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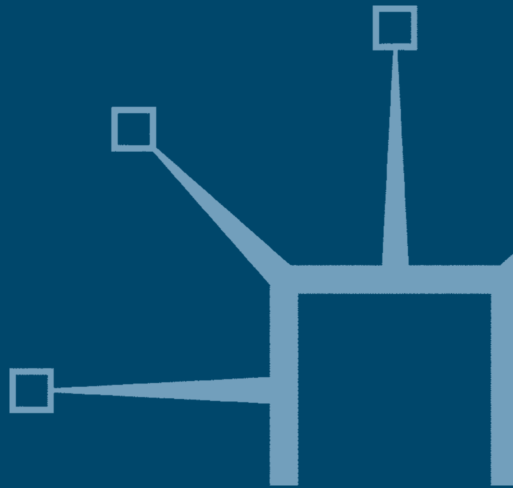
Greece's New Political Economy

State, Finance, and Growth from Postwar to EMU

George Pagoulatos



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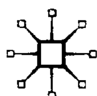

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First published 2003 by
PALGRAVE MACMILLAN
Houndmills, Basingstoke, Hampshire RC21 6XS and
175 Fifth Avenue, New York, N.Y. 10010
Companies and representatives throughout the world

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ISBN 0–333–75277–5 hardback

This book is printed on paper suitable for recycling and made from fully managed and sustained forest sources.

A catalogue record for this book is available from the British Library.

Library of Congress Cataloging-in-Publication Data

Pagoulatos, George, 1967–
Greece's new political economy : state, finance, and growth from postwar to EMU / George Pagoulatos.
p. cm. – (St. Antony's series)
Includes bibliographical references and index.
ISBN 0–333–75277–5
1. Greece – Economic conditions – 1918–1974. 2. Greece – Economic conditions – 1974– 3. Greece – Economic policy. 4. European Union – Greece. I. Title. II. St. Antony's series (Palgrave Macmillan (Firm))

HC295 .P29 2003
330.9495′07 – dc21 2002035531

10 9 8 7 6 5 4 3 2 1
12 11 10 09 08 07 06 05 04 03

Printed and bound in Great Britain by
Antony Rowe Ltd, Chippenham and Eastbourne

So, too, our problem is not a human problem of muscles and endurance. It is not an engineering problem or an agricultural problem. It is not even a business problem, if we mean by business those calculations and dispositions and organising acts by which individual entrepreneurs can better themselves. Nor is it a banking problem, if we mean by banking those principles and methods of shrewd judgement by which lasting connections are fostered and unfortunate commitments avoided. On the contrary, it is, in the strictest sense, an economic problem or, to express it better, as suggesting a blend of economic theory with the art of statesmanship, a problem of political economy.

J.M. Keynes, 'The Means to Prosperity', *The Collected Writings of John Maynard Keynes*, vol. IX, London, Macmillan – now Palgrave Macmillan, 1933/1972, pp. 335–6.

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List of Abbreviations

ABG	Agricultural Bank of Greece (also Agricultural Bank)
ASE	Athens Stock Exchange
BIS	Bank for International Settlements
BoG	Bank of Greece
CAP	Common Agricultural Policy
CB	Central Bank
EC	European Community
ECB	European Central Bank
EcoFin	Council of Economic and Finance Ministers
EDA	United Democratic Left
EEC	European Economic Community
ELG	export-led growth
EMS	European Monetary System
EMU	Economic and Monetary Union
ERM	Exchange Rate Mechanism
ESCB	European System of Central Banks
ETVA	Hellenic Industrial Development Bank
EU	European Union
EUR	euro
FDI	foreign direct investment
GATT	General Agreement on Tariffs and Trade
GDR	Greek drachma
GSEE	General Confederation of Greek Labor
GDP	gross domestic product
GNP	gross national product
HBA	Hellenic Bank Association
IMF	International Monetary Fund
IPO	initial public offering
ISI	import substitution industrialization
KKE	Communist Party of Greece
KEPE	Center of Planning and Economic Research
MITI	Ministry of International Trade and Industry (Japan)
MP	Member of Parliament
NATO	North Atlantic Treaty Organization
NBG	National Bank of Greece (also National Bank)
ND	New Democracy

OAE	Industrial Reconstruction Organization
OECD	Organization for Economic Cooperation and Development
OEEC	Organization for European Economic Cooperation
OTOE	Greek Federation of Bank Employee Organizations
PASOK	Panhellenic Socialist Movement
PEE	Panhellenic Exporters' Association
R&D	research and development
SCB	state-controlled bank
SE	Stock Exchange
SEV	Federation of Greek Industries
SMEs	small and medium-sized manufacturing enterprises
SYN	Coalition of the Left
UNCTAD	United Nations Conference on Trade and Development

Acknowledgements

Draconian word limits, after squeezing out some sixth of the intended manuscript and eliminating many footnotes and references, impose frugality in my expression of acknowledgements. The numerous moral and intellectual debts I have amassed during four years of work on this book far outnumber the credits that can be given here. Among those who offered ideas and advice on this project I would especially like to mention Bill Branson, Anthony Courakis, Nikiforos Diamandouros, Gabriella Etmektsoglou, Aris Hatzis, Panos Kazakos, Mark Mazower, Nicos Mouzelis, Nicos Papandreou, Anthony Papayannides, Apostolis Philippopoulos, Nicholas Sabanis, Calliope Spanou, George Tsebelis, Thanos Veremis, and Susannah Verney.

I wish to thank, without involving, Sarantis Kalyvitis, Antonis Kamaras, Margarita Katsimi, Thomas Moutos, Theodore Pelagidis, Ioanna Pepelasis-Minoglou, Dimitri Sotiropoulos, and Panos Tsakloglou for taking the time to comment on various early sections. I am grateful to Euclid Tsakalotos and Heather Gibson, who not only read and discussed extensive parts of the manuscript but also gracefully endured what appeared to be endless pestering on my part. Dimitris Bourikos and Dimitris Katsikas were immensely diligent in compiling statistical data, providing excellent research assistance. For the same reason I wish to thank Nicos Demenagas and Vassiliki Plati.

A small part of the background work draws on research conducted during my doctoral thesis, including interviews with about 30 senior government and central bank officials and other policy experts. I would compromise the confidentiality of my sources if I mentioned them here by name, so I can only thank them once again anonymously. But I wish to express my appreciation to former governor Dimitris Halikias for devoting a great deal of time in going patiently through the policy details with me. Fragments of this book were presented as papers at Princeton University, New York University, the South Western American Political Science Association, the European Union Studies Association, and the European Institute at the LSE. I acknowledge kind permission from Frank Cass Publishers and Nova Scotia Publishers to use material from articles published in *South European Society and Politics*, and *Current Politics and Economics of Europe*. I wish to thank Eugene Rogan and Richard Clogg, editors of the St Antony's Series, for supporting this

publication. My thesis examiners Jack Hayward and Loukas Tsoukalis encouraged the development of some incipient ideas into what eventually became this book.

My studies at Oxford were generously funded by the Rhodes Scholarship Trust. Funding from the Hellenic Studies Program and the Hannah Seeger Davis postdoctoral fellowship at Princeton University is gratefully acknowledged. Nancy Bermeo and her South European Research Group under the Princeton Center of International Studies provided an excellent and welcoming academic environment. Jochen and Anne Twele offered warm hospitality for which I am deeply thankful. Dimitri Gondicas has done more than anyone would deem humanly possible to promote Greek scholarship at Princeton. Pan Yotopoulos took time to discuss at length with me various aspects of economic development and financial policies. His knowledge and international policy experience were invaluable, and so was his unwavering moral support. The late Vincent Wright, my Oxford supervisor, was an inspiring teacher and a Mensch, whose splendid wit and self-deprecating humor were matched by immense kindness and dignity.

As with any human effort, the endless hours of solitary work for this project were warmed by the devoted presence of treasured companions and friends. Tatiana's cheerful affection accompanied this book all the way from crude draft to polished end product.

Finally, my debt to my parents is beyond reckoning. This book is for them.

1
Introduction: the Importance of Finance and the Origins of Developmentalism

How does a country progress from the ruins of war to sustained prosperity, from widely rural composition to a modern European economy, from sociopolitical underdevelopment to a full-blown liberal democracy? What are the underpinnings of contemporary financial globalization, how did we get there, and what does it mean for a single country's political economy? What is the role of the state and of financial institutions in that long trajectory of a nation from destitution to internationalized middle-income economy status? What are the political implications of finance for a postwar developing country, for its democratization, into the Eurozone?

Such were some of the fundamental questions that motivated the research leading to this book, though they are by no means all systematically addressed in it. Several works exist on the economics of postwar Greece, and so is the case with works that fall within the comparative sociology and politics literature.[1] Such accounts, however, often tend to develop in splendid isolation, as asymptote discourses, one discipline ignoring the other. This book seeks, among others, to bridge the conceptual gap between politics and economics, thus falling within the broader subdiscipline of comparative political economy.

Grossly generalizing, political scientists are the exact opposite of neoclassical economists: the first are political optimists and economic pessimists, while the second are political pessimists and economic optimists. Neoclassical economists believe that market forces would do an excellent job if it were not for the interference by governments inherently prone to messing up the economic process, distorting efficiency. In contrast, political scientists (or at least those among them who are not uncritical converts to neoclassical methodology) are optimistic that

democratic politics is – for all its shortcomings – able on the whole to deliver the goods if only it were not constrained by economic and market forces. Works that draw on neo-institutional or comparative political economy insights entail the possible advantage of taking on board both sides of the story. That is both the political skepticism of economists about the incentive structures that often frustrate the public policy realm, and the nonreductionist, institution-centered, and power-sensitive view of political scientists onto the economic process.

The account spans about five decades. Missing out on important details and lacking a close-up on the policies and politics of change is an inevitable shortcoming of any approach over the relatively *longue durée*. The main advantages include the possibility of a broad overview of the subject matter, broad in terms of historical time span and (given the scope of the particular subject matter) in thematic terms as well. This breadth counsels against seeking to provide parsimonious explanations for the dynamic flow of change. The account of change takes rather the form of comparative statics, examining the successive configurations corresponding to each particular stage of the adopted periodization. The latter can be perceived as roughly divided into early postwar and the 1950s, the 1960s, the dictatorship period, the 1970s economic crisis coinciding with democratic transition, the mostly stagflationary 1980s, financial liberalization, and the post-liberalization internationalized political economy. Of course, subperiods overlap, the lines separating one from another are by definition artificial and far from clear-cut. Any historical taxonomy remains a *post hoc* conventional enterprise, meant to conceptualize and arrange a reality whose development has taken place in a uniquely complex, ambiguous, and disorderly manner. The comparative statics-like depiction notwithstanding, each 'stage' develops dynamically, being somehow spermatically contained in its antecedent circumstances.

The underlying argument of the book is not that each of the aforementioned stages was driven by the state–finance connection, but that the state–finance connection crucially served the overarching political economy and government priorities of each period. Now this is not a functionalist argument, for it does not substitute aggregate outcomes for intentions, neither does it assume overarching and impersonal systemic functional 'needs'.[2] Instead it is an argument for path dependency and institutional stickiness: financial interventionism was initially adopted as a textbook policy instrument for a developing country; then – being institutionally available – it was utilized for a wider range of purposes than presumed by its original *raison d'être*, aptly subjected, among others, to political expedience, and producing a number of undesired

consequences. Finally, financial liberalization (the opposite state–finance configuration) became a principal instrument for externally induced economic adjustment, and potentially the conveyor belt to an unprecedented Europeanization and internationalization of the Greek political economy. This is the argument in a nutshell. As such it is not inconsistent with the micro-foundations of socioeconomic phenomena, though methodological individualism and rational choice whenever applicable (far more in the case of political and corporate actors than with voters and the public)[3] will usually be tacitly inferred rather than empirically or theoretically validated.

The book follows an eclectically structuralist and institutionalist outlook. The original forces bearing upon a small and relatively open economy's policy course are traced in the international system and political economy. Small states contribute to the international balance of power, but their individual input is disproportionately low compared to the degree of their subjection to the international regime. They are policy receivers rather than policy agenda setters. It is in the international political economy that one finds the sources of policy constraint and normative blueprint. The autonomous role of small states is substantially upgraded (or their heteronomy reduced) by their participation in international or peripheral formations, such as the European Union (EU). Such formations mediate and transform pressures and policies applied by other global-level powerful actors (or simply dynamics unleashed as an unintended result of politico-economic forces interacting in the global sphere).[4] Though in that latter sense international constraints (which by the same token include opportunities) are endogenously transformable, from the standpoint of a small open economy they are predominantly exogenous, and they are considered here as such. *Mutatis mutandis*, the same applies to the membership constraints deriving from the EU. These constraints and obligations are typically vested with the force of institutional statute; they usually incorporate the 'objective' imperatives of adjustment to the particular juncture of the European political economy under conditions of supranational and intergovernmental interdependence. Incorporating these imperatives into formal policy and institutional text relieves them of ideological ambiguity, and vests them with an urgent sense of ineluctability that allows them to be internalized with less friction by the domestic sociopolitical order of member states.

External structural pressures and constraints are applied to the national policymaking system via transmission belts of international regime interdependence, market integration, elite interaction, and so on. These same mechanisms are also bearers of ideological influence and

policy paradigms, generating policy convergence, 'learning', compliance, as well as dissent. Their impact is crucially mediated by the domestic institutional framework, which includes the organizational attributes of the state, the market, the political system, and civil society.[5] Such institutional attributes at the aggregate macro-level amount to structural properties of the economy, polity, and society, in terms that allow us, for example, to talk of underdevelopment of capitalist, democratic, or civil society institutions. A structural endowment corresponding to a particular 'stage of development' offers the basic litmus test for the appropriateness and viability of institutional and policy imports. Broader contextual noninstitutional factors of the sociopolitical and economic reality (important events, cyclical trends, and so on) that do not display the normative strength and durability of institutions also filter external policy and ideological inputs, helping define the terms of their domestic reception.

Institutions are notoriously resistant to change, not least because they are embedded into broader social systems of production, 'nested' at global and regional level, interdependent with other institutions (Granovetter 1985, 1992; Boyer and Hollingsworth 1997). Status quo interest coalitions flock around them, tending to reproduce a status quo legitimizing discourse, further reinforced by the recognition of the sunk costs invested in the existing institutional order. Institutions change nonetheless, in an incremental rather than radical manner, by way of a dynamic interaction in which the impact of institutions is also mediated and filtered by their surrounding context (March and Olsen 1989: 53–67; Thelen and Steinmo 1992: 16ff; Wilson 2000). Interests (state-political, socioeconomic, or corporate; indigenous or transnational) are the foremost agents of institutional change, facilitated or promulgated by contextual transformations and a reconfiguration of domestic and international-level power balances. Once effected, institutional change not only statically represents the given configuration of power but dynamically affects it as well, by altering the distribution of resources between actors.

The case of Greece

Postwar Greece is inviting for comparative political scientists and economists alike, as its course offers a case study of several distinct historical experiences. In the early postwar decades, especially in the 1960s, Greece represented a success story of economic development, combining low inflation with impressive rates of economic growth, a record

comparable to that of high achievers such as postwar Japan. Then, following the 1973 international economic crisis, monetary stability was succeeded by high inflation, while from the end of the 1970s prolonged stagnation also settled in. Economic policies in the 1980s remained expansionary and divergent from the European standard, with a brief interlude of stabilization in 1985–87. Stagflation lasted more or less until the first half of the 1990s, when a resolute disinflationary effort began to be seriously pursued. In the 1990s economic policies gradually converged toward the European orthodoxy of economic adjustment. By the end of the 1990s and the beginning of the 2000s the Greek economy had succeeded in quelling inflation, posting economic growth rates that consistently exceeded the EU average.

At the political level, the 1950–67 period, under mostly right-wing and briefly centrist-liberal governments, was one of cachectic democratic institutions, a 'guided' crowned democracy during which the Communist Party was outlawed and the Left was politically persecuted following its defeat in the 1945–49 civil war (Mouzelis 1986; Nikolakopoulos 2001).[6] A military dictatorship followed in 1967–74, turning the repressive policies of the postwar regime into a fully fledged authoritarian state. Transition to a liberal pluralistic democracy took place in 1974 led by Constantine Karamanlis and his newly founded center-right wing conservative party of Nea Democratia (ND). The rise to government of the socialist party (PASOK) under Andreas Papandreou in 1981 signified the consolidation of the Third Republic, proving that democracy had indeed become 'the only game in town' (Linz and Stepan 1996; Gunther et al. 1995: 5ff). The 1981–2000 period was led by and large by PASOK governments, except for a government term of the ND in 1990–93, and a brief interlude of transitional coalition governments in 1989–90.

At the level of international integration, the post-1950 period began with politico-economic tutelage of Greece by the US, initially within the Marshall Plan governance framework, and more broadly within the framework of a patron–client relationship under the cold war regime and NATO (Couloumbis et al. 1976: 103–46; Iatrides 1983). In the 1950s, Greece became a member of the main international organizations, such as the International Monetary Fund (IMF) and the OEEC (later renamed the OECD), and participated in the Bretton Woods system. The Association of Greece with the European Communities began formally in 1962. After a relative 'freeze' during the junta, the association developed into full EC membership in 1981, participation in the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS) in 1998, and membership in the European Economic and Monetary Union

(EMU) in 2001. During the 1990s Greece made rapid and consistent strides on the road toward its institutional and economic Europeanization.

Four main comparative discourses summarize the 50-year postwar course of Greece, corresponding to successive and overlapping stages in its trajectory: economic development, sociopolitical democratization, Europeanization, and globalization. These discourses serve as conceptual lenses for understanding the development of the Greek political economy in the second half of the twentieth century. They also serve the aim of this research project, which is to place Greece in a comparative setting. Many national case studies suffer from a creeping ethnocentrism. Only by exploring the sources of ideational influences, the policy models, the comparative distinctness and dissimilitude, and the international-level cross-national constraints is it possible to understand why a country follows particular institutional and policy pathways instead of others.

That said, European models had a crucial influence on the development trajectory of postwar Greece, as will be seen in the relevant chapters. European national models also defined the process of European integration; their influence is present in the contemporary reality of the EU and thus of Greece. The historical template for the European Commission was the French Planning Commission (Featherstone 1994), the single market program including trade and financial liberalization was representative of the Anglo-American influence, while the overall EU architecture may be viewed as an intellectual offspring of the German postwar social market economy, and the European Central Bank (ECB) as modeled on the Bundesbank (Dyson and Featherstone 1999; Radaelli 1999). Since these are among the chief institutions to define Greece's political economy since the 1980s, this remark is particularly germane.

Banks and the political economy of finance

The controlling variable in this study is the financial regime. The importance of finance has not gone unnoticed by social scientists. In Keynes's writings economic disturbances are consistently portrayed as starting in the sphere of money and finance and then moving on to the 'real economy'. Macroeconomics, as devised by Keynes, is irrelevant in an economy that does not use credit. Well before Keynes, Marx viewed money as increasingly encompassing all aspects of social life in capitalist societies, objectifying social relations. Classical sociologists such as Weber (1922/1978: 166ff) emphasized the control of the state and large banking institutions over money as a source of power in itself.

Contemporary political science, on its part, has not been especially attentive to the importance of financial institutions, with some notable exceptions. These include Zysman (1983), Moran (1984), Woolley (1984), Loriaux (1991), Goodman (1992), Maxfield (1990, 1997), Haggard et al. (1993), Pérez (1997a), Verdier (2000), and others. Such authors have been intrigued by issues such as the politics of banking and central banking, the state–finance connection, its institutional architecture and its political implications. Speaking of the postwar French state, Loriaux (1999: 241) singled out 'its capacity to influence investment through its control over credit allocation' as the state's most powerful tool. Skocpol argued that a state's control over financial resources tells us more than could any other single factor about its 'capacities to create or strengthen state organizations, to employ personnel, to co-opt political support, to subsidize economic enterprises, and to fund social programs' (cited in Woo-Cumings 1999b: 11).

State control over finance corresponded to the state-directed postwar financial systems that Zysman (1983) defined as credit-based. In such financial regimes government administered prices in the financial system so as, among other things, to facilitate its interventions in industrial affairs. Credit-based, state-controlled financial systems represented the strongest form of financial interventionism or credit interventionism, the latter being a subset of the former. Some policies of financial interventionism (such as capital and foreign exchange controls or quantitative credit ceilings) could also form part of the other traditional types of financial systems, such as capital market-based ones (see next paragraph). The main features of financial interventionism and financial liberalization are summarized in Table 1.1.

A credit-based system in the postwar era is mainly juxtaposed to a capital market- or market-based system (the Anglo-American model), where market competition determines prices, the allocation of resources, and the monitoring of companies. Government keeps at an arm's length from finance and industry, financial markets are active, a diversified banking system provides relatively short-term credit, while investment and production decisions are company-led (Zysman 1983). 'Though government policies may influence those decisions, they do not add up to a conscious strategy of adjustment or of development' (Zysman 1983: 18).

Distinct is the type that Zysman (1983) defined as negotiated credit system (such as that of postwar Germany and other Rhine-capitalist and neocorporatist economies). This is also a bank-dominated financial regime, but here government does not control the financial system

Table 1.1 Financial interventionism and financial deregulation/liberalization

Financial interventionism
- State control over commercial bank ownership or management
- State-imposed institutional specialization of banks
- Discretionary fixed interest rates and interest rate ceilings
- Quantitative credit controls and quotas
- Special bank investment ratios for financing public debt and selected sectors
- Capital and foreign exchange controls
- (Bank-based financial system and weakness of capital market)

Financial deregulation/liberalization
- Liberalization of interest rates, deregulation of credit restrictions
- Despecialization of specialized credit institutions: agricultural or development banks to operate as 'universal' commercial banks
- Opening of domestic market to foreign banks, securities firms, and other non-bank financial intermediaries; national financial institutions to establish foreign branches and networks
- Growth of public debt markets, development of capital and money market, erosion of banks' position as financial intermediaries
- New instruments and markets for corporate and public finance
- Abolition of inward and outward capital and foreign exchange controls regarding: foreign direct investment and access to domestic equity and real estate; outward direct and portfolio investment; foreign borrowing by domestic firms; repatration of capital; payments for invisibles, including profits and dividends; domestic foreign currency accounts; transactions in domestic securities by foreigners and foreign securities by nationals

Sources: OECD (1990); Haggard and Maxfield (1996).

directly, it only provides ad hoc special assistance when necessary in an otherwise negotiated relationship between major social partners (Zysman 1983: 16ff). Public banks may abound, but the role of government in finance is not interventionist, credit is not administered, and the capital market is relatively more developed than in credit-based systems. Both credit-based and negotiated credit systems can be regarded as bank-based or institution-based systems, characterized by the dominant position of bank institutions in industrial affairs, and by the 'integration of industrial and financial decision-making through … structured linkages between the state apparatus, banking and finance, and large-scale industry' (Cerny 1997: 175).

In institution-based financial systems banks play a pivotal role in economic development. They provide the mechanism for channeling the public's financial savings to prospective borrowers, transforming idle savings into productive investment. As financial intermediaries, banks present well-known advantages: they reduce the transaction costs associated

with bringing savers together with prospective borrowers; they are able to borrow short-term (allowing depositors constant access to their savings) and lend long-term (enabling the long-term commitment of funds necessary for the investment to generate returns) thus creating liquidity; they are able to economize on the information costs involved in making investment lending decisions, and they are able to assess and offset credit risks by diversifying their lending portfolios; they can offer helpful advice to small entrepreneurs, and they can redirect financial resources across sectors toward more productive activities in the economy (Levine 1997). In developing countries lacking accumulated wealth and an advanced industrial structure, banks are the main if not exclusive providers of investment finance. Capital markets in developing countries are underdeveloped, usually because the politico-economic environment discourages long-term undertakings, but also because firms lack a track record and reputation for creditworthiness necessary for raising funds in the equity and bond market.

As said, finance is not devoid of political implications. The type of financial regime is politically important because, among other things, it indicates where power lies. If financial resources are allocated by the market (as in the capital market-based systems of Britain and the US) then there is diffusion as well as relative mutability of control, and probably economic pluralism through the existence of competing (though collectively powerful in the structural sense) private interests. If financial resources are mostly handled and channeled by banks (as in German-type bank-based systems) then powerful and enduring industrial groups will tend to develop, firmly controlled by one or two dominant shareholders (often the banks themselves), able to operate with a relatively long-term horizon, perhaps also taking into account the interests of their broader 'stakeholders', not just the capital owners. If finally, as in postwar Greece, government is able, through credit interventionism, to direct financial resources to its favored sectors of production, then this government is able, for better or worse, to exercise a significant degree of control over the country's economic life. This may stimulate development but it may also create opportunities for particularistic distribution of resources.

Thus the politics of finance has to do primarily with the question: who controls finance? Is government the directly controlling force, is it the gatekeeper, or is it confined to set and enforce the broad ground rules, leaving it to the price mechanism to define resource allocation? In the latter case we may be spared government failure (the counterpart of market failure). But we may be facing coalitions of private financial

interests that are powerful beyond control, internationalized, and able to exercise heavy pressure upon governments.

Economic development and the importance of finance

The use of the term 'economic growth' in the title of this book comprises two rather distinct notions: 'growth' proper, and 'development'. The first refers mainly to a developed economy, the second mostly to a developing one. Though the two terms have often been used interchangeably in the literature, they are not exactly synonymous. Growth proper means straightforwardly more output, maximizing the gross national product (GNP). In the context of a developed economy, where growth rates are normally expected to be moderate, the economic growth objective comprises what is generally accepted to constitute the principal ambition of economic policy: increasing general societal welfare through higher rates of wealth production, and expanding employment opportunities. Growth in the context of an advanced economy is, it may be argued, temporally skewed in favor of societal rewards of economic growth that materialize in the present or in the immediate future.

Development, on the other hand, implies not just more output but a different composition of output than previously produced, resulting not only from greater efficiency but from changes in the technical and institutional arrangements and contributing inputs that define the kinds of output produced (Herrick and Kindleberger 1983: 21; Little 1982: 3ff). Growth *qua* development may signify advancements such as building up a modern state apparatus, including a reliable judicial system, a dependable public administration, a credible tax-collecting authority, a set of adequate regulatory institutions. It may also signify the selective development of economic sectors deemed as more important compared to others of lower value-added contribution. Growth in a developing economy context could be said to be more forward-looking, more keen to the deferral of present societal rewards for the sake of capital accumulation and investment. It could also be identified with a longer-term strategy of industrialization (the undisputed avenue to development for the more 'backward' postwar economies) and the build-up of a national infrastructure that would enable sustained economic growth in the future.

In countries at a less advanced stage of economic development, governments exhibited more activism in devising specialized institutions for industrial finance and in administering credit to expedite economic growth. According to the classical Gerschenkronian argument, industrialization in early industrializer Britain emerged as a result of long-produced

capital accumulation. In contrast, later industrializers (Germany, France, to a certain extent Italy, industrializing around iron and steel, where start-up costs were higher) had to rely on 'engineered' and specialized investment banks to generate and extend the long-term capital needed to finance industrialization (Gerschenkron 1966; Cameron 1967). These banks were motivated to acquire greater interest and participation in the industrial firms they had helped bring about. The more backward an economy relative to others, the greater the need 'to make the[ir] development into a less spontaneous and more deliberate process' (Hirschman 1958: 8), and the higher the emphasis on 'supply-leading finance'. The aim, as seen in the 1950s and 1960s, was twofold: 'to transfer resources from traditional (non-growth) sectors to modern sectors, and to promote and stimulate an entrepreneurial response in these modern sectors' (Patrick 1966: 175ff).

The unwillingness or inability of the private sector in latecomer countries to initiate industrialization on its own was associated with a number of market failures. The private sector was undercapitalized – especially where capital markets were underdeveloped – and thus unable to incur short-term losses; or those losses were very likely not to be compensated for by future profits. The private sector may have deemed it more profitable to invest in speculative activities (such as real estate or foreign imports) rather than manufacturing. A lot of those shortcomings may have been due to private sector shortsightedness, or information deficiencies regarding investment opportunities (Amsden 1992: 59ff).

For all such reasons, building a national industrial infrastructure remained the state's primary task. The reluctance of commercial banks to support private manufacturing investment through long-term loans or equity participations necessitated state intervention to ensure that resources were channeled into long-term development loans, government securities, or non- or low-interest-bearing deposits with the central bank to finance high value-added productive activities. On the other hand, in developing economies, oligopolistic banking systems predominated. If credit allocation was left to the market, the resulting equilibrium credit rates would attract unproductive activities such as import trade, where profit margins tended to be higher; credit market prices would tend to be unaffordable for the productive sectors such as manufacturing, exports, or agriculture. Thus government control of lending rates too was deemed necessary for economic development.

That was more or less the original postwar developmental rationale of financial interventionism, whose prominent objective was to encourage, support, or obligate capital transfusions to industry so as to produce

positive socioeconomic spillovers, externalities, or complementarities. Thus the later the industrialization (Southern Europe) the more active the state in engineering financial interventionism. In contrast, the more advanced the stage of industrialization, the less the extent of financial interventionism (Britain or postwar Germany). No doubt there were diversions from the pattern, due to the distinctness of national state traditions (cf. Dyson 1982; Loriaux 1988: 177ff). France's strong *étatiste* structures and specific circumstances of the postwar national unity government were reflected in a very pronounced state intervention in banking, despite the relatively mature industrial base. Or a colonial history in Spain had become crystallized into a powerful private banking cartel, which somehow diverged from the Mediterranean pattern of publicly owned banks.

In the early postwar period, as economies were faced with urgent balance of payments shortfalls and the pressing need for reconstruction and development, government intervention in finance became more systematic. Financial interventionism displayed tremendous adaptability to the particular conditions, needs, and objectives of a wide range of countries. As said, economies undergoing a stage of late-late industrialization (such as Greece) were main adherents to the institutional arrangements of administered credit. Financial interventionism became a prerequisite both for autarkic development strategies based on import substitution industrialization (where heavy protectionism, capital controls, and subsidized credit to industry were main instruments) and for open trade strategies of export-led growth (crucially based on favorable financial regulations for manufacturing and exports).

A crucial common denominator of financial interventionism was capital controls. Governments since the 1930s sought to preserve external balance by insulating their financial markets from international capital flows; they pursued higher monetary policy autonomy in the service of faster economic growth. Satisfying the Keynesian aspiration of holding down interest payments sought to contribute to the proverbial 'euthanasia of the rentier' and direct financial resources to productive use. The postwar Bretton Woods regime institutionalized the governments' leeway for monetary expansion.

Subject to a wide range of accompanying circumstances, financial interventionism exhibited not only a growth-oriented and developmental function, but a stabilization one as well. Thus, Britain during the 1960s exemplified the at least apparent paradox of a 'hands-off' state with almost no public institutions of special long-term banking and financial intervention except for a rather regular reliance on controls

over consumer credit. These controls were grounded less on a growth strategy and more on a Keynesian understanding of demand management as an instrument for controlling inflation (Shonfield 1965: 222–3). By contrast, credit policies in developed and developing interventionist states alike were extensively used in continental Europe both for stabilization and for supply-side purposes, to target financial resources to specific sectors and subsectors of production. As regards stabilization, from the moment the institutional apparatus of interventionism existed, it was easy for monetary authorities to rely on direct monetary instruments for protecting the currency or fighting inflation. This was the case in all countries that practiced credit controls. On the other hand, when it came to indicative planning and administered credit as industrial policy instruments, they were initially applied by postwar France, and soon followed by a second wave of industrializing continental countries such as Spain and (to a qualified extent) Greece. Indicative planning aimed to deploy investment 'at those points in the system where it produced an especially high return', seeking 'to improve the average capital–output ratio of investment as a whole' (Shonfield 1965: 225; also Hayward 1986: 25ff). Finally, in several European countries in the postwar decades, selective credit instruments were placed in the service of objectives combining development with social redistribution, such as interregional redistribution and the development of the periphery (in Italy, Spain, France, or Greece), the subsidization of low-cost housing construction (especially in Scandinavia), or financial support of agriculture and the small business sector (in most European countries).

So financial interventionism developed under different political regimes, with public or privately owned banking systems, for monetary policy purposes, often additionally for redistribution, and in most cases also in the service of advancing industrial development. Reflecting distinct but often cross-cutting development trajectories, European banking systems shared several elective affinities, before their liberalization and regulatory convergence began in the late 1970s and 1980s within the framework of a transformed global financial environment and European integration.

Origins of postwar developmentalism and the 'developmental state'

It would be appropriate at this point to more systematically place postwar developmental policies and institutions in their original conceptual framework. Economic development was the grand project that

captured the minds of economists and policymakers in underdeveloped countries after World War II. From the late 1940s and through the 1950s and 1960s the pioneers of the developmentalist school (Ragnar Nurkse, Paul Rosenstein-Rodan, Arthur Lewis, Walt Whitman Rostow, Albert Hirschman, and others) were shaping the policies of developing countries and international institutions such as the UN and the International Bank for Reconstruction and Development (later renamed the World Bank). Developmentalists rode on the early waves of Keynesianism, sharing some of its key ideas and assumptions: an enthusiastic belief in the primacy of economic growth and a strong preference for industrialization as the driving force of growth; an emphasis on aggregate phenomena such as the rate of saving (the share of income not consumed in GNP) and the rate of investment; the understanding of poor economic performance as often reflecting a lack of aggregate demand rather than a shortage of resources; a deeply held respect for market forces cohabiting with strong support for large-scale, short-term government intervention in the developing economy, interventionism to be reduced to a merely stabilizing function after the economy had reached a developed country status (Meier 1989: 82ff; Cypher and Dietz 1997: 135ff). In such ways, the developmentalist school in the 1950s and 1960s somehow formed a 'Keynesianism for the underdeveloped', converging in vital policy prescriptions.

Extensive government industrial investment and planning were a derivative of these ideas. Individual entrepreneurs were deemed unlikely to invest enough to push the less developed economy forward at its maximum potential rate, because of their inability to predict or 'appropriate' the potential benefits arising from spin-off industries and linkages. In the terms of more recent economic argument, adaptation of old capital structures to new technology may be difficult, as they often consist of many interlocking elements, the ownership and control of which (and thus the consecutive costs and benefits of change) may be divided among different firms and industries. Thus the investment of individual firms in machinery and human capital could only appear profitable if complementary investments were undertaken by other firms. In such cases, state intervention would step in to resolve problems of coordination, to cut the transaction costs involved for potential investors, and to limit potential negative externalities (Abramovitz 1986; Rodrik 1995; Chang 1999). These factors were deemed to necessitate a 'big push' of industrial investment and planning for the multitude of simultaneous investment decisions to be coordinated and the economy to be shifted away from its low-level equilibrium trap to rapid and sustainable growth

(Rosenstein-Rodan 1989: 513ff). On the same wavelength operated Nurkse's theory of 'balanced growth': large-scale increases in supply across a large number of industrial sectors should be coordinated with a large-scale increase in demand generated by the same expansion. The demand-side stimulus would come from industries expanding as a result of the overall balanced investment program, as these industries would need more inputs of raw materials, intermediate or semi-processed products, and labor; their buying inputs would create income for their suppliers, which would then be transposed into a further expansion of demand by other firms and their workers buying the increased array of domestic goods available (Thirlwall 1978: 177ff; Cypher and Dietz 1997: 141–2).

Another derivative of these writings was the advocacy of what would later become known as import substitution industrialization (ISI). Given an existing demand in developing countries for imported consumer goods, it made sense to base the rationale for postwar industrialization on the home replacement of these goods, which would also help meet the balance of payments problem. Thus there was a prima facie case for industrial protection to encourage import substitutes. This notably included temporary tariff protection of 'infant industries', allowing them to produce at lower costs and to compete favorably with foreign producers. Protection should be premised on the social rate of return (in terms of new production techniques and labor force training) exceeding the rate of return on the investment (Meier 1989: 297ff). Though ISI policies were indispensable in the first steps of industrialization of many developing countries, their retention beyond a certain point led to overall higher prices, uncompetitive hothouse industries producing goods of inferior quality, overinvestment in the import-substituting industries, declining exports, chronic balance of payments crises, and low growth (Balassa 1980). The expansion of ISI from consumer goods into intermediate and capital goods production confronted investments of higher capital intensity and a larger import content, which aggravated the balance of payments. On the demand side, domestic markets were increasingly inadequate for achieving a minimum efficient scale of production (Meier 1989: 303). For such reasons, the litmus test for ISI success lay in knowing when to abandon it for an open trade, export-oriented strategy (Meier 1989: 407–12) (See Table 1.2 on development trajectories).

With an eye on the different priorities faced by developing countries, and with reference to post-1930s Japan, Chalmers Johnson is credited with coining the concept of the 'developmental state' (Johnson 1982, 1995). Contrary to an American-type 'market-rational' regulatory state, a 'plan-rational' developmental state intervenes through an operationally

Table 1.2 Development trajectories

	Economic structure	*Core policies*
1. Import substitution		
a. Primary-product export phase (PPE) Brazil pre-1930, prerevolutionary Mexico	Raw materials or food exports, traditional agriculture, handicraft production, and limited manufactures	Free trade and foreign investment, gold-standard exchange-rate policy
b. Import substitution Phase 1 (ISI 1) Brazil and Mexico, circa 1935–55	Growing manufacturing activity, particularly consumer goods	Protection, fiscal and financial supports to industry
c. Import substitution Phase 2 (ISI 2) Brazil and Mexico, circa 1955–65	Industrial deepening in consumer durables and intermediates	Same as ISI 1, plus new role for state-owned enterprise and multinationals
d. Import substitution Phase 3 (ISI 3) Brazil and Mexico, circa 1965 to present	Continued deepening, including capital goods, increased manufactured exports	Same as ISI 2, plus new incentives to export and increased borrowing
2. Export-led growth		
a. Primary-product export phase Korea and Taiwan circa 1900–1945	Same as 1a	Colonial administration of economic activity
b. Import substitution Phase 1 (ISI 1) Korea, circa 1945–64 Taiwan, circa 1945–60	Same as 1b	Same as 1b
c. Export-led growth Phase1 (ELG 1) Korea and Taiwan through 1970	Manufacturing growth led by exports of labor-intensive goods	Devaluation, selective liberalization, financial and fiscal supports to export industry
d. Export-led growth Phase 2 (ELG 2) Korea and Taiwan, circa 1970 to present	Industrial deepening coupled with upgrading of exports	Targeted industrial policies

Source: Haggard (1990).

autonomous elite state bureaucracy (*in casu* the Japanese Ministry of International Trade and Industry – MITI) to identify and choose the industries to be developed, and to formulate the best means of an industrial rationalization policy. Such means involved the creation of public

financial institutions, indicative planning, an extensive reliance on public corporations, an unconsolidated investment budget separate from and not funded by the general account budget, government-supported R&D, an at least indirect control of government funds – thus not being subservient to the Finance Ministry (Johnson 1982: 314–20). Successful East Asian developmental states have been able to 'extract capital ... ; manipulate private access to scarce resources; ... [in most cases] resist political pressures from popular forces such as consumers and organized labor; insulate their domestic economies from extensive foreign capital penetration; ... carry through a sustained project of ever-improving productivity, technological sophistication, and increased world market shares' (Pempel 1999: 139). Other case studies of South East Asian countries[7] (but also cases as diverse as France, Austria, Finland, Brazil, and Mexico) have extended the concept to include a breadth of national trajectories, and have pointed out state control of finance as the single most important industrial policy tool in the hands of the developmental state (Wade 1990; Woo 1991; Woo-Cumings 1999a).

In his own typology, Peter Evans (1995) distinguishes the 'developmental state' from the extreme archetype of the 'predatory state' (where corruption and the appropriation of national resources via rent-seeking are endemic and structural), but also from the weaker form of what he called the 'intermediate state'. The intermediate state corresponds to the majority of national cases, characterized by inconsistencies. It lacks the integrity, proficiency, commitment, cohesiveness, and autonomy to withstand capture by vested interests – all features of the developmental state – but it is no predatory state either. In the intermediate state, sectors of incompetence and corruption coexist with pockets of efficiency, where public officials design and successfully implement important projects that are bound to benefit the economy and society as a whole. The Weberian attributes of meritocracy, professionalism, and competence may characterize some parts of the state apparatus, while others may be operating along personal ties, captured by private interests, subservient to lateral pressures. Thus an intermediate state, being fragmented, lacks the overall capacity to engineer the desired developmental transformations in the economy and society, though it may be successful in implementing these objectives in ad hoc particular areas of its jurisdiction. These concepts will be particularly helpful when examining the case at hand.

What becomes, however, of the developmental state after its mission has been accomplished? An armory of interventionist tools may be indispensable for accelerating and achieving development, but when a country has reached the level of its main trading partners 'external and

internal equilibrium tend to converge and market liberalization needs to be promoted, as opposed to being controlled and constrained' (Yotopoulos 1996: 223). In Lindblom's (1978) aphorism 'states have strong thumbs but clumsy fingers': once their developmental tasks of mobilizing capital and affecting structural transformations have been achieved, 'interventionist states slow economic growth by trying to fine-tune that which is too complicated to micromanage' (Herring 1999: 330). Hence liberalization succeeds developmental interventionism once the latter has outlived its purposes.

An overview of the book chapters

The book analyzes Greece's 50-year-long trajectory by keeping a central focus on the state–finance connection and its development. In an intellectual tradition that can be traced back to Marx, Hilferding, and Polanyi (1944: 250), the market (and by the same token, the exact nature of the state's role in the economy, including the financial regime) is not a 'state of nature' phenomenon. It is an institutional configuration resulting from a particular sociopolitical structure comprising power relations both at the domestic and the international level. In that vein, this book looks at: the international political economy regime, from which structural dependencies, obligations, and constraints emanate; the economic ideology and policy paradigm, a source of normative blueprint, policy inspiration, and pivotal peer pressure; the institutional arrangements (regarding the political system, financial and market institutions, the state and the central bank) which facilitate and constrain policy action; the sociopolitical and economic interests operating at the domestic and international level.

Chapter 2 examines the regime dependencies underlying Greek postwar economic and financial policies until 1973–74, dependencies emanating both from an international cold war environment and the Bretton Woods economic order. The applied economic 'model' is analyzed in detail, emphasizing the international ideological and policy influences that defined it. The chapter looks at the domestic sociopolitical factors, their interrelation with economic and financial policies, the applied policy pattern, and the political implications of credit interventionism.

Chapter 3 takes a detailed look at the institutions and policies of postwar developmental finance. The chapter places the Greek case in a comparative policy context and evaluates the influence exerted by foreign financial and industrial policy models. The developmental character of the Greek postwar state and financial interventionism is assessed, with a

focus on the role of banking institutions and the implications for industrial development.

Chapter 4 deals with the international economic crisis of the 1970s, and its effects on Greek economic and financial policies. These are examined in the context of the post-1974 sociopolitical democratization, which had a crucial impact on economic policies and the way in which financial interventionism was employed. The chapter explores the institutional, economic, and ideological transformations in the international and European environment over the 1970s and 1980s, and their significance regarding the international allocation of power. These factors are regarded as an external context from which pressures for domestic policy adjustment emanate. Greek economic and financial policies, and the decline of developmental credit interventionism, are considered in conjunction with their sociopolitical implications.

Chapters 5 and 6 analyze the politics, policies, policymaking, and political economy of Greek domestic financial liberalization in the second half of the 1980s and into the 1990s. The institutional attributes and the central role of the Bank of Greece in the policymaking process are examined and assessed, focusing on the question of central bank independence. An analytical framework of central bank 'policy strength' is adopted for analyzing the central bank's relations with government, the banking sector, and socioeconomic interests affected by credit deregulation. Economic and monetary adjustment and Europeanization from the second half of the 1980s and through the 1990s are discussed. The stakes, the winners and losers of financial liberalization are examined in detail, with special emphasis on the banking sector. Finally, a broader analysis of interest organizational patterns and state–society relations throughout the postauthoritarian period concludes Chapter 6.

Chapter 7 is devoted to the new political economy of financial liberalization and globalization, including the economic and financial implications of EMU. The chapter discusses the implications of increased capital mobility and financial deepening on the international allocation of power, on the national economy and financial system, on the business–labor balance, on political party ideology and policies, and on the political preferences of the public.

Chapter 8 reflects on the state–finance connection, arguing that the (loosely defined) developmental state has been transformed into a stabilization state. The chapter summarizes and elaborates on the main theoretical and empirical findings of the book, and extends them to some broader conclusions.

2
Regime Dependencies and the Political Economy of Postwar Economic Policies

Postwar growth and the cold war regime: external sources of domestic policy choices

The Greek postwar mode of economic development was shaped, in a path-dependent way, by the inexorable cold war regime conditions that prevailed after World War II. Along with countries such as West Germany, France, Britain, Japan, Taiwan, or South Korea, Greece remained at the forefront of American aid priorities. Greece was thus financially favored by that same cold war regime whose substantial sociopolitical price (in the form of suppressed civil and political rights and a defective development of democratic institutions) it carried through the entire post-civil war period. Following the standard definition, we view regimes as 'sets of mutual expectations, generally agreed-to rules, regulations and plans, in accordance with which organizational energies and financial commitments are allocated' (Ruggie 1975: 569), or more simply put, as 'principles, norms, rules, and decision-making procedures around which actor expectations converge in a given issue-area' (Krasner 1982: 185).

Wiser by the hard-won experience of the interwar crisis that had brought the liberal order to its knees, the Western postwar regime was still aimed at the old Wilsonian vision of offering a world 'safe for democracy', this time through a combination of politico-ideological defense against communism,[1] effective democratic institutions, and a spread of economic welfare and social rights to the Western societies. The interwar liberal democracy had already been defeated by the armies of the 1930s' unemployed before being finally rescued by those of the

Allied forces. The postwar Western democracy was to be safeguarded by an ever-expanding prosperous middle class, for, as Barrington Moore decisively put it, crediting Marx with the insight: 'No bourgeois, no democracy' (Moore 1966: 418).[2] Western prosperity as a fundamentally political project was underwritten by an international system of relatively open trade (increasingly so after the Kennedy Round of the 1960s) and exchange rate stability, supported at home by the appropriate mix of growth-directed economic policies seeking to bring about the Rostovian 'take-off' into sustained prosperity (Rostow 1960). This indicated a strategic American interest in the economic expansion of Western countries, which the US also saw as creating larger markets for its products rather than as increased competition for its exports. The US hegemonic role in that positive-sum liberal order entailed not only an American responsibility to support the Bretton Woods regime and world economic growth through its own balance-of-payments deficits. It also involved the power to promote US national interests by inducing political compliance and suppressing beggar-thy-neighbor tendencies toward destabilizing economic nationalism (Cohen 1977: 97; Kindleberger 1981; Keohane 1984; Gilpin 1987: 131ff).

Economic growth became the new universal creed to which governments very soon began to conform. In the early 1950s the annual reports of the OEEC (Organization for European Economic Cooperation) stressed the need to improve productivity as the key to expansion; in 1956 the term 'economic growth' was introduced for the first time. When the organization was renamed the OECD in 1960, article 1 of its charter stated the objective of achieving 'the highest sustainable economic growth and employment and a rising standard of living' for its member countries (Mazower 1998: 301).

One will find the principal sources of Greece's policy course as of the early 1950s: in the developmentalist orthodoxy of the time that privileged at least some degree of reliance on ISI; in the subjection to US hegemony promoting macroeconomic discipline and a relatively open trade orientation (even if still lukewarmly so); and in the 'objective' necessity of adopting a monetary policy that would protect the drachma from inflationary pressures so that the exchange rate, fixed in the Bretton Woods system, would remain competitive without crippling the country's exports. And then one should look at the domestic sociopolitical life filtering external pressures, and also seek to identify the broader contextual factors of the leading international 'success stories' and policy paradigms on which policymakers could draw. One should also examine those policymakers' own ideological and technocratic dispositions, and

their circle of direct policy influences and peer group. Though none of the above can be pursued here in adequate empirical detail, some fragments will be provided in the analysis that follows in this and the next chapter.

The interwar legacy and the antecedent circumstances of postwar growth

The beginning of the 'take-off' of the postwar Greek economy is broadly identified with the 1953 currency devaluation, stabilization, and relative trade liberalization. In a way, the post-1953 economic strategy was also a way of bridging what has been described as Greece's pre-World War II oscillation between an 'open' model based on the exports of primary goods, and an autarky-leaning protectionist model emphasizing the pursuit of industrialization (Vergopoulos 1981: 298ff). The first represented the entrenched, rather parochial agromerchant orientation of a Greek economy peripherally integrated in the international capitalist system. The second, with its proto-versions of attempts at ISI, would tend to become the leading trend under conditions of international recession or crisis in historical junctures such as the 1880s and the 1930s (Dertilis 1984; Mazower 1991).

A brief parenthesis on the historical background would be appropriate at this point. Even though Greece was affected by the European trade boom of the late nineteenth century, its structure of overwhelmingly agricultural exports for a long time remained averse to technological improvement via industrialization. In a 'Southern periphery' pattern, trade internationalization and the inflow of foreign capital expanded Greece's market, but would not by itself suffice to bring about a wave of industrialization as the economy tended to reproduce its traditional primary sector-based structure (Berend and Ránki 1982: 127–35). It was only when these propitious externally generated conditions (foreign capital, open markets, increase of productivity) were coupled with parallel domestic developments that Greek industrialization grew. Most notable among those domestic developments were a political decision (conformist to the spirit of the times) to direct resources to industrial growth, the build-up of a rudimentary institutional infrastructure to that effect, and the unexpected effects of the inflow of over 1 million refugees from Asia Minor in 1922 providing a large pool of mostly urban, manufacturing labor (Dritsa 1990: 73ff). The need to absorb this unprecedented labor surplus acted as the catalyst which – in accordance with many countries and with a South European pattern of that time (Ambrosius and Hubbard 1989: 336) – brought about a strongly protectionist shift to ISI,

with an emphasis on light consumer goods. Between 1922 and 1939 the secondary sector's share in GDP increased by 60 percent (Louri and Pepelasis Minoglou 2002). During the 1930s, the trend was bolstered by the need to protect the balance of payments in a world of autarkic economic policies, and tariff walls of import restrictions were further raised (Hadjiiossif 1993). This survived, more or less, until the partial (and short-lived) trade liberalization of 1953.

In contrast to preceding periods, the post-1953 Greek economy was bound to operate in a booming and relatively stable international economy, which – alongside the geopolitical factors pertaining to a US-imposed liberal-leaning economic orientation – enabled the Greek industrialization project to cast away its earlier heavier autarkic tendencies. Capital controls provided vital insulation from balance of payments pressures, thus allowing considerable economic policy autonomy in the form of the ability to set freely national interest rates with only limited reference to international ones. Entrusted, as it were, with defending the fixed parity with the dollar (1953–75), monetary policy was imbued with the internal disciplinary mechanism for ensuring central bank credibility in the pursuit of monetary stability, while at the same time allowing considerable leeway in the pursuit of developmental macroeconomic expansion.

The early postwar years in Greece were characterized by immense economic turmoil. For a brief phase in 1945, reconstruction involved extreme levels of deficit spending necessary to revitalize a devastated economy,[3] and a strengthening of government economic control, strict price controls to curtail speculative efforts, heavy taxation of wealth, and extensive wage increases aimed at restoring sociopolitical stability. This short-lived Keynesian experiment was led by Professor Kyriakos Varvaressos, minister of reconstruction, favored by the British, who were then keen on promoting a Keynesian-type recovery.[4] It failed, mostly under the pressure of the business sector which cut down on production and resorted to hoarding, while farmers turned to the black market's higher prices, and workers protested against the economic dislocation (Makinen 1986: 801–2; Kofas 1989: 23–4). Combined with the extensive speculation on the drachma and the hoarding of gold, these developments further aggravated the existing hyperinflation. However, the mostly laissez-faire policies that followed, far from managed to reverse the situation. Amidst extreme politico-economic and financial instability the central bank's foreign exchange reserves were depleted, the hoarding of gold continued, while the misappropriation of foreign aid funds and commodities by a small government-connected

economic oligarchy assumed scandalous proportions (Kofas 1989; Eliades 1954: 23ff).

Under the surveillance mechanisms established with the 1948 signing of the Marshall Plan aid, a clearer and more orthodox orientation was imparted to the Greek economy under the tutelage of the American mission. The US applied strict conditionality and a tight surveillance mechanism accompanying its postwar loans and Marshall Plan funds, demanding restrictive macroeconomic management (Kindleberger 1993: 432; Helleiner 1994: 62ff). The orthodox orientation was combined with an excessive concentration of control in the hands of the 1946-founded Currency Committee (to be discussed extensively in Chapter 3). As in a number of other European recipient countries (including Britain, West Germany, and France), the institutions that accompanied Marshall aid determined the formative stage of postwar economic development, maintaining a heavy influence in support of market growth, relatively open trade policies, and macroeconomic discipline.

At the same time, the increasing presence of Keynesian economists among the US economic advisors in Marshall Plan recipient countries (Hirschman 1989: 350) encouraged an ideological disposition toward more active government interventionism (what we may call a 'contextual Keynesianism'). Undoubtedly, the structural conditions of a developing country did not allow it to rely on the demand management instruments normally activated in advanced capitalist countries. Indeed, the Keynesian prescriptions of that time were ideally suited for closed industrial economies with rigidities in the labor market and a well-developed financial system. They were less appropriate for small, relatively open underdeveloped economies, where a demand stimulus risked generating a balance-of-payments crisis, and much less appropriate for agrarian societies with questionable effective demand and a limited banking structure (Hall 1989: 372).

In other words, external dependency and domestic structural conditions in Greece privileged a policy strategy that combined adherence to the neoclassical precepts of macroeconomic discipline with a degree of government interventionism, especially in the monetary sector, to confront the market failures associated with the status of a developing economy. Indeed, for a developing country, the acceptance of a higher degree of state interventionism than the one normally sanctioned by the neoclassical tradition favored receptiveness toward the developmentalist economic outlook and policy prescriptions. The presence in power during the 1944–52 reconstruction period of mostly centrist-liberal (but weak and unstable) governments further facilitated the adoption of a middle-of-the-road economic outlook.

Devaluation, restoration of monetary stability, and the outward-looking developmental strategy

The turning point was the April 1953 devaluation of the drachma, from 1-to-15 to 1-to-30 vis-à-vis the US dollar, that launched a successful stabilization of the economy. A range of government controls and regulations were abolished. Except for customs duties, all import and exchange controls were relaxed.[5] Quantitative restrictions on imports were replaced by moderate tariff rates, and the import of capital goods for large investment projects was exempted from tariffs. Combined with the monetary stability established after 1955, trade liberalization allowed cheaper imports of raw materials, capital goods, and modern manufacturing equipment. In effect, the relative liberalization of 1953 meant more than the simple adoption of an outward-looking developmental strategy, as it made possible the building up of a productive industrial sector and a sizeable domestic demand that would enable the shift to more systematic production of import substitutes (Coutsoumaris and Westebbe 1965: 189ff). Thus, ISI became the most crucial component of the post-1953 outward-looking developmental strategy. It should be emphasized that at least until the 1960s (when it began to champion open trade) the US was rather ambivalent if not supportive of the adoption of ISI policies by developing countries in its sphere of influence. That was not least because ISI regimes allowed internationally oriented firms to benefit either by providing capital goods to the expanding industrial sector of these countries or by taking advantage of the trade barriers to invest there directly and extract the rents provided by those barriers (Maxfield and Nolt 1990).

The 1953–55 liberalization momentum was short-lived. Import restrictions in the form of nontariff barriers were beefed up, especially during a 1958–60 stagnation of production combined with a deteriorating balance of payments. However, Greece's Western geopolitical integration and regime dependency prevented the balance-of-payments constraint from turning ISI into a course of economic autarky, such as those followed by the authoritarian economies of Spain, Portugal, and Latin America after the 1930s and into the postwar period (Hirschman 1971).[6] The export orientation of the Greek economy was to be propped up in the 1960s through stronger fiscal, credit, and other incentives in view of the Association Agreement with the EEC, and after realizing there was inadequate growth of exports, especially in view of the failure in changing their composition from agricultural to industrial goods.

The 1953 reform was strongly influenced by the successful monetary reform of West Germany.[7] In 1948, the Deutschmark was fixed at a new

competitive, underpriced parity, trade restrictions and administrative controls were abolished, and Germany's market-based, export-led rapid growth was launched. The intent of the 1948 reform was to create a credible currency, and to expand the supply of goods and services rapidly, before the money demand created by the monetary reform translated into inflation (Boltho 1996: 113ff). Clearly, there was no comparison between the advanced, world competitive industrial structure of Germany (which revived very rapidly after 1945) and the rudimentary manufacturing base of an underdeveloped Greek economy, which rendered chimerical the pursuit of export-led growth. However, the 1953 reform did impart a considerable degree of foreign-trade orientation to the Greek growth strategy, one that would be more pronounced in the second half of the 1960s. Until then, a manufacturing base would be propped up with the ISI developmental armory.

Foreign-trade orientation was in full accordance with one of the principal Marshall Plan objectives of stimulating European exports and raising foreign exchange so as to reduce the large balance-of-payments deficits. (Figures 2.1–2.3 demonstrate the GDP share of exports and imports and the degree of openness of several European postwar economies.) Not all European countries were subject to the same external constraint. One of the two most prominent exponents of the cheap-credit growth strategy (Pérez 1997a), Spain, being excluded from the Marshall Plan, had eschewed such a type of external disciplinary mechanism. The other, France, quickly subscribed to its own strategy of a partly nationalized and highly administered economy, followed by

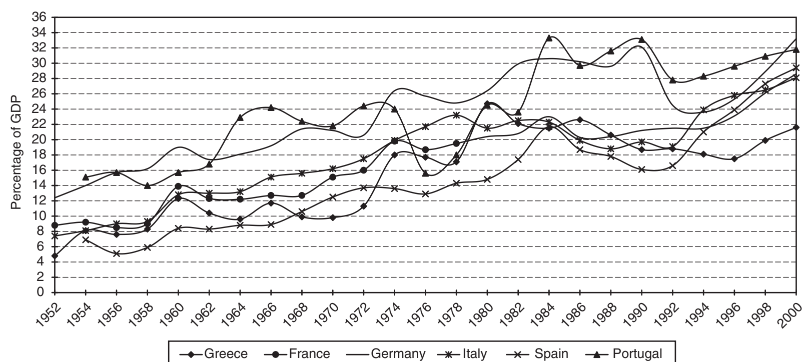

Figure 2.1 Exports as percentage of GDP: Greece and other European countries.*

* IMF data for 1950–58, not including services; EC data after 1960, including services.
Sources: IMF (1965), European Commission (2000c).

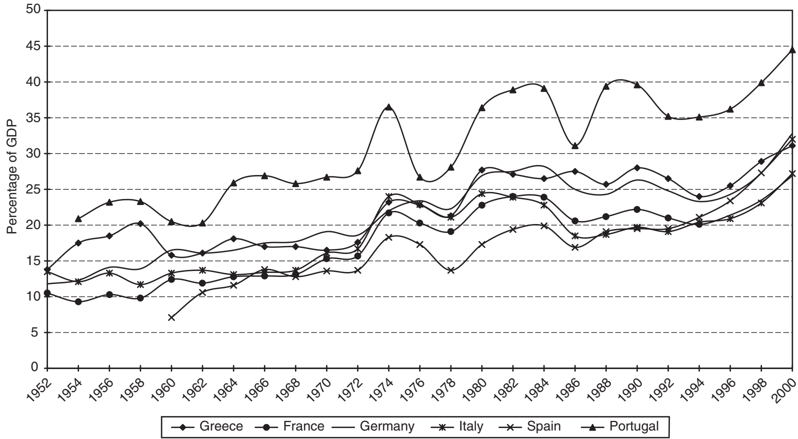

Figure 2.2 Imports as percentage of GDP: Greece and other European countries.*

* IMF data 1950–58, not including services; EC data after 1960, including services.
Sources: IMF (1965), European Commission (2000c).

