Stavroula Spanodimou
University of Athens

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The Greek Banking system after the 1929 crisis

The worldwide crisis of the 1929 affected the Greek economy and resulted to the 1932 bankruptcy. However, the economy quickly rebounded due to a holistic system of protection and control. The purpose of this paper is to study the responsiveness of the Greek banking sector regarding this crisis.

The paper consists of three parts: First, I examine the evolution of the banking system. In specific, after the 1929 crisis, one of the phenomena observed in the banking sector was the reduced number of banking institutions. Additionally, the banking sector, where the National Bank of Greece had central role, presented an increasing concentration. The commercial banks were controlled by the National Bank.

In this context, what is still of great importance is the role of the Central Bank, i.e. the Bank of Greece. And a main question arises: Did the Central Bank achieve to control the banks and solve the liquidity problems of the Greek economy?

The second part of the paper consists of the study of consequences of the banking system concentration in the entrepreneurial and in particular in the industrial sector. All indications exhibit that in various sectors of the Greek economy, the monopolistic structures were strengthened and banks were unable to find solvent customers, especially in the industrial sector.

Lastly, the third part of the paper focuses on the key driver responsible for the cartelization of the banking market; the Hellenic Bank Association. The Hellenic Bank Association was created in 1928 and acquired a basic role in the years to come after the crisis.

Special emphasis will be given to the relation between the Greek state and the world of finance. How did state intervention affect the course of the economic sector in general and the banking system in particular? What was the reaction of the Greek state towards the pursued policies concerning the Greek banking system? Conclusions are drawn a propos the Greek banking system and the monetary policy in the 1930s.

Introduction

At the beginning of the World War I, the collapse of the international monetary system, inflation and unstable exchange rate that followed globally, were unprecedented events. In Greece, in the Interwar period, and especially during the 1920s, two distinct time periods can be discerned[1]. One, from 1922 to 1927, which is a period characterized by the general destabilization of the economy due to continuous political changes, the arrival of the refugees from Asia Minor - along with their need for recovery - and the successive depreciations of the drachma.

After the World War I, the changes in the Greek banking system were important and occurred rapidly. One of them was the rapid increase of the number of banking institutions, operating in the form of public limited company. All these institutions had adequate capital base so as to face the difficulties that inflation brought at first and after that, the Great Depression of the years 1929-32.

Small banks were established by a number of local businessmen. These men benefited by wanting to expand their activities and, to some extent, to settle in Athens, which was rapidly becoming the financial center of Greece. In the years that followed the Great Depression, this trend of the establishment of banking institutions started to decrease.

The problems of the currency rate and the exchange stability were under broad discussions during this period. Yielding to the foreign factors' demands and to the need for a more modern banking system, the Greek politicians paved the way to the currency stabilization and the foundation of the Central Bank of Greece in 1928. This leads us to the second period, which is examined in this paper, from 1928 and 1932, with key characteristics the currency stabilization and the recovery course of the Greek economy.

[1] Salvanou A., 2004, The difficult birth. The Restructuring of the Greek banking system (1927-29), Athens (in Greek).

The evolution of the Greek banking system (1928-1932)

Greek Economy suffered from the unsustainable debt from accumulated deficits, the internal currency instability and the permanent passivity of current account and also, from the unstable external value of the currency. For Greece, the currency stabilization had to be the starting point of a shooting and restructuring process aiming for balanced public finances, floating debt's liquidation, settlement of war debts and a balanced external rate.

The weaknesses of the banking systems' structure became more significant with the expansion of economic and technological developments. The banking system consisted of a wide disparity of units with regards to the size and the economic capacity, adding to the fact that the necessary legislative framework, for the set up and operation of the banks, was lacking. The fact that, the National Bank of Greece not only concentrated the bulk of banking operations but also, had a dual role, as an issuing and a commercial bank, was also a drawback.

In this time period, specialization was absent from various areas of the banking activity. Concerning banking services, this lack of specialization resulted in high costs and low quality. Still, it must be noted that in 1927 the first step was made towards the division of labor into the banking system which led to the process of specialization in the years to follow.

Example of this specialization is the fact that two independent banking institutions (i.e. the National Mortgage Bank of Greece and the Agricultural Bank of Greece[2]) acquired the work of mortgage and rural credit from the National Bank of Greece, in 1927 and in 1929, respectively. Besides that, the National Bank of Greece lost its issuing privilege, which was transferred to the Central Bank of Greece (i.e. the Bank of Greece) in 1928.

The banking system during the 1929 crisis was in a reforming phase and as it is already stated, the main features were the specialization and concentration of the banking units. The Crisis accelerated these processes which were also strengthened and supported by state welfare as we will see later on.

An overview of the Greek banking system, at the end of 1928, shows that 46 banks were operating as limited companies. The four largest commercial banks -the

[2] The foundation of the Agricultural Bank of Greece was cardinal for the Greek economy especially during the crisis of 1929.

