the progress that had been achieved towards stabilisation, while stressing the need to effectively tackle a number of long-standing structural weaknesses in order to meet the main targets of economic policy: "The year 1994 was marked by notable progress towards the stabilisation of the Greek economy. The annual rate of inflation fell to 10.9 per cent from 14.4 per cent in 1993. The public deficit, on a cash basis, was reduced to 11.7 per cent of GDP from 13.4 per cent in 1993. The balance on current account improved significantly, with the deficit falling to the historically low level of US dollars 127 million, while foreign exchange reserves, including gold, rose to US dollars 15.4 billion at the end of 1994, compared with US dollars 8.7 billion at the end of 1993. The intermediate monetary policy targets were attained: monetary expansion fell to 8.3 per cent in 1994 from 15 per cent in 1993, […] while the rate of depreciation of the drachma against the ECU was contained to 5.6 per cent during the year, despite the monetary turmoil in May 1994. Finally, economic activity showed a limited recovery, notwithstanding the anti-inflationary policy stance. These positive results have contributed to boosting confidence and increasing the credibility of economic and monetary policies".[96] Further below, Lucas Papademos stressed that "favourable economic developments in 1994 […] should lead neither to complacency nor to the conclusion that sustainable stabilisation trends and the prerequisites for steady economic

95 Ibid., p. 18 for the data and pp. 19-20 for the criticism.

96 *Annual Report for the year 1994.* As mentioned in a footnote (p. 31), "… employees' average pre-tax earnings declined, in real terms, by about 9 per cent between 1990 and 1993 and their average disposable income by 10-11 per cent. By contrast, in 1994 real earnings increased by 1.5 per cent and disposable income by about 0.5 per cent".

growth have already been established. […] In spite of the progress that has been made, the structural problems of the Greek economy —fiscal imbalances and low productivity— have not yet been resolved and are not going to be tackled effectively unless radical reforms are introduced that will affect the size and functioning of the public sector, as well as the organisation of markets and production. The gap between the present state of the economy and the main economic policy objectives, namely fast growth and monetary stability, is still wide".[97]

In addition, he mentioned that "despite the significant fiscal adjustment of central government, the deficits of many public entities and enterprises widened appreciably" and that "investment activity […] fell short of the growth rate required for a substantial broadening of the production base, while unemployment, particularly among the young, remained at a high level, threatening to become a serious economic and social problem", and added that "these observations do not call into question the notable progress made. They underscore, however, the imperative need to keep up, persistently and systematically, the effort leading to the stabilisation and recovery of the economy. Furthermore, they imply that, for this effort to succeed, it is important to take structural measures aimed at fiscal consolidation, enhancing productivity and combating unemployment".[98]

The Governor pointed out that "in Greece, as in the other countries of the European Union, the main objectives of economic policy have to be achieved in the context of the process leading towards European economic and monetary integration". He referred to the goals, criteria and timetable set out in the Treaty on European Union, adding the caveat that economic developments and prospects in Greece inevitably hinged upon the international economic environment. Lucas Papademos highlighted the importance of real convergence: "Along with the establishment of stability, however, it is essential to promote, over the coming years, the real convergence of the Greek economy towards the economies of the other EU Member States. The attainment of real as well as nominal convergence constitutes a challenge for economic policy. It is, however, essential, not only because a rise in living standards is important to the welfare of the nation, but also because sustainable economic growth will contribute towards resolving the problems of public deficits and unemployment more effectively as well as towards reducing inflationary pressures".[99]

A very important document, endorsed by the ECOFIN in September 1994, was the revised Economic Convergence Programme 1994-1999, prepared by the Mini-

97 Ibid.

98 Ibid.

99 Ibid.

stry of National Economy in summer 1994 (when Y. Stournaras was head of its Council of Economic Advisers). The revised programme set out the economic policy objectives and framework for achieving the convergence criteria laid down in the Maastricht Treaty. As noted in a separate section of the Governor's *Annual Report,* entitled "Convergence of the Greek economy", the Convergence Programme aimed at "reducing the general government deficit from 13.2 per cent of GDP in 1994 [...] to about 1 per cent in 1999" and provided for the "stabilisation of public debt as a percentage of GDP in 1996 and its gradual reduction to 103 per cent of GDP by 1999. [...] To attain these fiscal targets, it will be necessary to achieve substantial primary surpluses in the government budget during the implementation of the Programme. Specifically, the primary surplus of the government budget is expected to rise gradually from 2 per cent of GDP in 1994 to about 6 per cent in 1999. This will require continuous efforts to increase revenue, chiefly by expanding the tax base and curbing tax evasion, and to stabilise primary expenditure as a percentage of GDP". And the Report concluded that: "Unless tax evasion is curbed, it will be difficult to achieve a sustainable improvement in fiscal aggregates and a more equitable distribution of the tax burden. Along with the efforts on the tax revenue front, it is also necessary to continue the process of rationalising public expenditure and improving the efficiency and quality of public administration".[100]

Regarding the role of the Bank of Greece in the effort to stabilise the Greek economy, Lucas Papademos stressed: "A significant part of the burden of attaining the inflation targets, particularly in the years immediately after the implementation of the programme, will be borne by monetary policy. A tight monetary policy is necessary in order to support a slow depreciation of the drachma, at rates not fully accommodating inflation differentials between Greece and its trading partners, which is an essential element of the convergence strategy. As in recent years, non-accommodating exchange rate policy is aimed at mitigating inflationary pressures and expectations and, more generally, at fostering economic discipline, with a favourable impact on the behaviour of market participants and, consequently, on production cost and prices".[101]

The Report discussed in detail the speculative attack on the drachma in May 1994 and its successful handling by the Bank of Greece: "After May 10 [...] strong pressu-

100 Ibid. As mentioned in a footnote, "Although at the end of the implementation period of the Convergence Programme, the government debt-to-GDP ratio will be higher than the reference value (60%) specified in the relevant Protocol annexed to the Treaty, it can be argued that this target is in line with the fiscal sustainability criterion, given that, under Article 104c of the Treaty, compliance with budgetary discipline is examined on the basis of whether the ratio of government debt to gross domestic product exceeds a reference value, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace".

101 Ibid.

res began to build up on the foreign exchange market […], leading to the loss of a substantial amount of foreign exchange reserves. The principal cause [...] were expectations that the lifting of the remaining restrictions on short-term capital movements [in the EU countries], planned for July 1, 1994 would be accompanied by a change in the exchange rate policy and a sharp depreciation of the drachma. [...] To dampen expectations of a devaluation [...], the government and the Bank of Greece advanced the lifting of exchange controls on short-term capital movements to May 16, 1994. With the removal of these restrictions, the liberalisation of capital movements, which had started in 1993, was effectively completed. [...] The Bank of Greece intervened decisively, by means of substantial sales of foreign exchange, to weaken pressures in the foreign exchange market and support the drachma. It also intervened in the domestic money market in order to control the increased demand for drachmas by raising the cost of funds for those taking speculative positions. The Bank of Greece increased its basic rates on lending to the commercial banks. [...] Pressures [...] eased substantially by mid-June, and the Bank of Greece ceased to intervene with sales in the foreign exchange market. [...] At the same time, [...] market confidence in the Greek government's commitment to an open market policy was enhanced. As a result [...], capital repatriation started during the summer months. [...] In fact, December-on-December, the effective depreciation of the drachma in 1994 was contained to 5.3 per cent (1993: 7.8 per cent), while the rate of gradual depreciation against the ECU was 5.6 per cent, compared with 6.6 per cent in 1993".[102]

Summing up his assessment of economic developments and prospects, the Governor noted, among other things, the progress achieved, as well as the drag from past economic policy failures: "Despite the efforts made over the last ten years, the necessary conditions for fast growth combined with stability have not yet been established. The high public debt relative to gross domestic product reflects failures of economic policy in the past and, at the same time, it imposes strong constraints on the conduct of economic policy in the future. […] The recent progress and the favourable short-term prospects are partly the result of the policy pursued, which, however, […] reflect[s] […] market expectations that fiscal consolidation and economic restructuring will continue and will be accelerated in the years ahead. Should this expectation not be realised, the progress made will prove reversible and, in particular, the external balance fragile".[103]

Last but not least, particular emphasis was placed on the significance of fiscal adjustment for economic growth and on the need to complete fiscal consolidation. "The

102 Ibid.

103 Ibid.

size of the public debt and high interest rates entail large debt servicing costs which, if not offset by substantial primary state budget surpluses over the next few years, will lead to a vicious circle of high interest rates, high public deficits and growing debt, making it impossible to restore stable conditions and achieve steady growth. There is therefore no room for relaxing fiscal discipline without painful consequences for the economy. It must be realised that, given the extent of the fiscal imbalances, meeting demands for benefits that are incompatible with budget constraints may temporarily alleviate some social pressure, but shifts the relevant cost to the not-so-distant future".[104]

It should be noted that on 29.12.1994, Law 2275/1994 (Article 1) ratified the loan agreements signed on 31.12.1993 and on 6.7.1994 between the Greek State and the Bank of Greece, regarding (a) the conversion of claims of the Bank of Greece on the Greek State; and (b) the conversion of the balance of the foreign exchange valuation differences account under Law 1083/1980 into long-term interest-bearing loans to the Greek State.[105] The conversion of claims in case (a), which, as mentioned in Sections 6.13-6.14 above, brought about a sharp rise of 22-26 percentage points in public debt, was a prerequisite for the subsequent participation of the Bank of Greece in the Eurosystem.

In early 1995, the General Council approved the "Participation of the Bank of Greece in the capital of the European Monetary Institute" (the forerunner of the European Central Bank, which operated from 1.1.1994 until 1.6.1998, when the ECB was established).

6.15 The liquidation and resolution of the Bank of Crete

The Bank of Crete continued to be managed by a Bank of Greece commissioner since 1988 (see Section 6.7 above). The initially appointed commissioner, Ioannis Kamaras, was replaced by K. Kalyvianakis (Bank of Greece Governor's Act 2279/28.12.1993 issued by Governor I. Boutos), in turn succeeded by K. Georgakopoulos (Governor's Act 44/24.2.1995 issued by Governor L. Papademos).

Following the enactment of Law 2330 ("Provisions on the resolution of Bank of Crete S.A.") in August 1995, and in accordance with Article 6(1) of that law, the General Council approved on 29.12.1995 a loan from the Bank of Greece to the Bank of Crete,[106] along with a press release to be issued on 2.1.1996, which, among other things, stated the following:

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104 Ibid.

105 Ibid.

106 General Council agenda no. 13/95 of 29.12.1995, paragraph 2.

"On 1.1.1996 a new banking société anonyme by the name 'Bank of Crete S.A.' and with a share capital of 38.1 billion drachmas was established and authorised by the Bank of Greece. [...] The new bank was established in accordance with the provisions of Law 2330/1995 [...] by directly applicable decisions of the Bank of Greece (Governor's Acts 2377, 2378 and 2379/1.1.1996), a relevant decision by the Minister of Trade and two joint decisions issued by the Minister of National Economy, the Minister of Finance and the Governor of the Bank of Greece [...]. The Greek State participates in the share capital of the new bank with non-voting preference shares of a nominal value of 38 billion drachmas, while the participation of the 'former Bank of Crete under liquidation (Law 2330/1995)' consisted in common shares of a nominal value of 100 million drachmas. The establishment of the new bank marked the end of a long period of management by a commissioner". The same was reiterated by L. Papademos in his *Annual Report* to the General Meeting of Shareholders in April 1996, who added that "the capital restructuring of the former Bank of Crete was also completed" and that the decision to place the former Bank of Crete under liquidation and to set up a new banking société anonyme "has greatly enhanced the credibility of the banking system".[107] More specifically, Governor's Act 2377/1.1.1996 withdrew the authorisation of the "former" Bank of Crete S.A., placed it under liquidation and appointed K.G. Tsaltas as its liquidator, while Governor's Act 2378/1.1.1996 authorised the "new" Bank of Crete S.A.

The Bank of Crete crisis put the Bank of Greece to a test: the latter had to deal with a bank that had abused the freedoms available in the context of the new post-1987 deregulated banking landscape, thereby exposing the entire Greek banking sector to systemic risk. The Bank of Greece liquidity-providing intervention prevented a contagion of risks, while the split into a "good" and a "bad" bank, a common practice internationally implemented for the first time in Greece, and the subsequent privatisation of the "good" bank averted the worst and confirmed the Bank's role as lender of last resort in Greece.

6.16 The path towards nominal convergence

January 1996 was heavy in political developments, as Prime Minister A. Papandreou resigned due to health problems and was succeeded by Costas Simitis on 18.1.1996. Also, the Imia crisis between Greece and Turkey, which was triggered on 26.12.1995 when a Turkish ship ran aground on the uninhabited islet, peaked in late January.

107 *Annual Report for the year 1995.*

At the General Meeting of Shareholders of the Bank of Greece in April 1996, the Governor stated: "The key features of the Greek economy in 1995 were substantial progress towards stabilisation combined with faster economic growth, but also limited structural adjustment which did not allow dealing effectively with the deeper weaknesses of the economy".

While noting on the one hand that "the further deceleration of inflation by about three percentage points, [...] the reduction in the general government deficit, on a national accounts basis, by about three percentage points of gross domestic product", coupled with "limiting the rate of gradual depreciation of the drachma against the ECU to 3 per cent", had contributed "to the inflow of private business capital from abroad, leading to a further reduction in average financing costs and to downward pressure on drachma interest rates",[108] on the other hand the Governor pointed out that "neither unemployment nor the balance of payments evolved satisfactorily". More specifically, "the relatively limited expansion of employment, along with greater labour supply (caused by increases in the active population, immigration and the female labour force participation rate), led to a rise in the unemployment rate to 10 per cent from 9.6 per cent in 1994" and "increased domestic demand was met to a significant extent by imports, resulting in a wider trade deficit, […] whereas the invisible trade surplus did not record a similar increase"[109] and, as a result, the current account deficit widened to 2.5% of GDP.

Once again, the Governor referred to structural factors: "Macroeconomic developments in the labour market and in external transactions reflect mainly the impact of structural factors which, at the microeconomic level, act as constraints on the growth of domestic production. These constraints become especially noticeable when aggregate demand rises at a fast pace. This phenomenon is to a large extent explained by low productivity, the inadequate quality of various domestically produced goods and services, as well as administrative structures and organisational structures that hamper the flexible adjustment of markets and productive potential to changing economic conditions".[110] The analysis led to policy recommendations: "The above facts confirm the need for immediate adoption of measures that will enhance the productivity and competitiveness of the economy". At the same time, it was highlighted that, out of all those factors that affected the course of the Greek economy, only the international environment was an exogenous factor, whereas all other factors (structural weaknesses, income constraints, the economic and mone-

108 Ibid.

109 Ibid.

110 Ibid.

tary policy, etc.) "can be influenced [...] by decisions and actions of the government and the social partners" and that "once the importance and implications of these factors for the economy are realised, the only obstacle to further progress will be our own behaviour".[111]

Regarding the nominal convergence of the Greek economy towards EMU economies, and fiscal adjustment in particular, L. Papademos warned that "The general government deficit, [. . .] despite its appreciable drop in 1995, is still the highest among all EU member states and almost three times the reference value laid down in the Maastricht Treaty as a criterion for participation in the monetary union. Furthermore, the deviation of the public debt ratio from the relevant convergence criterion is still considerable. Although the borrowing requirement of the general government declined, public debt is estimated to have increased to 111.7 per cent of GDP at the end of 1995 from 110.4 per cent twelve months earlier".[112] "Fiscal adjustment has not yet reached the level required to prevent a further rise in the public debt-to-GDP ratio".[113] And in connection with the further fiscal consolidation effort needed, he added: "The progress made in 1994-1995 towards fiscal consolidation is undoubtedly significant and promising. However, [. . .] fiscal adjustment has not acquired those structural characteristics which will allow a self-sustained reduction in the public deficit. The improvement achieved so far is therefore precarious and reversible. Far from justifying complacency, the present state of public finances necessitates stronger efforts towards deeper fiscal consolidation".[114] "The higher primary surpluses forecast in the convergence programme for the coming years do not seem feasible unless a more radical approach to the country's fiscal problem is adopted. [. . .] However, the size of the problem and the additional debt obligations that the state is likely to incur make it necessary to contain public expenditure as a proportion of GDP and reduce the participation of the state in business activities that eventually burden taxpayers instead of increasing social welfare. Reducing expenditure and speeding up the privatisation process should be economic policy priorities; quite rightly the government is moving in this direction. The relevant measures, though, should be more decisive and be implemented promptly".[115]

With respect to the monetary policy pursued in 1995, this was "aimed at contributing to the further decline of inflation and, at the same time, supporting the pro-

111 Ibid.

112 Ibid.

113 Ibid.

114 Ibid.

115 Ibid.

jected real GDP growth in a manner consistent with the disinflation objective". More specifically: "To attain the ultimate inflation goal, the Bank of Greece adopted two intermediate targets: to restrain the rate of drachma depreciation against the ECU to 3 per cent between the beginning and the end of the year, and to contain the growth rate of broad money (M3) to 7-9 per cent in 1995". The Report summarised the outcome of the policy pursued by the Bank of Greece as follows: "The rate of depreciation of the drachma against the ECU was contained to 3 per cent during 1995. Consequently, the target for the rate of depreciation of the drachma against the ECU between the beginning and the end of the year was achieved exactly. […] Broad money (M3) increased faster in comparison with both the 1994 outcome and the initial target for 1995 […] and eventually rose to 10.4 per cent at the end of the year, against a target of 7-9 per cent and an outturn of 8.8 per cent in 1994. […] Total credit expansion was restrained within the initial forecast range (6-8 per cent) and came to 7.9 per cent, compared with 8.9 per cent in 1994".[116]

In the same Report, the assessment of economic developments during 1995 was mixed: "On the one hand, it is a fact that notable progress has been made in numerous areas. The slowdown of inflation, the reduction in the public deficit as well as greater stability and confidence in the drachma exchange rate are particularly positive developments that contribute to the gradual establishment of stable economic conditions. At the same time, the significant increase in private and public investment lays the foundations for more rapid and sustained economic growth. On the other hand, it is quite clear that the road leading to the final goals of economic policy is still long and rough. Although the economy is undoubtedly nearer these goals than in the past, their attainment demands continuous efforts, because some basic problems, which by their very nature are hard to solve, have not been adequately dealt with".[117]

Lucas Papademos also discussed the complex relationship between monetary stability and economic growth, specifying the role of the central bank: "The central bank has set monetary stability as its primary objective, not because it underestimates the importance of growth but because monetary policy, given the instruments at its disposal, can influence only the price level in an effective and sustainable manner. Securing monetary stability, however, establishes a necessary and essential condition for economic growth. […] It is therefore imperative, in the current phase, that priority be given to dealing effectively with inflationary pressures, so that they do not become permanent; such an eventuality would have particularly adverse

116 Ibid.

117 Ibid.

repercussions on the economy, not only directly, by squeezing real incomes, but mainly indirectly, by increasing the cost of public debt servicing and reducing the international competitiveness of Greek products". As to the prerequisites for growth, he pointed out that "high economic growth will not occur automatically, with the attainment of stability, even though stability is a necessary condition for economic growth. The competitiveness of the economy must be enhanced, and this in turn presupposes a corresponding steady improvement in productivity, which can be realised primarily through structural reforms and investments that will help broaden the economy's production base and upgrade human capital. […] [Economic policy] should also comprise measures aimed at establishing an appropriate and stable framework for the efficient operation of markets, the modernisation of public administration and the upgrading of education at all levels".[118]

The Report also addressed incomes policy: "[…] salaries of civil servants rose by 2.5 per cent in January 1996 and will rise by another 2.5 per cent in July 1996. If the corrective increase of 2.1 per cent awarded in January, the carry-over effect and the impact of seniority are included, the average annual increase in earnings of civil servants will not exceed 9.5 per cent this year, compared with 13 per cent in 1995. [...] Moreover, in the private sector, under the National General Collective Labour Agreement signed on April 2, 1996, minimum pay will rise at a rate about one percentage point lower than in 1994 (8.2 per cent compared with 9.4 per cent). Collective bargaining at branch or occupational level is expected to lead to similar results".[119]

In his *Annual Report* for 1996, L. Papademos noted that the progress made in inflation and fiscal aggregates had been accompanied by negative developments in external balance and unemployment: "Progress towards monetary stability continued: inflation decelerated further; the fiscal deficit decreased; and the public debt-to-GDP ratio stabilised. For the first time in many years, the exchange rate of the drachma remained practically unchanged and interest rates actually fell. Meanwhile, economic activity started recovering […]". On the other hand, he pointed out that "certain preexisting macroeconomic imbalances deteriorated: the current account deficit widened and unemployment rose slightly further, despite an increase in employment", and concluded that "consequently, the basic challenge for economic policy is to combine progress towards monetary stability and fiscal consolidation with an expansion and upgrading of the country's productive capacity, which will render feasible the gradual absorption of unemployment and the attainment of external balance".[120]

118 Ibid.

119 Ibid.

120 Bank of Greece, *Annual Report for the year 1996.*

Developments in the Exchange Rate Mechanism (ERM) of the European Monetary System were relatively normal, while all aggregates that were associated with the convergence criteria evolved at a satisfactory pace. As mentioned in the Report, "to achieve its primary objective, namely a further deceleration of inflation, the Bank of Greece focused its policy last year on the attainment of two intermediate targets. The first was to maintain the drachma broadly stable on average against the ECU during 1996. Short-term exchange rate fluctuations were not ruled out, depending on conditions in money and foreign exchange markets or developments in inflation. The Bank's second intermediate target was the containment of broad money (M3) growth during the year to 6-9 per cent", while the Bank also "announced limits of […] 5-7 per cent for total credit expansion". The exchange rate of the drachma as well as monetary and credit aggregates were finally in line with the targets or limits that had been set. In particular, "the depreciation of the drachma against the ECU was contained to 1 per cent between the beginning and the end of the year, down from 3 per cent in 1995. At average annual levels, the ECU fell by 0.6 per cent against the drachma in 1996, compared with 4.1 per cent in 1995". Meanwhile, "the growth rate of M3 […] moved within the target range and finally reached 9.3 per cent by year-end. […] Total credit expansion in 1996 also remained within the forecast range [and] fell to 6 per cent".[121]

The Report also highlighted the role of interest rate policy in the attainment of the above targets: "Interest rate policy was the main means of achieving the exchange rate target and controlling liquidity. [...] The Bank of Greece reduced its intervention rates very little [..]: it gradually cut the overnight rate from 14 per cent at the end of 1995 to 12.4 per cent at the end of August 1996, and this rate remained unchanged until mid-February 1997, when it was further reduced by half of one percentage point".[122] Furthermore, reference was made to interest rates on government paper as well as to the importance of the issuance of long-term fixed-rate bonds: "The decline in interest rates on government paper was significant, both in nominal and in real terms. Nominal interest rates fell by 2.4 to 3.3 percentage points [...]. Yields on long-term government paper in other countries, such as Germany, the Netherlands and Austria, declined much less (by 0.30 to 0.60 percentage point)". At this point, the following remark and suggestion was expressed in the Report: "The issuance of long-term fixed-rate bonds is a particularly positive development, since it is helpful in assessing the fulfilment of the Maastricht Treaty criterion regarding the convergence of long-term interest rates. The market for these securities must be

121 Ibid.

122 Ibid.

deepened and broadened. Specifically, it is necessary and advisable to issue securities of longer maturity, because the convergence criterion is evaluated on the basis of government paper with a residual maturity of at least ten years".[123]

With respect to public finances, L. Papademos stressed that "strong emphasis must be placed on controlling public expenditure" and that "to permanently reduce public deficits, […] privatisation must be expanded and accelerated". He also pointed out that "large amounts have been paid so far out of the government budget [i.e. by society as a whole] to support the operation of public enterprises, banks, shipyards, agricultural co-operatives, etc." and that "in addition to reducing the deficits, privatisation will help improve the allocation of resources and the efficiency and competitiveness of the economy", while "the large deficits of the major social security funds are another serious structural problem, the resolution of which will be decisive for the substantial reduction of public deficits in the long term".[124]

The Report for 1996 explored for the first time the appropriate policies for dealing with the problem of unemployment, an important and pressing matter in view of the country's participation in the monetary union, "when it will no longer be possible to pursue an autonomous national monetary policy in order to support economic activity".[125] In addition, it thoroughly discussed the challenges faced by the Greek credit institutions after the full liberalisation of the capital account in 1994 and in the context of the emerging conditions and trends in the European Union; the preparations that banks needed to undertake for the introduction of the euro, in particular for their future participation, on competitive terms, in single monetary policy operations; and the necessary "technical adjustments for the changeover from the national currency to the euro".[126] The Bank of Greece, on its part, had almost completed the adjustment of its operational framework to the European standard.[127]

A key conclusion regarding economic policy, as stressed once again in the Report for 1996, was "the great importance of promoting structural reforms immediately in all sectors of the economy" in order to address the root causes "preventing a more substantive and lasting solution to fiscal problems and a faster deceleration of inflation" and the factors "negatively affecting competitiveness, the balance of payments and the labour market […]". As noted by Lucas Papade-

123 Ibid.

124 Ibid.

125 Ibid. In May 1997, the Bank of Greece held a roundtable on "The problem of unemployment in Europe" with the participation of distinguished academics: Franco Modigliani, Edmund Phelps, Christopher Pissaridis, and Charles Wyplosz (*Annual Report for the year 1997.*).

126 Bank of Greece, *Annual Report for the year 1996.*

127 Ibid.

mos, "the need to immediately promote radical structural reforms over the entire spectrum of the economy becomes all the more pressing in view of the establishment of the monetary union at the beginning of 1999 and Greece's entry by the end of 2001".[128]

6.17 Modernisation and information technology at the Bank of Greece

The introduction of information technology in the Bank of Greece proceeded at first with small steps, starting with the important decision to procure an IBM 3031 mainframe computer.[129] Several decisions can be found in General Council minutes, which addressed IT needs arising from time to time. It should be recalled that the cost of IT products was very high in the early 1980s. For instance, at its meeting no. 6/80 of 26.3.1980, the General Council approved the procurement of a 64 Kilobytes[130] memory for the Piraeus branch (paragraph 47) and of a banknote counting machine (paragraph 48). The cost of the former was "8,000 US dollars, 2,000 dollars less than the price paid last year, plus about 17% for freight, insurance and customs", whereas the cost of the "electronic device for counting banknotes and coupons" manufactured by the US company Glory was 425,000 drachmas.

At the same meeting, the General Council approved the participation of staff from the Data Processing Section of the Bank of Greece in IBM training courses in London.[131]

In 1984, the General Council made more than a dozen decisions in a single meeting, relating to the "renaming of the Organisation and Data Processing Department to Organisation and Programming Department, its organisational restructuring, and responsibilities of its units".[132] In 1994, it was decided to set up a new Strategic Planning and Information Systems Evaluation Section within the Organisation and Programming Department.[133]

In 1995, the Bank expanded its IT policy and objectives and sped up the pace of change. Within a few months, a number of important decisions were made: on 27

128 Ibid.

129 This was a high-end machine (System/370 compatible), announced on 6.10.1977 and first available on the US market in March 1978. The line was discontinued on 5.2.1985. Soon after the availability of memory extensions was announced in early 1983, General Council decision no. 12/83 of 27.5.1983 approved a memory extension from 24 bits to 31 bits.

130 To give an idea of the size, e.g. 50 Kilobytes correspond to the compressed image of a document page and 100 Kilobytes to a low-resolution photograph.

131 General Council agenda no. 6/80 of 26.3.1980, paragraphs 41-42.

132 General Council agenda no. 1/84 of 4.1.1984, paragraphs 9-22.

133 General Council agenda no. 4/94 of 16.3.1994, paragraphs 15-16.

January, the General Council approved the cost of external expert consultancy services for IT strategic planning and development.[134] Numerous decisions followed two months later, regarding the purchase of hardware and software, maintenance and rental of equipment, the computerisation of the Library Section and a new operating system for SWIFT.[135]

On 11.3.1995, a competition was carried out to recruit staff for the Data Processing Centre. The General Council approved the appointment of the successful candidates at its meeting no. 8/95 of 24.5.1995 and of another five runners-up at its meeting 1/96 of 29.1.1996.

In May 1995, the General Council decided to expand the scope of the Organisation and Programming Department and rename it Information Systems and Organisation Department,[136] while in October it discussed the further utilisation of the already established SQL database.[137]

This momentum was kept up in the following year: at one of its meetings,[138] the General Council approved the procurement of hardware and software for the Balance of Payments Statistics Division of the Economic Research Department, the procurement of hardware for the IT infrastructure of Treasury bills, and a technical support agreement for the Book-Entry Securities infrastructure.

Finally, a decision made at the meeting of 15.3.1996 concerned "approval of expenditure for connection with the worldwide information network Internet" (paragraph 43). The wording is indicative of the unclear perception of the Internet at the time.

6.18 Preparation for EMU entry

The 1997-2001 period was marked by a stepping up of economic and monetary policy efforts to meet the requirements for Greece's entry into the Economic and Monetary Union.

The Greek economy had been on a path of gradual improvement since the mid-1990s, geared towards macroeconomic stabilisation. In terms of economic indicators, this improvement meant a deceleration of inflation, a reduction of fiscal deficits

134 General Council agenda no. 2/95 of 27.1.1995, paragraphs 25-25a.

135 General Council agenda no. 3/95 of 24.3.1995, paragraphs 20-21, 22-23, 24, 25 and 26-27. Paragraph 28 referred to the regular annual renewal of maintenance agreements for the Cebamail (linking EU central banks).

136 General Council agenda no. 8/95 of 24.5.1995, paragraph 13. Soon afterwards (see General Council agenda no. 10/95 of 27.7.1995), this new Department was partially restructured.

137 General Council agenda no. 11/95 of 31.10.1995, paragraph 20.

138 General Council agenda no. 2/96 of 15.3.1996, paragraphs 40, 41 and 42.

and stronger economic activity, which outperformed the European average. All this contributed to the nominal as well as real convergence of the Greek economy towards the economies of the other EU Member States. Despite the significant progress achieved, challenges remained, relating to the sizeable external deficit and persistently high unemployment. This implied that the positive economic developments were associated with the successful implementation of tight fiscal and monetary policies. On the other hand, the two remaining challenges mainly reflected structural weaknesses, which had negative multiplier effects on both nominal and real economic aggregates.