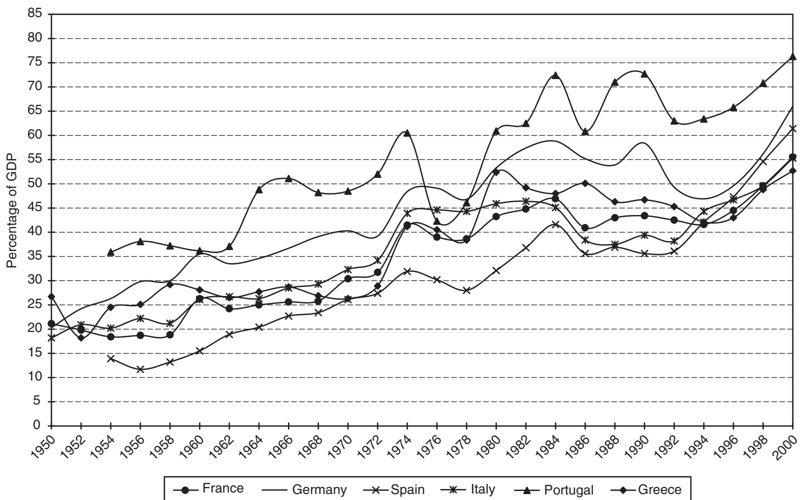

Figure 2.3 Openness (exports + imports as percentage of GDP) of European economies.*

* IMF data 1950–58, not including services; EC data after 1960, including services.
Sources: IMF (1965), European Commission (2000c).

institutionalized monetary laxity – the eventual point of convergence between a nationalistic Right and a pugnacious Left.

External regime dependencies were reflected in the limited range of domestic political options. Contrary to countries such as postwar France, where state regulation of credit and the economy was subject to serious debate between the socialist and the liberal/conservative wing of the Resistance's political leadership (Pérez 1997c: 183ff), the unqualified ascendancy of the conservative anticommunist regime in Greece narrowed the scope of the respective economic debate. Similarly, the composition of the governing and technocratic elite was not characterized by political inclusiveness (as in France, or even Italy, where the Banca d'Italia came to employ many Communist Party adherents). In the late 1940s and through the 1950s, Greek government and policy actors seeking to preserve their viability within the system were culturally, ideologically, or just tactically placed on the receiving end of US-approved policy models – as with the postwar German reforms. Like 1948 West Germany, 1953 Greece was characterized by a minimal political autonomy to forge a nationalistic economic strategy, such as that followed by France or Spain. International regime dependency and an incomplete development of domestic democratic institutions imposed a high degree of policy conformity.

Under the institutionalized structures of American politico-economic tutelage in a cold war world, there were few chances of considering any policy strategies departing from a fundamentally capitalist mode of development. Thus, calls for a bolder subordination of economic resources to state control, and a more command-oriented version of indicative planning toward the objective of heavier and faster (the unspeakable word: Soviet-type) industrialization were easily marginalized, at least until the 1960s.[8] When in the politically radicalized 1960s, a more expansionist and interventionist version of economic policy began to gain popularity, the army and the throne stood guardians against any substantial diversion from the economic and especially political blueprints of national rectitude (as the post-1965 events showed).[9] In the heavily charged cold war context of the early postwar period, any explicit defense of heavier state planning, let alone nationalizations, was tantamount to an admission of communist proclivities. Indicative, however, of the industrialization-oriented developmental outlook that assigned an important – though varying in its specifics – role to the state was that both the orthodox developmental strategy championed by Professor Zolotas (see below), and the left-wing inflation-accommodating version of heavier interventionism toward full-scale

industrialization,[10] both these views shared the lowest common denominator of state-assisted industrialization as the single path to economic development. Corroborated by the verdicts of nearly every international organization of the time as well as the American Mission, 'development via industrialization' was elevated into gospel truth. This broadly held belief in the urgency of industrialization meant other alternative strategies became quickly ostracized.[11]

The 'Greek economic model': ideology, strategy, and practice

If the regime dependencies and structural constraints of postwar Greece bestowed an 'orthodox' orientation to economic policies, the ideological origins and identity of the individual protagonists of economic policy helped translate this general structural predisposition into a specific policy mix.

Chief architect of postwar economic and especially monetary policies, Professor Xenophon Zolotas ruled as Bank of Greece (BoG) governor between 1955 and 1967 when, after the rise of the junta, he resigned. (He was reinstated in 1974–81.) Zolotas was educated as an economist in Germany, and witnessed the hyperinflation eroding the socioeconomic foundations of the Weimar Republic. Later on, as a prominent economist and policymaker with the BoG after the country's Liberation, he experienced the hyperinflation of the 1940s. He was driven by the price stability commitment that guided a generation of leading German economists of the postwar era, while also being an adherent to the kind of state-assisted, bank-led industrialization which had built Germany's robust economy in the previous century. Thus Zolotas shared a common conceptual framework with the 'ordoliberal' school of German economic thought which was represented, on the contemporary political scene, by Alfred Müller-Armack and Ludwig Erhard. So did two of the other principal economic policymakers of the conservative postwar cabinets, Spyridon Markezinis (coordination minister and protagonist of the 1953 reform) and Panagis Papaligouras (in charge of the Coordination, Industry, and Commerce ministries under various conservative governments) (Psalidopoulos 1996).

These influences imparted on Zolotas and other chief economic policymakers a deeply held belief in the primacy of monetary stability and in the value of the market price mechanism, combined with the understanding that the latter's normal function was conditional upon the existence of a developed economy which Greece lacked at that time.

Operating in parallel with these influences was the developmentalist school, which already in the 1950s provided the mainstream policy blueprint for developing countries. Works like Nurkse (1953) were compulsory reading in the BoG research department. In the 1960s, writings by Lewis and Rostow became the gospels of development, their ideas reverberating in the economic analyses and policies formulated by Greek state institutions. The developmentalist framework of ideas and policy prescriptions was significantly compatible with Keynesianism, as argued in Chapter 1.

Given the crucial developmentalist influence, one understands why any effort to classify postwar Greek economic policies exclusively in terms of Keynesian or neoclassical economic ideology fails to do justice to the eclecticism of policymakers, the various path dependencies that defined them, the sociopolitical and ideological context that surrounded them, and – not to be discounted – the inherent empiricism and political expediency of any real-world policy project (cf. Kazakos 2001). In an effort to place the Greek case along the Keynesian–neoclassical continuum[12] one should not overlook the predominantly developmental character of the Greek state's postwar economic role and objectives, necessitating a different prioritization than the one followed by either a typical market-liberal or a Keynesian state.[13] For instance, the role of banks as development instruments cannot be identified with either a neoclassical or a Keynesian tradition. Neither are low interest rates exclusively indicative of a Keynesian disposition: developmental states, otherwise built on solid neoclassical precepts but keen to allow firms to build up capital structure, long sought to keep interest rates below international rates if not negative in real terms (for example: early postwar Japan and South Korea), while others (like Taiwan) did not (Pempel 1999: 150).

The use of fiscal policy was revelatory of the eclectic coexistence of developmental with orthodox-neoclassical as well as (mostly from the 1960s) Keynesian policy prescriptions. The neoclassical underpinning was evident not only in the rigorous commitment to monetary stability but also in the avoidance of budget deficits. From 1957 through 1973 the ordinary budget was usually balanced or posted a surplus which served to finance (along with domestic and foreign borrowing) the investment budget.[14] After 1958 public investment increased with average annual rates ranging from 18 to 30 percent, but this is no more a 'Keynesian' than a 'neoclassical' feature for a developing country lacking both the necessary infrastructure and (to a certain extent) the accumulated private capital to finance it. Yes, deficit financing was employed, but, normally, strictly for capital investment. The government

emphasis on concurrent industrial investments in a number of industrial sectors pursued the idea of the 'big push' associated with developmentalists such as Rosenstein-Rodan: that was meant to release the chain reaction of complementary investments by the private sector that would feed the virtuous circles of growth. Financial dirigisme formed a most prominent instrument for deficit financing. Increasingly over the 1960s and into the early 1970s governments resorted to domestic borrowing to finance investment, the BoG providing on average over a quarter of the deficit financing. From the end of the 1950s and especially over the 1960s, a growing part of the government's public investment program was financed – instead of BoG advances – by the banking system through interest-bearing Treasury bills and other credits, as well as (after 1960) through the government's resort to the domestic bond market. After 1958, commercial banks were obliged to invest, in interest-bearing Treasury bills, 18 percent (subsequently in 1963 raised to 20 percent) of their average monthly increase of private deposits for financing public investment. Nominal interest rates on Treasury bills were fixed at the levels of 5–6 percent until 1972, amounting to average real rates of less than 2.5 percent for the 1960–72 period. The issue of government securities also served to absorb a part of the surplus savings in the economy, reducing bank liquidity.

Thus, although Greek economic policies in the 1950s and 1960s were not immune from the heterogeneous influence of contemporary economic ideas, one may clearly identify developmentalism as their most distinctive feature. Over the 1960s, as one developed country after another was subscribing to Keynesianism, Greek economic policy was indeed becoming increasingly expansionary and interventionist in the effort to accelerate industrialization. To the extent that such tendencies are typically associated with the Keynesian revolution, a Keynesian influence can be discerned in the readiness to make countercyclical use of monetary and fiscal policy on the downswings of the business cycle.

Countercyclical policies were applied for example to counter the economic slowdown of 1959–60, which was combined with the fear of a growing influence of the Left after 1958.[15] It was then also under the menacing spectrum of growing discontent with the conservative regime that the right-wing government of Constantine Karamanlis watered down its balanced budget commitment to adopt measures such as promoting public housing, universal farmers' insurance, and expanding employment through public construction projects. In a case like that, apart from advising government ministers to double their spending budgets,[16] the BoG shifted to aggressive monetary and credit expansion to

provide a stimulus to effective demand (Zolotas 1965: 52). In accordance with most OECD countries (whose public deficits were more or less kept under control until the early 1970s with very few countries exceeding 2 percent in GDP terms), monetary rather than fiscal policy remained the main short-term discretionary and expansionary policy instrument. Of Keynesian influence but also an integral element of developmentalist thought was what Zolotas referred to as the essential need for 'an effective expansionary impulse' to secure a high rate of utilization of available resources, necessitated by the 'limited factor mobility and the slow reactions of businessmen in less-developed countries' (Zolotas 1965: 15).

Indeed, money supply expansion (M1) was well above GDP growth rates for most of the 1955–73 period. As money supply growth was mostly used for investment, and expanding capacity in the economy, any increased demand failed to translate into inflation. Indicative of the expansionary monetary orientation was the fact that throughout the high-growth period of 1960–72 the main interest rates remained almost unaltered and kept below market clearing levels, whereas high economic growth rates should have normally pushed interest rates upwards. The cyclical character of monetary policy could be claimed to have been more a matter of variations in the degree of expansion than an alternation of expansion and contraction (Karamessini 1994: 136). Operating in the Bretton Woods framework of a fixed exchange rate and capital controls, monetary policy was thus able to sustain a virtuous cycle of growth with stability. Any inflation differential that favored the drachma amounted to a depreciation of the real exchange rate and improved competitiveness for the Greek current account. To the extent to which, during that period, the inflation rate in Greece tended to be overall lower, relative to its main trading partners, Greek exports were favored and imports were stemmed.

From the moment financial interventionism was enlisted in the service of inflation-free economic development, it became possible to offset the undesirable effects of monetary expansion by activating direct credit policy instruments such as quantitative controls and special reserve requirements. This dual function of credit interventionism (for expansion and for stabilization) gave it a self-correcting character that probably helps explain its longevity in the hands of monetary authorities. Thus a strategy of lower-cost credit to targeted sectors was made compatible with a fundamental commitment to maintaining monetary stability. Whenever credit expansion came to the point of threatening price stability and the external balance, credit rationing took over, limiting the degree of available liquidity without having to raise interest rates. In that, credit

policy – rather than fiscal policy – was the Greek postwar state's principal countercyclical instrument. The mechanism of credit controls and rationing allowed the BoG to reconcile the apparently contradictory objectives of monetary stability and low interest rates (cf. Pérez 1997b: 186).

The resulting synthesis between a steadfast commitment to monetary stability and developmental interventionism in finance thus formed the cornerstone of Greece's postwar model of economic growth. The policy mix rested on the doctrine of the long-run mutual interdependence between economic growth and monetary equilibrium (defined to include both price stability and the external sector, that is both internal and external monetary stability). In other words, while in the short run one could accept the possibility of a trade-off between these two objectives, in the longer run both objectives had to coexist as complementary lest the disproportionate and 'undue emphasis' on either would end up undermining both (Zolotas 1965: 1–2). In Zolotas's wording, 'monetary stability cannot be maintained in the longer run in a stagnant economy and … satisfactory rates of growth cannot be maintained steadily in an environment of monetary instability' (Zolotas 1965: 45). In tune with the classical–Keynesian synthesis of its time the doctrine did not lay claim to any great originality, but for the interesting absence of any mention of full employment as an objective.

According to this orthodox outlook, the rejection of a Keynesian (or purely inflationist for that matter) strategy of creating effective demand as a way out of Greece's considerable unemployment and underemployment was grounded on the recognition of Greece's underdeveloped status of the 1950s and 1960s. The structural shortcomings of a developing economy (organizational inefficiency of the private and public sector, severe inadequacy of managerial and labor skills) pointed to serious bottlenecks on the supply side, indicating the necessity for structural interventions in those areas. Any monetarily induced excessive expansion of demand was rejected on the grounds that it would only result in external deficits and inflation without positively affecting real income or the economy's productive potential (Zolotas 1965: 7ff). One could even read a deferred Keynesianism in that approach, championed by the BoG: demand management and 'embedded liberalism' (Ruggie 1982) were not rejected as flawed, but as structurally premature, as a case of putting the cart of managing demand toward eliminating unemployment before the horse of developing a productive market structure. Instead of being used as an instrument for fine-tuning aggregate demand toward price stability or full employment, fiscal policy was primarily aimed at enlarging the economy's productive potential. The supply-side commitment

of fiscal policy was mostly directed toward expanding the volume of savings and channeling them to investment. While the first (expansion of savings) was served mainly through tax incentives, in the second objective, tax measures were compounded by policies of government activism, deficit spending for the build-up of national infrastructure, and the establishment of development institutions.

This focus on supply rather than demand was not in recognition of the time lag between identifying a recession and applying a countercyclical stimulus – even though a conservative reluctance for deficit-financing had a lot to do with it. Indicative of a neoclassical-developmental outlook, eliminating unemployment was not regarded as an intrinsic component of optimizing the rate of economic development, as would be the case with advanced economies. On the contrary, it was deemed that seeking to maximize the labor employed per unit of investment would likely end up undermining the paramount objective of development optimization (Zolotas 1965: 185–6). From the moment then that the country's unemployment or underemployment problem was considered as structural, the government was freed from the duty of having to confront it by pouring money into the economy – as it had done briefly in 1945. Massive outflows of labor abroad took care of unemployment, with emigration peaking in 1972–73, when the economy reached the point of almost full employment.

In a way, the commitment to price stability substituted for the dearth of a broader social equity component in economic policy. In an economic and financial system biased in support of larger private enterprise, based on predominantly regressive taxation combined with significant tax concessions to capital holders, and characterized by relatively high toleration of unemployment and underemployment, with a rudimentary welfare state, the promise of 'universal' price stability was perhaps the only substantial element of a socially inclusive and 'egalitarian' economic strategy embedded in the developmental policy mix of the conservative political regime.[17] Apart from threatening the economic sustainability of growth, inflation also stood indicted of eating away at the real income of weaker economic strata, whose meager savings did not allow investment in inflation-safe assets.

Eventually, a relatively high tolerance of unemployment and the continuous existence of significant labor surpluses offered the additional political advantage of keeping labor demands under control. These factors, in any case, eroded labor bargaining power, but it was mostly the state corporatism of the 'guided' postwar democracy that kept unions on a leash. Indeed, if real wages were allowed to increase in the 1950s, it

was mostly to recover the large real income losses incurred during the extensive previous period of hyperinflation. Overall in 1960–73, real wage increases lagged substantially behind GDP growth rates. The first half of the 1960s brought a relatively more expansionary turn of incomes policies, which was more a function of the accumulating pressures and demands on the sociopolitical level (the political strengthening of the Left, and the 1963–65 rise to power of the Center Union government) than of a substantive change in economic policy doctrine. Overall, as the real rise of wages was accompanied by significant gains in productivity, their inflationary impact was suppressed. Given the low marginal productivity of agricultural labor, the reallocation of the workforce to manufacturing especially over the 1960s resulted in rapid increases in aggregate productivity per worker which offset wage rises. Needless to say, fear of inflation and a focus on the supply side meant that wages were not viewed through Keynesian lenses, that is as a determinant of effective demand. Instead they were seen primarily as an element of the cost of production, and thus as instrumental (if kept reasonably suppressed) to industrialization.

The outward-looking developmental strategy was significantly predicated on a continuous effort to restrain domestic demand in order to sustain a viable trade balance. Low levels of public spending (excluding investment), government-imposed wage moderation, regular appeals to the communal virtues of thrift (alerting against the vices of 'conspicuous consumption'), all worked toward that objective. At least until the intensified mobilization of sociopolitical dissent after the early 1960s, the suasion exercised by fluctuating degrees of political oppression combined with the unemployment specter ensured a considerable (by West European standards) extent of social acquiescence to wage suppression.

All that said, an inevitable question to be asked is the following: was postwar economic growth export-led, or was it led by demand? In spite of the much promoted and advertised export orientation of the postwar economy, there is by now strong agreement in the literature that the economic expansion achieved in the 1955–73 period was in fact not led by exports. Export promotion policies (to be looked at more carefully in Chapter 3) were relatively successful after 1965 in altering the composition of exports in favor of manufactured and semimanufactured goods replacing primary goods (Figure 2.4). Moreover, exports as GDP share overall increased steadily during the 1960s and 1970s. However, despite such significant improvements, exports were unable to keep up with the acceleration of imports, largely associated with the rise of domestic

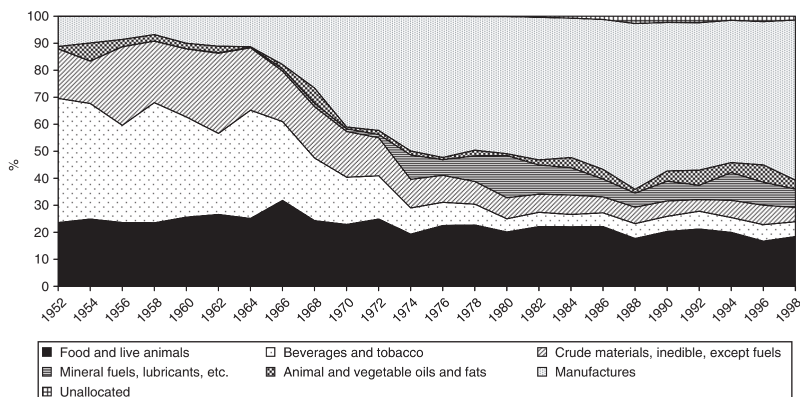

Figure 2.4 Greek exports of manufactured goods as percentage of total exports, 1952–98.

Source: Greek National Statistical Service (*Statistical Yearbook*, various issues, 1954–99).

demand, especially from the mid-1960s (Figures 2.1–2.2). In other words, compared to genuinely export-led-growth economies, the rate of increase in exports through the period in question was unimpressive, and most probably driven by, rather than being the driving factor of, growth. Several studies corroborate this conclusion (Lianos et al. 1990: 91; Kosteletou 1994; Riezman et al. 1995; Dimeli et al. 1997: 82).[18]

Despite the official denunciation of 'inflationary' demand expansion by the chief economic architects of the postwar period, the evidence suggests that growth was indeed demand-led to a significant extent, at least from the 1960s. Contrary, however, to other country cases where growth resulted from a concerted government targeting of higher wages and full employment as in Japan since 1960 (Yotopoulos 1996: 197ff), in the case of Greece effective demand was sustained by other means, some of which were intended and some the unintended consequences of government interventions:

(a) an ISI policy that systematically tolerated and supported an archipelago of small, family-based enterprises that absorbed a considerable proportion of the unemployed and underemployed;
(b) small, family-based commercial firms along with the ubiquitous and extensive side-economy. It was due to the extensive side-economy, self-employment, and multiple employment (Tsoukalas 1987) that real incomes of the middle-to-lower socioeconomic strata were higher than they officially appeared;

(c) the continuous agricultural subsidies (increasing after 1963 and during the junta) which in a country employing more than a quarter of its workforce in the primary sector amounted to a virtual incomes policy for the weaker strata;
(d) the incoming remittances from emigrant workers and seamen, supporting the purchasing power of the poorer socioeconomic strata and the periphery;
(e) the exponential growth of the housing sector over the second half of the 1950s, and through the 1960s and 1970s, constituted one of the most important pull factors of demand.[19]

As an expansionary policy for a developing, small open economy, housing construction held the important advantage of being both labor intensive and of a low import content. Pivotal in the sustained housing boom (apart from generous building licenses, and various measures facilitating the acquisition of small property) was the legal regime established in the second half of the 1950s, authorizing the exchange of building plots for apartments in the condominiums constructed upon them. As the system was largely self-financed, it could survive without bank credit (monetary authorities extended mortgage loans very sparingly until the 1970s, and rationed credit heavily against housing constructions). The construction boom led to low housing costs, which raised the people's disposable income. At the same time it decreased the cost of doing business, forming an indirect subsidy to the mass of small employers, driving down the wage bill of the production sector. Moreover, the significant linkages of housing constructions with other industrial sectors (cement, iron metallurgy, timber, and so on) were highly conducive to economic growth.[20] In its simultaneous expansion of both supply and demand, the housing industry may be claimed to have offered an original application of Nurkse's 'balanced growth' strategy.

Such structures and mechanisms counterbalanced to a certain extent the regressive character of taxation (with indirect taxes accounting for over 55 percent of total government revenues in the 1950s and 1960s) and the weakness of formal redistributive policies (as will be briefly discussed below). Only by taking these factors into account can one explain the relatively high growth of per capita private consumption in the 1960s and 1970s compared to OECD countries,[21] which becomes even more impressive if one considers Greece's relatively low income inequality, especially compared with the developing country group. It was also through these structures and mechanisms (along with an inbuilt expansionary orientation of monetary and credit policies) that

the equivalent of a Keynesian-type effective demand was allowed to be created, providing a stimulus to economic growth, despite the authorities' official stance against 'inflationary' consumption.

One can then explain the discrepancy between the actual role of demand as an engine of growth and the monetary authorities' proclamations to the contrary as a systematic effort of the BoG to underscore an uncompromising commitment against inflation, in order, among other objectives, to sustain a set of positive (and hopefully self-fulfilling) expectations about monetary stability. The fact that the BoG governor (a chief policymaker and the government's principal official economic advisor) held a considerably different view regarding the role of demand, is also an indication of the heterogeneous and often haphazard conditions that shaped real economic policymaking – as will also be illustrated in Chapter 3.

The political economy of developmental policies: a state-driven pattern

The removal of trade barriers after 1953 (to an extent paralleled at that time by only a few European countries) released a considerable growth potential. It also necessitated an even more activist and discretionary role on the part of fiscal, monetary, credit, and industrial policies to counteract the effects of trade opening on the balance of payments as well as on domestic production. Contrary to advanced European countries, these instruments of state intervention and industrial protection (discussed in Chapter 3) were not adopted with the principal purpose of guarding against the redistributive repercussions and socioeconomic inequalities produced by the market process. They were rather aimed, mostly, to offset the tendency of a system relying on incentive-based suasion rather than prohibition to undermine productive investment and development, by means of directing resources to consumption, hoarding, and 'unproductive' activities. In that sense, the institutions and policies of administrative discretion, controls, and restrictions that formed the system of Greek industrial protectionism and financial interventionism were not meant to contradict but to complement functionally Greece's otherwise relatively open trade developmental orientation.

The pattern of increased state intervention to offset the dislocating effects of liberalizing trade is familiar in the literature (Cameron 1978; Rodrik 1998a). In the case of a postwar developing country, this affirmed state role did not take the form of consensus-seeking welfare state or neocorporatist institutions (Katzenstein 1985). Instead, compensatory

government activism relied crucially on instruments of stabilization (such as quantitative credit controls, which by limiting credit expansion to trade were enhancing the pool of finance to domestic production) as well as sectoral protectionism (such as selective credit subsidies). Such types of instruments were provided by financial interventionism. Trade opening created the need to counterbalance its effects on domestic production through protectionist policies of ISI, and to sustain an outward-looking mode of development through selective support to the export sector. Add the imperative of succoring agriculture, and the tremendous political temptation of administered finance as a particularistic instrument, and the advantages of state interventionism and credit dirigisme appeared impregnable.

It is worth emphasizing the state-driven pattern of developmental protectionism. The state aimed at nurturing a new entrepreneurial middle class as part of the cold war project of regime consolidation, both at domestic and international level. It was the postwar state's objective function as defender of the Western politico-economic order, rather than the state's own internal resources, from which the state drew its authority, as somehow a surrogate of an overarching external regime. It was certainly not its own executive coherence and continuity (especially given the serious government instability until 1952) nor its autonomy vis-à-vis private interests (given the incestuous ties connecting postwar political elites with the thin economic oligarchy of the time) that allowed the state to rise above socioeconomic demands or, more accurately, to preempt them. Thus protectionism was supplied without having to be demanded. Being the chosen category entrusted to deliver economic development, industry was sheltered from foreign competition, propped up with all kinds of incentives and subsidies, and showered with credit, as will be seen in Chapter 3. This focus on the state supply of developmental policies, as opposed to their resulting from socioeconomic demands, needs to be further elaborated.

Standard analyses of developmental economic strategies, while inevitably hypothesizing some type of state strength (in the sense of economic nationalism, developmental interventionism, or plain political authoritarianism) circumscribed by the broader external regime and domestic structural dependencies (resource endowment, level of development, institutional legacies, and so on), are somehow ambiguous as to the importance they attach to the role of group interests. Quite assertive in that respect (and echoing rent-seeking approaches – Krueger 1974; Olson 1982) is Haggard's (1990) society-centered analysis, viewing economic reforms as responsive to particularistic group interests

(farmers, traders, the new industrial class, the small handicraft and manufacturing sector, civil service) that can lead to collectively suboptimal outcomes. Among such policy reforms potentially modeled as collective action problems Haggard includes stabilization, devaluation, trade liberalization, opening to foreign direct investment, fiscal, tax, or financial-market reform (Haggard 1990: 260–1).

However, one may assert the presence of entrenched rent-seeking interests around state-distributed economic resources without necessarily having also to attribute the initial adoption of these state policies to the mobilization of the related interest groups. As state protectionism offered to producers and other economic groups evolves and becomes consolidated, the political power of such groups (and their resulting ability to defend their protected status) grows too, having been at its weakest at the time of the inception of the protectionist policies. The argument should hold even stronger in a developing country like Greece, whose productive base was largely decimated by the war, the few surviving distributive coalitions having reemerged with their influence severely curtailed.

Put differently, interest group-based analyses assume a degree of societal organization that somehow antedates state decisions and strategies. This is what Garrett and Lange (1996: 74) call the 'null hypothesis of economic pluralism', that 'changes in the constellation of preferences in the private sphere will be quickly reflected in commensurate changes in public policies and institutions'. By positing collective action problems and the suboptimality of collective outcomes resulting from particularistic group pressure as the focal issues, such approaches, when applied indiscriminately, may be transposing pluralistic thinking into perhaps decisively state-centric policymaking systems.[22] An emphasis on group pressure should imply that the major socioeconomic stakes of state decisions are to be found within the market or civil society, or its historical equivalent. Greek civil society, however, in the early postwar years and through the 1950s was not even remotely capable of articulating demands to the holders of political power (cf. Tsoukalas 1987; Mouzelis and Pagoulatos 2002). As for the market, its survival was essentially a matter of state protection. Explaining state decisions on the basis of interest group influence should presuppose not only an ability of groups to exert their influence, but also a pluralistic framework within which such influence could possibly generate an impact, that is make a policy difference. Such a pluralistic framework did not exist in the Greek postwar regime, especially in its formative stages. Moreover, a pluralistic explanatory approach should logically imply the existence of multiple

and substantially different competing policy alternatives, one of which would be finally selected (also) as a result of the definitive group pressure. However, the nature of the regime and the national structural endowment, made possible only one of these potential alternatives (that is, an ISI strategy that retained a foreign-trade orientation and which was premised on monetary stability) to the point of rendering any others a priori politically or economically nonviable. Then group pressures could not be claimed to have had a definitive impact.

It is different if one speaks not of pluralist-type organized collective interests, but of individual interests taking advantage of elite access to political power-holders to extract favorable particularistic regulations. Historical and press accounts abound with references to the wealthy rentier and business class that surrounded government policymakers in the highly oligarchic democratic politics of the early postwar period. Powerful domestic private interests could make a difference in defining the specific and individual distributive gainers from industrialization, but not the fundamental policy coordinates of the developmental project. To reiterate the full point, industrialization of the particular kind was launched as a result of decisions taken at government/BoG level, without a definitive and formal societal input other than the lateral and largely personalistic or kinship ties linking political decision-makers with the postwar economic oligarchy (either what had remained of its old prewar component, or what had emerged as the wartime-nurtured, black-market-fed nouveaux riches). The state's powerful developmental armory (special licenses and restrictions, ad hoc exemptions, selective tax and other incentives, direct and indirect subsidies, and all kinds of interventionist financial policies) was inherently susceptible to particularism. From the moment the main strategic directions had been crystallized and the instruments of financial and industrial activism had been launched, the demand conditions were created for the mobilization of status quo business interests to increase their share of distributed benefits by extracting particularistic regulations and concessions often in the forms of selective exemptions from restrictive rules. Over the years, selective credit and other policies led to the formation and entrenchment of the corresponding groups of demanders, strategically oriented toward consolidating and further expanding their rents from industrial protectionism. In the process, as the 'guided democracy' of the postwar era developed, as elite political antagonism sought further footholds through access to mass mobilization, socioeconomic groups and interests pursued a higher policy impact even within the narrow confines of state corporatism.

All the above also explains why formal collective interest associations are omitted at this stage of the discussion. (They will be brought back in Chapter 6.) The dominance of lateral, particularistic politics in industrial and credit policymaking implies a more limited role for formal interest groups. Clientelism as a vertical, unintermediated form of state–society integration cancels the impact of encompassing and official interest representation. In the fragmented universe of clientelistic rent-seeking, sectoral, sectional, or individual socioeconomic interests compete with each other to extract government-controlled resources, and are ready to pursue them through means such as lateral access to power-holders, personalistic elite networks, and other informal substructures of resource dependency. However, the most defining feature of postwar policymaking lay not on the demand side but on its supply side, that is on the overarching power of state policymakers to impose unilaterally economic policy arrangements unhindered by procedures of policy consultation with formal interest representatives. In so far as labor policies and industrial relations were concerned, this overarching government power was expressed qua state corporatism. In credit policymaking, state unilateralism was identified with the Currency Committee and the BoG's central role within it, geared to the implementation of a developmental policy blueprint (encouraging manufacture and exports, penalizing consumption and imports) that left little room for pressure-induced diversions in anything more than determining the specific beneficiaries.

Winners and losers of the post-1953 political economy

Much like stabilization programs in other European countries (Italy in 1947, France and Germany in 1948) the Greek 1953 macroeconomic reform (and the persistence of a most probably undervalued currency through the rest of the period) generated its own direct gainers and losers. Real wages were suppressed and a transfer of resources was implemented with the drachma devaluation from rentiers and wage-earners to factors of production operating in the tradeables sector. Indirect taxation was intensified and direct taxation was alleviated to restore the saving power of capital holders deemed indispensable for productive investment (Hadziiossif 1994: 30). Given the program's dire redistributive direct effects for wage-earners and the population in general who saw their purchasing power shrink, it can be stated that the political regime's considerable authoritarian elements (not to discount the strong electoral majority enjoyed by the right-wing government of Field

Marshal Alexandros Papagos) served to facilitate the program's implementation by minimizing sociopolitical reaction.

Was trade liberalization cum devaluation an option dictated or at least successfully promoted by a coalition of economic interests, in particular banking and industry, as could be claimed to have been the case in West Germany (Hall 1983), especially given the stabilization of the drachma at a most probably undervalued rate during the years that followed? Even if we assumed that socioeconomic interests were in a position to exert influence in defining the 1953 policy outcome (which, as argued above, was not the case) the answer should still be in the negative. The maintenance of the drachma at an undervalued level constitutes a lasting subsidy for the tradeables and export-oriented sector of the economy, and indirectly benefits banks that – as in the German model – hold a portfolio of extensive industrial participation. However, in the early 1950s, the export-oriented section of industry was very limited, the vast majority of producers being oriented toward the domestic market. Exports comprised overwhelmingly primary sector goods, and the agricultural sector was incapable of articulating and effectively channeling any such policy demand. Contrary to Germany, the commercial banking sector lacked the incentive to promote (by pressure to central bank and government) an undervalued currency; long-term industrial finance in the early 1950s was still heavily underdeveloped, and equity participation of banks in industrial firms did not really pick up before the late 1950s. Thus, the banking sector, which to a great extent was under government control anyway, had no particularly strong sectoral interest either way regarding the level of the currency. Moreover, although a devalued currency may have given a competitive push to exports, it also created a burden in the ISI process by raising the price of imported raw materials, despite the abolition of various import duties. (On the other hand, it gave ISI a boost by making imports, especially of consumer goods, more expensive.) As far as the broader liberalization decision was concerned, opening trade (apart from a limited category of commercial and import interests – the latter harmed by devaluation anyway) was highly unpopular among domestic producers, who disfavored the prospect of external competition. Normally, the larger the high-skilled tradeable sectors, the greater the incentive a country has to embrace free trade (Rogowski 1989). This was undoubtedly not the case in 1950s Greece. Clearly, no domestic socioeconomic and business coalition could be strong enough to sustain the decision not only to devalue but to retain the currency at an underpriced level. Thus both decisions (a relative opening of trade and currency devaluation), its ad hoc particularistic

beneficiaries aside, were state-driven, and predominantly influenced by the regime dependencies described earlier in the chapter, including the susceptibility to a US-endorsed economic model. In that sense, the politically unpopular but economically successful reform of 1953 was the first step of a foreign-trade-oriented developmental strategy, predicated on an undervalued exchange rate.

The political uses of administered credit

Nonmarket allocative instruments are always exposed to moral hazard and can be captured by special interests. A glaring example is the political use of administered credit. Financial interventionism, and especially decisions as to the allocation of credit, was preferred by governments as a politically convenient instrument of intervention. It could target specific recipient groups, and it could benefit from lower political visibility, since it was implemented by administrative acts of the Currency Committee, which did not have to pass through the legislature. This made credit interventionism particularly amenable to political use and electioneering, as will be further illustrated in Chapter 3 (see Appendix 2). Financial interventionism was a central instrument for consolidating government control over collective socioeconomic life at least as far as financial resource allocation was concerned. In that sense the roots of state corporatism lay as much with the authoritarian tendencies of the postwar political regime as they did with the government's institutionalized ability to selectively determine the socioeconomic groups entitled to credit. By rendering the approval of finance conditional upon the organization into, for example, agricultural cooperatives or handicraft cooperatives,[23] the state consolidated and reproduced collective associations whose ability to guarantee access to financial resources for their members depended on their political approval by the government.

The archetypal case of politically manipulable as well as inflationary credit was agricultural finance. The deficit-financing of the agricultural sector (through side, off-budget accounts) was one of the principal factors responsible for the steady and often rapid monetary expansion, and thus a constant source of tension between the BoG and government. This was not unrelated to the fact that the BoG was the almost exclusive source of direct low-interest credit (in the range of 1 percent between 1955 and 1963, and 0.5 percent from 1964) to the government-owned Agricultural Bank, which was chronically unable to attract deposits. The agricultural sector was always organized on the grounds of state corporatism and the Agricultural Bank formed the government's long arm in the exercise of its

objectives (see Chapter 6). This was made possible by the complete dependence of the farmers on agricultural credit, and the complete government control over that credit. The volume and particular structure of Agricultural Bank funding were determined by the Currency Committee through monthly (for the short-term loans to farmers and cooperatives) and annual programs (for the total volume of long-term funding, and the special interest rates per loan category). The Agricultural Bank (subject to hierarchical government control but unrestrained from any qualitative credit controls by monetary authorities) was free to determine the specific credit recipients, sums, and exact procedures for granting the loans and for their repayment. Thus it was possible to distribute funds on fully clientelistic grounds, which was further facilitated by the fact that most short-term funds were not extended against any specified activity. A large portion of what appeared as loans for agricultural cultivation were in effect directed to consumption or to the purchase of urban property (Halikias 1976: 217). Agricultural credit was thus a major instrument of social redistribution. The ease of almost unconditional finance, combined with the vulnerability of agricultural production to unpredictable circumstances, created the conditions for a chronically high default rate of agricultural debt. The writing-off of agricultural debts eventually became the litmus test for the success of any government's claim to the farmers' vote.

Administered credit as substitute for redistribution

The obverse side of activism in credit policy, conservatism in fiscal policy, and repression on the political front was the authorities' abstention from developing a Keynesian-type welfare state. Developmentally oriented fiscal conservatism rejected welfare spending as economically imprudent. The fiscal basis for extending social spending (already heavily burdened with high – for West European standards – agriculture and defense expenditures) was slim. Moreover, the lack of a welfare state was compatible with the authoritarian-prone, and later in 1967–74 fully authoritarian, political regime. This was also exhibited in the other two outright authoritarian Southern European countries, Spain and Portugal, which coincided with Greece in state corporatism and the lack of welfare state institutions (Schmitter 1995; Seferiades 1998). If government could do away with labor demands through the political repression of left-wing labor unions and the appointment of regime-friendly union leaders, then little need existed for seeking to induce wage moderation through welfarist concessions and inclusion in neocorporatist

arrangements. Indeed through their control over trade unions, postwar governments could determine labor income; through the far-reaching regulation of agricultural sector prices and policies, they were able to affect primary sector income. Both were relatively suppressed, to service the objectives of industrialization and competitiveness. Postwar governments aimed at regime stability and popular acquiescence through the consolidation and expansion of a conservatively minded bourgeoisie and petty bourgeoisie, whose welfare was pursued through occupational schemes and particularistic policies such as state loans, licenses, concessions, jobs, indirect tax benefits, and welfare fund contributions. Being of a selective, excludable, and reversible nature, such redistributive instruments could cement and control clientelistic party and regime allegiances more easily than universalistic welfare state institutions.

As in other developing countries, a form of social insurance in postwar Greece was also provided through public works and public employment, the latter implying full job security (except for some periods, especially during the civil war and the junta) (Tsoukalas 1985). Again, taxing the banking system (politically induced credit from public banks to government, and the obligatory investment in Treasury bills) provided much of the finance necessary to sustain these activities.

Finally, housing policies formed an important instrument or substitute of social policy, especially benefiting the middle and lower-income strata, as already discussed. Contrary to other countries (most prominently in Scandinavia) where housing credit formed an important welfare state instrument (Tranøy 2000), mortgage loans throughout the postwar period were limited mostly to civil servants, and only expanded in as late as the 1970s.

With a 'cachectic democracy' (Nikolakopoulos 2001) of political repression, with one of the poorest and most agriculture-based European economies, and with a society largely devoid of the critical mass of culturally urbanized strata eager to lay claim to a universally higher standard of living, postwar Greece also lacked the societal demand conditions of a modern European welfare state. When social demands intensified in the 1960s under growing levels of per capita income, mass waves of urbanization, and the radicalization of political opposition, the conservative regime chose to pursue popular compliance through employing its available economic instruments. Being unable to manipulate the exchange rate, having committed its monetary policy to defending monetary equilibrium, having scant fiscal revenues to redistribute, and being tied in pursuing competitiveness through low production costs and tight incomes policies, the regime practiced politically minded discretion

through the government-controlled financial system. State-administered finance in a framework of political clientelism operated as a safety valve for defusing socioeconomic demands, forming (along with other instruments such as state jobs, special licenses, small-enterprise protectionism, and so on) the sociopolitical substitute for a European welfare state.

In conclusion

The postwar political economy was underpinned and externally circumscribed by the regime dependencies emanating both from a cold war international environment and the Bretton Woods system of fixed exchange rates. This external framework enabled (and domestic structural endowment prescribed) economic development initially pursued by ISI and financial interventionism, while retaining a foreign trade orientation and a commitment to monetary stability. The Greek postwar economic 'model' was defined in an eclectic fashion under the influence of the international ideological and policy context of its time, most prominently including the developmentalist economic orthodoxy and other policy paradigms (which will be discussed in detail in Chapter 3). These external influences were mediated by domestic sociopolitical and institutional factors as well as by the economic ideology of the principal policymakers. A state-driven policy pattern corresponding to a protected market and a deeply underdeveloped civil society characterized the postwar period. Chapter 3 offers a close examination of developmental financial institutions and policies, and an evaluation of their impact.

3

Policy Paradigms, Financial Intervention, and the Limits of Developmentalism

Developmental finance and the Currency Committee

In line with other European countries, the 1946 establishment of the Currency Committee centralized government control over the economic and financial system. This was largely inevitable given the immediate postwar circumstances. Bank assets were depleted, no new savings were flowing in, and hyperinflation remained persistent until 1951. Greece had been left in ruins, and reconstruction required new investment (frozen for nearly a decade), extensive replacement of antiquated or destroyed capital stock, and massive inflow of funds, as the banking system's lending capacity was weak. The Currency Committee supplanted the BoG in undertaking all monetary, credit, and foreign exchange policies. The Currency Committee consisted of the ministers of coordination[1] (chair), finance, agriculture, commerce, and industry, and the BoG governor;[2] decision-making was based on majority vote. The committee determined the volume of bank credit, the sectors or activities entitled to it, the exact percentages of expenditures entitled to bank finance, the specific interest rates, the terms and security to be demanded by the banks, and the exact procedures to be followed (Halikias 1978: 27–31).

The chief objective, especially after the 1953–55 stabilization, became to attract private deposits to the banking system. As long as most savings remained outside the official financial system they were directed to speculative and unproductive placements such as gold hoarding. As commercial banks were left with inadequate funds (and given the shrinking foreign aid) authorities would be forced to resort to inflationary monetary

expansion to enable the financing of the economy. So, as with other developing countries, attracting savings to the banking system was the necessary prerequisite for funds to become available for productive investment. This was achieved only after public confidence in macroeconomic stability was established in the second half of the 1950s, with the help of the attractively high deposit rates of the 1955–59 period. Subsequently, into the 1960s, deposit rates were lowered (Figure 3.1). This allowed the decrease of lending rates to industry and other favored sectors, as well as a reasonable differential between deposit rates and government bond rates, to attract investment in government paper.

Direct and selective credit instruments were causally interrelated with the structural underdevelopment of the financial markets, which limited the use of orthodox monetary policy instruments. Open market operations were effectively precluded by the thinness and virtual nonexistence of the securities market – also a result of the special investment ratios obliging banks to hold government securities.[3] Or, from the moment lending rates were fixed, and commercial banks had ample funds by controlling the majority of private savings, the discount rate had little importance, serving more as a simple manifestation of an official BoG policy stance rather than as a real instrument able to affect liquidity. Reserve requirements were the only orthodox monetary policy instrument effectively available in the hands of the BoG. However, rather unorthodox was the extensive reliance on special reserve requirements as

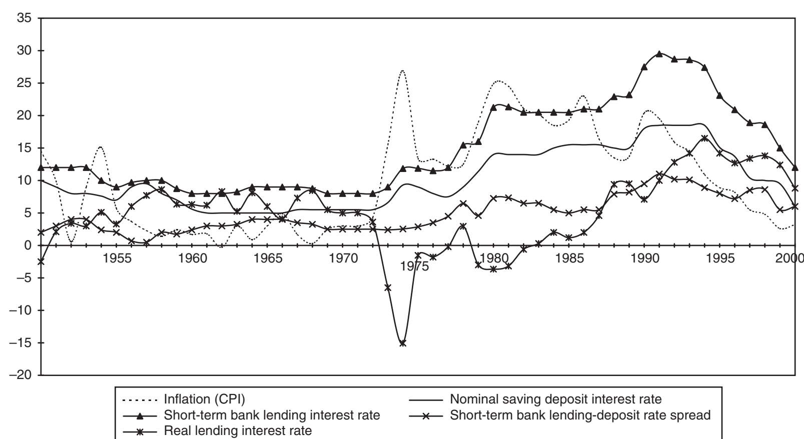

Figure 3.1 Inflation, interest rates, and short-term bank lending-deposit rate spread, 1950–2000.

Sources: BoG (1992, 2000); Ministry of National Economy.

compulsory deposits with the BoG, aimed to absorb a part of the commercial banks' excess liquidity.

The system of credit interventionism principally included: (a) a selective interest rate policy ensuring lower fixed lending rates for favored activities; (b) credit ceilings for lending to 'nonproductive' activities; (c) special reserve requirements, and minimum lending and investment ratios for favored activities (government securities, securities issued by public enterprises, loans to handicraft and small-medium manufacturing firms, and so on). While policies such as a BoG subsidy of lending rates were aimed at sectors considered as 'productive' (agriculture, manufacturing, exports, mining, during a certain period tourism), credit restrictions applied for financing 'nonproductive' housing construction, import trade, and the trade of consumer goods. Such credit ceilings to domestic trade were among the main direct instruments used for monetary stabilization. They rose by over 75 percent in nominal terms during the electoral year 1963 (in which the conservatives finally lost to the Center Union) as a government response to accumulating pressure by traders. (Figure 3.2 traces the flow of credit to import and export trade, and the development of exports.)

A restrictive bias of the BoG could be evidenced from the underdevelopment of housing credit. In other West European countries, subsidized housing was seen both as a redistribution policy, as well as a way of sustaining overall aggregate demand. In Greece, despite the extensive popular need for housing in the 1950s and 1960s, public housing programs

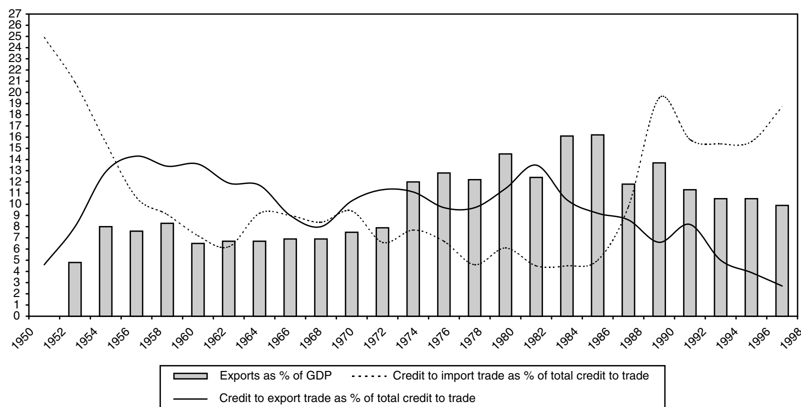

Figure 3.2 Credit to import and export trade as percentage of total bank credit, and exports as percentage of GDP, 1950–98.

Source: BoG (1992, 2000).

(applied by two state-controlled mortgage banks) were limited, and subsidized mortgage credit was extended to only a few targeted categories such as civil servants. The monetary authorities officially discouraged housing credit and obstructed the extension of finance to housing construction. They regarded housing as a consumption good and an unproductive investment which diverted scarce financial resources from manufacture and exports, where they could create more value added and generate precious foreign exchange. Nonetheless, the housing sector boomed, absorbing part of the finance officially directed to other 'productive' activities. The trend was reinforced under the 1967 dictatorship, when a more accommodative stance on housing credit was adopted. A solid bias toward investment in real estate (offering a higher sense of security) had been embedded in the Greek public as a result of a lasting folk memory of hyperinflation of the 1940s. The official aversion of monetary authorities to housing finance did little to change it.

Monetary and credit policies became overall very expansionary during the 1967–74 military regime. Credit terms were made more favorable for exports and manufacturing, and were further extended to include the previously restricted housing constructions and tourism. Expediting the industrialization strategy of its predecessors, the authoritarian regime was anxious to deliver rapid and sustained popular support. A broad range of credit decisions was transferred directly from banks to government authorities. During the dictatorship period, particularly its first years, the preexisting tendency of using credit policy as a means of wooing specific client groups not only did not recede but strengthened.

Industrial banking, policy paradigms, and lesson-drawing

Apart from the institutional and regime dependencies that shaped the outer framework of Greece's developmental course, the latter's exact policy content was defined, revised, and redefined over the 1950s, 1960s, and early 1970s under the combined impact of domestic learning-by-doing, international policy paradigm, and applied foreign experience. In that process foreign lesson-drawing had a notable impact (cf. Rose 1993). Westernizing Greek policymakers heading the economic ministries and the BoG naturally sought to draw policy justification from the developmental blueprints produced by international organizations like UNCTAD and the World Bank, as well as from the parallel policy experience of West European countries, irrespective of Greece's perceived backwardness compared to them. Though other successfully developing countries (Japan or Taiwan) had greater similarities, their

parallel trajectory with Greece made it premature for useful lessons to be extracted. Lesson-drawing operates with a time lag, in a process in which latecomers seek to emulate the advanced, *in casu* Western Europe to which Greek postwar elites evidently aspired. In the search for a panel of economic blueprints, the postwar policies of Germany or France had interesting lessons to teach, while Britain, on the other hand, appeared increasingly irrelevant.

A comparison with Britain yields striking dissimilitude, but should not be rejected out of hand. (Not least because the Anglo-American market-based financial and corporate governance model would, by the 1990s, rise into what some see as a global canon.) After all, Britain was among the principal foreign educational destinations of prospective Greek policy elites, it was the focal point of the Keynesian revolution that spread to the Western world, and it was also Greece's foreign 'protector' power briefly, until ceding control to the US in 1947, even entitled in the first few years to a representative on the Greek Currency Committee. Its policy influence should therefore not be considered as negligible.

For one thing, contrary to Greece, Britain's long-entrenched business elites and distributive coalitions resurfaced after the war, severely injured but otherwise in straightforward continuity (cf. Olson 1982). If early industrializer Britain needed to relaunch and restructure its productive base by shifting resources between sectors (very much the task of postwar developmental states) it would have to do so by displacing and reorganizing politically entrenched but increasingly unproductive industrial sectors, an enterprise of high political costs (Zysman 1983: 172–3). In contrast, Greece's industrial base was rudimentary and largely decimated by the war. Greek postwar reconstruction and development involved a process of labor movement from agriculture to industry and industrial capital accumulation to targeted high value-added sectors. Though far from a victimless political enterprise, this entailed a relatively limited range of status quo losers (mostly older commercial interests reluctant to expand into manufacturing), a wider range of direct beneficiaries (the new protected small-medium and larger-size manufacturing interests), and welfare losses (mostly in the form of deferred improvements in income standards) diffused widely enough across the population to minimize political cost.

The recognition that poor, developing, postwar Greece had no wealth to redistribute but only to generate was an important differentiating factor of Greece's chosen path from Britain's Keynesian trajectory. Engaged in active income redistribution, welfare provision, and nationalizations, fine-tuning the levels of demand management, with a powerful and

sophisticated private financial sector, with a banking system highly averse to industrial finance and restructuring, lacking institutions of government-led, long-term industrial credit, virtually lacking a national industrial policy authority for much of the postwar period, and struggling over the 1950s to retain an overvalued currency at the expense of its tradeables sector for the sake of British world power/reserve currency status and the City, Britain was Greece's exact opposite in every respect (Shonfield 1965; Crouch 1978; Hall 1983; Moran 1984). Plainly, there was very little if anything that the latter could learn from the former.

In contrast, the German model of banking engagement in industrial development was of considerable influence on Greek industrialization from the second half of the 1950s. The degree of attention paid by Greek policymakers to the German economic crisis and reconstruction in the interwar and the early postwar periods was enhanced by the German academic training of chief policymakers such as Zolotas, as well as by the growing irrelevance of the British, or for that matter the French case (whose economic nationalism presupposed an outward political assertiveness missing from 1950s Greece). This does not, of course, imply that Greece of the 1950s was in any comparable state of development to that of West Germany. But by adopting some of the principal policy instruments that Germany had employed in its own pursuit of industrialization from the second half of the nineteenth century onwards, Greek economic policy architects hoped to steer the country into a similar path of development. Thus, the success of the German case prompted Greek postwar policymakers to actively seek to orient banks toward the long-term financing of industry, through favorably suppressed interest rates and appropriate credit regulations. Industrial banking was also promoted through establishing specialized investment banks, with rather inadequate results, as will be seen below.

Clearly, the large structural disparity between the two countries dictated an eclectic application of the German experience. Indeed, the German route to economic growth had been historically constructed through one-off government intervention and henceforth monitored through arm's length regulatory presence to ensure that it remained a rapid highway for private entrepreneurship. Given the long-run accumulation of German industrial capital and the rationalization that had taken place before the war, the postwar resurgence of German industry was founded on a revived manufacturing base already organized along highly efficient lines, led by internationally competitive industrial giants, and thus in very little need of industrial restructuring (Zysman 1983: 251ff). Given the preexistence of a well-developed manufacturing

base, the main concern of German postwar policymakers was not to create that base, not even to restructure it, but to stimulate its long-run productivity and international competitiveness. They thus chose to ensure that German industry would continue to rely on the unobstructed allocative mechanisms of the market, responding to price signals rather than distortive government interventions. The social tensions created by capitalism would be managed by institutionalized mechanisms of inclusive, consensus-oriented collective bargaining and decision-making, and effectively cushioned by a developed safety net of welfare provisions and high wages. The bedrock of the 'social market economy' system that emerged was its ability to finance itself with the surplus created by its sustained profitability, high productivity, and market competitiveness.

Thus while German government activism was visible in fields such as technology enhancement, an arm's length encouragement of industry toward high growth sectors, and the extension of incentives such as tax exemptions, industrial policy relied on only limited use of subsidies, as compared to France, while nationalization was implemented in a restricted and pragmatic way as compared to its ideological promotion in early postwar Britain or France. This pragmatic self-restraint in government intervention was partly rooted in postwar aversion to the proto-Keynesian deficit-financing applied by the Nazis in the 1930s. Government self-restraint was famously witnessed in endowing the Bundesbank with a high degree of political independence that would enable Germany to build its economic and industrial growth on solid grounds of price stability.

German postwar conservative policymakers assigned government a function of safeguarding competitive market structures, a stand that resulted from attributing the interwar economic disaster also to the erosion of competition (Wolf 1995: 329). To ensure an additional source of competitive pressure, they welcomed free trade and rejected restrictions on current account convertibility. To preserve market efficiency, lending policies, including the extension of long-term capital, were left entirely for the banks to decide on profit-maximizing grounds. The considerable guarantees of sociopolitical and price stability fostered institutional predictability and the nondiscounting of future returns, vital preconditions for long-term finance and investment. Thus while government had nurtured a bank-led model of industrialization, it consciously abstained from the processes of financing that model, leaving the role to an autonomous and competitive banking system. A 'special partnership' characterized the government's relations with banks, which did not however assume the nature of direct state intervention, despite the

extensive tradition of state government banks. Banks managed government subsidies handed to them in the postwar decades for private sector capital projects, approved and distributed those subsidies in an 'almost para-statal position' (Shonfield 1965: 262–3). Instead of directly intervening, German governments signaled their policy preferences to the banks through 'utilitarian inducements' (Dyson 1986: 127), such as government loan guarantees or loan guarantees aimed at stimulating exports or securing supplies of raw materials. The banks' long ties with their industrial borrowers, and their institutionalized role in corporate governance (taking the form of an active participation in the management of industrial firms derived from their owning substantial stock in a broad range of corporations) was relied upon to guarantee that the banks' financial policies would be grounded on an optimal utilization of information at the individual micro-business level (Carlin 1996; Djelic 1998: 172ff).

Despite the attractiveness of the German model to the Greek policymakers of the 1950s and 1960s, the insuperable impediment in imitating it lay, of course, in the nonexistence of a developed industrial base. Thus the Greek economic strategy undertook to somehow reenact the German model with a historical time lag, which also provided part justification for the paternalistic government politics put in the service of expediting this 'catch-up' process. Industrial capital accumulation would have to be stimulated within a market economy framework but through a concerted and more extensive use of available government instruments. It strikingly emerged in that context that tax policies and investment incentives for attracting foreign capital, though vital instruments, would not suffice. The repatriation of profits as part of an open door strategy of inviting foreign investment (extremely favorable legislation for which was established after 1953) limited the effects of capital accumulation, while favorable corporate taxation policies typically operate after profits have been produced. What was needed was an institutional apparatus to provide industrial enterprises with the long-term 'patient' capital for undertaking investment, that finance provided, as in the German case, by the banking system. Contrary to the German case, however, the fledgling standing of Greek industry, the lack of know-how, of skilled labor, and of a reliable track record of manufacturing productivity, as well as the overall unpredictable evolution of industrialization in a country of still fragile political institutions, suggested that profit considerations alone would not suffice to direct long-term bank credit to industry. This crucial predicament oriented Greek authorities to a far more activist (compared to postwar Germany) developmental industrial

policy exercised through and upon the – already mostly public – banking system. And it necessitated the adoption of a far-reaching institutional framework of financial interventionism such as that practiced in other more developed (such as France or Italy) or similarly developing (such as South Korea or Taiwan) 'credit-based' industrializing economies. That was where the intended similarities to the German strategy ended.

Credit interventionism and the planning model: developmental policies without a developmental state

If the German (ordo)liberal model provided a paradigm of bank-led industrialization and sound macroeconomic management that exercised a powerful influence over Greek policymakers, the French model of credit and industrial dirigisme always lay at the antipodes of Greek policy debate. As, by the end of the 1950s, it was becoming clear that manufacturing growth was failing to pick up, Greek policymakers shifted to a more active employment of selective policy instruments. They turned toward a more systematic promotion of industrial finance, strengthening of export subsidies, an intensification of industrial activism, and the proclaimed adoption of the 'scientific' way of organizing economic life as represented by indicative planning. By that time Keynesian interventionism was becoming the unchallenged orthodoxy in many Western economies, aided by the 1958–60 recession.

From the 1960s onwards the Greek system of administered credit developed considerable similarities to the one applied by postwar France as part of indicative planning. That same French system was, in the early 1960s, also replicated by Spain, when trade and price liberalization on the one hand and indicative planning on the other were chosen to succeed the failed policy of autarkic development under Franco's first two decades of rule (Pérez 1997a; Lukauskas 1997). Regarding monetary and credit policies, Greek interventionism was founded on two pillars. The first was the provision of preferential credit to favored, high value-added sectors, implemented via means such as the administered variation of interest rates, quantitative and qualitative controls, and special investment ratios. In the Spanish case that was done largely through the creation of French-styled special rediscount lines, offering banks 'a source of cheap liquidity over and above the Bank of Spain's regular rediscount window, thus giving them strong incentive to lend to sectors eligible for such rediscounting' (Pérez 1997b: 175). The second pillar, regarding monetary policy, established reserve requirements in the form of holdings of public sector securities. Starting in 1958, Greek banks were compelled to

invest 18 percent (a percentage gradually raised) of their average increase in private deposits in low-interest-bearing Treasury bills, aimed to finance public investment.

This 'double-circuit' model was remarkably similar to the Franco-Spanish one, but with two major differences. First, contrary to the French and Spanish case, the rediscounting facility in the Greek case was of minor importance, used only as an extraordinary expansionary device. The rediscounting and temporary overdraft facilities would have provided a source of inflationary cheap credit along the French and Spanish lines, had it not been for the high interest rates charged by the BoG for the use of these facilities. This rendered them prohibitive for financing the banks' regular credit expansion. As the commercial banks controlled a high volume of deposits after 1956, the rediscount and temporary overdraft facilities were of minor value anyway. These mechanisms functioned more as a 'safety valve', ensuring the banks' liquidity at times of crises and temporary shortages – and in that sense formed more of an orthodox set of monetary policy instruments (Zolotas 1965: 76; Halikias 1976: 15, 49). The very limited use of the rediscount window is related to the second and most important difference between the Greek and the Franco-Spanish systems: that administered credit in the Greek case was not allowed to degenerate into cheap inflationary credit, despite the overall expansionary orientation of monetary policy. In so far as France was concerned, the inflationary strategy emerged as a corollary of the government's yielding to militant labor union wage demands, and then resorting to cheap credit in order to alleviate the cost on business (Loriaux 1991). Such labor mobilization constraint was partly suppressed by the authoritarian instruments of the Greek postwar political regime, culminating in the period of the junta. Moreover, an important explanation for the closer adherence of Greek policymakers to the primacy of monetary stability points to the institutional configuration of credit policymaking and the central bank's pivotal role in that process.