National Bank of Greece, the Bank of Athens, the Commercial Bank and the Bank of East- concentrated 2.037,5 million drachmas in total equity, for the 46 institutions, of 3.129,3 million drachmas (including the equity of the Bank of Greece which was about 421,9 million drachmas, so the concentration ratio was even higher). All of the above prove a banking system with an extremely high degree of concentration.

As already stated above, Greece had to face the problem of internal currency instability. In general terms, the stabilization of every currency should be accompanied with the reconstruction of the banking system of every country which promoted its monetary consolidation, but mostly from the creation of a Central Bank, which could respond to the modern principles of central banking.

The currency stabilization had dual content[3]: Greece had applied the gold exchange standard, with the requirement to maintain the rate of drachma and pound. In order to succeed, the League of Nations insisted on a banking reform[4], so as to establish an institution that would have the exclusive responsibility to support the national currency, without having any commercial interest. Thus, the establishment of a separate issuing institution was not (at all) negligible for the Greek economy and society. When Great Britain abandoned the gold standard, speculations were intensified leading to confusion the Greek financial circles, despite the fact that the drachma was connected to the dollar. After the moratorium, the momentary political instability coincided with the national financial situation improvement.

In May 1928, Greece reinstated in a state of currency convertibility in the context of fixed exchange rates. The relevant decree was released on May 12th, 1928, with which the drachma no longer belonged to the Latin Monetary Union. However, the drachma was not directly linked to gold, but to a gold currency basis, the English pound. The fact that Greece opted to connect with the English pound, while the dollar ruled the global monetary system, was undoubtedly a political decision that stressed out the close dependence of Greece from England. From the part of the National Bank, its nature, with a wide range of activities, would clearly prevent it from

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[3] Psalidopoulos M., 1929, The Crisis of 1929 and the Greek economists: Contribution in the history of Greek thought in the Inter-war Greece, Commercial Bank of Greece, Athens (in Greek).

[4] In 1927, with the Geneva Protocol the Greek government undertook fiscal and financial commitments for the economic reconstruction of the country, which the State should have resolutely implemented. In the banking field, the commitment was the resignation of the National Bank of Greece from the issuing privilege and the creation of a Central Bank that would be independent from state threats.

fulfilling the tasks coming from the international capital markets, which were also required from the economy.

Monetary stabilization coincided with the launch of the Bank of Greece and its official operation which started on May 14th, 1928. The establishment of the Bank of Greece was an international effort to create a network of cooperating central banks, which would facilitate the smooth functioning of international capital movements and the overall international economy. We could refer to the foundation of the Bank of Greece as a symbol of "involuntary modernization"[5] for the Greek banking system and the Greek economy, in general.

In addition, it was doubtful whether the new central bank could respond and maintain a monetary stability. Pledge for the Bank of Greece to respond to the objectives of its establishment, was its organizational integrity and the fact that its creation followed the most modern, at the time, conceptual organization of central banks. The most paradox phenomenon of the foundation of the Bank of Greece was the suspiciousness and even denial of the founders of the Bank and that the vast majority of the Greek politicians could not understand that a central bank had a more important role and had not only to do with the convertibility of the drachma and the exchange rate of the pound[6].

The existence of the Bank of Greece was constantly under question making it prey to pressures of the balance of payments, during the Great Depression of 1929. Any intervention on the money market, either via the increase of appropriations or, (more importantly) of monetary circulation, encountered the obstacle of the mandatory relationship, which had to be maintained between the circulation of its banknotes and its coverage. Under the pressure of adverse circumstances of the Great Depression, the Bank of Greece, after ensuring its survival, explored new ways to cope with its (new) role.

The unfavorable progress of the balance of payments during the difficult years of 1929-32 and the implications that this caused to the evolution of the Bank's coverage and to the monetary circulation, showed very quickly that the establishment of a central bank was not adequate to maintain stability. In 1927 and 1928, when

[5] Kostis K. (with the co-operation of Kostelenos G.), 2003, *The History of the National Bank of Greece, 1914-1940,* Athens (in Greek).
[6] As ref. 5.

"monetary stability" turned into reality, the prospects of the Greek economy differed significantly from those that actually occurred after the first half of 1929.

Concerning the role of the National Bank of Greece, after the establishment of the Central Bank, we need to mention that May 14th, 1928 marked, without any doubt, the beginning of a new era in the bank's history. For the first time since its establishment, the National Bank had to work without the issuing privilege and to lie, at least theoretically, under the guidance of the Central Bank of Greece. In fact, after the establishment of the Bank of Greece, the National Bank was a different bank from the one of the years before.

Therefore, during the crisis years, the Greek banking system had the peculiarity to have two "lenders of last appeal" but also two banks - the National Bank and the Bank of Greece - that intervened about the stabilization of the money and capital market. The National Bank of Greece tried to maintain a central and parallel role with that of the Bank of Greece, which is illustrated by the fact that had significant deposits compared with the rest of the merchant banks.

The relation of the Greek banking system with the industrial sector

The currency stabilization seemed to have created the conditions for the banks to change their policy towards entrepreneurial activity and in general, to change their investment policy. Thus, the first companies, which were directed by the banks, were created; and similar initiatives followed by other institutions. Unfortunately, the fact that legislation and any form of supervision and control – that could ensure public interest - were lacking; involved risks.