According to the Bank of Greece, "the structural adjustment of the economy has been slow and inadequate, while the evolution of unit labour costs, particularly incomes policy in the public sector, prevented a faster deceleration of inflation, adversely affected the country's international competitiveness, and did not help increase employment".[139]

The year 1997 was of particular importance to the Bank of Greece, especially in view of the upcoming launch of Stage III of EMU, as the Hellenic Parliament passed Law 2548 "Provisions relating to the Bank of Greece", which was published in the Government Gazette (A 259) on 19.12.1997. This law introduced a modern institutional framework to govern the operation of the central bank, in accordance with the provisions of Article 108 of the Treaty on European Union and the Statute of the European System of Central Banks (ESCB). The Bank of Greece would become an integral part of the ESCB upon its establishment in June 1998, irrespective of the date of Greece's entry into EMU.[140]

In more detail, Law 2548/1997 specified the key objectives and the main tasks of the central bank. Maintaining price stability was defined as the primary objective of the Bank of Greece and, without prejudice to this primary objective, the Bank would support the overall economic policy of the government. To achieve its primary objective, the Bank was provided with the necessary monetary policy instruments, while its institutional, personal and operational independence was safeguarded. In addition, in view of the Bank's new tasks and independence, as well as its future ESCB participation, the law introduced changes to the decision-making structure of the Bank of Greece: the Monetary Policy Council was established as a new body, responsible for the formulation and implementation of monetary policy and for

139 *Annual Report for the year 1997.*

140 Ibid. Also in 1997, the Bank of Greece inaugurated its Zolotas Lectures, focusing on policy relevant topics, in particular monetary policy and international economic relations, with a lecture by Hans Tietmeyer, President of the Deutsche Bundesbank, entitled "European monetary integration and its implications for the international monetary system" (ibid.).

decisions relating to exchange rate policy, the operation and efficiency of payment systems and instruments and the issuance of banknotes.[141] (See also 6.19 below).

The Extraordinary General Meeting of Shareholders of the Bank of Greece, which was held on 27.12.1997 to decide on the amendments to the Bank's Statute in accordance with the provisions of Law 2548/1997, renewed the term of Lucas Papademos as Governor for another six years. The reappointment of the Governor and the Deputy Governors, Nicholas Garganas and Panayiotis Thomopoulos, was effected by a Presidential Decree published in the Government Gazette on 26.2.1998. By another Presidential Decree published in the same issue of the Government Gazette, the six members of the Monetary Policy Council were appointed: namely, the Governor and both Deputy Governors, Vassilios Droukopoulos, Antonios Mantzavinos and Nikolaos Paleocrassas.[142]

Monetary policy was for the Bank of Greece the key policy by which it contributed to the national effort to meet the convergence criteria and join EMU. The monetary policy pursued in 1997, apart from supporting the projected growth rate of economic activity, sought, as the main policy target, to bring inflation down to 4.5% by end-1997 and below 3% by end-1998, and to attain two intermediate targets, relating to the exchange rate of the drachma and to broad money (M3) growth,[143] i.e. (i) a broadly stable exchange rate of the drachma against the ECU; and (ii) a 6%-9% growth rate of M3, with emphasis on the medium-term relationship between inflation and M3.[144]

Furthermore, the Bank of Greece continued to monitor developments in certain other monetary and credit aggregates which provided useful information on the future course of inflation. In this regard, it set monitoring ranges (rather than targets) of 8%-11% for the growth rate of the liquidity indicator M4 (comprising M3 plus non-bank holdings of government paper maturing in up to one year) and of 4%-6% for total credit expansion to the private and the public sectors, while at the same time monitoring the core inflation trend so as to enable policy instruments to be more readily adjusted to the forecast path of inflation.[145]

Throughout 1997, interest rate policy was the primary instrument used by the Bank of Greece to achieve its final and intermediate monetary policy targets. Moreover, as the interbank money market was characterised by excess liquidity in the

141 Ibid.

142 Ibid.

143 Comprising currency in circulation, private deposits, repos and bank bonds.

144 *Annual Report for the year 1997.*

145 Ibid.

first five months of 1997, owing to increased capital inflows at the beginning of the year and an acceleration of credit expansion to the public sector, the Bank of Greece intervened extensively in the interbank market, absorbing liquidity in order to maintain interest rates at levels consistent with its disinflation goal.[146] At the same time, to enhance the effectiveness of monetary policy, the Bank of Greece introduced a number of changes in its monetary policy framework.[147]

Monetary policy targets were broadly achieved in 1997, in an environment characterised at times, particularly during the last two months of the year, by considerable market pressures linked to international monetary disturbances. The drachma remained stable or appreciated vis-à-vis the major EU currencies, while it depreciated by 1.7% against the ECU. M3 grew by 9.5%, i.e. at a slightly higher rate than the upper limit of the target range. On the other hand, total credit expansion overshot the relevant forecast, largely due to changes in the methods and means of financing the central government deficit.[148]

In the last months of 1997, the drachma came under strong pressure. The monetary turmoil in Southeastern Asia, with its adverse repercussions on the foreign exchange and capital markets in several emerging economies, fuelled the pressure exerted on the drachma in October 1997. "The extent and duration of the pressure, however, reflected certain characteristics and weaknesses of the Greek economy which made it more vulnerable than other EU countries to market concerns and expectations". As pointed out in the *Annual Report,* "the factors behind the market pressures included: the current account deficit and the loss of competitiveness, the external debt of the private and public sectors, as well as market expectations regarding the entry of the drachma into the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS) accompanied by an adjustment of the exchange rate of the drachma. The Bank of Greece dealt with those pressures effectively by raising the interest rates and making extensive interventions in the money and foreign exchange markets".[149]

In early January 1998, the exchange rate of the drachma came under renewed pressure, and capital outflows occurred. In response, the Bank of Greece raised its intervention rates in the interbank market. Although the subsequent two months

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146 Until April 1997, the Bank of Greece absorbed some 1,300 billion drachmas on average per day.

147 Specifically, in mid-February 1997 it reactivated tenders for the acceptance of deposits or repos, and in end-March 1997 it established a two-tier standing facility for the collection of deposits to allow interbank rates to be more directly influenced by market conditions. See also Bank of Greece, *Annual Report for the year 1997.*

148 Ibid.

149 Ibid.

saw some occasional capital inflows and an easing of pressures on the drachma, the rekindling of the monetary crisis in Eastern Asia and market expectations that the drachma would join the ERM in May 1998 and would be devalued prevented money market conditions from returning to normal. As a result, interbank market rates remained relatively elevated. Given that interest rates would not be sustained at high levels for long without adverse effects on the economy, the government, in consultation with the Bank of Greece, judged it appropriate to promptly apply for ERM membership.[150]

On 16.3.1998, the drachma joined the ERM at a central rate of 357 drachmas per ECU, which implied a drachma devaluation of 12.3% relative to the rate of 313.05 drachmas per ECU at the fixing session of 12.3.1998. The new exchange rate was appropriate for offsetting the loss of competitiveness of Greek goods and services, which had resulted from the real appreciation of the drachma in the previous years, also taking into consideration the need to ensure exchange rate stability for at least two years before joining the monetary union, as required by the Treaty.[151] In this way, the convergence criterion on exchange rate stability would be fulfilled.

Markets reacted positively in the first weeks after the drachma's entry into the ERM. Specifically, from 16 March to 10 April 1998, 3.1 billion US dollars flowed into the foreign exchange market, resulting in an increase in foreign exchange reserves to 19.2 billion US dollars and a 2%-3% appreciation of the drachma against its central ERM rates. Over the same period, the Athens Stock Exchange price index rose by 40%. The price of 10-year government bonds also recorded a sharp rise, leading to a decline of two percentage points in their yields, to below 8%.[152] The favourable market reaction confirmed that both the timing of ERM entry and the level of the drachma's central rate were indeed appropriate (Malliaropulos and Hardouvelis, 1998).[153]

The entry of the drachma into the ERM of the European Monetary System on 16.3.1998 was an important event, which decisively affected economic developments and the policies pursued in 1998 and beyond. As Governor, L. Papademos stressed

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150 Ibid.

151 Ibid.

152 Ibid.

153 According to Malliaropulos and Hardouvelis (1998), the view that the exchange rate of the drachma was overvalued rested upon an arbitrarily selected base year for comparing inflation in Greece and in EU countries, without any weights applied. Instead, using 1972 as base year and weighting against the currencies of Greece's 21 major trading partners showed that the selected central rate was close to the long-term equilibrium value.

in his Report in April 1999: "The significance of the drachma's participation in the ERM for the economy's performance and prospects is manifold. First, another major step was taken towards fulfilling the convergence criteria as, according to the Treaty, ERM participation and exchange rate stability are prerequisites for joining the monetary union. Second, ERM entry and the simultaneous devaluation of the drachma led to a weakening of the pressures that had built up in foreign-exchange and bond markets mainly since October 1997 and persisted in early 1998 […].Third, after the drachma joined the ERM, the economic policy mix was redefined".[154] According to the Governor, the "successful entry of the drachma into the ERM and its subsequent smooth participation" reflected the "meticulous preparations and consultations that preceded it", as well as the "selection of the central exchange rate of the drachma […] to enable the Greek economy to regain international competitiveness […] and to set a stable central rate for the period until participation in the monetary union", i.e. a central rate that "had to be credible and consistent with sustainable external balance […] in the medium term". "However, the most important factor for the smooth participation of the drachma in the ERM was that the economic and monetary policies pursued since joining the mechanism were stability-oriented and compatible with ERM requirements, while labour market developments were consistent with the containment of inflationary pressures and the maintenance of the competitiveness regained following the devaluation of the drachma".[155]

The primary goal of monetary policy in 1998 was to achieve price stability by the end of 1999, which was compatible with an annual rate of inflation that did not exceed 2%. In more detail, in 1998 monetary policy was aimed at ensuring that inflation would resume a downward path as quickly as possible, following a temporary rise caused by the drachma devaluation of March 1998.

The intermediate target of the Bank's strategy was the relative stability of the drachma's exchange rate within the ERM. The conduct of monetary policy focused on attaining the primary objective of price stability by maintaining interest rates relatively high, thereby resulting in an appreciation of the drachma above its central rate against the ECU.

The drachma had remained strong since joining the ERM. More specifically, immediately after entry, significant capital inflows, coupled with the tight monetary policy of relatively high interest rates, led to a gradual strengthening of the drachma above its central rate against the ECU, which stood at 8.1% in mid-August. Capital

154 *Annual Report for the year 1998.*

155 Ibid.

inflows resumed in the last two months of the year causing the drachma to appreciate by 7%-8.5%, despite the substantial interventions of the Bank of Greece to restrain the appreciating pressure on the drachma.[156]

In 1998, after the drachma had joined the ERM, the Bank of Greece did not adopt any intermediate targets for M3 growth and credit expansion as in the past, but instead announced "indicative projections" of 6%-9% for M3 growth and 4%-6% for total credit expansion, which were deemed consistent with the intended decline in inflation over the medium term. M3 growth rose by 8.9% in 1998, within the forecast range, compared with 9.6% in 1997. However, total credit expansion reached 9.7% in 1998 (as in 1997), overshooting the projected range. The Bank of Greece noted that credit expansion to the private sector was affected in 1998 by the depreciation of the drachma, which increased the value in drachmas of outstanding foreign currency loans, without being associated with the flow of new loans.[157]

The Bank of Greece followed a policy of gradual cuts in its key interest rates in 1998. Nevertheless, interbank rates as well as deposit and lending rates fell even lower in the course of the year. Besides, on the back of lower inflation and weakening inflation expectations, coupled with growing confidence in the prospects of Greece joining the EMU, 10-year government bond yields dropped from 10.7% at end-1997 to 6.9% at end-1998.[158]

In December 1998, in the context of creating the necessary conditions for the conduct of the single monetary policy, Governor Papademos signed three agreements with the ECB, regarding: (a) the operating procedures of the ERM; (b) the linking of non-euro area Member States with the TARGET payment system; and (c) the cross-border use of collateral within TARGET.[159]

Regarding the prospect of EMU entry, the Report for 1998, presented by the Governor at the General Meeting of Shareholders in April 1999, stated that "it is feasible and highly probable that the criteria for the adoption of the euro in 2001 will be met in 1999, but it should not be taken for granted". Some exogenous effects, the behaviour of social partners (firms' pricing policy, wage increases), as well as new elements of uncertainty, although the impact from the crisis in Yugoslavia was not deemed significant, were mentioned as potential inhibiting factors.[160] Of particular

156 Ibid.

157 Ibid.

158 Ibid.

159 Ibid., and General Council agenda, "Authorising Governor L. Papademos to sign three agreements between the Bank of Greece and the European Central Bank", 30.11.1998, paragraph 2.

160 *Annual Report for the year 1998.*

interest was the analysis of the prospects of price stability, in connection with expectations about interest rate cuts and the role of social partners: "Labour's contribution, in 1999 and 1998, to the effort to hold prices down is recognised and important. However, the evolution of prices, at least in some markets, is not so satisfactory. Business firms must adjust their […] pricing policies to the new, more favourable, conditions […] in view of the country's entry into the more competitive environment of the single currency". In fact, "at the present juncture, stability or even reduction of prices will not only contribute to the achievement of the national goal of adopting the euro, […] but will also yield immediate and substantial financial gains. […] Businesses and self-employed professionals are rightly looking forward to interest rate cuts […]. However, they must understand that the more direct and substantial their contribution to the deceleration of inflation and its maintenance at a low level, the faster the desired interest rate cuts will proceed. This is because only when price stability has been achieved and secured will the Bank of Greece allow a significant reduction in interest rates".[161]

The year 1999 was marked by an historic event: the introduction of the single European currency, the euro, and the establishment of the European monetary union, in which Greece did not participate from the start. Since the beginning of 1999, the ERM II, which was based on the determination of central rates vis-à-vis the euro (instead of the ECU), replaced the ERM I of the European Monetary System, which the drachma had joined in March 1998. With the establishment of the euro area, the drachma entered the ERM II at a central rate of 353.109 drachmas per euro and with the standard fluctuation band of ±15%, as also applicable in the ERM I. For technical reasons, the new central rate of the drachma against the euro was slightly different from its previous central rate against the ECU.[162] On 17.1.2000, the central rate of the drachma vis-à-vis the euro was revalued by 3.5% to 340.750 drachmas per euro, in order to support a disinflationary monetary policy, thereby creating favourable conditions for sustainable growth.[163]

The primary goal of monetary policy for 1999 was to achieve and maintain price stability, i.e. an annual rate of inflation below but close to 2%. The Bank of Greece had underlined the importance of the timely attainment of this goal for

161 Ibid.

162 *Annual Report for the year 1999.*

163 Ibid. The central rate of the drachma was determined following several analyses based on alternative methodologies, as well as consultations with the country's EU partners and the ECB. While the choice of this particular level has been extensively debated, the fact is that the fluctuation of the drachma around that level under a liberalised capital account confirmed estimates that the parity was equal or very close to its long-term equilibrium value (Malliaropulos and Hardouvelis, 2000).

meeting the inflation convergence criterion of the Maastricht Treaty and had stressed that price stability should be maintained on a more lasting basis, especially in 2000, so that the competitiveness of the Greek economy would not be compromised.[164]

The background against which monetary policy was conducted in 1999 was determined by the participation of the drachma in the ERM II and by the Bank's intermediate target to maintain a relatively stable exchange rate of the drachma against the euro. Moreover, to assess monetary conditions, the Bank of Greece would use a broader liquidity indicator it had recently defined (M4N),[165] and total credit, having announced a forecast range of 7%-9% for the growth rate of each aggregate for 1999. These forecasts were based on certain assumptions regarding the income velocity of currency in circulation and the financing of the fiscal deficit, and were deemed to be consistent with the inflation target. Nevertheless, the Bank of Greece had pointed out that it would not automatically adjust its policy instruments to any possible deviations of those monetary and credit aggregates from relevant forecasts, but would carefully analyse the causes and nature of these deviations, evaluating their medium-term effect on inflation.[166]

The price stability goal was largely achieved in 1999. CPI inflation followed a downward path in the first half of 1999 and declined sharply from 3.9% in December 1998 to 2.0%-2.1% in the period from June to September 1999. From October 1999 onwards, it rose progressively, given that world oil prices had more than doubled, and reached 2.7% in December 1999. Nevertheless, core inflation, which reflects more accurately the endogenous trends of inflation by excluding developments in the prices of fuel and fresh fruit and vegetables, dropped to 1.9% in October 1999, three percentage points lower than in December 1998, and did not exceed 2% thereafter and up to the first quarter of 2000. This development indicated that a high degree of price stability had been achieved in 1999. Most importantly, measured by the Harmonised Index of Consumer Prices (HICP), by which the inflation convergence criterion would be assessed, average inflation stood at 2.1% in 1999 and fell further to 2% in the twelve months to March 2000. This meant that Greece had fulfilled the relevant convergence criterion of the Maastricht Treaty since December 1999.[167]

164 *Annual Report for the year 1999.*

165 M4N comprises currency in circulation, private deposits in drachmas and foreign currency, as well as private holdings of repos, bank bonds, money market fund shares/units and Greek government securities with a maturity of up to one year.

166 Ibid.

167 Ibid.

Turning to the exchange rate of the drachma, between ERM entry in March 1998 and early 2000, the drachma had not come under significant pressure that would create tensions in the foreign exchange market. During those two years, the conduct of a disinflationary monetary policy by maintaining relatively high interest rates, as well as favourable market expectations about the prospect of stabilisation and convergence of the Greek economy resulted in a constantly appreciated drachma vis-à-vis its central rate in the ERM. The positive deviation of the current exchange rate from the central rate ranged between 2% and 9%.[168]

More specifically, during 1999 and until the adjustment of its central rate against the euro by 3.5% on 17.1.2000, the drachma deviated from the central rate within a much narrower band of 6.5%-9%.[169]

The challenges for monetary policy in 1999 were associated with the prospect of the Greek economy's convergence and entry into the euro area, growing competition in the banking system and the participation of the drachma in the ERM II. The positive outlook for the convergence of the Greek economy, combined with the high interest rates necessitated by the disinflationary stance of monetary policy, brought about considerable capital inflows into investment in government bonds and short-term investment in the interbank market. Capital inflows created conditions of excess liquidity in drachmas, which was sterilised by the Bank of Greece through liquidity-absorbing operations, with a view to containing monetary and credit expansion at rates consistent with the inflation target. In a liberalised banking environment, the Bank of Greece could not exert direct control on credit expansion, while the appreciation of the drachma in the ERM II constrained the use of interest rates as a toll for limiting credit expansion. In this context, the Bank of Greece decided to adopt alternative measures to contain monetary and credit expansion. To this end, reserve requirements were imposed on banks in the form of non-remunerated six-month deposits with the Bank of Greece in amounts equal to those by which individual banks' credit expansion to the private sector and public enterprises and entities exceeded an annual rate of 12%. The aim was to mitigate the inflationary risks which were mainly associated with the fast rise in credit, consumer credit in particular.[170]

The annual growth of M4N turned out at 5.6% in 1999, compared with 9.8% in 1998. The year-on-year rate of increase in M4N had followed a downward path since

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168 Ibid.

169 Ibid. After the adjustment of its central rate and up until the end of March 2000, the drachma continued to gradually converge towards its central rate, and by end-March its appreciation had been reduced to less than 2%.

170 Ibid.

early 1999. Between March and July, it broadly hovered within the forecast range (7%-9%), but from August through December it remained below the lower limit of the forecast range. Nevertheless, total credit expansion, adjusted for the effect of the strong appreciation of the Japanese yen and, to a lesser extent, the US dollar on the outstanding amount of foreign currency loans, stood at 10.9%, higher than both the forecast for 1999 (7%-9%) and its 1998 level (9.1%).[171]

With respect to the fulfilment of the fiscal deficit criterion and to Greece's EMU entry, the Report noted that over the previous decade remarkable fiscal adjustment had been achieved, with the general government deficit falling from roughly 16% of GDP in 1990 to 1.6% of GDP in 1999 (or from 14.2% to 3.1% according to later estimates), reflecting on the one hand an improved primary balance, with large primary deficits turning to almost equal primary surpluses, and on the other hand (albeit to a lesser degree) reduced interest payments. The improvement of the primary balance was driven by "the almost uninterrupted and substantial growth of revenue as a proportion of GDP during the 1990s, while the primary expenditure-to-GDP ratio remained broadly stable". As a policy implication, the Report warned that "the trends of major fiscal aggregates and their more comprehensive analysis also imply that […] the fiscal consolidation effort should be based on the containment of primary expenditure rather than an increase in revenue, especially since a tax reform is advisable to enhance the competitiveness of the economy and promote employment in the new environment of 'tax competition' and 'tax approximation' which is gradually taking shape in the European Union".[172]

In the same Report, while noting that 1999 was the fourth consecutive year in which the growth rate of the Greek economy was clearly higher than the EU average, the Bank of Greece called once again attention to the major problem of unemployment. In the 1994-1998 period, which covered the first five years of the implementation of the Convergence Programme 1994-1999, the unemployment rate rose from 8.9% in 1994 to 10.8% in 1998, whereas in the EU it declined from 11.1% to 9.9%. The Bank of Greece underscored the structural weaknesses of the Greek labour market and the need to improve general education and vocational training systems in line with both market demand for skills and technological advances. Other measures recommended by the Bank of Greece referred to reducing the tax burden on labour, in particular on low-skill and low-paid labour; strengthening tax incentives for hiring young workers; lowering

171 Ibid.

172 Ibid., and Manessiotis and Reischauer (2001), p. 142.

total labour costs. Regarding the employment of women and the long-term unemployed, the suggested measures focused on the promotion of equal employment opportunities for men and women, as well as on life-long learning, respectively. Finally, measures aimed at greater flexibility in working hours and wages were seen as necessary by the Bank of Greece, which however acknowledged that the Greek labour market had proved flexible enough to absorb thousands of economic immigrants, modernise the collective bargaining system from 1990 onwards and allow for flexible working time arrangements, particularly in very small businesses.[173]

According to the Bank of Greece, the overall assessment of economic developments in 1999 led to the conclusion that "for the first time in several decades, conditions of monetary stability were established [which] was the outcome of a long and arduous effort" and that "the deceleration of inflation, progress towards fiscal consolidation and the relative stability of the exchange rate of the drachma against key European currencies have all contributed to the creation of a new economic environment, which is compatible with the fulfilment of the convergence criteria for the participation of Greece in the European Economic and Monetary Union (EMU)".[174]

At the same time, however, and in view of the country's future euro area entry, the Bank of Greece highlighted the new possibilities and prospects for the Greek economy. In more detail, at the General Meeting of Shareholders in April 2000, Governor L. Papademos stated the following: "Greece's participation in the euro area will decisively influence the functioning and performance of the Greek economy in the future. The adoption of the euro will cause considerable changes in the economic environment: it will bring benefits and create opportunities, but, at the same time, it will imply constraints and pose challenges for economic policy. The economy's performance in the coming years will therefore hinge upon the ability of the private sector and the economic authorities to secure the potential benefits, take advantage of the opportunities, adjust successfully to the constraints and deal effectively with the new challenges. The crucial issues for the post-entry period are the consequences of the introduction of the single currency for monetary stability, on the one hand, and for the acceleration of economic growth and, hence, the prospects for real convergence of the Greek economy in the next ten years, on the other".[175]

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173 *Annual Report for the year 1999, Monetary Policy – Interim Report 2000.*

174 *Annual Report 1999.*

175 Ibid.

Since early 2000, the Bank of Greece had repeatedly stressed the importance of timely preparation for the "day after" the adoption of the new currency, the euro. Weighing the pros and cons, it remarked that the prospect of price stability offered significant benefits, which however could only be reaped if structural measures and an appropriate economic policy were adopted, in order to ensure that Greek inflation does not exceed the European average. In turn, the ensuing macroeconomic stability and full participation in the euro area would support faster economic growth. The main contributing factors were the elimination of foreign exchange risk in intra-euro area transactions, the lower financing costs resulting from the integration of financial markets and the convergence of interest rates, as well as lower transaction costs. Nevertheless, all of the above factors could have a desirable, long-term effect only to the extent that economic policy makers took the necessary measures to improve the competitiveness of the Greek economy and exploit the country's comparative advantages.[176] The Bank of Greece stressed that, in a monetary union where a single monetary policy was conducted and fiscal policy had to comply with the Stability and Growth Pact, any deviations from price stability and average economic growth in the euro area were actually due to country-specific structural characteristics. Both economic theory and past experience suggested that the impact of the single monetary policy on inflation and economic growth across member countries depended considerably on the structure and functioning of their respective financial sectors and labour markets. In addition to structural characteristics, differences in the cyclical positions of euro area countries, as well as the asymmetric effects of external shocks on individual economies could also bring about economic performance divergences. Against this background, the primary objective of national economic policy after the country's entry to the euro area should be to step up efforts to raise the competitiveness of the small and open Greek economy. To this end, the reforms recommended by the Bank of Greece mainly focused on: (a) deregulating markets and reducing state intervention, with an emphasis on the energy, telecommunications and services sectors, as well as speeding up privatisations; (b) strengthening the role of the State in certain areas, particularly in improving education and vocational training and promoting new technologies, which would considerably raise productivity; (c) implementing institutional reforms that would boost investment, such as simplifying procedures for starting a business and attracting foreign direct investment; and (d) promoting reforms that would improve the functioning of the financial sector and the financing of small and medium-sized enterprises.[177]

176 Ibid.

177 Ibid.

In this context, fiscal policy should strike a balance between the objectives of fiscal consolidation, which would contribute to macroeconomic stability, and faster economic growth, by restructuring government expenditure and reforming the tax system. The Bank of Greece considered that the achievement of sustainable primary surpluses over the following few years was "indispensable" to ensure long-term fiscal balance, given that the public debt-to-GDP ratio remained particularly high. Furthermore, the Greek economy should be able to deal with potential strains on the budget associated with the future obligations of major social security funds and public enterprises. Almost prophetic about what the country would experience after the outbreak of the crisis in 2008, as early as in 2000 the Bank of Greece stressed in the *Annual Report* that "[…] fiscal consolidation efforts should be kept up so that fiscal policy can be given sufficient room for manoeuvre to deal with exogenous shocks that may affect the Greek economy once it joins the euro area".[178]

The year 2000 was a milestone in modern Greek economic history. The EU Summit in June of that year confirmed that Greece had met the convergence criteria for joining the euro area as of 1 January 2001. 2000 was particularly important to the Bank of Greece as well, which was faced by multiple challenges in the area of monetary policy but also had to carry out the necessary institutional, operational and technical adjustments for the introduction of the euro as a unit of account in Greece and for its own participation in the Eurosystem. The demanding objective of monetary policy was now to ensure a smooth transition to the euro through a gradual convergence of the current exchange rate of the drachma towards its rate of conversion into euro, as well as of interest rates in the domestic interbank money market towards the respective euro area rates.[179] This convergence had to be carried out in a way that would help contain domestic inflationary pressures associated with the easing of monetary conditions and reduce the impact of inflationary pressures on domestic prices as a result of the steep rise in world oil prices and the appreciation of the US dollar vis-à-vis the euro.