Indeed, the BoG's presence and the domineering personality of governor Zolotas in the Currency Committee allowed the central bank to keep close control of government interventions and to influence them toward its own preferred direction. Monetary and credit policy proposals adopted by the Currency Committee originated from the Credit Subcommittee, a clearly bureaucratic BoG substructure composed of the governor, the deputy governors and other BoG officials. The BoG superiority in economic research and policy formulation, as compared to any government agency, its monopoly of expertise in monetary and credit issues, and the continuity of its high-level personnel compared to the

mutability of government policymakers, allowed the Currency Committee output to reflect the BoG's policies to a significant degree, in spite of the lack of formal BoG independence from government.

This also helps explain Greece's better record of price stability from the 1950s through the early 1970s compared to both Spain and France. As Pérez (1997a) has shown for Spain, in the 1960s a strong bureaucratic elite of planners subordinated monetary policy to the objectives of rapid industrialization through an inflationary cheap credit strategy. It was only after the ascent in the Bank of Spain of a monetarist-leaning elite in the early 1970s that the central bank managed to overturn the influence of the planners, reverse course and promote (with the support of the banking cartel in exchange for accommodating banking interests) a policy of heavy monetary austerity. The Spanish planning corps was modeled after the powerful French Planning Commission, which had also managed to subordinate the Bank of France into a dirigiste system of cheap credit to industry. The commission lasted practically until the 1970s, when under mounting inflation its importance was diminished. The planners sought early on to establish a working alliance with the Ministry of Finance, and worked in concert with the other core economic bureaucracies (the Ministry of Industry, the Bank of France, and the National Credit Council) in devising the key policies of financial interventionism (Zysman 1983: 107ff; Hayward 1986: 22ff).

In Greece, in contrast, no comparably powerful officially designated government planning agency existed. The Currency Committee practically implemented industrial policy objectives in so far as credit policy instruments were concerned. The lack of a French-style planning bureaucracy allowed the BoG to reign supreme in credit policymaking. To a certain – though gradually diminishing – extent, this arrangement reflected the view of the American economic advisors of the 1950s. They were willing to set Greece off through import substitution on a foreign-trade-oriented industrialization track, but less keen in seeing the industrialization objective develop into either an autarky path or a threat to macroeconomic stability. Their aversion to planning was reinforced by their low regard for much of the political and business class, which they considered prone to speculatory activities, illiberal practices, favoritism, and corruption (cf. Freris 1986: 128ff; Kazakos 2001: 113ff). They trusted the BoG but were suspicious of the government bureaucratic machine and its wieldy subjection to political dictates.

The lack of systematic and assertive indicative planning deserves more attention. The bureaucratic dimension is an important one. Absent was the kind of bureaucratic elite of France or even Spain, the 'pervasiveness,

self-consciousness, and self-assurance' (Loriaux 1997b: 159) that would ensure the bureaucratic influence in the exercise of systematic state activism. In Greece, the Currency Committee came very close to playing the role of a planning ministry. Its intervention in the economy 'was a kind of "silent planning" which exercised very powerful pressure on private sector decisions without legally abolishing private property and profit' (Thomadakis 1994: 40). However, the Currency Committee's jurisdiction did not extend to detailed industrial policies per se, and it substantially lacked any serious longer-term planning ambition (its founding mission had been almost confined to confronting the hyperinflation of the early postwar period). As governor Zolotas was the only permanent member of the Currency Committee (ministers were subject to frequent replacement), the BoG retained major influence, aided by the fact that credit policy was – by definition – a special province of the central bank. As a result, the Currency Committee displayed a steady bias in favor of monetary policy at the expense of industrial policy. Attracted by the German model of central bank independence, Zolotas disliked indicative planning, which, as in France, would have subjected the BoG to the planners. These factors prevented Currency Committee policies from more boldly pursuing more rapid growth and industrialization in a way that might antagonize the BoG's commitment to monetary stability. This tension within the Currency Committee would be revealed during the 1967–74 dictatorship. Shorn of Zolotas's powerful presence, and under a military regime that had staked its claim to popular acceptance in its ability to deliver rapid economic growth, the BoG was forced to succumb to highly expansionary monetary and credit policies. These, combined with intensified dirigisme, did manage to accelerate the pace of industrialization, but overheated the economy, maximizing the impact of the 1973 inflationary shock.

Apart from the Currency Committee, the only government office that came close to a planning authority was the 1959-founded Center of Economic Research, renamed, in 1964, the Center of Planning and Economic Research (KEPE). The first five-year plan was delivered in 1959 by a group of independent technocrats under the center. Invigorated state activism was combined with the prospect of Greece's further opening its market in view of the EC Association agreement, which prompted an effort to step up the economy's export orientation through generous export subsidies. The growth targets of the 1959 plan were overshot by the economy's actual performance in the first half of the 1960s thanks to a booming international economy. A second five-year plan was prepared by KEPE and submitted to government in 1965. The presence of

Andreas Papandreou as founder of KEPE and by this time a member of the centrist government of his father, Georgios Papandreou, created conditions for a more active indicative planning, more extensive redistribution, and a heavier adoption of ISI policies in parallel with a more systematic support of industrial exports. The plan also entertained a benign neglect vis-à-vis housing, which was a more accommodating stance compared to the adamant opposition advocated by the BoG. But, caught in intense political controversy and instability, the plan was never implemented – until resurrected by the dictatorial government, which relied on it to a considerable extent.

The KEPE, an academic research institute outside government even though government-sponsored, was deprived of any policy surveillance and implementation mechanisms. Moreover, as the brainchild of Andreas Papandreou, neither the junta nor the subsequent conservative democratic governments were inclined to use KEPE, which was left to vegetate in the realm of government bureaucracy. By the mid-1970s, indicative planning was going out of fashion anyway. In fact, the most consistent economic critique raised against Greek government policies through the 1950s and 1960s, coming from a circle of left-wing structuralist-leaning economists, castigated exactly the lack of indicative planning institutions and the failure to enlist the interventionist instruments that would accelerate industrialization.[4] The five-year 'development programs' developed since the late 1950s (with the possible exception of the dictatorship period) were very poorly adhered to, mostly due to the lack of intragovernmental policy coordination, the ad hoc character of a wide array of policy measures, and business resistance. No other Greek government body operated that was even remotely comparable to the powerful French or even the Spanish Planning Commission, a 'virtual economic superbureaucracy' aimed to 'advance the role of private initiative' by 'supplant[ing] the antiquated corporativism ... with the principle of "administrative rationalization"' (Pérez 1997a: 67). And certainly, the politically dominated Ministry of Industry, epitomizing the structural deficiencies of Greek public bureaucracy, was no Japanese MITI. Throughout the postwar decades, Greek interventionist economic policies were predominantly aimed at confronting short-term problems, without considering the longer-term repercussions of adopted policies, while exhibiting a limited degree of consistency over time in the administrative design and implementation of industrial policy (Yannitsis 1988: 36ff).

Theorists of the developmental state agree on the capital importance of a powerful state bureaucratic elite, planning and implementing the policies of development (Evans 1995: 59; Kohli 1999: 123; Pempel 1999: 139).

In his discussion of developmental states, Evans (1989) argued that for a state apparatus to be effective in promoting economic development it must not just be internally coherent and strong but also embedded into the economic sphere without, however, becoming its captive; this he called 'embedded autonomy'. Chalmers Johnson summarized it by defining the Japanese developmental system as one in which '[t]he politicians reign and the bureaucrats rule' (Johnson 1982: 154). The politicians 'provide the space for bureaucrats to rule by holding off special interest claimants who might deflect the state from its main developmental priorities, and they legitimate and ratify the decisions taken by bureaucrats. The bureaucrats in turn formulate developmental policies, draft and administer the laws needed to implement the policies, and make midcourse adjustments as problems arise' (Johnson 1982: 154). And it is a common understanding of the 'developmental state' literature that such bureaucracy should be competent and meritocratic, able to set objectives independent of organized interests and external political pressures, and to formulate credible and consistent policies that do not change overnight.[5]

The ineffectiveness of indicative planning in the Greek case reflected a broader reluctance or inability to develop a strong developmental state machine of a French or Japanese type. Given the inevitably interventionist nature of the Greek state's economic role in the 1950s and 1960s, an administrative machine of more power, competence, and integrity would have smoothened out the political edges of policymaking, filtering ministerial voluntarism and the ad hocery of government meddling. It would have imposed rational standards of consistency and continuity, ensuring predictability and effectiveness in policy implementation. Instead, the severe weaknesses of government bureaucracy (with the exception of the BoG) deprived the policy process of its rationalizing function, allowing for too much discretionary authority to be concentrated at the highly politicized top executive levels of economic, credit, and industrial decision-making, inevitably compromising efficiency.

Indeed, two independent reports converged in their conclusions on the state of Greek public administration over the 1960s.[6] They found the government machine comprising 'a mosaic of bodies inadequately coordinated and isolated from each other', 'parallel small empires [that] favor the appearance of opportunistic fractions and the penetration of "political" influences' (Langrod 1964/2000: 181–3). They reported frequently overlapping authorities, blatant empiricism and recourse to partial half-measures. Both reports emphasized that the importance of the Coordination Ministry as an architect of economic policy and 'vanguard

of modernization' was not matched by successful results, especially due to its lack of coordination and its perceived antagonism with other ministries. In many cases, the allocation of competences reflected ossified structures and was to blame for seriously disjointed and fragmented policymaking. For instance, despite the fact that the Finance Ministry carried out most of the executive work in fiscal and monetary policy, its influence in broader decision-making was insignificant compared to that of the Coordination Ministry and the BoG. However, the Coordination Ministry's grasp over technology policies was almost negligible and its role in long-term policy design was seriously curtailed after the creation of KEPE – which, however, lacked any decision-making muscle as noted above (Langrod 1964/2000: 182; Wilson 1966/2000: 314–15). All evidence thus points to a disjunction between a strong government in the sense of a far-reaching armory of selective interventionist instruments including credit and industrial policies exercised by the state's mostly political leadership, on the one side. And, on the other, a weak state, in the sense of a feeble, unassertive, under-resourced and politically dependent bureaucratic apparatus leading to serious fragmentation and discontinuity of state policies. Greece offered a case of developmental policies without a – strictly speaking – developmental state.

Plenty of savings, not enough investment: the perverse effects of developmental finance

Despite the abundance of bank deposits after 1959 allowing for a rise in the volume of manufacturing credit, there was no equivalent increase of gross private capital formation in industry. Investment in manufacturing overall showed only a limited rise as a share of total investment, despite a considerable growth after 1965, and especially between 1968 and 1973 (Figure 3.3). Failing to materialize into capital investment, excess credit spilled over to consumption or investment in real estate. Greek investment in manufacturing between 1960 and 1976 averaged about 3 percent of GDP, one of the lowest proportions in the OECD area (which, however, of course comprised predominantly advanced industrialized countries). During the same period, investment in housing accounted for about 6 percent of GDP, almost 1.5 percent higher than the OECD average (OECD 1978: 29–30). However, the overall credit provided to industry after 1956 was more or less adequate, if not abundant, to allow the necessary take-off of industrial investment.[7] The reasons for the failure of manufacturing credit to generate proportionate industrial investment should be located with the banks and the industrial borrowers themselves.

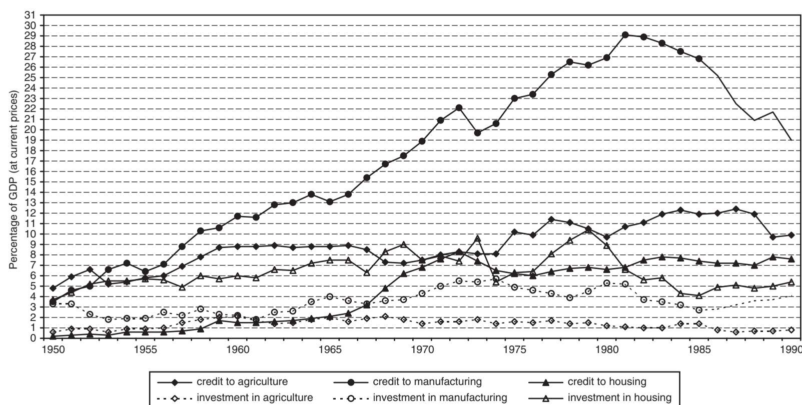

Figure 3.3 Bank credit and gross capital formation by economic activity as percentage of GDP, 1950–90.

Source: BoG (1992).

The economic and political environment offered some adverse conditions that may have discouraged industrial investment. A number of persistent structural weaknesses typically figuring on developing countries' problem lists (frequent changes in the tax system and other economic regulations, bureaucratic impediments, inefficient public administration, lack of a national infrastructure) all had a role to play. The political and executive instability after 1961 may also be viewed by some as an inhibiting factor. Events such as repeated allegations over an infiltration of the army by left-wing officers, the rising star of Andreas Papandreou (viewed by the Right as a dangerous radical) in his father's liberal Center Union party, the expanding electoral influence of the United Democratic Left (EDA), and the repeated demonstrations in the streets of Athens (throughout the period from 1961 until the April 1967 military coup) of thousands of Center Union supporters, students, and workers, sometimes erupting into violent episodes, created an overheated political climate.[8] The 'law and order' concerns emanating from the sociopolitical scene were further aggravated by serious recurrent crises in the bilateral relations with Turkey (in 1955 and 1964), always perceived as a permanent national security threat. However, the adverse impact of these factors on the economy should not be exaggerated. Despite its occasional intensity, political unrest never came close to really threatening the core of the bourgeois political regime. As long as the cold war continued (and at that time there was no perceivable end to it), no domestic political force seemed capable of moving Greece away

from the Western geopolitical camp. Thus, regardless of the occasional flirtation of government officials with higher degrees of state involvement in the economy, private property and investment were backed by unshakable regime guarantees, a factor which seriously discounts the explanatory importance of political instability as inhibiting investment.

The main explanations for the private sector's reluctance to undertake industrial investment should most probably be sought in the structure of incentives resulting from the particular configuration of developmental finance. Industrial investment involves a decision to commit resources for a long period of time, in anticipation of a high return in the future resulting from the purchase and utilization of capital goods. It thus involves forgoing the opportunity to place those financial resources – provided that they are available under the same conditions – in alternative forms of investment. The temptation to direct financial resources to outlets other than industrial investment can be suppressed either by penalizing those latter alternatives (such as current consumption or the investment in real estate) or by rendering particularly lucrative the industrial investment decision. That was the level at which monetary authorities attempted to intervene, lowering the prices of long-term industrial credit for capital investment, and raising lending rates or setting quantitative controls on credit to consumption or dwellings. However, authorities in some cases did not go far enough in setting and especially in enforcing such administrative measures, while in other cases restrictions themselves bred undesirable and perverse effects.

Despite its short-term efficiency, credit rationing generated undesired consequences in the middle and long run. The attempt to direct bank funds to manufacture combined with restrictions on lending to trade turned manufacturing enterprises into financiers of trade, thus consolidating an extensive underground credit sector. In that widespread practice known as 'round-tripping', bank loans to preferential borrowers were put to a different use, as these benefited from arbitrage opportunities across different credit markets. Given the lack of an adequate mechanism to monitor how the loaned funds were indeed invested, a favored borrower could overinvoice an investment, and redeposit the excess funds with an interest rate substantially higher than the lending rate obtained, or directly lend commercial and other activities with higher rates of return but less preferred access to credit (OECD 1995: 45). Round-tripping assumed scandalous proportions in the post-1973 period, by which time mounting inflation had turned real lending rates negative. By the second half of the 1970s it was estimated that some 60 percent of short-term loans to industry were used to finance commerce (where

returns were immediate and higher), while commercial firms in turn used some 50 percent of this credit from industry to finance consumer spending (Courakis 1981: 226).

Monetary authorities tried to promote long-term as opposed to short-term finance to industry through lower lending rates and a special investment ratio for that purpose. However, long-term lending to manufacture failed to improve substantially (Figure 3.4). To a certain extent, the high reliance of industrial firms on working capital reflected limited demand for long-term finance due to the dominance of labor-intensive production methods (Coutsoumaris 1963: 198). Moreover, almost all long-term loans were given against production, real estate security, or plant and equipment, requirements which together with the time-consuming procedures and the extra fees discouraged demand for them. The problem, however, was largely associated with the commercial banks' policy of finding ways to eschew regulations and to promote short-term at the expense of the less profitable long-term credit. Access to long-term loans of commercial banks was possible only to a small number of large-size industrial customers, many of which were under the banks' nexus of business interests. Rather than trying to attract new borrowers, banks found it easier to extend funds earmarked for manufacturing credit to their existing industrial clients, which – contrary to most newcomers – could also come up with the required collateral and guarantees. The great majority of businesses relied on short-term renewable

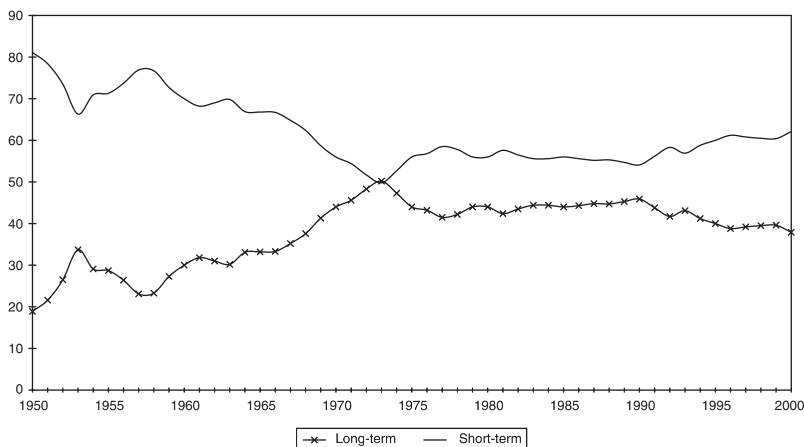

Figure 3.4 Bank credit to private sector by maturity, 1950–2000.
Source: BoG (1992, 2000).

(at the banks' extra profit) finance, through which they often financed their fixed investment (Halikias 1976: 109). However, excessive reliance of industrial firms on short-term credit increased their vulnerability to potential policies of monetary austerity.

The ease of access of manufacturing firms to bank credit, instead of expanding industrial investment, induced firms to compete not for better prices and quality but for the length of term of the commercial credits these firms would extend to their clients. Furthermore, credit controls led banks to focus on avoiding formal violations of regulations, often in full cooperation with their clients, instead of trying to evaluate their borrowers' prospects and real financial needs. The lack of adaptability of credit to the specific conditions of each industry or firm contributed to the excessive indebtedness of industrial enterprises. High indebtedness was in many cases the crucial factor that inhibited the increase in size of industrial firms and the development of a competitive manufacturing sector. It was thus that the interventionist regime contributed to what would be later perceived as systemic 'distortions' and the general failure to channel financial resources into production. These failures of credit interventionism, which remained small in the 1950s, 1960s, and early 1970s (mixed as they were with the considerable successes in the promotion of inflation-free development), would assume alarming proportions well into the 1970s, providing potent justification for the credit liberalization of the 1980s.

Committed to upholding private entrepreneurship, the Greek system was based on incentives but hardly any practically enforceable sanctions. As BoG officials admitted, penalties for enterprises and banks that violated many of the Currency Committee regulations were so severe that they were very often (especially in the largest cases – and under the weight of intervening political pressures) left unimplemented, further corroding the system's credibility (cf. Halikias 1976: 37, 58). This enforcement dimension can be better illustrated if juxtaposed with the means employed by other – admittedly more authoritarian-prone – versions of developmental states.[9] For instance, under the combined incentive and command devices used in South Korea, any firm not responding as expected to particular incentives 'may find … its tax returns … subject to careful examination or its application for bank credit … studiously ignored or … its outstanding bank loans … not renewed'. If incentive procedures did not work, government agencies did not hesitate to resort 'to command backed by compulsion' (Kim et al. 1980: 265). In postwar Japan, 'administrative guidance' involved the use of 'influence, advice and persuasion' by public officials having

the power to provide or withhold 'loans, grants, subsidies, licenses, tax concessions, government contracts, permission to import, foreign exchange, approval of cartel agreements, and other desirable (or undesirable) outcomes, both now and over the indefinite future' (Ackley and Ishi 1976: 236–7). Administrative guidance included tactics such as cooptation of business competitors for the coordination of investment, and 'getting even' with the miscreants (Johnson 1982: 265ff). Such acts of bureaucratic determination in the economic sphere were generally avoided by Greek postwar economic and monetary authorities. Besides, they presupposed a type of centralized government control, either in the form of a powerful ministry such as the Japanese MITI, or by way of state-coordinated corporate networks as in South Korea. Both versions were lacking in Greece's less assertive (given the absence of an overarching administrative machine) and less centralized (given the banks' relatively autonomous – though certainly far from immune from political intervention – portfolio policies) version of state-assisted capitalism. Thus, the limited assertiveness of the state in its developmental function figures as an important factor for its inadequate capacity to affect more drastically the cross-sectoral reallocation of resources toward manufacturing.

Large-size 'infant industries' cohabiting with the small enterprise sector

A factor limiting the demand for bank credit was the small average size of manufacturing firms, with a predominance of small family-based handicrafts of low profitability, and the high death rate of small businesses. The small average size of industrial firms indicated both a reluctance on their part to seek external finance and especially a tendency of the banks to avoid lending to them (Psilos 1964: 251; Coutsoumaris 1976: 161ff). The higher per unit credit risk and transaction costs of lending to small firms led banks to ration credit at the expense of small business borrowers. They demanded collateral of solid real estate guarantees that could match the sound and marketable assets of large customers. Thus the great majority of credit ended up with the largest companies (Ellis 1964: 61–2).

Overall, larger-size oligopolistic insiders of the industrial market were the most prominent gainers of state-assisted industrialization. To be sure, from the Japanese *keiretsu* and the Korean *chaebol* to the French national champions, the developmental project was identified with the effort to nurture large, internationally competitive firms, able to command the necessary scale and scope that would allow them to lead the

process of outward-looking industrialization. This was true for the East Asian economies as it was true for the authoritarian-free states of Europe. In France most associations representing smaller-sized businesses were excluded from the formulation of the Plan: '[t]he state was aiming for the first time at the elimination of "unproductive" firms' (Zysman 1983: 108). The postwar Greek state's programmatic ambition was not as far-reaching, and there lurked considerable self-doubt as to its capacity to single out and nourish the 'infant industries' of the future, but the legislative bias for larger-size companies was given – and to a great extent well-justified on economic grounds. At the same time, however, targeted cheap credit to the low-productivity handicraft and small-sized manufacturing sector suggested at least significant ambiguity in the state's industrial rationalization objectives. Along with 'picking the winners' administered finance was also picking the losers.

Comparatively harder access to credit prevented handicrafts and small and medium-sized manufacturing enterprises (SMEs) from financing the investment necessary for their modernization (thus consolidating the large-firm oligopolies) but it did not squeeze them out of the market. In a petty-bourgeois economy, with one of the lowest salariat and highest self-employment percentages in Western Europe, small family-based enterprises formed the social backbone of the conservative regime, strategically targeted by both right-wing and centrist political parties. Small family units were encouraged by operating at the margins of the official economy, by relying on lower-remunerated labor on the part of family members, lower welfare contributions, lower or evaded taxation, and so on. Moreover, the tradition of trade in the Greek economy had imparted businesses a distinct commercial bias visible in the mixed trade and manufacturing character of many enterprises as well as in their small size, short-range orientation, low proportion of own funds and fixed capital. Though policymakers recognized the inefficient nature of the predominance of small family-based units, they abstained from drastically encouraging their mergers into larger units, which would have produced redundancies at least during the transitional period. A pronounced effect of business familialism was that of cushioning unemployment and spreading welfare by enhancing real per capita income. Moreover, an extensive small business class stood at the receiving end of tax, credit, and other targeted government subsidies, thus forming a category politically manipulable and perhaps instinctively loyal to the regime. Thus, the economic commitment of successive Greek governments to 'industrial rationalization' was substantially circumscribed by their political commitment to sustaining the country's broad small-size business class.

Even the half-hearted developmental bias in support of larger-size units was not quite at the expense of the small enterprise sector. Postwar governments went to great lengths to declare their support for the small-enterprise sector through policies such as subsidized low-interest rate financing programs for handicraft and SMEs. The credit ceiling for handicraft/SME lending was raised repeatedly in the 1950s and 1960s; in 1963 all restrictions on credit for working capital were lifted and terms for handicraft/ SME credit were equalized with those applied to industrial firms.

More important was the fact that the survival of the small enterprise sector was compatible with the market strategy of large producers. Cushioned by tariff and nontariff barriers from foreign competition, large producers preferred to harmonize their prices with those of small marginal producers, thus deriving disproportionate profit margins, higher than large-firm efficiency standards would require (Ellis 1964: 178). Small family units are generally difficult to be driven out of the market anyway, since they are willing to work for very little. Such a live-and-let-live strategy allowed large firms to reap comfortable profits, sustained through regular transfusions of bank credit, while at the same time averting a mass failure of small businesses, which would have been disruptive for the status quo. This mutually beneficial arrangement, in which all governments and political forces obviously had a strong positive stake, underlay the persistently low overall efficiency of Greek manufacture at large.

Overleveraged: the capital structure of industry

The capital structure of industry in the 1950s and 1960s, with its large dependence on external sources of finance, was indicative of the perverse effects of the finance–manufacturing industry connection. Contrary to what is normally expected, the highest percentages of own funds did not occur in capital-intensive sectors but in labor-intensive, light manufacturing sectors, where smaller units predominated. This is understandable given the lower access of smaller firms to bank credit. Less explicable, nonetheless, is the fact that larger, capital-intensive manufacturing enterprises should display such high reliance on external sources of finance (which included most prominently bank loans at over 50 percent, as well as commercial credits from foreign suppliers of capital equipment) for their fixed capital investment. Overall, the average reliance of the Greek manufacturing sector on own funds for financing gross fixed capital investment in the mid-1960s was estimated to be in

the area of 20–25 percent, as opposed to percentages of well over 70–80 percent in advanced industrial countries (Halikias 1976: 118ff). Admittedly, the perverse capital structure of industry was, to some degree, the result of the economy's low level of industrial development, which prevented accumulation of profits to such an extent as to sustain the desired growth rates. Part of the overreliance on external finance also pointed to the indirect financing of trade by industrial firms. Still, the excessive dependence of firms, especially larger ones, on all but assured external funds created a moral hazard situation which underlay the failure of a considerable section of manufacturing industry to commit the necessary internal resources required for its modernization. As business profits derived from operating in a family-based, oligopolistic, and relatively protected environment found their way to lavish consumption and personal *enrichissement*, and as Greek industrial development was amply underwritten by state-directed credit, the conditions were laid for an extreme vulnerability of Greek industry in the face of a severe external financial shock.

The progressive deterioration of the capital structure of large industrial firms did not prevent banks from satisfying their credit demand, despite the fact that the firms' capital structure was supposed to be a principal banking criterion. Had that been the case, larger industrial firms may have been forced to resort to the capital market. Larger firms, traditionally family run, were averse to seeking finance in the equity and bond market, while SMEs were heavily discouraged from doing so by a tight set of restrictions. Capital market finance remained very low, with the new issue market virtually nonexistent. Equity financing was avoided not only for fear of loss of control but also on the grounds that it would require a steady payment of dividends, thus threatening to decrease those of existing shareholders and leave firms with fewer retained profits. Rightfully, then, some castigated the Greek industrialists' 'malthusian' approach to business, consisting of slowing down the development of their enterprise in order not to lose control over it (Germidis and Negreponti-Delivani 1975: 89).

Oligopoly structures and selective state protectionism

In what replicated rather poorly the German or even the more 'uneven' French model of bank involvement in industrial affairs (Zysman 1977: 199ff), Greek banks developed close relations with many of their corporate borrowers. For one thing, three development banks (all established in 1962–64) specialized in industrial investment. The state-owned

Hellenic Industrial Development Bank (ETVA) was the largest, while the two others were established by the state-controlled National Bank and the privately owned Commercial Bank group respectively. The ETVA emerged from the merger of two public development organizations created in 1954 and 1959, whose record of achievement was poor. The ETVA organized industrial zones in the Greek periphery, but tended to operate more as a lending rather than as an investment institution. Though meant to undertake higher risks than commercial banks by investing in new industrial ventures or dynamic smaller-scale firms, ETVA only marginally improved its credit pattern compared to its predecessors. Its participation in the equity capital of industrial ventures was limited, and ETVA was usually confined to extending lower-interest long-term funding to enterprises already financed by commercial banks.

Apart from the specialized development banks, the largest commercial banks (National Bank, Commercial Bank) also held controlling equity stakes in several industrial and insurance subsidiaries, in whose administration they participated (Table 3.1). Contrary, however, to the German universal banks, which they sought to emulate, Greek commercial banks were less successful in transferring technical know-how or developing internal mechanisms for evaluating the technical and financial feasibility of the industrial projects they were supposed to finance. Commercial banks lacked such specialized industrial operations and monitoring mechanisms, and even specialized development banks were underequipped in that respect. Inability to monitor industrial clients effectively was exacerbated by the closed family structure of most domestic firms. The serious discontinuity and brief tenure of appointees in the administration of state-controlled banks, a result of the politicization of government control, did not much help either.[10] Frequently, bank participation in the governing boards of industrial clients took a more informal and personalistic nature, boards occasionally being staffed with retired bank officials. This possibly indicated a payback for personal services, and reflected clientelistic networks of mutual accommodation between industrial customers and bank personnel rather than a systematic bank policy. But even where institutionalized links of banks with industry were more official and effective, they typically operated with questionable reliance on efficiency considerations. Assured and uninhibited lines of preferential credit to client firms served to protect the firms' oligopoly or monopoly position in their sector, breeding overleveraged hothouse industries of eventually high financial vulnerability.

For lack of a concerted and consistent state industrial strategy with specified and assertively sustained targets *à la française* (that is excluding

Table 3.1 Greek commercial bank participation in industrial and insurance corporations*

Industrial sector	*National Bank: number of corporations*		*Commercial Bank: number of corporations*	
	1958	*1969*	*1958*	*1969*
Insurance	3	4	4	4
Transportation	4	2	2	2
Chemicals	5	11	1	1
Textiles	10	6	4	3
Construction	6	7	1	–
Construction materials	4	3	2	2
Metal	3	4	–	–
Wineries	5	4	2	2
Hotels and hospitals	7	7	1	1
Energy	9	8	3	4
Iron and steel	2	2	1	–
Other industrials	2	9	4	5
Total	60	67	26	24

* Firms in which the banks own a minimum of 100 shares.

Source: NBG and Commercial Bank.

ad hoc politicized ministerial interventions), commercial banks were left to fill the void. The banks' purely economic incentives to ration credit ended up considerably reinforcing the status quo in the industrial market. Rationing decisions are typically based on criteria such as whether the prospective borrower has adequate collateral for the loan, the right organizational form, or a track record, or even the right social and political connections. The use of these criteria as signals for accepting or denying a loan helps banks economize on the cost of information required for assessing the credit risk. Such criteria, however, are skewed in favor of already established firms, and tend to deny funding to new small-scale upcoming competitive enterprises relying on new technologies and products, where risks are considered higher. In turn, increased collateral requirements compel business borrowers to undertake ventures of lower risk and return, which tends to lower the levels of value added from bank-financed investment.

The uninhibited flows of working and long-term capital from banks to a limited number of larger-size favored firms was a strong indicator of collusive links. Instead of promoting industrial development, close and

collusive bank–industry relationships ended up hindering competition and perpetuating the market's oligopolistic structure (Bourlakis 1993). They very often operated by blocking the entry of new competitive business rivals and by ensuring an easy ride for the established firms that cushioned them from the pressing need to modernize. Noncompetitive patterns emerged in several sectors, whereby firms would raise prices when demand increased, and simply reduce supply when demand fell, without altering their productive base. With profits not dependent on the firms undertaking new industrial investment and expansion, larger established companies had limited incentives to unsettle the existing oligopolistic structure. Though oligopolistic tendencies were to a serious extent inevitable in a small, introvert, underdeveloped market, the pattern of financial organization tended to enhance and reproduce those tendencies. Thus the closed banking oligopoly and the lack of alternative sources of finance collaborated in perpetuating parallel oligopoly structures in several industrial sectors.

Instruments of industrial protectionism and potentially particularistic government intervention, apart from special tax treatment, included: the certificate of expediency, often used to block competition to the benefit of established local monopolies; import licensing, also aimed at protecting domestic firms from competing imports. They also included tariffs, quotas, import payment controls, and preferential treatment of domestic producers in state purchases. Main beneficiaries of protectionism were the – labor intensive and best entrenched in terms of pressure power – traditional sectors (agro-industry, textiles, clothing and shoe industry, leather, oil and coal products, furniture) with more advanced industrial and technology sectors being the least protected (Yannitsis 1988: 29–30). Moreover, foreign investments that were approved usually belonged to types that were nonexistent in the Greek market, and thus did not expose established Greek companies to foreign competition.

Such protectionist devices led to potentially wide profit margins for industrial firms. They were kept high to counterbalance the evident structural shortcomings of investing in Greece, such as the lack of infrastructure, severe administrative impediments, and an underskilled labor force. Thanks to these ample profit margins, the ISI strategy, originally aimed at supporting the balance of payments, led to a hothouse domestic industry, producing, among others (along with consumer goods), overpriced raw materials,[11] that undercut the economy's export performance and competitiveness. In view of this perverse effect, the laws of 1961–62 attached major importance to the export potential of investments as a criterion for granting approval under the favorable framework. This competitive

turn, necessitated by the 1961 Association Agreement of Greece with the EC (effective from 1962), also meant that the objective of protecting domestic industries from the entry of foreign competitors should eventually, given time, cease to be of paramount priority. That is why 1961 may be identified as the turning point when ISI gave way to what was intended gradually to become an active and systematic export-oriented developmental policy.[12]

Normally in developing countries oligopolistic tendencies may indicate a process of market rationalization, while privileged bank–industry relations may suggest a concerted policy of devoting bank resources to strategic industrial development. To a certain extent, this also held true in the Greek case. However, these phenomena were also to a considerable extent subject to the forces of haphazard interventionism and political whim, facilitated by the political control over government-appointed administrations of state-controlled banks. An independent foreign observer described financial policy patterns as evincing 'the ingrown quality of Greece's small ruling elite, closely interconnecting political, financial and industrial circles' (Ellis 1964: 63). This meant that the interventionist tools of industrial policy were also easily employed as instruments for political patronage and elite accommodation. The remark is not trivial: competence and integrity in managing the institutional and policy resources of the developmental state can make a difference in the quality outcomes of development by defining whether the rents of economic interventionism will be spread broadly or captured by a few privileged power-holders (Yotopoulos 1996). While the wider overall welfare gains from Greek postwar developmental policies were far from negligible, serious bottlenecks in the rate of industrialization point, among others, to the corruptibility of interventionism by political and clientelistic considerations.

Banking power: high spreads and oligopoly profits

The political pattern of credit distribution operated in a dual manner: to create a wider mass of state-dependent financial beneficiaries (thus enhancing sociopolitical allegiances to the regime); and to further entrench the position of insiders of the decision-making process (thus self-serving as to the interests of the politico-economic status quo). Most prominent among those insiders stood commercial banks. Either state-controlled (like the National Bank) or private (like the Commercial Bank and its subsidiary Ionian Bank), commercial banks were run by prominent members of the politico-economic elite, who were moreover vested

with a crucial institutional role as intermediaries and distributors of developmental finance in the economy. Given the practical duopoly in the banking sector (the National Bank group and the Commercial Bank group normally controlled over 85 percent of the banking market) banks could enjoy comfortable profit margins. Throughout the postwar period, banks made use of their privileged access to financial decisions to ensure that their interests would be well served even under credit interventionism.

The considerable stability of administratively fixed nominal interest rates, combined with the consistently low levels of inflation, benefited the banks in allowing them to plan well in advance their costs of attracting savings (Papadakis 1978: 43–5). Operating in an environment sheltered from either internal or external competition, banks relied on the oligopoly profits assured under conditions of monetary stability, steady economic growth, a fast expansion of business transactions, and an abundance of deposits. The combination of banking oligopoly and administered credit accounted for the paradox of the real cost of capital remaining relatively high despite the regulatory system's explicit aim of ensuring cheap credit for production. Banks were left unrestrained to add various charges including sizeable commissions on top of the nominal rates set by the Currency Committee, charges that substantially raised the real cost of money.[13] Real lending rates overall in the 1960s remained higher than in most developing and developed countries (like Japan, Italy, France, Spain, Portugal, or Germany) though lower than in Taiwan (cf. World Bank 1989: Figure 4.2). Though deposit rates were lowered after 1957, to allow for a respective fall in lending rates, the latter was far less pronounced (Figure 3.1). Thus, while deposit rates between the second half of the 1950s and 1973 fell by 4–5 percent, lending rates to industry followed the fall of deposit rates only by half, while lending rates to trade remained stable and even rose, and only lending rates to exports were reduced by 3 percent. After 1959 the banks reaped a steadily increasing differential (spread) between deposit and lending rates. The spread reached its highest (4 units) in 1964–65, decreasing to 2.5 units in 1969–72, only to begin rising again rapidly from the mid-1970s.

All these facts suggest an accommodative stance of monetary authorities on behalf of the banking sector. If one was facing a private banking cartel (such as that of Spain) one might suspect a collusion between banks and monetary authorities, reflecting perhaps 'capture' of the latter by the private banking interests they were supposed to regulate. However, this argument does not make much sense in the Greek banking sector whose majority was publicly owned. Owing to both the composition and role

of the Currency Committee and to the extensive public control over banking, the state's regulatory instruments were given and did not have to be negotiated. Thus, what may appear as an accommodative stance vis-à-vis the banking sector is more understandable on central banking policy grounds. First, it indicated the BoG's 'orthodox' determination not to allow developmental financing of industry to turn into inflationary 'cheap credit'. Second, given the shallowness of the domestic financial market (lack of a developed capital and money market, no variety of specialized financial institutions, and so on) the Greek banking system was particularly vulnerable to the possibility of crises leading to shortages of liquidity and a run on the banks, because due to a lack of specialization such crises would affect uniformly the totality of banking institutions. Aware of this significant systemic risk, the BoG prioritized the health and strength of the banking system, allowing for a comfortable spread between deposit and lending rates, and tolerating conditions of oligopolistic profit margins for the sector as a whole.[14]

This particular financial configuration, however, entailed tremendous clientelistic potential for government over credit. Under the authority of the Currency Committee, credit decisions were subject to intragovernmental and intrastate (between government and BoG) debate and bargaining, in which developmental and monetary policy arguments played an important role. Despite the closed decision-making process, Currency Committee decisions – being administrative acts – were still subject to formal publicity, which to some extent restrained their partisan political function. The transfer of lending policies from the Currency Committee to the banks somehow divested credit allocation of its economic policy rationale, subjecting it to the portfolio objectives of individual commercial banks. Indeed, in 1957 commercial banks were given extensive control over their industrial credit policy as the ceiling on short-term lending to individual manufacturing firms was quintupled. Given the central role of short-term credit in the economy, the shift of financial decision-making to the credit institutions amounted to a transfer of power from monetary authorities to banks. This set commercial banks free to forge preferential links with their industrial clients. In so far as most bank administrations were government-appointed and politically controlled,[15] portfolio policy autonomy transformed public banks into the government's long arm for servicing party political and patronage objectives. This was enhanced further by the protection provided by the high secrecy conditions that surrounded the banks' loan policies, as opposed to the publicity to which Currency Committee acts were subject.

In conclusion

Through the postwar period, financial interventionism serviced a concatenation of objectives. It redistributed resources among sectors, rationed credit or suppressed it to serve monetary stabilization, or ensured that it flew in abundance where needed for productive purposes. It nurtured infant industries as well as smaller-size manufacturing enterprises producing consumer goods, thus becoming an effective tool of ISI. After the 1960s, it propped up the tradeables and export sector through generous credit and other subsidies, expediting the gradual shift toward an increasingly foreign-trade-oriented model of industrialization. The systematic channeling of resources to industry, for all its shortcomings, did manage to bring about the desired structural transformation to a degree that was not insignificant. The primary sector's share in GDP fell from 20 percent in 1965 to 14 percent in 1975 (Figures 3.5–3.6). The share of industry in GDP grew from 24 percent in 1960 to 32 percent in 1973, with the manufacturing sector rising from 15 percent in 1965 to 19 percent in 1975. Financial interventionism created specialized public institutions for industrial finance, engaging them, though inadequately, in long-run industrial affairs. Through the postwar period, financial interventionism funded public investment in national infrastructure required for development. At the same time, credit interventionism substituted for the lack of adequate mechanisms of socioeconomic redistribution, by steadily supporting agricultural income, as well as by facilitating financial conditions in the extensive handicraft and small-size

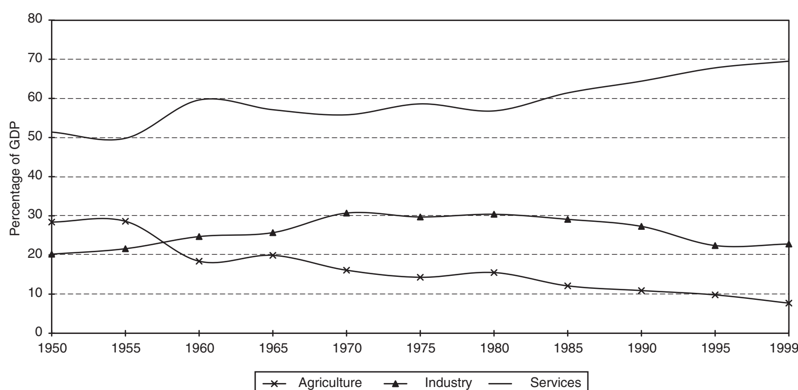

Figure 3.5 Sectoral share as percentage of GDP, 1950–99.

Source: Ministry of National Economy.

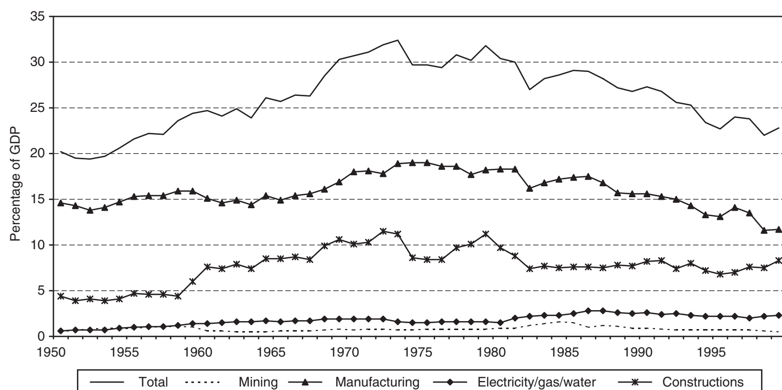

Figure 3.6 Industry as percentage of GDP, 1950–99.
Source: Ministry of National Economy.

manufacturing sector. Being amenable to particularism and political expediency, credit interventionism became a potent instrument for clientelistic and electoral purposes. The institutional configuration of a government majority in the Currency Committee and an extensive ownership and/or control in the banking system enabled the political use of credit.

Constraining factors notwithstanding, the BoG retained a very substantial degree of control over the final monetary and credit policy output, the most important testimony to that control being the impressive – by world standards – combination of high rates of economic growth with a persistent overall record of monetary stability. At first sight, the contribution of credit interventionism to that growth appears at least questionable. If the characterization of demand-led growth (as argued in Chapter 2) is valid, the leading sectors of development were precisely the sectors (housing) that had been totally ignored, indeed had been proscribed, by the Greek monetary and financial authorities. On the other hand, it should be fair to admit that without credit interventionism, that highly suboptimal development of manufacturing and exports, let alone the support of agriculture, would have appeared even more wanting, and the overexpansion of housing and consumption would have endangered both balanced growth and monetary stability. Though the far-reaching unintended consequences of credit interventionism have been amply demonstrated in this chapter, it would be foolish to conclude that in an *anti-monde* of nonexistent interventionism, the overall picture would have been better; indeed, it may have been far

worse, only in a different way. And it should be stressed that the perverse effects of administered credit were elevated into distortions of alarming proportions only in the post-1973 'cheap credit' period.

Clearly, within the framework of an industrial growth-driven system of financial dirigisme, pockets were sustained within which well-placed interests realized lateral gains reaping the rents of state intervention. Economic ideology and policies were developmental, but the state – strictly speaking – was not. Corresponding instead to Evans's (1995) 'intermediate state', it was characterized by widespread instances of submission to political infringements, lack of assertiveness vis-à-vis private interests, inconsistency and discontinuity in its goals, and inefficacy regarding their implementation, all such features coexisting with pockets of competence, integrity, and commitment to the developmental mission. The BoG itself displayed considerable efficiency in formulating developmental credit policies and defending monetary stability, yet serious inability to enforce financial regulations and prevent their spreading infraction. (Thus substantially qualified, the term 'developmental state' will continue to be employed in this book, for its heuristic importance in signifying the Greek postwar state's economic prioritization of development.)

The credit–industry connection, on its part, registered two pathologies. At first, in a poor replication of the German corporate governance model, bank involvement in industrial affairs reproduced overprotected oligopolies, obstructing market competition and the entry of more efficient newcomers. Second, in the familiar pathology of bank-based financial systems, the excessive reliance of the larger-size section of industry on all but assured lines of credit nurtured moral hazard type conditions, high indebtedness, and extreme vulnerability in the face of the first serious external shock. This was to appear with the 1970s crisis.

4
Crisis and Transition: Regime Change, Democratization, and the Decline of Developmentalism

The solid economic fundamentals on which the postwar developmental model was founded were superseded after 1973–74 and especially over the 1980s by a predominantly political calculus. On the international level, this change emanated from the crisis of the surrounding European political economy under the impact of monetary instability and stagflation. On the domestic level it coincided with the moment of political democratization.

Regime change: the 1970s crisis, end of stability, and the era of financial internationalization

In 1971 the US reneged on its role as the hegemon providing stability to the postwar monetary order. The growth of private international financial activity and heavily expansionary policies in the US over the 1960s (funding the Johnson administration's Great Society program and the spiraling cost of the Vietnam War) had heavily undermined the Bretton Woods system, and by the late 1960s inflation was becoming a principal international concern. The inflation, resulting from excessive monetary creation in the USA, was transmitted to the world economy via the channel of price levels in trade and via capital flows. Aiming to prevent a severe financial crisis at home, the Nixon administration in 1971 unilaterally suspended dollar convertibility into gold, imposed a surcharge on US imports, along with price and wage controls, leading to a substantial dollar devaluation that was tantamount to the breakdown of Bretton Woods (Gilpin 1987: 139–40).

The Smithsonian agreement at the end of 1971 was a last-ditch effort to resuscitate the Bretton Woods regime. It collapsed irreversibly, however, in February 1973 with a new devaluation of the dollar, as a number of European countries floated their currencies out of the Smithsonian band (Eichengreen 1996: 133–4). Throughout that period the Greek drachma remained tied to the US currency, thus following the latter's free fall, which combined with the overheating economy and the deteriorating international climate sent Greek inflation from 4.3 percent in 1972 to 15.5 percent in 1973.

In 1973 Bretton Woods was formally abandoned, replaced by a system of floating exchange rates. The momentous US policy shift of the early 1970s, though prompted by conditions of economic weakness, reflected a unilateral redefinition of national interest. It represented what would later become crystallized as a strategy of developing a market-based, structural power underwritten by the prominence of the US dollar and the size and depth of the American financial markets (Strange 1988, 1996). A (neo)liberal international financial order of free capital movements preserved US long-run policy autonomy in the face of growing external and internal deficits: the dollar as world currency and the preeminence of American financial markets ensured that the US would continue to receive the main share of international capital (Simmons 1999: 40ff; Walter 1993: 230ff). Thus in 1974 the US unilaterally lifted capital controls, initiating a spiral of competitive financial deregulation, followed by Canada, the Netherlands, Germany, Switzerland, Britain, and Japan over the 1970s, and other EC countries into the 1980s and 1990s. Through the 1980s and 1990s, the US (often via institutions such as the IMF, the World Bank, the GATT, and the Bank for International Settlements) consistently exercised intense pressure on developing countries to liberalize trade and capital (Milner and Keohane 1996a: 24). The process of external financial liberalization was substantially facilitated by its lower domestic political visibility (due to higher technicality, lack of directly affected socioeconomic groups, and so on) compared to trade liberalization (Helleiner 1994: 203ff; Kapstein 1992).

In this new international environment of highly volatile interest and exchange rates the ability of monetary authorities to control currency fluctuations was substantially curtailed. Currency depreciations under floating exchange rates did not provide the monetary 'fix' supplied by internationally coordinated and controlled devaluation under the fixed exchange rates regime. By raising the price of imported goods (especially including demand-inelastic ones such as oil) currency depreciation led to vicious destabilizing spirals of inflation and further depreciation.

Attacking inflation in that context only made the currency appreciate, canceling any export benefits sought in the first place. Trying to 'fine-tune' the way between the Scylla of inflationary depreciation and the Charybdis of export-eroding appreciation was practically impossible in an inherently nervous currency market that led to overshooting equilibrium currency values (Loriaux 1999: 268). To boot, it did not solve balance-of-payments disequilibria as the 'floaters' had hoped.

The two oil crises and the recession of the 1970s inflated public deficits and boosted the borrowing needs of both developed and developing economies, thus generating extensive demand for credit capital internationally. Through the 1950s and 1960s, banking interests had by and large been subordinated to the needs of full employment-oriented domestic interventionist policies – and that despite the operation of institutions such as the London Eurodollar market used by American banks to circumvent international capital controls and domestic financial restrictions. The requirement for financial intermediation on a global scale, however, rendered the international financial system the great winner of the oil crises. Responding to growing financial needs a rapid securities expansion and internationalization took place. This became known as securitization of assets, that is the open direct access of borrowers to investors' funds through the sale of publicly traded, open market securities (Cerny 1993). Securitization was boosted by the 1982 Latin American debt crisis, which dealt a serious blow to international banks; this led the latter to seek to supplement their declining profits with off-balance-sheet securities operations,[1] especially given the tightening bank capital adequacy requirements that followed (Lastra 1996). Similarly, the high international interest rates of the 1980s drew corporations to capital markets. Securitization further enhanced the globalization and integration of financial markets, and expanded, both domestically and internationally, the underwriting of debt and equity at the expense of traditional forms of investment such as commercial bank loans (Edey and Hviding 1995). Moreover, technological innovation helped generate a wide range of new financial instruments (variable-rate bonds, convertibles, futures, options, and swaps) that operated with high flexibility and speed, tailored to the needs of borrowers and investors, and designed to adjust to the risks of currency and interest rate volatility. As a result, between 1972 and 1987 the volume of funds raised on international capital markets climbed from US$20bn to US$450bn (Cosh et al. 1992: 23).

Huge financial flows reflected the exponential growth of world trade and investment. Between 1973 and 1987 the volumes of imports in

industrial capitalist countries increased to 22 percent in real GNP percentage terms, from 10–16 percent between 1880 and 1972 (McKeown 1991: 158). Before EC countries had proceeded with liberalizing their capital accounts, expanding market and trade integration in the EC area was rendering capital controls increasingly otiose. Companies could more easily get around capital controls through under- or overinvoicing their commercial transactions. Individual citizens could also circumvent capital and foreign exchange controls as a result of freedom of movement in the EC area and the expanding possibilities of information technology and telecommunications. In the case of Greece, an underground market for foreign exchange thrived, facilitated by the large number of expatriates, the internationalized shipping sector, and foreign exchange receipts from tourism. Thus the overall growth of investment facilitated the deregulation momentum by inducing governments to lift capital controls, which further enhanced the flow of investment capital (Goodman and Pauly 1993). Expanding international capital flows made any attempts to defend fixed exchange rate parities even less viable; this further stimulated the liberalizing (and inflationary for the weak-currency countries) trends.

Financial liberalization and globalization (to use the term that was coined later for a trend that emerged in the 1980s)[2] had significant implications for financial interventionism and the conduct of monetary policy. As capital is internationally attracted by less restricted markets, the domestic allocation of financial resources through *direct* monetary instruments (credit controls and regulations, interest rate ceilings, and directed credits) became undesirable and ineffective under conditions of internationalization. Capital controls that kept national interest rates below international ones tended to reduce savings and raise borrowing to unsound levels. As world interest rates rose, so did the regulatory and efficiency costs of the capital controls applied at the national level (Frieden and Rogowski 1996: 33–4). Thus, governments and central banks were forced to deregulate their domestic banking industries and rely more extensively on 'traditional' *indirect* monetary policy instruments (such as open market operations, rediscount facilities, and reserve requirements) (Padoa-Schioppa 1994; IMF 1995). These changes shifted power from national governments to their domestic financial communities, threatening governments with capital flight if they pursued independent monetary policies (Frieden 1991). Particularly for smaller and open economies, the logic of financial integration called for the reduction of the impact of domestic political factors on monetary policy, to enable central banks to align behind the conditions of international markets.

Even before becoming officially part of the European single market program, capital liberalization haunted West European financial systems. The prospect of capital liberalization operated as a powerful stimulus for domestic banking deregulation. From the moment domestic depositors and borrowers were able to access international financial markets, the domestic banks were forced to remain competitive, and they could only do so if they were not faced with heavier regulations, interest rate controls, and portfolio restrictions than their European counterparts. Domestic banks also needed to overhaul their portfolios, for otherwise they would be unable to maintain the competitive rates forced upon them by financial liberalization. Thus, international financial liberalization threatened with failure all restricted banking systems that refused to liberalize and compete. Capital liberalization could lead to closure of banks unable to attract customers, thus putting serious strain on systemic stability and raising claims on the central bank as lender of last resort. Domestic banks would be hard hit by financial interventionism much more than foreign ones, which can avoid restrictions through transactions with their home offices (Hanson 1994: 337–8). All these interdependent forces and processes operating in the international and European environment in the late 1970s and 1980s pushed credit liberalization onto the agenda of Greek policymakers, as will be examined in Chapter 5.

From the day after the collapse of Bretton Woods, the highly interdependent EC economies sought to operate collective currency pegs. It was not only the importance of intra-European trade but also the Common Agricultural Policy (CAP) which stood to be seriously disrupted by exchange rate swings. From the failed European Snake of the 1970s (attempting to maintain the 2.25 percent fluctuation bands of the Smithsonian Agreement) to the 1979-created European Monetary System (EMS) in the 1980s and 1990s (where a series of crises forced a widening of the fluctuation bands from 2.25 to 15 percent in 1993) the course was laden with obstacles. The removal of capital controls in the late 1980s (in accordance with the single market program) made EMS even more difficult to operate, thus clearing the way to the final adoption of a 'hard peg' through a full monetary union.

Indeed, the post-Bretton Woods international regime of capital mobility engendered a momentum toward monetary union. Fixed exchange rates under EMS (itself an offspring of the European economies' desire to limit extreme currency volatility) combined with growing capital mobility rendered monetary policy increasingly useless by turning it into a simple tool for maintaining the exchange rate. As theorized in the

Mundell–Fleming framework, the desideratum of fixed exchange rates in the face of massive capital mobility left little if any room for independent monetary policy (Webb 1991; Goodman 1992).[3] The argument, simplified, runs as follows: if capital mobility is low, an expansionary monetary policy may be able to stimulate real economic demand by avoiding undesirable effects, since the reduction of real domestic interest rates would not alter the real exchange rate or lead to reserve losses. However, if capital mobility is high, the lowering of interest rates in an attempt to stimulate the economy would only lead to capital flight as investors would seek higher returns abroad. By the same token, an attempt to disinflate by raising interest rates in an environment of high capital mobility attracts foreign capital, thus stimulating demand, expanding the monetary base, and undermining the disinflationary effort. In other words, under capital mobility, domestic interest rates are forced to match those prevailing internationally or regionally, thus essentially depriving the country of an independent monetary policy. Consequently, the erosion of monetary policy autonomy (and given the need to retain exchange rate stability in an international environment of freely moving capital) enhanced the desirability of a European monetary union (Tsoukalis 1997: 164ff; Moravcsik 1998: 238ff).

Such were the forces and processes that operated at an international and European level in the 1970s and 1980s, constituting a highly interdependent set of pressures and constraints on national developmental economic policies.

The domestic response: monetary expansion, stop–go, and the inflationary spiral

Though the eventual outcome of the post-Bretton Woods exchange rate volatility was to lead (via increasing capital mobility) to a disinflationary international regime, the immediate national policy reactions in the 1970s were, by and large, inflationary. Greek economic adjustment to disinflation came late, briefly in 1985–87 before being abandoned, until finally being restored on a permanent basis after 1990. The reasons for the delayed national policy response to the transformed external and European environment can be traced to the domestic political setting of the 1970s and 1980s, as will be seen below in this chapter.

A direct implication of the end of Bretton Woods was that determining the exchange rate came, formally, under national control. In an international context of floating exchange rates, monetary policy autonomy generated an inflationary politicization of monetary policy

by creating a situation under which governments would succumb to wage demands, induced by the rising cost of living. Then, as companies would pass on the rising wage cost to consumers through higher prices, governments would try to offset the ensued loss of competitiveness through depreciation or devaluation, prompting a new round of wage increases, and so on, in a vicious wage–price spiral.

After 1975 the drachma was disengaged from the dollar and pegged to a basket of currencies of Greece's main trading partners. A crawling peg policy was adopted,[4] to offset the negative effects of wage increases upon economic competitiveness. As inflation escalated after the second oil shock in 1979, the crawling peg was accelerated (the drachma was devalued again in 1983) and was only temporarily reversed during the 1985–87 stabilization program that began with a one-off devaluation of 15 percent (Alogoskoufis and Philippopoulos 1992). Over the 1970s the Greek economy was inflating at a substantially higher rate compared to its main trading partners. The drachma's weighted exchange rate parity between 1975 and 1982 depreciated by an annual rate of 9 percent, while in early 1983 it was devalued by 15.5 percent.

Growing monetization of budget deficits (as will be seen further on), along with the cost-push factors associated with the oil crises, led to persistently high domestic inflation in the 1970s. As in other European countries, the authorities attempted to respond to the 1974 recession by increasing monetary growth, in a typical countercyclical use of expansionary demand policy. In an inflationary international environment, monetary expansion further fueled inflationary expectations leading to higher wage demands, pushing the economy deep into the wage–price cycle. While the pursued stimulus was at least partly achieved, reflation brought the economy to a condition of extreme vulnerability. A stop–go pattern was evident in the harsh monetary tightening of 1978, when the BoG raised interest rates sharply (as opposed to the marginal and infrequent changes used until then), thus using interest rates to replace credit controls as the key instrument for monetary management.

