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## *The Bank of Greece, 1949-1951: Credit Control Changes in an Inflationary Environment*

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Since October 28, 1940 when Greece became involved in World War II and through 1948 the Greek economy was characterized by intense inflationary pressures. The adverse effects of the Albanian war, October 1940 - April 1941, the ensuing occupation, April 1941 - October 1944 and the subsequent internal civil strife on domestic production, along with the large expansion in the money supply which occurred during these periods, brought a serious deterioration in the public's confidence in the national currency, i.e. the drachma, and in the banks. This, in turn, adversely affected the volume of private deposits with the banks and induced a diversion of savings to gold hoarding.<sup>1</sup> This strongly inflationary environment was not conducive to economic development. Thus, when internal peace came to Greece in 1949, the Greek people, assisted by the Marshall Plan Aid Program, embarked on the effort of economic reconstruction and development. At that time, it was clear that the role of the Bank of Greece would be crucial to the success or failure of this venture. This study attempts to answer the question of whether the Bank of Greece was in possession of powers conducive to meeting this challenge.

### THE BANK OF GREECE BEFORE WORLD WAR II

The Bank of Greece, the central banking institution of Greece, was established in 1927 following an agreement between the Greek government and the Council of the League of Nations, which provided for a loan of 9 million

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<sup>1</sup> See KONDONASSIS, A. J., "The Greek Inflation and the Flight from the Drachma", *Economy and History*, Vol. XX:1, 1977.

pounds sterling to the Greek government.<sup>2</sup> Prior to this, the National Bank of Greece, a commercial bank, was the note issue bank. The Bank of Greece was founded as a limited liability company with an original share capital of 400 million drachmae.<sup>3</sup> The Head Office of the Bank was established in Athens and branches were located in various parts of Greece. The general conduct of the affairs of the Bank was entrusted to a Board of Directors which in turn was responsible to the Annual General Meeting of the Bank stockholders. The Board consisted of the Governor of the Bank, the Deputy Governor and nine Directors, at least five of whom "must be actively engaged in industrial, commercial and agricultural activity."<sup>4</sup> The Directors were elected at the Annual General Meeting for terms of three years, while the Governor and the Deputy Governor were appointed on the recommendation of the Board of Directors by the government and for terms of five years. Furthermore, the Statutes of the Bank of Greece authorized the Greek Minister of Finance to appoint a government Commissioner, who attended all Annual General Meetings and the meetings of the Board of Directors.<sup>5</sup> The Commissioner had no right to vote but could protest decisions of these two bodies if he considered them to be contrary to the Statutes or any other law. Any protest, if concurred in by the Minister of Finance within two days, acquired the force of a suspensive veto and the question in dispute was then submitted to settlement by an impartial committee agreed upon by both the Bank of Greece and the government.<sup>6</sup>

Before World War II, the primary objective of the Bank of Greece was to control the money supply through its vested monopoly power of note issue. A basic limitation upon this power was the provision that the Bank must maintain 40 per cent reserve in gold against all bank notes in circulation.<sup>7</sup>

Before the war the Bank of Greece did not exercise active quantitative or qualitative credit controls as these are understood in the Western world today. It made a relatively small volume of direct loans to the economy for general welfare projects, in which the other banks were not interested, and it attempted to influence the bank rates of interest by rediscounting commercial bank portfolios. However, this so-called British banking tradition was not very effective in Greece because there was no organized discount market and because the commercial banks, which held the rather sizeable volume of private deposits of about 24 billion drachmae in 1938,<sup>8</sup> did not choose to call on the

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<sup>2</sup> BANK OF GREECE, *Statutes*, (Athens: Printing House Pyrsos, 1952), p. 3.

<sup>3</sup> 80,000 shares at a nominal value of 5,000 drachmae each; these shares were sold to the public at home.

<sup>4</sup> BANK OF GREECE, *Statutes*, (Athens: Printing House Pyrsos, 1952), p. 13.

<sup>5</sup> *Ibid.*, p. 7.

<sup>6</sup> *Ibid.*

<sup>7</sup> *Ibid.*, p. 27.

<sup>8</sup> ZOLOTAS, XENOPHON, *Currency Problem and the Greek Economy*, (published in Greek), (Athens: Papazessis, 1950), p. 85.

Bank of Greece for an appreciable volume of assistance through rediscount of their portfolios. Moreover, in the absence of a liquid call-loans market and bills market, the Bank of Greece had no opportunity to carry on open-market operations for the purpose of implementing monetary and credit control.