Monetary policy in 2000 was conducted in a new environment for the Greek economy, which was characterised by: (a) much lower inflation than in the past, but still higher than average euro area inflation and the level that was considered to be consistent with price stability (2%);[180] (b) a significantly improved fiscal position of

178 Ibid.

179 *Annual Report for the year 2000.*

180 As mentioned in the Report, a high degree of price stability (on the basis of the average annual rate of increase in the Harmonised Index of Consumer Prices – HICP) was maintained until mid-2000, although thereafter, amid continued inflationary pressures as a result of higher world oil prices and an appreciated US dollar against the euro, average annual inflation picked up to 2.9% in 2000. Average annual HICP inflation, which stood at 2% in the twelve months to March 2000, made it possible to meet the relevant convergence criterion. Ibid.

general government and decreasing public debt; and (c) high and rising economic growth rate, which exceeded the EU average. However, the Greek economy was still characterised by structural weaknesses, resulting in persistently high unemployment and public debt-to-GDP ratio and a widening current account deficit.[181]

The main goal of monetary policy in the first half of 2000 was to help meet the convergence criteria on inflation, the stability of the exchange rate of the drachma and long-term interest rates. Following the decision reached in June regarding Greece's entry to the euro area, monetary policy shifted its focus to ensuring a smooth transition to the single currency, as well as to mitigating inflationary pressures caused by exogenous factors (such as rising world oil prices and the appreciation of the US dollar vis-à-vis the euro). The Bank of Greece slowly lowered its policy rates towards the ECB key interest rates and at the same time made interventions in the foreign exchange and money markets to ensure that the drachma's current exchange rate would smoothly converge towards its euro conversion rate by end-2000. All of the above took place amid foreign exchange market tensions from the end of 1999 through to the first few months of 2000, reflecting uncertainties as to whether Greece could meet the convergence criteria in time and, subsequently, as to whether the drachma's euro conversion rate would be its central rate in the ERM II. The climate reversed and expectations stabilised after the ECOFIN decision of June 2000 that the central rate of the drachma (340.75 drachmas per euro) would be its conversion rate. The interest rate on Bank of Greece interventions in the interbank market (for 14-day operations) was gradually lowered from 10.75% in the beginning of 2000 to 4.75% in December 2000 and was aligned to the respective ECB's rate on main refinancing operations. The interest rate cuts of the Bank of Greece led to declines in bank rates, which however were uneven: lending rates declined more than deposit rates, thereby reducing the spread between them by about one percentage point.[182]

In light of the above, it becomes evident that the interest rate policy of the Bank of Greece as well as its interventions in the foreign exchange and money markets ensured the convergence of the exchange rate and interest rates in a way which moderated inflationary pressures and favourably affected inflation expectations. However, the inevitable easing of monetary conditions in 2000 before euro area entry, coupled with the higher-than-projected increase in nominal GDP and the effect of some special factors, resulted in higher-than-projected increases in liquidity and bank credit. Specifically, the monetary aggregate M4N rose by 10.5% in 2000,

181 Ibid.

182 Ibid.

exceeding the upper limit of the forecast range (5%-7%). This development partly reflected portfolio shifts towards repos and money market fund shares/units, as well as higher demand for transaction balances in the context of strong nominal GDP growth. Total credit expansion accelerated considerably, while the contribution of the private sector to this rise (28.5% in 2000, compared with 14.2% in 1999) was larger than that of the public sector (16.1% in 2000, compared with 11.3% in 1999). To a great extent, stronger credit expansion to the private sector helped to meet increased demand, which partly reflected a pent-up effect from the 1999 measures to restrain credit expansion that expired in March 2000 and partly came about as a result of lower interest rates and stronger GDP growth.[183]

The Report for the year 2000 reviewed the changing conditions in the financial sector on the eve of EMU entry, summarising them as follows: “The Greek banking system has entered a phase of transformation and of reorientation of its strategic goals and activities, particularly after Greece’s entry into the euro area. The most important reasons are fast technological progress in the fields of communications and IT, increasing integration of international money and capital markets, as well as changes in the firms’ and households’ needs for bank products and services. Growing competition reduces profit margins related to the supply of traditional bank services and induces banks to intensify efforts to diversify their products and expand into new markets […]. The introduction of the single currency and the pricing of all goods and services in euro from the beginning of 2002 will increase transparency in banking transactions. It is estimated that this will accelerate the integration of financial markets and lead to the creation of larger banks or bank groups that will offer a broader range of financial products. The outcome will be a further strengthening of competition between banks, as well as an increase in their exposure to systemic risks that will no longer be confined within national borders, precisely because of the increased interdependence of the financial markets”.[184]

As noted in the Report, the expected further integration of money and capital markets following the introduction of the euro and the emerging trends in the financial sector “brought to the fore the role of national central banks in exercising prudential supervision over the banking system in euro area countries”. The Bank of Greece favoured comprehensive supervision encompassing the financial system as a whole, with the central bank in a leading role, as experience in other countries had shown that whenever the task of supervision was assigned to central banks, the emphasis was placed on the stability of the financial system through what is now

183 Ibid.

184 Ibid.

called macro-prudential supervision, as opposed to the micro-prudential approach adopted by other supervisory bodies. The comparative advantages of the central bank included its established operational independence, its ability to gather timely information and its expertise in identifying and addressing systemic risks. The combined effect of the above "guarantees that supervision of the financial sector can continue effectively and without shocks".[185]

Ahead of the adoption of the euro, it was important for the Bank of Greece to adjust its monetary policy framework and the technical parameters of monetary policy instruments. This adjustment was carried out in gradual steps during 2000, to avert any disruptions in money, foreign exchange and capital markets. Changes without a direct effect on monetary conditions were implemented in early 2000, while the timing and modalities of certain other changes in the operational framework which would, directly or indirectly, affect the conditions in money and foreign exchange markets were carefully designed by the Bank with a view to avoiding any unwarranted side-effects. The latter category notably included the harmonisation of the Bank's minimum reserve system with that of the Eurosystem, involving the establishment of a lower reserve ratio (2%), instead of a 12% ratio which was applicable until then. As mentioned in the Report for the year 2000, "in order to smooth the effect on liquidity conditions in the domestic money market, the Bank of Greece decided that the excess reserves were to be held in fixed-term deposits maturing gradually over a period of 18 months", while "at the same time, due consideration was given to the need to secure adequate liquidity in the period shortly after the entry of Greece into the euro area". Furthermore, given that a safe and reliable real-time payment system was essential for the conduct of the Eurosystem's single monetary policy (in which operations were exclusively processed through the respective national payment system and the cross-border system TARGET), at the beginning of 1999 the Bank of Greece launched Hermes-euro, which was linked to TARGET, while its drachma counterpart (Hermes-drachmas) became operative in March 2000. On 2.1.2001, the two systems were merged into a single Hermes system settling in euro, which facilitated the effective and smooth integration of domestic money and capital markets into the single European market, as well as efficient cash management by credit institutions.[186]

The year 2000, during which it had been confirmed that Greece could join EMU on 1.1.2001, was a milestone in Greek economic history. As noted by the Governor, this achievement was "the culmination of a long and arduous effort to stabilise the

185 Ibid.

186 Ibid.

Greek economy",[187] but at the same time should also be a stepping stone to "a consistently high economic growth rate, so as to speed up the real convergence of the Greek economy and reduce the high rate of unemployment", which should be "the primary objective of economic policy in the current decade".[188] The Bank of Greece considered that the real convergence of the Greek economy towards the other European economies within a reasonable time horizon (i.e. within a decade, as set by the Lisbon European Council for achieving EU growth objectives) was "certainly a desirable, albeit ambitious, goal". As L. Papademos stressed: "The environment of stability entailed by euro area membership is a necessary but not sufficient condition for real convergence. To achieve real convergence requires [...] implementation of appropriate fiscal and structural policies, faster modernisation and more efficient operation of both the public and the private sector".[189]

According to the Bank of Greece, the amount of effort that Greece had to make in order to achieve real convergence and raise employment was evidenced by specific data related to the gap between Greece and its European partners, as well as by anticipated developments in the EU. Specifically, in terms of purchasing power parity, GDP per capita in Greece was 67.3% of the EU average in 2000. The employment rate of persons aged 15-64 stood at 55.8% in Greece, compared with 63.3% in the EU, while the unemployment rate was three percentage points higher than the EU average. Besides, Greek productivity (GDP per hour worked) amounted to 62% of the European average and Greece's public debt-to-GDP ratio was over 100%, when in most EU countries it was close to the reference rate of 60%. Furthermore, chronic rigidities in certain markets and the inefficiency of public administration in Greece, compounded by an expected reduction in resources from Structural Funds after the forthcoming EU enlargement, were additional factors hindering the economy's real convergence. In the light of the above, the Bank of Greece stressed the need for economic policy makers and the social partners to focus their efforts over the following years on two "intermediate objectives": (a) raising productivity and competitiveness; and (b) completing fiscal consolidation.[190]

The Report for 2000 went on to discuss the main factors and policies that would affect the path towards fiscal stability, with special emphasis on the negative consequences of the social security system and adverse demographic prospects, as well as on reforms which would bring about a "substantial" improvement in

187 Ibid.

188 Ibid.

189 Ibid.

190 Ibid.

competitiveness and help to address the issue of high unemployment effectively, building on the experience and practices of other EU countries that had visibly reduced unemployment.[191]

At the General Meeting of Shareholders of the Bank of Greece in April 2001, Governor L. Papademos closed his Report for 2000 with the following remark and wish: "Only a few years ago, Greece's nominal convergence by the year 2000 and subsequent entry into EMU might have seemed to be a particularly ambitious, if not entirely unattainable, goal. This difficult venture was, however, successfully completed, thanks to the conduct of an appropriate policy, the efforts made by the social partners and widespread social acceptance. If the aims and actions of the social partners and the government are imbued with the vision of real convergence and full employment, which should normally enjoy the widest possible acceptance, then also this vision will become a reality". Ten years later, the goal of real convergence remained unfulfilled, despite some progress, becoming more remote after the debt crisis in Greece and the euro area.

6.19 Institutional and organisational changes

At institutional level, preparations for the single currency began at the Bank of Greece as early as 1997, irrespective of the final date of entry into the future monetary union. The technical preparation was a real feat, about which too little has been written. Hectic work was carried out to harmonise accounting methods with European standards and adapt procedures to the requirements of EMU. The Bank's staff, across all levels of hierarchy, gave a fight that could not have been won unless everyone worked in the right direction. And this fight was won.

In late 1997, the Hellenic Parliament passed Law 2548 on "Provisions on the Bank of Greece", whereby the institutional framework governing the Bank of Greece was harmonised with the provisions of the Treaty on European Union and the Statute of the European System of Central Banks (ESCB). The Bank of Greece became a member of the ESCB as soon as it was established in June 1998. Under that law, the Monetary Policy Council was established, as a body responsible for monetary and exchange rate policy. Furthermore, the Extraordinary General Meeting of Shareholders of the Bank of Greece held on 22.12.1997 approved the necessary amendments to the Bank's Statute, including the provisions on its independence.[192]

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191 Ibid.

192 *Annual Report for the year 1997*, and General Council agenda, "Harmonisation of the Statute of the Bank of Greece with the draft Law 'Provisions on the Bank of Greece'", 28.11.1997, paragraph 2.

These decisions of the Extraordinary General Meeting of Shareholders were ratified by Law 2609 on 11.5.1998,[193] explicitly stating that "the primary objective of the Bank of Greece shall be to ensure price stability. Without prejudice to this primary objective, the Bank shall support the general economic policy of the Government". These provisions were accompanied by the necessary safeguards of the institutional, personal and operational independence of the Bank of Greece.[194] Meanwhile, the Bank, with a number of publications, undertook to inform the public on the upcoming economic and monetary union, the prospective adoption of the euro and its implications for the Greek economy and society.[195]

Given that the national central banks would be responsible for implementing the monetary policy formulated by the European Central Bank, and with a view to testing operational preparedness for the requirements of the ESCB, the Bank took part with great success in a number of tests carried out at the EU level in the second half of 1998. Adjustments were also made in the areas of the institutional framework of the domestic foreign exchange market, monetary policy instruments, statistics and payment systems, in line with European standards. In 1998, an Office for the Management of ESCB-related Foreign Exchange Operations was set up.[196] In 1999, organisational changes were made in key functions, such as the Monetary Policy and Banking Department, the Government Financial Operations and Accounts Department, the Information Systems and Organisation Department and the Administration Department, and an Information and Communications Office was set up, among other things in charge of the Bank's website.[197]

In 2000, the statistics function, formerly part of the Economic Research Department, became a separate Statistics Department.[198] Finally, it was decided to set up a Historical Archive of the Bank of Greece, to highlight the Bank's role in Greek economic history since its foundation.[199]

With a view to ensuring a more effective management of its gold reserves and their eligibility for foreign reserve asset transfers by national central banks to the

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193 *Annual Report for the year 1998.*

194 *Annual Report for the year 1997.*

195 General Council agenda, "Special publications of the Bank of Greece regarding EMU and changeover to the euro", 22.11.1997, paragraphs 10-12.

196 *Annual Report for the year 1998*, and General Council agenda, "Establishment of an Office for the management of ESCB-related foreign exchange operations", 10.3.1998, paragraphs 13-14.

197 *Annual Report for the year 1999.*

198 *Annual Report for the year 2000.*

199 *Annual Report for the year 1999,* and General Council agenda, "Establishment of a historical archive at the Bank of Greece", 3.9.1999, paragraphs 22-24.

future European Central Bank, the Bank of Greece decided an upgrading and conversion into gold bullion conforming to international standards. The upgrade applied to gold reserves kept abroad (at the Federal Reserve Bank of New York, the Bank of England and the Union Bank of Switzerland in Zürich), as well as in the vaults of the Bank of Greece.[200]

As part of the efforts towards modernisation, the Electronic Secondary Securities Market (HDAT) was set up within the Bank of Greece, covering all over-the-counter transactions in government securities and ensuring automation not only of the secondary but also of the primary securities market, as well as the greatest possible transparency. In the area of information systems, the Bank of Greece completed the necessary adaptations to put in place the IT infrastructure supporting payment systems and balance-of-payments compilation, while steps were taken to address the millennium bug.[201] HDAT was effectively launched in May 1998, enabling, among other things, the reliable valuation of the relevant portfolios of banks, insurance undertakings and other firms.[202] Improvements in HDAT continued in the following years, with the development of an electronic trading system for securities and the introduction of a new segment for repos and a credit risk management system, helping to reduce systemic risk in the Greek banking system. Adaptations were also made with a view to interlinking the book-entry securities system with the HERMES payment system.[203] Furthermore, it was decided to set up a special depository for securities, which would also provide custodian services.[204]

To enable the smooth integration of the Bank of Greece into the Eurosystem as of 1.1.2001, a number of substantial adjustments were also made. Specifically, (i) the drachma balances of credit institutions' accounts with the Bank of Greece, which were associated with the conduct of monetary policy, were converted into euro; (ii) the HERMES and the EURO-HERMES payment systems were merged

200 *Annual Report for the year 1997*, and General Council agenda, "Upgrade of the Bank's gold reserves", 14.2.1997, paragraphs 3-4; "Upgrade of the Bank's gold reserves held with the Federal Reserve Bank of New York", 18.4.1997, paragraph 5; "Upgrade of the Bank's gold reserves", 17.7.1997, paragraph 2; "Upgrade of the Bank of Greece's gold reserves", 9.9.1997, paragraph 2; and "Utilisation of the Bank of Greece's gold reserve kept at the Federal Reserve Bank of New York", 25.6.1999, paragraph 2.

201 *Annual Report for the year 1997.*

202 *Annual Report for the year 1998.*

203 *Annual Report for the year 1999*, and General Council agenda, "Expenditure for installing and supporting the operation of HDAT, the repo market and the system for the real-time settlement of transactions in book-entry securities, and addition to the existing system", 5.2.1999, paragraphs 32-37; "Approval of expenditure for expanding the HDAT system to make it accessible by foreign banks and for interlinking the book-entry securities system with the Hermes payment system", 17.11.1999, paragraphs 18-20.

204 General Council agenda, "Establishment of a Special Securities Depository at the Bank of Greece and provision of custodian services", 9.9.1997, paragraphs 11-14, and *Annual Report for the year 1998.*

into a single system to ensure that as from 1.1.2001 all interbank market operations are conducted in euro; (iii) the Bank undertook major investment in technological equipment and adjusted its system for the management of foreign exchange reserves; (iv) the Bank's accounting system successfully migrated to the euro environment, and its systems of communication with the ECB were adjusted; (v) the systems related to the management and trading of Greek government securities successfully migrated to the euro environment, public debt was redenominated in euro and, as from 2.1.2001, HDAT operated in euro. At the same time, the Bank implemented an information campaign, in cooperation with the ECB, so as to properly prepare the public for the introduction of the euro and the withdrawal of the drachma.[205]

In the context of improving the procedures and methods for government securities trading, competitive bid tenders were introduced, securities were dematerialised and the institution of Primary Dealers was put into effect; in February 1999, Primary Dealers comprised eight Greek and six foreign banks. Moreover, the government established, by Law 2628/98, the Public Debt Organisation, which started operating in 1999.[206] On 29.4.1999, the Annual General Meeting of Shareholders decided to dematerialise the shares of the Bank of Greece. Furthermore, by new amendments to the Statute (Articles 8, 9 and 13), approved by the extraordinary General Meeting of Shareholders of 7.10.1999, enabled: (i) an increase in maximum government participation in the share capital of the Bank to 35%, so as to compensate for a possible decrease in social security funds' participation; and (ii) a split of Bank of Greece shares, subject to government approval; and (iii) a modification of the minimum number of shares needed by a shareholder to participate and vote at General Meetings.[207]

A notable development in 1998 was the boom in the Athens Stock Exchange, with share prices rising by 85% between end-December 1997 and end-December 1998. This enabled banks to improve their capital base by tapping the stock market. Favourable stock market developments were attributed by the Bank of Greece to the entry of the drachma into the ERM, the downward trend of nominal interest rates and the higher profits of most listed companies. Yet, the Bank noted that, despite the steep rise in share prices, the P/E ratio in the Greek stock market did not exceed the respective levels seen in other countries of the European South, namely Italy, Spain and Portugal.[208] Share prices and trading volumes on the Athens Stock Exchange

205 *Annual Report for the year 2000.*

206 *Annual Report for the year 1998.*

207 *Annual Report for the year 1999.*

208 *Annual Report for the year 1998.*

moved upwards in 1999, particularly in August and September, falling sharply thereafter. Just before the start of this downward path, Governor Papademos issued a strong but carefully worded warning to investors.[209]

Overall, the Composite Athens Stock Exchange Index rose sharply by 102.2% between December 1998 and December 1999 (reflecting the rise observed in the year to September), compared with increases of 58.5% in 1997 and 85.1% in 1998.[210] For the Bank of Greece, developments in the Greek stock market also revealed its weaknesses as a market in transition to maturity. Large numbers of new market participants in summer 1999 lacked the necessary knowledge and understanding of the risks involved. As a result, excessive expectations were created, which did not reflect the market's fundamentals. Alongside the first downward correction in September 1999, the market also faced challenges as a result of short-selling by securities firms. Eventually, in order to prevent a spillover of these problems to the broader financial sector, the Bank of Greece took action twice, on 27.9.1999 and on 17.3.2000, to facilitate the financing of natural persons (against collateral of securities) and securities firms.[211]

6.20 The banking system

In the new, deregulated international financial environment, banks faced strong competition from insurance companies and mutual funds. Bank intermediation declined, as savers now had more options for placing their money and financial innovation gained ground. The upcoming introduction of the euro would speed up financial integration in Europe, removing barriers to market entry. The late 1990s saw the lifting of the last remaining restrictions on the Greek financial system: among other things, foreign currency-denominated deposit accounts were fully deregulated; the compulsory conversion into drachmas of income arising from investment abroad and flowing back into Greece was abolished; and non-residents were allowed to open bank accounts. Of course, banks needed to carry out the necessary adjustments, both for the upcoming changeover to the euro and for coping with the new competitive environment. The changeover to the euro would entail costs for banks, not only in terms of the technical adjustment of their operating and accounting systems, but also in terms of their income, insofar as they would lose foreign

209 "Alert to investors: Bank of Greece Governor warns and advises…", front-page feature in *Kathimerini*, Sunday edition, 19.9.1999.

210 *Annual Report for the year 1999.*

211 Ibid.

exchange business. Against this background, the most dynamic parts of the Greek banking sector were reoriented to the provision of flexible and innovative products and to universal banking business models. At the same time, there was a tendency towards forming financial groups, comprising diverse subsidiaries, such as mutual funds, investment firms, securities firms, insurance undertakings, etc. Despite the satisfactory profitability of Greek banks, the Bank of Greece strengthened its prudential supervision, keeping a close eye on certain credit aggregates such as consumer credit and loans in foreign currency.[212]

These developments continued well into 1999. The banking system underwent significant consolidation through mergers and acquisitions, and banks strengthened their capital base, expanded their activities (also abroad, often in cooperation with foreign credit institutions) and considerably improved their profitability. In the face of stronger competition and reduced bank intermediation, banks implemented cost-cutting policies through mergers and introduction of new technologies, and expanded into new lines of activity, such as insurance, asset management and supply of new financial products and derivatives. Despite consolidation, the size of Greek banks remained small by EU standards.[213] In addition, the Bank of Greece noted that banks' high profitability was partly due to high stock market gains in 1999.[214]

Another point made by the Bank of Greece was that interest income, traditionally the main income source for banks worldwide, represented only a small share of Greek banks' income, although this share tended to increase. The fast growth of this income reflected the large increase in loans to the private sector (in particular households) since 2000, whereas the spread between lending and deposit rates had diminished. A stronger increase in interest income was expected in view of the shift in bank credit towards the private sector, as these loans offered higher yields than government paper, as well as in the context of the reduction in the reserve ratio from 12% to 2%.

On the other hand, income from commission fees had been declining, which was seen as a negative development, given that this type of income contributes to a further diversification of bank income sources and is less volatile and less exposed to the business cycle. Nevertheless, banks' capital adequacy was seen as satisfactory, with the relevant ratio standing at 16.5% by end-June 2000, offsetting increased credit risk associated with strong credit expansion, most notably in the area of consumer credit.[215]

212 *Annual Report for the year 1997.*

213 *Annual Report for the year 1999.*

214 Ibid.

215 *Annual Report for the year 2000.*

On 15.12.1998, the Bank of Greece and the Hellenic Capital Market Commission signed a Memorandum of Understanding, establishing a framework for information exchange and mutual assistance between the two institutions in order to ensure coordinated and effective supervision of both credit institutions and investment firms.[216]

In the context of its bilateral and/or multilateral cooperation with other central banks in the Balkan region, the Bank of Greece signed an agreement on supervisory cooperation with the Central Bank of Albania (January 1999)[217] and an agreement with the Central Bank of the Former Yugoslav Republic of Macedonia (February 1999) on cooperation in the areas of banking supervision, monetary policy, capital market, statistics, cross-border payment systems and staff training.[218]

In the field of banking regulation and supervision, the Bank of Greece set general criteria and principles to govern banks' internal control systems, instructed banks to establish independent audit and risk management functions and required them to report, on an annual basis, on the adequacy of their lending procedures. The Bank also established a framework of minimum quantitative criteria for assessing the adequacy of banks' loan loss provisions. Capital adequacy was broadly satisfactory in 1998, with the average capital adequacy ratio standing well above 8% and rising.[219]

Lastly, as part of payment system modernisation, the Bank of Greece created the HERMES system, the real-time gross settlement (RTGS) system for payments in drachmas.[220] Since the beginning of 1999, an RTGS for payments in euro (Euro-HERMES) operated alongside the Trans-European Automated Real-time Gross Settlement Express Transfer System (TARGET), while work was carried out to incorporate additional functionalities into the drachma RTGS system and to introduce a new Accounting Plan for the Bank of Greece. In the area of information systems, the Help Desk and the Information Systems Security Unit were set up.[221]

In that period, the Bank of Greece stepped up its personnel training programme, enriching it with subjects such as the use of new IT systems, Greek and international money and capital markets, new risk management methods and tools, etc.[222] In

216 *Annual Report for the year 1998*, and General Council agenda, "MoU between the Bank of Greece and the Hellenic Capital Market Commission", 21.12.1998, announcement.

217 *Annual Report for the year 1998.*

218 *Annual Report for the year 1999.*

219 *Annual Report for the year 1998.*

220 *Annual Report for the year 1997*, and *Annual Report for the year 1999.*

221 *Annual Report for the year 1998*, and *Annual Report for the year 2000.*

222 *Annual Report for the year 1997*, and *Annual Report for the year 1998.*

1997, the Bank of Greece launched its Monthly Bulletin of Conjunctural Indicators (replacing the Monthly Statistical Bulletin) and, as from 1999, a new bimonthly Bulletin of Regional Conjunctural Indicators for Macedonia-Thrace, prepared by its Thessaloniki Branch.[223]

Committed to promoting economic research and disseminating research results, the Bank of Greece held, in cooperation with the Brookings Institution, a two-day conference in December 2000, entitled "Greece's Economic Performance and Prospects". The conference covered a broad range of topics, with a focus on monetary, economic and structural reform policies.[224]

223 *Annual Report for the year 1999.*

224 *Annual Report for the year 2000.* A volume with the papers and the findings of the conference was published in English in 2001, followed by a Greek version in 2002. See Ralph C. Bryant, Nicholas C. Garganas, George S. Tavlas (eds), *Greece's Economic Performance and Prospects,* Bank of Greece & The Brookings Institution, 2001 (http://www.bankofgreece.gr/BoGDocumentEn/Greece%27s_Economic_Performance_and_prospects.pdf).

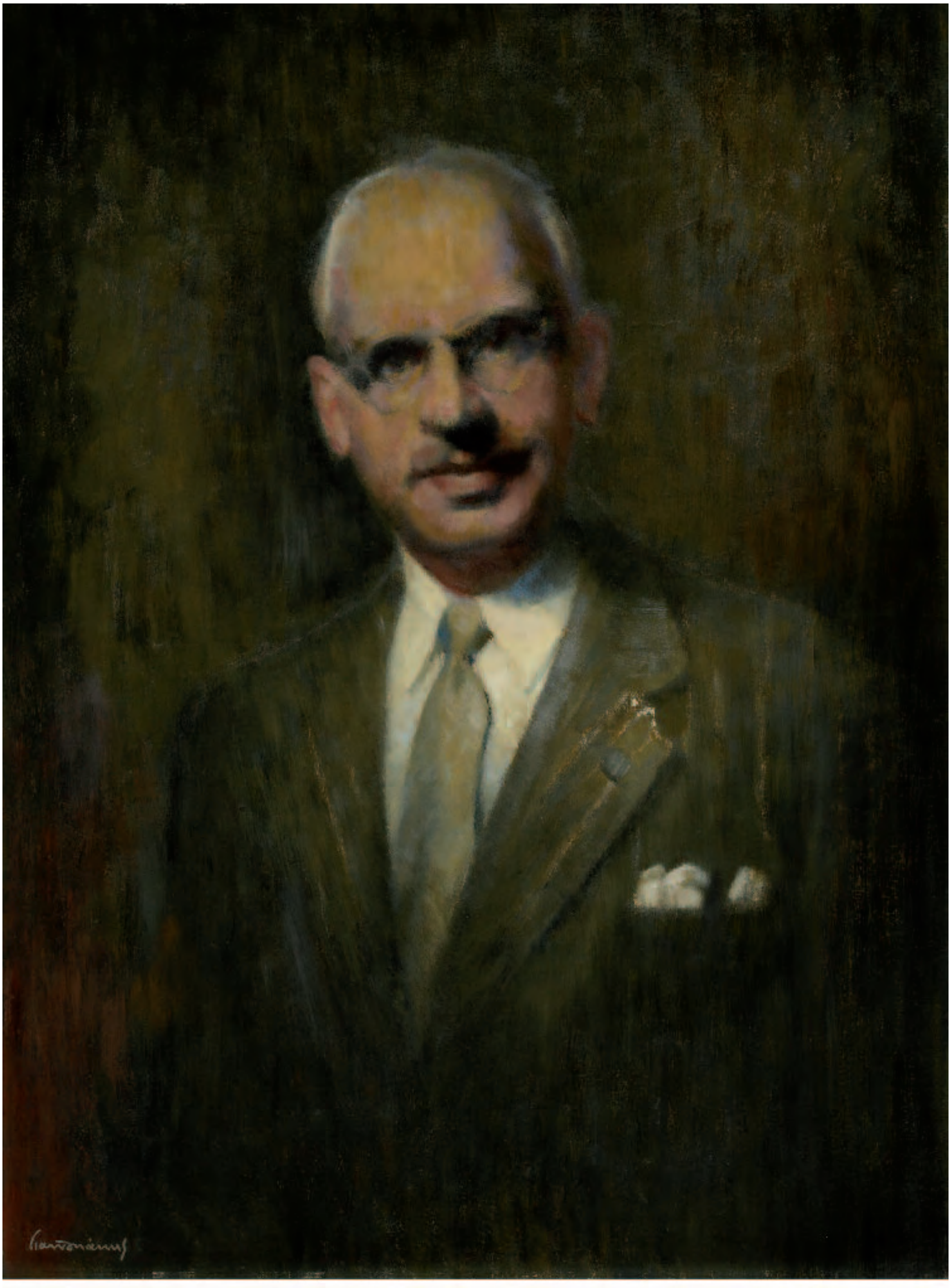
PORTRAITS OF GOVERNORS FROM THE BANK OF GREECE COLLECTION

Alexandros Diomidis (term: 21.4.1928-29.9.1931)
By Dimitris Kokotsis (Kokotsakis)

Emmanouel Tsouderos (1st term: 31.10.1931-13.8.1935; 2nd term: 20.3.1936-10.7.1939)
By Spyros Vikatos

Ioannis Drossopoulos (term: 10.7.1939-28.7.1939)
By Alexandros Korogiannakis

Kyriakos Varvaressos (term: 4.8.1939-11.2.1946)
By Achilleas Varvaressos

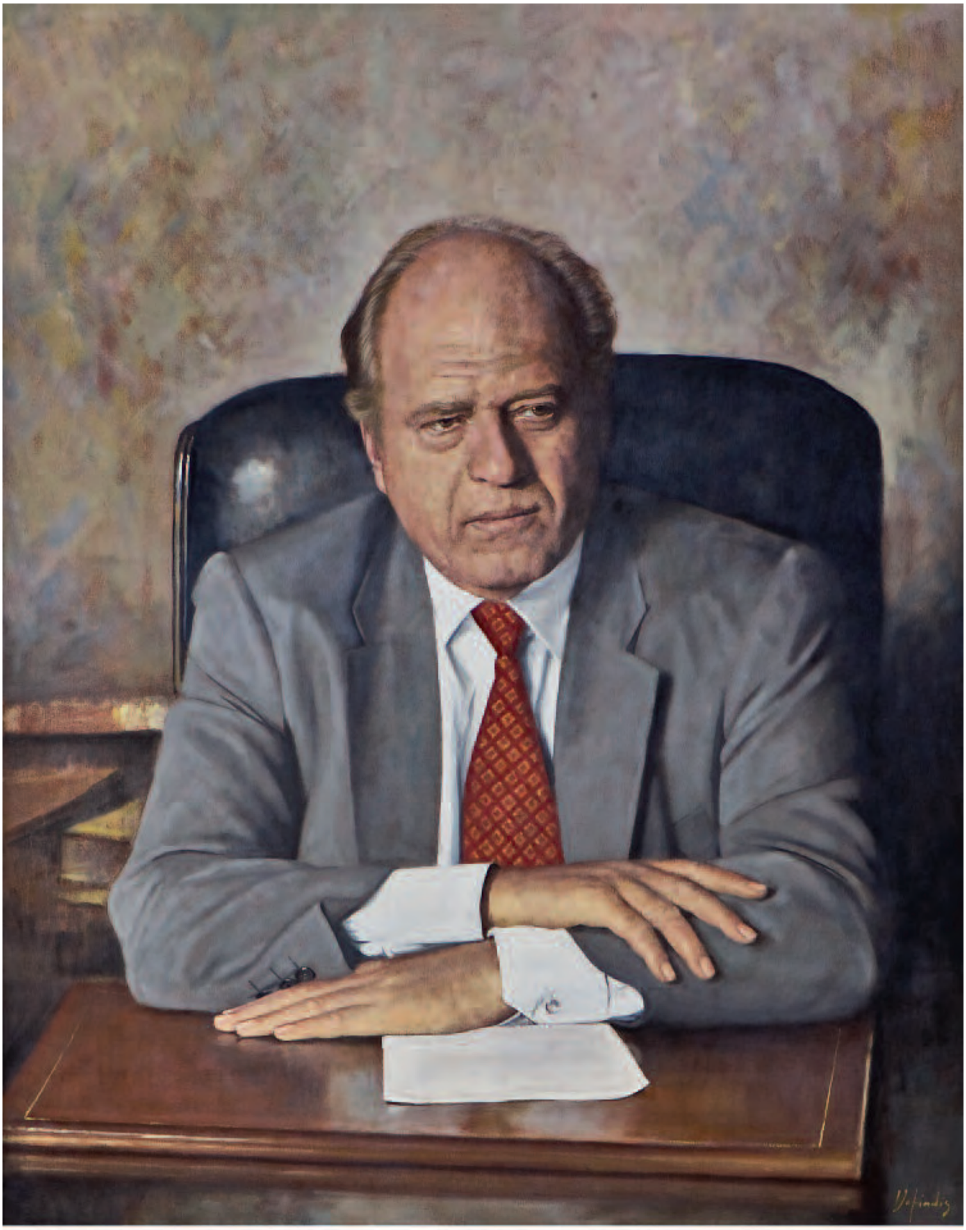


Xenophon Zolotas (1st term: 12.10.1944-8.1.1945;
2nd term: 5.2.1955-7.8.1967; 3rd term: 26.11.1974-3.11.1981)
By Dimitris Giannoukakis