With the second oil shock, inflation soared from 12.5 percent in 1978 to 19 percent in 1979 to 24.9 percent in 1980. In view of the severe destabilization, the monetary authorities attempted to suppress the growth of money and credit supply, and interest rates were raised in September 1979. However, real lending rates remained negative (Figure 4.1), which – given the strong inflationary expectations – enhanced the demand for loans. In effect, monetary and credit expansion in 1979–80 was restrained more as a result of a steep fall in the volume of deposits and the balance-of-payments deterioration rather than a determined policy

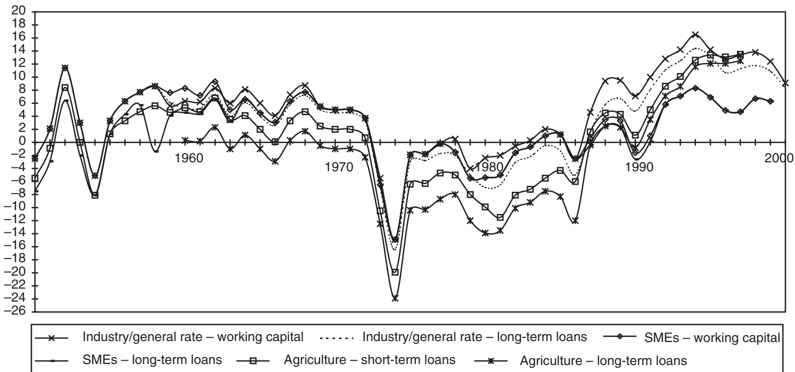

Figure 4.1 Bank lending, real interest rates, 1950–2000.
Source: BoG (1992, 1998, 2001).

of monetary austerity. Any effects of the lukewarm 1979–80 stabilization would further evaporate under the 1981 electorally driven expansion, which raised the government's net borrowing from 2.6 percent in 1980 to 9.1 percent in 1981 in GDP terms, heavily overshooting the announced monetary targets.

The political economy of democratization and its impact on developmentalism

The effects of the external price shock were not allocated equally. The sheltered, nontradeables sector (much of the services industry including banking, construction, and most public enterprises) was less affected by the rise of cost factors. Being sheltered from international competition, such companies were able to withstand the increased production costs by raising their prices – which further contributed to inflation. On the other hand, companies of the open (tradeables) sector (most of manufacturing, tourism, much of the transport industry) being subject to international competition could not raise their prices, and sought to offset their loss of competitiveness through currency depreciation or devaluation – which again fueled inflation by raising the prices of imported goods.

Industrial protectionism contained in the developmental legacy made the state particularly susceptible to sectoral pressures for a monetary policy 'quick fix' to offset the growing loss of competitiveness. Or rather, providing that fix was regarded as an integral part of the state mission of creating the economic conditions for the survival of the productive base of a small opening economy. As part of an export-oriented deepening of

industrialization, revived post-1974 with the effort to gain full accession to the EC, the Karamanlis government sought to prop up manufacturing exports and direct investment toward heavy industry. However, if state-led or state-assisted industrialization as development strategy had been fully warranted in the postwar decades, its extension in the second half of the 1970s was far less auspicious. Cost-push factors had dramatically deteriorated and some of the heavy hothouse industry sectors on which public investment would focus (such as shipbuilding) were already on the verge of international decline. Similar or worse was the case of traditional labor-intensive light industries of consumer goods (such as textiles), principal beneficiaries of postwar ISI protectionism, which into the 1970s were losing ground to low-cost East Asian producers.

The 1974 transition of Greece to democracy substantially expanded the limits of protectionism at the expense of macroeconomic discipline. On the supply side of state policies, the loss of the state's pre-1974 repressive political mechanisms (which among others had allowed unit labor costs to decline by over 30 percent in 1967–74 relative to the EC) necessitated a heavier reliance on social and economic policy instruments for cementing public support. This meant presently delivering (instead of deferring) tangible economic benefits and effectively sheltering the real economy from international shocks (cf. Katzenstein 1985). On the demand side, the democratization of political and associational activity (see Chapter 6) enabled socioeconomic groups, especially labor, to pursue their interests more effectively. Real unit labor costs (the share of labor costs in output) rose (at the expense of profits) by about one-third between 1975 and 1985 (Alogoskoufis 1995: 161).

By the mid-1970s and into the 1980s, conditions were probably ripe for what sociologists would view as increased affluence and political democracy (Greece's graduation from a developing country status) undermining societal willingness to defer consumption, thus leading to declining rates of capital accumulation, slower rates of economic growth, and higher inflation (Goldthorpe 1978). Aside from the ideological extravagance, demagogic fervor, and political maximalism of the democratic transition period (Pappas 1998), the origins of the growing societal impatience and immoderacy of social demands could also be traced back to the politically radicalized 1960s. After a seven-year authoritarian suppression, sociopolitical demands reemerged intensely invigorated. The cumulative outcome of these circumstances amounted to a transfer of systemic power from state to societal politics, translated into a pronounced job-saving, industry-protective commitment – which also helps explain why the industrial sector continued to receive state

support despite the political weakening of the industrialists' federation (SEV) after 1974.

Such conditions entrenched the power of selective credit recipients. The predominance of economic protectionism over the need to disinflate, and the governments' continuing if not growing political dependence on groups such as farmers and the small business sector, greatly obstructed any efforts to raise interest rates, let alone take away from those groups the preferential treatment bestowed upon them over the course of several decades. As Dimitris Halikias, BoG governor of 1984–92, moderately acknowledged, 'given the resistance of strong economic interests, it was difficult for the monetary authorities to move to a substantial rise of interest rates, which in most cases remained at levels below inflation' (Halikias 1995: 86). Indeed, the decision to disinflate within the framework of an administered credit regime would entail directly raising dozens of special preferential lending rates (over 90 different interest rates existed by the early 1980s). This would amount to shifting the cost of stabilization in an immediate and visible way to the wide range of socioeconomic groups favored by credit interventionism, a painful redistributive decision governments preferred to avoid. In other words, the inflationary crisis of the 1970s (culminating in the prolonged stagflation of the 1980s and early 1990s) revealed what a fortuitous economic environment combined with political repression had helped conceal: that the accrual of discretionary credit policies on behalf of selected categories had rendered monetary policy highly inflexible by multiplying the political cost of either monetary stabilization or the return to a less discretionary regime.

A background ideological development underpinned the reluctance to disinflate. Since 1963–64, economic policies had been assuming an increasingly activist and expansionist orientation. Considerable monetary expansionism also characterized the 1967–74 dictatorship, several of whose leading economic policymakers were self-proclaimed Keynesians. With a reasonable time lag, such economic dispositions also echoed the maturing Keynesian hegemony in the Western world (led by the public conversion to Keynesianism of the US administration in the 1960s, later followed briefly by West Germany under the Social Democrats).

The politicized pattern of domestic reaction to external shock and the extensive economic and financial crisis of the 1970s were causally associated with the particular features of the Greek developmental financial model. Financial interventionism over the 1950s and 1960s, combined with the political regime's authoritarian proclivities, had been an instrument in the hands of a *formally* strong state. Emphasis is attached

to the word 'formally', as Chapter 3 has expounded on the substantial factors that delimited state strength. Apart from bureaucratic weaknesses, these factors chiefly included the subjection to political control and the willingness to yield to private oligopolistic economic interests. Any state strength thus did not derive from a French- or Japanese-type powerful bureaucratic apparatus, and it did not reach a tantamount degree of rational planning. But state strength was a function of the appreciation of the state's developmental mission, even if that was implemented in the limited version of an incentive- rather than a sanction-based approach. Selective credit policies joined by industrial and tax policies allowed governments to somehow direct the creation of an entrepreneurial class, orchestrate business life, shepherd the course of economic development. Ultimately, unlike other national models of France, Spain, or Japan, this version of a developmental state mission was one in which politicians ruled, almost exclusively, and bureaucrats mostly executed – the notable exception of the BoG's crucial codecisional role in monetary and credit policy notwithstanding. State strength then derived from the abundance of selective policy instruments, the underdevelopment of sociopolitical and institutional mechanisms to control their use and abuse (mechanisms referring either to an advanced pluralistic civil society or a developed system of independent public control institutions), and the weakness of both a politico-ideological opposition and a convincing technocratic alternative to the developmental financial model.

Built under different economic and structural preconditions, the developmental institutional apparatus was available at a time of intense economic crisis and heightened political necessity. The advantage to be gained from developmental finance is predicated on a structural condition of comparative backwardness. By the 1970s, however, Greece had turned from a developing stage into a middle-income country status (Figure 4.2), from a mostly agricultural economy into a newly industrialized country. That was evinced, among others, in its high energy dependency, which maximized the harshness of the oil shocks. From the moment the economy had matured from its developing, rural-based status into an adequate stage of industrialization, targeted monetary expansion toward manufacturing could only obtain very limited productivity gains. In such a context, the political utility of developmental finance superseded its economic *raison d'être*. Developmental financial institutions outlived their developmental objectives, being deployed to cushion the effects of the 1970s price shock in a manner that eventually undermined the necessary adjustment and overall economic competitiveness

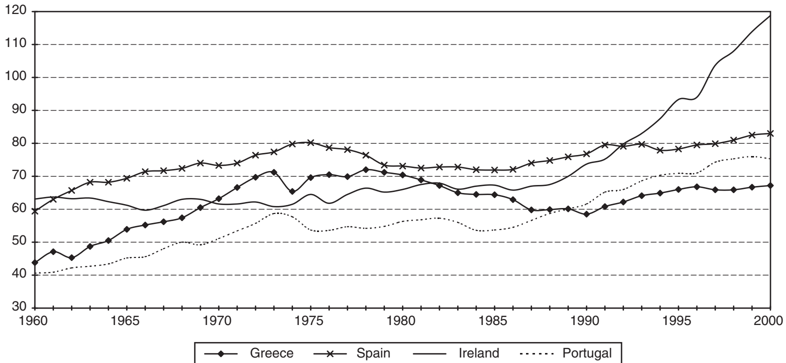

Figure 4.2 Greece and Europe GDP per capita, 1960–2000 (PPS, EU-15 = 100).
Source: European Commission (2000c).

of both the industrial base and the financial system, as will be further seen below.

Skewed toward political imperatives and inconstancy instead of bureaucratic objectives and continuity, the developmental state was particularly susceptible to the uniform primacy of politics over policy during the South European democratic transition (Maravall 1993). Any bureaucratic continuity was further disrupted by the 1974 change of political regime, despite the restriction of a civil service purge to only extreme cases of pro-junta partisanship. Being then minimally exposed to bureaucratic control, economic, financial, and industrial policymaking of the postauthoritarian period was easily instrumentalized in the service of two paramount political projects. The first, pursued by the Karamanlis governments of 1974 and 1977, aimed to consolidate the fledgling republican polity and dissociate his New Democracy (ND) Party from the authoritarian-prone legacy of the postwar Right. On the political front these objectives were pursued by legalizing the Communist Party and by establishing full political and civil rights. Karamanlis's dogged pursuit of Greece's acceptance into the EC, despite strenuous domestic opposition and foreign obstacles, was also meant, among others, to provide an external shield to the fragile Republic.[5] On the economic front, the Karamanlis governments sought to demonstrate government determination and strength, to appeal to politically progressive social strata, and to affirm government economic control. Thus the ND government in 1976 nationalized a few large companies (including the Commercial Bank group, also comprising the Ionian Bank and other subsidiaries) whose powerful owners had cooperated

with the colonels. The ND overall pursued a centrist interventionist economic policy mix, spiced with particularistic financial handouts to friendly businesses and constituencies, a clientelistic-leaning policy pattern that became increasingly expansionary in the run-up to the October 1981 election.[6]

The second paramount political project that instrumentalized economic and financial policies was the one followed by the first socialist government of PASOK under Andreas Papandreou in 1981. Concerned about the viability of a left-of-center socialist government (practically the first in modern Greek history), PASOK sought to cement a wide popular base of 'nonprivileged' social strata through a broad range of often clientelistically targeted social benefits.[7] Although the policies were defended along the lines of a Keynesian structuralist-leaning economic rationale, and although they responded to a real lag in social spending by catching up with Western European levels, electoral expediency was strongly discernible in the expansionism of the 1980s (more on which anon).[8]

As democratization forced the state to accommodate intensified socioeconomic pressures in a political context of fierce party opposition, lack of monetary restraint and inflationary cheap credit after 1974 signified a political strengthening of society vis-à-vis the state. As government spending and public debt grew, so did the state's financial vulnerability. Debt monetization, used sparingly and mostly for investment purposes during the postwar period, became after 1974 a principal function of the state-controlled financial system. The postwar developmental financial configuration, devoid of its external monetary stability guarantees and domestic fiscal restraint, turned into a factor of prolonged stagflation. The BoG, whose lack of formal independence from government in the Currency Committee framework was supposed to facilitate the coordination of monetary with developmental policies, post-1973 was forced to subordinate its disinflationary objectives to persistent macroeconomic expansionism. Figure 4.3 gives an indication of the high degree of Currency Committee activism. The BoG political dependency, the government control over the majority of the banking system, and the obligatory bank investment requirement in government securities, all amounted to a soft budget constraint that enabled the heavy politicization of economic interventionism over the late 1970s and especially through the 1980s. The post-1973 economic and political setting favored the pursuit of growth over macroeconomic stability, and ended up obtaining neither.

Thus the institutional continuity of credit interventionism pre- and post-1974 could hardly disguise the bold change in its policy usage and

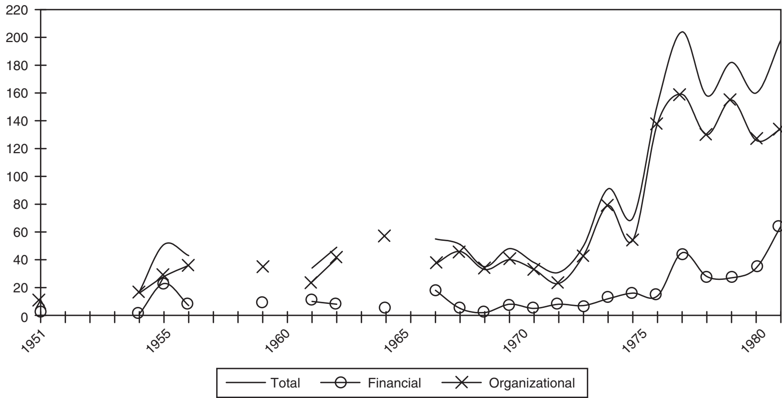

Figure 4.3 Acts of the Currency Committee, 1951–81.
Source: *The Official Gazette*, 1951–81.

economic effects. The 1973–74 juncture disrupted the economic continuity of the developmental regime, but its institutions and policies continued nonetheless to be deployed by way of incremental 'muddling through' to stabilize what was perceived as a cyclical downturn. Though financial distributionism was integrally contained in the developmental regime that emerged from the 1950s, the relative gains and losses produced were not capable of leading to heavily disruptive economic outcomes as long as that regime continued to operate by observing the fundamentals of fiscal and monetary stability on which it was premised. That was its major difference from the post-1974 redistributive-minded interventionism. Having abandoned the postwar commitment to macroeconomic stability (given the loss of the Bretton Woods protective umbrella, the novel international environment of stagflation, and the a priori political decision not to deflate), postauthoritarian interventionism soon slid into a vicious cycle of deficits and inflation.[9]

Being aimed at stabilizing the business cycle, the expansionary monetary policies of the post-1973 period were of a countercyclical nature and revealing of the way in which Keynesian thinking had been internalized by Greek economic policymakers.[10] It should be emphasized that, strictly speaking, such use of countercyclical policies was a misapplication of Keynesianism, since Greece in the 1970s (with the exception of 1974) was not in recession, nor did it have high unemployment – the *loci classici* of Keynesian policy (Figure 4.4). That was distinct from the pre-1973 pattern. In effect, the postauthoritarian inflationary use of finance could be claimed to have echoed the French postwar inflationist strategy of

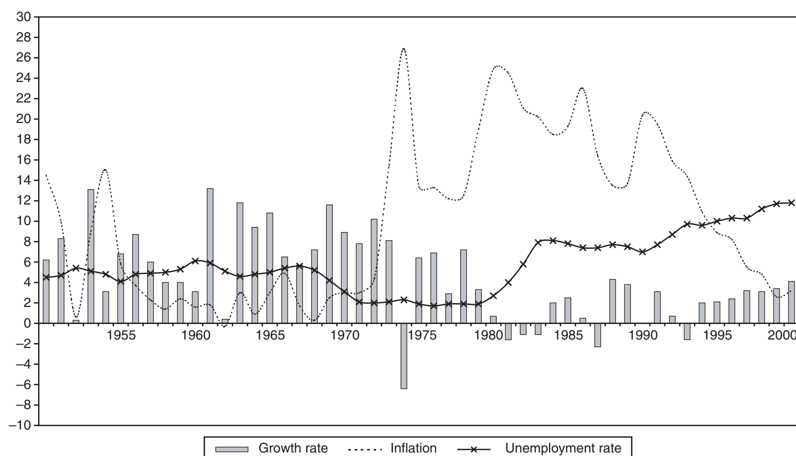

Figure 4.4 GDP growth, unemployment, and inflation in Greece, 1950–2000.
Sources: OEEC (1959), UN (1963), Ministry of National Economy (1976, 2001).

encouraging painless and hidden transfers serving to alleviate social conflict. This meant a pattern of 'satisfying the monetary demands of all groups and letting the resulting inflation determine the relative value of these money assets' (Zysman 1983: 138; Maier 1978: 56–9). Based on wage increases and cheap credit via repressed rates, the inflationist strategy could only be sustained by periodic devaluations.

Undoubtedly, inflationism involved important redistributive repercussions. In general, businesses as borrowers may benefit from inflation for reducing their debt burden, possibly also for reducing labor's real wages. (However, business owners themselves may lose as rentiers.) Wage-earners lose from inflation if real wages decrease, but they gain if employment increases. As expected by the standard literature, high and unanticipated levels of inflation transferred wealth and income from creditors to debtors, from fixed-income earners such as wage-earners and workers to owners of capital, from current holders of debt to future taxpayers (Keynes 1923/1972; Maier 1978). As high inflation led to negative real interest rates, financial interventionism post-1973 signified a financial redistribution from depositors (who received negative real deposit rates while having very few alternative investment opportunities) and nonfavored borrowers (who incurred relatively higher interest rates) to favored borrowers (industry, agriculture, exports, and the public sector).

In so far as negative welfare effects were spread across broad and widely overlapping socioeconomic categories they were prevented from

generating any organized opposition. In a postauthoritarian decade impregnated with fervent ideological conflict, inflation was not the axis along which social groups were divided and political allegiances were forged. A considerable range of losers from inflation were (or regarded themselves as) gainers of expansionism. For example, small depositors tended at the same time to benefit as mortgage, SME, or agricultural borrowers. The rise of welfare entitlements in the first half of the 1980s served to compensate lower-middle-class strata for much of their real income losses. The widespread side-economy (estimated in the area of 35 percent of GDP) complicated the picture even further. Overall, money illusion (that is, not fully taking into account the inflation expected to occur when estimating real income from money income) concealed the real costs of inflation, thus serving as a kind of palliative for socioeconomic discontent.

The stagflationary 1980s

The post-1974 period represented the – failed – effort of an ideologically eclectic conservative government (one that was more eager than ever to demonstrate its progressive, socially conscious credentials) to react to the stagflationary crisis by way of easing the levers of fiscal and monetary policy. By 1980, public consumption had risen by nearly 40 percent from 1974, while public investment remained almost unchanged. The 1980–81 electoral cycle that followed the second oil shock of 1979 completed the damage.

Greece's entry to the EC in 1981 coincided with the rise to power that same year of PASOK. Its professed aim of economic stabilization was soon overrun by a demand stimulus, hailed both as a strategy of recovery and as an instrument for income redistribution. As the socialist government sought to stabilize its political grip by appealing to left-wing and socioeconomically marginalized strata, redistribution or plain electorally minded expansion constituted a main pillar of its political strategy (Clogg 1993). Consequently, in the 1980s Greece diverged greatly from the EC economic policy standard (Verney 1996). Between 1975 and 1990, government spending in Greece rose from around 29 to 51 percent of GDP, compared to an EU average increase from 42 to 47 percent, and an OECD average increase from 35 to 39 percent.

The Papandreou government postponed the liberalization reforms encouraged by the EC, and attempted (during the 1981–85 first government term) to pursue its own supply-side 'structuralist' strategy of state intervention, emphasizing institutional reforms such as democratic

planning and socialization, under the theoretical guise of subordinating monetary stability to the goal of industrial and agricultural protection, restructuring and development (Tsakalotos 1991a, 1998). The 1981–85 period was characterized by very slow progress in liberalization and the removal of trade barriers, as dictated by the hard core of Greece's obligations to the EC. In a digression from Karamanlis's famous alleged dictum on the country's EC accession 'I have thrown you into the water, you must now learn how to swim', the state was warming the water for the reluctant swimmers. Though tariffs and quotas were dismantled, in accordance with the interventionist strategy of the first half of the 1980s, these were replaced by selective protectionist policies relying on nontariff barriers such as quantitative restrictions or a regulatory tax on imports (established in 1984 and abolished only as late as 1989) and export subsidies (Mitsos 1989; Katseli 1990: 236). Total state aid to manufacturing as a percentage of value added was estimated at 24.3 percent in 1986–88 and 14.6 percent in 1988–90, compared to an EC average of 4 and 3.5 percent respectively, and percentages in the area of 3–6 percent for either Spain or Portugal (OECD 1993: 16). Protectionism began to decline significantly only after 1990.

In addition, over the second half of the 1970s and into the 1980s, state-controlled banks (SCBs) were directed to take over a number of mostly ailing key firms in order to save jobs and avert the failure of important industrial sectors. The rise in the number of bank subsidiaries is shown in Table 4.1. Haphazard credit policies of the past had come home to roost. This last ditch effort of what remained of a developmental state seeking to prop up industrial growth amidst a highly adverse economic environment took on a more systematic form when a broad number of overindebted industrial enterprises were brought under the 1983-established Industrial Reconstruction Organization (OAE). Between 1983 and 1987, the OAE received 250 applications from firms in financial distress, of which 44 larger-size firms were initially accepted, to which another 10 were later added (European Commission 1992: 17). Though the OAE was supposed to overhaul the ailing companies and preferably return them to the market, any privatization intention was frozen until 1990.[11] Even then, however, the reluctance of private investors to take on such overstaffed, overindebted firms without radical but politically painful overhaul kept the firms under the OAE until well into the 1990s. They were kept alive by constant financial transfusions that burdened the public debt while often constituting a form of illicit subsidy.

The OAE affair had grave implications for SCBs, which were forced by government to accept the conversion of their debt claims against OAE

Table 4.1 Holdings of National Bank and Commercial Bank Groups (number of firms)

	1971		*1981*		*1987*	
	Majority holdings (>50%)	*Total holdings (>10%)*	*Majority holdings (>50%)*	*Total holdings (>10%)*	*Majority holdings (>50%)*	*Total holdings (>10%)*
National Bank Group						
Banking	5	5	5	8	5	8
Insurance	3	7	5	8	4	8
Investment	–	–	3	4	2	4
Tourism	2	4	5	14	5	14
Industry	4	22	9	67	9	69
Various	4	14	4	10	4	13
Total	18	52	31	111	29	116
Commercial Bank Group						
Banking	5	6	6	6	7	7
Insurance	3	4	2	3	1	3
Investment	–	–	1	1	1	1
Tourism	1	1	1	1	1	1
Industry	5	7	5	11	4	11
Various	1	5	1	3	3	7
Total	15	23	16	25	17	30

Sources: NBG and Commercial Bank.

firms into equity participation. Through debt capitalization an additional number of ailing firms (totaling 75 by 1990) were acquired by their former SCB creditors (especially the National Bank), usually against the will of the banks' administration. The new SCB industrial subsidiaries were subject to very lax budget constraints and various abuses of political control. Having easy credit access, they gradually amassed large debts and developed into grave portfolio burdens, probably the chief problem for the SCB sector by the end of the 1980s. By 1989 the accumulated debts of OAE firms corresponded to about 13 percent of the general government debt of that year. To the nonperforming bank loans copiously extended to OAE firms should be added a large volume of accumulated arrears from loans granted to public firms and entities. As a result of government-imposed lending to both public sector and ailing industries, in 1988 the average (unweighted) own capital/total assets ratio of Greek commercial banks was around 3 percent compared to a risk-weighted 8 percent minimum ratio eventually required by the EU (European Commission 1992: 34).

The macroeconomic picture was even more depressing. As domestic supply failed to respond to the growing demand created by fiscal expansion, inflation and the trade balance deteriorated – especially given the removal of trade barriers following Greece's 1981 entry to the EC. In a familiar pattern exhibited by other European countries, higher trade integration canceled the stimulus that a public deficit could produce, since most of the increased spending leaked away into imports. Throughout the 1980s the economy remained trapped in double-digit inflation and virtual stagnation, with an annual average growth of less than 1 percent, well below the EU, OECD, or Southern European average (Figures 4.5–4.6). The supply-side shocks of the 1970s had a longer-term

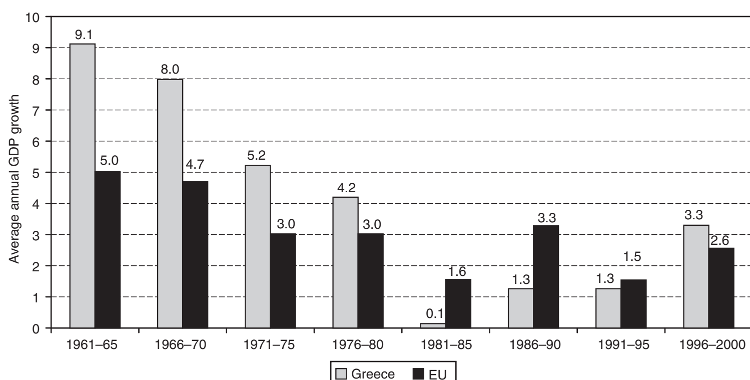

Figure 4.5 Economic growth: Greece and EU, 1961–2000.
Source: European Commission (2000c).

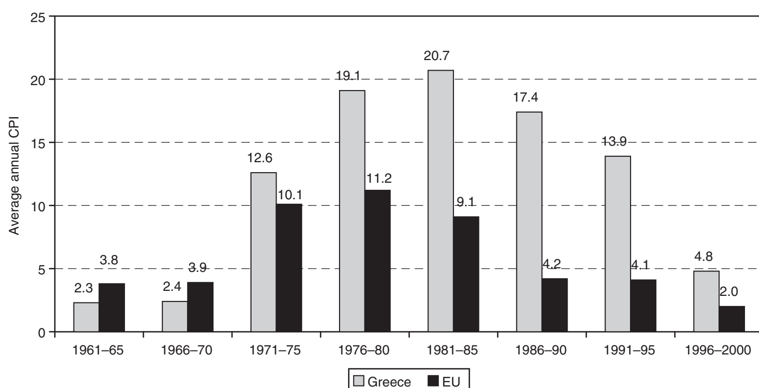

Figure 4.6 Inflation: Greece and EU, 1961–2000.
Source: European Commission.

debilitating impact on industrial productivity, with firms over the late 1970s and into the 1980s directing a growing amount of finance into working and capital maintenance costs rather than the purchase of new capital equipment (Dimeli et al. 1997: 39–40). Private investment failed to pick up, reacting to the real wage increases above productivity growth during 1982–85, a falling profit share, a hostile environment of antibusiness attitudes by government officials, fear of nationalizations during the initial PASOK years, extreme labor union militancy, and a generally deteriorating macroeconomic environment. During 1979–90, average annual increase in fixed capital formation in Greece was (negative) −0.8 percent (against a 2.3 percent EU average, 3.3 percent in Portugal, and 4.3 percent in Spain) (Figure 4.7). During the same period, labor productivity increased by an annual average of 0.5 percent, compared to an annual 3 percent in Greece's trading partners. Both per capita income and relative wage levels in Greece as a percentage of the EU average decreased by about 4 percentage points (OECD 1993: 13ff). The prolonged period of public and private disinvestment continued through the severe monetary austerity programs of the first half of the 1990s, with debilitating implications for economic productivity. One can clearly identify the late 1970s and 1980s as the beginning of a gradual but steady deindustrialization (Louri and Pepelasis Minoglou 2002). Figures 3.5–3.6 show the decreasing share of industry and manufacturing in GDP. The economic

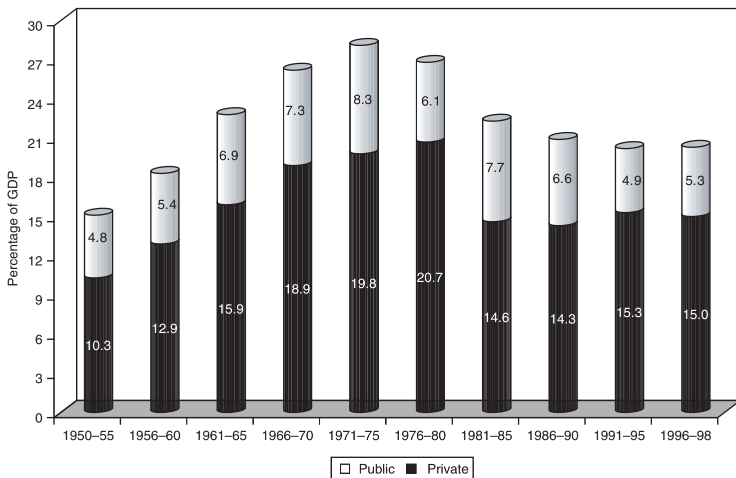

Figure 4.7 Average gross fixed capital formation by sector, 1950–98.

Source: BoG (1992, 2000).

decline was reversed only in the mid- and second half of the 1990s, under the propitious circumstances of a growing stock market, deescalating inflation and interest rates, and copious EU structural funds.

The soaring public debt entailed a vicious self-feeding quality. During most of the 1980s, international interest rates stood at particularly high levels. This factor, combined with the significant drachma depreciation over the 1980s, raised the cost of debt servicing. To protect from inflation and repressed returns on deposits, savings flew out of the country. This undercut the banking system's ability to finance the government debt – by purchasing government securities or by providing direct, low-interest or interest-free credits to public entities and enterprises. As its debt grew, the government increasingly relied on the obligatory investment ratio of commercial bank deposits in Treasury bills. By ensuring a cheap way of financing public deficits, thus eschewing the impact of the government's budget constraint, the investment ratio was tantamount to indirect public debt monetization. Accelerated money creation was an attractive method of public deficit-financing as it avoided the economic and political costs of raising taxes or issuing interest-bearing government debt. However, the moral hazard of easy government access to finance encouraged fiscal laxity. When government was gradually deprived of its privileged borrower status the cost of servicing the accumulated debt rose dramatically, as will be seen in Chapter 5.

The distortion of credit interventionism

The Bretton Woods collapse and the stagflationary crisis deprived the Greek financial system of its ability to operate as a mechanism of inflation-free industrial growth. Past policy defects started looming more ominous now. The established ties linking commercial banks to the prospective and rising industrial champions of the 1960s turned into knots of pathological financial dependencies with the lame ducks of the late 1970s and 1980s. As industrial production costs rose dramatically, so rose the firms' need for constant financial transfusions.

Thus, on the credit demand side, from the second half of the 1970s and especially into the 1980s a familiar path dependency was exhibited, one associated with developmental states in decline. Controlled and subsidized bank finance encouraged protected industrial firms with access to preferential credit to remain highly leveraged, avoiding access to the capital market. This increased their vulnerability to external shocks, soon making them unable to repay their debts, thus loading banks with a host of nonperforming loans. In such a way, industrial failure ended up

threatening banking systemic safety, a risk even further 'socialized' if one considers the familiar moral hazard problem associated with firms 'too big to fail'. Governments are prone to rescue large firms to avert the social cost of their going bankrupt. This, however, encourages such firms to constantly expand (given their assured line of credit) which only further amplifies the cost of their failure. At the end of the day the bill is picked up by the state (and thus passed on to the public) either in the form of an inflationary refinancing of the bad loans in order to bail out the failing firms, or through direct fiscal handouts to write off their debts (Woo-Cumings 1999b: 12–13).

A more market-based financial system might have diffused the financial burden. A banking system less subject to government control would have withstood pressures for the extension of uninhibited flows of credit, especially at the negative real lending rates of the 1970s and 1980s. The unfolding of the 1970s economic crisis in the parallel context of democratic transition maximized the government need to prevent a rise in unemployment. This political need further intensified as the effects of the 1979 oil crisis were compounded by the 1980–81 electoral cycle. PASOK's rise to power terminally postponed a painful labor-shedding restructuring of the ailing part of the manufacturing sector.

Thus through the 1970s crisis and into the first half of the 1980s, credit interventionism was divested of both its developmental and stabilization function. In an effort to ease the supply-side shock, nominal interest rates rose at a far slower pace than the galloping inflation, becoming negative in real terms. This was in direct contrast to the postwar use of credit policy with a commitment to monetary stability. By becoming inflationary, credit interventionism was also shorn of its developmental role, as – instead of financing new investment – copious bank credit was extended to cover short-term operational needs in order to keep alive the hard-hit industrial enterprises. Credit expansion was even more difficult to control because, given the insufficiency of long-term savings, any tightening of money supply would be regarded as undermining the firms' investment, most of which was funded by short-term bank credit. Credit interventionism allowed the state to provide painless short-term solutions to the crisis, postponed the necessary adjustments, underwrote a generation of ailing and overleveraged industrial firms, and burdened the SCBs with a chain of bad loans and failing industrial subsidiaries.

The political decision to cushion the external shock of the 1970s by retaining a constant flow of cheap finance did not manage to avert the bankruptcy of about a fifth of the manufacturing sector between the

mid- and the late 1970s (Papandreou 1991: 2). Assured credit lines deterred the exit of an extensive number of overindebted firms. The net profit rate in manufacturing (profits after depreciation and financial charges in relation to equity capital) fell from 15 percent between 1970 and 1973 to about 8 percent in 1979, and turned negative in 1982 (OECD 1987: 32). Though some 40 percent of all firms between 1979 and 1986 were steadily making losses, only 7 percent declared bankruptcy, and these were predominantly small-size (Papandreou 1991: 14). Constant financial transfusions to loss-making firms were not only universally preferred by the firms and government alike, as they postponed the painful readjustment, market exit, and redundancies. They were also, to some extent, convenient for the banks themselves, which having accumulated large stakes in overindebted ventures were loath to see them collapse. Up to the early 1990s (when the European Commission imposed universal accounting transparency standards) banks were window-dressing their balance sheets by accruing interest on nonperforming loans.

Thus financial interventionism was transformed from chief developmental instrument into a mechanism for short-term political and electorally minded 'quick fixes'. (As Figure 4.8 demonstrates, since 1974, the elections of 1977, 1996, and 2000 were the only ones where an electoral cycle in the economy was largely absent.) The fiercely revived party politicization and polarization of the postauthoritarian period (Bruneau et al. 2001: 58ff), and the systematization and routinization of clientelistic

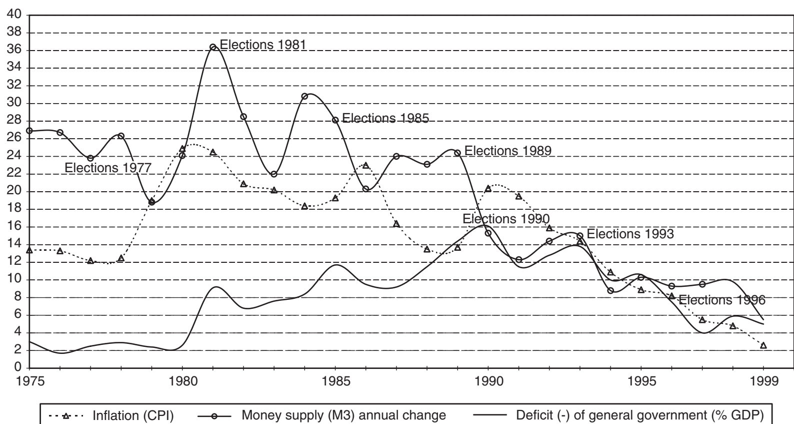

Figure 4.8 The electoral cycle: fiscal and monetary expansion, 1975–99.
Sources: Ministry of National Economy, BoG (1993–2001).

accommodation, entrenched the political employment of credit interventionism, further alienating it from its developmental and stabilization rationale.

Hence an answer is also provided to the paradox of the high leverage of Greek industrial firms not leading up to a real banking system crisis from the moment the firms' debt burden became impossible to service. While the state forced SCBs to cushion the crisis of industry to their great detriment, it also averted the collapse of state banks by helping them improve the appearance of their balance sheets, or by directly bailing them out (as it did with ETVA and the Agricultural Bank in the late 1980s and 1990s). Not being subject to any tight fiscal framework, being able to monetize public deficits by taxing the banking system, the state socialized financial losses by inflating its debt.

As real lending rates became negative and special obligatory investment requirements expanded, financial interventionism, which had once ensured comfortable oligopoly profits for domestic banks, turned into a source of aggravation. Along with suffering a severe deterioration of their portfolios, banks were also apprehensive over the gradual opening of the banking system to external competition following Greece's entry to the EC in 1981. These factors intensified bank pressures for a part liberalization of the system, that is not in actually reducing protectionism but in allowing interest rates to rise in accordance with inflation, and in withdrawing obligatory investment ratios and other government-imposed burdens.

The shift to economic stabilization and disinflation

Gradually from the second half of the 1980s, the international and European disinflationary regime was internalized into domestic economic policymaking and institutional design. The starting point of economic convergence was the stabilization program initiated soon after the June 1985 reelection of PASOK to power, as will be seen in Chapter 5. The program included virtually no other structural reforms apart from credit liberalization, and it was abandoned by Premier Papandreou in spring 1987 in what would prove to be the beginning of a deleteriously long period of electoral expansionism. Nevertheless, it was the first systematic move toward the orthodox economic adjustment orientation that would prevail throughout the 1990s.

What were the transmission belts that brought about this adjustment to the disinflationary international regime and the neoliberal-leaning economic paradigm of the 1980s? Which were the mechanisms that

gradually transformed external pressures into domestic policy output, turning the developmental into a disinflationary state?

Drawing on Bennett (1991), one may identify a fourfold framework of (highly interrelated and often difficult to separate) processes through which policy convergence might arise: *emulation*, where state actors copy action taken elsewhere; *elite networking*, where convergence is brought about by transnational policy communities; *harmonization* through the international regimes and the recognition of interdependence resulting from the transnationalization of economies; and *penetration* by external actors and interests, where states are forced to conform to actions taken elsewhere by external actors. These processes operate as transmission belts in passing international policy pressures into the national policymaking system. Adjustment to these pressures was a Europe-wide phenomenon, though implemented with different timing, sequencing and scope, cross-national variation resulting from the dissimilarity of institutional endowments, domestic economic conditions, and sociopolitical context.

Across the EC governments over the 1980s, parallel programs were initiated whose prominent feature, among others, was a bold redrawing of the public–private boundary to the benefit of the latter. The project of 'rolling back the state' was prompted as Europe's response to the anticipated erosion of its competitiveness under conditions of internationally spreading market globalization and liberalization. Corresponding to the process of harmonization mentioned above, the European response consisted of a strategy of enhancing EC economic competitiveness through strengthening the efficiency of national economies via 'structural adjustment' policies of market integration and liberalization. The redefinition of the state's role, among others, was implemented through simplifying or abolishing national postwar regulatory structures (deregulation) followed by establishing new regulatory frameworks mostly aimed at systemic safety and consumer protection (prudential reregulation) (Majone 1996a).

Thus domestic financial deregulation can be viewed as an integral part of a wider EC momentum of marketization, liberalization, and privatization policies converging toward a lesser or redefined state role (Müller and Wright 1994). European financial reform relied extensively on EC competition policy, which on the whole incorporated: (a) the outcomes of national government efforts to protect their industrial sectors; (b) the mobilization at EC level of transnational enterprises to ensure access to cross-border markets; and (c) the formidable policy control of the European Commission (Helleiner 1995: 330; Allen 1996: 178–9; Schmidt

1997; Lavdas and Mendrinou 1999). Over the 1980s, one EC country after another proceeded to stimulate internal banking competition through deregulating interest rates, removing domestic and cross-border obstacles, phasing out direct lending controls and investment requirements, and encouraging the creation of new financial instruments. France, a paragon of financial dirigisme, adopted bold deregulation measures in the 1980s which led to a 'Big Bang' in its financial market (Cerny 1989). During the same decade, that other paragon of postwar developmentalism, Japan, underwent far-reaching financial liberalization known as the 'Biggu Bangu' (Laurence 2001). Over the 1980s and into the 1990s, South European financial interventionism (in Italy, Spain, and Portugal) was dismantled by liberalization. Arguably, the single financial market program, complemented by EMU, represented an affirmation of the rising importance and power of the internationalized financial sector and central bankers (Dyson et al. 1995). Moreover, the new strict 'sound finance' orientation satisfied the typically inflation-averse European bankers. Thus, the implementation by national systems of EC-sponsored financial reform programs (itself an offspring of internationalization and interdependence), signified an erosion of the impact and sovereignty of domestic politico-institutional factors. At the same time, it indicated a dimension of effective transnationalization of policy communities serving as a force for convergence.

A common enhancing factor of national liberalization programs was the unfolding transformation of the industrial environment and industrial culture in Europe, resulting from the growing globalization of economic activity. Increased permeability of national frontiers deprived national firms, public or private, of their protection from foreign competition. Fiscal constraint or burdened bank portfolios or high interest rates pressured firms to turn to capital markets. European competition regulation disallowed long-entrenched practices of overt or covert industrial subsidies (a great part of which were granted through the banks), thus forcing firms to become self-sustaining. Increasing interdependence and the transnationalization of business activity compelled larger firms to adopt an international strategy, by contracting transnational alliances or engaging in direct foreign investment. These changes coincided with a spreading understanding that 'national champions' or even public monopolies should have few inhibitions about seeking to promote their own corporate strength and profitability, rather than some vague notion of 'national interest' (Hayward 1995: 2). Much had to do with the changing nature of strategic industries: shipbuilding, steel and coal, traditional pillars of industrial dirigisme, entered after the

1970s into steep decline and financial crisis. Such developments coexisted with a rapid tertiarization of economies and of foreign direct investment but also with the inherent decline of dirigisme as a rational project. In an open, regionally integrated (EC) and diversified economy (entailing mobility of factors of production, flexible specialization, and extensive choice in the marketplace), the state was deemed culturally and institutionally incapable of playing a leading role in industry (Cohen 1995: 24). Thus the pursuit of long-term developmental economic strategies became increasingly difficult, yielding instead to 'short-term, piecemeal, "muddling through" tactics of incrementalist market improvisation' (Hayward 1995: 12).

Associated with the transforming international economy and industrial marketplace was the neoliberal and supply-side economic ideology of the 1980s, in the ascendant in Greek society particularly from the second half of the 1980s.[12] Economic neoliberalism was internationally championed by major industrial and financial business interests, anxious to gain competitiveness on a global scale (Strange 1985). It had a crucial impact in structuring the perceptions of international and domestic actors, offering them a convincing legitimizing discourse for implementing market-oriented reform. Under the ideological influence of the New Right, state intervention was met with acute general skepticism, a transformation which, embedded as it were in the new economic environment, merits characterization as a paradigm shift. As Vincent Wright summarized the main tenets of the neoliberal ideological paradigm:

> state officials cushioned from the rigours of the marketplace, inevitably strike up collusive and costly relations with privileged groups; private provision is *inherently* more efficient than public goods; state intervention, with its market-distorting bias, harbours inevitable unintended and unwelcome consequences; industrial policy is a mask for politicized market distortion; selected national champions invariably turned out to be expensive white elephants or lame ducks.
>
> (Wright 1995: 340)

Placed in a 'policy receiver' position by virtue of its standing in the EU periphery, Greece was susceptible not only to external economic and institutional pressures but also to the international ideological and policy paradigm. Just as financial interventionism in postwar European and developing countries had contributed a model for the Greek developmental interventionist system, so too did the dismantling of administered

finance in Europe after the 1970s offer a blueprint for Greek credit deregulation. For reasons relating also to their academic backgrounds and professional training, Greek banking policymakers of the second half of the 1970s and the 1980s were particularly exposed to the Anglo-American banking model.[13] During that period, and certainly through the 1980s, a perception intensified among banking policy experts including the BoG that credit interventionism had failed to deliver both in terms of banking efficiency and channeling resources toward productive investment.[14] Greek experts were highly attentive to the banking deregulation experiment which, beginning from Britain in the early 1970s, was sweeping through other European banking systems during the 1980s. It was in this context that the policy transmission mechanism identified as emulation operated, that is the employment of a policy of another country 'as an exemplar or model which is then adapted and, one would hope, improved upon' (Bennett 1991: 221; cf. Rosenau 1996: 259).

The radical shift of monetary policy direction in Europe reflected the powerful impact of monetarism in academic discourse. Of all economic policies, monetary policy is probably the most exposed to academic influence. Being relatively aseptic toward social, political, and redistributive considerations crucially affecting other macroeconomic policies, monetary policymakers are single-mindedly focused on their parsimonious set of objectives confined to ensuring monetary and systemic stability and enabling economic growth. In that pursuit central bankers are guided by both empirical observation and theoretical argument, the latter usually serving as the narrative for conceptually framing and explaining the former. By the late 1970s, assisted by high inflation, monetarism was providing an increasingly attractive conceptual framework for viewing economic management, and monetary and credit policy in particular. Drawing on the classical[15] doctrine that an increase in money supply generates inflation rather than output growth, monetarists advocated that governments should adopt a 'steady but moderate' rate of money growth (Friedman 1968, 1973).[16] Consequently, monetarists strongly contradicted both monetary activism and the Keynesian belief that public deficits could be used to stimulate the economy. Instead of the Keynesian bias in support of demand management, monetarists championed supply-side policies, such as extensive deregulation and privatization, as the appropriate strategy for generating sustained economic growth by increasing the level of potential output. They maintained that banking should also, like other economic sectors, be subject to the microeconomic imperative of efficiency-maximizing competition, which better enables financial institutions to react flexibly to demand and supply

changes in financial markets. This a priori position that restrictions should be lifted as obstructive to banking competition underlay many monetarism-inspired pronouncements that financial interventionism had failed to produce its anticipated allocative results, and instead was generating a host of perverse effects (Shaw 1973; McKinnon 1973).[17]

The appeal of monetarism to central bankers came naturally. For one thing, one of monetarism's fundamental propositions was that instead of the two traditional Keynesian instruments for controlling inflation, that is monetary and fiscal policy, monetary policy alone is effective while fiscal policy is not.[18] In an economic conjuncture of mounting inflation, the monetarist doctrine emphasized the need for increasing control in the hands of central bankers, and raised reasonable expectations for more independence from their governments. Recognizing the commitment of monetarism to combating inflation even at a considerable cost to employment, commercial and development bankers across Europe, typical net creditors and thus natural opponents of inflation, also enthusiastically aligned behind the new monetary ideology.

Policy linkages within the neoliberal reform agenda necessitated parallel action in interdependent fields. The neoliberal agenda exhibited a self-enforcing quality, one set of policies leading to another. For example, as financial liberalization deprived European governments of the ability to influence real interest rates, the cost of servicing large public debts rose dramatically. As a result, governments were compelled to offset public debt by generating consecutive primary budget surpluses (that is net of interest payments). For countries with high public debt and deficits (viz. Greece), the policy mix of fiscal discipline was completed with the need to maximize budget revenue through privatization. And for privatization of larger enterprises to succeed, a developed capital market was pivotal, reinforcing the need for financial liberalization.

The paradigm shift incorporated the additional dimension of elite networking and peer pressure within the European expert community. From the second half of the 1970s, in view of Greece's prospective entry into the EC in 1980, expert contacts and exchange between BoG officials and technocrats and their European counterparts intensified. Interaction of EC with Greek government and central bank officials became stronger after a 1985 EC balance-of-payments support loan combined with the single market program. The domestic banking expert community became increasingly subject not only to the fashionable monetarist ideas of the time but also to the personal influence of their peers. By the mid-1970s the idea that 'money matters', the case for banking competition, and the perception that credit regulation was responsible for serious

'rigidities', 'distortions', and 'misallocation of resources' (terms that were to prevail in the Greek banking discourse of the 1980s) had already captured the minds of European central bankers and were being elevated to virtual monetary orthodoxy. Even for convinced Keynesians, the sweeping trend of monetarism, enhanced by the internationalization of expert communities, exercised an influence resistance to which could often entail the cost of marginalization within the peer group. Through professional conformism the members of the academic, technocratic, and policymaking profession (especially those in the geopolitical semiperiphery of policymaking) under conditions of heightened international exchange adjust to the leading paradigm. As Richard Rose (1988: 233) put it, 'professional tribalism is as strong as national ethnocentrism'. In other words, '[w]hen a small number of like-minded people constantly communicate privately and informally, and read the same reports and journals …' (Moran 1984: 35), they 'then go forth to "spread the word" to their respective societies and governments' (Bennett 1991: 225). In Greek banking liberalization, the formalized relations with the EC competent bodies and committees were highly significant, from the Committee of the Central Bank Governors and the Directorate General XV (Internal Market and Financial Services) downward to specialized committees at the lower levels. At the top level the EcoFin, the Internal Market Council and the Monetary Committee, and notably the Commission services, served as powerful transmission mechanisms of policy directions. In such ways, institutional constraints, policies, ideas, formal and interpersonal exchange combined in providing effective transmission mechanisms for financial liberalization pressures.

A set of domestic circumstances offered the catalyst for the disinflationary shift to take effect. The 1973–85 period had made it clear that periodic nominal depreciations of the exchange rate can be effective only for a short-run stabilization of real output, and are incapable of improving the long-run competitiveness of the Greek economy. Similarly perceptible was becoming the lack of any other than a short-run trade-off between inflation and growth: inflating an economy's way out of unemployment may sustain employment levels only for the short run, but soon the economy will end up with both high inflation and low growth. An emphasis on rational and noninflationary expectations, and an unreserved faith in the importance of credibility in policy commitments were the underlying theoretical tenets.

With the June 1985 reelection of PASOK the expansionist phase had been completed. Wider public sector employment had grown significantly (mostly toward party adherents), unprecedented welfare

entitlements had been extended, certain socialist ideas had been put to work (Tsakalotos 1991a), an almost nonaligned foreign policy had been pursued, occasionally defiantly, at least rhetorically, to both NATO and the EC. Notably, the rise of PASOK to power concluded the consolidation of democracy by incorporating the losing side of the civil war. It was thus of historical importance in finishing the entire post-civil war trauma, putting an end to the sense of social disenfranchisement of left-of-center-wing citizens. These objectives were served predominantly by expansionary and redistributive policies, which placed concerns of economic soundness and efficiency second. However, on the day after the 1985 election, the economic cost of attaining these political objectives had accumulated to unsustainable levels, with inflation galloping in the area of 20 percent, fueled by the monetization of public deficits, and an urgent balance-of-payments crisis. PASOK, the standard bearer of social change in 1981, had run out of new ideas. At this critical junction, by force of inexorable macroeconomic pressure rationalized by an *ex post* strategic decision, the Papandreou government turned to the EC for precious political capital. The 1985 EC balance-of-payments support loan, followed by strict policy terms, offered the framework for making (Europeanization) virtue out of (macroeconomic) necessity.

If 1974–85 was for PASOK a period of nonconformity toward the EC, the outset of PASOK's second government term signaled the beginning of convergence to the EC policy paradigm. In that process, financial liberalization and the gradual uprooting of developmental finance was politically important as the first (if not sole) major structural reform put forth to implement the return to disinflationary orthodoxy.

In conclusion

The transformation of the international economic environment following the Bretton Woods collapse substantially deteriorated the conditions underpinning developmental state policies. International monetary instability, combined with growing levels of capital mobility, eventually necessitated a more or less universal shift of Western countries to disinflation over the 1980s. The Greek domestic response to the international momentum of financial liberalization and disinflation was somehow delayed, mediated as it was by domestic sociopolitical factors. Two major political projects promoted an expansionary and by and large inflationary economic response to the novel conditions of the post-Bretton Woods era: democratic consolidation after 1974, and the consolidation of the political party shift after the socialists' 1981 rise to power.

Spreading sociopolitical democratization intensified the countercyclical, protectionist, redistributive, and overall political use of developmental finance. Financial interventionism engendered a soft budget constraint, providing cheap working capital to crisis-ridden industrial firms and easy finance to government for noninvestment purposes. Devoid of its external monetary stability guarantees and domestic fiscal restraint, financial interventionism turned into a factor of prolonged stagflation. The high dependency of industrial production on mostly short-term bank credit, one of the main weaknesses of postwar developmental finance, culminated in increased financial vulnerability, leading to a chain of defaults or nonserviceable loans, which heavily burdened bank portfolios and the state budget. By allowing constant credit transfusions to failed enterprises and growing government deficits, credit interventionism entrenched the financial and industrial decline, postponing the necessary financial and structural overhaul of both private and public sector. As the perverse effects of credit interventionism were coming home to roost, the financial system that had ensured banks comfortable oligopoly profits in the past was now turning into a source of grievance. These factors, combined with the policy paradigm shift in Europe over the 1980s and the institutional reforms entailed in the process of European integration, created forceful pressure for domestic financial liberalization and sharp monetary adjustment.

5

Central Bank, Government, and the Politics of Financial Liberalization

This and the following chapter examine the evolution and politics of Greek financial liberalization, which spanned from the second half of the 1980s through the first half of the 1990s (Appendix 3).[1] Main attention is devoted to the domestic protagonist of that process, the Bank of Greece (BoG). This chapter focuses on the BoG–government relations, the question of central bank (CB) independence, and the BoG's actual role in formulating and implementing reform. These issues are better analyzed through a framework of what will be called CB 'policy strength'. The same framework is also used in Chapter 6 to discuss the role of the various socioeconomic interests that were affected positively or negatively by credit liberalization. A point made in this and the following chapter is that, even within a framework of limited or no institutional independence, a CB can display substantial operational autonomy that renders it more than a simple agent of government decisions.

Greek financial liberalization was a clear case of externally induced reform, brought about as a result of the various converging pressures surveyed in Chapter 4. Briefly summarized, the first component of the external constraint referred to the 'positive' institutional obligations entailed in the European single market program. Some of them were incorporated as terms in the 1985 EC loan to the Greek government, requiring the abolition of all subsidies provided through the credit system. The second component of the external constraint referred to the objective economic necessities arising from the prospect of capital liberalization in the EU (which, for the countries of the periphery, had to be completed by 1994). The road to capital liberalization had to be

smoothed by the deregulation of credit restrictions, including interest rate liberalization. Conventional wisdom determines the appropriate 'sequencing' of financial liberalization, so that domestic (liberalization of interest rates and credit controls) should come before external financial liberalization (removal of capital controls) in order to avert capital flight and to allow the domestic banking system to compete with foreign banks (McKinnon 1991). A subsequent wave of institutional reform was the Economic and Monetary Union (EMU) program, entry to which was contingent on the participation of national currencies in the European Monetary System (EMS). The combination of liberalized capital movements and stable exchange rates necessitated the full alignment of national monetary policies behind the EMS even for those EC/EU member states that had not yet entered the EMS (Branson 1990).

A second, domestic factor weighed heavily in the pressures to liberalize: the urgent need for disinflation. In the aftermath of the 1985 elections, when PASOK was reelected, deficits were at record levels, inflation around 20 percent, the balance of payments in crisis. Aggravated by the electoral expansion of 1984–85, the post-election macroeconomic outlook was unsustainable, and this time it could not be blamed on the previous government. There was a prolonged macroeconomic instability turning into serious political liability. Under such conditions 'politicians may delegate macroeconomic policy to relatively insulated CBs and finance ministries, which are less likely to intervene in financial markets' (Haggard and Lee 1993: 12). An EC-sponsored stabilization program was introduced. Monetary stabilization required the CB ability to raise real interest rates (which since 1973 had been mostly negative) to European levels and above. That was predicated on interest rate liberalization, as will be explained further below.

Even in the face of such compelling pressures, liberalization was no easy enterprise, as it involved important political and redistributive implications. Selective credit recipients had entrenched their power and it was difficult to withdraw their privileged financial status. As favored sectors had until then relied on cheap administered credit, deregulation was bound to hit them hard. At the same time, the surrender of government control over finance also implied a loss of power for political actors who had been able to offer cheap credit to specific groups for clientelistic purposes. So a familiar question inevitably arises: how did reformers overcome resistance from status quo actors with a vested interest in the continuation of credit interventionism?

This question is pertinent in our case not only because vested interests hurt by credit liberalization were vocal and well entrenched

(big industries, handicrafts, farmers), but also because between 1987 and 1990 deregulation evolved amidst highly adverse political circumstances. In spring 1987, a few months before interest rates were liberalized, the stabilization program was abandoned. Between 1988 and early 1990 (when after three national polls and unsuccessful coalition cabinets a majority government of the ND was finally formed) the economy was subject to prolonged electoral expansion, during much of which coalition partners competed in satisfying group demands. This often placed the government in direct opposition to the BoG's deregulation policies, as these were raising the cost of money and depriving government officials of the ability to control it. (Though, even after deregulation, indirect government control over credit continued as the majority of banks remained state-controlled.) In addition, liberalization was clearly contravening the interests of the Finance Ministry, since interest rate deregulation raised the cost of public sector financing and public debt servicing.

The argument advanced in this chapter is that, apart from the compelling external pressures already described, the actual reforms were greatly facilitated by the considerable *policy strength* enjoyed by the BoG. And that despite the BoG's lack – at the time of reform – of what the literature broadly identifies as CB independence. Our case study helps illustrate policy strength as subordinate to institutional independence but in effect vital in determining the CB's ability to overcome resistance and successfully implement contentious policy programs such as liberalization.

Institutional independence: a framework of analysis

Institutional resources and constraints circumscribed the BoG's policy action. The prominent set of constraints pertained to the BoG's institutional position vis-à-vis government, or, more specifically, to the question of independence. The literature generally proposes two main lines of approach as criteria of CB independence from government. The first and dominant approach considers a certain set of formal legal and statutory requirements that have to be satisfied in order for a CB to be considered independent. This formal approach distinguishes political independence ('the capacity to choose the *final goal* of monetary policy, such as inflation or the level of economic activity') from economic independence ('the capacity to choose the *instruments* with which to pursue these goals') (Grilli et al. 1991: 366; Goodman 1992: 9ff). Political independence is determined by the conditions of appointment of the CB's

administration, its relations with government and its formal responsibilities (Table 5.1, criteria 1–10). Economic independence is defined by the government's influence in determining how much to borrow from the CB and the nature of monetary instruments controlled by the CB (Table 5.1, criteria 11–14).

The second approach to CB independence in essence responds to the crucial objection raised against the above-described formal approach, that is that a CB may appear to be legally independent but in practice be strongly influenced by the government, or the converse. This second *behavioral* approach questions to what extent the statutory criteria adopted by the formal approach correspond to actual practice. The formal and the behavioral approaches have usually coincided in their findings, and are thus considered equally reliable (Goodman 1992: 9). Misleadingly, authors of the economic stream of literature (Grilli et al. 1991: 366) tend to identify institutional with formal independence. However, if the notion of institutional independence is to signify more than a formalistic legal framework which might not even correspond to reality, it must also include institutional variables such as behavioral patterns, compliance procedures, and standard operational practices (Hall 1986: 19; Thelen and Steinmo 1992: 2ff), all of which are denoted by the notion of behavioral independence.