## THE BANK OF GREECE AFTER WORLD WAR II

After World War II the role of the Bank of Greece was modified and strengthened. Relations between the Bank of Greece and the commercial and other banks grew closer primarily because the banks became dependent on the Bank of Greece for funds.<sup>9</sup> Also the relationship between the Bank of Greece and the government became much closer than prior to World War II partly because the Bank of Greece made large advances to the government for the purpose of covering current budget deficits, but also because certain organization changes were made which strengthened the bonds of the Bank and the government.

### *The Currency Committee*

Among these changes one of the most important was the creation of the Currency Committee, which was established in early 1946 pursuant to agreements between the British government and the Greek government as regards British economic assistance. Law number 1015 of 1946, which established the Currency Committee, provided that the Committee would sit in the Bank of Greece office in Athens, would utilize personnel of the Bank of Greece and would have ultimate jurisdiction and control over monetary, credit and foreign exchange policies.<sup>10</sup> The Currency Committee was presided over by the Minister of Financial Coordination and its other members were the Governor of the Bank of Greece, the Ministers of Finance, Commerce and National Economy, and two foreign experts, one British and one American, designated by the Greek government.

The delegation of such power to the Currency Committee took account of the facts that as a result of World War II and its aftermath the monetary and credit functions of the Bank of Greece had to be expanded and modified, and that the government had direct and vital interests in the formulation of appropriate monetary and credit policies designed to assist in the economic reconstruction and development of Greece. In addition, before the end of 1948, it became

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<sup>9</sup> For several years following the end of World War II the volume of private deposits with the commercial banks was low indeed as compared to the pre-World War II volume of bank deposits. Thus, the Bank of Greece was called upon to provide from note issue a major portion of the total credits to the economy. For instance, at the end of 1948, the Bank of Greece provided about 70 per cent of the total volume of credits to the economy.

<sup>10</sup> BANK OF GREECE, *Report for 1946*, (Athens: 1947), p. 51.

evident that further changes in the Greek banking system and in the Greek credit mechanism were needed to enable the Bank of Greece to implement appropriate credit control policies.

### *Direct Lending*

It was decided by the Currency Committee that in order to strengthen the position of the Bank of Greece in the implementation of credit policy the Bank should lend directly to commercial and industrial establishments. This direct contact, the committee contended, would furnish the Bank of Greece with much needed direct information about the borrowing public (i.e., feel of the market) which was denied to it by the absence of an organized discount-market and a bank inspection and supervision service. Moreover, the authority to lend directly to the various economic units would make it possible for the Bank of Greece, the bank of last resort, to render financial assistance to projects of national concern for which the commercial banks as profit-making institutions might not show any, or "sufficient", interest.

Actually, direct lending by the Bank of Greece was not a completely new practice in Greece. It will be remembered that the Bank of Greece made a limited amount of direct loans for general welfare projects before World War II. The original authority for such loans is to be found in the Bank of Greece Statutes. Thus, the decision of the Currency Committee to have the Bank of Greece enter into direct lending represented an expansion of a relatively old practice which proved to be different only in one respect, namely, the fact that it was operated on a relatively larger scale than during the pre-war period. However, in authorizing direct lending the Currency Committee cautioned that it should not be done on such a large scale that the Bank of Greece was competing excessively with the other banks, and the Bank should not be influenced by "profit motive considerations."

The magnitude of direct lending by the Bank of Greece in comparison with that of indirect lending (i.e., through the other banks) is shown in Table 1. The data show that of the total volume of credit from note issue, about 17

TABLE 1

BANK OF GREECE DIRECT AND INDIRECT LOANS OUTSTANDING  
AT THE END OF YEAR 1949-1951  
(in billion drachmae in current prices)

Type of Credit	1949	1950	1951
Total credit from note issue	2,276.8	3,149.3	3,920.8
Lent directly by the Bank of Greece	387.8	549.9	785.6
Lent indirectly through other banks	1,889.3	2,599.4	3,135.2

Source: Bank of Greece, *Confidential Report for February 1951*.

per cent in 1949, about 17 per cent in 1950 and about 20 per cent in 1951, was directly lent by the Bank of Greece and about 83 per cent in 1949, 83 per cent in 1950 and 80 per cent in 1951 was made available to the economy indirectly through the other banks. Thus, under the circumstances prevailing in Greece, direct lending by the Bank of Greece may not be considered "excessive."