Georgios Mantzavinos (term: 11.2.1946-22.2.1955)
By Alexandros Korogiannakis

Dimitrios Galanis (term: 7.8.1967-4.5.1973)
By Anna Kallia-Vitali

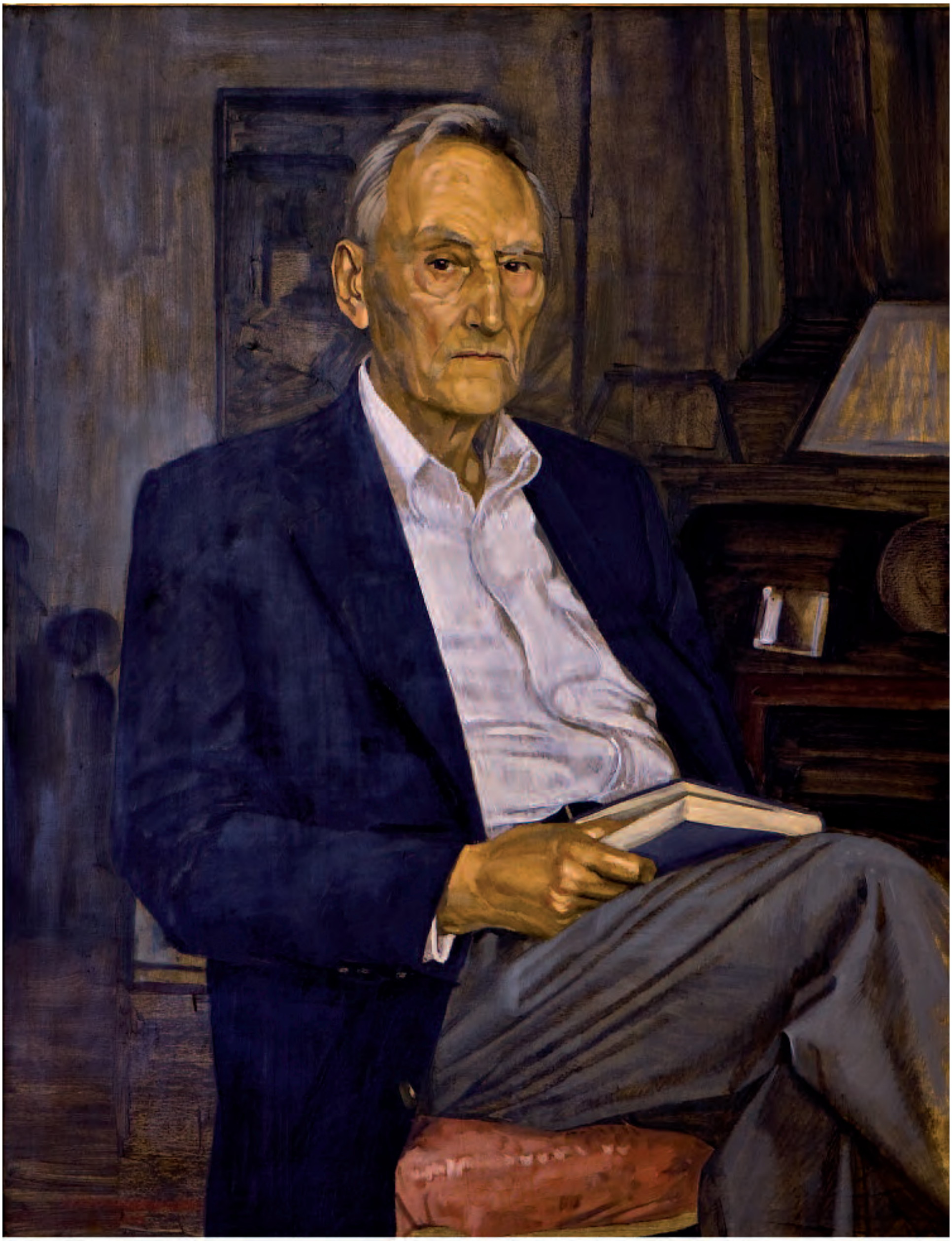
Panayis Papaligouras (term: 9.8.1974-24.10.1974)
By Michel Vafiadis



Gerasimos Arsenis (term: 3.11.1981-20.2.1984)
By Michel Vafiadis

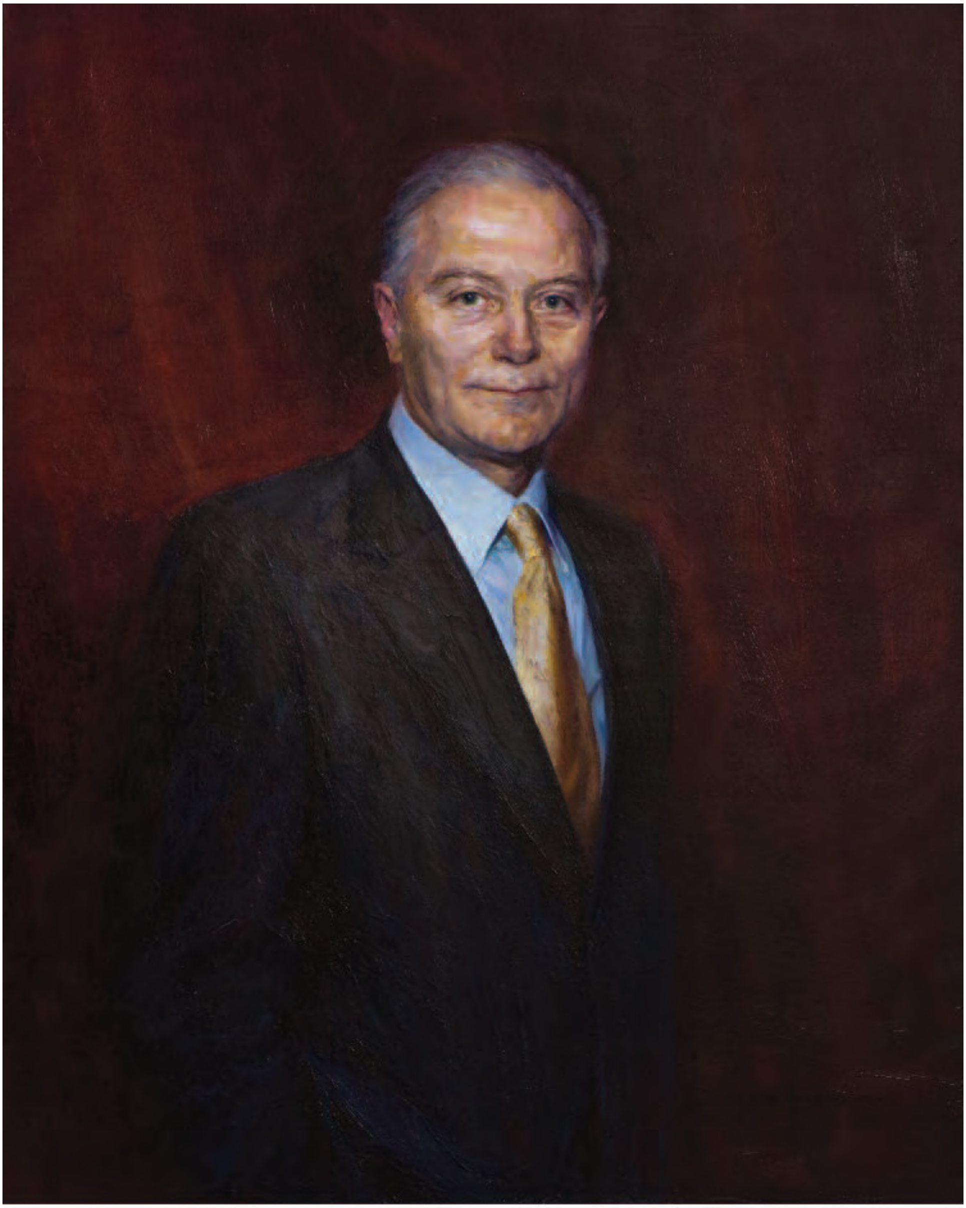
Demetrios Chalikias (term: 20.2.1984-20.2.1992)
By Michel Vafiadis

Efthymios Christodoulou (term: 20.2.1992-1.12.1993)
By Christos Bokoros



Ioannis Boutos (term: 1.12.1993-26.10.1994)
By Kostas Papatriantafyllopoulos

Nicholas Garganas (term: 14.6.2002-14.6.2008)
By Kostas Papatriantafyllopoulos



Georgios Provopoulos (term: 20.6.2008-today)
By Stefanos Daskalakis

7 THE ECONOMY IN THE ERA OF THE EURO, 2001–2008

7.1 Introduction

This comparatively shorter period covers the first years of Greece's participation in the euro area, from 2001 to 2008, when the global financial crisis intensified. Insofar as these first years were marked by enthusiasm for a united Europe and its common currency, as well as for the ensuing benefits for countries like Greece from the drastic reduction in borrowing rates both for the private and the public sector, this period can be seen as the honeymoon of the euro, before the outbreak of the global crisis and the subsequent euro area crisis. The post-2008 period will be discussed in a separate section at the end of this chapter. Before that, it is necessary to review this relatively short period in the history of the Bank of Greece: it was the "roaring 2000s", when the Bank's warnings against an overheating of the economy fuelled by excess borrowing, failure to stem inflation and widening fiscal deficits fell on deaf ears. The key feature of that period was that, by adopting the euro, Greece became part of a broader economic area, within which it had to trade off its monetary and exchange rate sovereignty against the benefits that would arise. The Bank of Greece would from now on implement the single monetary policy and participate in its formulation, but would no longer conduct a national monetary policy, while its core functions would be to ensure price stability (a task mainly carried out through public interventions and statements) and to supervise the domestic credit system.

7.2 The first year of Greece's participation in the euro area and of the Bank of Greece as member of the Eurosystem

2001, the first year of the country's participation in the euro area, was a turning point for the Greek economy, which, since the adoption of the single currency on 1.1.2001, entered a new monetary environment that ensured a high degree of price stability and favoured economic growth. At the same time, the year 2001 was a milestone in the history of the Bank of Greece, as the Bank became a member of the Eurosystem (which comprises the ECB and the national central banks of the countries that have adopted the euro) and started implementing the single monetary policy.

As a necessary condition for the implementation of the single monetary policy in Greece, the euro had to be introduced in scriptural form, and the domestic money market had to be linked to the euro area money market. This endeavour was successfully carried out on 1.1.2001, following systematic preparations and coordinated actions by the Bank of Greece and domestic credit institutions. In the course of 2001, the production of euro banknotes and coins was completed, followed by the frontloading of credit institutions. The Bank of Greece, in cooperation with the government, commercial banks, economic agents and professional cash handlers, played a decisive role in the smooth introduction of euro banknotes and coins and the gradual withdrawal of the drachma from circulation from 1.1.2002 onwards. A major component of this preparatory work was an information campaign that was implemented by the Bank of Greece and lasted for several months. The euro cash changeover marked the completion of the process for the introduction of the single currency and the transition to a new monetary environment.[1]

The primary objective of the single monetary policy of the Eurosystem – in the formulation and conduct of which Greece has participated since 2001 – is to achieve and maintain price stability in the euro area. Without prejudice to this objective, monetary policy also supports the general economic policy goals in the European Union.[2] In 2001, the single monetary policy was conducted in an environment characterised by significant economic slowdown in the euro area and worldwide, as well as heightened uncertainty in international financial markets in the wake of the 9/11 terrorist attacks in New York. Although in the first four months of the year, against the background of rising inflation, the ECB kept its key interest rates unchanged, thereafter (between early May and early November 2001) lowered its

1 *Annual Report for the year 2001.*

2 Ibid.

policy rates on four occasions, by a total of 150 basis points, judging that monetary developments did not pose risks to price stability in the medium term.[3]

The performance of the Greek economy in 2001, the first year of EMU participation, was determined by the single monetary policy of the ECB, national economic policy and developments in the global economy. Global economic developments contributed to a slowdown in the growth rates of exports of goods and services, industrial output and private business investment, but their adverse impact on economic activity was offset by other factors, such as buoyant private consumption and a strengthening in residential investment. As a result, real GDP growth remained unchanged from 2000, at 4.1%, well above the euro area average.[4] Inflation in Greece broadly mirrored the pattern of euro area inflation, but stood at higher levels: in 2001, average annual HICP inflation was 3.7% in Greece, compared with 2.9% in 2000 and 2.6% in the euro area. The persistence of inflation at a relatively high level was primarily due to the indirect and lagged effect of exogenous factors that had emerged in 2000 (higher international oil prices, appreciation of the US dollar vis-à-vis the euro) and to a much lesser extent to a slightly faster rate of increase in unit labour costs, which nevertheless had declined sharply compared with 1994 (when Greece started its effort to meet the convergence criteria under the Maastricht Treaty). As noted by Governor L. Papademos, while "the fall in interest rates due to the changeover to the single monetary policy had a clear expansionary impact on demand", it did not eventually lead to an "increase in inflationary pressures (although it may have prevented their reduction), because, on the one hand, a significant part of the rise was channelled to imported products and, on the other hand, the intensifying price competition on the import side kept in check the profit margins and the rise in the prices of domestic products".[5]

The Bank of Greece estimates about the impact of the euro cash changeover on price developments are also of particular relevance. Indeed, on the basis of data from the national CPI for the first quarter of circulation of euro banknotes and coins in 2002, the new currency contributed 0.5 percentage point to the annual rate of increase in the level of prices excluding fuel and fresh fruit and vegetables. Price increases concerned goods and services provided mainly by sole proprietors or small family businesses, although, in some cases, they were also associated with the pricing policies of large corporations. This upward rounding of prices was only partly offset by a downward rounding implemented by the public sector and some large

3 Ibid.
4 Ibid.
5 Ibid.

private enterprises. It should also be noted that hikes in the prices of certain goods that accounted for roughly 20% of the CPI basket, had already been recorded shortly before the introduction of the euro, i.e. between September and December 2001. Besides, the findings of a relevant survey confirmed that the main effect of the cash changeover on inflation stemmed from higher prices of services rather than of consumer goods. Finally, another survey showed that the rounding-up of prices was not peculiar to Greece, with the Greek percentage of round-ups standing close to the euro area average.[6]

The current account deficit fell to 6.2% of GDP in 2001 (from 6.8% in 2000), still remaining high. Of course, as noted by L. Papademos, the adoption of the single currency had significantly reduced the importance of the current account deficit (and its financing) as a constraint on the conduct of economic policy. Nevertheless, developments in the current account balance "continue to provide useful information about the competitiveness of the Greek goods and services both in the domestic and in the world markets and affect GDP growth".[7]

With respect to public finances, as mentioned in the *Annual Report*,[8] the systematic effort made over a number of years resulted in a small general government surplus in 2001, amounting to 0.1% of GDP, against a deficit of 0.8% of GDP in 2000, according to the then available data.[9] At the same time however, L. Papademos noted that the observed elimination of the general government deficit resulted mainly from reduced interest payments, while the increase in the general government primary surplus was marginal, reflecting exclusively increased capital transfers to general government from the EU, given that primary expenditure remained unchanged as a percentage of GDP, and government revenue and social security contributions decreased.

The implementation of the single monetary policy in Greece from 2001 onwards pushed bank rates downwards. Deposit rates converged almost fully to the respective euro area rates, and the weighted average rate on deposits and repos fell by

6 *Monetary Policy 2001-2002,* and *Annual Report for the year 2001.*

7 *Annual Report for the year 2001.*

8 Ibid.

9 Deficit figures were repeatedly revised over the next years. According to the initial EDP notification by the NSSG to Eurostat (27.2.2004), the general government deficit ratio was below the reference value of 3%, both in 2000 (2.0% of GDP) and in 2001 (1.4% of GDP). Subsequently, following a fiscal audit, the revised deficit ratio notified to Eurostat on 31.8.2004 was in excess of 3%, i.e. 4.1% of GDP for 2000 and 3.7% of GDP for 2001. This revision was mainly due to a change in the methodology for recording defence spending, but also to the revised surpluses of social security funds, changes in the timing of revenue recognition, and a revision of the level of total (non-defence) expenditure of the State Budget. On the basis of the latest available estimates (European Commission, *Statistical Annex to European Economy – Spring 2013 and Autumn 2013*), the general government deficit was 3.7% of GDP in 2000 and 4.5% of GDP in 2001.

2 percentage points in 2001. Similar reductions were also observed in bank lending rates.[10] It goes without saying that monetary and credit aggregates in Greece were no longer influenced by a national monetary policy pursued by the Bank of Greece, as was the case prior to 2001, whereas they only partly reflected the effects of the single monetary policy, which was formulated at the euro area level. As pointed out in the *Annual Report* by Governor L. Papademos, 2001 saw a considerable deceleration in the increase in M3, which was now a component of the euro area M3. Greek M3 growth moderated to 6.7% in the fourth quarter of 2001, from 12.8% one year earlier. This moderation was mainly associated with a slowdown in credit expansion to both the private and the public sectors, although credit growth in Greece was higher than in the euro area. Total credit expansion slowed down to 15.7% in 2001, from 20.2% in 2000.

With respect to the changing composition of bank credit, the Bank of Greece noted that credit expansion to households (housing and consumer loans) had accelerated to 40%, while credit expansion to enterprises had declined to 18.6%, with the exception of tourism-related and leasing companies. However, the outstanding amount of bank loans to households accounted for only 18% of GDP at end-2001, well below the respective euro area ratio (50% of GDP at mid-2001). In addition, the share of household loans in total loans was lower in Greece than in the euro area. Nevertheless, the Governor pointed out that the share of household loans in total loans had been increasing, with direct implications for the quality of Greek banks' loan portfolios. Certainly, another factor behind strong credit expansion to households was a decline in bank rates in Greece, as a result of ECB interest rate cuts. Specifically, the interest rate on consumer loans fell to 12.7% in December 2001, from 14.7% in December 2000, while that on housing loans dropped to 5.8% from 8.2% in the same period.[11] (For developments in the banking system and the Bank's supervisory role in 2001, see Section 7.5 below.)

Turning to the medium-to-long-term prospects of the Greek economy and the challenges for economic policy, in April 2002, 16 months after the adoption of the euro, Governor L. Papademos noted in his *Annual Report* for the year 2001 that the impact of significant factors that had supported long-term growth prospects would gradually, and perhaps substantially, fade five years ahead. Such factors included inflows from the EU budget as well as the expenditure associated with the Athens 2004 Olympic Games. On the other hand, he stressed that the "comfortable financing conditions for households and firms", which had supported economic growth

10 *Annual Report for the year 2001.*

11 Ibid.

in the previous years, were expected "to continue in the future", although he clarified that "this means that they will remain more favourable than they were before Greece joined the euro area, but not necessarily more favourable than they are today" and cautioned that "in Greece the debt of the private sector, and more particularly of households, as a percentage of GDP is still low, compared with the euro area as a whole or the US. Nevertheless, while Greek households are not overindebted, on the basis of available data, the persistence of current trends over a number of years may increase their liabilities excessively. This would create problems as far as debt servicing is concerned, with negative effects on consumer spending and economic activity. The Bank of Greece is of course monitoring these developments closely and is striving [...] to increase transparency in the credit market, so as to – among other things – make credit risk management by banks more efficient and prevent negative developments of this type".

This assessment of the long-term economic outlook, including the diminishing effect of favourable factors, had important policy implications: "First, [...] resources available during the current period must be utilised efficiently, so as to multiply their effectiveness and prolong their beneficial effect. Second, fiscal policy must be able to mitigate the short-term consequences of cyclical shocks due to the gradual decrease in the positive contribution of the above factors and, more generally, the impact of shocks that could cause fluctuations in economic activity. Therefore, the fiscal consolidation effort will have to be sustained, as provided for in the Greek Stability and Growth Programme, so that fiscal surpluses and a drop in the public debt-to-GDP ratio over the coming years will make the conduct of anti-cyclical fiscal policy possible whenever necessary, without impeding the achievement of balanced budgets in the medium term. Third, appropriate conditions and policies must be created and formulated in time, in order to help maintain high growth rates, mainly by increasing net exports and utilising opportunities in the world market. Such policies include those aimed at attracting foreign direct investment. Greece must take advantage of its participation in the euro area more, and expand its trade transactions with the other Member States, while particular attention must also be paid to developing trade with the EU candidate countries. The expansion of exports presupposes, inter alia, that Greece will succeed in utilising its comparative competitive advantages (primarily in the sectors of tourism and shipping, but also in certain branches of agricultural and industrial production). Such advantages also include Greece's position in a geographical region where it is – so far – the only Member State of the EU. The question therefore is how Greece can improve the conditions and policies that will provide continued and substantial support to the growth dynamics of the Greek economy over the next ten years".[12]

According to the Governor, the answer to this question was "reforms in several sectors [that] will have to be accelerated and widened in scope, so as to increase the efficiency of the economy and improve its competitiveness", as well as the "completion of fiscal consolidation, and the steady reduction of the debt-to-GDP ratio […which] will also contribute to the achievement of growth targets and […] enable fiscal policy to help stabilise economic activity in the short term".[13]

As key policy priorities with a view to long-term fiscal stability, L. Papademos identified the reform of the social security system (the "major economic policy issue"); the tax reform; and effective control on primary public expenditure, by introducing rules and limits across all the components of the public sector and by enhancing transparency concerning total – current and future – liabilities of the general government sector.

In his *Annual Report* for 2001 (April 2002), Governor L. Papademos elaborated further on the social security issue, which was a ticking time bomb threatening fiscal stability. Once again he identified a combination of factors as the root cause of the problem, namely (a) population ageing; (b) the pay-as-you-go character of the existing pension system; and (c) the accumulation of financial burdens from past policy choices. A reform of the pension system was necessary to secure its viability, to safeguard long-term fiscal stability, as well as to ensure a fairer distribution of the burden across generations. According to the Bank of Greece, a comprehensive approach to the problem was warranted, involving: (a) policies geared towards boosting employment, through the integration of immigrants into the formal labour market and the social security system; (b) strategies to reduce contribution evasion; and (c) a policy for better linking pension contributions to benefits, through parametric and structural changes, as well as through the direct funding of welfare or social policy benefits by the ordinary budget rather than by social security funds. In connection with this, and with respect to the crucial issue of social security funding, L. Papademos drew the attention of the successive governments to a high and rising public debt and to the urgent need to reduce it, adding that the resources needed for financing the social security system should come from cuts in other, non-productive government expenditure rather than from increased total expenditure or a higher tax burden.[14]

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12 Ibid.

13 Ibid.

14 See *Annual Report for the year 2000.* (published in April 2001, when public debate was dominated by the pension reform plan prepared by the then Minister of Labour and Social Affairs, Tassos Giannitsis, which was never implemented), as well as *Annual Report for the year 2001.*

In addition to the pension and tax reforms, and with a view to promoting sustainable growth after Greece had joined the euro area, the Governor highlighted the importance of reforms aimed at modernising public administration; enhance the efficiency of the labour market; increase market competition, particularly by opening up the energy market; speed up privatisations; and further improve the effectiveness of the banking system.

Summing up the assessment of Greece's economic prospects and of policy challenges in the era of the euro, L. Papademos highlighted the following: "The prospects of achieving real convergence and full employment are favourably affected by the adoption of the euro and the monetary and exchange rate stability this entails [...]. The real convergence process is, however, impeded by the constraints imposed by high public debt, low productivity, and the combination of ineffective functioning and insufficient competition in some markets. Consequently, the monetary stability ensured by the adoption of the euro [...] should not lead to complacency and a slackening of the efforts to complete fiscal consolidation and improve the economy's productivity and international competitiveness. Furthermore, the main goal should be to achieve and maintain price stability in our country, which cannot be ensured solely by means of the single monetary policy. The conduct of an appropriate national economic policy is also required, as well as the contribution of the social partners, through the implementation of a prudent pricing policy and agreements on collective wage increases that match the rise in productivity and ensure price stability. [...] Through a systematic approach, prudence and consensus, we can successfully carry out the reforms that will lead to a significant improvement in competitiveness and the completion of fiscal consolidation. These are the two main prerequisites that must be ensured in order to achieve full employment and real convergence and enhance social cohesion".[15]

As mentioned at the beginning of this chapter, the Bank's warnings were not heeded, and its recommendations were not acted on. In the eight years that followed, not only did fiscal consolidation remain incomplete, but also fiscal deficits widened, while the international competitiveness of the Greek economy suffered considerable losses.

L. Papademos resigned from the Bank of Greece on 27.5.2002, when he was appointed Vice-President of the ECB. On 14.6.2002, Deputy Governor Nicholas Garganas was appointed Governor of the Bank of Greece, and Nikolaos Paleocrassas became Deputy Governor.

15 *Annual Report for the year 2001.*

7.3 Macroeconomic and monetary developments, fiscal adjustment and structural problems, 2002-2007

In his first Report as Governor, presented to the Annual General Meeting of Shareholders in April 2003, Nicholas Garganas noted that the high degree of economic stability and credibility stemming from Greece's EMU participation had contributed in recent years to an acceleration in GDP growth, which stood at 4% in 2002, i.e. roughly unchanged compared with 2000 and 2001, despite the adverse international economic environment. The Governor highlighted the positive contribution of considerable inflows from the EU Structural Funds. On the other hand, he pointed out that the rise in employment had been small and the unemployment rate had declined at a slow pace. Moreover, average annual HCPI inflation had picked up slightly to 3.9% in 2002 (from 3.7% in 2001) and its differential from the average euro area inflation had widened, while the current account deficit had narrowed only marginally, to 6.1% of GDP (from 6.2% in 2001). With respect to the latter, the Governor remarked that, although "the existence of a high current account deficit, which reflects a shortfall in domestic saving relative to domestic investment, is to be expected in a fast-growing economy which is traditionally a net capital importer […], the deficits recorded in recent years seem to stem also from a loss of price competitiveness", and warned that "if the current levels of the deficit persist, they could have negative repercussions on growth and employment". The policy implication was that there was a need for further structural reforms in the product and labour markets, as well as fiscal adjustment, in order "to improve the competitiveness of the Greek economy and achieve real convergence towards the other euro area countries".[16]

On the monetary front, Greek M3 growth continued to slow down in 2002, falling to 2.1% in the last quarter of 2002, from 4.4% one year earlier (according to revised data), before turning negative (-0.2%) for the first time in December 2002. Overall, monetary dynamics remained weak in 2002, with the Greek M3 growth rate corresponding to about one third of that for the euro area aggregate. This was due to weaker credit expansion to firms and households, as well as to a shift from repos (which were again subject to tax) to longer-term deposits and government paper. At the same time, interest rates on deposits and repos dropped by 0.3 percentage point on average, also on the back of lower ECB key interest rates. However, real interest rates largely hovered in negative territory, as inflation was above

16 *Annual Report 2002.*

nominal interest rates. Interest rates on housing loans also declined, while those on consumer/personal loans remained unchanged at their December 2001 level.[17]

Notably, loans to households accounted for 61.4% of total credit expansion, a considerably higher share relative to 2001 (46.7%) and 2000 (34.7%). However, households' total liabilities vis-à-vis the banking system stood at 22.3% of GDP at end-2002, compared with 47% in the euro area. Therefore, Governor N. Garganas considered that Greek households' indebtedness was not high by European standards. In this connection, a survey conducted on behalf of the Bank of Greece indicated that the majority of bank debtors were households of relatively high income and wealth, while the outstanding balance of loans did not exceed, on average, their annual income, even in the lowest income brackets.[18]

In November 2002 and April 2003, looking into the social security issue from a longer-term perspective, N. Garganas also highlighted the need to speed up the establishment of the other two pillars based on capitalisation: the second pillar, i.e. occupational funds, and the third pillar consisting in voluntary retirement savings. Such a three-pillar system would offer multiple advantages, as it would: (a) offer workers a wider array of options regarding their social security coverage; (b) help to reduce mandatory social security contributions and public expenditure for pensions; and (c) improve the relationship between contributions and benefits. Moreover, the Bank of Greece warned that, despite potential social reactions, failure to reform social security in a timely manner would lead to much heavier tax burdens on future generations.[19]

In the *Annual Report for 2003,* presented at the General Meeting of Shareholders in April 2004, Governor N. Garganas took stock of the performance of the Greek economy in the first three years of euro area participation and observed that, although the growth rate had remained high, productivity was still low and the decline in the unemployment rate had not been satisfactory. Most worryingly, inflation had remained above the euro area average, implying further competitiveness losses. In addition, the current account deficit, which had declined slightly to 5.7% of GDP in 2003, had overall increased in the preceding four years, while the fiscal position had deteriorated, with the general government deficit coming close to the reference rate of 3% of GDP in 2003 (based on data available at the time) and public debt declining marginally and remaining above 100% of GDP. N. Garganas reiterated

17 Ibid.

18 Ibid. and General Council Agenda, "Contract with ICAP for the conduct of a survey on Greek household borrowing and indebtedness", 30.7.2002, paragraphs 2-3.

19 *Annual Report for the year 2002.* See also *Monetary Policy – Interim Report 2002.*

that achieving real convergence called for a policy geared towards the dual goal of reducing inflation and increasing productivity and growth. It was therefore necessary to speed up structural reforms that would make the Greek economy more competitive. In this respect, the Bank recommended: (a) promoting reforms to ensure a more flexible labour market, as well as active employment policies combining flexibility and job security and encouraging labour demand and supply; (b) supporting entrepreneurship, with an emphasis on R&D and innovation; (c) speeding up privatisations, opening up closed-shop (regulated) professions and strengthening the role of the Competition Commission; (d) upgrading the education system and modernising public administration; (e) pressing ahead with fiscal consolidation, in tandem with effectively tackling the social security problem; and (f) maintaining price stability, in cooperation with the social partners, through wage moderation and appropriate pricing policies. As N. Garganas warned – and subsequent developments proved him prophetic – "… however, these reforms are essential […] for rapid and sustainable economic growth […]. Failure to act will have dire consequences".[20]

In general, the Governor never failed to stress that the competitiveness of the Greek economy as a member of the euro area hinged upon reforms that would counteract the loss of national policy instruments, such as exchange rate policy.[21] Greek governments should seek to offset the impact of a persistent positive inflation differential vis-à-vis the euro area by fiscal and labour market policies, as well as structural reforms to enhance productivity and competitiveness. Euro area membership left no room for complacency in economic policy; rather than a reward for the country's past achievements, it should be seen as a commitment to a reform policy in the future. A similar stand was taken by the Governor at ECB bodies, where, unlike what some could expect of a central banker of a Mediterranean country traditionally favouring more relaxed policies, he fervently advocated monetary discipline, at the European level as well, rather than a short-term discretionary policy that would fan inflation.

Turning to monetary developments, the downward path of interest rates continued in 2003, with a concurrent increase in M3 growth. However, interest rates in Greece were still well above euro area average rates, with the widest interest rate differential observed in consumer loans. Consumer loan growth had declined less than the growth of total loans to households in 2003. On the other hand, 2003 witnessed the first housing loan securitisation to be carried out by a Greek bank.[22]

20 *Annual Report for the year 2003.*

21 For a comprehensive evaluation of competitiveness losses in the 2000s, see Malliaropulos (2011).

22 *Annual Report for the year 2003.*

In April 2005, the Report for 2004 confirmed a weakening in the robust economic growth rate, from 4.7% in 2003 to 4.2% in 2004, while a further slowdown to about 3% was projected for 2005.[23] Strong GDP growth and the hosting of the 2004 Olympic Games boosted employment, but this was not accompanied by a significant decline in the unemployment rate, which stood at 10.5% in 2004, 2.5 percentage points higher than the EU-15 average.[24] HICP inflation remained unchanged at its end-2003 level of 3.2%. However, core inflation picked up in 2004 (3.4%) relative to 2003 (3.1%). According to N. Garganas, persistently high core inflation was due to inflationary pressures from higher labour costs[25] and inadequate competition in certain markets.[26] On the positive side, the current account deficit decreased markedly, to 3.9% of GDP in 2004 from 5.6% in 2003. This decrease could only be sustained if further reforms to raise productivity and competitiveness were implemented, as repeatedly stressed by the Bank of Greece.[27]

Even stronger was the Governor's warning about fiscal imbalances: based on the then available data, the general government deficit rose further in 2004, to 6.1% of GDP, the highest ratio in the euro area. Primary expenditure of the ordinary budget, which included compensation of central government employees, pensions and grants, grew by 15.1%, while investment budget expenditure rose by 12.8%. The general government deficit as a percentage of GDP was much higher than the initial budget forecast (for a mere 1.2% of GDP!).[28] The overrun was partly due to a technical factor, i.e. the 2004 Fiscal Audit, which, because of the way it had been carried out, ended up in undermining the credibility of Greek statistics and of the country in general. The audit not only failed to trigger institutional changes that would ensure reliable Greek statistics in the long run, but also proved to be ineffective, as it had been motivated by domestic political considerations which however affected an area where the markets are the ultimate judge. The harm that was done would become evident much later, when the Greek crisis broke out.