In formal terms, the BoG's institutional independence through the first half of the 1990s was practically nonexistent. A League of Nations CB, the BoG (founded in 1928) was initially endowed with a strong orthodox monetary and exchange-rate policy orientation and important statutory guarantees of legal independence – not least for the purpose of satisfying Greece's numerous creditors (Mazower 1991: 103ff; Pepelasis-Minoglou 1998). The 1928 Charter provided for a five-year term of BoG governors, an independent arbitration commission to resolve disputes in case of disagreement between the BoG and government, and seriously restricted the BoG's direct or indirect financing of government or public enterprises. In the postwar years, however, these provisions were either ignored in practice (limits set on government financing were being breached already since 1932), formally amended (the five-year into a four-year term), or rendered inactive (the arbitration commission). The specific criteria for evaluating the BoG's (lack of) independence are summarized in Table 5.1. As Table 5.1 shows, until 1994 the BoG satisfied only three out of ten listed formal criteria of political independence (criteria 3, 5, and 9), and then the second (5) not fully, while the first (3) and the third (9) were satisfied in the formal but not in the behavioral sense. The degree of behavioral adherence to the

Table 5.1 Formal and behavioral criteria of BoG institutional independence (until 1994)

	Main criteria	*Formal adherence*	*Behavioral adherence*
1	Governor appointed by CB Board	Governor appointed by government upon recommendation by the BoG Board (General Council)	Governor appointed by government decision; BoG General Council typically confirmed the appointment
2	CB governor appointed for more than 5 years	Governor appointed for a 4-year renewable term	Real average governor's term during 1982–94 was 3 years, though the 1984–92 governor served two full terms
3	No provision for dismissal of CB governor/dismissal possible only for nonpolicy reasons	Dismissal possible only for violation of BoG statutes and for nonpolicy reasons	Dismissal possible at discretion of prime minister and for political reasons; between 1993 and 1994 two governors were replaced
4	CB governor prohibited from holding any other office in government	Governor not allowed to hold any other office in government unless authorized by executive branch	1982–84 governor was simultaneously economy minister; 1992–93 governor was the former economy minister
5	All the CB Board is not appointed by the government	BoG Board (a nonpolicy General Council) formally appointed by Shareholders' General Assembly, i.e. by the government as majority shareholder	The General Council had only some administrative duties and no role in monetary policy; BoG policy exercised exclusively by the governor
6	CB Board appointed for more than 5 years	No proper CB Board existed; members of the (nonpolicy) General Council appointed for a 3-year renewable term	No proper CB Board existed; terms of BoG General Council members normally renewed repeatedly
7	No participation of government representative is required	A government commissioner appointed by the executive with a suspensive right	No role of government commissioner in policy matters
8	CB alone has authority to formulate monetary policy; no government approval required	BoG participated in formulation of monetary policy in an advisory capacity; since 1982 the monetary policy framework was 'decided by the government'	In cooperation with the economy minister, BoG was in practice the responsible authority for setting monetary targets and formulating monetary policy, but not against government disagreement
9	In case of conflict with government, CB is given final authority over	In case of BoG conflict with government statutory provisions existed for an arbitration commission	Arbitration commission did not operate, conflicts were not publicized; conflicts resolved typically according to the

	issues clearly defined in the law as CB objectives		government's view rather than that of the BoG
10	Price stability explicitly mentioned as the only or major CB goal	Price stability was mentioned as main BoG goal in the 1928 initial charter but was suspended in 1932; no such clause since then	BoG pursued price stability cum economic growth until 1973; since then, with varying intensity depending on the circumstances, BoG was forced to compromise its pursuit of price stability either through a conscious policy of monetary expansion (1982–85) or as result of excessive electoral distributionism (1981; 1988–89)
11	CB direct credit to government is nonautomatic, at a market interest rate, explicitly stated as temporary, and subject to a limited amount	Initial 1928 BoG charter set strict terms and limits to temporary BoG advances to government; under Currency Committee limits were lifted, rate was symbolic, and advances assumed permanent character; from 1982 outstanding credit should not exceed 10 percent of annual budget expenditure; since 1994 any credit advances are prohibited	Even after 1982, under extreme government pressure, BoG extended advances in favorable terms and practically over the 10 percent limit
12	CB does not participate in primary market for public debt	In the postwar period there were no serious restrictions to CB participation in primary market for public debt; 1982 law allowed BoG to engage in transactions on Treasury bills; since 1994 BoG is prohibited from any securitized lending to government	The BoG systematically facilitated the government's deficit financing by participating in the primary market for public debt
13	Discount rate is set by CB	Discount rate was BoG responsibility since 1928; in 1946 it was transferred to Currency Committee; since 1982 it has been set by the BoG	Even under the Currency Committee the BoG was making use of the authority of setting the discount rate; after 1982 the authority belonged mainly to the BoG
14	Banking supervision not entrusted (or not exclusively entrusted) to CB	Since its establishment the BoG was exclusively responsible for banking supervision	(Same as in formal)

CB: Central Bank; BoG: Bank of Greece.

Source: Pagoulatos (2000a).

formal criteria was even lower. From the formal criteria of economic independence until end 1993 only criterion 13 was satisfied (but then, the discount rate was of minimal importance anyway in a regime of administered interest rates). Criterion 11 was only partly satisfied after 1982, when a limit to the BoG direct credit facility was instituted. The policy record confirmed the lack of CB independence. For example, the BoG supported the reflation of the 1974–77 period, objected to that of 1979–80 but was unable to constrain it, while in 1981–84 it officially came under the national economy minister, who also undertook the BoG governorship. However, from 1994, when the Maastricht-imposed abolition of the monetary financing of government deficits came into force, the BoG satisfied all the formal criteria of economic independence with the exception of one (criterion 14).[2] Finally, in 1997 and in accordance with the EMU program establishing the European System of Central Banks, the BoG was granted complete institutional independence. The law instituted price stability as the principal BoG statutory objective, independence from any government instructions or advice, exclusive BoG authority in the exercise of monetary policy, a six-year renewable term for the governor and deputy governors, and a Monetary Policy Council to assist the governor. All these institutional reforms, however, came later. By the time credit liberalization was initiated, the BoG was clearly not independent.

In order to evaluate the exact framework of BoG–government relations it is important to understand that governments may well have a positive interest in allowing their CB a significant degree of autonomy. Particularly governments whose administration is plagued by inadequate resources, low efficiency, and questionable reliability are in need of good independent advice on the situation of the economy. The more autonomous the CB, the more objective and reliable the advice (Moran 1984: 25ff). Less evidently, but more importantly, independence is considered to enhance the CB's credibility and effectiveness in combating inflation (Giavazzi and Pagano 1988; Cukierman 1992). In their effort to boost growth and employment, increase competitiveness, redistribute income, enhance social welfare, in short deliver quick signs of good economic performance, democratic governments may be prone to excessive and inflationary macroeconomic expansion. While displaying a somewhat inbuilt inflationary bias because of their tendency to short-termism, governments nonetheless loathe high rates of inflation, which erodes living standards and drags the economy into a vicious circle. Thus governments along with economists, to put it in Zolotas's memorable turn of phrase, end up agonizing 'between the Scylla of numismatic

plethora and the Charybdis of economic anaemia' (Zolotas 1977: 340). If market actors are aware of the government's incentives to inflate (including eating away the value of its debt) they build inflationary expectations into their behavior by incorporating the expected inflation in their wage demands or pursued company profits. It is thus, in this line of argument, vital for market actors to receive a forceful message that the CB is both committed against inflation and strong enough to resist government pressures (contra Posen 1998; Forder 1998). Of particular concern to state actors is the issue of creditworthiness: harsh market penalties (in the form of higher premiums) await borrower governments lax in combating inflation. For all such reasons it is desirable for democratic governments to have one macroeconomic policy instrument which can respond exclusively to the technical requirements of the economy, and to achieve that it is in their interest to extend a significant degree of autonomy to their CB (Woolley 1985: 334).

If the above hold true, it then also follows that the requirement for a more autonomous CB should grow stronger at times of persistently high inflation and public deficits. In such an economic environment CBs pursue a more assertive role. The CB's bargaining power increases as it becomes the government's last resort for achieving macroeconomic stabilization, even more so under conditions of government reluctance to curtail its deficits. Thus, while CB strength and autonomy are conventionally presented by much of the economic literature as being positively correlated with low inflation, from a political viewpoint it is the reverse causation that appears more interesting. That is, CBs in an inflationary environment, under their governments' auspices or mere tolerance, are in effect strengthened not weakened. It is the persistence of high inflation itself that empowers CBs, leading governments to entrust them with more decisive control over monetary instruments in pursuit of disinflation.

Exploiting windows of opportunity: policy strength beyond institutional independence

The degree of independence determines the CB's institutional resources by circumscribing an outer layer of permitted or habitual action. However, independence, or lack thereof, does not tell us everything about how a CB will actually operate within that framework. The argument to be developed here is that, even without institutional independence and amid an adverse politico-economic environment, a CB might be able to utilize available opportunities and resources or generate new

ones in such a way as to end up implementing policies highly congruent with its original preferences.

We may thus juxtapose the two aforementioned notions of formal and behavioral independence to a notion – weaker but of significant analytical interest – of *policy strength*. This latter indicates the ability of a CB to operate with the desired efficacy within a certain framework prescribed by the degree of its government-granted independence or the lack thereof. A high degree of policy strength would mean that the CB still retains substantial control and flexibility in certain policy areas where government is unwilling or technically unable to impose its policy options. From this niche of operational autonomy a CB can exploit windows of opportunity to put forward even radical policies within the government's tolerance. This framework is particularly useful when examining CB policies that do not fall strictly within the hard core of monetary policy, *in casu* financial deregulation.

What does policy strength in the above sense mean in practice? First, that a CB is highly resourced in the technical and organizational sense, and in full control of its internal resources (*resource capability*). Second, that it has a policy agenda of its own with clearly fixed objectives (*agenda identification*). Third, that it is determined to take advantage of all available opportunities circumscribed by the existing constraints upon its independence in order to pursue its objectives (*policy determination*). Fourth, that it is more or less able to keep other actors away from the policy realm that it claims to control (*policy insulation/arena control*). In sum, policy strength means that the CB commands all necessary resources for shaping policy, knows what its policy objectives are, is willing to pursue them, and is able to do so effectively by keeping its policy realm relatively protected from intruders. Since these four criteria are not explanatory variables but descriptive categories that help define the more abstract notion of policy strength, no attempt will be made to measure those criteria. It is in this conceptual framework of policy strength that the BoG policymaking and relations with government and (in Chapter 6) socioeconomic actors will be examined.

Internal central bank resources and organization

Since its establishment in 1928 the BoG was endowed with ample finance and a consistently high quality of human resources. The governor's seat has been normally held by top-level technocrats, who overall exhibited significant job tenure and continuity (Table 5.2). A combination of undisputed technocratic competence, a consistent appearance of

Table 5.2 Bank of Greece governors, 1946–2000

Appointment year	*Governor*	*Previous office held*
1946	Georgios Mantzavinos	BoG Deputy Governor
1955	Xenophon Zolotas	BoG Co-Governor
1967	Dimitrios Galanis	BoG Deputy Governor
1973	Constantinos Papayiannis	One-time Finance Minister
1974	Xenophon Zolotas	BoG Governor
1981	Gerasimos Arsenis	UNCTAD official
1984	Dimitris Halikias	BoG Deputy Governor
1992	Efthymios Christodoulou	Alternate Economy Minister
1993	Yannis Boutos	Ex-Coordination Minister, MP
1994	Loucas Papademos	BoG Deputy Governor

political neutrality, flexibility in dealing with government, and a long-standing career with the BoG have historically proven strong assets for survival during government changes.

The sheer number and quality of the BoG's staff always placed it in a position of unrivalled superiority compared to any other government agency or bank institution. Career tenure and favorable employment circumstances of the higher-ranking personnel, their similarity of academic backgrounds, closeness of technocratic views and professional attitudes, considerable exposure to European policy milieus (especially since Greece's 1981 entry to the EC) and considerable stability in service, have all been factors enhancing the BoG's efficiency in formulating policy. Such conditions have been rather atypical in the Greek civil service, where remunerations have been lower, working conditions much poorer, recruitment mostly nonmeritocratic, and promotions more highly subject to party political criteria (Spanou 1992). In all matters relating to monetary and credit policies, the CB occupied a position of unrivalled resource superiority vis-à-vis any government or banking sector service.[3]

Consistency and continuity characterized the BoG's policy orientation over the years, not unrelated to the exposure of BoG staff to similar influences. Due to a high degree of westernization and the regular input from the EC and international organizations (OECD, IMF, BIS) BoG cadres were keen to internalize soon the ongoing transformations of the international economic and banking environment. From these milieus originated regulatory norms and policy directions of considerable impact on the BoG. Consistency and continuity, evident in the similarity of content and style of the governors' annual reports, owed much to the fact that the bank was traditionally able to develop its own internal

hierarchy. Successive BoG administrations relied strongly on that same infrastructure of economic advisors, department directors, and deputy directors for the formulation of policy. This is not to say that the BoG was immune from political intervention. While an outspoken party-political involvement would be considered a disadvantage to service longevity, all higher officials, from the governor to the department directors, would have to enjoy at least the government's tacit political approval. Moreover, no BoG official would be expected to rise to the position of governor or deputy governor without the powerful backing of the premier or the national economy minister. Nonetheless, the technocratic skill, policy expertise, and civil service ethos of this internal apparatus somehow shielded the BoG from external political intervention.

The inherent complexity and indeterminacy of monetary management (Moran 1984: 51ff) enhanced the comparative advantage of the BoG's 'staying power' and resource superiority toward government. Though deregulation policy per se presented less theoretical intricacy than monetary policy proper, it remained considerably inaccessible because of the regulatory system's highly complex nature, and the difficulty to assess the interrelatedness and implications of policy measures. So all governments typically relied on BoG resources and policy recommendations. When it came to credit deregulation, and as an interviewed government official eloquently put it, 'the BoG people had built that whole system up, thus they were the only ones who could bring it down'.

In sum, the BoG was able to rely on an unrivalled pool of highly capable internal resources, corroborating the first criterion of resource capability. The surrounding circumstances that facilitated or constrained BoG policy action must now be examined. A consideration of these factors will help delineate the features of CB policy strength.

Agenda identification, policy determination, and exclusiveness: policymaking under government constraint

CBs in general favored domestic financial liberalization as it improved their ability to conduct monetary policy unhindered by government interventions. The emergence of persistent deficits and inflation after the 1970s dramatically altered the conditions for the effective exercise of monetary policy. For one thing, direct credit controls, the postwar state's leading stabilization instrument, were becoming increasingly incapable of stabilizing the economy: as public deficits were pushing money supply growth upwards, it was hard to control credit supply

without changing the interest rate levels. Administered interest rates, however, being subject to political bargaining, prevented the CB from applying its own interest rate policy. Special obligatory investment ratios (see Table 5.3) and the borrowers' recourse to the informal credit markets precluded the CB exercise of effective monetary control (BoG 1987: 37). Government securities forced upon the banking system at a government-determined interest rate forestalled the CB exercise of open market policy. Without the exercise of open market operations (buying and selling government securities) the CB was unable to control the interest rate effectively. Only a developed money market, according to the underlying CB view, would allow effective control of monetary aggregates by enabling the CB's regular unobstructed response to short-term liquidity changes (BoG 1987: 42). Domestic financial liberalization was thus deemed necessary, to allow the CB to employ its indirect monetary policy instruments more effectively toward disinflation, and respond more flexibly to the restrictive conditions of the international markets.[4]

For such reasons credit liberalization had been on the BoG agenda since at least the early 1980s, if not before. Two banking committee reports in 1980 and 1981 (one officially under the BoG)[5] coincided in advocating the 'smooth transition' to a market framework, and proposed the gradual liberalization of interest rates, the abolition of most credit controls and regulations, the establishment of a capital and money market, the weakening of the banking oligopoly, and the termination of BoG subsidies to commercial banks (Harissopoulos Committee 1981: 140ff). The EC accession prospect provided reformers with a convenient pretext, though EC regulations were neutral as to the operation of various financial instruments including capital controls. After several years of severe monetary destabilization and stop–go macroeconomic management, the BoG had begun to view credit liberalization as the only strategy for regaining monetary control in a highly inflationary environment. However, government was reluctant to surrender its financial policy instruments during the recession and electoral period preceding the crucial poll of October 1981. A gradualist reform process was followed (at a very modest pace) after the 1981 election of PASOK, aided by the fact that the BoG deputy governor (promoted to governor in 1984–92) had been an early proponent of liberalization (Halikias 1976, 1978). Responding to EC encouragement, in 1982 the Currency Committee was abolished and a ceiling was instituted on BoG advances to government, both measures aimed at restraining the accelerating deficit monetization. In the first half of the 1980s, interest rates were gradually unified upwards. The abolition of the Currency Committee

did not indicate so much a liberalizing commitment, rather the decision of the powerful national economy minister and BoG governor Gerasimos Arsenis to undertake full, developmentally oriented control over economic policy.[6] Nonetheless it can be claimed to have marked symbolically the beginning of the dismantling of the postwar interventionist financial apparatus.

It was only after the 1985 reelection of PASOK – amid galloping inflation and a serious balance-of-payments crisis – that credit deregulation was recognized as necessary for monetary stabilization and accorded official government backing. The stabilization program, launched in autumn 1985, was designed to sharply curtail domestic demand, reduce the public sector borrowing requirement (a reduction of public expenditure was decided), and enhance competitiveness (a 15 percent drachma devaluation was implemented followed by a tight mandatory incomes policy). The program was backed by an EC balance-of-payments support loan, whose conditionality included the gradual abolition of credit subsidies. In the propitious political climate of the 1985–87 stabilization, banking liberalization was formulated in detail and officially endorsed as government policy (Karatzas Committee 1987). Several important, mostly preparatory measures were taken during 1985–87, but the seminal act of liberalizing the lending rate was implemented in June 1987 (see Figures 3.1 and 4.1). Rising real interest rates testified to the restrictive direction of monetary policy, which played the leading role in macroeconomic adjustment.

Stabilization was abandoned in spring 1987 just as the economy was picking up. Premier Papandreou was said to have been intent on taking advantage of the visible economic recovery and call an early general election in 1988, but an unexpected worsening of his health prevented the alleged plan from materializing. A prolonged period of preelectoral economic expansion, three national polls, and consecutive caretaker coalition governments followed before a majority government of the ND was able to emerge, in April 1990. By that time the economy had deteriorated badly, inflation at 20 percent, the government deficit at unprecedented heights. The coexistence of two and three parties in coalition governments instead of counterbalancing rent-seeking claims on financial resources actually reinforced them (cf. Alesina and Perotti 1994). An implicitly hostile multiparty coexistence in government created multiple veto points (Tsebelis 2002) which intensified the economic policy conundrum.

How did deregulation proceed in that increasingly adverse political environment? During the 1988–89 period, the BoG was pressed by

government to deviate from its cautious gradualist strategy. Several deregulation measures during late 1988 and 1989 carried visible traits of a clientelistic imperative, releasing finance to specific categories of recipients some of which had previously lobbied the government intensely, or shifting authority to state-controlled banks (SCBs) for easing conditions of finance or rescheduling debts. These policies, added to the rise of the general government deficit, contributed to an alarming degree of liquidity expansion, which forced the BoG, in the final months of 1989, to impose temporary credit ceilings. At the same time a number of BoG measures facilitated the monetization of public deficits, such as increasing instead of decreasing, as liberalization would want, the ratio of obligatory bank investment in Treasury bills. Indeed, the most destabilizing effect of the 1988–89 period was caused by the swelling government deficit (Figure 4.8). The insistence of the finance minister on prolonging its monetization was a serious source of tension between Finance Ministry and BoG. The process of gradually phasing out the special investment ratio in Treasury bills (Table 5.3) began only after 1990, indicative of the BoG's heavily circumscribed influence.

Overall, then, the 1988–89 phase was characterized by a less than assertive use of monetary instruments. Nonetheless, deregulation progressed and interest rates remained on an upward course, serving the CB effort to control rising inflation. The BoG's lack of political independence dictated extensive recourse to the art of tactical political

Table 5.3 Obligatory investment ratios on commercial banks

	Dec. 1985	*Dec. 1987*	*Dec. 1989*	*Dec. 1991*	*Dec. 1993*
Public sector total	48.5	56.0	56.5	39.0	9.0
Primary reserve requirement					
– Deposits with the BoG	7.0	7.5	8.0	9.0	9.0
Secondary reserve requirement					
– Investment in Treasury bills	38.0	38.0	38.0	30.0	
– Loans to public corporations	3.5	10.5	10.5		
Private sector total	26.5	10.0	10.0	10.0	
Loans to ailing firms	1.0				
Long-term loans to industry	15.0	0.0[1]			
Loans to SMEs and handicrafts	10.0	10.0	10.0	10.0	
Loans for fruit/vegetable production	0.5				
Total	75.0	66.0	66.5	49.0	9.0

[1] Abolished July 1987.

Source: OECD (1995).

compromise. In the absence of any institutional record of BoG independence, personal politics played a considerable role. Likeminded and supportive economic ministers ensured delegation of authority to the CB, minimal government control, a significant margin for BoG maneuver. Discordant economic ministers meant constant need for prior ministerial approval, less BoG initiative, increased caution and insecurity.

Thus, both monetary and deregulation policy were not immune to government control and political objectives, confirming the BoG's lack of institutional independence. However, what has been identified as *policy strength* allowed the BoG to exploit windows of opportunity and pursue its desired policies to a significant extent despite its lack of independence, as will be shown further on.

An additional feature, acquired with the government's complicity, formed a crucial pattern of BoG policymaking: the tendency to exclude outsiders. This relates to the fourth defined component of CB policy strength: policy insulation/arena control. The absence (until its 1997 endowment with full independence) of any institutionalized historical link of the CB with Parliament contributed to the relative insulation of BoG policymaking from the external sociopolitical environment. Thus, the BoG was able to keep out of the public eye and focus on its esoteric mode of operation aimed at exercising suasion on the government. In an era of increasing demands for democratization and multilateral deliberation, the CB had remarkably been left free to rule by decree (some 2000 BoG Governor Acts, with the power of formal legislation, were issued between 1982 and 1992). The frequency and ease of BoG administrative interventions, the hidden agenda, and the fact that real outcomes of decisions often became visible many weeks or months after the decisions had been implemented, gave the BoG a unique control over its policy domain by making it difficult for external interests to react in a timely and effective manner.

This pattern of exclusionism did not develop against the government's wishes. By allowing the CB to shield itself from external pressures, the government in effect was able to claim that the CB was managing monetary policy with a degree of autonomy toward government. In practice all governments employed a tactic of somehow distancing themselves from the BoG's most restrictive policies. Aware of the eventual inevitability of some unpopular measures, the government would deflect their political cost onto the CB by employing a tactic of scapegoating. By being unaccountable to any institution other than the executive, the BoG was able to absorb the political shock of unpopular policies more easily than government.

Placed in the above conceptual context, the BoG's cautious but occasionally unambiguous critique of the government (as expressed in several annual reports) also acted as an affirmation of autonomy. As such it enhanced the BoG's ability to play its role of scapegoat more convincingly, facilitating unpopular policies. This was a positive sum game between CB and government. The government could implicitly point the finger at the BoG for raising interest rates or abolishing credit subsidies while at the same time benefiting from the disinflationary effects of these policies. The CB could only relieve the government effectively from the political cost if it was also able to appear as acting autonomously. It could achieve this, for example, through openly distancing itself from a fiscal management it regarded as too expansionary. This pattern unfolded especially in the 1990s, when economic adjustment and finally EMU entry were led by the BoG's rigorous disinflationary policy.

The decade of adjustment (1990–2000) and the national consensus over EMU

The April 1990 election brought to power a neoliberal-leaning center-right-wing ND government whose official ideological and political proclamations contained unambiguous commitment to economic liberalization, marketization, and privatization. So the EC, whose pressure by that time had intensified, found a cooperative partner. When government turned to the EC for another balance-of-payments support loan in 1991, the Commission was keen to include austere adjustment policies among its conditions, as well as a stricter surveillance mechanism. Again in the early 1990s, macroeconomic stabilization, the reduction of public deficits and inflation, took precedence over microeconomic reforms.

By 1990 the bulk of credit deregulation was completed, though specific loan categories were still being subsidized (Table 5.3). For three consecutive years before 1990 monetary targets had been overshot, with liquidity expanding due both to the abolition of credit controls and the swelling government deficit. In 1990 the BoG's restrictive monetary policy was closely adhered to. That was significantly facilitated by the 1990 Stock Exchange boom, which, by responding to private sector capital needs, alleviated demand previously exerted on the credit system. At the same time, and despite the higher government deficit, increased absorption of government paper by the nonbank public decelerated credit expansion to the public sector (Figures 5.1–5.2). Reflecting the BoG's deflationary stance, monetary targets for 1991 were undershot. After 1990, the annual rate of increase in M3 was consistently lower than that of nominal GDP.

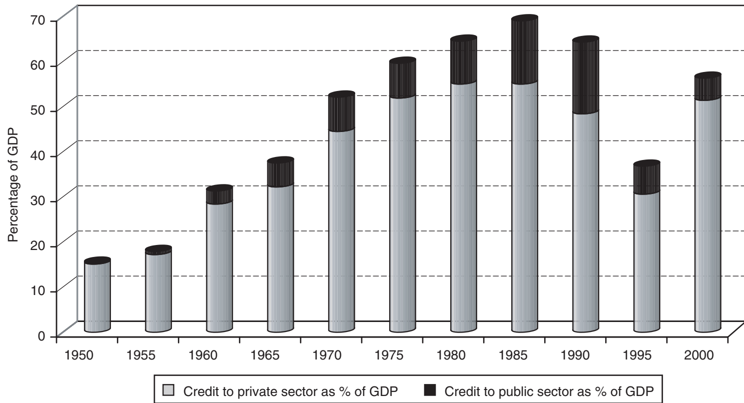

Figure 5.1 Total bank credit and credit by sector as percentage of GDP.
Source: BoG (1992, 2000).

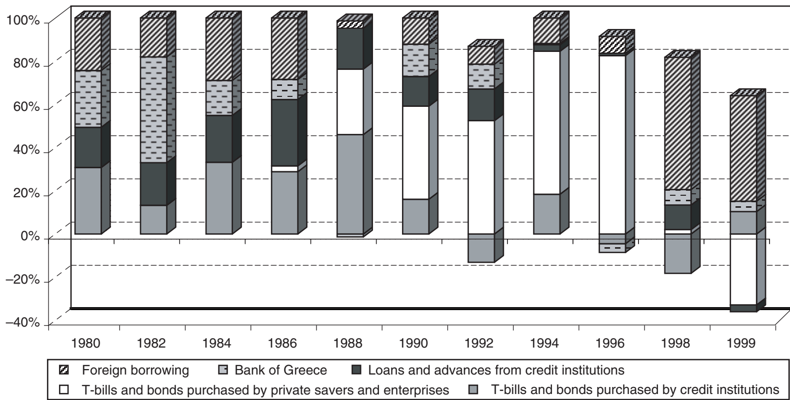

Figure 5.2 Sources of financing the public sector borrowing requirement.
Source: BoG.

The nonaccommodative monetary policy inaugurated in 1990 ('hard drachma' and high real interest rates) continued with new vigor under the PASOK governments of Papandreou in 1993 and Simitis in 1996 (see Figure 5.3). If the 1980s was the decade of policy experimentation, erratic and inefficient economic management, and discontinued measures, the 1990s was a decade of stability, consistency and continuity in policy direction, and a gradual build-up of economic policy success. The definitive influence for that transformation certainly had a lot to do with the EU factor, which imparted to Greek economic policymakers a clear, tangible, and

positive set of policy directions. Throughout the 1980s PASOK and ND were divided and highly polarized over economic and structural policies. By the time the socialists regained power, however, the same economic strategy for satisfying EMU entry requirements was officially shared by both parties. By 1998, when Greece entered the ERM, there was a growing sense of attainability of the EMU nominal convergence targets, and Greece was officially admitted and joined the EMU in January 1, 2001.[7]

The importance of the external constraint factor cannot be overstated. Very much like other EU countries had done by binding themselves to the Maastricht criteria, the Greek government entered an externally imposed discipline mechanism that forced adjustment by rendering the cost of noncompliance insufferable (cf. Dyson and Featherstone 1996). Financial and capital liberalization multiplied the costs of any substantial derogation from the pursued healthy economic 'fundamentals' and of any serious stain on the government's policy 'credibility'. The March 1998 successful drachma devaluation and ERM entry in an environment of free capital movements (fully liberalized after spring 1994) and high interest rate differentials, led to massive inflows of mainly short-term capital.[8] These posed the constant threat of a tantamount outflow (with perilous effects on the external account and the economy at large) at the first signals of a government retreat from its announced policy targets. The imminence and salience of this external constraint exercised a most potent suasion for economic adjustment.

The convergence process of Greece to qualify for EMU membership was characterized by an unusually high degree of sociopolitical consensus, which peaked in the second half of the 1990s, as EMU was elevated from a daydream to an increasingly achievable prospect. With the exception of the Communist Party, there was no substantial political force to seriously question the objective of EMU entry. Though the particular austerity policies followed were subject to intense political dispute, from the ranks of both major parties and especially from the Left, the objective as such was not seriously questioned. For a high-inflation peripheral country with the EU's lowest or second lowest per capita income, whose currency had consistently declined since 1975, EMU represented the promised land of monetary stability and sound economic policies, not to mention the purely political benefits of becoming a member of the advanced Eurozone. The widespread gains of EMU entry were so salient and overwhelming that any Eurosceptical argument was *ipso facto* marginalized.

Party-political consensus was a reflection of converging socioeconomic preferences. Generally, transnationalized banks and corporations

are expected to support the monetary union, aspiring to the efficiency, lower-transactions-costs gains of a single currency, while domestically oriented producers would tend to be indifferent or hostile (Frieden and Jones 1998: 178–9). A distinct issue is the real currency appreciation followed in the transitional period, which is particularly painful for export-oriented sections of manufacture and primary production (see Chapter 6). Those same sections may be opposed to a monetary union since it implies surrendering the possibility of using currency depreciation to enhance competitiveness. However, even that kind of opposition was moderated in Greece in recognition of the very poor results achieved by monetary accommodation and depreciation in the past. On the other hand, labor unions (with the exception of those affiliated with the Communist Party) also progressively began to support the EMU objective, though in a far less unambiguous manner given the heavy transitional cost of restrictive economic, especially wage, policies (cf. Josselyn 2001). Real wages had declined during the 1985–95 period, and price stability, along with the higher regulatory, welfare, and income standards of the EU, represented a favorable prospect. (As unions represent labor market insiders, and in the Greek case predominantly the wider public sector, the unemployment issue as part of the EMU transitional trade-off weighed only indirectly on their policies.) Thus, on average, socioeconomic and sectoral divisions were absorbed into an overall positive stance vis-à-vis EMU, especially in the second half of the 1990s.

The momentous monetary policy shift and the role of financial liberalization

For a brief period after 1985–86 and more strongly through the 1990s, monetary policy bore the brunt of stabilization, given the persistently high public deficits. At the same time, credit liberalization intensified the need for the BoG to keep a tight control over the reform process and to offset the short-term inflationary release of liquidity (resulting from abolishing credit restrictions) with the appropriate policies of monetary austerity.

Under the strain of the rising government deficit, combined with EC pressure to limit its monetization, the government from the second half of the 1980s resorted to more extensive domestic borrowing, this time by also turning to the nonbank market. Beginning in 1986 the government began to sell Treasury bills to the public, and by the end of the decade nearly one-fifth of the total public deficit was financed in that way. Government debt was popular as a result of the initial concentration of

households' wealth in bank deposits, an underdeveloped financial market, capital controls, the sparse menu of alternative financial assets, and a discriminatory tax treatment. After the 1987 interest rate liberalization, and especially into the 1990s, the government's high borrowing needs exercised a constant upward pressure on interest rates, raising the cost of public debt financing. The shift from negative to positive real interest rates, following their 1987 liberalization, led to a growth of the debt/income ratio from an annual average of 4 per cent in 1979–87 to an average 7.3 percent between 1987 and 1995 (Tsakalotos 1998: 123). Consequently, by the end of the 1980s and early 1990s, the public debt acquired a vicious dynamic of its own. High interest payments impeded the deescalation of both deficits and inflation, necessitating ever higher interest rates (to incorporate a premium against inflation, the fear of devaluation, and the rising stock of government debt) and the real appreciation of the drachma, thus undercutting business competitiveness, producing disinvestment and stagnation, and further obstructing fiscal consolidation.

Over the 1990s, financial liberalization led macroeconomic adjustment and disinflation in three closely related ways. First, as mentioned, financial liberalization was the sine qua non for allowing monetary policy to become assertive and carry the brunt of stabilization. Liberalization allowed the introduction of new instruments of monetary management. It enabled the BoG to rely flexibly on open market operations, seeking to influence short-term interest rates in the interbank market as its main intermediate goal.[9] Second, financial liberalization generated flexible conduits of intermediation (mostly short-term government securities markets and the associated distribution channels such as mutual funds) which – after the government had shifted away from deficit monetization – allowed for public deficits to be absorbed by private investors. Third, the greater role of private investors in public deficit-financing subjected government to stricter discipline in its monetary and fiscal policy. Private investors subjected government policy to greater market scrutiny, and market rates instead of 'repressed' interest rates raised the cost of public debt financing (OECD 1995: 58–60).

Deregulation enabled the upward convergence of real interest rates toward EU levels (in fact, at much higher than EU levels) (Figure 5.3) making possible the reversal of the previous policy of accommodation or managed depreciation of the drachma. This amounted to a momentous monetary and exchange rate policy shift, coming to full accord with the Bundesbank-led European central banking orthodoxy of the time. The German CB was broadly considered the paragon of that orthodoxy,

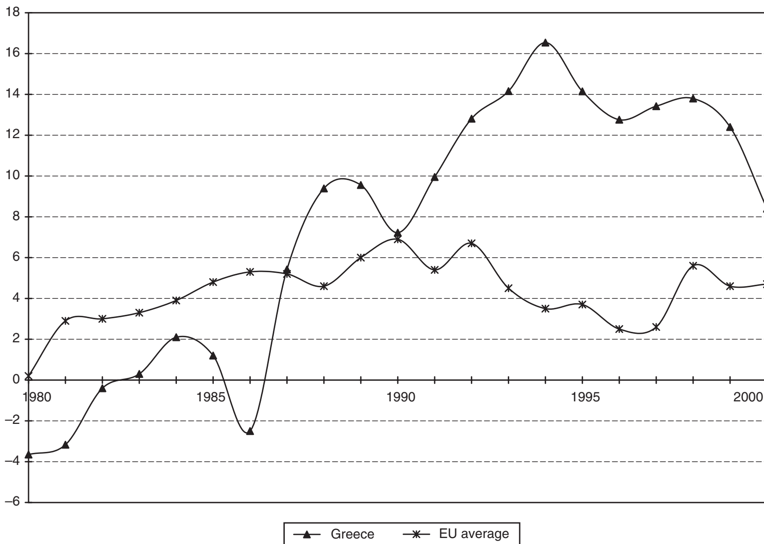

Figure 5.3 Real short-term interest rates: Greece and EU, 1980–2000.
Sources: IMF (2000), Ministry of National Economy.

having successfully managed to sustain what was perceived as a virtuous cycle of a strong appreciating currency, low inflation, and excellent export performance. That starkly contrasted the post-Bretton Woods vicious cycles of frequent devaluations and inflation displayed by countries such as Britain or Italy in the 1970s, and France until the 1983 U-turn and establishment of the so-called *franc fort* (Goodman 1992). Thus, at a time of monetary instability, the monetarist Bundesbank (Johnson 1998) had risen to a policy model and natural anchor of the EMS, leading the way for Greece's monetary adjustment. Indeed, following the October 1985 devaluation, the rate of depreciation of the Greek currency vis-à-vis the basket of currencies of its main trading partners was lower than the inflation differentials between Greece and its main trading partners, eventually amounting to a real appreciation of the Greek currency. By targeting the exchange rate, monetary policy became the chief instrument for disinflation, aimed to break a spiral of devaluation in the 1970s and 1980s that led to higher import prices, then higher overall prices and finally higher wages and further devaluation. The nonaccommodating exchange rate policy squeezed imported inflation and restrained the ability of businesses to pass on their cost rises to consumers in the form of higher prices, forcing firms to resist

wage pressures and intensify efforts to raise their productivity in order to be able to compete with imports. (However, the effort to raise competitiveness by increasing productivity was thwarted by the mounting cost of credit and the crowding out of private sector finance by government paper especially over the first half of the 1990s, making it difficult for firms to finance their investment.)

Though high short-term interest rates in most of the 1990s successfully maintained a disinflationary exchange rate policy, the considerable cost of monetary austerity on the real economy was partly tempered, among others, by two factors associated with the underdevelopment of Greek banking competition. First, households were net creditors[10] since their access to mortgage and consumer credit remained low (a result, among others, of the tight regulation of mortgage credit and heavy quantitative and other restrictions on consumer credit). Thus, the high cost of money did not exercise a significantly adverse effect on households. And second, businesses too were considerably insulated from the effect of high interest rates, as commercial banks did not have to raise lending rates to fully shadow the BoG's high interest rate policy. That was because commercial banks tended to fund their loans from their own deposits, that is deposits collected from the general public instead of drawn from the interbank market.[11] (Indeed, Greek bank deposits, as a percentage of total bank liabilities, were traditionally high, in the 80 percent range, compared to below 50 percent for the EU average; at the same time, Greek bank loans as a percentage of bank deposits in the 1990s were among the lowest in the EU.) Both these factors cushioned, to an extent, the negative effects of monetary austerity on the real economy, which in fact grew steadily after 1994, assisted by EU structural funds.

Central bank and government: the stakes of liberalization

Though placed on the agenda definitively in autumn 1985, interest rate liberalization was not initiated before summer 1987, that is not until production and exports were picking up following the 1985 devaluation. Deregulating the banking system during an economic downturn carries significant risks (Caprio et al. 1994). The high lending rates that follow liberalization (and given the lack of financial alternatives offered by a developed stock market or the possibility of access to foreign credit markets) can be debilitating to the borrowers' net worth, deepening the recession and causing financial distress. Apart from undercutting revenues derived from taxing the banking sector (through noninterest-bearing

reserve requirements with the CB and obligatory investment in government paper) and further burdening the public deficit and debt, deregulation could also pose a threat to financial systemic safety. Thus economic conjuncture also constrained the timing of deregulation.

The issue was less straightforward when it came to the BoG stance vis-à-vis external liberalization, that is deregulation of the capital account after domestic credit liberalization had been completed. Capital liberalization may have a disciplining effect, but that is gained by surrendering monetary policy autonomy to the international markets. An open capital account limits a country's ability to conduct monetary policy and defend a given exchange rate level, and increases exposure to international monetary shocks, through the capital as well as the current account. A government's decision to subject itself to the heavily constraining conditions of an open capital account denotes a commitment to monetary and fiscal discipline, raising its credibility, 'signaling' an increase of capital inflows and enabling the recovery of the external balance (Haggard and Maxfield 1996: 211ff; Rodrik 1989). However, a national economy is thus also subjected to the ominous threat of a currency crisis, through the familiar process: if investors deemed that the exchange rate was set at an unsustainably high level, they would be unwilling to hold drachma assets such as Greek government securities unless offered very high interest rates to offset the serious devaluation risk (exacerbated in the case of Greece's poor macroeconomic fundamentals until well into the late 1990s). Very high interest rates and an overvalued currency (given their heavy cost on debt servicing, production, and the trade balance) would make the drachma's appreciation appear even less sustainable, further increasing speculative pressure against the currency, in the familiar downward spiral evinced in numerous currency crises around the world in the 1980s and 1990s. Such was the pattern behind several speculative attacks on the Greek currency between 1994 and 1998, which the monetary authorities managed to withstand successfully. In recognition of such powerful external capital constraint, governments in general tend to be politically opposed to capital liberalization (Goodman and Pauly 1993; Andrews 1994).

The exact timing of capital liberalization (and the extent of delay Greece would demand from the EC/EU) became an issue during the 1990–93 government period. Some neoliberal-leaning policymakers tended to view capital liberalization favorably, as the external disciplinary mechanism that would accelerate macroeconomic – including fiscal – adjustment required for nominal convergence. But the stance was clearly not unanimous. For example, while the BoG governor of the

1990–92 period tended to advocate a speedy abolition of capital controls well before the July 1994 deadline, his successor (1992–93) (contrary to the neoliberal national economy minister of the same period) was more skeptical and supported a more gradual adjustment.

The rationale that led the BoG to a robust defense of domestic financial liberalization as a precondition for monetary stabilization has already been described. Of course, at least in theory, lending and deposit rates could still be raised administratively within the interventionist framework of direct credit policy instruments, at levels high enough to satisfy the need for monetary harshness or corresponding to their estimated equilibrium prices. However, none of the three major actors involved (European Commission, government, or BoG) favored this adjustment strategy, which ran counter to the conventional policy wisdom of the time. Hence such an option never really entered the agenda. The Commission, in view of the single market program, pressured unambiguously for complete (albeit gradual) financial liberalization. The BoG had well internalized the orthodox view that only liberalized interest rates and market-determined allocation of finance (with the exception of some ad hoc quantitative ceilings whenever credit expansion threatened to bring overheating) would allow the necessary monetary policy leeway and flexibility to rip the inflation out of the system. Administratively fixed interest rates, even if set at disinflationary levels, would subject monetary policy to constant political bargaining and government-imposed objectives. Thus credit liberalization also served the long-held BoG pursuit for more political and policy autonomy from government. From its own standpoint, and given the pressing need to proceed with stabilization, the government also had some interest in doing so by setting interest rates free (thus shifting the responsibility and blame for monetary stringency to the CB) rather than raising them administratively (which would have burdened government with the political cost of disinflation).

Credit deregulation generated winners and losers within the government. For its role in increasing the BoG ability to disinflate, deregulation was viewed positively by government in general and the national economy minister in particular. Moreover, contrary to fiscal and structural adjustment, stabilization via monetary austerity (that is real currency appreciation and high interest rate differentials relative to the EMS basket of currencies) entailed the political advantage of allowing the stabilization cost to be distributed in an apparently indiscriminate manner, saving government from hard redistributive choices (cf. Pérez 1997a: 39–40). Thus the almost exclusive reliance on monetary austerity for

disinflation (its other dire repercussions notwithstanding) entailed the political advantage of allowing government to eschew a bolder pace of fiscal and structural adjustment. The latter involve a far heavier and more direct sociopolitical cost, while their beneficial results (especially of structural adjustment) are produced with a considerable time lag. Similar was the rationale against a heavier reliance on restrictive income policies for disinflation. Real income of wage-earners had shrunk consistently since 1985, and continued to do so through the first half of the 1990s. More importantly, collective bargaining had been liberalized, and its importance for the private sector was limited anyway by the low unionization of private sector employees. Any attempt to rely on more restrictive incomes policies would shift the cost of disinflation to wider public sector employees, jeopardizing the support of (socialist-friendly) unions for both the government and the EMU objective.

The losers of financial liberalization included the 'spending ministries' such as those of Industry, Agriculture, and Defense, as well as public enterprises deprived of their privileged lines of credit (cf. Haggard and Maxfield 1993: 296). Principal among the direct losers of liberalization was the Finance Ministry (the Treasury, for a time a separate entity from the National Economy Ministry) agonizing over the rise of the debt-servicing burden. Tensions arising between BoG and Finance Ministry were significantly alleviated after the latter merged under the National Economy Ministry in 1992, only to revive, however, as the Treasury was separated again during a brief period under the socialist governments. Throughout the 1990s, the institutional empowerment of CBs following the Maastricht Treaty, and the increasingly close monitoring of macroeconomic convergence by the European Commission, were critical for maintaining consistency and commitment in the BoG's monetary stabilization effort. Crucial also was the presence at the helm of the CB after 1994 of Professor Lucas Papademos, a widely respected monetary economist, pragmatic proponent of the orthodox mix of drastic disinflation and fiscal overhaul combined with growth-enhancing structural liberalization. Such factors facilitated a relatively more drastic public deficit reduction and helped deflect pressures by the government's fiscal authorities for prematurely lowering interest rates.

In conclusion, financial liberalization, a decision politically unloved by the government in many ways, was nonetheless adopted in the face of inexorable external pressure and domestic macroeconomic constraints. Its adoption and implementation, which paved the way for disinflation, were facilitated by two crucial factors. The first was the fact that prolonged macroeconomic instability was by the mid-1980s

becoming a political liability for the government. And the second factor involved the considerable policy strength exhibited by the BoG, a notion defined as weaker than CB autonomy or independence but crucial nonetheless. Since its 1980 official endorsement of deregulation, and despite the very slow pace of implementation until the 1985 election, the BoG displayed significant policy commitment in carrying out a gradual rationalization and upward unification of interest rates that cleared the way for the bolder policies of the post-1987 phase. In that phase, the BoG steadily sought to exploit available windows of opportunity, and promote liberalization and monetary reform, as will be further shown in Chapter 6.

6
Banks and Socioeconomic Interests: Winners and Losers of Financial Reform

As any institutional and policy reform, credit liberalization produced gains and losses for different socioeconomic groups. This chapter concludes the analysis of the politics of liberalization. Attention is now focused on the financial and banking sector, its relations with the central bank (CB), and the socioeconomic and producer interests affected by liberalization. A final comment on interest organization in Greece follows at the end of the chapter.

Exhibiting policy strength: central bank and the banking sector

A CB, it has been observed, is a Janus-like institution, with one face sympathetically turned toward government and the other toward the banks (Moran 1984: 46–7). By their public role CBs are committed to safeguarding monetary stability. At the same time CBs are also high protectors of the banking system's longer-term interest, geared to ensure greater efficiency, soundness, and systemic safety. With regard to the Greek banking system this BoG duality of purpose held true, and it was not frictionless. Tensions typically arose whenever the BoG applied policies the banks deemed too restrictive. On the other hand, both BoG and banks shared a common interest in abolishing fixed interest rates and obligatory investment requirements imposed upon bank deposits. And, like CBs, commercial banks in general are negatively disposed toward high and unpredictable rates of inflation, which erode their real interest earnings.

A brief descriptive parenthesis is due here on the Greek commercial banking system, traditionally highly concentrated, oligopolistic and state-controlled (Figures 6.1–6.2). The largest credit institution, the National Bank of Greece (National Bank or NBG), was established in 1841 as the country's first private bank. Though deficit-ridden, the Greek Treasury acquired a significant minority stake in the NBG's share capital, which in the 1910s developed into full government control over the bank's administration (Kostis and Tsokopoulos 1988: 57–8). The state affirmed its presence in banking in the 1920s, when the National Mortgage Bank and the Agricultural Bank were established as specialized credit institutions, but apart from the NBG the rest of the commercial banking system remained privately run. In 1953 the NBG was forced to merge with the Bank of Athens, then the second largest commercial bank, into one National Bank, as part of a government-imposed banking rationalization program. Subsequently in the 1950s, the NBG–Commercial Bank duopoly handled nearly 90 percent of the country's savings (Psilos 1964: 194). The next major move to consolidate government control over banking came in 1976, when the Commercial Bank group, second largest after the NBG, was nationalized. State control over commercial SCBs has been mostly indirect, exercised through the ownership of the majority or a controlling share of their capital by a number of public sector entities and welfare funds, which after 1953 and through most of the 1990s were officially represented by the finance minister.

The BoG–banking sector relations during financial liberalization confirm what was defined in Chapter 5 as CB policy strength. The credit deregulation program during the 1980s was initiated, placed on the agenda, formulated, and implemented chiefly inside the BoG. There was a conscious tendency on the part of the CB – keen to entrench its policy realm vis-à-vis external pressures – to keep contacts with the banks relatively infrequent and unofficial. Throughout the policy stages and particularly during implementation, the BoG sustained an open network for exchange and consultation. While, however, information and views were exchanged, and the banks' proposals were taken into account, bank representatives were excluded from formally participating in the policymaking stages. No drafts of BoG governor acts or decrees were submitted to the banks in advance for approval, and the timing and circumstances of implementation were decided by the BoG without obligation of prior consultation with, or even official information to, the banks.

The BoG exclusionism toward the banks was not only attributable to a Weberian civil service attitude that valued highly the efficiency of closed, hierarchical policymaking structures. It was also due to an effort

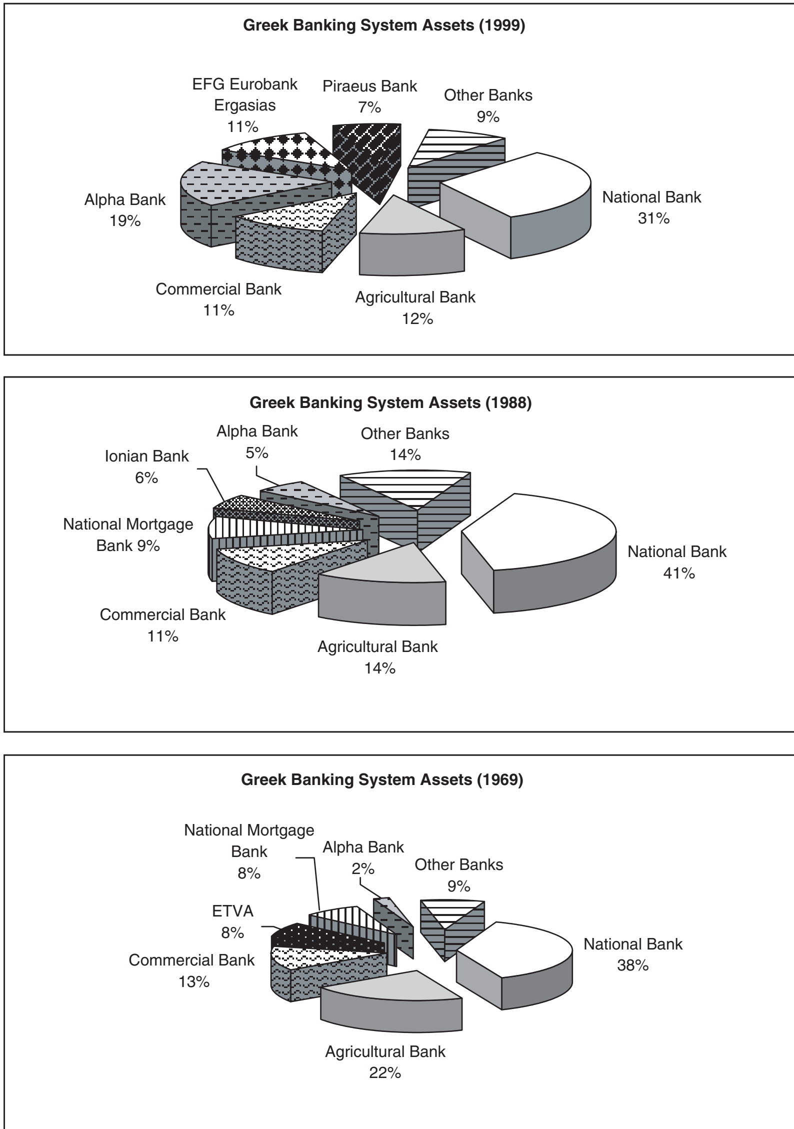

Figure 6.1 The Greek banking system by total assets, 1969–99.
Sources: Zitridis (1971); BoG; HBA.

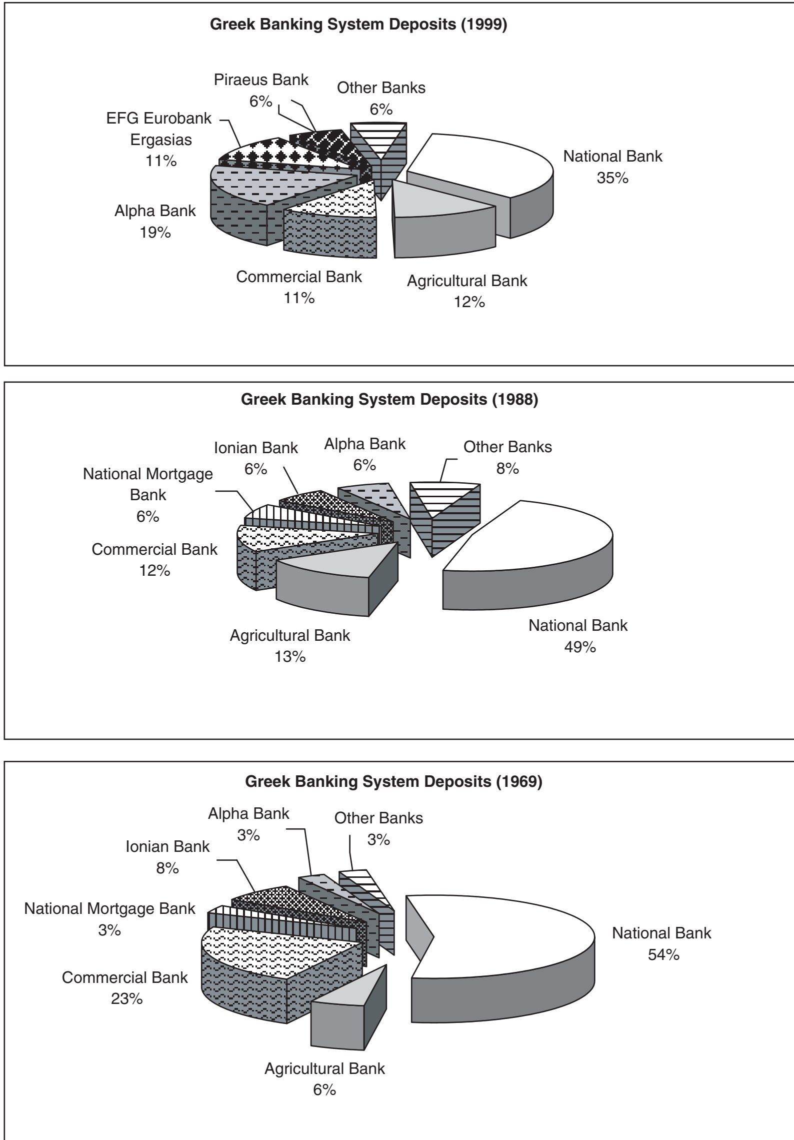

Figure 6.2 The Greek banking system by total deposits, 1969–99.

Sources: Zitridis (1971); BoG; HBA.

to shut the powerful NBG out of the policy process. Indeed, the BoG's relationship with the banks is virtually a case study of the NBG's unique status. Despite its long history and intimidating market share, the NBG's real standing could only be comprehended against the background of the political system. The NBG's sheer size and command of economic resources always dictated the appointment as governor of a personality who enjoyed the premier's absolute confidence. It was the exact combination of this top-level government insider status with the NBG's degree of control over the economy that justified the regarding of the NBG governor's position as being of almost equal power, some would even say higher, to that of the BoG governor. From there stemmed the acquired right of the NBG governor to deal with economic ministers on collegial terms, and his (it was always 'his') semiofficial but significant role as a crucial actor in economic and monetary policymaking. From there also emanated the BoG's permanent tension and unease with what the CB always criticized as the excessive and unwarranted interference by the NBG in monetary policy matters. On a deeper level, the tense BoG–NBG relationship was also indicative of the fact that any deliberate isolation of the CB from external actors in the pursuit of its policies was actually largely aimed at shielding itself from government, the only actor effectively capable of really embarrassing the BoG.

On a range of matters, the BoG was sure to keep a constant eye on the National Bank. In order to avoid seriously displeasing the NBG while at the same time safeguarding its monetary policy realm, the BoG usually pursued a policy of accommodating its old rival's interests wherever that did not significantly affect its own agenda. For example, the BoG turned a blind eye to a number of minor (but considerable in their cumulative effect) quasi-monopolistic privileges enjoyed by the NBG by excluding them from deregulation. It also exercised deliberately lenient supervision when it came to breaches of banking regulation by the NBG, and in some cases by other larger banks too.[1]

Financial and banking sector gains and losses from liberalization

The disinflationary turn of economic policy after 1985 and more consistently from 1990, and its being predicated upon credit liberalization, rendered the BoG a protagonist of macroeconomic adjustment, increasing its bargaining power. Indirectly, in such a way, the removal of credit interventionism, which commercial banks had steadily demanded since the late 1970s, was also elevated into a top policy priority. It was not an independent political strengthening of the banking sector that brought this

result. Quite the contrary, the banking industry in its majority remained tightly controlled by government, a political lame duck. (With the exception of two minor banks in the early 1990s, bank privatizations did not begin until the second half of the 1990s.) It was rather the reverse process that took place: the banking sector emerged stronger *as a result* of government adopting the BoG agenda of monetary reform and liberalization.

As will be seen below in this chapter, the political leverage of other interest categories such as handicraft/SMEs and farmers was derived mainly from the popular base they commanded. The mere thought of politically disaffecting such a broad electoral clientele forced governments to accommodate SME and farmers' demands to the widest possible extent. No such concern existed regarding the banking sector, and that was one of the reasons why historically it had been forced to carry a large burden of the government's developmental and redistributive policies. Until well into the 1980s, the banking sector's power to effectively pressure government in the pursuit of its interests was severely hampered as a result of mainly three factors: the institutionalized regime of financial interventionism, the extensive state control over most of the banking sector, and the dominant developmental doctrine of industrialization followed by the political pursuit of redistribution. Being government-appointed and heavily regulated, managers of the SCB sector could not afford to antagonize the government in any of its decisions on which its mind was set. All they could expect to do was to exercise significant personal impact toward positively influencing those decisions. Like big industrial capital, that was the field in which they could be particularly successful. So whatever political leverage the banking sector had was a combined function of the vast economic resources it commanded and the bankers' elite penetration and insider status within the governing class.

A small and conspicuous lobby, the bankers (the subjection of SCB managers to government control and replacement notwithstanding) could often act in a coordinated way by virtue of the sector's concentration and oligopolistic structure. This was despite the practical nonexistence of a weighty bankers' association. Indeed, the 1928-founded Hellenic Bank Association, revived in its postwar existence in 1963, was devoid of any serious resources or influence until well into the 1990s, and banks tended to promote their interests individually. Apart from the closeness cultivated through extensive informal contact, there was important common ground on which bank interests objectively converged. In the 1960s the banks had succeeded in persuading the Currency Committee to protect the market oligopoly by restricting entry to foreign competitors. In the 1980s and preliberalization, banks

were more or less united by their common opposition to credit interventionism exercised via – or despite – the BoG.

Moreover, it should be emphasized that SCBs throughout the postwar and especially post-1974 period operated like a second state budget. Excessive ambiguity and lack of transparency surrounded the financial give-and-take between government and SCBs. Upon intervention from government or governing party officials, large sums of bank credit would be directed to all kinds of favored recipients, from specific private firms to government projects to client groups to sensitive electoral constituencies. Given the murky waters surrounding SCB financial transactions, all bank accounts prior to 1992 (when, as EC policy, a universal accounting system was adopted) should be regarded as highly unreliable. (One should keep this in mind when assessing the official figures of bank profitability provided in Figure 6.3.) For instance, in the 1970s and 1980s, SCBs regularly received an annual unofficial financial 'support' from the BoG, to improve their balance sheets.

Financial liberalization overall presented a bankers' window of opportunity for getting rid of restrictions and taxes and for maximizing profit. The abolition of exchange controls and freeing of capital movements also

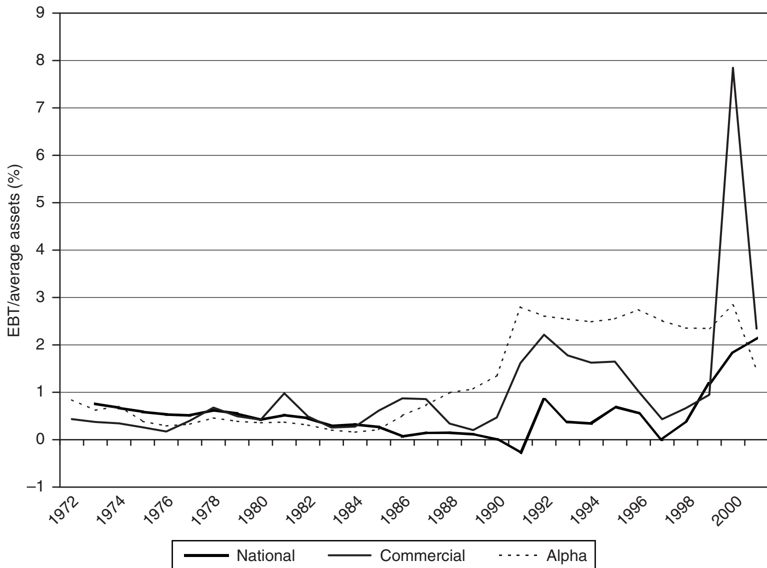

Figure 6.3 Greek bank average asset profitability.

Source: Bank accounts.

increased the potential for arbitrage and fees earned through handling international financial transactions. Thus banks – especially private ones – had been early champions of deregulation, and were consistently pressing the BoG for a faster pace of reform, at least in certain areas. SCBs, on the other hand, carried the burden of problem portfolios. This placed them at a disadvantaged starting point compared to private competitors. In addition, SCBs derived a disproportionately high percentage of profits (nearly 50–70 percent in 1988) from sources other than interest rates (such as commissions or costs charged on clients) (BoG 1990: 53) and from a host of smaller state-granted privileges which were to be swept away by liberalization. Thus, Greek banks (and particularly SCBs as the most burdened in a banking system which was the least competitive and second most concentrated in the EC) were also apprehensive of the single financial market, dragging their feet on the implementation of EC directives. A protectionist tendency outwards and an apparent liberalizing disposition inwards summarized the attitude of Greek banks, not significantly at odds with other European national banking sectors.