The composition of direct lending is given in Table 2. The data show that direct lending by the Bank of Greece was extended to practically every sector of the economy. In other words, it can be said that the Bank of Greece attempted to maintain direct contact with every segment of the borrowing public. Table 2 shows that the major portion of total direct lending was devoted to the financing of import trade, tobacco trade and the government programme of purchasing agricultural products, i.e., subsidization of farmers and farm cooperatives. Financing of these sectors obviously fell within the realm of nationally defined priorities; hence, the emphasis assigned to them by the Bank of Greece was generally consistent with the objective of direct lending as conceived by the Currency Committee.

#### *Reserve Requirements*

It is estimated<sup>11</sup> that the commercial banks chose to hold cash reserves equal to about 12 per cent of their total deposit liabilities before the war. The Bank of Greece, acting in accordance with the Bank Statutes, imposed legal reserve requirements on these banks. The required legal reserves were 7 per

TABLE 2  
COMPOSITION OF BANK OF GREECE DIRECT LENDING OUTSTANDING  
AT THE END OF YEAR, 1949-1951  
(in billion drachmae in current prices)

Purpose	1949	1950	1951
General Trade	68.7	104.3	171.3
Tobacco Trade	116.4	113.3	160.8
Industry and Manufacturing	26.5	67.9	73.1
Gov't. Purchasing of Agricultural Produce	84.8	129.0	192.9
Miscellaneous	91.4	135.4	187.5
Total	387.8	549.9	785.6

Source: *Bank of Greece, Reports of the Governor for 1949, 1950, 1951.*

<sup>11</sup> HALKIOPOULOS, GEORGE, *Interest Rates in Today's Money Market*, (published in Greek), (Athens: Papazessis, 1950), p. 18.

cent of total private deposits in 1938.<sup>12</sup> From 1941 to 1948, in view of the disorganization of the Greek banking system brought about by World War II and its aftermath, the enforcement of legal reserve requirements was discontinued.

In August, 1948, Public Law 588 was passed by the Greek government on the recommendation of the Currency Committee. This law, among other provisions, authorized the Currency Committee to impose legal reserve requirements on the commercial banks. Accordingly, the Currency Committee decided to require the National Bank of Greece and the other banks which held deposits of public corporations<sup>13</sup> to hold legal cash reserves of 15 per cent against these deposits and a legal cash reserve of 5 per cent against all other private deposits.<sup>14</sup> By a decision made in January, 1949, the Currency Committee increased the reserve ratio against public corporation deposits to 22 per cent and against private deposits to 10 per cent.<sup>15</sup> Finally, in February, 1950, these reserve ratios were increased to 25 per cent and 12 per cent for public corporation deposits and private deposits respectively.<sup>16</sup> In every case, the committee also provided that these legal reserves were to be held in a special account with the Bank of Greece.

It must be remembered that the Greek commercial banks did not create demand deposits as a general consequence of lending and investing operations because the great majority of business and financial transactions were settled in cash. Thus, the imposition of legal reserve requirements must not be viewed primarily as an instrument of credit control. The Currency Committee and the Bank of Greece justified this measure by stating that "it represented sound banking principles since it would tend to promote individual bank liquidity and would tend to make the position of the Bank of Greece more effective in supervising the operations of commercial banks." Perhaps also this measure was viewed as having a salutary influence on credit conditions by contributing to the improvement of public confidence in the commercial banks. If public confidence in the banks was increased, this might lead to an increase in the volume of private deposits with the banks which in turn might make it possible

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<sup>12</sup> *Ibid.*

<sup>13</sup> Public corporations were 1) institutions whose revenues were derived exclusively from taxation and which performed governmental functions both national and local in character, e. g., defence, road building, sea port construction, etc.; 2) social insurance organizations whose revenues were derived in part from taxation and in part from contributions of employers and employees. In 1938, public corporation deposits amounted to 13.6 per cent of total bank deposits. From 1945 to 1948, more than one-half of total bank deposits were deposits of public corporations.

<sup>14</sup> BANK OF GREECE, *Annual Report of the Governor for 1948*, (Athens: 1949), p. 56.

<sup>15</sup> BANK OF GREECE, *Annual Report of the Governor for 1949*, (Athens: 1950), p. 56.

<sup>16</sup> *Ibid.*, and Halkiopoulos, *op. cit.*, p. 18.

for the Bank of Greece to reduce its credit assistance to the economy from note issue.

#### *Other Organizational and Credit Control Changes*

Another provision of Public Law 588 established an Advisory Committee composed of the Governor of the Bank of Greece, as chairman, and of the governors of the other banks as members. The purpose of this committee was to provide a forum where differences of opinion regarding credit control policies could be discussed so that closer cooperation might develop between the Bank of Greece and the other banks.<sup>17</sup>

Finally, Public Law 588 required that the banks should submit monthly reports to the Currency Committee and the Bank of Greece showing total credits extended by them to the various sectors of the economy.<sup>18</sup> These reports were considered essential sources of information for the Currency Committee and the Bank of Greece in order to determine whether or not credit extension by the banks followed the general credit policy objectives of the Committee and the Bank of Greece.