Meanwhile, following the ECOFIN's decision of 5.7.2004, an Excessive Deficit Procedure (EDP) was opened against Greece. The set of measures to reduce the deficit submitted by Greece in November 2004, although in the right direction, were

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23 *Annual Report for the year 2004.*

24 Ibid.

25 With particular regard to labour costs, the Bank's analysis and policy recommendations are summarised in: *Monetary Policy 2003-2004,* Appendix to Chapter V "The impact of wage increases on economic performance", pp. 126-130, March 2004.

26 *Annual Report for the year 2004.*

27 Ibid.

28 Ibid.

not considered sufficient, according to the European Commission's assessment on 22 December.[29] Thus, the EDP was stepped up, from Article 104(8) of the Treaty to Article 104(9), i.e. the last step before sanctions. New recommendations were issued on 17.2.2005, when Greece was granted a one-year extension of the deadline and was invited to reduce its deficit below 3% of GDP by end-2006. In response, the Greek government prepared and submitted a revised update to its Stability and Growth Programme for 2004-2007, which was reviewed by the ECOFIN on 12.4.2005 and found to be in line with the recommendations of the Council's previous decision.[30] On 24.11.2005, the European Commission assessed the biannual progress report submitted by Greece and noted that most of the fiscal adjustment had been due to lower investment spending, while current spending had only been curtailed to a limited degree.

Furthermore, the assessment of the Updated Stability and Growth Programme 2005-2008 by the European Commission and the ECOFIN stated that the long-term sustainability of Greece's fiscal position was seriously threatened by the high public debt, compounded by the expected burdening of public finances as a result of population ageing.[31]

Against this background, N. Garganas stressed that: "Fiscal consolidation, in the context of the revised Updated Stability and Growth Programme 2004-2007, as well as in the longer run, is a top priority for the years ahead. The magnitude of fiscal imbalances is indicated by the very high levels of the general government deficit and debt, which are the highest in the euro area. Furthermore, the impact of population ageing on pension and health expenditures is expected to be quite large and growing after 2015 and to be the largest (as a percentage of GDP) in the euro area. If fiscal imbalances are not addressed effectively on time, the public sector's creditworthiness and macroeconomic stability will be jeopardised. There will also be unfavourable implications for the viability of the social security and health systems, specifically as regards their ability to cover pension and health expenditures, as well as for the quality of services the public sector provides. Instead, early progress with the correction of fiscal imbalances will help safeguard such social and public benefits, in an environment of economic stability and growth". At the same time, he explained the relationship between the necessary sustained improvement of the fiscal position and the pursuit of economic growth and social progress: "Over the

29 "… Greece has taken no effective action to correct its excessive deficit", European Commission, Press release IP/04/2004 and SEC (2004) 1622, p. 5.

30 *Annual Report for the year 2004.*

31 *Annual Report for the year 2005.*

longer term, fiscal policy should be geared towards attaining a budgetary position of close to balance or in surplus, so as to facilitate debt reduction to sustainable levels, i.e. not exceeding the reference value of 60% of GDP provided for by the Treaty on European Union. Besides the envisaged sharp reduction of the deficit in 2005 and 2006, there will be a need for a durable further improvement in the fiscal position through structural changes in public expenditure and revenue collection. Purely indicatively, a debt reduction to, say, 60% of GDP by 2015 would require – on the basis of certain assumptions regarding mainly nominal GDP growth and interest rates – primary surpluses of more than 4% of GDP annually, compared with a primary deficit of 0.4% of GDP in 2004. The gradual decline in government debt will imply lower interest payments, thus releasing considerable resources for other uses. There will also be a need for strict control and review of current expenditures, broadening the tax base and curbing tax evasion. This will ensure that the deficit reduction will be consistent with undertaking adequate public investment in infrastructures and human capital, as well as with implementing further cuts of direct tax rates, which are desirable both because high tax rates act as economic disincentives and because there is intense 'tax competition' among the EU countries".[32]

The Report for 2004 discussed more thoroughly the projected serious demographic changes, which were expected to have major implications for the pension system. On the one hand, higher average life expectancy, reflecting improved living conditions and health, and on the other hand, the low fertility rate of roughly 1.3, which was falling short of the 2.1 threshold needed to renew the population, would lead to a 38% rise in the population aged 65 or over and to a 4.5% decrease in the population aged 15-64 between 2005 and 2030. Those data suggested that the elderly dependency ratio (i.e. the number of persons aged 65 or over as a percentage of the number of those aged 15-64) would rise from 26% in 2005 to 37% by 2030. As a result, pension expenditure was projected to rise from 12.4% of GDP in 2005 to 22.6% of GDP in 2050. Moreover, total age-related spending should increase from 21.1% of GDP in 2005 to 32.6% of GDP in 2050. As mentioned in the Report, although it was not safe to rely on projections referring to such long horizons, these estimates clearly demonstrated the magnitude of the problem. Another consequence would be that, despite the positive effects on productivity from a higher share of labour force with longer work experience, the increase in the workforce's average age also implied lower adaptability to new technologies, which would weigh on productivity growth. However, the negative impact of population ageing on the viability of the social security system in general could be eased through measures aimed at raising the

32 *Annual Report for the year 2004.*

employment rate, such as encouraging the labour market entry of immigrants, increasing female labour market participation and limiting early retirement.[33] Early retirement was strongly criticised by the Bank of Greece as socially unfair and uneconomic. Given that an early retiree received a pension which was a multiple of total contributions paid during his/her working life, while a person retiring at the statutory retirement age received a pension that was only a fraction of his/her total contributions (even if it might be higher in absolute terms), this inevitably gave rise to blatant social inequalities. Furthermore, early retirement placed a huge burden on the finances of social security funds, as this translated into a reduction in social security contributions and a corresponding additional increase in pension payments. Besides, contribution evasion was directly linked to the non-contributory nature of the existing social security system, to the extent that the weak link between contributions and benefits acted as a disincentive for insured workers to pay their contributions.[34]

With regard to monetary and credit developments in 2004, M3 growth in Greece increased considerably, while interest rates on new loans to households, and mostly on consumer loans, fell significantly, unlike those on business loans, which remained broadly unchanged. The above developments were reflected in the growth rate of loans to households, which remained elevated (close to 28%) at end-2004. In particular, consumer loans grew by 37.9% year-on-year in the last quarter of 2004. At the same time, the share of household loans in total loans continued to increase, reaching 44.1% at end-2004, compared with 39.7% at end-2003 and 36.4% at end-2002.[35]

As stressed in the 2005 *Annual Report,* which was published in April 2006, GDP growth was stronger than the EU-15 average for the tenth consecutive year, despite a relatively small deceleration to 3.7% and an anticipated further slight decline to 3.5% for 2006 according to Bank of Greece forecasts. However, a number of serious macroeconomic and structural imbalances still remained, as evidenced by relatively high inflation rates (with HICP inflation rising to 3.5% and driving the differential from the euro area average further upwards), an unemployment rate that was among the highest in the EU (despite a small drop to 9.9%) and a current account deficit which widened significantly to 7.9% of GDP in 2005. N. Garganas added that the sizeable current account deficit was attributable to the relatively high level of investment alongside a shortfall in savings (as a result of the fiscal deficits and

33 Ibid.

34 *Annual Report for the year 2005.*

35 *Annual Report for the year 2004.*

household consumption behaviour), as well as to low structural competitiveness and losses in international price and cost competitiveness. In sum: "This uneven performance of the Greek economy reflects, on the one hand, the loose monetary conditions that currently prevail across the euro area and, on the other hand, the large budgetary deficits, the relatively high rate of unit labour cost growth in a series of years […] and the serious structural weaknesses of the Greek economy". The Report recorded a fall of 2.4 percentage points of GDP in the general government deficit in 2005, noting that the deficit was the second highest in the euro area and underscoring the government's commitment (in line with the aforementioned ECOFIN recommendation of 17.2.2005) to correct the "excessive deficit situation" by end-2006.[36]

Turning to monetary developments, interest rates continued on the same trend in 2005, with small movements in interest rates on business loans (upward changes in some categories) and decreases in interest rates on (consumer and housing) loans to households. In fact, although the ECB raised its key interest rates by 25 basis points, interest rates on consumer loans dropped further in December 2005, on the back of strong bank competition in the area of consumer credit.[37] Against this backdrop, the share of household loans in total loans kept rising and accounted for 61.6% of the increase in total credit by Monetary Financial Institutions (MFI), i.e. banks and money market funds,[38] to enterprises and households in 2005, compared with 60.3% in 2004.

According to the 2006 Report presented by N. Garganas at the Annual General Meeting of Shareholders in April 2007, the Greek economy continued to grow strongly in 2006, by 4.3%, performing better than expected (the Bank of Greece forecast in April 2006 was for a slowdown to 3.5%). From a longer-term perspective, Greece had experienced a protracted period of economic growth, with its GDP growing by 4.1% on average over the past ten years and per capita GDP by 3.7%. This had resulted in a faster convergence of living standards in Greece with the average of the more advanced EU countries. The main drivers of the upturn observed between 1997 and 2006 were stronger domestic demand, also supported by inflows from EU Structural Funds; a rise in public and private investment in the run-up to the Athens 2004 Olympic Games and as a result of several structural reforms; high credit growth, coupled with lower borrowing costs, due to the deregulation of the financial system in the 1990s and the country's subsequent euro area entry; as well as increased exports to the markets

36 *Annual for the year Report 2005.*

37 Ibid.

38 Ibid.

of Southeastern Europe. The combined result was a drop of one percentage point in the rate of unemployment, from 9.9% in 2005 to 8.9% in 2006; an increase of 2.5% in productivity; and a slight decline in inflation to 3.3% in 2006 from 3.5% in 2005.[39]

In the context of these favourable economic developments, Greek M3 growth accelerated in 2006, exceeding the respective euro area average since the second half of the year. Another indication of the favourable environment was a shift from (more liquid) saving deposits towards time deposits with an agreed maturity of up to two years.[40] Yet, bank deposit and lending rates followed the upward path of the ECB key interest rates, although their rise was smaller compared with the remaining euro area countries, and some categories of consumer and housing loans even saw interest rates fall.[41] Meanwhile, the growth rate of total MFI credit picked up in 2006, mainly driven by business loans, with MFI holdings of corporate bonds making a considerable contribution. By contrast, the growth rates of both financing of general government and credit to households weakened. With respect to households, this slowdown in credit expansion was primarily associated with consumer credit and secondarily with housing loans. Overall household indebtedness reached 44% of GDP at end-2006, from 38% in December 2005.[42]

In his Report for 2006, Governor Garganas extensively discussed appropriate policies for increasing potential growth, concluding that: "[…] structural reforms must continue over a wide range of sectors of the economy in order to reduce rigidities in the labour and product markets, upgrade human capital, improve the efficiency of public administration and, eventually, restructure the economy's production base. It will thus be possible to reshape the Greek economy so that its future growth will rely on exports and business investment to a much greater extent than is the case today. These reforms will increase opportunities for all to participate in a more broadly based process of growth. It is also extremely important that the education system be restructured at all levels so as to increase productivity, boost employment, reduce unemployment and limit income inequalities. School and university graduates will thus have the qualifications required for them to keep abreast of technological developments and take part in the rise of technologically advanced branches of economic activity, besides benefiting from this rise and, thereby, improving their income prospects".[43] In addition, in view of new legislation (Law

39 *Annual Report for the year 2006.*

40 Ibid.

41 Ibid.

42 Ibid.

43 Ibid.

3536/2007) aimed at encouraging the integration of immigrants into the labour market, the Report discussed the impact of immigration on the Greek economy and concluded that: “In general, the economic activity of migrants contributes to GDP growth, increases labour market flexibility, helps contain labour costs and delays population ageing. Recent legislative initiatives for the regularisation of immigrants are in general viewed positively by the social partners, given that they simplify the necessary procedures”.[44]

2007 was a turning point for international economic developments, as it saw financial market turmoil and a surge in oil and food commodity prices. These developments also impacted on the Greek economy, and annual GDP growth decelerated from 4.2% in the first half of 2007 to 3.7% in the second half. (It is worth noting here the unfortunate proposal by the National Statistical Service of Greece (NSSG) to revise GDP upwards by almost 26.0%. The size of the proposed revision met with sarcastic comments by international media and further undermined the credibility of Greek statistics. Eventually, Eurostat approved a GDP revision of only 9.6% for the years 2000-2007.) Furthermore, average annual inflation fell to 3% in 2007, from 3.3% in 2006, before rising again to 3.6% in the last months of 2007, compared with 3.2% in the fourth quarter of 2006. (For 2008, the Bank of Greece projected an average annual inflation rate of about 4%, i.e. one percentage point higher than the 2007 figure.) At the same time, the current account deficit, which had remained persistently high in the previous years, widened further to 14.1% of GDP in 2007. The growing deficit reflected the Greek economy’s lower competitiveness, a shortfall in domestic savings relative to domestic investment, as well as the impact of high oil prices. In light of the above, the Bank of Greece recommended the adoption of measures aimed at strengthening the Greek economy, making it more resilient to external shocks. Such measures should include the continuation of the fiscal consolidation effort under the Updated Stability and Growth Programme 2007-2010, with a view to drastically reducing the fiscal deficit and public debt. At the same time, measures to improve productivity, reduce production costs and increase competitiveness and national savings were warranted in order to reduce the current account deficit.[45]

International developments did not seem to have affected bank lending in Greece, as credit expansion, mainly to the private sector, remained elevated, at 21.2% in the last quarter of 2007, compared with 21.3% one year earlier. The annual growth rate of MFI credit to households remained strong in 2007 (fourth quarter of 2007:

44 Ibid.

45 *Annual Report for the year 2007.*

23.2%), despite falling year-on-year (fourth quarter of 2006: 26.7%). Household indebtedness reached 41% of GDP in December 2007, or 45.5% of GDP including securitised loans. Moreover, the upward path of key ECB rates pushed bank deposit and lending rates in Greece further up.[46]

More generally, the Bank of Greece highlighted the need to shield the Greek economy from the negative effects of developments in international financial markets, inflationary pressures and an incipient slowdown in global economic activity. Therefore, it called for fiscal consolidation and policies to raise competitiveness, with priority on structural reforms in domestic markets. (To this end, the Bank of Greece commissioned the Foundation for Economic and Industrial Research (IOBE) to conduct a survey on wage and pricing policies at the firm level.) In addition, the Bank of Greece noted that the benefits of economic growth of previous years were not evenly distributed across the population and stressed the need to address poverty, afflicting one fifth of Greek households. Against this background, the Bank of Greece argued that it was necessary to place much greater emphasis on productivity-led growth rather than demand-led growth, with a view to better insulating the economy from external shocks.[47]

7.4 Institutional and organisational changes, 2001-2008

Right from the start of this period, the Bank of Greece faced a massive logistical challenge, i.e. ensuring the smooth withdrawal of drachma banknotes and coins and the timely and adequate supply of euro banknotes and coins, to avoid disruptions in cash transactions.

In 2001, the Bank of Greece recruited 21 technicians for its Printing Works Department (IETA), while both IETA and the Cash Department were equipped with state-of-the-art machinery for counting, sorting and authenticating banknotes, as well as for destroying withdrawn coins. The early preparations of the Bank of Greece were key to the successful production and distribution of euro banknotes and coins and to the safe and timely frontloading of banks with euro cash. Moreover, the Bank of Greece, in cooperation with the ECB, engaged in broad-ranging communication activities to familiarise the public with the new currency. Specifically, 500 training courses were held across Greece in 2001, during which 6,500 professional cash handlers from private and public enterprises

46 Ibid.

47 Ibid. and General Council Agenda, "Contract with IOBE for the conduct of a survey on firms' wage and pricing policies", 23.4.2007, paragraphs 5-6.

and credit institutions were trained in checking the authenticity of euro banknotes.[48] The communication initiatives undertaken by the Bank of Greece included events held in Athens and other cities in Greece, distribution of information leaflets and a mass media campaign, alongside special training programmes targeted at schoolchildren.[49]

The euro cash changeover progressed smoothly and quickly, thanks to warm public acceptance and the Bank's timely preparation.[50] Credit institutions were frontloaded with euro coins as from 1.9.2001 and with euro banknotes as from 1.10.2001. A total of 3,233 bank branches and post offices across Greece were initially frontloaded. Finally, on 17.12.2001 euro coins began to be frontloaded to the public in the form of starter kits. The circulation of euro banknotes and coins and the parallel withdrawal of drachmas started on 1.1.2002. The necessary conversion of automated teller machines (ATMs) was rapid and was completed all over the country in just three days. A faster-than-expected adjustment of the public and enterprises to the new currency was evidenced by the fact that more than 90% of all transactions were already carried out in euro by the end of January. The last phase of the euro cash changeover was completed on 28.2.2002, when the dual circulation period ended. The total value of drachma banknotes and coins withdrawn by end-February amounted to 2.7 trillion drachmas, or around 90% of the currency in circulation as of 31.12.2001.[51] Lastly, in order to ensure the security of transactions in the new currency, the Bank of Greece took the necessary steps to establish and operate a National Counterfeit Centre, while National Analysis Centres for counterfeit banknotes and Coin National Analysis Centres were set up by the Hellenic Police.[52]

During the period under review, the Bank of Greece continued to upgrade its IT systems and operations, with a view to enhancing functionality and effectiveness in the context of the Eurosystem. Thus, in 2002 the equipment supporting the

48 *Annual Report for the year 2001.*

49 Ibid.

50 Ibid. and General Council Agenda, "Procurement of paper for the production of euro banknotes", 30.6.2000, paragraph 10; "Procurement of machinery for the processing of euro coins", 29.5.2001, paragraphs 10-11; "Withdrawal of drachma banknotes in circulation in view of the circulation of euro banknotes", 29.11.2001, paragraphs 2-3. The Bank also commissioned a number of surveys aimed at gauging the response of businesses to the euro changeover. See General Council Agenda, "Contract with ICAP company for a survey on the behaviour of commercial enterprises with respect to the introduction of the euro", 4.3.2002, paragraph 4. For the relevant communication activities of the Bank of Greece, see General Council Agenda, "Public information campaign of the Bank of Greece regarding euro coins", 29.11.2002, paragraph 16.

51 *Annual Report for the year 2001.*

52 Ibid.

Electronic Secondary Securities Market (HDAT) and the repo market was replaced with a new, more advanced system. In this connection, the systems supporting the operations of the Foreign Exchange Department were upgraded, while the procurement of the Trados software was approved for the Economic Research Department with a view to supporting the work of its Publications and Translation Section. In addition, IETA was equipped with state-of-the-art machinery, following the strategic decision to choose Greece as one of the countries that would produce euro banknotes. Moreover, the International Relations Service, the Secretariat Section and the Communication, Press and Public Relations Section were restructured to facilitate cooperation with the Eurosystem.[53]

Another important institutional initiative of the Bank of Greece was its active contribution, since 1995, to the development of the operational framework of the Hellenic Deposit Guarantee Fund (TEK), a legal person in private law providing a deposit guarantee scheme. TEK was established under Law 2324/1995 by the Bank of Greece and the Hellenic Bank Association, which held 60% and 40%, respectively, of its initial capital. In 2000, the law was amended (by Law 2832/2000), and later on (under Law 3746/2009) TEK expanded in scope and was renamed Hellenic Deposit and Investment Guarantee Fund (TEKE). The Bank of Greece has held a controlling interest in the fund, in its successive forms, and a majority in its Board of Directors, chaired ex officio by one of its Deputy Governors. Thanks to prudent management by the Bank of Greece, TEK/TEKE has evolved into one of the best capitalised deposit guarantee schemes in Europe. Its importance became evident after 2008, when it played a key role in the resolution of T-Bank and Proton Bank, as the Hellenic Financial Stability Fund had not yet been established.[54]

In addition, a new IT system needed for the Bank of Greece to join the Interbank Electronic Cheque Clearing System DIASCHEQUE (the Bank had been a majority shareholder in "Interbank Systems S.A.", or DIAS S.A., since mid-1995), while the necessary IT infrastructure was set up in 2005 to enable the exchange of statistical data with the ECB and other international institutions.[55] Furthermore, the expenditure required for linking the Bank's IT systems with the electronic trading platform of the Athens Stock Exchange was approved in March 2003.[56] In December 2005, the

53 *Annual Report for the year 2002.*

54 *Annual Report for the year 1995.* See also www.hdgf.gr.

55 *Annual Report for the year 2005.* General Council Agenda, "Participation of the Bank of Greece in the Interbank Electronic Cheque Clearing System (DIASCHEQUE)", 31.8.2004, paragraphs 11-15. See also *Annual Report for the year 1995.*

56 General Council Agenda, "Approval of expenditure for interlinking the Bank's IT systems with the trading platform of the Athens Stock Exchange", 14.3.2003, paragraphs 15-16.

Bank of Greece decided to undertake the cash settlement of transactions on the Athens Exchange and the Athens Derivatives Exchange, thereby helping to improve the ratings of both exchanges by the ECB and international rating agencies.[57]

In 2006, the Bank of Greece, in the context of its organisational restructuring, decided to gradually suspend the operation of 10 branches, 26 agencies located within Internal Revenue Offices and 8 Sections at its Head Office. Specifically, the Argostoli and Drama branches would close in 2007, the Piraeus, Agrinion and Xanthi branches in 2008, the Sparta and Florina branches in 2009, the Corfu and Rethymnon branches in 2010 and the Pyrgos branch in 2011. Those branches were converted to outlets, carrying out transactions with the State and public organisations, while the operations of the Piraeus branch were transferred to the Head Office in Athens.[58]

Noteworthy organisational reforms in 2007 included a remodelling at the Bank's Head Office to accommodate the Historical Archives Service and the Disaster Recovery Site; the installation of the Securities Management Application Real-time Technology (SMART) for the Central Securities Depository of Athens;[59] and the decision to establish the Museum of the Bank of Greece, aimed at serving as an invaluable point of reference for research and documentation in Greece's monetary history, especially from the first quarter of the 20th century onwards.[60] Meanwhile, aiming to promote economic research, the Bank had launched in 2003 its Working Papers series, featuring studies by Bank of Greece economists and associates.

On 3.11.2003, the Bank of Greece held an event to commemorate its 75th anniversary, featuring speeches by the then Prime Minister, C. Simitis, the Governor of the Bank of Greece, N. Garganas, the President of the ECB, Jean-Claude Trichet, as well as L. Papademos, Vice-President of the ECB and former Governor of the Bank of Greece, focusing on "Growth and stability in Europe – The role of monetary policy".[61]

After the demises of former Deputy Governor, Ioannis Pesmazoglou, in late 2003 and former Governor, I. Boutos in mid-2004, the Bank of Greece adopted resolu-

57 *Annual Report for the year 2005* and General Council Agenda, "Undertaking by the Bank of Greece of the cash settlement of transactions on the Athens Stock Exchange and of derivatives of the Athens Derivatives Exchange", 12.12.2005, paragraphs 5-7.

58 *Annual Report for the year 2006.*

59 *Annual Report for the year 2007.*

60 General Council Agenda, "Establishment and operation of the Museum of the Bank of Greece", 29.6.2007, paragraph 12.

61 *Annual Report for the year 2003* and General Council Agenda, "Celebration of the 75th anniversary of the Bank of Greece", 29.11.2002, Announcement. The speeches can be found in the publication available at http://www.bankofgreece.gr/BogDocumentEn/75_YEARS.pdf.

tions in their memory.[62] In June 2004, Professor Xenophon Zolotas, the longest serving Governor of the Bank of Greece passed away. The Bank held an event on 25.2.2005 to honour his memory. Among the speakers were the President of the ECB, Jean-Claude Trichet, and the former Governor of the Bank of Greece, D. Chalikias.[63]

7.5 The banking system and the supervisory role of the Bank of Greece, 2001-2007

At the end of 2001, the size of Greek banks was still comparatively small by European and international standards. In terms of total assets, their domestic market share stood at 80%, with the remainder of the market shared among specialised credit institutions (10%), foreign bank branches (9.5%) and cooperative banks (almost 0.5%). The asset market share of credit institutions directly or indirectly controlled by the State had declined to 53%, from 63% at end-1998, also reflecting the acquisition of the National Industrial Development Bank (ETBA) by Piraeus Bank. As noted by the Bank of Greece, the broadly unchanged market share of foreign bank branches indicated that the initial forecasts of stronger competition in the domestic market from foreign credit institutions as a result of euro area participation had not materialised. However, competition had been intensifying in the Greek market, particularly in the areas of consumer and housing credit that had showed the highest rates of credit expansion, and intermediation margins had declined as a result. Moreover, the decision of the Bank of Greece to allow the establishment and operation of Financial Companies, mainly engaging in the provision of consumer and personal loans, was expected to further strengthen competition in that market segment. Although the *Annual Report for 2001* (published in April 2002) noted that total household indebtedness as a percentage of GDP remained relatively low compared with the euro area average, it cautioned that "this could possibly point to a problem with the allocation of credit and to overindebtedness of particular households", calling on credit institutions "to prevent a deterioration in the quality of their consumer and personal loan portfolios".[64]

62 General Council Agenda, "Resolution on the death of the former Deputy Governor of the Bank of Greece, Ioannis Pesmazoglou", 28.11.2003, paragraph 2, and "Resolution on the death of the former Governor of the Bank of Greece, I. Boutos", 12.7.2004, paragraph 2.

63 *Annual Report for the year 2004* and General Council Agenda, "Resolution on the death of the honorary Governor of the Bank of Greece, Xenophon Zolotas", 11.6.2004, paragraph 2. For the commemorative publication, see https://www.bankofgreece.gr/BoGDocuments/ZOLWTAS.pdf (in Greek).

64 *Annual Report for the year 2001.*

In the area of banking regulation and supervision, the Bank of Greece adopted a number of measures, often as part of EU-wide interventions: (a) the minimum initial capital of credit institutions (incorporated as sociétés anonymes) was raised from EUR 11.7 million to EUR 18 million, in view of the need for credit institutions to undertake sizeable investment in infrastructure so as to remain competitive; (b) the maximum period allowed for credit institutions to accrue interest on overdue loans was reduced from 12 to six months; (c) a moratorium was allowed on part or all of overdue obligations of credit institutions facing liquidity shortages and potential capital inadequacy, so as to give them time for remedial action before the adoption of more radical corrective measures became inevitable; and (d) the framework of co-operation between the Bank of Greece and the auditing profession was strengthened. In addition, "the discretionary scope of the Bank of Greece has been expanded in order to better serve the broader goal of financial stability: the Bank may determine capital requirements also at the level of individual institutions, further to general capital requirements". The Bank of Greece considered that further steps should be taken towards the development of a regulatory and tax framework for securitised loans, to ensure a more efficient management of bank assets. Also, having established a framework of mandatory (general and specific) provisioning ratios for non-performing loans, it urged banks to maintain provisions above the supervisory minimum levels. Banks' capital adequacy ratio for credit and market risks had declined to 12.6% in the first half of 2001, i.e. down by roughly two percentage points from the 1998-2000 average. This was largely associated with the release of banks' high minimum reserve holdings with the Bank of Greece (see Chapter 6.18 above) and the use of those funds for granting loans to the economy.[65]

On 15.1.2003, after assessing the risks entailed by the high rate of credit expansion, particularly in consumer loans to households, the Bank of Greece raised the provision coverage ratios for non-performing loans by 10 percentage points and introduced special arrangements regarding provisioning for housing and consumer loans.[66] It should be recalled that, owing to the deregulation of the banking system, the Bank of Greece could no longer impose restrictions on credit expansion or control the level of bank interest rates for macroeconomic purposes. Nevertheless, there were still some useful tools at hand, namely the provisioning policy and, secondarily, the establishment of transaction transparency rules to the benefit of borrowers (although their main objective was to safeguard financial stability). The

65 Ibid.

66 *Annual Report for the year 2002.*

above clearly demonstrate that the criticism that the Bank of Greece allowed credit expansion to run out of control after the country's entry into EMU is unfounded.