Thus overall, SCB fears notwithstanding, the financial sector was a principal supporter, recipient, and beneficiary of financial liberalization (Figure 6.3). At a direct account not only did the financial sector's share of participation in the economy grow but the intrasectoral balance between credit and financial services was radically altered to the latter's benefit. However, the effects of reforms exhibited a positive-sum quality for the entire financial system. Incumbent actors such as banks improved their standing compared to the pre-1987 period, also by expanding through financial subsidiaries (such as mutual funds, portfolio investment, securities companies, and so on) into new highly profitable areas. At the same time a growing number of new actors and institutions emerged, responding to the broad range of new authorized services.

Moreover, the 'hard drachma' policy that followed banking liberalization until EMS entry was a boon for the (sheltered) financial sector, allowing banks to reap sizeable profits from a growing volume of financial transactions in a steadily appreciating (in real terms) national currency. Indeed, the given commitment of monetary authorities to a policy of real appreciation of the drachma as the principal instrument for achieving disinflation and nominal convergence, combined with the very high real interest rates, attracted domestic and international investors to drachma-denominated financial assets. The almost certain policy framework and the preannounced objective of EMU entry rendered this type of investment both profitable and low-risk, as long as the 'hard drachma–high interest rates' monetary policy continued.

The game, of course, became more risky as the 'deadline' for EMS entry approached, necessitating a devaluation so that the overvalued drachma could join the EMU at a competitive parity.[2]

As a combined direct effect of reforms, average profitability ratios of Greek large commercial banks rose, with pretax profits over assets climbing from 0.3 in 1987 to 0.7 in 1990 to 1 percent in 1992 (the latter being higher than the OECD average) (OECD 1995: 53). At the same time small private banks, specialized and flexible, positioned themselves as 'niche players' in the market and saw their profits multiply. Further, between 1987 and 1993 commercial banks' own funds approximately quintupled, and productivity rose by 163 percent, largely due to extensive investment in new technology (Kostopoulos 1994). By 1994 Greek commercial banks had increased to 18 (from 13 in 1988), and there were 21 foreign commercial banks (from 19 in 1988), 90 mutual funds (from 2 in 1988), 15 portfolio investment companies (from 6 in 1987), a number of merchant banks, 10 leasing companies (from 3 in 1987), and around 60 securities companies (instead of approximately 30 stockbrokers in 1986), all evidence indicating the rapid development of specialized financial services (Korliras 1994: 24). Existing banks were the first to colonize, via specialized financial subsidiaries, the newly emerging financial sector.

All these new nonbank actors emerged as a result of deregulation. They were nonexistent or unable to play any notable role during its formulation and implementation. Moreover, the role of the nonbank financial community as an interest group was negligible during the deregulation process due to the underdevelopment of money and capital markets and the thinness of the Athens Stock Exchange (ASE). Equity capitalization in GDP percentage terms grew from 6.75 percent in 1980 to 15 percent at the end of 1993, while total capitalization growth (including both equities and bonds) was more dramatic, from 8.75 percent in 1980 to 58 percent in 1993 (OECD 1995: 55). In 1989 only 119 companies were listed on the ASE (from 116 in 1980), up to 150 in 1993. Even then, banks and insurance companies accounted for the bulk of equity capitalization as larger Greek industrial firms (traditionally family-run and bank-financed) avoided going public. Nonbank institutional investors were scarce, pension funds too weak to trade in the ASE. Pension funds were government-controlled, obliged to invest their funds mostly in the form of bank deposits, secondarily in government securities, and (to a lesser extent) other shares. Insurance companies (several of which were subsidiaries of commercial banks and especially SCBs) held much of their assets in bank deposits, and tended to invest in

real property or fixed-interest securities rather than private sector equity. Only progressively toward the end of the 1990s did insurance companies and pension funds become major institutional investors in the capital and bond market.

The phasing out of the compulsory investment ratio in Treasury bills (completed in 1993) brought about an important transfer of power from government to the banks. As a result of high inflation, the majority of the public debt was short-term. This forced the government each month to sell new issues of securities to repay large volumes of previous issues that were reaching maturity. The withdrawal of the compulsory investment ratio not only allowed banks to demand an attractive yield in order to absorb the new issues of government paper. It also gave them the chance to redeem any government securities reaching maturity, or to sell them when short of liquidity, or to replace them with loans to the private sector if that was deemed more profitable. Banks were paid substantial commissions for all debt issues and redemptions they intermediated. By expanding the range of alternative investment opportunities, deregulation allowed banks and savers an increasing role in defining the terms under which government could sell its securities, progressively divesting government of its privileged access to finance.

This left government with mainly two instruments for influencing market demand for its securities. The first was the ability to exempt government paper from taxation, thus sustaining a form of illicit competition with other alternative forms of investment. Only in 1998 did government begin taxing the interest earned on state bonds. The second indirect instrument pertained to the government's continuing control over SCB administration. Despite the growing autonomy of SCB managers in the 1990s they remained subject to government pressures, though their bargaining power and ability to resist such pressures were relatively enhanced. Thus stronger banks (especially the NBG or – to a lesser extent – the Commercial Bank) were able, in exchange for purchasing a new issue of government paper, to demand, for example, a piece of favorable regulation or their inclusion in key public sector projects or other lucrative arrangements. Bargaining of this type was not exclusively reserved for SCBs; the two or three major privately owned banks could also engage in such forms of exchange. Banking liberalization and marketization transformed the statist politics of bank–government relations into a perhaps equally oligopolistic (in terms of the small number of sectoral players) structure of relations, but one in which banking market actors were substantially better resourced and the state divested of crucial interventionist instruments held in the past.

High spreads: the politics of banking oligopoly

Through the Bretton Woods period, average interest rate spreads (the differential between deposit and lending rates, a main source of bank income) in the Greek banking sector gradually increased, stabilizing in the area of 2.5 percentage units until 1973. From the mid-1970s and until the 1987 interest rate liberalization, the average spread increased substantially, ranging from 3 to 7 percentage units. However, this did not translate into a rising income for the banking sector in general, as it was more than offset by a number of unfavorable circumstances. These included rising unit labor costs for banks (SCB personnel flooded with patronage appointments), accumulating nonperforming loans, and the obligatory channeling of a growing share of bank assets into low-interest-bearing government securities and other mandatory investments. The latter is evidenced in the decreasing share of loans in total assets, as seen in Figure 6.4. Thus, during that pre-1987 period, banks carried the cost of cheap finance to industry, to various credit demanders, and especially to government. From the banking sector, often via negative real deposit rates, the cost of inflationary finance was passed on to the depositors, and thus diffused under the latter's prominent inability to act collectively. Indeed, despite the negative real deposit rates of the 1973–88 period, the share of deposits over total bank liabilities remained almost unaltered, given the lack of alternatives.

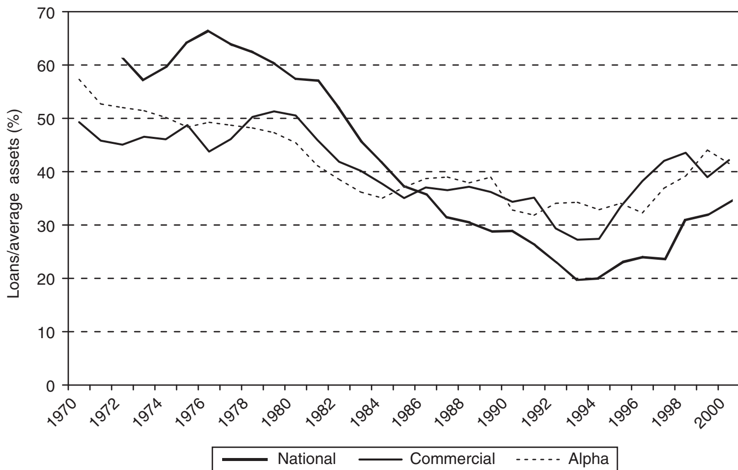

Figure 6.4 Greek bank loans/average assets ratio.
Source: Bank accounts.

The rise of interest rate spreads at unprecedented levels after the 1987 liberalization testified to the effort of SCBs, in particular, to recover the accumulated losses of the preceding period. The fact that spreads remained at high levels until the 2000s indicated that oligopolistic conditions in the Greek banking sector persisted despite liberalization. The spreads remained among the highest in the EU even after Greek interest rates had converged with those of the Eurozone and Greece had entered the EMU (Figure 6.5). Initially, in the early 1990s, the policy of high spreads was led by SCBs burdened with bad portfolios and concerned over being able to meet the new capital adequacy standards specified by the Second EC Banking Directive. When, after 1992, banks were obliged to adjust to the EU-imposed universal accounting standards, the profitability of SCBs dropped steeply, as they were forced to discontinue accruing interest on nonperforming loans. Indicative of the dire condition of SCBs, the NBG in 1990 had declared losses and had distributed no dividend. Other private and younger credit institutions carried much healthier portfolios and lower staff costs, and would have been in a position to afford more competitive interest rates had they decided to do so. However, private banks also chose to align their rates behind those of the larger SCBs, extracting comfortable profit margins. Bank competition was mainly confined to the areas of operational restructuring or expansion into new financial services, leaving interest rates aside.

Reflecting oligopolistic patterns of banking behavior, credit remained skewed in favor of larger established enterprises, while until the late 1990s banks made no particular effort to attract deposits. On the contrary, the

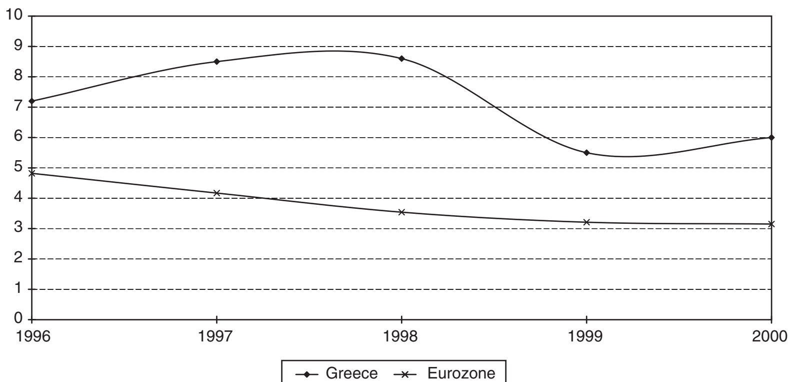

Figure 6.5 Short-term bank lending-deposit rate spread: Greece and Eurozone, 1996–2000.

Sources: BoG, ECB.

banks seemed to be primarily concerned with providing (zero-risk) finance to the public sector, reluctant to grant new loans to private businesses, in a cautious attitude reflecting a past record of bad debts still carried in their portfolios. It was only toward the end of the 1990s that bank credit policies started to become more aggressive, but on average interest rate spreads remained persistently high. There was an element of caution there, attributed to what was presumed to be a slow reaction of bank clientele to more attractive interest rates, the consequence of a long tradition of administered, universal credit policies. To a certain extent, this inflexibility of the public was corroborated by their reluctance to abandon traditional bank deposits for alternative forms of savings even when – from the beginning of 2001 – most real deposit rates approached zero or even negative levels. In this second, late 1990s stage of falling interest rates, the persistence of high spreads at levels almost twice the OECD average was even less justified since the large banking groups (including SCBs) had improved their capital standing, overhauled much of their bad portfolios, and – in 1999 – had achieved enormous profits from transactions in the ASE. Through oligopolistic practices, banks passed on to their clients the cost of maximizing profitability and building healthy balance sheets, to withstand European competition.

Facing the arena of socioeconomic interests

True to Lowi's (1972) famous dictum that 'policies determine politics', extending preferential finance to a range of interests had created a host of stakeholders in banking liberalization, whose losses stood to be proportionate to their previously provided degree of credit support. Liberalization unfolded in an environment which – post-1974 – was becoming increasingly pluralistic, as will be seen at the end of this chapter. Thus, the chances of interest translating into action and of that into effective influence also depended considerably on the interest groups' organizational resources. A brief overview of the nonfinancial socioeconomic interests provides evidence of the BoG's policy insulation and arena control as components of policy strength.

The trade sector

To begin with the beneficiaries of credit reform, the trade sector (except for exporters) was a main gainer of liberalization, and its steady advocate over the years. The traders' effective pressure upon the 1977 ND government (also given the sector's predominantly conservative ideological

proclivity and strong ND Party affiliations) had contributed to bringing about the first 1980 official BoG denunciation of credit rationing. The beneficial effects of the 1988 abolition of credit restrictions to trade were visible, as total lending to trade grew rapidly in the following years (Figure 3.2). Through its top-level representative organization, the Athens Chamber of Commerce and Industry, the trade sector provided influential advocacy and mobilization in support of liberalization, but without any participation whatsoever in formulating deregulation policy. As a result of the mixed nature (trade and manufacturing) of a large section of small-medium and larger industrial enterprises, the Chamber delivered a pro-liberalization alliance that included many industrial firms.

Handicraft and small–medium scale manufacturing enterprises (SMEs)

The most ardent opponent to deregulation was the SME sector. Their large number drew on a tradition of widespread self-employment associated with the relative underdevelopment of large industrial concerns.[3] Due to their predominance in the economy (representing over 99 percent of the total number of manufacturing firms),[4] SMEs commanded considerable political influence. Their official leading representative, the Athens Chamber of Small and Medium-Sized Industries, enjoyed public legal status, privileged political access to government, both under the ND and especially under PASOK. Its constituency included all enterprises entitled to special finance from the earmarked SME funds. Membership being mandatory, the Chamber tended to enjoy absolute organizational density, and in 1990 claimed a (nominal) membership of about 50,000 active SMEs. The Chamber pressured for its demands by lobbying key government ministers and powerful players of the governing party. As a result of their political weight, SMEs had managed to prolong their favorable finance regime practically until the early 1990s, when, under the pressure of EMU deadlines, deregulation could not be postponed further.

The SME finance regime was grounded on a convincing rationale, as briefly seen in Chapter 3. Given the banking system's rigidities, large established firms were excessively favored against newer, smaller, upcoming ones. Considerations of redistribution and fairness also supported special SME treatment. However, by the 1980s considerable evidence was accumulating linking SMEs with low efficiency, generating serious doubts about the rational utilization of SME credit (BoG 1984: 27; Yannitsis 1988: 40ff). In addition, commercial banks were consistently

pressing for the abolition of portfolio restrictions and looked forward to attracting SMEs as normal borrowers under market terms. Along came the pressure of finance ministers forced to pick up the bill of forfeited state guarantees for old SME bank loans. These factors, nonetheless, were still insufficient in bringing about the uprooting of a well-entrenched regime. The EC gave the decisive push. Aside from championing the termination of subsidies, the Commission promoted a structural reform strategy that supported larger-size SMEs but discouraged the individual operation of smaller SME units. Pressure materialized into positive obligation when abolishing special credits was included in the terms of both EC loans of 1986 and 1991, the latter setting the deadline for July 1993. The 1987 halfway abandonment of stabilization and the government shift to populism had prevented the BoG from putting forward the abolition before 1990, as, under the electoral climate, SMEs had successfully pressured governments against reform. Then, en route to Maastricht, the obligation became inescapable.

Given the sector's clout, the BoG was especially careful to avoid antagonizing the SMEs. In meetings sought by SME representatives, the BoG constantly underplayed the reforms' importance, presenting them as a measure of EC-imposed rationalization of a limited adverse impact on SMEs. The BoG tried to convince SMEs as well as concerned ministers that the phasing out of the earmarked contributions to the SME Special Reserve would not visibly affect SME finance, as the remaining stock would suffice to cover the large majority of needs. The stock indeed was significant, but a sizeable portion of it, known only to BoG and Finance Ministry services, was being extended to public corporations. Lacking their own independent research resources, SME representatives were unable to counter BoG projections.[5]

The medium–larger size manufacturing sector

The case was distinctive when it came to the Federation of Greek Industries (SEV), the principal representative of medium and larger manufacturing firms. As SEV accepted firms with over 25 employees, the majority of its members were really SMEs. In the late 1980s, SEV listed a membership of 3000–3400. Most were also involved in commercial and export activity, and many were active in imports. Internal diversity increased when many services companies, including banks, joined in the 1980s. Despite industry's losses from the abolition of preferential lending rates and the subsequent rise of the cost of money, SEV officially expressed support to banking liberalization. Its endorsement was a function of SEV's

role as voice for broader private business, and of the mixed industrial/commercial activity of most of its members.

SEV's support resulted from viewing deregulation as a necessary precursor and integral part of a general liberalization program. At some stage, SEV anticipated liberalization would sweep a number of other areas industry strongly wanted to see liberalized, such as capital movements, taxation, labor market, and price controls. SEV's support also resulted from admitting the unsustainability of repressed credit in an environment of persistent inflation and rising public deficits, and comprehending early on the irreversible momentum of European integration. Always a pro-market force (at least in its official pronouncements, and to the extent to which that did not threaten state protection in areas such as public procurement and others) SEV was an early champion of European integration. This stance imposed requirements of internal consistency, including support for financial liberalization, in order to maintain credibility. For all these reasons – to which should be added the close ties between industrialists and bankers – SEV supported banking liberalization.

SEV's pro-liberalization stance was not as wholehearted as it might have wanted to appear. Undoubtedly, SEV had good reasons to expect that the abolition of investment ratios for government finance would release bank funds for the private sector, and was thus an ardent supporter of the measure. But SEV was also aware that, given the difficulty of curtailing the government's borrowing needs, competition between government and banks for attracting savings into Treasury bills and bank deposits respectively, would be pushing lending rates upwards. The absorption of savings by government securities and banks would be crowding out the capital market by discouraging investment in private sector securities, also due to the higher taxation of the latter. Early on it became clear that the BoG's post-deregulation intention was to keep the cost of money high. The alternative of cheaper borrowing from international markets faced, apart from the exchange rate risk, various technical difficulties, especially in the early years. So manufacturing stood to incur considerable losses from what would hence become its constant source of tension with the BoG and successive governments. As Figure 6.6 shows, following 1987, credit to manufacturing as a share of total credit to private sector visibly declined.

Pressures were exercised in the 1990s by SMEs, industrialists, and exporters against the BoG's 'hard drachma' policy. Though economic and monetary stability remained a desideratum for business, the latter's 'sound finance' commitment was not uniform in its degree.

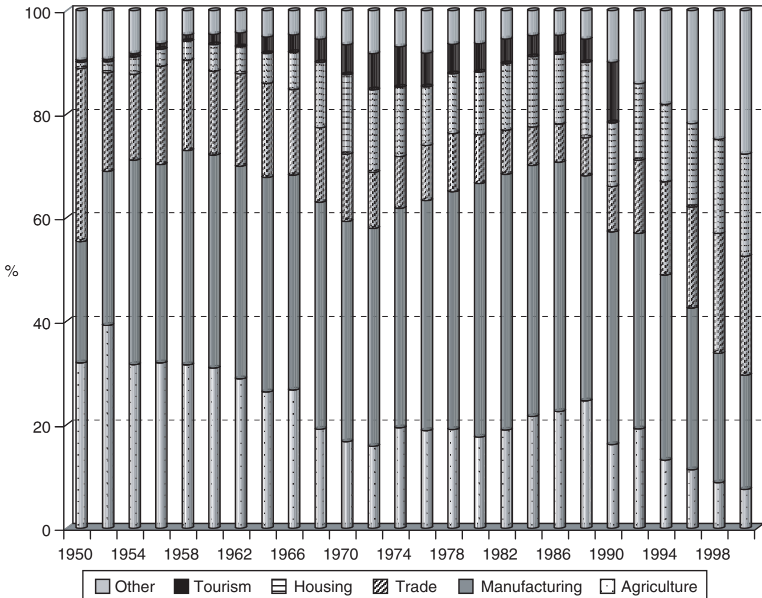

Figure 6.6 Bank credit to private sector by economic activity, 1950–2000.
Source: BoG (1992, 2000).

Clearly import-dependent producers were more ardent in their support of disinflation than export-oriented ones. On the other hand, a nonaccommodating exchange rate policy was accepted even by a section of exporters as inevitable for its instrumental role in limiting the degree of imported inflation. Exporters whose products depended highly on imported materials were more tolerant toward 'hard drachma' than exporters of products with a low import content. Labor-intensive tradeables branches (like the traditional textile industry) that pursued their competitive advantage through lower production costs were hard-hit by 'hard drachma', much more than capital-intensive branches were. On the other hand, especially after 1994, a growing number of mostly larger-size firms, given the prohibitive levels of domestic lending rates, had turned to foreign borrowing. Their accumulated liabilities in foreign currencies encouraged a strong 'hard drachma' preference. So business stance was far from uniform or unambiguous, but a general disquietude over the BoG's strict monetary policy over the 1990s was felt in varying intensities.

In conclusion, SEV and medium-larger industry, given the constituency's diversity, were eclectic supporters of BoG policies. Forced to

compromise a 'sound finance' proclivity with the interests of credit-dependent, export-oriented members, SEV was led to a generic and lukewarm support of liberalization, subsequently balanced through a highly critical stance against what it regarded as prolonged and excessive monetary austerity.

Exporters

Exporters were a category whose growth (after the shift to more active export-oriented industrialization during the 1960s) had relied on generous tax and credit incentives. Exporters were a case of conflicting allegiance. As traders they tended ideologically to oppose credit controls, but as exporters they benefited from state support. Having realized that the phasing out of export credit subsidies was among the first obligations imposed from as early as Greece's entry to the EEC, they fought their own 'rearguard battle'. True, exporters were the main losers from credit deregulation and among the first to experience its effects. Yet, if one considers the EC and BoG deregulation pressure and the extremely favorable export credit status quo, one should conclude that exporters were indeed successful in delaying its abolition. An overview of the exporters' organizational resources would help us understand that qualified success.

The main organization, the 1945-established Panhellenic Exporters' Association (PEE), claimed around 2000 members in the second half of the 1980s, out of some total 3500–4000 companies estimated to be active in exports. PEE's constituency though small in number was influential, including the dynamic export-oriented champions of national industry. Since 1980, PEE controlled its own Export Research Center, a small and efficient institute monitoring the development of exports and exchange rate parity with Greece's main trade partners. That granted PEE significant resource autonomy on the policy field that mattered most, exchange rate policy.

PEE was far from an easy organization to confront. First, because of its strong interest in exchange rate policy, PEE had systematically cultivated a quasi-insider status with the BoG. Like SEV, PEE had used its statutory membership in the BoG's (nonpolicy) General Council as a base for internal networking and access to information. That 'infiltration' enabled PEE to prevent consecutive BoG attempts to withdraw export credit subsidies, and facilitated an effective targeting of pressure with the right sense of timing. Second, more than any other group, PEE was able to successfully articulate a broader national interest discourse. Exporters invoked their crucial contribution to the national economy,

and reminded governments that state support was necessary as Greek companies were competing under economic adversity with European firms systematically subsidized by their home governments.

Third, a much wider range of production than PEE's formal constituency had a vital stake in exports. A large number of farmers and SMEs not listed as exporters depended on export trade companies in order to access foreign markets. This vital connection endowed PEE with some of the additional pressure power of agriculture and industry, forcing any government to think twice before disaffecting export-oriented producers. So PEE was able to offset its numerical disadvantage as an interest group, and enhance its bargaining power toward government through a combination of three advantages: insider access, compelling legitimizing discourse, and a vital connection with pivotal producer groups.

Two of the exporters' main credit-related privileges were phased out or abolished: the special interest rates for export, and the so-called 'prefinancing of exports'. Both BoG reforms were implemented by mid-1984, being among the first fundamental steps to deregulation. Beginning in 1983, the lending rate to the export trade was equalized with that of the import trade, from 10.5 and 14 to 21.5 percent. This resulted in a steep 1983 fall of total credit to the export trade, from which exporters took several years to recover (Figure 3.2).

But the heaviest blow came with the gradual phasing out and final abolition of the 'prefinancing of exports' regime under which exports were subsidized through preferential interest rates and the refunding of interest. To facilitate trade, exporters were allowed to keep foreign currency abroad and reimport it afterwards. However, as real drachma interest rates during the first half of the 1980s were lower than international rates, exporters tended to eschew their obligation to reimport their foreign currency, something very difficult for the BoG to control. Alerted by the adverse effects on the balance of payments, the BoG was leaning strongly against the regime. Thus, from at least the beginning of the 1980s, the government was caught between BoG and EC abolitionist pressure on one side, and the exporters' intense resistance on the other. At the same time, competitors, such as import traders, were protesting against what they considered unequal treatment. For the first few years the BoG was only able to gradually reduce the scope of prefinancing and slowly release interest rates upwards as the government, yielding to PEE pressure, resisted a faster pace of reform.

Finally in April 1984, invoking an urgent balance-of-payments crisis, the BoG managed to persuade the national economy minister to accept the abolition of the prefinancing of exports. This, combined with the

'hard drachma' policy which later followed, led exporters to a long period of grievance. Realizing that the matter was largely political, the BoG presented the government with data demonstrating that the impact of abolishing export subsidies was actually smaller than exporters claimed it to be. The BoG argued that most of the export trade sector was actually of a mixed nature, both foreign- and domestic-oriented, and that under regulated credit the domestic-oriented section was incurring a higher interest rate in order to subsidize the export-oriented section of the same industry or company. So, in effect, deregulation only brought the interest rate paid by the average mixed export company close to the average rate paid by the same company under the regulated regime. The argument's bottom line was that the true net losers from liberalization were actually confined to a minority (some 10 percent) of exclusive exporters. The government tried to offset the loss by satisfying a range of other demands, such as expanding an export support system, providing export insurance, and extending forms of export subsidies directly from the state budget, often at the margins of EC acceptability.

Thus, even exporters, where one would expect homogeneity, were divided along subsectional lines (exclusive or nonexclusive export activity). While their association presented a unified stance and drew on important organizational resources, the BoG was able to invoke subsectional divisions in its effort to persuade government to abolish the export finance regime.

Farmers

Deregulation affected farmers negatively through the gradual liberalization of the Agricultural Bank of Greece (ABG), provider of over 80 percent of agricultural credit. The process, which began in 1984 but picked up pace after the 1985 election, consisted in the ABG's step-by-step 'commercialization'. Already from 1983–84 the BoG had begun to curtail ABG funding, forcing it to compress its annual program of credit expansion until the ABG was finally obliged to finance lending by attracting deposits. In 1989 commercial banks were allowed to lend to agricultural cooperatives and unions, and in 1991 the ABG was permitted to expand to all categories of loans undertaken by commercial banks. However, the state budget continued to subsidize ABG lending rates which, until the mid-1990s and despite the steady rise, still remained at lower than market levels.

Numerous (the Greek primary sector by the end of the 1980s employed about one-quarter of total civilian employment) and significantly homogeneous given the absence of large landownership, farmers have

been a group no Greek government could afford to displease. Yet, the reaction BoG reforms faced was surprisingly weak. The explanation should also be sought at the organizational level.

Tight government control of agricultural cooperatives combined with their almost complete dependence on state resources and a fusion between party–state and trade-union functions, all indicated a long-rooted quasi-state corporatist organizational structure which reached its apogee in the 1980s (Mavrogordatos 1988; Kioukias 1994). The Confederation of Agricultural Cooperatives had the monopoly of farmer representation and a large hand in the distribution of subsidies to the cooperatives via the ABG. The vast majority of cooperatives did not have their own funds and depended exclusively on EC and state funding. Heavily controlled by PASOK since 1983 and state-funded, the Confederation operated as a 'devolved government agency' (Mavrogordatos 1988: 88) solidly aligned behind the money-raising Agriculture Ministry. Monopolistic peak representation, nevertheless, historically coexisted with entrenched local-clientelistic grassroots pressure patterns. Throughout the postwar period cheap finance was extended to farmer groups through the ABG as a result of particularistic mobilization of those groups and direct lateral access to local patron MPs or government ministers.

The ABG's relation with farmer cooperatives was often tense, largely due to their high default rate. However, when it came to opposing BoG reforms, the ABG and farmers, together with their grand patron, the Agriculture Ministry, were all in the same boat. As the farmers' lobby was practically headed by the agriculture minister, who would pressure BoG on their behalf, the conflict would inevitably assume an intragovernmental character. In most cases the BoG received the steady backing of the national economy minister who, by virtue of overviewing the financial system, normally supported easing the agricultural burden on the banking sector. However, the gradualism of BoG reforms testifies to the compromising tone adopted by the economy minister vis-à-vis agricultural interests.

In any case, the impact of credit liberalization on farmers was offset by other favorable circumstances, especially copious EC subsidies. Between 1980 and 1989, total spending (that is national state budget plus EC expenditure) in support of Greek agricultural income rose as percentage of agricultural product from 16 to 39 percent (Maravegias 1992: 37ff). Thus, thanks to direct EC handouts, the rising cost of ABG finance was drastically offset and governments were able to collect the political dividend from the farmers' visible welfare improvement. Moreover, the persistently large number of defaulting ABG borrowers (cooperatives

and individual farmers) meant that a significant percentage, having no intention of repaying their loans, were practically indifferent to the rising cost of money. In conclusion, first, the transformation of pressure politics, via quasi-state corporatism, into intragovernmental politics, and, second, the offsetting of the cost of agricultural credit liberalization by growing EC subsidies, explain the apparent paradox of the farmers' weak reaction to liberalization.

Central bank strength and the bankers' rise

This account has provided a brief analysis of the constraints and facilitating circumstances to credit liberalization emanating from the socioeconomic arena. Notable among the constraints was the political leverage of interest groups, particularly SMEs and farmers. Significant facilitating factors of deregulation were the organizational weaknesses of those groups: the incapacity of farmers' associations to handle policy matters without the Agriculture Ministry's intermediation, or the lack of adequate technocratic policy resources of SME representatives. Notably, the segmentation and functional ambiguity of industry and trade prevented dispossessed subcategories from perceiving a notion of common interest toward deregulation, let alone articulating a solid stance toward it.

The BoG retained significant control over the policy arena by insulating policymaking from external group pressures. Policies were designed unilaterally by the BoG, their timing decided in closed consultation with government, with a strong tendency to exclude affected interests from the process. Closed and secretive policymaking, however, entails the serious risk of finding oneself isolated from the societal arena and market reality, failing to predict the actual scope of reactions, and possibly ending up having to revoke policies under heavy sociopolitical pressure. In several cases before implementing a potentially contentious measure, the BoG would resort to consultation with affected categories, particularly those with which it shared a common ideological wavelength, such as SEV and the Chamber of Commerce. In the government and BoG dealings with the groups mentioned, certain patterns emerged. Under the premise of being the ultimate power-holder in economic management including deregulation, government was the main target of group pressure. In response to that pressure the government often applied a tactic of scapegoating. It claimed that reforms were inevitable as imposed by the EC/EU, or claimed BoG sovereignty in implementing them.

The account of credit deregulation in this and Chapter 5 illustrates the significant policy strength of the CB despite its institutional dependence

on government. On the grounds of all four specified criteria (resource capability, agenda identification, policy determination, and policy insulation/arena control), the BoG demonstrated considerable policy strength vis-à-vis the government and affected socioeconomic and sectional interests.

The abolition of developmental finance institutions, like their establishment a few decades earlier, did not result from socioeconomic interest group or sectoral pressures, though such pressures played their role in influencing the timing and detail of policy reform. Instead, both the administrative regulation and the deregulation of credit corresponded mainly to a state-directed pattern of structural and policy reform in which the CB played a prominent role.

More as a secondary effect rather than as a primarily intended consequence, financial liberalization advanced the interests of the banking sector, allowing it to recover from the accumulated portfolio burdens of the 1970s and 1980s. In improving the health of the domestic banking system such a result was concordant with BoG objectives. More than that, the banking sector emerged powerful after liberalization. But the bankers' rise was not a result of their own organizational mobilization or political muscle. It was not even a direct reflection of the ascent of their European counterparts – for as long as most of the banking sector remained government-controlled, its response to the external environment was mediated by government will. The bankers' rise was an outcome of the government's decision to adjust to the imperatives of disinflation, and the consequent vesting of the CB with increasing authority. The flip side of the BoG's newly acquired monetary policy effectiveness was the banking sector's rising competitiveness, profitability, and ensuing political strength. Indicative of a state-centric economy, the bankers' rise did not reflect substantive coalitional realignments in the market or civil society but an externally induced policy shift and consequent recasting of power balances within the broader state machine. The bankers' rise was more of a belated jump on the bandwagon of state-led reform rather than the result of a political coming of age.

A comment on interest organization: from state corporatism to *parentela* to concertation?

State corporatism, clientelism, an anemic and politically repressed civil society have been among the terms characterizing postwar state–society relations, as seen in Chapter 2. We now place this chapter's discussion of the interests surrounding credit reform in a broader conceptual

framework, by looking at the state–society relations pattern that underpinned the Greek political economy of the postauthoritarian period. The lack of a typical neocorporatist mode of interest organization and tripartite organized policymaking (as defined by Schmitter 1979, 1981) until the 1990s is generally agreed upon. Most authors assert an unflinching postwar state corporatist or (postauthoritarian) quasi-state corporatist tradition, reinvigorated under the Andreas Papandreou governments (Mavrogordatos 1988; Sotiropoulos 1996; Zabarloukou 1996). My contention to this would be that the term 'state corporatism' should be mostly confined to cases of developmental states controlling considerable instruments of political coercion, both willing and able to vertically align centrally organized collective interest associations behind state plans and developmental objectives. With the possible exception of the most dirigiste agricultural policy sector, the generalization of the state corporatist argument for the post-1974 period is rather problematic. In postauthoritarian Greece (as in the postwar period) the state in general continued to exhibit internal fragmentation and discontinuity, its developmental objectives being even more vague and weakly articulated than before, the state systematically colonized by the governing party, especially during the 1980s. The state's coercive instruments are now mostly nonauthoritarian, limited to legalistic regulation of, and judicial intervention in, associational and trade union activity, and the ability to hold unions financially dependent (Ioannou 1996: 502ff). State–society relations post-1974 are functionally integrated in a system of party-political clientelism. Thus the state corporatist argument overstates the degree of state control over organized interests and the possibility of state-imposed concertation, and underestimates the fragmented and often rent-seeking character of interest mobilization. This chapter has provided evidence of such pluralistic fragmentation.

One can perhaps only talk of a persisting quasi-state corporatist tradition in the organization of agriculture, given its vital dependence on state subsidies both for production and associational activities. On the other hand, the operation of peak collective associations post-1974 did not correspond to a real centralization of collective bargaining, nor to an ability to autonomously engage in tripartite negotiations and social pacts, but only served to disguise the internal fragmentation. There was only a semblance of neocorporatist institutions, one that became more manifest in the pseudo-corporatism (Kazakos 1991: 61ff) of the socialist government–trade unions relations of the 1980s. Indeed, the coexistence of state corporatist proclivities with pockets of sectoral corporatism amid pluralistic pressure patterns has warranted the branding of

the Greek case as one of a 'disjointed corporatism' (Lavdas 1997). This is meant to denote 'the combination of a set of corporatist organizational features and a prevailing political modality that lacks diffuse reciprocity and remains incapable of brokering social pacts' (Lavdas 1997: 17).

By the same token, however, the post-1974 associational landscape can be conceptualized in exactly the reverse terms, namely a case of corporatist patterns and instances operating in a generally pluralistic interest group setting. While accepting the state corporatist characterization for the pre-1974 period, the postauthoritarian reality until the early 1990s was probably leaning more strongly toward the pluralist side of the continuum (Kazakos 1991: 54ff; Pagoulatos 1999b: 200ff). Features included competition of interests, low coordination of access attempts, relatively open boundaries of mobilization; multiple, overlapping, unstructured, unstable relations; low degree of institutionalization; an adversarial type of interaction and politicization; limited ability of peak organizations to commit and to ensure compliance of members (Schmitter 1979; van Waarden 1992: 44). It was a pluralism distinguished by an interest fragmentation of a *corporatiste* quality – in the French meaning of the word *corporatisme*, signifying 'the myopic and exclusive pursuit of short-term, sectional interests' (Hayward 1991: 383). More specifically, at the broader macro-level, that particularistic version of state–society relations and interest mobilization may be claimed to have constituted a *sui generis* case of *parentela* pluralism (LaPalombara 1964: 306ff; Peters 1995: 194–7). *Parentela* shares strong common features with *clientela* mainly in the particularistic attachment of certain (usually subsectoral) interest groups to government, and very frequently both forms of relationships coexist. However, *clientela* relationships are directed at the bureaucracy (which implies a considerable degree of strength, continuity, and autonomy of the latter), whereas *parentela* relationships are aimed directly at the governing or politically dominant party, which brings us closer to the Greek case of a weak and politically subservient government bureaucracy. Indeed, as a number of studies point out, client interest groups or voter groups pursued access to state resources through their attachment to the party in power (cf. Lyrintzis 1984; Petmetzidou-Tsoulouvi 1987: 199–200; Charalambis 1989). The latter acted as patron, retaining a strong role in policymaking. The post-1981 effort of PASOK to consolidate the government shift by politically colonizing the bureaucracy and controlling most of the country's associational activity (Mavrogordatos 1988; Sotiropoulos 1996) served to reinforce the *parentela* tradition.

The affirmation of a *parentela* pluralism operating at the postauthoritarian macro-level does not deny, nor does it exclude, as stated, the parallel

existence of 'considerable corporatist organizational continuities particularly in the form of sectoral corporatist enclaves which have been the result of mutations of traditions of state corporatism' (Lavdas 1997: 17). In fact, it may well be argued that the exact effect of post-1974 political and civil democratization was the transmutation of a macro-level state corporatist tradition to a set of pluralist arrangements, albeit one strikingly close to its state corporatist predecessor. Indeed, *parentela* arrangements closely resemble the corporatist pattern of interest groups relationships, especially the state corporatist model (Peters 1995: 197).

It will later be argued that this *grosso modo parentela* pluralism of the postauthoritarian period, under the socialists in the 1990s gradually took on more decisive neocorporatist features. Obviously, the combination of state corporatism with political repression in the authoritarian-prone postwar decades had canceled one of the essential prerequisites of neocorporatist compromise, that is the uninhibited political legitimization of labor. However, as the inability of a neocorporatist pattern to develop extended into the postauthoritarian period, it may be worth questioning why substantial neocorporatist arrangements failed to unfold until well into the 1990s.[6]

When one seeks to identify the deeper underlying reasons why neocorporatist institutions failed to take root in postauthoritarian Greece, then historical tradition is not an exclusively determining factor. The *metapolitefsi* decades (post-1974 and 1980s) did not offer the opportunity for neocorporatist institutions to evolve, not solely because of the adverse international political economy (capital mobility, monetary instability, stagflation) but also because of the inauspicious domestic preconditions regarding the two other factors of the neocorporatist equation, that is capital and the state. Neocorporatist institutions in Western Europe had developed with the mission of transforming the zero-sum or negative-sum conflictive relation between capital and labor into a positive-sum long-term coexistence (Lange 1984). The prisoner's dilemma-type problem to be resolved by establishing neocorporatist institutions was effectively one of time-inconsistency. In an environment of political and macroeconomic stability, both sides, capital and labor, in the longer run would be better off tempering present demands for further profits or higher wages respectively, provided that the gains of labor moderation were reinvested. Coordinated and centralized wage bargaining institutions contributed to reducing inflation as workers and employers internalized more of the positive and negative externalities of their wage-setting behavior (Calmfors and Driffill 1988). The 'precarious balance of power between labor and capital' (Kurzer 1993: 251),

amounting to far-sighted mutual compromise, resulted in higher future production and income for both sides. The condition under which both social partners would subscribe to this rationally optimal intertemporal trade-off would be each side's certainty that the other would act in the same way. This requisite of mutual confidence was provided by the respective institutional arrangements, whose credibility, however, was largely dependent upon the credibility of the third party, arbiter and 'honest broker' of the neocorporatist deal, the state. For neocorporatism to function it required not only far-seeing capitalists and workers; it also required a credible state. And that was where the Greek chances of neocorporatism in the 1970s and 1980s were doomed, even if the other conditions were to be propitious (which they were not).

One can reinforce this argument by comparing with post-transition Spain. Spain was faced with an equally or more unfavorable macroeconomic environment as Greece (given the higher rates of unemployment) and a parallel (though by no means identical) transition to democracy.[7] Yet Spain's postauthoritarian mode of industrial relations was far more consensual than that of Greece. Indeed, as some authors have suggested, post-Franquist Spain was a representative case of Southern European neocorporatism (Schmitter 1995; Pérez-Díaz 1993, 1999; Royo 2000). One might choose to pursue the differences between the Spanish postcolonial, 'old money' capitalist class, and the upstart, less developed, more precarious, state-protected Greek business capital, or the respective labor movements. But it could hardly be contested that at least one crucial explanatory factor here lay with the qualitative distance of the Spanish state from the Greek. Equipped with a highly qualified, meritocratically recruited civil service elite, the great majority of which had been bequeathed from the Franco era (Linz and Stepan 1996: 252), the Spanish state stood for unflinching continuity even in the face of changing political regimes. The impressive convergence of the main political forces over the common objective of Europeanization as exemplified in the Moncloa Pacts (Maravall 1997: 84ff) vested government with an even greater sense of continuity and legitimacy, allowing it to play the role of the credible arbiter which underlay Spain's neocorporatist trajectory. Via state credibility and consensus-oriented party politics, unified under a widespread agreement over EC membership, postauthoritarian Spain was prompt in making the qualitative leap from state corporatist to neocorporatist concertation. That was not the picture in Greece until well into the 1990s.

Indeed, in postauthoritarian Greece such conditions of government policy continuity and significant bipartisan convergence over fundamental European and economic policy objectives did not crystallize

until after 1993, when active political consensus over the EMU-oriented main directions of economic policy was achieved. This development was largely a function of the pragmatic endorsement by PASOK of orthodox, EMU-directed economic adjustment upon Papandreou's October 1993 return to power – and the *ipso facto* termination of a revanchist, en bloc opposition to the ND government's similar macroeconomic stabilization and market liberalization program. More importantly, party convergence over an orthodox pro-Maastricht policy agenda was consolidated with the 1996 rise to power of the reformist, Europeanist social democratic faction of PASOK led by Kostas Simitis, as well as by the exercise of a moderate opposition by the ND, a party traditionally identified with promoting the Europeanist agenda. From the second half of the 1990s, with the blessing of the European Commission, the socialist government pursued a strategy of social dialogue and social pacts as a prerequisite for implementing several policies of macroeconomic and structural reform (pension reform in 2001–2 being the foremost example). The relative depoliticization and bipartisan pragmatic convergence over the EMU agenda vested government policy in the post-1974 period with an unprecedented degree of (expected and real) policy continuity, stability, and credibility. Thus, a relatively more propitious set of circumstances for the unfolding of neocorporatist strategies was realized.

There are some further reasons why the 1990s were ripe for the evolution of *parentela* pluralism into a neocorporatist concertative pattern. State corporatism had been a corollary of postwar government authoritarian practices. *Parentela* pluralism, on the other hand, developed from two major elements of the postauthoritarian period: party-political polarization and associational freedom. During the Karamanlis governments, in a hyperpoliticized society conditioned nonetheless by long-entrenched clientelistic reflexes, resurgent group demands were directly targeted at the conservative governing party. Under Papandreou in the 1980s, the bureaucratization of clientelism (Lyrintzis 1984) created a political context that maximized the *parentela* elements. The newly acquired freedom of associational life, combined with the widespread endorsement of a militant anticapitalist rhetoric by the early PASOK[8] and the Left, encouraged maximalist union demands while undermining any effort for concertation let alone 'social partnership' with the employers. During the 1990s, however, and especially after 1993, for reasons elaborated in the previous chapters, the economic constraint was rendering pragmatic adjustment an increasingly ineluctable policy path, eroding the appeal and primacy of ideological politics. PASOK was now (already since the second half of the 1980s) officially embracing

modern European social democracy along with the need for drastic disinflation and a market-led, gradualist adjustment. Accordingly, socialist trade union leaderships, under the influence of their EU peer, were 'learning' and turning to a systematic adoption of neocorporatist strategies, wage moderation, and social pacts.

A representative example of change at the sectoral level was the banking sector, where on a cross-national European and EU scale, neocorporatism has been widespread and employee peak organizations have been quite influential in sectoral policymaking (Coleman 1994). However, the Greek Federation of Bank Employee Organizations (OTOE) was excluded from policy deliberation on both banking deregulation and – later – reregulation. While the EC umbrella organization of national banking employee associations participated in the European Commission banking legislation processes, OTOE was excluded from all expert committees on domestic banking reform (such as in 1987 and 1992) that operated under government auspices. However, following credit liberalization, the Greek banking sector exhibited signs of a move in a sectoral corporatist direction. For instance, the Hellenic Bank Association (HBA) (which was dormant) took steps to upgrade its status into that of a representative peak organization, institutionalizing contacts among its members. Furthermore, the intense zero-sum politicization formerly characterizing the OTOE of the 1980s was relaxed in the 1990s in favor of a technocratically informed 'realistic' strategy of encompassing sectoral interest representation, and the institutionalization of communication channels and top-level collective bargaining between bankers and employees. This was also a break from the HBA's past, since, unlike some of its European counterparts, the HBA had never played the role of a real employers' association for the sector (Kostis 1997: 169–70).

Be that the case, the lack of concertationist and tripartite institutions at the crucial moment of the government shift to economic adjustment and financial reform (initially following the 1985 stabilization and then more decisively after 1990) meant that that shift would be implemented without the entrenched and institutionalized resistance confronted by liberalizing governments in codecisional neocorporatist regimes. Instead, credit interventionism had produced a range of selective beneficiaries, whose opposition (for good or for bad) was fragmented and dispersed, and whose precarious presence, given the lack of inclusive institutions, was incapable of permeating the decision-making mechanisms. Moreover, in the absence of a prior social democratic pact committing capital to undertaking productive investment, and given the state's pivotal role in steering economic growth under the previous

developmental regime, the transition to disinflation was bound to be even more stifling for growth.

To summarize the main points of this section: state–society relations have evolved from a predominance of state corporatist features and trade union repression in the postwar period until 1974, to *parentela* pluralism and intensely adversarial industrial relations in the postauthoritarian period between 1974 and the end of the 1980s. In the 1990s, the previously intense government-political interventionism in trade union organization and activity was relaxed, financial autonomy of labor unions was increased, the General Confederation of Greek Labor (GSEE) acquired significant political autonomy, and collective bargaining was liberalized. Increasingly into the 1990s, the autonomous role of social partners emerged, wage moderation became the rule, consensus-oriented, neocorporatist-type procedures and institutions (both bipartite and tripartite) were strengthened, centralized collective bargaining and the pursuit of social pacts coexisting with highly decentralized company-level agreements. The new political economy of financial liberalization, globalization, and the EMU found the organization of state–society relations at the moment of its highest maturity compared to the entire postwar and postauthoritarian period.

7
The New Political Economy of Financial Integration, Globalization, and the EMU

Financial liberalization accelerated the European and international integration of the Greek economy in the 1990s. This chapter examines the transformation of the financial system, focusing on its broader economic and political implications within the framework of the European and globalizing political economy.

A new framework: the mixed effects of financial liberalization and the EMU

EMU membership entails far-reaching transformations. For a weak-currency, high-inflation country like Greece, the euro offers not only the tremendous benefit of monetary stability (lost and never recaptured since the early 1970s), but also the unprecedented *acquis* of a potentially strong world currency. The EMU relieves the economy from the balance-of-payments constraint, probably the heaviest burden on economic policy through the history of the modern Greek state, exacerbated in the stagflationary 1980s, when the current account deficit (excluding EU transfers) averaged 8 percent of GDP. The EMU eliminates the very rapid and large capital movements that tend to precede, and occasionally precipitate, currency devaluations (Taylor 1995: 60). By establishing a common currency and monetary policy, the EMU encourages higher financial stability within the Eurozone (European Commission 2000a). The transition from a high-inflation to a low-inflation economic environment generates certain long-term financial markets (such as fixed-interest mortgages or long-term debt instruments) that were nonexistent

or dormant during the period of persistent inflation. As EMU convergence was realized in Greece, the yield curve, for example, for government securities was extended to 20 years, a marked improvement over the conditions until just 1998, when only short-term maturities were issued. Apart from efficiency advantages, diversified long-term financial markets provide better cushioning in the face of shocks (cf. Ramaswamy and Sloek 1997).

Notable indeed are the implications of the EMU regime for macroeconomic stabilization. For one thing, the interest rate decline substantially reduces the debt-servicing cost, facilitating fiscal consolidation. As public debt is euro-denominated, the within-EMU holders of government securities are not subject to exchange rate risk nor do they fear an erosion of their asset value by inflation. The elimination of the exchange rate premium and the inflation premium allows government to borrow at relatively moderate interest costs, as long as its debt is not perceived as subject to default risk. In the Greek case as elsewhere, the EMU nominal convergence criteria excluded the debt to GDP ratio, the rate of which by the end of 2000 was over 100 percent. It was estimated in 1998 that 14 years would be required to bring the debt down to 60 percent of GDP if the government's net primary borrowing requirement were to be sustained at a 5 percent level, real long-term interest rates were 5 percent, and real annual output growth remained at 4 percent (OECD 1998: 63). Under less propitious conditions public debt convergence could require several decades.

The EMU consolidates the disintermediation shift of the 1980s and 1990s, that is the shift from bank lending to transactions in securities. In Europe as well as in Greece, the movement from bank-based toward increasingly securitized finance was followed by growing 'equitization' over the late 1990s (though the latter was reversed by the 2000–1 economic slowdown). The euro generates an integrated money and capital market of higher depth, liquidity, and efficiency, allowing the level of investment in any EMU country to become increasingly independent of the level of domestic savings. New financial instruments such as derivatives (forwards, options, and swaps) allowing actors to hedge against possible future currency disturbances, are claimed to enable a more efficient reallocation of the risks created by liberalization. Among others, more integrated capital and credit markets enhance the capacity of EMU member states to respond to national-level asymmetric shocks by acting as channels of interstate risk sharing (Asdrubali et al. 1996). Presently, European financial markets remain relatively fragmented, but as financial portfolios begin to contain assets from many Eurozone economies

they could help diffuse the negative effects that may follow national-level asymmetric shocks. It could well be countered, however, that enhanced international capital mobility may tend to accentuate such asymmetric shocks (Buti and Sapir 1998: 162ff).

The possibility of an asymmetric economic shock affecting one specific Eurozone country or region is a well-known problem resulting from the Eurozone not being an optimum currency area. If there were to be a symmetric economic shock, such as a Eurozone-wide recession, the European Central Bank would be in a position to effectively confront it by loosening its monetary policy. Having surrendered the independent instruments of monetary and exchange rate policy, the country/ies affected by an asymmetric economic disturbance or shock (for example, a slower productivity growth compared to the other EMU economies, or receding market demand for a product or sector of national specialization) given the nonexistence of an EU-level fiscal policy, would be forced to rely on the remaining instruments of national fiscal policy (substantially constrained, however, by the imposed 3 percent cap on the public deficit), a suppression of real labor costs and prices to bolster competitiveness (but labor market rigidities get in the way and the effectiveness of incomes policies is seriously questioned under a regime of free collective bargaining), and labor mobility toward other EU economies (which is hampered, however, by serious institutional and cultural barriers) (Bayoumi and Masson 1995; Bayoumi and Eichengreen 1996; Eichengreen 1998). A peripheral country with significant structural weaknesses (a relatively extensive primary sector, a manufacturing sector dominated by traditional, low-productivity, small-scale units, a rather oversized domestic-oriented services sector) and lacking the flexibility of prompt adjustment, Greece under the EMU may be particularly susceptible to an enduring supply-side shock, especially if existing market rigidities persist.

The gradual transformation of credit-based into increasingly market-based (securitized) financial systems has significant implications, most obvious of which is the capital market's growing centrality. Even in Germany, that bastion of 'stakeholder capitalism' and bank–industry partnerships, a bolder promotion of elements of Anglo-American type corporate governance was signaled in 2001 by the abolition of the capital gains tax on corporate asset sales, to facilitate German companies intending to divest themselves of cross-shareholdings. Where the flow of economic resources used to be largely defined by active credit and monetary policies, the shift to a market-based financial system renders the national capital market (increasingly integrated into a Europe-wide

capital and money market) the pacesetter of economic activity. Stock market fluctuations exercise a growing impact on the real economy, affecting the business cycle, as was demonstrated by the wealth effect released in the 1999 *annus mirabilis* of the ASE, but also the long and painful plunge that began in the year immediately following. (From a historical high of 6355 in September 1999, the ASE index began a free fall, reaching down to 2314 in July 2001, and briefly went even below the 2000 mark in the days following the September 11 terrorist attack on New York.) In an economy with a wide number of equity owners among the public, rising stock prices increase household wealth, making consumers feel more wealthy (regardless of whether they realize their capital gains) thus raising their spending. By the same token, falling stock prices curtail investment spending and, through declining equity wealth, consumption. As the stock market increasingly affects consumer confidence, it exercises a growing influence on macroeconomic outcomes.

The importance of the capital market also implies a direct exposure to the short-term fluctuations and medium-term trends of major international financial markets. Capital mobility and the growing integration of world markets are the transmission belt of financial globalization, with the American economy and market acting as the global economic pacesetter. Thus, for example, on 14 March 2001, the ASE tumbled by 5.19 percent in a single day. The downfall was similar in the other major European stock markets, reacting to the steep drop of the Dow Jones index below 10,000 for the first time for more than two years. The wealth effect produced by a nearly decade-long US inflation-free economic and stock market growth had sustained a prolonged spending and borrowing spree of American households, thus also offering an injection of effective demand to the European and the world economy. By the same token, the negative wealth effect launched after the heavy decline of American stock prices in 2001 threatened the European economy with a serious contractionary impact, not to mention the risks of financial systemic stability.[1] National and EU-wide cyclical fluctuations are more susceptible than ever to international financial developments.

More broadly, a very high degree of global interdependence has now taken root. As a result, the impact of an American recession can affect the rest of the world through channels other than trade, namely foreign direct investment and financial contagion via stock markets. By the end of the 1990s the correlation between American and European share prices rose to its highest of the century (80 percent as opposed to just 40 percent in the mid-1990s) except for the period during the Great Depression (Brooks and Catao 2000). A 2001 study of the Greek Capital

Market Committee found the ASE correlated by 40 percent with the Frankfurt SE, and through that with the New York SE. Though stock markets do tend to be more correlated at times of high volatility as opposed to calmer periods, the strength of the correlation reflects some more enduring facts: the elimination of capital controls which has created something closer to a global equity market; the tendency of big companies to be listed on more than one market; also the increased share that overseas profits occupy in the overall profits of many companies, a result of a wave of transnational mergers and acquisitions.

There are serious potential negative implications involved in the emerging centrality of the capital market. Stock markets and particularly hostile takeover mechanisms may involve a distortion of the intertemporal trade-off, favoring short-term, static outcomes at the expense of longer-term, dynamic efficiency ones. Short-termism is a principal feature of financial decisions in a capital market-based system. Corporate stock is evaluated (by fund managers, institutional investors, and the public) on the basis of quarterly results. The resulting corporate governance culture places a premium on a high return on equity rather than an expansion of sales and employment. Forced to constantly deliver shareholder value, company managers (whose remuneration consists to a large extent in company stock) concentrate on short-term profits and share-price performance, possibly at the expense of investment decisions leading to longer-term optimization (Schleifer and Summers 1988; Franks and Mayer 1990; Corbett and Mayer 1991). The 2002 post-Enron avalanche of major accounting and financial scandals demonstrated, among others, the abusive and destructive potential such distortive incentive structures entail when combined with corporate venality and deficient regulatory institutions. In the American-type system of corporate governance, the shareholders' democratic control over the management in defense of the company's longer-term interest could prove illusory. Small shareholders are often powerless, while institutional shareholders of publicly listed corporations are more likely to sell their equity than to invest time and money in trying to improve company management (*The Economist* 2001a).

The almost instantaneous manner in which capital markets react to real or perceived surrounding circumstances is revealing of their notorious short-termism and volatility. Capital markets are prone to herd behavior, moving prices out of line, and leading to speculative bubbles (Krugman 1995: 34ff). As the US dotcom boom of the 1990s proved, even the most mature capital markets can immaturely succumb to fads. True to Keynes's famous 'beauty contest', financial markets are very

often driven less by objective facts and more by 'what average opinion expects average opinion to be'. Apart from often mislabeling these beliefs into 'fundamentals', such behavioral patterns are inherently prone to degenerating into self-fulfilling prophecies, as all opinion shifts to the same direction (Shiller 2000). Thus investment capital was easily misallocated from robust and profitable 'old-economy' companies to even the most eccentric 'new economy' start-ups, lacking both a sound business plan and any realistic profitability prospect. When the bust came in 2000–1, even the most sensible 'new economy' business plans could not attract capital at any price (*The Economist* 2001b). Stock market bubbles do affect the real economy, Friedman notwithstanding (Yotopoulos and Sawada 1999; cf. BIS 2001: 123ff).

Among the principal defaults of a capital market-based financial configuration is that increased financial competition encourages speculative activities (such as foreign exchange speculation and speculative maturity mismatching) that are unproductive and may also be destabilizing (Strange 1986, 1998). Such problems loom larger in shallow capital markets (such as that of Greece in the 1990s) where manipulation and gaming become easier. The availability of a wide array of highly liquid (and potentially more profitable – at least in the short run) portfolio investment options undercuts long-term productive investment. A liberalized financial system should ideally provide financial instruments that support productive industrial activity. In reality, it more often than not ends up directing funds into short-term profitable financial assets instead of investment in the real economy. Moreover, there is significant risk of credit liberalization (combined with low interest rates) leading to a consumption boom, financed by excessive private sector indebtedness, which at a subsequent stage may act as a drag on growth, amplifying downturns.[2] The possibility that a liberalized financial system may end up behaving in a procyclical manner has raised CB policy concern over perhaps targeting interest rates not only against high inflation but also against excessive borrowing (BIS 2001: 130ff). In sum, the real economy may be adversely affected by financial liberalization and competition (Gibson and Tsakalotos 1994; Helleiner 1996; Rodrik 1998b; Eatwell and Taylor 2000).

By the same token, however, it may be countered that the speed with which capital markets react guarantees that asset prices are constantly adjusted toward reflecting the perceived course of the economy, the changing allocation of risk, and the latest developments in technology and ideas. This may provide capital markets with a comparative advantage compared to bank-based systems. Banks respond to similar external

stimuli much more tardily, raising the threat of bad loans accumulating to a systemic crisis. Capital markets disperse and diversify financial risk, contrary to credit-based systems, which may concentrate finance in a small number of firms. Thus capital markets decrease the risk of a banking crisis resulting from highly leveraged firms (that is, firms with a high debt/equity ratio) vulnerable to a shock transmittable to the banking system through an accumulation of nonperforming loans. Exit from a bank-created economic collapse, complicated by business–political interdependencies, cross-shareholdings, and jammed price signals, is more slow and tortuous, as the Asian financial crisis of the late 1990s may be claimed (at least according to one school of thought) to have demonstrated (Krugman 1998).

The rapid development of the Greek capital market in the 1990s allowed larger-size business firms to diversify their sources of funding, decrease dependency on bank credit, and improve their capital structure.[3] This is particularly important even more since it was overindebtedness that bred the failed industries of the 1970s and early 1980s, as seen in Chapters 3 and 4. Annual initial public offerings (IPOs) in the ASE rose from 13 in 1997 to 24 in 1998, 42 in 1999, and 48 in 2000. The total capital drawn in the ASE was EUR 12.9 bn in 1999 and EUR 11.6 bn in 2000, of which EUR 1.84 bn and 2.56 bn respectively went to IPOs (Capital Market Committee 2001: 46ff). From the moment overall economic and institutional conditions had improved, and despite the substantially declining cost of bank finance, a growing number of companies preferred to turn to the capital market. This, *ceteris paribus*, meant an overall lower cost of capital, and stronger balance sheets through an improved debt/equity ratio (Figures 7.1–7.2 demonstrate the improved capital structure of Greek industrial firms.) On the other hand, Greek corporate debt increased as well after interest rates declined in the late 1990s, climbing from 15 percent of GDP in 1997 to 40 percent in 2001 – still well below the 50 percent average of the Eurozone.