According to some views the described changes did not satisfactorily cope with the problem of adherence by the commercial banks to the policy objectives of the Currency Committee. After Public Law 588 was enacted, widespread criticism was expressed that its provisions were insufficient to secure the full cooperation of the commercial banks and hence that the banks' adherence to the policy objectives of the monetary and credit authorities could not be assured.<sup>19</sup>

In the early part of 1950 the Bank of Greece, through the Greek government, requested the Board of Governors of the Federal Reserve System to designate an American banking expert to visit Greece and to study the Greek banking system with the expressed purpose of making appropriate recommendations for further reorganization of the Greek banking system. The Vice President and General Counsel of the Federal Reserve Bank of Kansas City, Mr. Delos C. Johns, was designated for that purpose and he together with the two foreign members of the Currency Committee, Theodore Gregory and John Gunter, constituted a committee which studied the Greek banking system and submitted a report to the governor of the Bank of Greece on June 30, 1950.

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<sup>17</sup> BANK OF GREECE, *Annual Report of the Governor for 1948*, (Athens: 1949), pp. 29-30.

<sup>18</sup> *Ibid.*, p. 25.

<sup>19</sup> Zolotas, *op. cit.*, p. 100; Varvaressos, KYRIAKOS, *Report on the Economic Problem of Greece*, (published in Greek), (Athens: Nafteboriki, 1952), p. 34; BANK OF GREECE, *Annual Report of the Governor for 1950*, (Athens: 1951), p. 33; Halkiopoulos, *op. cit.*, p. 16.

This report supported substantially the earlier expressed views that the commercial banks could not be counted on to cooperate fully in the execution of of monetary and credit policy.<sup>20</sup> Cases were cited in which some banks paid interest rates to depositors in excess of the legal maximum, discriminated unduly among borrowers and evaded law and regulations in various respects by conducting transactions which were not truthfully reflected in their accounting records.

To reduce or eliminate such abuses and to promote unification and standardization of banking practice in Greece, the committee recommended that adequate supervision and inspection powers be granted to the Currency Committee and the Bank of Greece. These powers should include jurisdiction over the corporate existence of the banks, the licensing of banks and the capital requirements of banks. To implement these powers, the committee recommended that an inspection agency located in the Bank of Greece should be created. This agency should regularly audit the accounts and the financial condition of banks in order to determine compliance or non-compliance with law and policy directives of the Currency Committee. In addition, the report recommended that in order to render effective the powers of supervision and inspection, enforcement procedures should be provided, such as the power to suspend and close banks which consistently violated the law. The committee stated:

Laws regulating banking, like other laws in the public interest, are not better than their observance. Indeed, if they are not observed and, if need be, enforced, it would be better not to have them because not only their purpose is defeated, but the dignity, and prestige of the state suffer from their non-observance.<sup>21</sup>

Furthermore, the report argued that the extension of credits to the banks by the Bank of Greece implied the obligation on their part to accept lawful supervision and inspection of their operations.

... the banker who abides by the law, runs a sound bank and correctly conceives his bank as a quasi-public institution has nothing to fear from lawful supervision. In truth, he welcomes ... as wholesome and salutary aids to his managerial responsibilities.<sup>22</sup>

Another recommendation of the Gregory, Gunter and Johns report concerned the status of deposits of public corporations. It must be remembered that deposits of public corporations constituted a major portion of total deposits with the commercial banking system in the post-World War II period.<sup>23</sup> When the question of the appropriate location of the deposits of public corpo-

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<sup>20</sup> GREGORY, T., GUNTER, J. AND JOHNS, D., *Report and Recommendations on Certain Aspects of the Greek Banking System*, (Athens: 1950), p. 16.

<sup>21</sup> *Ibid.*, p. 16.

<sup>22</sup> *Ibid.*, p. 17.