The Bank of Greece called attention to the impact of the downward spiral of the Athens Stock Exchange (ASE) on the Greek banking system since the end of 1999, reflected mainly in banks' lower pre-tax profits in 2002 despite strong economic growth. Relying on retail business and their extensive branch networks abroad, Greek banks had managed to mitigate the impact on profits. However, their capital adequacy ratio was adversely affected, declining from 13.6% in 2001 to 12.5% at end-2002, still remaining higher than the regulatory minimum of 8%. The core (Tier 1) capital ratio also remained higher than 8%, indicating the high quality of banks' equity.[67] This notwithstanding, the Bank of Greece urged banks to further strengthen their capital base, by issuing subordinated debt and hybrid instruments, while it closely monitored the development of internal credit risk measurement and management systems by certain large banks. Further banking regulation measures in 2002 included: (a) the release of banks' redeposits with the Bank of Greece earmarked for financing small-scale manufacturing firms, also given that the access of such firms to finance would now benefit from the newly established Guarantee Fund for Small and Very Small Enterprises under Law 3066/2002 and from recourse to other sources; (b) expansion of the scope of consolidated supervision to include banks' real estate management subsidiaries; and (c) the option, under certain conditions, of banks to use an internal model-based approach to market risk capital requirements.[68]

Conditions in the banking market took a turn for the better in 2003, as the continuous decline in the Athens Stock Exchange index came to a halt and the international economic environment improved. Overall, Greek banks' profitability increased by 46.8% relative to 2002. In addition to a rebound of net income from commission fees and financial operations in the context of stock market recovery, profitability was supported by higher net interest income as a result of fast credit expansion, particularly in the area of retail banking, as well as by a more moderate growth in operating costs. Another positive development was the rise of banks' capital adequacy ratio to 12.8% in 2003, as regulatory capital grew more strongly than risk-weighted assets, although the Tier 2 ratio dropped to 10%. The increase in regulatory capital reflected valuation gains from fair value accounting of real property under IAS 16, the issuance of subordinated debt, as well as hybrid capital, namely long-term securities convertible to equity where holders are ranked below

67 Ibid.

68 Ibid.

other creditors in the event of liquidation. Moreover, no bank had a capital adequacy ratio lower than the level seen as satisfactory, i.e. 9%. Nevertheless, in the presence of uncertainties in the international environment and noting a shortfall against the provision coverage ratio, the Bank of Greece called on banks to improve their capital ratios, also factoring in the risks entailed by fast credit expansion to the private sector. The Bank stated that it would continue to monitor the adequacy of provisions and, where appropriate on a case-by-case basis, impose additional capital requirements above the minimum 8% under Pillar II of the New Basel Capital Accord (Basel II).[69] The transition to the International Accounting Standards (IAS) as from 2005 was both a milestone and a challenge for the banking system, given the cost of the transition itself and the expected impact on banks' balance sheets.[70]

Greek banks increasingly used internal models for the assessment of credit and market risks, based on the options available under the new capital adequacy framework. Furthermore, a rising number of banks used risk transfer instruments such as securitisation and credit derivatives, in order to reduce the relevant capital requirements. The Bank of Greece encouraged this practice, provided that credit risk transfer was genuine and the quality of banks' loan portfolios was not adversely affected, which would undermine their capital position in the long run. In this context, the Bank of Greece issued two circulars on the supervisory treatment of securitisation and credit derivatives.[71] On the other hand, the internationalisation of Greek banks' activities observed since the late 1990s, especially their expansion to the countries of Southeastern Europe, had supported their growth, but had also increased the potential risks that banks had to properly address.[72]

In addition, the Bank of Greece developed special quantitative models to evaluate the resilience of the Greek banking system to potential crises. Specifically, these models would measure the impact on banks' capital adequacy ratio from adverse developments in key macroeconomic aggregates, with a view to assessing the shock-absorbing capacity of Greek banks.[73]

In 2004, the capital adequacy ratio of Greek banks rose, on a non-consolidated basis, to 13.5% (2003: 12.8%), reflecting a 15.2% increase in regulatory own funds, and, on a consolidated basis, to around 12.8%, from 12% in 2003. On the other hand, the (non-consolidated) Tier 1 ratio declined further to 9.6%, as Tier 1 capital grew

69 *Annual Report for the year 2003.*

70 Ibid.

71 Ibid.

72 Ibid.

73 Ibid.

moderately, whereas Tier 2 capital rose substantially.[74] By Governor's Act 2557/26.1.2005, the Bank of Greece raised the provision coverage ratios for non-performing consumer loans from 70% to 90% and for doubtful loans from 84% to 100%. This measure aimed to prevent risks to banks' financial soundness from strong consumer credit growth, as well as to encourage banks to write off unrecoverable non-performing loans.[75] Furthermore, acknowledging the growing importance of operational risk worldwide, as a result of the complexity of banking operations and increased IT dependency, the Bank of Greece complemented the institutional framework for banks' internal control systems by specifying the principles and standards for the operation of their IT systems. Furthermore, reference was also made to the fact that the Basel II framework would introduce capital requirements against banks' operational risk as from 31.12.2006. Regarding liquidity risk, Bank of Greece Governor's Act 2560/1.4.2005 introduced two minimum liquidity ratios (a liquid asset ratio and an asset/liability mismatch ratio). At the same time, banks were requested to carry out stress tests to assess the impact on their capital adequacy from adverse credit and market risk scenarios, including extreme changes in probability of default, loss given default, interest rates, equity prices and exchange rates. Moreover, as mentioned in the *Annual Report for 2004* (April 2005), Greece had requested to be included in the IMF's Financial Sector Assessment Program (FSAP), which – among other things – would assess the Greek banking supervision framework against the 25 Core Principles for Effective Banking Supervision and the standards established by the Basel Committee.[76]

The capital adequacy ratio of Greek banks remained broadly unchanged in 2005, at 13.3%, well above the regulatory minimum of 8%, although the Tier 1 ratio declined further to 8.7%.[77] However, in the face of a rise in total household borrowing and concerns about potential overindebtedness and its implications for banks' credit risk, the Bank of Greece commissioned a new survey to TNS-ICAP. The survey was conducted in the fourth quarter of 2005 and covered 6,000 households in urban and semi-urban areas, 3,120 of which responded fully. The survey showed that 47% of households had taken on a loan, while the average outstanding debt per household had risen by 26.4% relative to 2002. Moreover, between 2002 and 2005 the median debt-to-income ratio and the median debt-to-wealth ratio had increased. Both ratios were particularly high for households at the

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74 *Annual Report for the year 2004.*

75 Ibid.

76 Ibid.

77 *Annual Report for the year 2005.*

lower income and wealth brackets, although their debt as share of total debt was lower than 5% in either case. The percentage of households whose monthly debt service payments were lower than 40% of their monthly incomes had reached 88%, from 85% in 2002, supported by low interest rates. Overall, households' debt-to-income and debt-to-wealth ratios were seen as reasonable. Nevertheless, the Bank of Greece advised banks to ensure that, in the approval of loans, the amount of debt service payments relative to disposable income did not exceed 30%-40% for any given customer.[78]

On the other hand, the operation of the Risk Consolidation System of Tiresias S.A. since 2003 had helped banks to obtain extensive information about borrowers' full credit history and thus manage the associated credit risk more effectively.[79]

Overall, the liquidity of Greek banks appeared to be satisfactory based on the two liquidity ratios established by the Bank of Greece. On 31.12.2005 the liquid asset ratio stood at 23.3% and the asset/liability mismatch ratio was -2.2%, safely meeting the regulatory thresholds of 20% and -20%, respectively. Finally, the loan-to-deposit ratio came to 94.5% in 2005, lower than the euro area average of 119% for 2004, but higher than in 2004 (86.1%, which suggested a growing weight of interbank market financing and bond issuance among bank funding sources).

In the second half of 2005, new stress tests were carried out to assess the impact on banks' own funds under worst-case scenarios of credit quality deterioration and adverse changes in equity prices, interest rates and the exchange rate of the euro. The stress tests revealed that equity price decline and credit quality deterioration had the strongest impact on banks' capital adequacy ratio by one percentage point, leaving it however well above the regulatory minimum of 8%.[80] In the same year, the aforementioned assessment of the Greek financial system by the IMF was completed, and the relevant report was released in January 2006. The assessment report confirmed that Greek banks were profitable, well-capitalised and liquid, but faced a number of challenges that were mainly associated with risks arising from strong credit expansion, a high ratio of non-performing loans to total loans (NPL ratio) and the adverse impact on banks' competitiveness from their small size and labour market rigidities. The IMF found that the supervision conducted by the Bank of Greece was effective and that Greece was fully compliant with 22 criteria, largely compliant with eight other criteria and (until then)

78 Ibid. and General Council Agenda, "Contract with TNS-ICAP S.A. for the conduct of a survey on Greek household borrowing and indebtedness", 30.8.2005, paragraphs 2-4.

79 *Annual Report for the year 2005.*

80 Ibid.

non-compliant with only one criterion.[81] The criteria reflected the Core Principles for Effective Banking Supervision established by the Basel Committee on Banking Supervision. Besides, the implementation of the International Financial Reporting Standards did not appear to have significantly affected the overall capital adequacy of Greek banks. Still, by Governor's Act 2577/2006, the Bank of Greece introduced a framework of operational principles and criteria for the evaluation of the organisation and internal control systems of credit institutions, with a view to ensuring a level playing field across banks and mitigating operational risk without imposing an excessive regulatory burden.[82] Also, in order to strengthen competition and help bank customers to make informed decisions, the Bank began in 2005 to regularly publish on its website comparative data on interest rates and commission fees charged on key banking products, as reported by banks. In the same vein, the Bank established ongoing cooperation with the Ministry of Development as well as with consumer associations, and dedicated considerable resources to examine customer complaints and conduct on-site inspections.[83]

More generally, the Bank of Greece contributed to the preparation of legislation for the transposition into Greek law of the EU Directives adopting the rules of the Basel II Accord for calculating bank capital requirements.[84] Once again, the capital adequacy of the Greek banking system was found to be satisfactory. Specifically, the CAR stood at 13.6% in 2006, compared with 13.3% in 2005, while the Tier 1 ratio was 9.5%, compared with 8.7% in the previous year. However, at banking group level, both ratios declined relative to 2005. Namely, the CAR stood at 12.2%, compared with 13.2% in 2005, while the Tier 1capital ratio was 9.9%, down from 10.9% in the previous year. On a positive note, the quality of banking groups' capital remained broadly unchanged, as the share of core capital in total capital remained roughly the same (79.1% in 2006, against 80.9% in 2005).[85] The main risk facing Greek banks was credit risk, as lending accounted for 62% of their assets, compared with 49.7% for EU banking groups. Furthermore, the NPL ratios for household loans, despite their improvement, continued to be more than double those in the EU. In this respect, the Bank of Greece recommended that banks should take measures to improve the quality of their loan portfolios and increase the coverage ratio of provisions

81 The criterion in question referred to the legal protection of Bank of Greece staff against lawsuits when carrying out their duties in good faith and without negligence, as also applicable to civil servants and the staff of the Hellenic Capital Market Commission. See *Annual Report for the year 2005.*

82 Ibid.

83 Ibid.

84 *Annual Report for the year 2006.*

85 Ibid.

to non-performing loans. Moreover, the Bank of Greece requested commercial banks to formulate policies that would bring their NPL ratios down to 3.5%, as well as to always take into consideration loan approval percentages, credit risk pricing, NPL recovery procedures, loan-loss provisioning and write-offs.[86] On the other hand, banks' risk-weighted assets for market risk, despite having increased by 57.8% in 2006, still accounted for a small percentage (4.3%) of total weighted assets.[87]

Despite the global financial turmoil of 2007, the Greek banking system managed to remain profitable and well-capitalised. Profitability – especially that of banks active in Southeastern European markets – was high, although rapid credit expansion could expose some banks to credit and country risks. The Bank of Greece also warned banks to refrain from lending to borrowers with poor credit scores, as the resulting short-term improvement in profitability was outweighed by an increased risk of steep losses in the future. Besides, the Bank of Greece commissioned once again a private polling company to conduct a survey on household indebtedness.[88] As the increase in banks' risk-weighted assets outpaced regulatory capital growth, the capital adequacy ratio of banking groups declined from 12.2% at end-2006 to 11.2% at end-2007. This notwithstanding, its level was deemed satisfactory, as it was close to the level recorded for large banks in the EU. Similarly, the Tier 1 ratio fell to 9.2% in 2007, from 9.9% at end-2006.[89]

Credit risk remained the main risk faced by Greek financial institutions, while market risk continued to be less of a concern during 2007. However, the liquidity ratios showed considerable volatility, signalling the banking system's liquidity risk. In any event, two liquidity stress tests with scenarios of turmoil continuing until end-March and end-June 2008, respectively, confirmed that banks' liquidity should be continuously monitored. In addition, the turmoil in international markets, strong credit expansion and the penetration of Greek banks into new markets confirmed the need for continuously adjusting risk measurement mechanisms, as well as for correlating the two measures, in line with the Basel II supervisory framework.[90]

In the light of those new risks facing the financial system, coupled with the need for their timely identification by the supervising authority, a number of training courses were organised, focusing on market risk assessment and a more effective supervision of the banking system, the new accounting standards, as well as on risks

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86 Ibid.

87 Ibid.

88 General Council Agenda, "Survey by TNS-ICAP S.A. on Greek household indebtedness", 1.10.2007, paragraphs 13-14.

89 *Annual Report for the year 2007.*

90 Ibid.

related to e-banking. Training continued throughout the period under review, to keep the Bank's staff abreast of ongoing developments.[91] Moreover, training activities were also carried out in 2007 in the areas of the new TARGET2 payment system, and the detection and prevention of e-fraud and money laundering.[92]

In the context of further promoting cooperation with foreign central banks, particularly in countries of Southeastern Europe and Asia, two international meetings were held in 2001, in Athens (in May) and in Rhodes (in October), bringing together the 16 members of the Central Bank Governors' Club (from Balkan, Black Sea and Central Asian countries) and chaired by the Governor of the Bank of Greece. Distinguished economists and senior officials from international economic organisations delivered speeches on monetary and exchange rate policies and banking supervision.[93] Similar meetings were held in Thessaloniki in May 2002 and in Nafplion in October 2002, focusing on international economic financial developments.[94] In June 2005, the Bank of Greece hosted the annual roundtable of the "EURO 50 Group", which brought together distinguished economists, academics, bankers and politicians from Europe, North America and Japan, focusing on "An Assessment of the Single Monetary Policy of the ECB", while on 6.10.2005 the Bank hosted the meeting of the ECB Governing Council.[95] In addition, in an effort to promote cooperation between the Eurosystem and non-euro area Mediterranean central banks, the Bank of Greece, together with the ECB, hosted the third Euro-Mediterranean seminar in Nafplion in January 2006. The main focus of the seminar was on capital account liberalisation and the reform of monetary policy instruments in Mediterranean countries.[96]

Furthermore, a number of Memoranda of Understanding regarding the supervision of credit institutions were signed with the National Bank of Yugoslavia in Belgrade in December 2002, with the Bank of Romania in Bucharest in January 2003,[97] with the Banking Regulation and Supervision Agency of Turkey in Istanbul in January 2005 and with the Central Bank of Cyprus in Athens in March 2005.[98] Finally, in July 2007 the Governors of the national central banks of Albania, Bulgaria, Greece, Cyprus,

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91 *Annual Report for the year 2002*; *Annual Report for the year 2004*; *Annual Report for the year 2005*; and *Annual Report for the year 2006*.

92 *Annual Report for the year 2007*.

93 *Annual Report for the year 2001*.

94 *Annual Report for the year 2002*.

95 *Annual Report for the year 2005*.

96 *Annual Report for the year 2006*.

97 *Annual Report for the year 2002*.

98 *Annual Report for the year 2004*.

FYROM, Romania and Serbia met in Athens to strengthen cooperation in the area of banking supervision, with a view to safeguarding financial stability in the region.[99]

7.6 The Bank of Greece in the wake of the 2007-2008 global crisis and on the eve of the Greek crisis of 2009

In February 2007, the most severe turmoil in financial markets after the Crash of 1929 broke out in the United States. In August 2007, the crisis spread to Europe. By early 2008, the turbulence had spilled over to the rest of the world via globalised financial markets. Compounded by a surge in oil, food and other commodity prices, this strongly affected the real economy, mainly of advanced countries.

Meanwhile, on 14.6.2008 the terms of Governor Nicholas Garganas and of Deputy Governor Nikolaos Paleocrassas ended. On 20.6.2008, George Provopoulos was appointed Governor of the Bank of Greece, and Eleni Dendrinou-Louri became Deputy Governor. Panayiotis Thomopoulos continued to serve as Deputy Governor, a position he had held since 26.10.1994. (His long tenure, following successive renewals of his term, ended on 26.2.2009.)

In September 2008, world economic developments took a dramatic turn, with the default of Lehman Brothers and the collapse of confidence in the financial system. Against this background, a credit crunch was observed, equity prices dropped dramatically and business confidence deteriorated sharply, while by the end of 2008 most advanced economies had fallen into recession.[100]

The intensification of the global crisis since September 2008 started to affect the Greek economy. The main contagion channels of the international crisis and its impact to the domestic economy were the financial system and the external balance. In more detail, the financial crisis brought about a decline in credit supply and a tightening in banks' credit standards, while credit demand by households and firms decreased amid worsening expectations. Furthermore, the worldwide economic downturn led to a decline in Greek exports of goods and services, including shipping and tourism.[101] In response, the government passed Law 3723/9.12.2008,injecting liquidity of EUR 28 billion to the Greek banking system. The Bank of Greece had already recommended this course of action and encouraged commercial banks to take advantage of these facilities, which at first banks had dismissed as unnecessary or were reluctant to use fearing a stigma effect.

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99 *Annual Report for the year 2007.*

100 *Annual Report for the year 2008.*

101 Ibid.

As early as early 2008 the Bank of Greece noted that the crisis had revealed the structural weaknesses and imbalances of the Greek economy. Besides, as repeatedly stressed in the past, the level of the fiscal deficit, the high public debt and the large current account deficit were major sources of concern.[102]

In essence, the Bank of Greece noted that the global crisis had brought into sharp focus the unsustainable growth model of the Greek economy since the country had joined the euro area. It became evident that the strong economic growth of that time had been driven by external factors, such as euro area participation and the favourable international economic environment, rather than a restructuring of the domestic production base. At the same time, participation in the euro created a climate of security, while lower interest rates drove credit expansion and domestic demand sharply upwards. With domestic demand outpacing domestic supply, inflation soared to levels above the European average, resulting in a widening current account deficit and a high and rising foreign debt.[103]

A top priority on the agenda of the Bank of Greece – even before the outbreak of the Greek fiscal crisis in late 2009 – was once again the pressing need for fiscal consolidation and structural reforms aiming to raise competitiveness and productivity. But most importantly, the Bank of Greece kept stressing that, in times of tight budgetary conditions, emphasis should be placed on the reallocation of public spending towards more effective uses, in order to support the more vulnerable social groups and boost public investment, which is clearly more growth-generating than other government expenditure components.[104] At the same time, reforms to cut red tape and enhance competition would also contribute to higher productivity and economic growth.[105] As Governor G. Provopoulos remarked in April 2009: "Thus, a prima facie restrictive fiscal policy could in fact have an expansionary effect. Conversely, in the current circumstances, a prima facie expansionary fiscal policy would entail multiple fiscal costs – both directly and in the medium run – so that it would ultimately turn out de facto to be restrictive". In addition, "[…] any increase in Greece's fiscal deficit would not even have a counter-cyclical effect, since it would lead to an outright increase in the costs of borrowing for both the public and the private sectors, thereby directly undermining the recovery".[106]

102 Ibid.
103 Ibid.
104 Ibid.
105 Ibid.
106 Ibid.

Sadly, this recurring appeal from the Bank of Greece went unheeded by the government of that time, while the government that came to power after the October 2009 election did not fully realise its significance before it was too late.

CONCLUDING REMARKS

In the present study, we dealt with a major institution in Greek economic life, the Bank of Greece, tracing its path during its first 80 years. Starting with an overview of the international background against which the world economy has evolved since 1928, we went on to a brief discussion of the key events and developments in the Greek economy in the same period. We looked back at Greece's banking history before 1928, thus deepening our understanding of certain key aspects of the functioning and evolution of the Bank of Greece, while also discussing the problems and views that had a broader impact on central banking theory and practice. Moving on to the main part of the narration, we looked at the activity of the Bank of Greece year after year, and its respective assessments, forecasts, recommendations and actions in the fulfilment of its mandate. This narration is divided into chapters, each covering a long period, helping to highlight the main features of policy making and goal setting in each period. Having done this, we can now summarise the analysis and attempt to answer the questions raised in the introduction.

In assessing the contribution of an institution to the economy, one needs to have a number of criteria defined in advance, so that judgment can be objective and any criticism can be consistent and well-founded. Unfortunately, this is often not the case in social sciences, with the result that sound judgement tends to give way to rhetoric and emotional or voluntarist interpretations of facts and events. One such approach is the cynical view that dealing with Greek economic and banking history is much ado about nothing. Another is giving too much credit to the ability of policy to transform the present by providing a prospect for the future, which logically leads to expecting from an institution to have and use infinite potential within a de facto finite and predetermined system of social relations. However, institutions cannot give an identity to those who have lost theirs nor can they accommodate those that feel economically and politically disoriented for expressing their views and for aligning themselves in a common cause. Institutions do not exist in society in order to betray their role and substitute other state authorities and institutions in their tasks. They serve the purposes for which they have been established in the first place, according to their statutes. They act right when they adhere to their statutory objectives and procedures and when their actions are guided by the purpose they have been mandated to serve. They act wrong when they violate the principles governing their existence and operation.

A second element essential for an impartial observer is a grasp of time, evolution and change in economic and social life. Institutions change over time, in line with changing circumstances, perceptions and realities. This causes their functioning to change too; their statutes are amended through legitimate democratic procedures, their tasks are revised in the light of new circumstances that often necessitate a change of course and new ways of operation, in response to new challenges.

Against this background, looking at how the Bank of Greece has acted within the Greek economy and society, we can conclude that throughout its long years of operation the Bank has always shown commitment to the principles that it was expected to uphold, according to its Statute.

Initially (from 1928 to 1941) the Bank undertook to safeguard the stability and convertibility of the currency. It fought its way into an environment in which it was unwanted. Indeed, an independent central bank was not something that the majority of entrepreneurs or economists wanted back then; both seemed to be more or less comfortable with the way in which the Greek banking system operated and with the dominant position of the National Bank. The establishment of the Bank of Greece was a decision made by a Greek government under pressure from the League of Nations and desperate to ensure monetary equilibrium and access to funds necessary for rehabilitating its refugees and promoting economic development. Its establishment was also necessary for bringing the country in line with the then prevailing international standards. The Bank of Greece had rough forming years, struggling to establish itself within the domestic banking system and at the same time fighting the raging storm of the global economic crisis of 1929, which had knocked hard on the country's door in 1932. With its unwavering commitment to safeguarding the convertibility of the currency, it did everything in its power to achieve this goal, but ultimately failed, and a sovereign default followed.

Should one put the blame on the Bank of Greece for this? Anyone who is ignorant of the historic abandonment of the gold standard by Great Britain in 1931 and of the devaluation of the US dollar in 1933 might attempt to do so, but would be wrong. Despite the above adversities, quite soon the Bank of Greece, taking advantage of the protectionist international environment, recovered from the free market the temporarily lost foreign exchange, while also improving its financial position thanks to the government's legislation on conversion of gold deposits. The economy recovered within a year after the default and navigated through the agricultural crisis and protectionism towards gradually overcoming its weaknesses. Meanwhile, the Bank of Greece increasingly consolidated its position in the domestic banking universe, acting, as we saw earlier, as lender of last resort, and heroically managed to rescue Greece's gold reserves.

In the next period (from 1941 to 1944), the legitimate Administration of the Bank of Greece handled the country's affairs abroad, securing resources for the future and the presence of Greece in international conferences at the side of the victors of World War II. Back in occupied Greece, the collaborationist Administration acted as dictated by the occupation forces. Even in that period one cannot but praise the determination with which the legitimate Administration successfully handled and served, amid peculiar political situations, the interests of the occupied Greek people.

In the years from the country's liberation in 1944 to the stabilisation of the drachma in 1953, the Bank of Greece was once again in the frontline, giving fight after fight for recovery and reconstruction. The process was long, due to the war-time monetary disaster, the civil war and the prevailing speculative psychology. In that period, the Bank of Greece, in cooperation with the successive governments and Greece's allies, and through a process of learning by doing, managed to gradually restore normal conditions in the economy, create liquidity and regain control on monetary and credit developments, ultimately leading to the much-desired stabilisation.

Then followed the golden era of the 1950s and 1960s. The Bank of Greece ensured monetary equilibrium, a prerequisite for the economic development that the governments of the time sought to achieve. Thus, the country transformed from a poor agricultural to a medium-income agro-industrial economy, recording for two decades the second highest growth rate (after Japan) among OECD countries, with very low inflation. The anchor of the fixed exchange rate provided scope for the Greek economy to develop. Greece did not become a major European economy, but adapted to the Bretton Woods era, narrowing its economic gap from the developed world and leaving behind its neighbouring countries, which were experimenting with other economic models. Much credit for this success should go to the Bank of Greece, although the centralised and overregulatory role of the Currency Committee has been criticised later on. Despite the fact that the policies of the military dictatorship (especially after the collapse of the Bretton Woods system) were not free of contradiction, the Bank of Greece, by corrective actions, steered the country into the post-1974 period without any major economic disturbance.

The period from 1971 to 1984 includes the two oil shocks, the world economy's transition to floating exchange rates and shift from demand-side to supply-side policies, as well as the drawing up (by the European Communities) of the plan for the European Monetary System, the forerunner of the Economic and Monetary Union. At the same time, it became evident that the Greek society was at the end of a period of economic growth and facing a need to look for a new safe anchorage. Greece joined the European Economic Community (EEC) as a full member in 1981, while a few months later the alternative economic policy model advocated by the opposition in the late 1970s became a government programme.

The Bank of Greece remained focused on its mission as a public policy institution, supporting economic policy and fostering the return of the Greek economy to a path of growth through a reduction of fiscal deficits. It invariably stressed the need for policy to adapt to the new, post- Bretton Woods environment. Its task was far from easy, given its obligation to comply with government choices that were legitimised by the Greek people's vote and held the majority in the Currency Committee. But even when the latter was abolished, the Bank of Greece had to continue a deficit financing policy under the growth strategies of the governments of the time. Nevertheless, the Bank of Greece early identified the shifts in international economic theory, criticised the failure of economic policy to break with the stagflation nightmare, and amid shocks, regained the lost ground after 1984.

The period from 1984 to 2001 started with a reshaping of the domestic monetary, credit and banking landscape, in particular after 1987. The transition of the banking system away from a centralised model of financing the deficits and supporting the agricultural sector and the country's defence needs took place in parallel to the supervision and steering of credit towards the real economy. The banking system acquired considerable freedom, within a framework of preventive and suppressive controls, combined with the new international obligations of Greece as an EEC member country. It was assisted by the full acceptance of the European *acquis communautaire* by the governments in power after 1985. The desire to participate in the European processes bore fruit. Monetary policy became increasingly tighter and the governments of the 1990s allowed greater freedom to the Bank of Greece, so as to enable accession to EMU. As a result of the monetary regime shift that took place, inflation gradually fell to single-digit levels and growth rates became stronger since 1995 and for more than a decade, initially also thanks to the reduction of fiscal deficits. The Bank of Greece not only spearheaded the effort for full membership of EMU, but also successfully carried out the often overlooked but major task of adjusting its operational framework to that of the Eurosystem and the changeover from the drachma to the euro. At the same time, as a member of the Eurosystem, the Bank of Greece was granted full independence from the government in the performance of its tasks, and the maintenance of price stability was enshrined in its Statute as its primary objective.

In the next period, marked by the entry and participation in the euro area (i.e. from 2001 to 2008, which is the last year covered by the present history), Greece started by adopting the euro as its national currency. As if it had no right to relax, the Bank of Greece soon found itself on the horns of new dilemmas, associated with ample liquidity as a result of borrowing at euro area interest rates; consumer credit expansion; and inflationary pressures. Such pressures led the Bank of Greece to systematically criticise all the governments of the first decade of the 21st century for the weaknesses of the economic policies pursued, in particular the failure to promote and complete economic reforms and adjustments required by the country's full integration into the new international environment. At the same time, however, the Bank was deprived of the exchange rate policy tool. With growth rates diminishing and with the major Greek political parties accusing each other of creative accounting that undermined the country's credibility in international financial markets, the future of the Greek economy was bleak. The Bank of Greece performed its duty, by warning, recommending and criticising. As the credit bubble inflated, more and more disregarded the Bank's criticism on economic policy – it is important to note that such criticism, far from overstepping into the government's field of competence, was always meant as policy advice regarding possible corrective actions.

To sum up, the Bank of Greece as an institution has served the country well since 1928. The first 80 years of its history, despite its efforts to the contrary, have seen one default (in 1932) and long periods of high inflation (in 1944-1953 and 1980-1994). This was because the governments of the country in these periods, relying on their democratic legitimacy, confined the Bank of Greece to a role of an obsessed schoolteacher trying to persuade a bad pupil back to a track of progress and learning. The country's governments, by voting in favour of the Maastricht Treaty, accepted the predominance of the Bank of Greece in matters of monetary policy, financial stability and supervision. The Bank's independence after 1998 offered it high degrees of freedom which it lacked in the past. And the Bank made best use of this freedom in order to warn against adverse developments, always within its mandate.

One could therefore argue that the Bank of Greece, as an institution, has lived up to its statutory role. Its history is the history of the Greek economy, with all its achievements and setbacks. For 80 years, the Bank of Greece has played a dual role. On the one hand, it has been a guardian of monetary stability: it delivered this stability (given the limitations arising from the operation of the political system) for long periods of Greek economic history, and whenever it did not, it was not its fault. On the other hand, it has been a soldier standing at the side of the Greek people and the Greek economy, offering great services to the national economy in its 80 years of operation. Today, its independence can once again, as has happened in the past, contribute to a return of the Greek economy to a path of growth and economic progress.

ANNEXES

1

STATISTICAL DATA ON THE GREEK ECONOMY

Table 1.1 Macroeconomic data, 1928–1939[1]

In million drachmas

Year	Nominal national income	Percentage changes in nominal national income	National income at 1914 constant prices	Percentage changes in national income at constant prices	Public debt	% of national income	Goverment deficit/ surplus	% of national income	Total revenue	% of national income	Total expenditure	% of national income	Price index 1914 = 100
1928	46,128	-	24,693	-	38,038	82.46	1,102	2.40	10,552	22.88	9,450	20.49	1,942
1929	44,529	-3.46	23,156	-6.22	38,602	86.69	372	0.84	18,730	42.06	18,358	41.23	2,019
1930	42,701	-4.10	25,387	9.63	41,310	96.74	218	0.51	11,394	26.68	11,176	26.17	1,798
1931	39,404	-7.72	25,581	0.76	43,039	109.22	-22	-0.06	11,077	28.11	11,099	28.17	1,666
1932	43,665	10.81	24,627	-3.73	43,161	98.84	27	0.06	9,144	20.94	9,117	20.88	1,823
1933	49,123	12.50	25,799	4.76	42,687	86.90	770	1.57	8,476	17.25	7,706	15.69	1,881
1934	52,475	6.82	27,090	5.00	44,985	85.73	491	0.94	9,237	17.60	8,46	16.67	1,887
1935	54,989	4.79	28,388	4.79	47,363	86.13	598	1.09	10,647	19.36	10,049	18.27	1,986
1936	59,368	7.96	29,274	3.12	49,630	83.60	531	0.89	13,214	22.26	12,683	21.36	2,005
1937	67,692	14.02	30,980	5.83	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	2,186
1938	72,342	6.87	33,291	7.46	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	2,233
1939	67,250	-7.04	30,948	-7.04	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

N/A: data not available.
1 For the columns regarding public debt, deficit/surplus, revenue and expenditure, each year refers to a two-year period, e.g. 1928 refers to 1928/1929, etc.
Sources: Mazower (2002), Kostelenos et al. (2007) and Psalidopoulos (1989).