To briefly summarize: capital market-based systems facilitate exit, with all that implies, both on the negative side (lack of trust relations, low 'loyalty', short-sightedness, sensationalism and herd behavior, speculative conduct, disincentives to invest efforts in improving company performance through 'voice'), but also on the positive side (a speedier rebound from crisis, faster market recovery, less chance of inefficient and overleveraged firms continuing to burden the market, and so on). It could thus be argued that an optimum mix needs to rely on both: capital markets able to diversify sources of finance, but also a sound banking system able to provide 'patient capital' when needed and liquidity at moments of crisis.

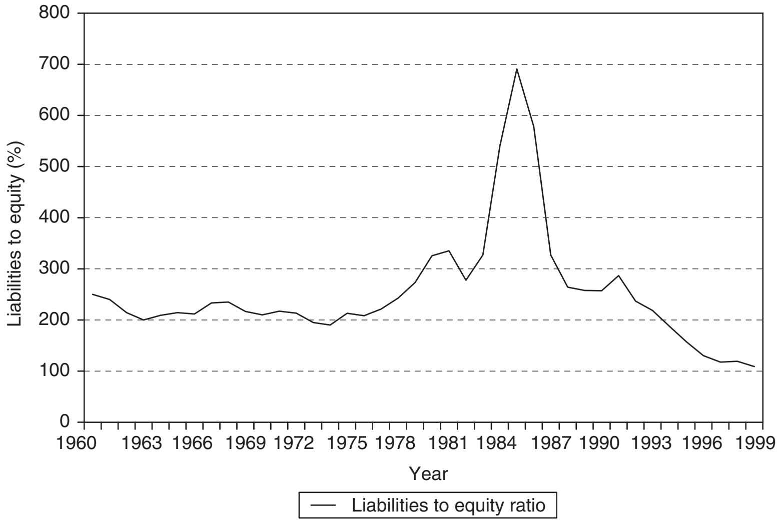

Figure 7.1 Greek industrial firms' leverage, 1960–99.
Source: Federation of Greek Industries.

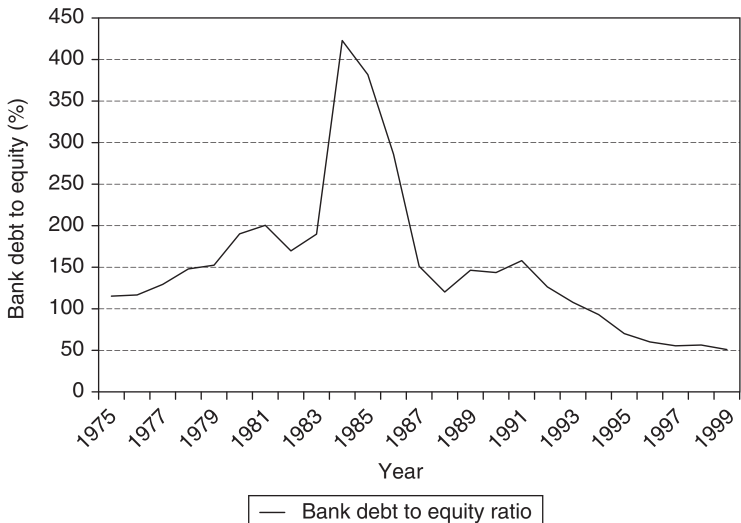

Figure 7.2 Bank debt to equity ratio of Greek industrial firms, 1975–99.
Source: Federation of Greek Industries.

Implications for banking: bank-based systems persisting despite growing disintermediation

The deregulation and integration of capital markets under a common European currency accelerate the shift from a bank-based to a securitized financial system. However, disintermediation should still be viewed as an unequivocal trend rather than as an obtained end-state. In the beginning of the 2000s, the Eurozone financial system continued to be bank-based, with bank loans amounting to 100 percent of the area's GDP, twice the ratio of the US – though lower than Japan's 107 percent. Despite the exponential growth of European equity and bond markets over the 1990s, stock market capitalization in the Eurozone remained in the area of 71 percent in GDP terms, as opposed to 163 percent in the US and 137 percent in Japan (Belaisch et al. 2001).

In Greece, equity capitalization rose from 2 percent of GDP in 1985 to 15 percent in 1994 to 169 percent in 1999, receding to 98 percent in 2000 following the decline of stock prices (Capital Market Committee 2001: 40). As in continental Europe, financial liberalization in Greece has notably increased the role of the capital market but has clearly not as yet reversed the financial system's bank-based character. Liberalized banking competition is thus the main aftermath of financial deregulation, involving important efficiency as well as systemic safety implications (as will be seen below). Overall, the Greek banking sector has reaped significant efficiency gains following its liberalization in the 1990s (Tsionas et al. 2001). As the belated decline of the interest rate spread helps demonstrate (Figure 6.5), liberalization increased bank competition in interest rates, though with a significant time lag. Falling lending rates and more aggressive banking competition animated demand for credit (which had been suppressed by the high interest rates over much of the 1990s). Consumer credit grew at an average annual rate of 41 percent over the period 1994–2000, but the ratio of consumer credit to GDP in 2000 was only 4.5 percent in Greece compared to 10 percent in the Eurozone members. Similarly, the corresponding ratio for mortgage lending in 2000 stood at about 8 percent compared to an EU average of 40 percent. The rate of growth of lending to industry was considerably slower. With total percentage of lending over bank assets still one of the lowest in the EU, bank credit in Greece is bound to grow significantly in the EMU environment.

EMU membership has entailed a loss of bank income from all activities associated with controlling foreign exchange risk, currency conversion, and financial derivatives operations including two or more

national EU currencies. The total Eurozone-wide transaction cost associated with these activities was estimated in the area of 1–2 percent of the EU GDP, a significant amount of resources, which after the introduction of the common currency flew from the banking sector back to production, households, or the public sector. However, such income losses forced banks to diversify their income sources and reap the profit opportunities generated by the new liberalized environment. On the assets side, banks developed trading activities and securitization operations (including fees opportunities for advising and underwriting), while the fall of traditional deposits from the 2000s was countered by money market mutual funds and other liabilities (Belaisch et al. 2001). Income from the management of investment and pension funds controlled by the larger banking groups has been assuming important proportions in Greece and throughout the Eurozone. In 2000, the majority of mutual funds operating in the Greek market were banking group subsidiaries. Moreover, the copious windfall income achieved from securities trading, especially during the Greek stock market boom of 1998–99, allowed SCBs previously burdened with bad debts to clean up their portfolios and list very high profits, as already seen in Figure 6.3. This, among others, enabled the National Bank, which in the 1980s had suffered greatly from government-imposed financial burdens, to become the 'national champion' of Greek banking.

A uniform trend of increasing concentration is visible in the Eurozone as well as in Greece, a consequence of the single financial market. This results from national-level consolidation through mergers and acquisitions toward creating larger-size banking groups or financial conglomerates able to reap economies of scale and scope in providing a wide range of financial products, with less reliance on traditional retail banking whose profitability is declining. Such a concentration trend toward higher efficiency and rationalization in the Greek banking sector has been, however, generally inhibited in fear of anticipated trade union reaction to the redundancies bank mergers would have to entail if the desired efficiency results were to be reaped. (More on bank mergers and privatizations further below.)

Banking systemic safety implications are more complex. Under liberalized banking conditions the risk–return relationship tends to deteriorate and risk premia fall as banks compete to increase their market share (Stiglitz 1989; Gibson and Tsakalotos 1994). Traditional corporate lending typically commands very thin margins, and competition may eventually flatten out income from fees and commissions. A suppression of profitability (and barring an ability to cut costs) resulting from extreme

bank competition among too many credit institutions may lead banks to high-yield/high-risk activities, thus eroding the quality of bank portfolios (Belaisch et al. 2001; Strange 1998). On the other hand, the consolidation/concentration tendency toward larger-scale financial institutions or 'national champions' strong enough to undertake an internationalization strategy (arguably, a more likely prospect for the small Greek market than the 'extreme competition' scenario) may lead to banks that are 'too big to fail', raising moral hazard considerations. Such factors may increase overall systemic risk, given the important negative externalities involved in financial institution failures. It may be countered here, however, that liberalization, with the new financial products it creates, allows banks to better diversify their portfolios, and to enter new high-profit margin financial activities, thus offsetting some of the increased risks resulting from bank competition. It can never be overemphasized that banking liberalization necessitates higher standards of ever vigilant banking regulation and supervision to guard against the increased hazards for systemic safety (Saapar and Soussa 1999; Goodhart 1995; Kapstein 1994).[4]

Redistributive and political implications of globalization, and the business–labor balance

The political economy of increasingly market-based financial systems as a dynamic process is underwritten not only by the US hegemonic power at an international level (Strange 1995: 64ff), but also by the progressive defiance on the part of globalized financial market interests (Frieden 1991: 441; Rajan and Zingales 2001). To a certain extent, financial globalization reflects a capture of US economic and financial policy by these interests, pressing for financial markets deregulation and internationalization which expands their profit margins. One may accede to what Bhagwati (1998) christened 'the Wall Street–Treasury complex', following in the footsteps of the older-day military–industrial complex. There is a chain of economic–political dependencies that is thus created. The economic power accumulated by globalized US financial capital as a result of deregulation over the 1980s and 1990s is translated – via 'elite pluralism' and party funding (Lowi 1979; Petracca 1992) – into political influence. This renders it virtually impossible for any US administration seeking political viability to defy (among others) the interests of Wall Street, whose pursuit could be summarized as 'keeping the world a free place' for US-based globalized financial capital. Thus, capital controls have largely remained outside the agenda of the US government and the

IMF, even in the late 1990s and early 2000s when critiques against unfettered short-term capital movements were mounting, especially in Europe. The chain of structural dependencies is completed at the global level, with American-type financial capitalism becoming the institutional pacesetter of European economies, precluding not only European national but even EU-level policy divergence from the direction of 'deeper and freer' financial markets. Global-level asymmetry of national power generated the need for a coordinated if not unified European response to US global superiority – hence the significant cross-party convergence of economic policies at European cross-national level.

Serious political impediments emerge on the way to controlling or 'governing' financial globalization. Crucial is the fact that while the costs of financial openness (financial instability, loss of policy autonomy, and so on) are consequential, they are collectively dispersed and anonymous, contrary to the benefits, which accrue to particular and well-placed actors (international financial firms, multinational enterprises, rentiers, and so on). Thus, opponents of unfettered financial globalization face, among others, a collective action-type problem that does not allow them to offset the pressures exercised by the well-placed beneficiaries of financial openness. This is exactly the opposite of what takes place in the field of trade, where the costs of trade restrictions are widely dispersed, whereas the benefits accrue to particular protected groups (UNCTAD 1990: 112).

Significant redistributive outcomes are produced in such a context. Financial liberalization and globalization enhance the domestic weight of internationally oriented economic actors as well as the influence of foreign investors on domestic policies in support of ever greater liberalization and deregulation. Globally mobile capital is increasingly able to win tax exemptions by threatening to migrate and destroy jobs. Capital mobility should be considered a structural feature of the international system (Andrews 1994), which greatly enhances the systemic power of capital.

A brief parenthesis is warranted here on the 'structural dependence of the state on capital' thesis. According to this argument, under capitalism, government policies, as much as everyone's material conditions, are dependent upon the decisions of capital owners. The reason for this structural dependence is that no government can simultaneously reduce profits and increase investment. As business investment is a function of expected returns, policies that transfer income away from owners of capital reduce capital's rate of return and thus investment. Politicians seeking reelection must anticipate the impact of their policies on the decisions of firms, because these decisions affect employment, inflation,

and the personal income of voters. What renders this power of capital structural is that, under a capitalist system of production, capital owners do not even have to organize; it suffices that they pursue their own private self-interest (Przeworski and Wallerstein 1988: 12–13; also Lindblom 1978: 172ff; Offe and Ronge 1984; Przeworski 1985).

As governments strive to save jobs by luring business, tax competition contributes to shifting the tax burden from capital to working households (Rodrik 1997: 63ff; Palley 1998: 83ff). Removing trade barriers and capital controls amounts to a shift of bargaining power on the basis of mobility potential. On the losing side are largely immobile factors of production or holders of fixed assets: domestic firms relying on locally specific assets; blue-collar and a considerable section of white-collar labor in the Eurozone, characterized by low mobility, given cross-national language, cultural, and institutional barriers. On the winning side are mobile factors of production and holders of liquid assets: footloose financial capital, multinational corporations, flexible firms able to shift their production abroad, high-skilled, white-collar labor (Milner and Keohane 1996b; Quinn 1997). Capital mobility increases the 'voice' of capital owners by affording them the power to threaten with 'exit' (cf. Hirschman 1970).

Internationalization of capital and abolition of controls diminish the national authorities' capacity to tax mobile capital. Consequently, the tax burden will tend to be confined mainly to small depositors, whose access to international tax-free markets is practically prohibited by the small size of their savings and the relatively high transaction costs involved. Thus the direct redistributive effect of capital liberalization will tend to favor the wholesale end of the spectrum, big, mobile business and financial capital, at the expense of small savings. On the other hand, capital account liberalization encourages a uniform reduction of the tax burden on savings, to match a lower international standard. At first sight this would appear as a positive-sum development for both financial institutions and depositors, big and small. However, this lowering of the tax burden on savings is not devoid of redistributive implications, as it may probably be offset by a proportionate increase of the tax burden on income or consumption. Regardless of how exactly that burden is distributed, the general trend rather unequivocally suggests considerable gains for the financial sector (which, at lower tax rates, is better able to attract savings). Among the beneficiaries are holders of mainly larger-size mobile financial capital, able to eschew domestic taxation on income, assets, or consumption by turning their wealth into tax-free cross-border financial capital.

A pronounced effect of globalization in Western Europe has been a universal trend toward increasing returns of capital at the expense of labor, largely a result of competition emanating from the emerging markets of South East Asia, later Latin America and Eastern Europe. In the US since the 1980s an increasingly large share of output is being reserved for the owners of capital, while the share of gross value added going to wages and salaries has been declining, and the trend has been similar in Europe (Dore 2000). Such has also been the trend in Greece between 1985 and the late 1990s,[5] which, however, could be attributed to the consecutive stabilization programs aimed to redress the steep rise of the wage bill and decline of corporate profits during the 1974–85 period. Given this background, as well as the still qualified degree of internationalization of the Greek economy, globalization can be pointed to only as an indirect factor behind that trend.

Reflecting the pressure for increasing returns on capital, 'maximizing shareholder value' has become the driving credo of market-based corporate governance, a change visible, among others, in both the rhetoric and the practice of the remaining SCBs. For example, the National Bank administration especially from the second half of the 1990s progressively replaced traditional invocations of the general interest of the national economy[6] with forceful and explicit references to profitability and shareholder value as the unquestionable driving objectives. That said, and though change is clearly advancing, corporate governance in Greece continues to retain most of its traditional features. Publicly quoted companies for the most part tend to rely on stable shareholder systems. Hostile takeovers in the national capital market are rare (though this may be changing after the collapse of the ASE index in 2000–1 left many companies listed on the ASE with a market value much lower than their book value, rendering them vulnerable to a potential hostile bid). A monitoring role is, to a considerable extent, delegated to banks, supplemented by reputation monitoring from suppliers, customers, and to a lesser extent expert institutes and associations. The vast majority of smaller companies continue to rely on bank finance. Venture capital, though rapidly growing, remains limited, and far less willing to undertake significant risks than its international counterparts, preferring dynamic firms with an established track record of profitability over new untried ventures.

Admittedly, the effects of redistribution benefiting capital owners are mitigated by the multiplicity of overlapping economic roles and interests to which actors in an advanced stage of financial capitalism subscribe. The growing strain in the workplace (with significant levels of

unemployment in Europe producing job insecurity, trimming labor market regulations, intensifying pressure for greater productivity) is counterbalanced by constant improvements in price and nonprice competitiveness of products and services, and an ever-expanding range of consumer and investment choices. These are benefits that accrue to working households as well.

On the production side, macroeconomic stability enables longer-term business planning and investment. Competitive pressure on the supply side, low-cost finance, and venture capital institutions simplify and minimize business start-up costs and facilitate bounce-backs. Financial deepening improves the prospects of young, dynamic, and risky firms, which typically tend to bring new technologies to the market, and which under a less developed financial system were 'rationed out' in the absence of sufficient tangible collateral. Easier market exit – including the job market – has easier entry as its corollary. Amid conditions of growing mobility and flexibility (the EU Lisbon agenda) market losers can be more easily transformed into market gainers, as well as the reverse. Some categories of especially lower-skilled workers and employees may be losing out in terms of job security and shrinking benefits, but they are gaining as consumers, mortgage borrowers, and small investors, or (to take it even further) as potential small entrepreneurs. Developed forms of financial capitalism correspond to a plurality and multifariousness of economic roles and identities, employees being at the same time consumers, borrowers, asset owners, and investors. The distribution of either positive or negative outcomes from the political economy of the EMU depends not only on the relative position of socioeconomic interests and actors, but mostly on their flexibility of adjusting by transforming their position. Such questions point to the deeper 'life politics' (Giddens 2000: 40) of individual choices in an economic and work environment transformed more rapidly than societal value systems are able to cope with.

The new political economy thus rests on an implicit trade-off, that of sacrificing welfare state stability and security for the sake of broader welfare opportunities, access to which is increasingly defined by skills and the ability to use new technologies. The configuration of market flexibility affords eventually unlimited opportunities to the mobile and highly skilled (able, among others, to make better-informed choices) at the expense of depressed wages, shrinking security, and declining welfare prospects for the unskilled. The basis for that is that the unskilled are more abundant, more 'substitutable', in the global economy as a whole than they are in their national economies; the opposite is true for skilled employees and capital (Rodrik 1997; McKeown 1999: 14). At the

same time, a parallel visible effect of market globalization for developed societies is that the number of unskilled and manual workers is steadily declining, increasingly comprising immigrant strata, and that skills and occupations are constantly being upgraded, tending toward a highly professionalized, meritocratic, postindustrial society (Esping-Andersen 1999: 294). This leads to a rise of socioeconomic inequality along with the erosion of solidarity of interests between skilled and unskilled labor.

Notable are the redistributive implications of the strong disinflationary bias contained in the EMU architecture. True, except for the short run, there is no real trade-off between price stability on the one hand and growth and employment on the other. On the longer than short run, an economy can well end up with both, as well as neither. However, subscribing to the strategic primacy of disinflation (and associating it with an ever strict definition of what constitutes a tolerable level of inflation – as the 2 percent mark set by the ECB makes clear) entails an at least short-term trade-off with regard to employment, at the latter's expense. The institutionalization of a price stability commitment in the architecture of the new European economy (as reflected in the ECB's constitutional job description) affects the power balance between business and labor. Price stability seems to best serve the objective interests of financial capital, since inflation undercuts the value of financial assets (cf. Frieden 1988). Moreover, as disinflation is typically pursued through tight monetary policies of high interest rates, this amounts to income transfers from borrowers to lenders, to the benefit of financial capital. However, financial capital is averse to economic recession, which decreases bank profits by suppressing credit demand, raises the chances of businesses defaulting on their debt, and reduces bank income from capital market transactions and liquid assets management.[7] The interest of industrial capital, on the other hand, lies in a balance between moderate unemployment and moderate inflation. A very low rate of unemployment is against business interests as it increases labor's bargaining power, but too high unemployment erodes business profits by depressing consumer demand.

An important determining factor of the relative power of business versus labor stems from the fact that the higher the unemployment the lower the bargaining power of labor. Under the threat of job losses, workers are less determined to press their demands, while business has greater bargaining power in pursuing labor market deregulation as a strategy of reorganization of production and job creation. Moreover, during a downswing of the business cycle, markets tend to have a positive strategic interest in a rise in unemployment, which is considered to

reduce inflationary pressures thus making it easier for the CB to relax its monetary policy. The more enduring results of labor's decreasing bargaining power are already evident in the official policy pronouncements and practices in Europe, such as OECD and Commission reports consistently advocating structural liberalization. Several authors have identified this structurally embedded pressure toward greater liberalization of labor market and welfare system institutions as the 'Americanization' of the European model (Crouch and Streeck 1997).

The results of capital mobility on labor restraint: shift to neocorporatism?

By almost every measure considered (removal of institutional barriers, volume of capital flows, growing correlation of interest rate changes across national markets), international financial markets are now more integrated than since the nineteenth century (Simmons 1999: 62).[8] As argued earlier, the existence of a credible exit option of globalized capital enhances the power of internationalized companies and investors to influence regulatory, tax, and employment policies in their favor. By sapping labor's bargaining power to the benefit of mobile, internationalized business capital, capital mobility induces wage restraint on the side of labor in order to prevent capital from exercising its exit option (Kurzer 1993; Rodrik 1997: 14ff). This effect of open markets and capital mobility (derived from the private capital's threat of disinvestment) on labor restraint in countries like Greece is arguably mitigated by high degrees of public sector employment and the predominance of public sector unions in the ranks of national-level labor representation.[9] On the other hand, though the opening of the Greek economy in institutional terms (single European market, capital liberalization, a single currency) has been unprecedented, by the end of the 1990s the internationalization of the Greek economy, measured along several criteria (trade openness, FDI flows and stocks, correlation between domestic savings and investment, international differentiation of stock portfolios, number of Greek multinationals) remained relatively limited (Mastroyiannis and Pelagidis 2002) (see Figure 2.3). These factors may be claimed to have prevented business from reaping in full the bargaining power dividend from capital globalization. On the other hand, the emerging market economies of neighboring Balkan countries in the 1990s gave a decisive internationalization boost to the larger Greek firms, by creating an unexpected outward destination for the erstwhile inward-looking Greek business capital. As an instance of internationalization and mobility, this demonstration

of an exit option entailed a notable increase in the structurally embedded political strength of business capital. Along those lines, one may discern traces of the impact of a relatively higher internationalization of Greek capital in the significant wage moderation exercised by trade unions during the 1990s (Figure 7.3). This should also be attributed to the maturing of a moderate trade union leadership politically affiliated with the consensus-seeking post-1996 socialist government of Kostas Simitis, and keen to facilitate the effort of obtaining the EMU nominal convergence criteria.

In Greece, an important process towards national-level tripartitism developed in the 1990s and especially since the second half of the 1990s, where long-term collective agreements have emerged under government sponsorship (instead of the erstwhile patronage and control) and with the increasing autonomy and credibility of social partners. As argued in Chapter 6, this suggests the transmutation of a domestic tradition of state corporatism (succeeded in the postauthoritarian period by *parentela* pluralism, carrying many of the state corporatist features) into an increasingly neocorporatist mode of interest representation. Features associated with the neocorporatist mode or what (in 1990s terms) is otherwise identified as a model of coordinated market economy (Soskice 1990, 1999) include: a financial system traditionally allowing long-term, 'patient' finance to companies; industrial relations affording unions an important role that allows for coordinated wage bargaining at a sectoral or national level and potentially cooperative

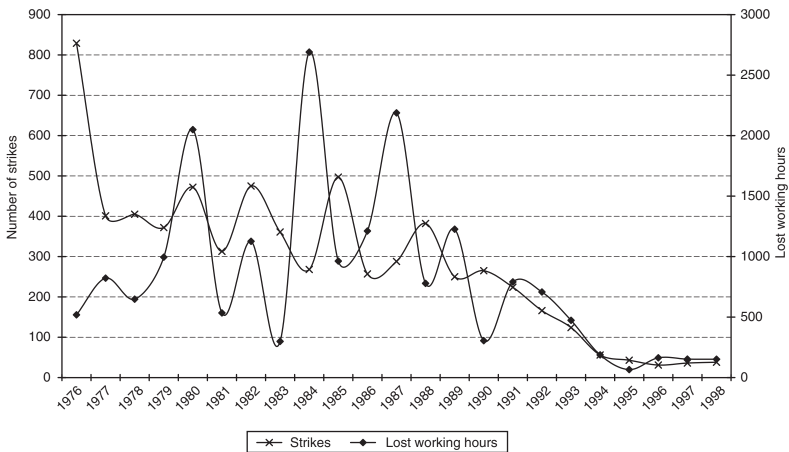

Figure 7.3 Number of strikes and lost working hours (× 10,000).
Source: Ioannou (1999).

industrial relations at company level (Ioannou 1996); gradually from the late 1990s (under European Commission auspices) education and training systems encouraging initial vocational training of young people with a growing involvement of organized business, to ensure provision of highly skilled employees; intercompany systems that enable substantial technology and standard-setting cooperation between companies – a collective good for employers. The EU systematically promoted these latter policies, which substantially enhanced convergence toward a coordinated market economy model (as opposed to an Anglo-Saxon and Irish-type liberal model) during and after the 1990s. Institutions of market coordination including labor market regulation are suggestive of a particular pattern of business reaction to external and cyclical shocks: firms are eventually likely to lower prices and tolerate lower profits to retain market share rather than shed workers, because the structure of the labor market discourages lay-offs, and access to 'patient' bank capital renders a low-profit strategy more viable (Hall 1999: 144).

The gradual promotion by the Greek socialist governments in the 1990s and early 2000s of policy strategies identified with a coordinated market economy model mirrored the type of 'supply-side' neocorporatism (or 'competitive neocorporatism' – Rhodes 2001) sponsored by the EU. Indeed, aiming to enhance the acceptability and endurance of macroeconomic adjustment and structural reforms, and under the consensus heading of 'social dialogue' and 'social partnership', the EU in the 1990s promoted elements of concertation and 'social pacts' (Schmitter and Grote 1997; Falkner 1999; Fajertag and Pochet 2000; Regini 2000; Crouch 2000). Neocorporatist tendencies were stimulated by social democratic governments making up the overwhelming majority of EU countries, especially in the second half of the 1990s. As has been demonstrated in the past, social democratic governments aiming to deliver a relatively higher degree of public investment or social expenditure have succeeded best in terms of inflation and unemployment where labor has been strong and centrally organized, overcoming collective action problems that get in the way of wage moderation (Boix 1998; cf. Goldthorpe 1984; Lindberg and Maier 1985). In contrast, conservative economic policies have been most successful where labor has been weaker and fragmented (Boix 1998; Alvarez et al. 1991; Garrett and Lange 1986).

At a company level, the neocorporatist trend was advanced in the early 2000s by EU legislation obliging, among others, European firms to inform and consult workers' representatives about certain corporate actions including company strategy. The neocorporatist strategy somehow represented the convergence point between social democratic

governments pressured by internationalized markets to deliver macroeconomic discipline and structural liberalization on the one side, and increasingly pragmatic trade unions seeking to defend as many of their interests as possible on the other. Business adheres to the bargain as long as it promises to deliver the collective goods of wage moderation and politically viable welfare state reform. These factors seem to have somehow offset the initial globalization-induced structural constraints to neocorporatism, constraints associated with growing government inability to manage demand, normally expected to undermine both the governments' need for union cooperation and the latter's incentive to organize collectively (Streeck and Schmitter 1991). The endurance of neocorporatist patterns could be expected to be higher in economies with an extensive wider public sector, which resists labor union disintegration, such as Greece or Italy (Regini and Regalia 1997); or, conversely, highly internationalized economies with an advanced neocorporatist tradition enlisted to negotiate wage restraint and welfare state reform, such as the Low Countries (Jones 1999).

Neocorporatist concertation is often sectorally based (Lehmbruch 1984: 60ff) corresponding to Soskice's 'industry-coordinated economies' (Soskice 1999: 106ff). Such examples in Greece were the banking sector or the telecom and energy sectors, gradually in the second half of the 1990s – as before that these strongholds of trade unionism were bastions of adversarial industrial relations. 'Sectorization' reflects the scientification and functional differentiation of industrial sectors and policy communities, a development encouraged by European market integration and globalization. As companies in the European single market and euro-currency financial market strengthen their capital base and move to economies of scale and scope through cross-border mergers and acquisitions, production as well as governance structures become increasingly integrated along sectoral lines, blurring national-level divisions (Schmitter 1990: 12; Hollingsworth et al. 1994; Hollingsworth and Boyer 1997; Kitschelt et al. 1999: 444). On a global scale, such sectoral integration, made possible by capital globalization, is also demonstrated in the cyclical fluctuations of stock prices in world capital markets affecting entire sectors. An example was the cross-national decline of the telecoms industry at the end of the 1990s or of the airline industry in 2001. Such market conditions encourage concertation along sectoral lines (or the part disintegration of macro-level neocorporatist arrangements), especially given that much of EU regulation affecting national industries is sector-specific.

Thus, across Europe, financial globalization and the resultant disinflation have tended to encourage a supply-side neocorporatism leading to

wage moderation (and in some countries such as the Netherlands open to labor market flexibility), aimed to prevent capital from exercising its exit option. However, by forcing wage moderation and labor market liberalization under the menacing specter of disinvestment and unemployment, financial globalization may also be said to erode the confidence preconditions of the neocorporatist compromise (labor conceding to wage restraint and industrial relations peace in exchange for capital providing jobs) upon which wage moderation is founded. This is an inherent contradiction contained in globalization-induced supply-side neocorporatism. And there lies, more broadly, a discernible tension between the positive-sum neocorporatist compromise on the one side, and the intensified zero-sum conflict between labor and capital associated with the effects of free capital mobility and globalization on the other. One witnessed this tension in Greece directly after the EMU accession in the early 2000s. Then the consensus-driven second half of the 1990s (aimed almost exclusively at general-welfare-enhancing macroeconomic reforms requiring wage moderation on the labor unions' part) gave way to the hard post-EMU reality where real convergence through higher than EU average growth rates is supposed to be led by structural market liberalization. The government agenda of far more contentious structural reforms in the labor market and pension system in the early 2000s confronted early-1990s-style solid resistance by the until then cooperative unions. In spring 2001, the General Confederation of Greek Labor (GSEE) successfully rallied public opinion against the PASOK government's initial proposals on pension reform. This forced the government to a humiliating retreat, and the subsequent signing, a year later, of a social pact containing significant concessions to the unions. The GSEE emerged as labor's encompassing, independent representative, and the politically dominant interlocutor in the social dialogue over pension reform, reinforcing evidence of a neocorporatist transmutation.

By virtue of its results rather than its underlying political intentions, financial reform was instrumental in dynamically transforming the political preconditions of economic adjustment, for at least three reasons. First, the marketization and privatization of the predominantly state-controlled banking sector and its opening to international competition expedited its transformation into a cutting-edge sector forced to adjust and expand into new products and services in order to withstand cross-border market pressure in a rapidly evolving financial environment. (Table 7.1 and Figure 7.4 demonstrate the redrawing of the public–private boundary in the Greek banking system.) The need to respond to the new post-liberalization realities brought about the formal disengagement

Table 7.1
(a) Bank privatizations

Year	*Acquired bank*	*Buyer*	*Previous owners*
1991	Bank of Piraeus	UNICO	Commercial Bank
1992	Bank of Athens	Korean holding group	National Bank
1996	Bank of Attica	Deposit and Loan Fund, and Engineers Pension Fund	Commercial Bank
1998	General Bank	Interamerican Insurance and other institutional investors	Army Pension Fund
1998	Bank of Crete	Eurobank	State
1998	Bank of Macedonia-Thrace	Bank of Piraeus	National Bank, ETEVA, Postal Savings Bank
1998	Bank of Central Greece	Egnatia Bank	Agricultural Bank
1999	Ionian Bank	Alpha Credit Bank	Commercial Bank
2001	ETVA	Bank of Piraeus	State

(b) Bank mergers and acquisitions

Year	*Bank*	*Buyer*	*Previous owner*
1992	Commercial Bank	Investment Bank	Investment Bank was owned by Commercial Bank
1997	Eurobank	Interbank	
1997	National Mortgage Bank	National Housing Bank	National Housing Bank was owned by National Bank
1997	Bank of Piraeus	Chase Manhattan (Greece)	
1998	Bank of Piraeus	Crédit Lyonnais (Grèce)	
1998	Bank of Piraeus	Xiosbank	
1998	Eurobank	Bank of Athens	
1998	National Bank	National Mortgage Bank	National Mortgage Bank was owned by state pension funds
1999	Bank of Piraeus	National Westminster Bank (Greece)	
1999	Eurobank	Ergobank	
2000	Agricultural Bank	Bank of Nova Scotia (Greece)	
2001	National Bank	Alpha Credit Bank	

Sources: BoG; Eichengreen and Gibson (2002).

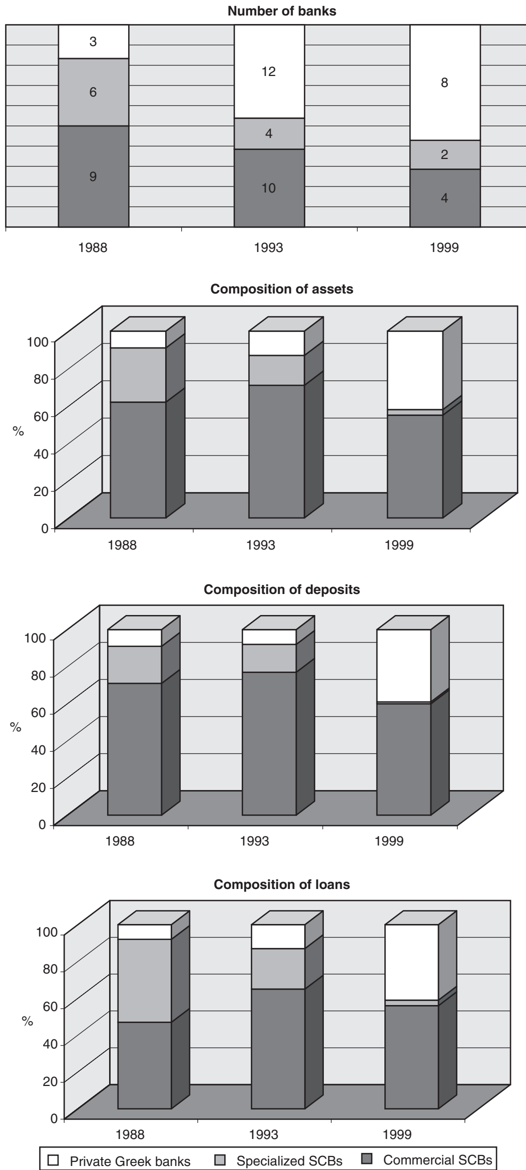

Figure 7.4 State retreat from the Greek banking system.

of SCBs from government hierarchical control and public sector hiring and accounting procedures.[10] Clearly, two of the principal unspoken economic reasons for continuing state control over major banks, that is easier government access to finance and a line of defense of the currency in the event of an external speculative attack, have lost their importance under conditions of financial integration and EMU membership. (Though there remains, under conditions of financial internationalization, the substantial issue of retaining the largest banks under Greek management control, to keep them oriented toward domestic enterprises, thus financing economic growth.) External competitive pressure, privatization of several SCBs, and marketization of labor relations undercut the influence of established bank employee unions, previously powerful bastions of wider public sector trade unionism, itself the strongest pillar of post-1974 organized labor.

Second, the EU-imposed capital adequacy standards after 1992 forced banks to widen their capital base and privatize most of their (predominantly loss-making) industrial subsidiaries in order to limit their nonfinancial investments. Consequently, as financial reform led to the privatization of important SCB industrial subsidiaries, their transfer to the private sector meant a significant redrawing of the public–private boundary in the industrial sector to the detriment of both public sector and the corresponding trade unions. As a trend, expanding the private at the expense of the public enterprise sector tends to decrease labor union militancy, as workers in the private and especially the tradeable sectors are more subject to competitive pressures for wage moderation than those in the sheltered sectors (Moene and Wallerstein 1999: 237). Moreover, privatizations in general gave a decisive boost to the stock market, spreading equity ownership to wide strata of the population (for example, a number of public enterprises such as the Greek Telecom or the Greek Oil Company were floated over the second half of the 1990s and massively oversubscribed). More on the implications of that anon.

A third way in which financial reform and development helped transform the political preconditions of adjustment was by precipitating the deindustrialization and tertiarization of the Greek productive base. Indeed, between 1991 and 1999 the number of people employed in the banking and financial sector increased by 49 percent (from 196,000 to 293,000). That was at the expense of the total number of people employed in manufacture and handicrafts, which dropped by 19 percent (from 699,000 to 569,000), and there was a similar trend in primary sector employment (a 17 percent decrease). In terms of share of overall employment, employment in the banking and financial sector rose

from 5.4 percent in 1991 to 7.4 percent in 1999, while manufacturing and handicrafts fell from 19.2 to 14.4 percent. Deindustrialization was also an effect of what one may be tempted to characterize as the 'Dutch disease' economy of much of the 1990s: high interest rates and an overvalued currency until 1998, leading to rapid financial sector growth, undercutting export performance, creating a bias against investment in tradeable sectors. The growth of the tertiary sector brings along lower trade union militancy as fragmentation and disintegration corrode unionism in the private services sector (cf. Locke and Thelen 1995). The new market requirements especially in the tertiary sector encourage deregulated employment arrangements, differentiation, and individual negotiation of work contracts, all of which undercut trade union influence.

To summarize the argument: the Greek case is consistent with the thesis that financial integration and globalization overall undercut labor union bargaining power by expanding the exit option of capital and by promoting tertiarization and the disintegration of labor agreements. These conditions encourage social democratic governments and trade unions to embrace neocorporatist strategies as means of defending labor bargaining power as well as achieving wage moderation and structural reforms necessary to prevent disinvestment and a rise in unemployment.

Left and right under a disinflationary regime

The EU-level mechanisms of institutionalized interdependence (not least of which is the transmission mechanism of a monetary system or union and a single financial market) entail the additional possibility of allowing national governments to put the blame for unpopular policies on the EU (cf. Kohler-Koch 1996). Under actual conditions of deepening market Europeanization and globalization, this invocation of the external constraint (which in other times would have been regarded as tactical scapegoating) is now a perfectly credible strategy of policy justification. It has allowed governments to obtain comparatively increased levels of popular tolerance for conditions and policies that in other times may have called for widespread sociopolitical or even antisystemic opposition. In Greece's case, the entrenchment of unemployment at persistently high levels (Figure 4.4) and the gradual advancement of unpopular structural reforms (such as privatization and a part liberalization of the labor market) have met with relatively less resistance than would have been expected by any observer of Greece's hyperpoliticized, polarized, and contentious sociopolitical affairs of the 1970s and 1980s. Clearly, public understanding has relatively grown that the ability of

national governments to respond independently to economic strain has substantially narrowed.

Two major developments underlie the relative depoliticization (compared to the 1970s, 1980s, or even early 1990s) of economic policy, developments of an ideologico-political and of a socioeconomic nature respectively. The first has to do with the progressive shift during the 1980s and 1990s of social democratic parties in EU countries to the right, followed by a convergence of both center-left and center-right to the middle.[11] The intensity of the twin external constraint (that is the one derived from capital liberalization and policy convergence under EMU) is largely responsible for the movement of European social democratic parties toward more conservative-liberal economic policies. The new 'centrist' consensus combines monetary and fiscal rectitude, and the endorsement of structural liberalization, with the pursuit of both economic competitiveness and socioeconomic cohesion through 'active' labor market policies, social dialogue, and the 'empowerment' of citizens. 'Third way', 'new center', 'stakeholder capitalism', 'flexicurity' (market flexibility with social security) have been some of the buzzwords employed to summarize this new consensus (Pagoulatos 2001b). This centrist shift during the 1990s afforded social democracy a notable political advantage, allowing it to claim both the traditional support of labor unions and the newly acquired approval of business capital to whose need for macroeconomic discipline and liberalized markets reformist social democracy pragmatically responded. The need to offset this newly acquired advantage of reformist social democracy in a post-cold war world explains the apparent ideological abandonment by some conservative parties of the more contentious versions of the New Right agenda (which had never gone down very well with traditional conservative constituencies – Boix 1998) for more centrist, middle-of-the-road, or plainly populist positions. In accordance with this general trend, the ND Party after 1993 and in the 2000s moved away from its neoliberal agenda of the 1985–93 period.[12] It embraced a more pragmatic-looking, centrist, almost a-ideological political discourse emphasizing unemployment and social issues rather than structural liberalization and privatization (which had become widely unpopular during the ND's government term).[13]

Thus party ideological and policy convergence is the political corollary to the externally induced, international political economy-driven emergence of a disinflationary EU-wide regime (Forsyth and Notermans 1997). Stated differently: the external economic regime rewards disinflationary and contractionary policies with eventually low interest rates and – perhaps – inflows of investment, and penalizes expansionary policies

with macroeconomic instability, higher interest rate premia, and capital flight. Consequently, the commitment to macroeconomic discipline is the option toward which both center-right and social democratic parties will tend to converge (albeit with varying degrees of consistency or ideological integrity). As expansionary policies prioritizing full employment over price stability had been ideologically identified with social democratic rather than center-right-wing governments (cf. Alesina and Roubini 1992), the impact of the disinflationary regime affected most strongly the social democratic end of the party spectrum, leading to the shift of PASOK, after its 1993 return to power, to 'orthodox' economic policies.

Acknowledging convergence and growing similarities is, of course, far from conceding that the left–right division is over. This is hardly the case at least in so far as the two main party camps (center-left versus center-right) are concerned. First, the great divide between left- and right-wing economic and social policies, despite its weakening, survives in the form of differential policy mixes, a moderate versus a stronger reliance on market forces and privatization, a more versus a less protective approach on social welfare and employment policies, a more versus a less distinct emphasis on public investment policies (Boix 1998; Esping-Andersen 1999; Kitschelt 1999: 323). Social democratic governments have been shown to maintain a capacity for relatively more expansionary policies despite market sanctions (Garrett 1996). Along this axis, traditional constituencies remain aligned, trade unions and the public sector normally skewed towards the Left, larger-size business usually leaning toward the Right.[14]

Moreover, the left–right cleavage is reproduced by the existence of traditional ideological/symbolic allegiances and party clienteles. In that sense, the political heritage of the two main party camps (PASOK and ND) operates as a stabilizing element of the strongly majoritarian two-party system (Bruneau et al. 2001: 57ff; Blondel 1968; Sartori 1976: 122ff; Lijphart 1984, 1999: 66ff). Traditional clienteles largely tend to stick to their party, avoiding the psychological and information costs of political relocation. As the hard core of party electorate remains loyal, it forces the party to reproduce its ideology to a higher degree than that which would perhaps be required by the rational imperatives of flexible adaptation to the changing socioeconomic environment.

While financial internationalization forces governments to converge towards orthodox economic policies, it also tends to accentuate sociopolitical conflict by increasing inequality and threatening social *acquis*. Party convergence around the middle ground may at the same

time be weakening the ability of the two-party system (PASOK and ND) to absorb social grievances. This may be leading some of the losers of orthodox economic adjustment policies to the periphery of party dualism, where perhaps future potential for antisystemic sociopolitical opposition is nourished (cf. Kriesi 1999).[15] (The international, Seattle- and Genoa-type, antiglobalization social movement is one version of what forms such opposition could take. The appalling resurgence of extreme-right-wing xenophobic populism in Europe is another.) The main function, however, of party convergence remains the lending of increased credibility to economic orthodoxy, enhancing the pool of popular support or at least passive acquiescence to macroeconomic discipline – at least as long as it does not tangibly and directly threaten vested interests.

The second parallel development associated with the relative depoliticization of economic policy, and one that eventually consolidates the convergence around economic orthodoxy, is a development of a socio-economic nature. It concerns the creation of wider strata of shareholders and bondholders in the financial system, and eventual stakeholders in the policies that ensure the financial system's sustained growth.[16] Spread across the political spectrum, owners of financial stock (whose best-off section form the new domestic rentier class) have an interest in 'sound finance' and market-oriented structural reforms, to support a stable growth of the financial market. Their entrenchment and wide political spread strengthen the convergence of mainstream parties toward orthodox economic policies and may tend to offset the resistance of trade unions to market liberalization. With an admitted degree of simplification, one would say that the stakeholders of financial system growth become potential defenders of a disinflationary economic orientation. The argument may, of course, be substantially qualified by the possible disjunction between 'objective' and perceived interest: the link between orthodox economic policies and the stockholder/voter's individual welfare may be obfuscated by information costs and sheer incognizance of economics. Ideological and policy preference may be jointly shaped by other parallel economic roles held by the particular voter, his/her main position in the production process, sectoral or sub-sectoral lines of economic interest. At a deeper level of analysis, it can be countered that political and electoral preference need not be grounded on the voter's rational individual interest, especially a kind of interest defined along strictly utilitarian lines. It may well result from ideological commitment, impulsive behavior, ideological or traditionalist considerations, class or clientelistic allegiance, or a broader perception of

what is generally good for society. However, though rational behavior cannot be universally assumed at the level of individual citizen actors (as opposed to institutional, corporate, or political actors), it would be unwise not to regard material interest as probably the most important among several criteria for the voters' economic and electoral preferences.[17] When all reservations about rationalist voter motives are made, the fact remains that the association of a growing number of citizens' economic welfare with the growth of the capital market *does* carry an impact in favor of orthodox economic policy dispositions.

In other words, the democratization of the financial growth dividend through the spread of a model of popular shareholder capitalism has relatively enhanced the pool of sociopolitical support to orthodox economic policies. Thus, the interests of employees remunerated in shares or stock options, and even more importantly investors in pension funds, become more closely aligned to the interests of companies, reducing opposition against lower business taxes or market liberalization policies that include labor market flexibility. Equity incentives and liberalized labor market conditions undercut collective class allegiances and unionization. All that said, the association of individual welfare with stock market growth might well prove tentative. If stock markets after the 2000–1 plunge remain stagnant, then not only will the number of those attracted to owning equities decline (even in the indirect form of avoiding equity-based mutual funds), but a growing number of working citizens who are also small investors will realize that their main income is derived from their workplace instead of their portfolio. This, combined with the new tensions and inequalities released by globalization and the erosion of social benefits, may contribute to a new wave of labor activism and collective action. In other words, it is far too early to tell whether the newly founded popular allegiance to the financial market (a matter of the 1980s and 1990s in the US, of nearly a decade in major EU countries, and of a mere few years in Greece – though apparently already extinct after the 2000–2 bear market) represents a structural or merely a cyclical development.

The broad category of stockholders in Greece (by the year 2000 modestly estimated at well over 1 million, that is one-tenth of the Greek population) is highly heterogeneous, ranging from farmers, employees, and small pensioners to high-earning executives, big proprietors, and traditional rentiers. To this virtual 'stock market party' (as the press branded it in the 'bubble' months that preceded the steep and prolonged fall of the ASE) should also be added indirect investors through mutual funds or private pension plans. The anticipated expansion of the role of

private pension and insurance funds will render a wide majority of the population positively dependent on the good health and steady growth of equity markets. The same effect is produced after the downward convergence of Greek deposit rates to Eurozone levels, following Greece's formal entry in the EMU in 2001. With deposit accounts yielding net interest returns near or below inflation levels (for the smaller-scale depositors) a growing percentage of savers are forced to turn to alternative, financial market-based investment opportunities. Total mutual fund assets in 2000 corresponded to 46 percent of bank deposits, from 52 percent in 1999 but just 10 percent in 1994. The total number of mutual funds rose steadily from 148 in 1996 to 178 in 1998 to 265 in 2000, with purely equity-based mutual funds increasing from 29 to 40 to 120 respectively (Capital Market Committee 2001: 62ff). Closer integration of equity markets in Europe and abolition of restrictions such as those regarding local currency exposure, all results of monetary union, are expected to further boost the performance of mutual and pension funds, rendering them more attractive to small investors in Greece and Europe-wide. Thus a number of parallel interconnected processes seem to be increasing the importance of the domestic financial and capital market for the interests of a wide and growing section of the public. It remains to be seen to what extent the internationally shaken public confidence in the markets following the US-made financial scandals of 2002 will manage to restrain the trend of financial market growth.

Summarizing the argument

Reflecting the constraints posed by globalization and high capital mobility, economic policies in Europe in the 1980s and 1990s have tended to settle at a low-inflation, higher unemployment equilibrium. Governments in Europe in the 1980s and 1990s prioritized macroeconomic stabilization and disinflation. Along those lines, there was significant policy convergence between conservative and social democratic governments, though this far from implies the eradication of political differences. The pragmatic adoption by social democratic parties (including PASOK after 1993) of more 'orthodox' economic policies has afforded them the notable ability to claim both the support of their traditional labor (or petty bourgeois) constituencies and the newly acquired approval of business capital (cf. Pagoulatos 2000b). This, in turn, has pushed conservative parties (including the ND) to abandon the more contentious versions of the New Right agenda for more centrist if not populist positions on economic policy. Apart from the party-political

convergence toward macroeconomic discipline, the 'sound finance' orientation is bolstered by the increased volume of small shareholders and pension fund investors who have a positive stake in the disinflationary and market-oriented economic policies that promote stable financial market growth.

The EMU, which overall is salutary for the Greek economy, accelerates financial integration in the Eurozone, which, among others, enhances the capacity of Eurozone economies to respond to national-level asymmetric shocks. Though Eurozone financial systems including that of Greece remain predominantly bank-based, the relative importance of capital markets rises, a trend which also increases the susceptibility of national economies to international financial market fluctuations. Both positive and negative effects are associated with this development.

Far from a 'natural event', the new political economy of financial internationalization is underpinned by the structural power of the US and US-based globalized financial capital. The new political economy has notable redistributive implications, producing winners (mobile factors of production and holders of liquid assets) and losers (less mobile factors of production or holders of fixed assets). As other European economies, Greece too is subject to these dynamics, though their impact has not as yet always been felt. Capital mobility undercuts labor union bargaining power, expanding the exit option of capital and promoting the disintegration of labor agreements. These conditions encourage social democratic governments and trade unions to embrace neocorporatist strategies for achieving wage moderation and for minimizing the loss of social entitlements, as the Greek case well into the 1990s demonstrated.

8
State, Finance, and Growth: Beyond the New Political Economy

The manifold importance of the state–finance connection

We have traced the political economy of postwar Greece from the 1950s to the present by focusing attention on the state–finance connection. This focus has been warranted in many ways. State-controlled credit was the most important developmental instrument during the postwar decades. State control included the ownership and management control over credit institutions as well as the administrative fixing of the rules and prices under which financial resources were allocated. State-controlled credit provided the principal tool for financing government spending. It operated, whenever it did, as the long arm of indicative planning and industrial policy. Financial interventionism allowed state actors to define infant industries and 'national champions', to afford preferential treatment to selected sectors, subsectors, or individual producers, and to exclude others. A bank-based financial system, with a heavily undeveloped capital market, forced businesses to turn to predominantly state-controlled credit institutions for finance. State-controlled finance served as a principal mechanism of state intervention, being both an instrument of economic stabilization and one of (re)distribution and selective policies. Financial interventionism substituted for the feebleness of redistributive functions, by cushioning less competitive (but usually politically substantial) socioeconomic groups from market forces. Especially after 1974, financial interventionism provided a constant financial lifeline for the government's distributive activities, and in that sense formed an inseparable extension of the modern redistributive as well as clientelistic state. The armory of postwar financial interventionism (capital controls, credit restrictions, special reserve requirements) was systematically relied upon for monetary stabilization.

The entire developmental model of the postwar Greek economy (as in other developmental states) was premised on state-controlled finance. Both economic growth and monetary stability during the Bretton Woods era were made possible under financial interventionism.

Financial interventionism was pivotal in supporting Greece's postwar industrialization and development, as well as in underwriting the economic decline of the 1980s. Credit interventionism created overleveraged industrial enterprises of high vulnerability to an external shock, such as that of the 1970s. It generated a moral hazard condition of easy credit to those overindebted firms as well as to government, 'socializing' the cost of the failure of the former, and facilitating electorally driven fiscal laxity for the latter, and in both cases postponing painful overhaul and restructuring. Thus, to a significant extent, the results of the abusive distortion of financial interventionism were evinced in the inflationary public debt trap of the 1980s and much of the 1990s, where a growing share of economic resources was swallowed up in servicing interest payments, crowding out productive investment. As the effects of institutionalized financial laxity accumulated beyond the point of being economically sustainable, they necessitated a particularly harsh disinflation in the 1990s, led by financial liberalization and monetary reform.

Financial liberalization, the dismantling of the state–finance connection, was of no less momentous implications. On a real as much as symbolic level it meant the final abandoning of the postwar developmental institutions of administered finance. On a state sovereignty level, it completed the alignment of the domestic economy to European and global financial market forces. On a macroeconomic level it meant accession to the primacy of disinflation, and its pursuit through indirect instead of direct monetary instruments – which also implied the erosion of expansionary policies. On a socioeconomic level financial liberalization brought a significant reallocation of economic (and thus, one might say, political) resources from sectors traditionally favored for developmental or redistributive purposes (manufacturing industry, SMEs, agriculture) to an increasingly emboldened financial sector and mobile, globalized business capital. On a political and ideological level, financial liberalization also generated the forces that would buttress the disinflationary or stabilization state, as will be further discussed below. Financial deepening promoted a rentier mentality and a wide number of stockholders and eventual stakeholders in 'sound finance' and macroeconomic discipline. Finally, at the level of institutional architecture, financial liberalization had important regulatory implications, as monetary and banking policies were transferred from the sphere of government

intervention to the regulatory jurisdiction of an eventually independent central bank. Overall, the effects of financial liberalization involved the government at large subscribing to a mechanism of self-imposed macroeconomic discipline through institutional self-binding. It involved a choice of policy commitment over policy discretion. It finally involved a transition from the primacy of politics that had dominated the postauthoritarian era to the primacy of policy and the constraining impact of economics.

From developmental to stabilization state

The gradual postwar build-up of interventionist financial institutions and policies, in full accord with the orthodoxy of the time and in line with the cold war regime dependencies, was justified primarily by the overwhelming primacy of economic development. The crisis of financial interventionism came with the dramatic change of the international economic as well as domestic political regime in the post-1973 period. However, the severe distortions and inflationary effects emanating from the crisis of financial interventionism did not lead to financial liberalization until after a significant time lag. Certainly not before external pressure had peaked and prolonged macroeconomic instability was turning into an economically unsustainable state of affairs as well as a serious political liability. It was only when these pressures had played themselves out, that government conceded to the gradual abolition of credit interventionism, which had also proven a vital and enduring political instrument. Thus financial interventionism, though initially founded on a compelling economic rationale, outlived both its developmental and stabilization mission, having ended up serving the political exigencies of democratization, social redistribution, party consolidation in power for either the ND or PASOK, or sheer electioneering and clientelism.

In other words, not only the postwar but also the postauthoritarian configuration until the late 1980s continued to rely on the institutions and policies of financial interventionism. These had been initially placed at the service of a developmental state, and then post-1974 were fossilized under the convenient inertia of the political and distributional status quo. As we have argued, the state was developmental in its economic ideology but less so in its administrative organization and function. It was not developmental in the strict sense of a strong, operationally autonomous ‘plan rational’ bureaucratic apparatus of high competence and integrity, but it was in its prioritization of development and its employment of financial interventionism as a principal tool.

When it finally came to be implemented, the dismantling of the developmental state (which by that time was delivering stagflation rather than growth) via financial liberalization formed simultaneously the adjustment response to the overpowering need for macroeconomic stabilization and disinflation, as well as the means for achieving it.

The change in the international and European economic environment after 1973 and into the 1980s, and its attendant institutional and ideological transformations, marked a change in the quality and configuration of the factors circumscribing the state's role over finance. These constraining factors pointed to state capacities in the sense of the economic and political feasibility of the state's policy options, and in that sense they also denoted a change in the state's policy preferences and priorities. The economic configuration of capital mobility and exchange rate instability, especially after a period of prolonged high inflation in Europe, entailed the almost single-minded prioritization of macroeconomic stability and disinflation over employment and redistribution.

The liberalized international financial regime that succeeded the collapse of Bretton Woods had as its primary characteristic floating exchange rates that were supposed to act as the main stabilization mechanism, both internationally and domestically. An imbalance in the foreign account would be handled by devaluation of the exchange rate. But for devaluation to succeed the domestic price level must not increase in tandem with devaluation, that is domestic inflation needs to be controlled. That is easier said than done, since the prices of tradeables by definition tend to increase in tandem with devaluation. Domestic stabilization, therefore, required the prices of nontradeables to decrease to offset the impact of the increase in the prices of tradeables. This has been a main reason why the post-1974 liberalized international financial regime has incorporated an inherent deflationary bias.

The disinflationary international regime (Forsyth and Notermans 1997) that gradually emerged was far less a set of 'generally agreed-to rules, regulations and plans' than the Bretton Woods international order had been. Much more was owed to the sheer force of not-too-orderly competition between powerful states, including the hegemony of a less multilaterally oriented US, and a growing defiance on the part of multinational market players and financial corporations, all subject to the opportunities and constraints of economics and technology. The deeply political nature of the institutions and policies produced by the international interplay of power, competition, and necessity justifies its treatment in terms of an international political economy regime (albeit one of intense disorder) rather than merely an international economic context.

Though endogenously transformable from the standpoint of global power actors, this international political economy acquired the compelling force of an exogenous, objective constraint when it came to small open economies and democracies with no capacity to affect global outcomes unilaterally.

The deflationary bias of the liberalized international financial regime certainly has a lot to do with the fact that developed countries setting the pace of the 'Washington consensus' are typically international creditors, thus staunchly preoccupied with maintaining low inflation. Capital mobility (that is, the free cross-border movement of short-term capital) has transformed foreign exchange markets into financial asset markets, so that exchange rates are no longer so much driven by the needs of trade finance but by the search for quick speculative gains. Market volatility creates financial risks, associated with severe exchange rate fluctuations, financial contagion, and the threat of a general loss of liquidity (though in the Eurozone context the room for speculative gains is limited). Even if financial risks may be hedged through specific instruments such as derivatives, they do raise the overall cost of financial commitments. Given the risk of financial crises provoked by large capital movements, risk-averse European governments (or for that matter the ECB) have sought to establish 'credibility' in the eyes of global financial markets. For that they have to subscribe to policies which elevate financial stability above growth and employment. The paramount objective of defending macroeconomic stability, translated into low budget deficits and a proclivity to high real interest rates, meant that European markets in the 1980s and 1990s tended to settle in a low-growth, high-unemployment equilibrium (Eatwell and Taylor 2000: 111ff; Bermeo 2001).

The corollary of the liberalized international environment is the change in the relative position of actors in the economy. Capital mobility has increased the tax burden on labor and eroded its bargaining power. Industry remains important but in no way comparable to its former status as the favorite child and prospective engine of postwar development, while the limits of national industrial policy are heavily circumscribed by EU competition rules. The banking system is no longer government-controlled and forced to subsidize developmental or redistributive priorities, but free to operate along profit-maximizing lines. The central bank has been granted full political independence, is institutionally prohibited from participating in the primary market for public debt, and is officially endowed with a statutory commitment to price stability. Government itself has no channel of access to preferential

credit by taxing the banking system, but is forced to finance its deficit by resorting to the internationalized money markets. On the ascending side in terms of importance and bargaining power are financial markets, banks, financial investors, institutional stockholders and bondholders. Given that both government and the private enterprise sector as deficit units rely exclusively on liberalized financial markets able to demand constantly higher returns, disinflation becomes a principal normative determinant of the system given the supreme bargaining power of the (typically inflation-averse) creditors within the system.