The reorganization of the operation, the rationalization, and the new directions towards a closer relationship with the entrepreneurial sector and more specific, with industry, completed the adjustments that the National Bank of Greece went through as a banking organization, which was in transition from a joint form to a commercial bank. After the loss of its issuing privilege, the National Bank of Greece opened broad horizons related to industry. This occurred not only due to the removal of the issuing privilege and later on, of the rural credit, but also because of the fact that industry was converted to the only economic sector that the Bank could use its resources.

The pursuit of company mergers didn't confined only to industry but involved every sector that the banks had interests and where the competition from companies could cause problems in the servicing of their debts. The horizontal integration together with the absorption of inefficient businesses for other businesses and the creation of large units were the main objectives of the National Bank of Greece. Also this might have been a way to normalize risks that could cause competition. But, in the case of the National Bank of Greece this led to the creation of monopoly regimes across the industrial sector. These prevailing monopolistic conditions were reproduced by the fact that there were difficulties of access to credit and also, that banks were unable to find solvent customers.

Except the legislation framework that the state introduced after 1931, we must notice that, generally, the banking system was almost solely based on private initiative and state control was non-existent. Apart from the Postal Savings, the Deposits and Loans Fund and the Agricultural Bank of Greece, which were state banking institutions, the rest of the banks were private enterprises. Only in the case of the National Bank of Greece, the state had an indirect, but loose, control.

In 1931, a systematic attempt was made to introduce legislation which would regulate the banking operation, organization and control. The legislation framework, that was established, limited the banks' freedom of action, created the conditions that helped the trends of specialization and concentration and also, restricted the tendency to establish small local banks.

The Hellenic Bank Association

Before the introduction of a legislation concerning the banking sector, the unconditional competition hid high risks for most banking institutions. The situation worsened, when two new banking institutions appeared in the Greek banking market, the Italian-Greek Bank and the English-French Bank of Discount. These new institutions were respectively subsidiaries of the Commerciale Italiana and the Ottoman Bank. On top, they implemented a lending system to customers that, up to that time, the Greek banks applied only under restrictions. The aforementioned system had to do with open accounts with personal guarantee. Other institutions, being afraid of the threat of losing more market share, were forced to emulate this loan scheme, shortly leading to significant assets.

Several Greek banks and the National Bank of Greece took the initiative to found the Hellenic Bank Association (October, 1928), in order to reduce this unconditional and destructive competition. Under the pressure of the large banks, smaller institutions gradually joined the Association, which then evolved into an informal body, defending the interests of banks and setting up a powerful lobby in the Greek Parliament.

Apart from lobbying for the promotion of professional issues, the Association during the first year of operation, turned into a cartel: the reduction in deposit rates, the definition of the purchase conditions of foreign exchange, the terms of recovery values were some of the activity areas that the Association developed, in order to limit the impact of an unconditional competition, leading banking costs soaring.

However, the agreements of the Association were not for the benefit of all Greek banks. The National Bank of Greece had a comparative advantage over other banks for a great part of its deposits. The establishment of the Association was a reaction of the large commercial banks to the limiting problem of their profitability, which was created by the monetary stabilization, succeeding to some extent the smaller institutions' drifting[7].

Conclusions

The global economic crisis affected the Greek economy, which required great efforts to overcome the very serious structural obstacles. The Greek economy was able to surpass its problems much faster than any other country, with little cost, despite the fact that the crisis had dramatic consequences in some sectors. Besides that, with the effort for self-sufficiency during the crisis, the Greek economy managed to lay the foundations for rapid economic development, which only disrupted by the World War II.

The outbreak of the Crisis in October 1929 stimulated speculations. The decreasing number of banking institutions and the early recession of the Greek economy increased the need to find an optimal solution to exit the crisis. The Great Depression was unquestionably the most important economic fact of the Interwar period.

[7] As ref. 5.

The deepening of the crisis actually forced the Greek government to follow the only path left. In September 1931, England was unable to respond to its currency pressures, withdrawn from the gold standard and left the pound to vary freely. The whole edifice of the previous years collapsed, especially in Greece, where the Central Bank was completely unprepared to face a crisis of this intensity, despite the fact that England's problems were already apparent.

The Bank of Greece couldn't act as a Central Bank and control the Greek banks so as to solve the liquidity problems of the Greek economy. The consequences of the Crisis in the banking system highlighted the weaknesses in its structure and the lack of an oversight mechanism[8].

The Crisis of 1929 caused to the Greek economy currency and financial problems. The insistence of the government to maintain monetary stability led the Greek economy in recession, the banking system to collapse and the foreign exchange to complete exhaustion. The Crisis marked the Greek economy, entering a prolonged phase of anguish, and ultimately culminated with the declaration of bankruptcy on October 26th, 1932.

[8] Bank of Greece, 2009, *The crisis of 1929, Greek economy and the reports of the Bank of Greece for the years 1928-1940*, Athens (in Greek).

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