Table 1.2 Macroeconomic data, 1948–1974

In billion drachmas

Year	Nominal GDP	Percentage changes in nominal GDP	GDP at 1970 constant prices	Percentage changes in GDP at constant prices	Government debt1[1]	% of GDP	General government deficit	Interest payments	Primary deficit/surplus	General government expenditure	Total revenue	Consumer price index (CPI) 2000 = 100
1948	19,132	-	58,288	-	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
1949	25,158	31.50	69,982	20.06	0,943	3.75	N/A	N/A	N/A	N/A	N/A	N/A
1950	30,247	20.23	74,355	6.25	0,946	3.13	N/A	N/A	N/A	N/A	N/A	N/A
1951	36,038	19.14	80,511	8.28	0,945	2.62	N/A	N/A	N/A	N/A	N/A	N/A
1952	37,563	4.23	80,746	0.29	2,774	7.38	N/A	N/A	N/A	N/A	N/A	N/A
1953	49,121	30.76	91,291	13.05	2,617	5.33	N/A	N/A	N/A	N/A	N/A	N/A
1954	56,594	15.21	94,123	3.10	2,729	4.82	N/A	N/A	N/A	N/A	N/A	N/A
1955	64,921	14.71	100,533	6.81	2,545	3.92	N/A	N/A	N/A	N/A	N/A	N/A
1956	75,240	15.89	109,277	8.70	3,284	4.36	N/A	N/A	N/A	N/A	N/A	N/A
1957	80,459	6.94	115,858	6.02	3,641	4.53	N/A	N/A	N/A	N/A	N/A	N/A
1958	83,703	4.03	120,481	3.99	3,574	4.27	N/A	N/A	N/A	N/A	N/A	N/A
1959	87,114	4.08	125,308	4.00	7,988	9.17	N/A	N/A	N/A	N/A	N/A	N/A
1960	93,225	7.01	129,201	3.11	9,700	10.40	0.3	0.3	0.6	20.7	24.6	1.55
1961	104,921	12.55	143,772	11.28	11,579	11.04	1.0	0.4	1.4	23.4	28.9	1.58

1 Central government for the period 1948-1956, general government therafter. Each year refers to a two-year period, e.g. 1949 refers to 1948/1949.
Sources: Bank of Greece, *The Greek Economy. Research Papers and Statistical Series,* Economic Research Department, Athens, 1980 (in Greek), Greek Ministry of National Economy, *The Greek Economy 1960 – 1997. Historical Macroeconomic Statistical Series,* Athens, 1998 (in Greek), and European Commission, AMECO database. ➛

Table 1.2 Macroeconomic data, 1948–1974 *(cont.)*

In billion drachmas

Year	Nominal GDP	Percentage changes in nominal GDP	GDP at 1970 constant prices	Percentage changes in GDP at constant prices	Government debt1[1]	% of GDP	General government deficit	Interest payments	Primary deficit/surplus	General government expenditure	Total revenue	Consumer price index (CPI) 2000 = 100
1962	110,907	5.70	144,612	0.58	13,148	11.85	0.8	0.5	1.3	26.4	32.4	1.58
1963	123,467	11.32	159,171	10.07	17,622	14.27	1.9	0.7	2.6	30.5	36.9	1.62
1964	138,671	12.31	171,177	7.54	21,422	15.45	2.0	0.9	2.9	36.4	43.1	1.64
1965	157,956	13.91	187,009	9.24	25,432	16.10	0.9	1.2	2.1	43.4	48.9	1.69
1966	174,810	10.67	197,011	5.34	32,074	18.35	1.5	1.3	2.8	49.9	57.4	1.77
1967	188,416	7.78	206,176	4.66	38,703	20.54	-0.5	1.5	1.1	59.2	64.8	1.80
1968	202,632	7.54	217,895	5.68	45,366	22.39	1.2	1.8	3.0	65.1	73.9	1.81
1969	228,995	13.01	238,201	9.32	56,721	24.77	3.6	2.1	5.7	70.3	82.8	1.85
1970	258,000	12.67	258,000	8.31	63,762	24.71	2.4	2.8	5.2	78.6	91.8	1.91
1971	287,422	11.40	278,551	7.96	72,194	25.12	0.4	3.3	3.7	88.6	101.4	1.97
1972	329,977	14.81	303,973	9.13	87,455	26.50	0.0	3.7	3.7	97.7	114.9	2.05
1973	428,216	29.77	329,269	8.32	94,283	22.02	-0.3	4.8	4.5	119.5	140.2	2.37
1974	507,328	18.47	323,307	-1.81	114,334	22.54	-8.8	7.1	-1.7	164.5	175.8	3.00

1 Central government for the period 1948-1956, general government therafter. Each year refers to a two-year period, e.g. 1949 refers to 1948/1949.
Sources: Bank of Greece, *The Greek Economy. Research Papers and Statistical Series,* Economic Research Department, Athens, 1980 (in Greek), Greek Ministry of National Economy, *The Greek Economy* 1960 – 1997. *Historical Macroeconomic Statistical Series,* Athens, 1998 (in Greek), and European Commission, AMECO database.

Table 1.3 Macroeconomic data, 1975–2008

In million euro

Year	Nominal GDP	Percentage changes in nominal GDP	GDP at 2005 constant prices	Percentage changes in GDP at constant prices	Debt	% of GDP	General government deficit/surplus	% of GDP	Interest payments EDP	% of GDP	Primary deficit/surplus	% of GDP	General government expenditure	% of GDP	Primary expenditure	% of GDP	Total revenue	% of GDP	Consumer price index (CPI) 2000 = 100
1975	2,306		96,636	6.4	566	24.6	-68	-2.9	18	0.8	-50	-2.2	662	28.7	644	27.9	594	25.8	3.41
1976	2,868	24.40	103,304	6.9	701	24.5	-47	-1.6	27	0.9	-20	-0.7	825	28.8	798	27.8	778	27.1	3.86
1977	3,359	17.11	106,300	2.9	860	25.6	-85	-2.5	29	0.9	-56	-1.7	1,010	30.1	981	29.2	925	27.5	4.33
1978	4,099	22.03	113,954	7.2	1,145	27.9	-119	-2.9	43	1.0	-76	-1.9	1,245	30.4	1,202	29.3	1,126	27.5	4.87
1979	5,086	24.09	117,714	3.3	1,391	27.3	-122	-2.4	65	1.3	-57	-1.1	1,537	30.2	1,472	28.9	1,415	27.8	5.80
1980	6,106	20.05	118,538	0.7	1,734	28.4	-160	-2.6	86	1.4	-74	-1.2	1,847	30.3	1,761	28.8	1,687	27.6	7.24
1981	7,310	19.72	116,641	-1.6	2,500	34.2	-635	-8.7	148	2.0	-487	-6.7	2,589	35.4	2,441	33.4	1,954	26.7	9.01
1982	9,194	25.77	115,358	-1.1	3,759	40.9	-673	-7.3	146	1.6	-527	-5.7	3,353	36.5	3,207	34.9	2,680	29.1	10.92
1983	10,970	19.31	114,089	-1.1	4,549	41.5	-829	-7.6	246	2.2	-583	-5.3	4,224	38.5	3,978	36.3	3,395	31.0	13.12
1984	13,643	24.37	116,371	2.0	6,477	47.5	-1,154	-8.5	399	2.9	-755	-5.5	5,470	40.1	5,071	37.2	4,315	31.6	15.54
1985	16,646	22.01	119,280	2.5	8,992	54.0	-1,934	-11.6	595	3.6	-1,339	-8.0	7,175	43.1	6,580	39.5	5,241	31.5	18.55
1986	19,891	19.50	119,876	0.5	10,985	55.2	-1,913	-9.6	819	4.1	-1,094	-5.5	8,473	42.6	7,654	38.5	6,560	33.0	22.81
1987	22,408	12.65	117,119	-2.3	13,755	61.4	-2,148	-9.6	1,156	5.2	-992	-4.4	9,533	42.5	8,377	37.4	7,385	33.0	26.56
1988	27,266	21.68	122,155	4.3	17,981	65.9	-3,105	-11.4	1,868	6.9	-1,237	-4.5	11,805	43.3	9,937	36.4	8,701	31.9	30.15
1989	32,406	18.85	127,797	3.8	22,365	69.0	-4,610	-14.2	2,193	6.8	-2,417	-7.5	14,415	44.5	12,222	37.7	9,805	30.3	34.28
1990	39,111	20.69	126,797	0.0	31,131	79.6	-6,216	-15.9	3,660	9.4	-2,556	-6.5	20,168	51.6	16,508	42.2	13,952	35.7	41.28
1991	48,302	23.50	130,728	3.1	39,698	82.2	-5,488	-11.4	4,045	8.4	-1,443	-3.0	22,841	47.3	18,796	38.9	17,353	35.9	49.31

* Calculation by reduction.

Sources: (a) Ministry of National Economy, *Key National Accounts Aggregates of the Greek Economy, 1960-1999 (ESA 95)*, Athens, January 2001; (b) Eurostat, EDP Notification Tables, October 2012; (c) AMECO database; and (d) European Commission, *Statistical Annex of European Economy,* Autumn 2002 and Autumn 2013. ➛

Table 1.3 Macroeconomic data, 1975–2008 *(cont.)*

In million euro

Year	Nominal GDP	Percentage changes in nominal GDP	GDP at 2005 constant prices	Percentage changes in GDP at constant prices	Debt	% of GDP	General government deficit/surplus	% of GDP	Interest payments EDP	% of GDP	Primary deficit/surplus	% of GDP	General government expenditure	% of GDP	Primary expenditure	% of GDP	Total revenue	% of GDP	Consumer price index (CPI) 2000 = 100
1992	55,839	15.60	131,643	0.7	49,030	87.8	-7,037	-12.6	5,869	10.5	-1,168	-2.1	27,582	49.4	21,713	38.9	20,544	36.8	57.14
1993	62,873	12.60	129,537	-1.6	69,238	110.1	-8,538	-13.6	7,145	11.4	-1,393	-2.2	31,819	50.6	24,674	39.2	23,281	37.0	65.37
1994	71,302	13.41	132,128	2.0	76,957	107.9	-7,043	-9.9	8,967	12.6	1,924	2.7	34,764	48.8	25,797	36.2	27,721	38.9	72.48
1995	89,555	25.60	134,903	2.1	86,876	97.0	-8,246	-9.2	10,188	11.4	1,942	2.2	40,967	45.7	30,779	34.4	32,849	36.7	78.96
1996	98,397	9.87	138,085	2.4	97,793	99.4	-6,746	-6.9	10,539	10.7	3,793	3.9	43,372	44.1	32,833	33.4	36,836	37.4	85.43
1997	108,885	10.66	143,106	3.6	105,186	96.6	-6,613	-6.1	10,314	9.5	3,702	3.4	48,851	44.9	38,537	35.4	42,434	39.0	90.16
1998	118,399	8.74	147,922	3.4	111,924	94.5	-4,698	-4.0	9,823	8.3	5,125	4.3	52,481	44.3	42,658	36.0	47,956	40.5	94.46
1999	126,155	6.55	152,979	3.4	126,558	100.3	-4,013	-3.2	9,443	7.5	5,430	4.3	56,005	44.4	46,562	36.9	52,098	41.3	96.95
2000	137,930	9.33	158,378	3.5	140,971	102.2	-5,031	-3.6	9,996	7.2	4,965	3.6	63,627	46.1	53,631	38.9	58,537	42.4	100.00
2001	146,428	6.16	165,026	4.2	151,869	103.7	-6,542	-4.5	9,497	6.5	2,955	2.0	66,318	45.3	56,821	38.8	59,816	40.9	103.37
2002	156,614	6.96	170,702	3.4	159,214	101.7	-7,465	-4.8	8,633	5.5	1,168	0.7	70,614	45.1	61,981	39.6	63,041	40.3	107.13
2003	172,432	10.10	180,848	5.9	168,025	97.4	-9,738	-5.6	8,472	4.9	-1,266	-0.7	77,143	44.7	68,671	39.8	67,290	39.0	110.91
2004	185,266	7.44	188,746	4.4	183,187	98.9	-13,940	-7.5	9,176	5.0	-4,764	-2.6	84,333	45.5	75,157	40.6	70,583	38.1	114.12
2005	193,050	4.20	193,050	2.3	212,418	110.0	-10,539	-5.5	8,668	4.5	-1,871	-1.0	86,097	44.6	77,429	40.1	75,219	39.0	118.17
2006	208,622	8.07	203,682	5.5	224,876	107.8	-11,973	-5.7	9,188	4.4	-2,785	-1.3	94,407	45.3	85,219	40.8	81,844	39.2	121.95
2007	223,160	6.97	210,884	3.5	239,490	107.3	-14,418	-6.5	10,008	4.5	-4,410	-2.0	106,009	47.5	96,001	43.0	90,915	40.7	125.48
2008	233,198	4.50	210,431	-0.2	263,284	112.9	-22,880	-9.8	11,673	5.0	-11,207	-4.8	117,992	50.6	106,319	45.6	94,848	40.7	130.69

* Calculation by reduction.

Sources: (a) Ministry of National Economy, *Key National Accounts Aggregates of the Greek Economy, 1960-1999 (ESA 95)*, Athens, January 2001; (b) Eurostat, EDP Notification Tables, October 2012; (c) AMECO database; and (d) European Commission, *Statistical Annex of European Economy,* Autumn 2002 and Autumn 2013.

2

GOVERNORS AND DEPUTY GOVERNORS OF THE BANK OF GREECE, 1928–2008

Table 2.1 Governors of the Bank of Greece, 1928-2008[1]

Governors	From	To
Alexandros Diomidis	21.04.1928	29.09.1931
Emmanuel Tsouderos (1st term of office)	31.10.1931	13.08.1935
Emmanuel Tsouderos (2nd term of office)	20.03.1936	10.07.1939
Ioannis Drossopoulos	10.07.1939	28.07.1939
Kyriakos Varvaressos[1]	04.08.1939	11.02.1946
Xenophon Zolotas (1st term of offfice – Co-governor)	12.10.1944	08.01.1945
Georgios Mantzavinos	11.02.1946	02.02.1955
Xenophon Zolotas (2nd term of office)	05.02.1955	07.08.1967
Demetrios Galanis	07.08.1967	04.05.1973
Konstantinos Papayiannis	07.05.1973	09.08.1974
Panayis Papaligouras	09.08.1974	24.10.1974
Xenophon Zolotas (3rd term of office)	26.11.1974	03.11.1981
Gerassimos Arsenis	03.11.1981	20.02.1984
Demetrios Chalikias	20.02.1984	20.02.1992
Efthymios Christodoulou	20.02.1992	01.12.1993
Ioannis Boutos	01.12.1993	26.10.1994
Lucas Papademos	26.10.1994	14.06.2002
Nicholas Garganas	14.06.2002	14.06.2008
George Provopoulos	20.06.2008	

1 During the Occupation (1941-1944) Governor Kyriakos Varvaressos and Deputy Governor Georgios Mantzavinos followed to London (under Mandatory Law 3004/7.5.1941) the Greek government into exile. Occupation-era governments in Greece dismissed Kyriakos Varvaressos and Georgios Mantzavinos in 1941 and appointed initially Miltiades Negrepontis as Acting Governor (24.4-3.7.1941) and subsequently Demetrios Santis (3.7.1941-20.1.1943) and Theodoros Tourkovassilis (19.4.1943-13.4.1944) as Governors. After the country's liberation, all dismissals and appointments by occupation-era governments concerning members of the Administration of the Bank of Greece were cancelled by Law 89/15.1.1945.
Source: Historical Archives of the Bank of Greece. See also https://www.bankofgreece.gr/BogDocumentEn/Governors.pdf.

Table 2.2 Deputy Governors of the Bank of Greece, 1928-2008

Deputy Governors	From	To
Emmanuel Tsouderos	21.04.1928	31.10.1931
Emmanuel Kamaras	25.11.1931	30.05.1932
Kyriakos Varvaressos	01.03.1933	04.08.1939
Georgios Mantzavinos[1]	28.09.1936	11.02.1946
Ioannis Arvanitis	04.08.1939	26.04.1941
Stylianos Grigoriou	28.03.1945	02.02.1955
Vassilios Kyriakopoulos	05.02.1955	24.12.1955
Demetrios Galanis	31.12.1955	07.08.1967
Ioannis Pezmazoglou	11.02.1960	05.08.1967
Konstantinos Thanos	05.01.1968	10.09.1969
Efstathios Panas	11.09.1969	09.08.1974
Nikolaos Kyriazidis	09.08.1974	05.01.1977
Nikolaos Harissopoulos	21.10.1975	06.11.1981
Evangelos Devletoglou	23.12.1977	08.11.1978
Georgios Drakos	24.11.1978	20.10.1981
Demetrios Chalikias	16.11.1981	06.02.1984
Evangelos Kourakos (1st term of office)	10.07.1982	11.02.1986
Panagiotis Korliras	20.02.1984	30.08.1985
Efstathios Papageorgiou	17.09.1985	17.09.1989
Georgios Provopoulos	01.10.1990	29.11.1993
Vassilios Antonioudakis	01.10.1990	19.12.1991
Panagiotis Pavlopoulos	21.02.1992	29.11.1993
Evangelos Kourakos (2nd term of office)	01.12.1993	04.09.1996
Lucas Papademos	01.12.1993	26.10.1994
Panayiotis Thompoulos[2]	26.10.1994	26.02.2009
Nicholas Garganas	05.09.1996	13.06.2002
Nikolaos Paleocrassas	14.06.2002	14.06.2008
Eleni Dendrinou-Louri	20.06.2008	

1 During the Occupation (1941-1944) Deputy Governor Georgios Mantzavinos followed to London (under Mandatory Law 3004/7.5.1941) the Greek government into exile. Occupation-era governments in Greece dismissed Georgios Mantzavinos in 1941 and appointed Andreas Papadimitriou (3.7.1941-16.11.1944) and Spyridon Hatzikyriakos (5.4.1943-5.10.1944) as Deputy Governors. After the country's liberation, all dismissals and appointments by occupation-era governments concerning members of the Administration of the Bank of Greece were cancelled by Law 89/15.1.1945.
2 Succeeded by Deputy Governor Ioannis Papadakis on 3.3.2009.
Source: Historical Archive of the Bank of Greece. See also https://www.bankofgreece.gr/BogDocumentEn/Deputies.pdf.

3 GOVERNORS OF THE BANK OF GREECE 1928–2008: SHORT BIOGRAPHICAL NOTES

Alexandros Diomidis

Alexandros Diomidis studied in Greece, France and Germany. He obtained a Doctorate Degree in law in 1895 in Leipzig and a Doctorate Degree in political sciences in 1905 in Weimar, and became Assistant Professor of Administrative (Fiscal) Law at the University of Athens. In 1908 he was appointed Secretary to the Greek Delegation to the Second Hague International Peace Conference. In 1909 he was appointed Prefect of Attica and Boeotia and in 1911 he was elected as member of the Hellenic Parliament. He served as Minister of Finance in the period 1912-1915 under the Venizelos government. He participated in the National Defence uprising and represented the provisional Thessaloniki-based government in France and Great Britain. He was actively involved in the negotiations with the Allies that led to a loan agreement. Between 1918 and 1919, he was Minister of Foreign Affairs and from 1918 to 1920 he was Co-Governor of the National Bank of Greece. Between 1920 and 1922 he lived abroad and returned to Greece to take up the Ministry of Finance in the S. Krokidas government, but soon resigned due to his opposition to the execution of "the Six". He was Governor of the National Bank of Greece (1923-1928) and Governor of the Bank of Greece (1928-1931). From 1931 to 1941 he was member and subsequently Chairman of the Supreme Economic Council, while from 1945 until 1949 he was Chairman of the General Council of the National Bank of Greece. In 1945 he was appointed President of the Supreme Council for Reconstruction, and in 1946 he was elected member of the Academy of Athens. He joined the Sophoulis government as minister without portfolio and Deputy Prime Minister (January-July 1949), while following Sophoulis's death he became Prime Minister (July 1949-January 1950). He was one of the most prominent figures of economic, scientific and political life in interwar Greece. He wrote several books, mainly in the field of economics, as well as studies regarding the Byzantine Empire and its economy.

Emmanuel Tsouderos

Emmanuel Tsouderos studied law at the University of Athens and economics in Paris and London, and obtained a Doctorate Degree in law. He was elected member of the Cretan Assembly, representative of the Cretan State to the Hellenic Parliament, and commissioner of public security and public works in the Administrative Committee of Crete. Following the union of Crete with Greece, he continued his parliamentary career and served as technical advisor of the Greek delegation at the Versailles Peace Conference, and as Minister of Transport and Minister of Finance in 1924 and 1925, respectively. From 1925 onwards, in his capacity as Deputy Governor of the National Bank of Greece, he actively participated in the negotiations with the Financial Committee of the League of Nations that led to the establishment of the Bank of Greece. Between 1928 and 1939 he was Deputy Governor (1928-1931) and subsequently Governor of the Bank of Greece (1931-1939). During World War II, he was Prime Minister of the Greek government in exile from 21 April 1941 to 14 April 1944. Following the country's liberation, he was Vice-President of the government and Minister of Coordination with the National Progressive Centre Union (EPEK) party, while in 1950 he was elected member of the Hellenic Parliament in the constituency of Piraeus and, later on, of Athens. He served as minister without portfolio in the Papagos government from 19 November 1952 to 6 October 1955. He authored several studies and books, including: *Το Κρητικόν Πολίτευμα του 1896 [The Cretan State of 1896]* (1903), *Η αποζημίωσις των ανταλλαξίμων [Compensation of exchange populations]* (1927), and *La Banque de Grèce* (Paris, 1928).

Ioannis Drossopoulos

Ioannis Drossopoulos was recruited by the National Bank of Greece at the age of 18, as soon as he graduated from high school. He worked in various towns across Greece before being transferred to Athens, where his career took off, becoming, in 1911, by decision of the General Meeting of Shareholders, Director of the bank's head office in Athens. In 1914 he was appointed Deputy Governor and in 1918 Co-Governor of the National Bank of Greece, while in 1917 he served as Minister of Food for two months. In 1926 he became Minister of Finance in the Kondylis government. In April 1928 he was appointed Governor of the National Bank of Greece, and in 1939 he succeeded E. Tsouderos as Governor of the Bank of Greece, but passed away 18 days after. I. Drossopoulos was the first governor of a major credit institution in Greece who, without formal academic qualifications but relying on his first-hand knowledge of the banking system, was universally recognised by Greek society and honoured with high-ranking state offices.

Kyriakos Varvaressos

Kyriakos Varvaressos obtained a Doctorate Degree from the Athens Law School in 1906 and went on to study economics and statistics at the Universities of Berlin and Munich, while working as an intern at the Royal Prussian Statistical Office. In 1911 he was appointed Head of Section at the Statistics Department of the newly-established Greek Ministry of Agriculture, Commerce and Industry, becoming Director of that department in 1913. In 1916 he was seconded to the Food Service as Director General of the Ministry of Food, where he remained until 1918, when he was elected non-tenured Professor of Political Economy at the University of Athens. He served as technical advisor of the Greek delegation at the Versailles Peace Conference. He was removed from his academic position in 1920 and reinstated in 1922, while in 1924 he was elected Full Professor of Political Economy at the Athens Law School. He was appointed Economic Adviser at the National Bank of Greece in 1924 and at the Bank of Greece in 1928.

In 1932 he was invited by Eleftherios Venizelos to take up the Ministry of Finance. In the next year, he was appointed Deputy Governor of the Bank of Greece, while in parallel taught as Full Professor at the University of Athens. In 1936 he was elected member of the Academy of Athens. Following Drossopoulos's death, he was appointed Governor of the Bank of Greece. During the Axis Occupation, he served as Minister of Shipping and Minister of Finance in the London-based Greek government in exile and later represented the country at the international peace conferences. Between May and September 1945 he was Vice-President of the Voulgaris government, with unlimited authority in economic matters. Later on, he resigned from that position and all other public offices he held in Greece, and settled in the United States. He was Executive Director and subsequently Chief Economist at the World Bank. In January 1952 he submitted his Report on the Economic Problem of Greece, as commissioned by the Plastiras government. His work as an author includes *Η θεωρία του πληθυσμού [Population theory]* (1913) and *Αι οικονομικαί συνέπειαι της συνθήκης των Βερσαλλιών [The economic consequences of the Treaty of Versailles]* (1922).

Xenophon Zolotas

Xenophon Zolotas studied law at the University of Athens, as well as economics and political sciences at the Leipzig Graduate School of Management (Handelshochschule) and at the University of Leipzig, from which he obtained a Doctorate Degree in economics in 1926. In 1928 he was elected Assistant Professor at the Athens Law School, and soon afterwards Full Professor of Political Economy at the Aristotle University of Thessaloniki. In 1931 he was elected non-tenured Professor of Political Economy at the Athens Law School and in 1933 he became Full Professor, a position he held until his retirement in 1968. In the 1930s he was member of the Supreme Economic Council, Head of the Greek Delegation to the Economic Council of the Balkan Pact, and Chairman of the Board of Directors of the Agricultural Bank of Greece. After the country's liberation, he served for three months as Co-Governor of the Bank of Greece to later return as its Governor from 5 February 1955 to 5 August 1967 and from 26 November 1974 to 27 October 1981. He held several senior offices, serving among other things as (twice) caretaker Minister, as Greece's representative at the IMF, as member of international committees and, most prominently, as Prime Minister from 23 November 1989 to 11 April 1990. He was member of the Academy of Athens since 1952.

He launched the scientific journals *Επιθεώρησις Κοινωνικής και Δημόσιας Οικονομικής [Review of Social and Public Economics]* (1931-1943) and *Επιθεώρησις Οικονομικών και Πολιτικών Επιστημών [Review of Economic and Political Sciences]* (1946-1967). As an author, he left a rich legacy in the areas of economic theory and policy, fiscal policy and monetary policy. Several of his studies were either originally written in or translated into English, French, Russian and German. For a full bibliography, see Psalidopoulos (2008).

Georgios Mantzavinos

Georgios Mantzavinos studied at the University of Athens, from which he obtained a Doctorate Degree in law. In 1906 he was recruited by the State General Accounting Office. He gradually moved up all hierarchy levels to the very top, becoming Director General in 1928. He served until 1936, when he was appointed Deputy Governor of the Bank of Greece, a position he held even in exile during the Occupation period. Between May 1943 and May 1944 he was also Minister of Finance in the Greek government in exile. In 1945 (April-October) he became Minister of Finance in the P. Voulgaris government, while from February 1946 to February 1955 he was Governor of the Bank of Greece. Mantzavinos had an excellent knowledge and understanding of fiscal, monetary and banking matters, greatly contributing to the transition of the war-torn Bank of Greece and Greek economy to reconstruction and normalcy.

Demetrios Galanis

Demetrios Galanis studied law and economics at the University of Athens and economics at the University of Berlin and the Berlin Graduate School of Management (Handelshochschule). In 1926 he joined the Commercial Bank of Greece, where he worked for nearly a quarter of a century. In 1945 he was appointed Minister of National Economy, while from 1945 to 1951 he was professor of banking policy at the Higher School of Industrial Studies in Piraeus (now the University of Piraeus). He served as General Manager of the Marshall Plan Reconstruction Loans, Chairman of the Board of the Greek Postal Savings Bank, Chairman of the Board of the Economic Development Financing Organisation (OXOA), and Vice-President of the Greek Public Power Corporation (DEH). From December 1955 to August 1967 he was Deputy Governor of the Bank of Greece. On 7 August 1967 he was appointed Governor of the Bank of Greece and remained in this position until his death, on 4 May 1973, which makes him one of the longest-serving central bankers in Greece. His published work includes: *Αι τράπεζαι ως ιδιωτικά και ως κρατικά ή ημικρατικά ιδρύματα [Banks as private and as public or semi-public institutions]*, *Νομισματική πολιτική και πιστωτικοί έλεγχοι [Monetary policy and credit controls]* and *Προοπτικαί και προβλήματα της Κεφαλαιαγοράς [Prospects and challenges of the capital market]*.

Konstantinos Papayiannis

Konstantinos Papayiannis studied economics at the University of Neuchatel in Switzerland. Between 1921 and 1951 he worked at the eponymous family industrial and commercial business in Athens. In 1935 he was appointed Secretary General of the Athens Traders Association and from 1936 to 1941 he was its President. Between 1939 and 1951 he was Head of the Commercial Sector of the Athens Chamber of Commerce and Industry. In 1946 he was elected member of the Hellenic Parliament, while he was also a founding member of the New Party led by Spyridon Markezinis. In the 1952 election he was elected member of the Hellenic Parliament in the constituency of Athens with the Greek Rally party, taking up the Ministry of Finance in the Papagos cabinet. In 1953-1954 he was Head of the Greek delegation at the conferences held in Geneva for the General Agreement on Tariffs and Trade (GATT), as well as at the NATO conference in 1953. From 1968 until 1973 he was member of the Board of Directors of the National Bank of Greece. In 1973 he served as Governor of the National Investment Bank for Industrial Development (ETEBA). On 7 May 1973, K. Papayiannis was appointed Governor of the Bank of Greece, resigning on 5 August 1974.

Panayis Papaligouras

Panayis Papaligouras studied law, economics and political sciences at the University of Athens, while he obtained a Doctorate Degree from the University of Geneva. In World War II he served in the Middle East as an army reserve officer, and in 1945 he became Secretary General of the Ministry of Supply. In 1946 he was elected member of the Hellenic Parliament with the Unity Party in the constituency of Argolida and Corinthia, while he was re-elected to the Hellenic Parliament with the Greek Rally party in 1951 and 1952. He served as Deputy Minister (1952-1953) and then (1953-1954) Minister of Commerce. In 1954-1955 he was Minister of Coordination of the Papagos government. In 1956 he was elected Member of Parliament with the National Radical Union (ERE) and in 1958 with the New Political Movement party. From 1956 to 1958 he was Minister of Commerce and Industry under C. Karamanlis. In the years 1961, 1963 and 1964 he was re-elected Member of Parliament with the ERE party. From 4 November 1961 to July 1963 he served as Minister of Coordination, and then in 1967 as Minister of National Defence. On 9 August 1974 he was appointed Governor of the Bank of Greece for a four-year term, but resigned on 24 October of the same year. In 1974 and 1977 he was re-elected to the Hellenic Parliament, this time with the New Democracy party. Over the period 1976-1980 he drew up the Economic and Social Development Programme of the New Democracy, and subsequently led the negotiations of Greece's accession to the EEC. In 1977-1978 he served as Minister of Foreign Affairs. He published political and philosophical studies, as well as the seminal work *Θεωρία της διεθνούς κοινωνίας [The theory of international society]* (1941).

Gerassimos Arsenis

Gerassimos Arsenis studied law at the Athens Law School and economics at the Massachusetts Institute of Technology (MIT).

In 1960 he joined the United Nations Secretariat (Prebisch Group), where he worked for the next 20 years. From 1964 to 1967 he served as Director of the Research Division of the OECD Development Centre in Paris. In 1967, following the establishment of a permanent secretariat of the United Nations Conference on Trade and Development (UNCTAD), he re-joined the United Nations as a senior economist working closely with Raúl Prebisch in the areas of planning and trade with the Third World. He engaged in research and economic diplomacy in the context of discussions on the reform of the international monetary system. He was appointed Deputy Director (1971) and Director (1973) of UNCTAD on monetary and trade finance issues. As from 1976, he dealt with matters related to foreign borrowing and debt in the context of UNCTAD and the Paris Club, while he worked as advisor to several governments on foreign borrowing and trade debt settlement matters.

On 3 November 1981 he was appointed Governor of the Bank of Greece. In parallel to his position as Governor, he was also appointed Minister of National Economy on 5 July 1982 and Minister of Finance on 27 March 1984. Arsenis resigned from Bank of Greece Governor on 2 February 1984. He was elected Member of Parliament, and served as Minister of National Defence (13 October 1993-22 September 1996) and Minister of National Education and Religious Affairs (25 September 1996-13 April 2000).

Demetrios Chalikias

Demetrios Chalikias studied at the Higher School of Economics and Commercial Sciences (ASOEE, now the Athens University of Economics and Business) in Athens and at Cambridge University, UK.

From 1951 to 1954 he worked for the Ministry of Coordination as Secretary General and Economic Adviser. In 1957 he joined the Economic Research Department of the Bank of Greece, while in August 1974 he became Economic Adviser (Chief Economist). In November 1981 he was appointed Deputy Governor of the Bank of Greece and in July 1982 he became Chairman of the Bank's Monetary and Credit Policy Committee. Between 20 February 1984 and 19 February 1992 he served as Governor of the Bank of Greece. Throughout his professional career, D. Chalikias held various public offices related to the banking sector and monetary policy.