<sup>23</sup> See footnote 13.

rations first arose in 1928, these deposits were relatively small. They continued to be small in comparison to private deposits between 1928 and 1938. In 1928 the Greek government granted preferential rights to these deposits to the National Bank of Greece, probably as a compensation for loss of the issue privilege which was given in 1927 to the newly created Bank of Greece. Because of the importance of these deposits during the post-war period, these preferential rights of the National Bank of Greece were challenged by the other banks on the grounds that the 1928 law did not give a clearly monopolistic position to the National Bank of Greece. The report of the three experts states that as a result of the deposits of public corporations in the post-war period, the banks actively bid against the National Bank for these deposits and offered interest rates on such deposits in excess of the legal maximum of 5 per cent. Under the circumstances prevailing in 1950, Gregory, Gunter and Johns argued, neither the quasi-monopolistic position of the National Bank of Greece nor the lack of clarity in the law should be allowed to continue. In view of the fact that the preferential rights of the National Bank of Greece were expiring on December 31, 1950, they recommended that the Greek government through the Bank of Greece work out a transitional arrangement, with the minimum amount of unsettling effects on the financial position of the National Bank of Greece, under which the quasi-monopolistic position of the National Bank of Greece would be abolished but also unrestrained competition for the public corporation deposits would be prevented.<sup>24</sup> Specifically, they recommended that on January 1, 1951, all deposit of public corporations should be transferred to the Bank of Greece which would assume exclusive liability thereon to the respective depositing public corporations. The Bank of Greece would in turn allocate back to each transferring institution an amount of these funds equal to the amount of its deposits of public corporations as of the close of business on June 30, 1950. The remaining balance of such transferred deposits and the new deposits received by the Bank of Greece after 1 January, 1951 should be allocated to the commercial banks in proportion to their respective share capital and ordinary reserves at the end of the preceding calendar year. All deposits of public corporations which were allocated to the commercial banks by the Bank of Greece should be deemed to constitute revolving advances to the respective banks receiving such allocations and by the Currency Committee. The Bank of Greece in turn should pay interest at the same rate to public corporations on their respective deposits. These amounts of funds allocated by the Bank of Greece to the other banks should be available to these banks for lending and investing in accordance with the policy objectives of the Currency Committee. In the event of a bank making loans and investments not complying with established credit policy, it would be within the power of the Currency Committee to curtail or abolish the participation of

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<sup>24</sup> Gregory, Gunter and Johns, *op. cit.*, p. 35.

the offending bank in the allocation of funds derived from deposits of public corporations.<sup>25</sup> The proposals made by the Gregory, Gunter and Johns report were designed: (1) to avoid the pressure on the structure of interest rates which might be generated by the active bidding of the banks for deposits of public corporations; (2) to assure that funds derived from its deposits of public corporations were used in conformity with established Currency Committee objectives; (3) to increase the credit control powers of the monetary authorities by giving them the authority to regulate the utilization of a major portion of the total volume of deposits, i. e., deposits of public corporations; (4) to put the Currency Committee in a position to know whether or not the banks complied with its policy directives; and (5) to give the Currency Committee the power to enforce observance of the law by the banks.

It is evident that the Gregory, Gunter and Johns report contained important recommendations designed to improve the structure and operation of the Greek banking and credit system. These recommendations were favourably received by the Currency Committee and the Bank of Greece. The 1950 annual report of the Governor of the Bank of Greece praises the report and expresses the gratitude of the Bank to the authors of the report. As a consequence of the recommendations presented by Gregory, Gunter and Johns the Greek government passed Law 1611 on 31 December, 1950, and Law 1665 on 27 January, 1951.

Law 1611 incorporated the recommendations that pertained to the deposits of public corporations. Law 1665 authorized the Currency Committee to exercise supervision over the operations of the banks and to take steps to organize a bank inspection service.

## CONCLUSIONS

The major conclusions of this study are that a number of potentially significant credit control policy changes were introduced in Greece during the period from 1949 to 1951. Of particular importance was the coordinating role of the Currency Committee, which brought together economic and political expertise in the formulation of monetary and credit policies; and the Gregory, Gunter and Johns report recommendations which led to the passage of noteworthy Greek legislation, including the regulation of public corporation deposits and the creation of a bank inspection agency. The expanded and modified role of the Bank of Greece was also underscored, and specifically that the Bank was called upon to assist the economy and the Greek government in a major way by providing a large volume of credits from note issue.

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<sup>25</sup> *Ibid.*, pp. 38-40.

Notwithstanding the importance of these changes, the Bank of Greece alone could not be expected to restore monetary stability and to assure the reconstruction of the Greek economy. Other forces such as the establishment of internal peace and the receipt of substantial economic assistance under the Marshall Plan Aid Program helped shape the economic, social and political environment of the immediate post-1949 period. In addition, in the decade of the 1950's, other developments such as the attainment of greater political stability and improved public confidence in the monetary and credit systems assisted in solidifying and accelerating the gains in the dual fronts of monetary stability and economic development.