His work as an author includes: *Οικονομική και Ισοζύγιο Πληρωμών [Economic growth and balance of payments], Το πρόβλημα του ελληνικού ισοζυγίου πληρωμών [The problem of the Greek balance of payments]* (1956), *Η Εκβιομηχάνισις της Ελλάδος [The industrialisation of Greece]* (1958), *Δυνατότητες και Προβλήματα πιστωτικής πολιτικής: Η ελληνική εμπειρία [Credit policy prospects and challenges: the Greek experience]* (1976), *Νομισματική Πολιτική για το έτος 1991 [Monetary Policy in 1991]* (1991), *Οικονομική σταθεροποίηση και ανάπτυξη: Η περίπτωση της Ελλάδος [Economic stabilisation and growth: the Greek case]* (1993), *Πορεία προς την Ευρωπαϊκή Νομισματική Ένωση [The road to the European Monetary Union]* (1996), *and Η Ελλάς στην Ευρωπαϊκή Νομισματική Ένωση [Greece in the European Monetary Union]* (2000).

Efthymios Christodoulou

Efthymios Christodoulou studied economics at Hamilton College and then pursued postgraduate studies at Columbia University in New York, from where he obtained a Master's degree in Economics in 1955. He was a senior economist at the National Bureau of Economic Research in New York and Lecturer at the New York University. As from 1959, he served as Economic Adviser at the National Bank of Greece, while in 1965 he was appointed Director General of the National Investment Bank for Industrial Development (ETEBA). In 1977 he became CEO of Olympic Airways S.A. From 1979 to 1981 he was Governor of the National Bank of Greece and President of the Hellenic Bank Association. From 1984 to April 1990 he was member of the European Parliament and representative of the Group of the European People's Party. He served as Alternate Minister of Foreign Affairs (April-September 1990) and as Minister of National Economy (October 1990-February 1992).

On 20 February 1992 he was appointed Governor of the Bank of Greece, and on 19 November 1993 he submitted his resignation. In the European elections of 1994, he was re-elected to the European Parliament with the New Democracy party, while later on he became CEO of Hellenic Petroleum S.A.

Ioannis Boutos

Ioannis Boutos studied law at the University of Athens and economics at the London School of Economics. In 1950 he was elected Member of Parliament with the Liberal Party in the constituency of Messinia and in 1956 he was re-elected with the same party. In the elections held in 1961, 1963 and 1964 he was elected to the Hellenic Parliament, this time with the ERE party, whereas in the elections of 1974 and 1977 he was elected with the New Democracy party. He served as Deputy Minister of Coordination in 1961-1963 and in 1967 in the Kanellopoulos government. In 1974, when Constantinos Karamanlis returned to Greece and democracy was restored in the country, he joined the National Unity government as Deputy Minister to the Prime Minister. In the first government formed by C. Karamanlis after the election of 1974, he was appointed Minister of Commerce. From February 1975 to September 1976 he served as Alternate Minister of Coordination, and then as Minister of Agriculture until the election of 1977. Between November 1977 and May 1978 he was Minister of Finance and later on Minister of Agriculture until May 1980. In the Rallis government he served as Minister of Coordination from May 1980 until his resignation on 10 October 1980. In the elections of 1981 and 1985 he was re-elected member of the Hellenic Parliament in the constituency of Messinia with the New Democracy party. In the European elections of 1984, he led the party's ballot and was elected to the European Parliament. He left the New Democracy party on 15 July 1985, remaining an independent Member of Parliament until 1989. I. Boutos was not a candidate in the national election of June 1989, but ran again in the elections of 5 November 1989 and 8 April 1990 for State Deputy with the Democratic Alignment, with the ballot of the Panhellenic Socialist Movement (PASOK). In September of the same year he joined PASOK. On 1 December 1993 he was appointed Governor of the Bank of Greece, to resign on 26 October 1994.

Lucas Papademos

Lucas Papademos studied at the Massachusetts Institute of Technology (MIT), where he obtained a Bachelor's degree in physics, an MSc in electrical engineering and a PhD in economics.

From 1975 until 1984 he taught successively as Lecturer, Assistant Professor and Associate Professor in economics at Columbia University, New York. In 1980 he joined the Federal Reserve Bank of Boston as Senior Economist. From 1984 until 1985 he was Visiting Professor of Economics at the Athens School of Economics and Business. In 1988 he was elected Full Professor of Economic Sciences at the University of Athens.

Between 1985 and 1993 he held the position of Economic Adviser (Chief Economist) at the Bank of Greece. In parallel, he served as Head of the Bank's Economic Research Department from 1988 until 1993. On 1 December 1993 he was appointed Deputy Governor and on 26 October 1994 Governor of the Bank of Greece. On 26 February 1998 his term as Governor of the Bank of Greece was renewed for six more years. Following a consensus nomination by EU finance ministers (ECOFIN Council), in April 2002 the European Parliament delivered a favourable opinion on the appointment of L. Papademos to the office of Vice-President of the European Central Bank (ECB). On 26 April 2002 the General Council of the Bank of Greece awarded him the title of Honorary Governor, while on 27 May 2002 he resigned from the position of Governor of the Bank of Greece to assume his duties as Vice-President of the ECB, a position he held from 1 June 2002 to 31 May 2010. In November 2011 he was invited to lead the country's Coalition Government, serving as interim Prime Minister of Greece from 11 November 2011 to 16 May 2012. Throughout his tenure at the Bank of Greece as Economic Adviser (Chief Economist), Deputy Governor and Governor, he took part in various committees and councils. He was member (1985-1993) and Chairman (1989) of the Committee of Alternates of the Committee of the EC Central Bank Governors. He was also member of the Monetary Committee of the European Communities (1985-1988 and 1990), of Greece's Council of Economic Experts for several years (1985-1988 and 1991-1994) and of the Council of the European Monetary Institution (1994-1998). He served as Governor of the International Monetary Fund for Greece (1994-2002).

He was elected Chairman of the Monetary Policy Sub-Committee of the Committee of the EC Central Bank Governors in 1993, and served as Chairman of the Monetary Policy Sub-Committee of the Council of the European Monetary Institute in 1994-1995. In 1986-1987 he was member of the Padoa-Schioppa Study Group, which was formed by J. Delors and prepared the report on "Efficiency, Stability and Equity: A Strategy for the Evolution of the Economic System of the European Community", while in 1989-1990 he participated in the Angelopoulos Committee, which prepared the Report on the "Stabilisation and Recovery of the Greek Economy".

In his capacity as Vice-President of the European Central Bank, he was member of the Executive Board and of the Governing Council of the ECB (2002-2010). In addition, he participated in many international committees and bodies, such as the Financial Stability Forum and its successor, the Financial Stability Board (2006-2010), the Economic and Financial Committee of the European Union (2002-2010) and the Central Bank Governance Group at the Bank for International Settlements (2002-2010).

In 2006 Lucas Papademos was elected member of the Academy of Athens. His work as an author is extensive, comprising books, articles and research papers on macroeconomic theory and policy, the functioning of the financial system, monetary policy, as well as on financial stability and economic policy in the European Union.

Nicholas C. Garganas

Nicholas C. Garganas studied at the Athens School of Economics and Business (ASOEE). He worked for the Agricultural Bank of Greece (1964-1966) and pursued postgraduate studies in economics at the London School of Economics. Between 1966 and 1968, under an OECD scholarship, he studied at the University College London, where he obtained a Ph.D. in economics. In 1970-1971 he taught at Brunel University. Between 1968 and 1975 he served as research officer at the National Institute of Economic and Social Research in London.

In 1975 he joined the Bank of Greece as a senior economist. He was member of the OECD Economic Policy Committee (1975-1988), of the Economic Policy Committee of the European Communities (1982-1985) and of the Monetary Committee of the European Communities (1985-1987 and 1994-1998). In 1985-1987 he served as Chief Economic Adviser in the Greek Ministry of National Economy and was a founding member of Greece's Council of Economic Experts and member of the Board of the Centre of Planning and Economic Research (KEPE). From 1984 until 1993 he was Director-Adviser in the Economic Research Department of the Bank of Greece and, from 1993 to 1996, held the position of Economic Adviser (Chief Economist) at the Bank. N. Garganas was appointed Deputy Governor of the Bank of Greece on 5 September 1996. He was member of the Committee for the Examination of Long Term Economic Policy (known as the Spraos Committee) from September 1996 to November 1997, and Chairman of the Deposit Guarantee Fund in Greece (1996-2002). Since December 1997 he has been an Honorary Fellow of the London School of Economics and Political Science. He was member of the Economic and Financial Committee of the European Union (1998-2002). On 26 February 1998 he was reappointed Deputy Governor of the Bank of Greece, and on 14 June 2002 he was appointed Governor of the Bank of Greece. His term ended on 14 June 2008, but by its decision of 12 May 2008 the General Council of the Bank of Greece awarded him the title of Honorary Governor. He served as Governor of the International Monetary Fund for Greece from 14 June 2002 to 14 June 2008.

N. Garganas has published several books and articles, mostly in the areas of macroeconomics, economic modelling, European economic and monetary union, and monetary policy.

For his full curriculum vitae (in Greek), see http://el.wikipedia.org/w/index.php?title=Νικόλαος_Γκαργκάνας.

Georgios Provopoulos

Georgios Provopoulos was born in Piraeus and studied economics at the Department of Economics of the University of Athens, while he continued his studies at the University of Essex, UK, obtaining a Master's degree in 1974 and a Doctorate degree (Ph.D.) in 1977. Both as an undergraduate and a postgraduate student he was awarded scholarships by the Greek State Scholarships Foundation (IKY). From March 1979 to September 2007 he taught at the Department of Economics of the University of Athens. In parallel to his academic career, he held high-ranking positions in research institutes, as well as in the banking sector. He was Chairman of the Board of Directors of the Centre of Planning and Economic Research (KEPE) (1989-1990), President of the Council of Economic Experts of the Ministry of Economy and Finance (1989-1990), and Deputy Governor of the Bank of Greece (1990-1993). He was General Manager of the Foundation for Economic and Industrial Research (IOBE) from December 1993 to August 1997, Economic Adviser and Executive General Manager of Alpha Bank from January 1994 to March 2004, Chairman of the Board and CEO of Emporiki Bank from March 2004 to August 2006, and Vice-Chairman and Managing Director of Piraeus Bank from October 2006 to May 2008. On 20 June 2008 he was appointed Governor of the Bank of Greece.

He has written numerous studies and articles. His book (co-authored with P. Kapopoulos) entitled *Η Δυναμική του Χρηματοοικονομικού Συστήματος [The dynamics of the financial system]* received in 2003 the award of the Academy of Athens (Class of Ethical and Political Sciences). His participation in international organisations, governing councils and committees stands as follows:

- Member of the Governing Council of the European Central Bank (ECB) (since June 2008).
- Alternate Governor of the International Monetary Fund (IMF) for Greece (1990-1993 and from 2008 to the present day).
- Vice-President of the Hellenic Bank Association (2004-2008).
- Member of the Monetary Committee of the European Union (1990-1993).

• Member of the Angelopoulos Committee which prepared the Report on the "Stabilisation and Recovery of the Greek Economy" (April 1990), as commissioned by Ecumenical Government Prime Minister Professor X. Zolotas.

• Chairman of the Committee for the study and implementation of mutual fund status in the Social Security Funds (established by joint decision of the Ministers of Economy and Finance, and of Health, Welfare and Social Insurance).

• Chairman of the Committee established in November 1989 for the reform of the Greek tax system.

• Chairman of the Board of Directors of ICAP S.A. (2000-2005).

• Member of the Board of Directors of the Foundation for Economic & Industrial Research (IOBE) (1998-2006).

• Member of the Board of Directors of TITAN CEMENT company (1996-2004).

• Member of the Board of Directors of the Hellenic Center for Investment (ELKE) (1999-2004).

• Member of the Coordination Committee of the Ministry of Finance for the reform of the tax system (the so-called "Georgakopoulos Committee"), established in February 2001 by the Minister of Finance.

4

STAFF NUMBERS BY CATEGORIES

Table 4.1 Staff numbers by categories

Bank of Greece staff, 1928-1940

	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940
Heads of Section	24	35	32	30	27	39	41	47	42	54	56	55	54
Accountants, cashiers, secretaries	36	62	67	67	57	69	66	79	98	105	151	155	152
Junior accountants, junior cashiers, junior secretaries	69	102	138	158	159	163	157	158	191	223	270	310	386
Assistants, cash handlers	72	162	234	220	230	318	375	369	371	450	466	491	550
Clerks	19	80	54	52	42	3	1	-	-	-	-	-	-
Probationary employees	-	-	-	-	-	205	207	267	265	374	387	353	444
Copiers	-	6	76	87	87	-	-	-	-	-	-	-	-
Typists	125	165	177	180	158	220	199	212	256	207	193	190	18
Security officers, senior messengers	-	5	10	10	10	10	10	10	10	11	12	13	13
Collectors	46	119	171	180	141	159	178	171	193	210	232	261	247
Messengers, doorkeepers, night watchmen	74	156	194	206	176	206	223	212	258	259	282	290	289
Probationary messengers	-	-	-	-	-	-	-	-	-	3	3	3	5
Workers/technicians	-	-	-	-	-	-	-	-	-	-	9	12	15
Total	465	892	1,153	1,190	1,087	1,392	1,457	1,525	1,684	1,896	2,061	2,133	2,173

Source: Bank of Greece, *The 50th Anniversary of the Bank of Greece, 1928-1978,* Athens, 1978 (in Greek).

Table 4.2 Staff numbers by categories

Bank of Greece staff, 1941-1955

	1941[1]	1944[2]	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955
Accountants	1,344	1,395	1,186	1,232	1,570	1,618	1,730	2,040	2,029	1,861	1,997	1,977
Cashiers	508	709	808	911	888	950	1.053	995	1.040	969	953	933
Lawyers/Legal Services Department	13	25	35	43	44	47	60	60	64	43	48	50
Technicians/Technical Services Department	26	59	157	175	208	230	253	254	270	241	219	222
Office clerks, typists, switchboard operators	-	-	391	395	103	196	215	70	154	140	115	115
Security officers, senior messengers, messengers	270	253	247	258	275	326	385	394	388	384	321	317
Workers	53	12	58	57	53	42	50	49	33	27	26	22
Cleaners	156	213	197	193	189	187	185	185	179	172	154	157
Temporary staff under Laws 751/1948 and 1836/19513	-	-	-	-	43	182	16	43	35	25	-	2
Day-wage earners	-	659	-	-	-	-	-	-	-	-	-	-
Total	2,370	3,325	3,079	3,267	3,373	3,778	3,947	4,090	4,192	3,862	3,833	3,795

1 On 28.4.1941.
2 On 14.11.1944.
3 War veterans, etc.
Sources: Bank of Greece, *The 50th Anniversary of the Bank of Greece, 1928-1978*, Athens, 1978 (in Greek) and Governor's Annual Report, various years.

Table 4.3 Staff numbers by categories

Bank of Greece staff, 1956-1966

	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966
Administration	2	2	2	2	3	3	3	3	3	3	3
Accountants	1,939	1,915	1,907	1,906	1,710	1,732	1,717	1,661	1,688	1,642	1,603
Cashiers	914	892	910	910	787	821	819	811	768	824	866
Legal Department	57	55	54	53	50	49	48	46	43	41	39
Technical support	214	214	205	201	182	199	216	223	220	229	233
Office clerks, typists, switchboard operators	113	110	111	111	96	185	186	181	214	210	233
Security officers, messengers, guards	302	300	261	240	214	161	175	183	263	269	294
Workers	16	15	15	15	14	12	11	10	22	22	25
Cleaners	151	151	142	150	146	167	151	155	186	188	180
Temporary staff under Laws 751/1948 and 1836/1951	9	8	8	8	-	-	-	-	-	-	-
Total	3,717	3,662	3,615	3,596	3,202	3,329	3,326	3,273	3,407	3,428	3,476

Source: Bank of Greece, *The 50th Anniversary of the Bank of Greece, 1928-1978,* Athens, 1978 (in Greek)

Table 4.4 Staff numbers by categories

Bank of Greece staff, 1967-1979

	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Administration	1	2	2	2	2	2	2	2	3	3	3	3	3
Accountants	1,508	1,437	1,449	1,451	1,482	1,504	1,503	1,510	1,461	1,501	1,459	1,359	1,263
Cashiers	832	820	814	796	788	837	848	864	910	880	973	916	899
Legal Department	35	36	35	31	30	32	28	33	31	28	36	34	34
Technical support	209	197	203	206	233	279	299	341	346	376	385	297	289
Office clerks, typists, switchboard operators	259	259	291	287	346	390	439	522	522	516	507	491	470
Security officers, messengers, guards	289	253	204	242	261	256	261	296	212	217	221	331	385
Workers	25	20	20	18	26	28	41	47	46	71	58	69	43
Cleaners	174	172	166	168	176	191	190	214	221	222	225	223	212
Total	3,332	3,196	3,184	3,201	3,344	3,519	3,611	3,829	3,752	3,814	3,867	3,723	3,598

Sources: Bank of Greece, *The 50th Anniversary of the Bank of Greece, 1928-1978,* Athens, 1978 (in Greek) and *Governor's Annual Report,* various years.

Table 4.5 Staff numbers by categories

Bank of Greece staff, 1980-1993

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Administration	3	2	3	3	3	3	2	2	2	1	3	2	3	3
Accountants	1,328	1,283	1,175	1,122	1,360	1,416	1,405	1,390	1,378	1,363	1,320	1,309	1,265	1,243
Cashiers	866	838	824	879	912	1.003	986	969	966	969	947	933	896	892
Legal Department	32	32	31	31	35	34	34	34	35	38	39	41	39	37
Technical support	318	307	304	310	328	321	308	300	309	292	266	263	248	245
Office clerks, typists, switchboard operators	457	457	441	409	400	370	335	317	301	296	207	193	149	145
Security officers, messengers, guards, logistics employees	392	372	361	347	548	507	513	491	484	482	482	523	485	485
Workers	45	113	95	109	71	39	20	18	29	28	9	5	5	11
Cleaners	222	210	201	195	193	185	177	171	157	152	130	182	170	161
Total	3,663	3,614	3,435	3,405	3,850	3,878	3,780	3,692	3,661	3,621	3,403	3,451	3,260	3,222

Source: Bank of Greece, *Governor's Annual Report,* various years.

Table 4 6 Staff numbers by categories

Bank of Greece staff, 1994-2008

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Administration	3	3	3	3	6	6	6	6	6	6	6	6	6	6	6
Economists[1]		51	50	50	50	48	45	42	44	43	39	38	40	39	30
Accountants	1,234	1,070	1,084	1,195	1,221	1,215	1,205	1,159	1,167	1,200	1,180	1,155	1,060	1,123	981
Cashiers	1,036	971	975	964	959	950	943	950	950	928	908	883	843	815	742
Technical support	300	270	282	303	298	292	293	296	292	310	302	293	280	277	258
Legal services	39	38	38	37	39	39	34	37	37	35	35	32	32	36	34
Typists	144	70	68	63	62	60	54	42	41	37	33	33	22	19	17
Security	423	301	300	298	296	358	347	343	339	333	325	320	356	342	333
Auxiliary staff		135	128	126	123	118	113	86	75	73	59	56	48	35	31
Cleaners	145	132	130	135	130	126	132	129	118	115	93	86	79	71	62
Workers	12														
Total	3,336	3,041	3,058	3,174	3,184	3,212	3,172	3,090	3,069	3,080	2,980	2,902	2,766	2,763	2,494

1 From 1995 onwards, the number of staff members from the category of "Economists" is not consistent with different from total economists employed, as the Bank started including newly recruited economists in the category of "Accountants".
Source: Bank of Greece, *Governor's Annual Report*, various years.

5 MONETARY AGGREGATES

Table 5.1 Monetary aggregates, 1928–1939

In billion drachmas

	Currency in circulation	Money supply M1	Liquid assets M3	Bank of Greece discount rate (%)
1928	0.316	14.873	N/A	9.0
1929	0.298	14.222	N/A	9.0
1930	0.297	13.889	N/A	9.0
1931	0.290	11.336	N/A	12.0/11.0[1]
1932	0.241	11.411	N/A	12.0/11.0/10.0/9.0[2]
1933	0.246	12.997	N/A	7.5/7.0[3]
1934	0.273	14.380	N/A	7.0
1935	0.281	14.729	N/A	7.0
1936	0.283	15.346	N/A	7.0
1937	0.281	16.817	N/A	6.0
1938	302.10	16.058	N/A	N/A
1939	378.10	N/A	N/A	N/A

N/A: data not available.
1 The interest rate was changed to 12.0% on 26.9.1931 and to 11.0% on 29.10.1931.
2 The interest rate was changed to 12.0% on 21.1.1932, to 11.0% on 20.2.1932, to 10.0% on 8.8.1932 and to 9.0% on 3.12.1932.
3 The interest rate was lowered to 7.5% on 6.6.1933 and to 7.0% on 14.10.1933.
Sources: Kostelenos (1995) and Psalidopoulos (1989).

Table 5.2 Monetary aggregates, 1946-1959

In billion drachmas

	Currency in circulation	Money supply M1	Liquid assets M3	Bank of Greece discount rate (%)
1946	N/A	N/A	N/A	N/A
1947	N/A	N/A	N/A	N/A
1948	1.149	1.538	1.415	N/A
1949	1.753	2.344	2.208	N/A
1950	1.812	2.621	2.453	N/A
1951	2.070	3.215	3.027	N/A
1952	2.348	3.553	3.362	N/A
1953	3.378	5.216	4.944	N/A
1954	3.847	6.194	5.948	N/A
1955	4.894	7.673	7.641	N/A
1956	6.031	8.658	9.969	11.0
1957	6.996	10.276	14.062	11.0
1958	7.613	11.227	17.014	11.0
1959	8.803	13.050	21.695	10.0/9.0[1]

1 The interest rate was lowered to 10.0% in April 1959 and to 9.0% in October 1959.
Source: Bank of Greece, *Η Ελληνική Οικονομία. Ερευνητικά Δοκίμια και Στατιστικές Σειρές (The Greek Economy. Research Papers and Statistical Series),* Volume III, Athens, 1984 (in Greek).

Table 5.3 Monetary aggregates, 1960-2000

In billion drachmas

	Currency in circulation M0	Money supply M1	Liquid assets M3	Bank of Greece discount rate (%)	Liquidity indicator M4N
1960	10.5	13.8	25.8	6.0	N/A
1961	12.2	15.7	30.0	6.0	N/A
1962	14.4	18.5	37.0	6.0	N/A
1963	16.8	21.3	45.2	5.5	N/A
1964	20.2	25.4	52.3	5.5	N/A
1965	23.3	29.1	58.9	5.5	N/A
1966	26.1	32.1	69.8	5.5	N/A
1967	33.4	39.5	81.4	4.5	N/A
1968	33.1	40.5	95.8	5.0	N/A
1969	35.4	43.7	111.5	6.5	N/A
1970	38.9	48.7	133.7	6.6	N/A
1971	43.0	54.5	163.2	6.5	N/A
1972	50.6	67.2	201.9	6.5	N/A
1973	64.9	83.9	232.0	9.0	N/A
1974	80.2	100.2	280.4	8.0	N/A
1975	91.6	115.7	355.9	10.0	N/A
1976	111.7	140.2	450.8	10.0	N/A
1977	132.2	165.6	558.2	11.0	N/A
1978	160.1	202.9	704.9	14.0	N/A
1979	182.9	235.4	837.1	19.0	N/A
1980	209.6	267.9	1,039.0	20.5	N/A

Sources: Ministry of National Economy, *Η Ελληνική Οικονομία 1960-1997. Μακροχρόνιες Μακροοικονομικές Στατιστικές Σειρές (The Greek Economy 1960-1997. Historical Macroeconomic Statistical Series),* Athens, 1998 (in Greek) and Bank of Greece, *Governor's Annual Report,* various years.

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Table 5.3 Monetary aggregates, 1960-2000 (cont.)

In billion drachmas

	Currency in circulation M0	Money supply M1	Liquid assets M3	Bank of Greece discount rate (%)	Liquidity indicator M4N
1981	260.5	335.3	1,417.1	20.5	N/A
1982	300.2	389.7	1,821.4	20.5	N/A
1983	342.6	449.4	2,221.5	20.5	N/A
1984	400.8	542.5	2,905.7	20.5	N/A
1985	505.3	675.1	3,722.0	20.5	N/A
1986	541.4	738.8	4,479.0	20.5	N/A
1987	628.9	843.4	5,551.9	20.5	N/A
1988	735.5	973.2	6,832.5	19.0	N/A
1989	969.3	1,264.9	8,500.8	19.0	N/A
1990	1,162.0	1,583.4	9,799.2	19.0	N/A
1991	1,255.5	1,742.9	11,001.9	19.0	N/A
1992	1,410.0	1,968.2	12,588.5	19.0	N/A
1993	1,512.0	2,223.7	14,474.8	21.5	N/A
1994	1,687.7	2,793.5	15,755.4	20.5	N/A
1995	1,863.6	3,149.0	17,380.4	18.0	N/A
1996	1,941.4	3,548.0	19,005.3	16.5	N/A
1997	2,185.5	4,002.6	20,807.4	14.5	N/A
1998	2,229.3	4,538.5	22,689.3	N/A	N/A
1999	2,671.9	N/A	N/A	N/A	35,828.9
2000	2,672.9	N/A	N/A	N/A	39,578.1

Sources: Ministry of National Economy, *Η Ελληνική Οικονομία 1960-1997. Μακροχρόνιες Μακροοικονομικές Στατιστικές Σειρές (The Greek Economy 1960-1997. Historical Macroeconomic Statistical Series),* Athens, 1998 (in Greek) and Bank of Greece, *Governor's Annual Report,* various years.

Table 5.4 Monetary aggregates,[1] 2001–2008

In million euro

	Currency in circulation M0	Money supply M1	M2	Liquid assets M3
2001	7,180	77,986	109,832	143,842
2002	7,401	79,111	110,292	141,157
2003	8,791	88,243	122,577	149,577
2004	10,835	102,530	137,877	163,099
2005	12,212	111,419	167,618	175,640
2006	13,377	113,485	185,751	193,617
2007	14,247	113,084	212,893	219,927
2008	16,318	106,917	246,627	251,397

1 As of 31 December of each year.
Source: Bank of Greece, Greek contribution to euro area monetary aggregates, https://www.bankofgreece.gr/Pages/en/Statistics/monetary/monetary.aspx

6 BANK OF GREECE: FINANCIAL RESULTS

Table 6.1 Bank of Greece: Annual financial results, 1928-1941

In billion drachmas

Year	Income	Expenses	Profits	Share of profits transferred to the Greek State
1928	0.116	0.055	0.061	0.019
1929	0.225	0.116	0.109	0.036
1930	0.181	0.136	0.045	0.006
1931	0.177	0.143	0.034	-
1932	0.262	0.192	0.070	0.017
1933	0.217	0.178	0.039	0.002
1934	0.207	0.168	0.039	0.003
1935	0.226	0.180	0.046	0.005
1936	0.249	0.186	0.063	0.014
1937	0.302	0.221	0.081	0.022
1938	0.358	0.242	0.116	0.039
1939	0.384	0.295	0.089	0.026
1940	0.422	0.334	0.088	0.026
1941	0.464	0.417	0.047	0.005

Source: Bank of Greece, *Governor's Annual Report,* various years.

Table 6.2 Bank of Greece: Annual financial results, 1946-1974

In billion drachmas

Year	Income	Expenses	Profits	Share of profits transferred to the Greek State
1946	34.299	29.463	4.836	-
1947	49.736	49.629	0.107	-
1948	84.417	80.972	3.445	0.300
1949	119.026	116.449	2.577	-
1950	157.708	154.612	3.096	-
1951	205.973	203.394	2.579	-
1952	239.221	236.471	2.750	-
1953	255.071	239.821	15.250	6.000
1954	0.291	0.279	0.012	0.006
1955	0.322	0.305	0.017	0.011
1956	0.423	0.380	0.043	0.026
1957	0.479	0.408	0.071	0.050
1958	0.445	0.405	0.040	0.025
1959	0.455	0.414	0.040	0.025
1960	0.523	0.434	0.089	0.071
1961	0.538	0.445	0.093	0.075
1962	0.599	0.508	0.091	0.073
1963	0.638	0.534	0.103	0.084
1964	0.690	0.583	0.107	0.088
1965	0.801	0.697	0.104	0.086
1966	0.867	0.765	0.102	0.083
1967	0.909	0.770	0.139	0.112
1968	1.055	0.773	0.282	0.248
1969	1.093	0.778	0.315	0.279
1970	1.247	0.840	0.408	0.296
1971	1.335	0.858	0.477	0.329
1972	1.746	0.949	0.797	0.661
1973	2.365	1.490	0.875	0.770
1974	6.879	1.683	5.196	5.078

Source: Bank of Greece, *Governor's Annual Report,* various years.

Table 6.3 Bank of Greece: Annual financial results, 1975-2000

In billion drachmas

Year	Income	Expenses	Profits	Share of profits transferred to the Greek State
1975	5.680	2.133	3.547	3.397
1976	5.874	2.716	3.158	2.985
1977	7.670	3.099	4.571	3.561
1978	5.776	3.423	2.353	2.129
1979	7.394	3.814	3.580	3.326
1980	9.033	4.551	4.482	-
1981	6.277	5.686	0.591	-
1982	9.804	7.311	2.493	-
1983	11.870	9.629	2.241	-
1984	15.570	11.898	3.671	-
1985	15.082	14.078	1.004	-
1986	17.134	15.357	1.777	-
1987	17.659	16.601	1.058	-
1988	20.725	19.473	1.251	-
1989	35.701	24.143	11.558	-
1990	35.914	28.432	7.482	-
1991	42.087	32.218	9.869	-
1992	44.648	33.900	10.748	-
1993	68.141	37.399	30.742	-
1994	74.711	44.979	29.732	23.131
1995	85.112	50.258	34.853	30.269
1996	92.129	55.517	36.612	31.232
1997	164.498	64.064	100.434	94.432
1998	169.800	68.604	101.196	90.717
1999	188.053	77.921	110.132	99.703
2000	274.979	107.752	167.226	152.030

Source: Bank of Greece, *Governor's Annual Report,* various years.

Table 6.4 Bank of Greece: Annual financial results, 2001-2008

In million euro

Year	Income	Expenses	Profits	Share of profits transferred to the Greek State
2001	803.430	297.145	506.285	457.899
2002	553.925	340.689	213.236	155.993
2003	529.351	311.091	218.260	172.418
2004	598.624	393.019	205.605	153.345
2005	610.799	382.340	228.459	150.121
2006	830.854	586.218	244.635	160.725
2007	825.498	540.814	284.684	180.878
2008	823.546	598.462	225.084	139.268

Source: Bank of Greece, *Governor's Annual Report*, various years.

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The aim of the present study is to provide a detailed account of the Bank's efforts to achieve monetary equilibrium and financial stability in the context of the developing Greek economy from 1928 to 2008. By tracing the history of the Bank of Greece from 1928 to 2008, this book ultimately aims to highlight the landmarks in the history of the Greek economy and banking system during these years.

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