Reflecting the impact of the transformed international political economy, the Greek state has shifted in its financial and economic role to prioritizing macroeconomic stabilization and disinflation. It has been transformed from (a weak and incomplete version of) a developmental state to a fully fledged 'stabilization state'.[1] What defines a developmental state and what distinguishes it from a stabilization state? A developmental state sought to enlist a mechanism of controlling and allocating financial resources to the primacy of economic growth. The keyword was development, signifying a more far-reaching process than growth, not just more output but a different composition of output than previously produced, derived from technical and institutional transformations. An institutional framework was thus devised so as to substitute for the market's perceived failure to promote long-run development. Through various interventionist instruments (government subordination of the central bank, bank nationalizations, credit and capital controls, financial regulations, administered interest rates, selective credit policies and indicative planning, specialized banking institutions), domestic production was protected, and finance was directed to economic activities considered pivotal for economic development. The state's principal attachment to the developmental objective did not mean that macroeconomic stability was ignored. The conservative economic record of Greek postwar governments until 1973 unambiguously testified to the fact that price stability and payments equilibrium were consistently at the forefront of government priorities. These, however, were not viewed as objectives in themselves, but as the necessary preconditions for allowing sustained economic development. Development was the paramount objective, and macroeconomic stability was the necessary precondition for achieving it.

The transition to a stabilization state as regards the state–finance connection is anteceded by two major events. One is that Greece has graduated into the developed middle-income country group, its markets have become more complete and better operating, the economy needing less

intervention, and in any case incapable of growing at the high rates that were possible at an earlier stage of development. Developed status is also consolidated by membership of the EU, through which Greece partakes in the collective dividend of European progress, be it in the form of institutional modernization, international political upgrade, structural adjustment in various fields, or plainly increased financial inflows. This also implies that the pace of Greece's economic policies in the 1980s and especially in the 1990s was being set by the developed economies of the EU. The second major event is the international economic and ideological decline (amid a European environment of sustained monetary instability and high public deficits) of the postwar interventionist model that had underpinned developmental state strategies.

A stabilization state is not a Keynesian state pursuing stabilization through interventionist policy means (such as the incomes policies or price and credit controls extensively relied upon in the past) which under the new liberalized environment are increasingly rendered obsolete or ineffective. A stabilization state will seek to rely on the market and to diminish state interventions under the premise that interventions would create longer-run disequilibria by distorting market signals and resource allocation. In the 1990s EMU transition period, the stabilization state would enter a self-binding process of subscribing to international institutions such as the EMU nominal convergence criteria or surveillance mechanisms, that is external mechanisms inducing politically painful adjustment by altering the government's incentive structure. To a considerable extent, a stabilization state also parts company with the Keynesian stabilization role of using macroeconomic expansion to even out the business cycle, though the 2001 international recession has certainly tested the limits of this self-restraint – as will be further discussed. The EMU framework discourages the countercyclical use of fiscal policy through its austere restrictions on government deficits. Even if EMU member states were to defy the rules of the already loosening Stability and Growth Pact (prescribing a maximum limit of budget deficit not exceeding 3 percent of GDP) or the intergovernmental commitment to balanced budgets or primary surpluses,[2] the Pact's disciplinary role would be taken over by public debt markets (raising risk premia on new debt), the Maastricht Treaty no-bail-out clause (prohibiting EU governments from helping each other), and potentially financial regulators as well (prohibiting large exposures of banks to government bond holdings) (Lemmen 1999; Eijffinger and de Haan 2000). Thus, fiscal discipline in the EMU is not just the result of intergovernmental agreement enshrined in institutional text, nor just a matter of cyclical ideological disposition

in support of neoliberal precepts. It is the direct consequence of liberalized and globalized financial markets penalizing any medium- to long-term divergence from fiscal discipline.[3] As for the countercyclical use of monetary policy, it is restrained not only by the monetarist-leaning (though not quite, as will be seen below) ideology of the ECB but especially by its inability to redress national-level asymmetric shocks.

Which is the economic ideology underpinning this new policy configuration? If the postwar Greek developmental state reflected an eclectic orthodox–developmentalist mix that included a residual Keynesianism, and the postauthoritarian economy a misapplication of Keynesian precepts, the stabilization state can be associated with a residual monetarism tempered by strong portions of economic pragmatism. The European economic orthodoxy of the later 1980s and 1990s, upon which the EMU was founded, echoes monetarism in its strict adherence to the primacy of disinflation, and the crucial role it attaches to monetary policy as exclusively committed to monetary stability combined with an undisguised distrust of fiscal policy as the right instrument for fighting recessions. However, the pragmatic orthodoxy of the 1990s has not been truly monetarist. The ECB independence grates on Friedman's well-known opposition to central bank independence. Moreover, the endorsement of fixed exchange rates (as early as the EMS project) was a departure from the monetarist doctrine (McNamara 1998: 173). The role of the ECB in easing or tightening the monetary stance may have little to do with the aggressive monetary activism of many European central banks of the 1960s or 1970s, but it does not suggest a commitment to stable money growth either. (Only a minority of economists continue to believe that stable money growth can guarantee a stable economy.) As happened with the US Federal Reserve in 2001, the ECB's monetary policy also loosened at the first substantial signs of a Eurozone slowdown in 2001 – though without this necessarily implying a green light toward relaxing fiscal policy. The ECB has refrained from fully endorsing (the monetarists' favorite) monetary targeting, which forms only the first of its mixed 'two-pillar' policy strategy. The second pillar (which some have interpreted as inflation targeting) includes the assessment of a wide range of nonmonetary economic variables, such as labor market indicators (including wages and unit labor costs), fiscal policy indicators, and financial market indicators (such as the yield curve and stock prices) (Issing 2000).[4] Such 'formal' deviations from the monetarist doctrine notwithstanding, the ECB echoes (German-styled) monetarism in viewing inflation as 'always a monetary phenomenon' and attributing 'a prominent role to money' (Issing 2000).

The ECB assigns primacy to disinflation to a degree that is notably stronger than that followed by the Federal Reserve in the 1990s. Since its inception, the ECB has defined price stability within the 0–2 percent inflation range (ECB 1999),[5] whereas the Federal Reserve under Alan Greenspan has come to accept the looser 0–3 percent definition, and to accommodate a considerably more important role of monetary policy in enabling economic growth.[6] Clearly, the ECB, lacking any previous track record, has been more hard-pressed to establish anti-inflationary credibility than the Federal Reserve post-Volcker, and this is a chief factor to explain the disparity. Both the ECB's aversion to countercyclical activism and the Bundesbank-led deflationary monetary policies of the 1980s and 1990s as a precondition for allowing low interest rates can be interpreted with reference to monetarism.[7] Moreover, one can read the ECB's adamant anti-inflationary stance as a (monetarist-leaning) forceful position in support of supply-side structural adjustments rather than monetary or fiscal easing as the only avenue for raising the rate of economic growth. Indeed, the surrender of macroeconomic instruments for the purposes of economic growth has the almost exclusive reliance on supply-side policies for fighting unemployment as its corollary (Allsopp and Vines 1998: 5ff; Issing 2001).

The state's changeover from a developmental to a stabilization economic mission is not simply a mirror image of its external environment. External pressures and constraints do not amount to one-way options; they simply increase, often unbearably so, the cost of noncompliance. The decision whether or not to conform continues to rest in the hands of national policymakers, as several examples of nonconformist government policies in Europe have demonstrated. More importantly, of interest here is not just the extent to which external pressures are internalized by the domestic policy system, but the deeper transformations that these pressures help bring about in state ideology, preferences, strategy, and ultimate policy behavior. The state policies, which under the postwar or postauthoritarian conventional wisdom used to appear as necessary, desirable, or feasible, are under the new international configuration treated as politically precarious, economically hazardous, or fundamentally flawed. The state's role in the economic process is defined under the conceptual framework of a disinflationary or 'sound finance' paradigm that determines the meaning state actors impart to their policies as well as the direction these policies take (cf. Hall 1993). It is in that sense opportune to refer to a substantive transformation of the state's role in the economy.

Certainly, the contractionary impact of a disinflationary regime is mitigated if not offset by other momentously favorable circumstances

established by EMU. A common currency allows, for instance, Greece as a Eurozone country to conduct most of its foreign trade in euro, thus easing the pressure exercised by currency markets on its balance of payments. Not having a foreign exchange constraint in trading with the EMU partners is in itself expansionary. Should the euro become a reserve currency, the foreign exchange constraint is removed in trading with the rest of the world as well. And of course, a reserve currency would allow European economies cheaper and more secure access to capital. A functioning euro, given the size of its constituency, makes the Eurozone, and all national economies that comprise it, a 'price maker' instead of a 'price taker'. This would afford national governments a relatively higher degree of economic independence from international monetary constraints as compared to any recent period, say from the mid-1970s to the late 1990s. These factors, including the anticipation that commercial demand for the euro will counterbalance speculative demand, create a framework that makes it possible even for a state prioritizing monetary stability to influence investment and redistribution to a greater extent than perhaps expected under the constraining Stability and Growth Pact.

Thus in the EMU landscape the state acts in the broader sense as custodian of macroeconomic stability and hands-off market regulator, and growth is expected to result:

(a) From expanding privatized and liberalized competitive banking and financial systems in the Eurozone operating upon market efficiency standards that enable them to afford lower, flexible, and less volatile interest rates. Price stability allows the price system to perform its informational role more effectively, improving the allocation of resources and the conduct of macroeconomic policy. The Stability and Growth Pact is expected to free financial resources (which, among others, were diverted to hedging against inflation) to be directed to investment and long-term growth (Barro 1997; Feldstein 1999). The chosen policy mix seems to be one of tight fiscal policy that allows the longer-term interest rates to remain low (the 'Clinton–Greenspan' policy mix) rather than a lax fiscal policy that would need to be counterbalanced by a harsh monetary policy (the 'Reagan–Volcker' mix).

(b) From increasingly liberalized product and labor markets and other structural reforms (which are not devoid of social and redistributive implications). Especially for a smaller peripheral country in need of structural adjustments such as Greece, increased competition under EMU creates a strong external push for advancing liberalization in

the product, services, and labor markets, including greater flexibility in wage and employment conditions to offset the loss of control over monetary policy.

(c) From any remaining EU structural funds – at least for the European periphery. For Greece, EU financing (structural funds and cohesion fund) through the First Community Support Framework (1989–93) amounted to an annual average of 4.5 percent of GDP, and average annual financial inflows through the Second Community Support Framework (1994–99) reached 7.2 percent of GDP (Christodoulakis and Kalyvitis 2001: 22ff). The Third Community Support Framework Fund ends in 2006. That said, one of the greatest challenges ahead for the Greek economy is to sustain the economic growth rates of the second half of the 1990s after the EU financial inflows have been terminated. That will be especially difficult given the tight constraints the large public debt poses on the exercise of fiscal policy combined with the relatively low productivity and competitiveness of the Greek economy.[8] Under such circumstances fiscal and structural policies will be hard pressed to stabilize the economy in the event of an (endogenous or exogenous-driven) asymmetric shock.

The primacy of macroeconomic discipline is not, however, incompatible with developmental objectives. An environment of sustained monetary stability may prove conducive for state developmental functions, exercised, however, in a more indirect manner. The stabilization state is still assigned with delivering fundamental public goods, beginning with creating and safeguarding regulatory conditions that allow markets to operate efficiently. That said, the expansion and integration of markets revive concern over market failures, intensifying the need for ever higher and supranational regulatory vigilance. Moreover, principal among the state's developmental tasks remain public investment in infrastructure, education and training, new technologies and R&D, where private initiative often lacks adequate incentives or capacity to mobilize. For instance, investment in new technologies and especially employee retraining may be far less efficient if attempted without coordination with labor and business; business may be incapable of resolving its own collective action problems without state mediation. In such or similar cases the state assumes the flexible, indirect developmental role of an honest broker, a mediator of social pacts, aimed to expedite economically necessary and politically sustainable structural and sectoral adjustments. Even a countercyclical fiscal stimulus in the event of a recession remains possible under EMU, provided it is of a short-term

direct nature and the overall budget prospect in the medium term remains positive. Forced to respond 'to the parameters of a globalized world economy', the stabilization state is no longer a 'direct provider of growth', but rather 'a partner, catalyst, and facilitator' (World Bank 1997: 1).

State, power, and finance

The deregulation of financial interventionism was path-dependent upon the conditions of its inception. The concentration of financial power in government hands and the relative weakness of private capital (if compared to advanced capitalist Western Europe) meant that the initiative, decisive authority, and political control for dismantling credit dirigisme could only come from the state itself.

Both domestic financial interventionism and financial liberalization were not imposed on the state by influential interest coalitions of the market or civil society. The accommodation of particularly powerful socioeconomic claimants, different in each case, may have been targeted in order to vest policy arrangements with a necessary minimum degree of societal support. Possibly the minor specifics of these arrangements were fine-tuned toward satisfying particular interests and minimizing distributive losses of others. Nonetheless, state policymakers (including the Bank of Greece) in both cases retained exclusive initiative for the design, formulation, and implementation of the respective institutional reforms. In other words, financial interventionism and financial liberalization, standing at the antipodes of financial configurations, were both state-directed institutional arrangements. They were both adopted by state (government and BoG) policymakers, financial interventionism in order to promote economic development and financial liberalization in order to facilitate macroeconomic stabilization. They were not *directly* imposed by an external actor or economic regime, though such factors weighed crucially on the final policy decision, especially in the case of liberalization. And they did not result under the force of organized pressure from dominant sections of capital, though such pressures were present, exercised, and taken on board, and the final policy outcomes were 'sold' to policy beneficiaries with an eye on enhancing the government's political returns.

The strength of the state that such a policymaking pattern entailed was not a function of a 'developmental' elite state bureaucracy characterized by proficiency, commitment, cohesiveness, operational autonomy, and resistance to private interest capture or political infringements. Such features marked, to a significant extent, only

the BoG, whose instruments, however, were confined to monetary and credit policies, falling short of a fully fledged developmental function. The BoG indeed testified to a high degree of policy strength, defined through our fourfold framework of resource capability, agenda identification, policy determination, and policy insulation/arena control. In contrast, any government strength was derived largely from the direct control over developmental economic instruments (prominently including credit dirigisme and state banking) and the indirect political control over collective socioeconomic life, via patterns of state corporatism or *parentela* pluralism. The permeating politicization of government intervention was an enduring integral feature of the developmental state both in the postwar and, more strongly, in the postauthoritarian period, when it assumed a less haphazard, more systematic form. This fragmented, 'intermediate' state (Chapter 3) lacked the overall capacity and perhaps will to engineer the desired developmental transformations in the economy and society (as the heavily qualified achievement record of industrialization demonstrated), despite ad hoc successes in implementing its developmental objectives in particular policy areas.

Powerful state elites (government ministers, the central bank, the Currency Committee) had a leading role in shaping the developmental state's institutions and policies under conditions of relative sociopolitical underdevelopment and economic protectionism. Capital controls, financial and industrial interventionism, import substitution policies, all formed a nationalist-leaning institutional apparatus aimed to moderate the impact of the international economy by altering foreign price signals, serving among others the paramount objective of conserving foreign exchange. In contrast, amid conditions of market internationalization, regime interdependence, and European integration, the role of state actors in institutional and economic policy design decreases.[9] Economic opening and market integration transfers power from labor to business, from state actors to private capital holders, from national government to intergovernmental and supranational authorities, from national to transnational interests. Under the political economy of Europeanization and globalization it makes sense to look more carefully at the demand rather than the supply side of public policies, to seek to explain policy and institutional outputs less in terms of state-centric objectives and policy processes and more in terms of transnational regime interdependence and country-based or internationalized market coalitions. The transition to this globalized political economy of market interdependence via financial deregulation and capital account liberalization

is perhaps the final major act, the swan song, of the developmental state, implemented through state-directed, exclusive, top-down policymaking.

Financial interventionism in the hands of a developmental state (even one with the serious structural limitations of the Greek public bureaucracy) was a factor of state strength, positively correlated to the underdeveloped status of both the economy and civil society. The balance changes post-1974, when the economy has reached an adequate level of development, and the sociopolitical system has turned into a pluralistic liberal democracy. Socioeconomic interests here have greater political capacity to mobilize, they command considerable resources, including benefits earned and consolidated as vested *acquis* resulting from postwar state clientelism. By that time, a state-protected industrial structure has crystallized, and Olsonian-type rent-seeking groups have become entrenched (Olson 1982), as the politics of credit deregulation showed (Chapter 6). Moreover, in a bank-based system, industrial firms have developed close accommodative ties with the banks, which often allow them preferential lines of finance as a function of middle-level arrangements with less need for political intermediation. It should be emphasized that the postwar configuration endowed industrial capital with important bargaining power which stemmed not only from its elite infiltration, but mostly from it being viewed, under the prevalent developmental policy doctrine, as the principal engine of economic growth. Even more accommodating, due to its superior know-how and expected added value, was the treatment of foreign investment capital. Unlike advanced Western economies, business capital in developing Greece was courted perhaps less for its direct job-creating role and more for its pivotal contribution to the build-up of a national productive base.

As a result of political democratization, not only business but especially labor has become more assertive. Intensified political competition for the vote of a growing small middle class, including small business owners, self-employed professionals, and so on, has raised their bargaining power as well. The post-1974 and particularly the post-1979 period combined these features with a stagflationary economic conjuncture. Economic crisis, a prolonged downswing of the business cycle, an inflationary environment, transform developmental instruments of strength into sources of economic weakness. Being the holder of the extensive discretionary policy resources emanating from the control of direct monetary instruments, the state is forced to direct these resources to accommodating the grievances of competing groups hard hit by the economic downturn. The vicious inflationary cycle and the 'debt trap' resulting from the expansionary use of financial interventionism erode

the state's economic power, intensifying socioeconomic demands while undercutting the state's ability to meet those demands. Inability to satisfy the extensive socioeconomic pressures and to deliver economic stability and growth generates disillusionment that undermines the state's political legitimacy and strength (cf. Maravall 1997). That was, at the domestic level, the situation in the second half of the 1980s, necessitating the recourse to monetary adjustment and macroeconomic stabilization.

The surrender of the credit and eventually monetary policy instrument renders the state financially sound but politically weaker, given the loss of discretionary power. State interventionist authority is transformed into regulatory capacity, that is the ability to define a broad, universal, and minimalistic framework of economic activity rather than to directly intervene to influence that activity. Through a conscious self-binding strategy of surrendering tactical instruments for the sake of strategic objectives, the state may be strong, in the sense of having brought about more conducive conditions for achieving its economic mission of providing inflation-free growth in a sustainable way (though this is yet to be proven). However, it is a strength derived from substantially narrowing down some of the state's other practices, including clientelistically minded financial distribution, growth-minded protectionism, socially minded redistribution, and electorally minded employment of macro- and microeconomic policies.

The politics of economic reform

Rather than being treated as 'noise' or as an exogenous nuisance to the elegant parsimony of economic theorizing, the independent role of politics upon economic reform imposes its own terms of policy implementation. As the stages of financial liberalization and 'deepening' unfold, so do their real effects on the economic process and societal interest arena. As the market impact of reforms feeds into the 'real' economy, winning beneficiaries embrace the reforms effectively or less so, interest dissatisfaction assumes the form of organized political grievance, whereas wider long-term benefits are – typically – silently diluted. At the same time that policies generate their politics, the reverse process also makes its mark. Whereas, for instance, the sober technocratic pace of the 1985–87 stabilization allocates disinflation costs in an at least technically indiscriminate way, the electoral, polarized politics of 1988–89 transforms credit deregulation into a clientelistic spree.

The inseparability of financial and monetary reform from its surrounding politics in a constant game of challenge, interaction, and

compromise, will substantially affect not only the preconditions and implications of policy but its very content as well. If the road to the market-liberal promised land of sustained growth through a competitive, open, financially 'deep', and liberalized economy passes through many long years of stabilization, then this transition itself involves its own set of policies, and its own distinct share of state initiative to deal with the politics these policies generate. In so far as the general reform orientation came in response to severe 'objective' external constraints (originating from both European integration and globalization), the main challenge of state reformers lay perhaps not so much in initiating or in designing reform, but in sustaining it. This, among others, entailed seeking to vest policy implementation with the irreversibility of institutional self-binding. Such self-binding was provided, as already argued, by the Maastricht convergence criteria, by the granting of full independence to the central bank, and by financial liberalization itself, multiplying the cost of policy divergence from economic orthodoxy. Prolonged stabilization politically generates its own economic policy instruments and institutions, which consolidate the state's transformation into a stabilization state.

Development, equity, redistribution

Greece's standing as a 'backward' economy (to use the least charitable postwar term) in the 1950s and 1960s meant that the normative dilemma (equity versus efficiency) through which more advanced European economies of the Keynesian era were forced to navigate was deferred in the Greek case. It was not only Greece's civil war trauma that had bequeathed a very un-Keynesian disposition to substantial questions of equity, identifying them with a suspicious socialist agenda. It was not even only the foreign tutelage, which skewed economic policy toward the objective of building a Western-type market economy open for Western products, if only through statist means. (On a parallel track, 'Keynes at home, Adam Smith abroad' summarized the stance of many Western European countries after the 1960s.) It was not even the political understanding that much of the grievances arising from the unresolved questions of equity would be left to follow the channel of (foreign migration) exit rather than dissenting voice, wherever loyalty to the conservative regime was a sheer impossibility. It was even more strongly the deep-held belief that the question of equity should be premised upon the availability of sustainable and redistributable wealth, and should thus be preceded by the accumulation of such wealth

through economic development. Be it an honest technocratic credo or an astute political strategy for obtaining the acquiescence of the masses, the cause of development was heralded as the simultaneous solution to both equity and efficiency.

However, even in that authoritarian-prone semblance of a Western-type democracy that was the postwar Greek polity, public grievances (if not systemically outcast in time) could assume political means of expression, thus calling to be dealt with. Since the political sphere tended to exclude carriers of dissent, the reinclusive functions would have to be carried out by the trickle-down effect of the anticipated gains of economic development. Where dissenting citizens were disenfranchised by politics, the economy sought to reenfranchise them. (The strategy was particularly abused by the dictatorship.) Financial interventionism was assigned to performing a notable part of this inclusive function, albeit in a highly particularistic way.

The postauthoritarian governments, under the constraints posed by the country's transition to democracy, attempted to rely on financial interventionism, disregarding the fact that principal preconditions which had economically sustained it were, into the 1970s, becoming increasingly obsolete. In addition, the long-deferred equity question, whose part suppression had formed the cornerstone of the postwar conservative developmental regime, was by now resurfacing with unprecedented political wrath. The fiscal expansion, typical of a South European postauthoritarian trajectory, was exactly aimed to afford social legitimacy to a born-again centrist conservative ND in the 1970s and to cement PASOK's hard-won social coalition in the first half of the 1980s by affirming a commitment to social redistribution.

In general, the postwar developmental state was (re)distributive[10] mainly through a particularistic use of industrial, credit, and to a certain extent agricultural policies, while showing considerable restraint in its use of income, fiscal, and overall monetary policies. Within the official framework of its support to industry and exports for their pivotal role in development, the postwar regime was able to target resources to government-favored private firms, either in the form of bank credits or selective 'incentives' and protectionism. This configuration of policy instruments changed in the post-1974 period. The servicing by postauthoritarian governments of broader redistributive objectives, and the effort to catch up with the standards of the West European welfare state meant an overall greater reliance on both monetary and fiscal expansion, as well as a readiness to accommodate wage demands through lax incomes policy. On the other hand, the process of industrialization by

the late 1970s had entered a stage of structural decline, and consensus was growing among policy experts about the perverse effects of credit activism and its potentially subversive impact on the effectiveness of monetary policy. Thus toward the end of the 1970s industrial and credit policies were losing their importance compared to the pre-1973 period; their revival under the first PASOK term in the 1980s was ineffective and short-lived. From a postwar instrument of structural transformation of the economy, developmental credit and industrial policies into the 1970s and 1980s (generously propped up by post-1981 inflowing EU funds available for structural change) became a means for shoring up existing economic structures and supporting the least competitive strata in society.

Ideas, institutions, and interests in economic policy

The historical continuum in which this case is examined allows us to draw some broader conclusions on the role of ideational factors in shaping economic policy and the conditions of paradigm shift. Ideologies filter the way in which economic reality is perceived, interpreted, and acted upon. Weber had long suspected that 'worldviews give direction to actions that are independently propelled, like trains on a track, by material and ideal interests' (cited in Hamilton 1994: 192). Economic ideology affects economic policy responses to given circumstances by conceptually framing (both in the positive and in the normative sense) those circumstances. By attaching value to a menu of policy alternatives, economic ideology favors some at the expense of others. By defining the policies to be chosen, or the reputation of policymakers, ideas carry a transformative impact on economic conditions (Jacobsen 1995; Majone 1996b; Blyth 1997; Pagoulatos 1999d). In our case, developmentalism, Keynesianism, or monetarism, all have offered evidence substantiating the above.

Economic ideology affects the economy by defining policy responses, but the reverse process takes place as well. The objective quality of the surrounding economic circumstances crucially favors one set of economic ideas over another. The adoption of any ideological framework itself is contingent upon real economic conditions. These include the socioeconomic structural endowment (early postwar Greece being a textbook case for developmentalism but not for Keynesianism); the international regime (Bretton Woods versus floating exchange rates); the particular moment in the evolution of the economic cycle (a 1959–60 recession calling for countercyclical deficit financing); the objective economic context (chronic inflation and high public indebtedness ruling out a reflationary response to the early 1990s recession);

salient economic events (a balance-of-payments crisis after the 1985 elections in Greece precipitating the adoption of disinflation). Prolonged inflation in the 1970s and 1980s eventually ended up favoring the objective of disinflation and monetarist precepts. Capital mobility also engendered a deflationary bias of national macroeconomic policies. By the same token, periods of low inflation and sluggish growth or recession (2000–1) internationally revive faith in a Keynesian stimulus by relaxing both monetary and fiscal policy, and intensify criticism against the Stability and Growth Pact. Thus the menacing specter of a 'debt trap', by the same token, begins to give way to that of a 'liquidity trap'. While monetary instability favors the primacy of disinflation and monetarist-type macroeconomic strategies, recession economics largely remains Keynesian.

Economic conditions, resulting as the intended and especially as the unintended effects of coordinated and uncoordinated state and market activity, create an 'objective' environment to which states and market actors are in one way or another pressed to adjust. Policy shifts evolve by way of a Hirschmanian oscillation between varying degrees of state involvement (Hirschman 1982). In the early 2000s, the international terrorist threat, followed by an avalanche of mega-size financial scandals, have given rise to a public-safety public-interest discourse in the US spreading to Europe. This discourse promotes international coordination, stronger regulation, and even the renationalization of a broad range of financial, trade, communication, transportation, technological, and other activities. As a general trend this may only represent a temporary reaction, but it does temper down substantially the ideological primacy of business freedom and unrestrained market efficiency that prevailed in the 1980s and 1990s. In broader terms, the generalized pessimism of the early 2000s, following the end of the prolonged US economic euphoria of the 1990s, has made globalization seem far less irreversible than before, especially if assessed under the light of the 1930s historical experience (cf. James 2001).

In parallel with such ideological cycles evolves a build-up of recent historical experience regarding capitalist crises. This build-up of historical learning narrows the limits of policy debate and broadens those of economic pragmatism. Thus, under the accumulated international experience of proto-Keynesian and Keynesian exits from recession from the 1930s through the 1960s, stagflation in the 1970s, and a long struggle against inflationary expectations in the 1980s and part of the 1990s, the economic orthodoxy of the 2000s seems to be more encompassing, pragmatic, and 'wiser' than that of previous periods. Indeed, the real threat of deflation revives the importance of countercyclical fiscal policy

when inflation is low and interest rates have nowhere lower to fall. Such a context helps distinguish more clearly the correct use of a Keynesian fiscal stimulus from its erstwhile inflationary misapplication of using deficit-financing not merely to cushion recession but as a constant boost to economic growth. (Since the 1960s and 1970s many Western governments demonstrated how much easier it was to loosen the budget in a downturn than to tighten it up in the upswing, giving rise to widespread and justified fiscal skepticism.)

'Objective' conditions nonetheless are still to a great extent subject to (inter)subjective interpretations provided through ideational frameworks. For instance, the definition of a 'tolerable level of inflation' is highly susceptible to the surrounding economic ideational context and 'national' anti-inflationary culture (Busch 1993). Thus the sustained disinflationary commitment of the EU over the 1990s has been attributed to the influence of the German Bundesbank, a traditional bearer of a relentless defense of price stability rooted in the traumatic experience of the Weimar Republic hyperinflation (Dyson and Featherstone 1999). Similarly in the Greek case, an anti-inflationary national policy discourse, rooted in folk memories of prolonged monetary instability and war hyperinflation, allowed the postwar BoG to prioritize price stability as a precondition for development, without significant opposition. That same discourse, at least in the earlier postwar period, did not favor deficit spending, considering it a demonstration of fiscal irresponsibility and politicking. Conversely, identifying a long record of price stability with the (mostly right-wing or authoritarian) postwar governments, by the post-1974 period had significantly blunted sociopolitical reflexes against inflation. By the second half of the 1970s, a considerable section of the Greek public and the political spectrum even positively identified a more lax and inflation-accommodating macroeconomic stance with progressive politics.

Broader observations can be made regarding the interplay between ideas, institutions, and interests. Institutional and policy change in the international economy results principally from the mobilization of governments, supranational authorities, and transnational economic interests all seeking to take advantage of windows of opportunity for advancing their objectives (Story and Walter 1997; Pagoulatos 1999a). Hence, for instance, the US and countries with developed financial markets such as the UK, along with globalized financial capital, pressed for financial liberalization globally as conducive to their interests. Under conditions of prolonged inflation, the bargaining power of central bankers and the internationalized financial sector (the 'sound finance' coalition) rose, as discussed in Chapter 4.

Apart from economic conditions, domestic adjustment to external pressures and to the dominant international policy paradigm is also mediated by political and institutional factors, some of which have been reviewed in this book. The political regime of the 1950s and 1960s, aligned behind the cold war camp, allowed very limited divergence from the policy mixes that constituted the acceptable economic orthodoxy of the time. The ideology of the political party in power was an important factor, as policy divergence from the economic orthodoxy in the first half of the socialist 1980s showed. But the mediating impact of governing party ideology is less decisive under conditions of accelerating internationalization/European integration and domestic economic pressure, as the significant cross-party convergence over the 1990s demonstrated. National junctures engendering a primacy of political over policy objectives (democratic transition in 1974, party regime consolidation in 1981) undercut the impact of external economic pressures and defer domestic economic adjustment to the international policy paradigm.

Institutional facets of the state structure and the financial system facilitated particular domestic economic policy responses by having an impact on the macroeconomic constraints under which governments operate. A state-controlled banking system and a politically dependent central bank operating under the Currency Committee rendered deficit-financing easier, enabling the governments' recourse from the 1960s through the 1980s to developmental, Keynesian, or pseudo-Keynesian expansion. A more independent central bank – or a CB de facto granted higher operational autonomy by government, like the BoG after 1985 and especially in the 1990s – will have the power to counteract the government's fiscal expansionism with monetary austerity. A powerful bureaucracy will be able to design and implement industrial and other sectoral policies and influence economic activity toward the desired direction; a weak one will undercut the action scope and effectiveness of a developmental state. A fragmented civil service of low policymaking capacity and authority rendered economic policy more permeable vis-à-vis external influences. Such influences usually originated from top ministerial advisors recruited directly from elite academia, international organizations, or transnational corporate circles often representing the hard core of policy orthodoxy. Thus, paradoxically, as a result of an incoherent administrative machine, economic policymaking was rendered continuously open to the latest ideological and policy developments in the international economic and academic environment. On the policy demand side, institutional organization affects the types of distributional claims societal actors place on government. A more centralized

neocorporatist structure of interest organization and wage bargaining (Greece increasingly from the second half of the 1990s) facilitates wage moderation, while fragmentation encourages rent-seeking behavior and obstructs an effectively coordinated response to unfavorable financial reform, as seen in Chapter 6.

Different institutional configurations generate their own winners. Industry was the champion of the postwar period, labor a relative gainer of 1974–85, and domestic state-controlled banks rather an overall net loser in the 1970s and 1980s until deregulation. By the same token, the EMU era marked the powerful entry into the policy game of internationalized financial capital, and through that, the domestic banking sector as well. Since the 1990s and especially after the 1994 liberalization of capital movements, economic ministers have been obliged to retain an open line of communication with major global financial market firms, drumming up their confidence in the prospects of the Greek economy, agonizing to avert any sudden outflow of capital or downgrading of government paper, trying to sell chunks of privatizable public companies or to lure investors to the ASE. Never in the postwar period has economic policy been so routinely dependent on the approval of private financial capital. Attracting financial market confidence has succeeded the developmental era ritual of major domestic and international industrial enterprises lobbying government ministers to extract licenses, subsidies, exemptions, and other favorable concessions for their investment and business activity.

Different stages of capitalist development are also associated with distinct ideations and images of capitalist vigor and success. In the mainstream imagery, the nation's economic well-being in the postwar developmental period was measured by the number of new industries, the smelting furnaces, and the rate of overall economic growth with paramount emphasis on manufacturing. The postauthoritarian period through the 1980s advanced (and eventually failed to meet) an expansionary standard of success, in the form of an economically viable resource redistribution and pluralistic social spending. The new political economy of financial market-based capitalism ideologized a far more disciplinarian macroeconomic commitment, with a booming stock market as central yardstick of economic growth and success.

On a final note: some comparative and normative considerations

Our account offers a strong caveat against approaches that tend to view the Greek case through the lenses of national exceptionalism.

Historiographical and social science literature of modern Greek society and economy has been plagued by accounts which tend to reproduce a sense of Greek 'uniqueness', regarding either its subjection to the American hegemony of the postwar era, or the problematic functioning of its democratic institutions of that period, or the employment of state and finance institutions, or the recent economic experience of the 1980s and 1990s. Contrary to such ethnocentric accounts, we have placed our subject matter within a comparative framework of state–finance configurations. This has shown the Greek financial system and political economy of the postwar period to fit the general pattern of developing economies both in the developmental role of state institutions and in the authoritarian-prone or incomplete maturation of democratic political and civil society institutions. After 1973 the Greek economy is subject to the same crisis and forceful pressures emanating from the international environment. Its stagflationary response to the regime shift following the Bretton Woods collapse parallels that of advanced European economies, as Greece has graduated from its developing country status. Democratic transition and consolidation (a shared experience with the Iberian peninsula) open the way to the full politicization of economic and financial policies, eventually leading to serious divergence from the new disinflationary European orthodoxy in the 1980s. Yet, even that divergence is anything but 'unique', given, for example, its strong similarities with the (nonetheless more short-lived) French socialist 'reflation in one country' experiment of 1981–82. Finally, adjustment to the disinflationary orthodoxy via financial liberalization and monetary austerity brings the full convergence of Greece with the EMU nominal criteria and with the EU policy canon as well. Far from 'unique' or 'exceptional' (or at least not more than any national trajectory could claim to be), the Greek case is interesting not only for what it says about itself, but also for what it relates regarding the general policy patterns of which it forms part.

Let a bold generalization be ventured at this point. From the 1950s to date perhaps the central issue guiding economic institutional design and policy planning has been: how to devise the appropriate set of institutions that would maximize the comparative advantages of the country? Diverse experience emanating from different national trajectories has suggested more than one route to success. Depending on the particular stage of development, overarching regime, and surrounding socioeconomic and political conditions, different models and paradigms have driven reform efforts across time. None has been able to operate unconstrained from path dependencies created by past choices, and

none is devoid of redistributive implications, economic, sociopolitical, and intertemporal trade-offs of all sorts. No policy solutions, including the most successful, are devoid of perverse effects, and all involve consequential dilemmas. It thus comes to no surprise that there are no permanent or universally 'right' institutional remedies and policy fixes. As the various unintended consequences of financial interventionism have amply demonstrated, the successful developmental state of yesteryear may be the lame duck or the greatest impediment of tomorrow (Japan provides evidence for that). And its dismantling may solve a category of problems, but only to generate a new set of different ones. That said, one should not trivialize the positive aspects of financial interventionism: since 1980, three-quarters of the member countries of the IMF, developed, developing, and emerging alike, have been hit by financial crises.[11] Greece was an exception, crucially also assisted by its ability to rely on state-controlled finance. Interventionism breeds its perverse effects, but noninterventionism may lead to other kinds of undesirable consequences.

Greece's postwar boom was not a case of Keynesian prosperity but the take-off of a developing country. Greece's equivalent of *les trentes glorieuses* was a time of deferred welfare though steadily decreasing poverty, and sociopolitical deprivation, both of which leave no grounds for postwar era nostalgia. Then Greece's own belated experience with Keynesianism in the 1970s and 1980s was flawed and far from having been crowned with success. In fact, it may have offered a potent argument for the wisdom of surrendering some economic policy control to external technocracy agents less susceptible to the vagaries of electoral politics. (It may also, even more wisely, have suggested an institutional reform path of rendering electoral politics less debilitating in their economic impact.) With the hindsight of the relatively successful economic adjustment of the 1990s, a major lesson to be drawn is that in the era of increasing globalization and interdependence unilateral divergence comes at a heavy financial price. Independent policy efforts to contravene the dictates of global-capital-imposed economic orthodoxy by substantially raising social spending and tightening social regulation are highly likely to meet with rising inflation, faltering economic growth, and higher unemployment down the road.

However, this admission of 'gloomy' pragmatism should far from imply an uncritical *in toto* acceptance of the 'sound finance' orthodoxy. Quixotic expansionary attempts doomed to fail as they seek to defy the overwhelming power of global financial markets are the best match for the Panglossian belief in the superior self-regulating efficiency of unfettered financial liberalization. Certain items of the orthodox agenda

retain their robustness as policy prescriptions. These include the merits of open trade, the overhaul of insurance and pension systems, the need to ground social redistribution on sound public finance, the divestiture of at least some state-owned business firms (followed by bold reregulation), the rationalization and marketization of a certain range of state-controlled activities, followed by a clear delineation of the public–private boundary. Other items of the currently orthodox agenda, however, have been laid bare to compelling dispute. While the dismantling of barriers for cross-border investment capital has spread growth opportunities, the total deregulation of restrictions on the movement of purely speculative short-term capital has left many economies under the Damoclean sword of a financial collapse, transferring unprecedented power to the hands of collectively irrational global financial market players. Inasmuch as unilateral national opt-outs from this global financial disorder are hardly viable, the degree of absurdity of this particular dimension of financial globalization has rightfully intensified calls for global-level universally coordinated action oriented toward 'governing' and taxing short-term capital movements (Sachs 1998; Krugman 1999).[12] Regaining democratic control over economic policy inevitably passes through multilateral and supranational cooperation, aimed at establishing a substantial degree of global control over short-term capital movements, that is enforcing a global governance over financial globalization (cf. Ruggie 1995).

All that said, today's antiglobalization backlash, comprising as it does anything from rationalist proponents of global-level institutional reform to zealots of antimarket Ludditism, parochial anti-Americanism, and cultural nationalism risks throwing away the baby with the bathwater. A dangerous paradox has been noted, among others, underlying the reaction to globalization: that is a tendency of blaming social dislocations caused by what is today a largely self-regulating international market on excessive international regulatory intervention and encroachment in national policy sovereignty (Streeck 1996: 314). This 'democracy illusion' fails to comprehend the exact nature of supranational interdependencies, seeking instead refuge in an affirmation of national interest. It thus ends up obstructing precisely those multilateral supranational-level procedures necessary for the emergence of effective regulatory reform and global-level governance.

Appendix 1: Governments and Prime Ministers in Greece, 1950–2000

Year	*Government*	*Prime Minister*
1950[1]	Coalition [Liberal Party]	Sophocles Venizelos
1950	Coalition [National Progressive Center Union – NPCU]	Nicolaos Plastiras
1950	Coalition [Liberal Party]	Sophocles Venizelos
1951	Coalition [NPCU]	Nicolaos Plastiras
1952	Greek Rally (right-wing)	Alexandros Papagos
1955	Greek Rally	Constantine Karamanlis
1956	National Radical Union [NRU] (right-wing)	Constantine Karamanlis
1958	National Radical Union	Constantine Karamanlis
1961	National Radical Union	Constantine Karamanlis
1963	Center Union	Georgios Papandreou
1964	Center Union	Georgios Papandreou
1965	Transitional [min][2]	Georgios Athanasiades-Novas
1965	Transitional [min]	Elias Tsirimokos
1965	Coalition [NRU/Center Union apostates]	Stephanos Stephanopoulos
1966	Coalition [Center Union/NRU]	Ioannis Paraskevopoulos
1967	Transitional [min]	Panagiotis Canellopoulos
1967	Dictatorship	Constantine Kollias
1967	Dictatorship	Georgios Papadopoulos
1973	Dictatorship	Spyridon Markezinis
1973	Dictatorship	Adamantios Androutsopoulos
1974	Government of National Unity	Constantine Karamanlis
1974	New Democracy (ND)	Constantine Karamanlis
1977	ND	Constantine Karamanlis
1980	ND	Georgios Rallis
1981	Panhellenic Socialistic Movement (PASOK)	Andreas Papandreou

(continued)

Year	*Government*	*Prime Minister*
1985	PASOK	Andreas Papandreou
1989	Coalition [ND/Left Coalition Party]	Tzanis Tzannetakis
1989	All-party 'Ecumenical' Government	Xenophon Zolotas
1990	ND	Constantine Mitsotakis
1993	PASOK	Andreas Papandreou
1996	PASOK	Kostas Simitis
1996	PASOK	Kostas Simitis
2000	PASOK	Kostas Simitis

[1] Election years in bold.
[2] Min: Minority governments that did not receive the Parliament's vote of confidence.

Appendix 2: Clientelistic Policies of the Currency Committee

The Currency Committee authorized loans to farmer cooperatives (1959); amended its former decision in favor of a local chamber of commerce (1959); exempted particular companies from its previous decision on financial obligation (1965, 1980); extended favorable provisions to additional subsectors and branches of economic activity (1960); granted personal housing loans to army officers and veterans (1959); offered loans or settlement or suspension of the repayment of debts incurred by newspapers and magazines (1959, 1960, 1967, 1969, 1974, 1980); approved personal loans – with a state guarantee – to (government-friendly) individual publishers, often by explicitly exempting them from previous Currency Committee restrictions, for the purposes of restructuring their company or financing a publishing activity (1959, 1960, 1965, 1967); approved individual loans to doctors or actors for investment in their professional activity (1960); offered loans to local authorities for public works (1959); took a large number of decisions authorizing the extension of the deadline or the suspension of the repayment of loans granted to companies (1959, 1960, 1965, 1966, 1974, 1977) or foundations and collective associations (1960, 1964), or the extension of a special, state-guaranteed BoG loan for the repayment of an overdue industrial company debt to the National Bank (1965); authorized bank loans to selected large industrial firms over the limit of 20 percent of the bank's capital (1959, 1961, 1964, 1965, 1966, 1967, 1968, 1969, 1974).

Many of the Currency Committee decisions taken a few months before a national election were revelatory of the electoral motives behind them. To take, for example, 1977 (the least expansionary electoral year compared to the entire 1981–93 period): Currency Committee measures included loans to Athens newspapers (1977), financial facilities to regional farmers who were hit by fire four years before (1977), one-year extension in the repayment of bank loans granted to natural and legal entities in seven particular prefectures of Greece (1977), credit facilities to regional farmers hit by an earthquake five years before, credit facilities to farmers hit by the heat and the drought in Crete and the Peloponnese (1977).

Appendix 3: Financial Liberalization in Greece: Selected Measures

1982	Currency Committee abolished.
1983	Various special interest rates adjusted to the general higher rate.
	Preferential interest rates for exports abolished.
1984	Various operations allowed without BoG prior approval.
	BoG trading of Treasury bills to the public on the government's behalf.
1985	Banks allowed, under conditions to, issue letters of guarantee without prior BoG approval.
	Several credit facilities eased, credit ceilings raised.
1986	Special interest rates equalized upwards.
	Treasury bills transactions between commercial banks permitted, under restrictions.
	Agricultural Bank and National Mortgage Bank gradually commercialized.
1987	Some deposit rates liberalized.
	Ceiling on short-term lending rate abolished.
	Obligatory ratio (15 percent) for financing private fixed investment abolished.
1988	Minimum lending rate abolished.
	Reserve/rebate system eliminated.
	Credit restrictions to various categories (construction, trade, services) mostly abolished.
1989	Interest rates on current account and sight deposits liberalized.
	Lending rates to public enterprises and entities liberalized.
	Banks allowed to reschedule debt including forfeited letters of guarantee.
	Banks allowed to lend public corporations without BoG approval.
	Various credit restrictions lifted.
1990	Auctioning of Treasury bills to banks introduced; individuals and legal persons authorized to participate.
	Despecialization of specialized banks continued.
	Special ratio for financing public corporations reduced.
1991	Investment ratio for purchasing Treasury bills down from 40 to 30 percent.
	Ratio for public enterprise and entities financing abolished.
	Banks granted exclusive responsibility for SME loans.
1992	Forward market in foreign exchange created.
	Special investment ratio for SME financing reduced from 10 to 5 percent.
	Investment ratio for purchasing Treasury bills down from 30 to 15 percent.
	Exporters allowed forward operations in exchange markets.

(continued)

1993	Medium and long-term capital movements with EC countries liberalized.
	Minimum savings deposit rate abolished.
	Investment ratio for SME finance abolished.
	Companies free to borrow in foreign exchange.
	Bank investment ratio into Treasury bills abolished.
	BoG–commercial bank transactions in government bonds introduced.
1994	Consumer credit relatively liberalized.
	All short-term capital controls abolished.
	Currency market fully deregulated.
	Investment ratio for financing public corporations abolished.
	BoG independence legally instituted.
1995	Immaterial Securities Settlement System introduced.
	Government bonds issued in foreign currency included in BoG's intervention instruments.
	Factoring, leasing and venture capital legislation.
	Deposit Guarantee Fund established.
1996	Housing loan interest rates liberalized.
	Provisions regarding monitoring procedures of banks' credit risk.
	Specialized banks expand into new operations.
1997	Greek residents free to open foreign currency accounts with Greek institutions.
1998	Athens Derivatives Exchange established.
	Various prudential regulation measures.
	Secondary Electronic Securities Market allows trading in government bonds and nonstock-exchange instruments.
1999	Payments settlement system established.
	Repos transactions introduced in Secondary Electronic Securities Market.
	Daily BoG publication of Government Securities Purchase Prices Bulletin introduced.
2000	Transactions in gold liberalized.
	Loans allowed for purchasing stocks, secured by new or existing stock.
	Average ratio of BoG reserve requirements down from 12 to 2 per cent.

Notes

1 Introduction: the Importance of Finance and the Origins of Developmentalism

1. See works cited in various parts of the book.
2. On functionalism see Elster (1982, 1983: 55ff).
3. A classic critique of the behavioral assumptions of neoclassical economics is Sen (1977); see also Friedman (1996).
4. For standard treatises on these themes see Keohane (1984, 1989) and Martin (1999).
5. We follow the standard definition of institutions as 'a set of rules, formal or informal, that actors generally follow, whether for normative, cognitive, or material reasons, and organizations as durable entities with formally recognized members, whose rules also contribute to the institutions of the political economy' (Hall and Soskice 2001: 9; also North 1990: 3).
6. Admittedly, round numbers exercise a certain mystique. I take 1950 as the symbolic rather than real historical beginning of the postwar period, being formally the first year of peace following the 1945–49 bloody civil war. Historically more accurate – though numerically less elegant – candidates, could include 1945 (first year after Liberation), 1947 (year of the Truman Doctrine speech), or 1953 (end of the 1944–52 reconstruction period, beginning of stabilization and development).
7. South Korea, perhaps the archetype of the authoritarian developmental political economy, is summarized as comprising 'a highly bureaucratized, penetrating, and architectonic state; a state-dominated alliance of state and property owners for production and profits; and repressive social control of the working classes' (Kohli 1999: 128).

2 Regime Dependencies and the Political Economy of Postwar Economic Policies

1. Not only in Greece was anticommunism made a constituent element of the postwar regime. In France and Italy, for example, the US made Marshall aid conditional on the exclusion of communist parties from government (Eichengreen 1996: 109).
2. A panel study of 100 countries during 1960–95 concluded that improvements in the standard of living predict increases in democracy (Barro 1999).
3. Industrial production in 1945 was at 33 percent, production of cereals at 45 percent, and net national income at 31 percent of their 1939 levels (BoG 1978: 238ff). The economy reached its prewar levels of production only in 1950.
4. Britain emerged from the war as Greece's foreign 'protector' power until 1947, when unable to shoulder the financial cost of such a role it ceded control to the US.

5. These liberalization measures were necessitated by the severe distortions caused by the previous system of heavy import and monetary restrictions, which authorities lacked the resources to enforce. Combined with a highly overvalued drachma, these restrictions had led to an anomaly of multiple exchange rates (which were abolished with the exchange rate adjustment), a stagnation of exports, importers passing on the cost of import duties to price increases, and a widespread black market (BoG 1978: 389ff; Eliades 1954: 52ff).
6. The Spanish autarkic model of the 1950s was based on indiscriminate and inflationary ISI, which resulted in an appreciating real exchange rate, current account shortfalls, and loss of industrial competitiveness. In 1959 autarky was abandoned and the Franco regime subscribed to an open trade strategy launched with an orthodox stabilization plan that, among others, prohibited the monetization of government deficits and regulated the cheap credit provided to the private sector. Industrialization was inspired by French indicative planning. Government intervened through subsidies, tax alleviations, tariff advantages, and preferential lines of credit (Prados de la Escosura and Sanz 1996: 364ff).
7. The similarities were acknowledged by the protagonist of the 1953 reform, coordination minister Spyros Markezinis (Markezinis 1953: 13, 27). The 1953 reform was secretly formulated by a closed circle comprising the Greek ministers of coordination, trade, and finance, the BoG governor, former coordination minister Zolotas, two representatives of the US Mission in Greece, two US Embassy officials, and a representative of the Monetary Committee (Markezinis 1953: 14).
8. Such as the proponent of Soviet-type industrialization Batsis (1947/1977), and especially Professor Angelopoulos in the periodical *Nea Oikonomia*, echoing the 'structuralist' school of the 1950s and 1960s.
9. In 1965 the Center Union prime minister Georgios Papandreou was undercut by the throne and forced to resign amidst a crisis over who would control the National Defense Ministry. The acute political instability that resulted culminated in the 1967 military coup.
10. That was the strategy advanced by Professor Angelopoulos and *Nea Oikonomia* (see note 8).
11. Such was the strategy proposed by Varvaressos (1952). He questioned larger-scale industrialization on the grounds that it would entrench an externally dependent, monopolistic, and speculative industrial class. Instead, he proposed development based on agricultural reorganization and growth, the promotion of small, consumer-oriented enterprises to revitalize the periphery, and the development of housing as means for expanding productive employment.
12. Psalidopoulos (1990) and Karamessini (1994) follow this debate along the Keynesian–neoclassical axis.
13. I was first alerted to this aspect by Panos Kazakos.
14. After 1947 and through the 1950s, current budget deficits and public investment were financed by US aid and counterpart funds, which until 1957 covered over 75 percent of the total budget deficit. The total volume of US aid gradually declined after 1951–52, until by the end of the decade and into the 1960s it was mostly limited to alleviating the extraordinarily high defense budget (Freris 1986: 148–50).

15. In 1958 the communist-leaning United Democratic Left (EDA) emerged as the second largest party, with 25 percent of the popular vote.
16. Personal interview with ex-governor Zolotas.
17. The conservative-developmental strategy can be claimed to have allowed for a – deferred – egalitarian component drawing on Kuznets (1955). According to this analysis, inequality increases at the initial stages of development because economic growth is mostly concentrated in the urban centers, where high incomes coexist with high disparities. Ultimately, however, rising demand for industrial labor in urban centers causes wages to rise, and the low-paying rural sector to shrink in size, leading to a decline in inequality.
18. A world-leading shipping sector was also an important pillar of postwar economic growth.
19. The housing boom was enhanced by mass urbanization, and the wide fragmentation of small land property among the population given the absence of a large West-European-type landed aristocracy.
20. I owe this point to Pan Yotopoulos.
21. Average annual growth rate of private consumption between 1960 and 1973 was 6.6 compared to a 3.8 percent OECD average (OECD 1991; Greek figures from updated National Economy Ministry statistical series).
22. This state-centric interpretation of economic policies accords with the Greek legal and jurisprudential tradition being viewed as drawing on German positivism, regarding the state as both the source of rights and their delimiting authority. (Only since the 1980s and 1990s have the courts shifted towards French positivism, where the state is not only the source but also the guarantor of rights.) One can thus interpret the tolerance exhibited by the courts toward massive civil rights violations in the postwar decades also in terms of a jurisprudential and broader political culture (Pollis 1988: 57ff).
23. Currency Committee Act (1112/29.8.1959) for the extension of small loans to handicraft associations.

3 Policy Paradigms, Financial Intervention, and the Limits of Developmentalism

1. Later renamed the Ministry of National Economy.
2. During 1946–51 the Currency Committee also included as members one representative of the British and one of the US government. Its composition during the dictatorship was limited (apart from the BoG governor) to the national economy and the finance ministers, but after 1974 it was reinstated in its initial composition.
3. Open market operations – buying and selling government bonds – as an orthodox monetary instrument aims to influence the money supply or the market interest rates by affecting banking system liquidity.
4. That was the circle of Professor Angelopoulos and the periodical *Nea Oikonomia* (see Chapter 2, note 8).
5. The achievements of the developmental state model are far from uncontroverted, especially in the light of the post-1980s experience. Since the 1980s, a growing number of studies argued that Japan's industrial success was either ill-founded or occurred despite industrial policy and not because of it

(Porter et al. 2000). It could well be argued that Japan's deep and prolonged financial and economic crisis of the 1990s and early 2000s was worsened by those same features which had formed the basis of its postwar industrial model, that is intimate bank–industry relations and the industrial tradition of 'lifetime employment'. After Japan's stock market bubble burst, banks continued lending to favored firms that should have been allowed to go bankrupt, a fact which discouraged firms from cutting investment or employees as profits fell. During the bubble, firms depended almost entirely on banks, which in turn relied on shares and property as collateral for lending. That left banks completely exposed to falling asset prices. A more sober assessment, however, should boil down to knowing the difference between being developmental and being developed: Japan was very successful in engineering development through institutions such as MITI, but too reluctant to eradicate them as soon as their mission had been completed, by which time they had turned into a heavy liability.

6. Similar findings are more or less produced by later studies (Mouzelis 1978; Makrydimitris 1995; Spanou 1998; Sotiropoulos 1996, 2001; Pagoulatos 2001a).
7. This view has been championed by BoG officials (Zolotas 1965; Halikias 1976) but it has also been endorsed by nearly all other independent observers, including proponents of a more accelerated industrialization (Ellis 1964; Psilos 1964, 1968; Yannitsis 1988).
8. The Center Union Party of Georgios Papandreou refused to recognize the legitimacy of the 1961 conservative government under Constantine Karamanlis, denouncing it for widespread electoral fraud and violence. In 1965 the democratically elected G. Papandreou government was brought down in a parliamentary coup instigated by the throne.
9. In so far as development involves a sacrifice of present consumption and the deferral of societal welfare, regimes of the type that O'Donnell (1973) would identify as bureaucratic authoritarian may be claimed to have been well equipped to elicit (via unscrupulous ideological indoctrination or sheer coercion) compliance with the overbearing objectives of a nationalistic developmental project. On the other hand, this potential advantage is widely offset by the reduced ability of authoritarian regimes to obtain the cooperation of citizens at times of economic crises, their lower resilience during such crises (given the overlapping of 'procedural' and 'performance' legitimacy), and their overall limited incentives and access to information compared to democracies (Maravall 1995: 14–15). Overall the literature, especially in the 1980s and 1990s, has been cautious in drawing broader generalizations regarding the correlation between democracy and economic growth. Przeworski and Limongi (1993) and Maravall (1997) survey the literature on both sides and conclude on an agnostic tone. Either way, political authoritarianism is an inordinately heavy price to be paid for economic development.
10. For example, between 1950 and 1980, 11 governors alternated as CEOs of the National Bank, Greece's largest state-controlled bank, corresponding to an average tenure of little less than three years.
11. Ellis (1964: 293) provides examples.
12. Trade liberalization under the Association Agreement did not take effect before the 1970s. Greek industrial exports enjoyed free Community access

from 1968, and by 1975 two-thirds of EC exports entered Greece duty-free. In appreciation of the need to protect Greece's infant industries, import restrictions for a list of products manufactured in Greece (some 40 percent of Greek imports) would not vanish until 1984 (Tsoukalis 1981: 30ff).

13. Ellis (1964: 54–5) estimated that commercial bank commissions raised effective average lending rates from a nominal 10.5 to 14–15 percent.
14. Though some of the lending policies described earlier were certainly not conducive to systemic safety.
15. That is the National Bank and all specialized credit institutions with the exception of those belonging to the (privately owned until 1976) Commercial Bank group.

4 Crisis and Transition: Regime Change, Democratization, and the Decline of Developmentalism

1. Claims must be included on balance sheets if they have been acquired with 'hard cash'. Off-balance sheet operations include money management and dealing in over-the-counter markets for foreign exchange and financial derivatives.
2. In this book, the term 'globalization' is used in a loose sense, of a slightly higher order than 'internationalization', to refer to an (existing) globalization process rather than an (illusory) end-state of perfectly globalized markets (cf. Perraton et al. 1997).
3. Obstfeld and Taylor (1998) called it the 'open economy trilemma'.
4. Under the crawling peg, monetary authorities periodically changed the nominal exchange rate to defend the balance of payments in a way that amounted to a constant depreciation of the drachma.
5. The prevalence of Karamanlis's almost single-minded pursuit of EC membership on the government agenda vested any longer-term economic projects with a transitory nature, as economic policy orientation sought to align behind what was vaguely speculated to become (and versions varied) the new post-accession reality. On the other hand, there was a considerable degree of agnosticism regarding the specifics of an EC-oriented economic strategy (more industrial protection to confront the prospect of EEC competition, or less? A French, a German or a British model of state activism?). Combined with the yet (in the 1970s) nonexistent recent paradigm or generally acknowledged 'success story' of overcoming stagflation, such conditions did not help articulate a clear and viable economic strategy.
6. On ND Party and ideology see Pappas (1998, 2001) and Kalyvas (1998).
7. On PASOK Party and ideology see Spourdalakis (1988) and Puhle (2001).
8. During 1974–81 and in the first years of the Papandreou government, inequality and the level of poverty were reduced significantly, and roughly half of this improvement can be attributed to measures taken by PASOK (Tsakloglou 1997). However, the extensive borrowing of the 1980s only shifted the financial burden of this redistribution to the next generations.
9. The assertiveness of this remark should be moderated, however: the 1970s stagflation was a totally new international conjuncture.
10. It was an only apparent paradox that some of the economic policy protagonists of the Karamanlis governments of the 1970s – most notably BoG governor

Zolotas and coordination minister Papaligouras – were those same policy-makers of the predictatorial period whose economic policies had been far more conservative. One can understand the endorsement of more actively Keynesian and expansionist policies by these actors predominantly in terms of adaptation to the transformed postauthoritarian politico-economic environment, and their appreciation of the superior political necessity dictating such policies, as explained above. After all, eclecticism bordering on empiricism was always an active feature of the economic 'ideology' and practice of postwar governments.

11. By the mid-1980s the nationalized sector was large, state ownership amounting to 18 percent of total assets in textiles, 50 percent in fertilizers, 55 percent in cement, and 100 percent in shipbuilding, in addition to 100 percent of public utilities and transport (railway, urban, and air), and over 80 percent of the commercial banking system (Caloghirou et al. 1993: 81).
12. After the 1984 election of the centrist-liberal Constantine Mitsotakis as leader of the ND, the major opposition party reshaped its ideological profile into that of a modern, neoliberal-leaning center-right-wing party, adopting an aggressive antistatist, promarket political agenda. On the basis of that agenda the ND rose to power in April 1990, but market liberalization and privatization policies proved unpopular, and the ND, after returning to opposition in October 1993, was forced to temper its neoliberal profile with populist undertones.
13. Two largely overlapping expert committees were set up in 1980 (under the BoG and the Coordination Ministry respectively) to elaborate the financial reforms needed in view of Greece's accession to the EC. Their members, which included several representatives of the private banking sector, were mostly of a British or American academic and technocratic background. This was in stark distinction with the postwar period, when the European continent was a principal provider of BoG, governmental, and banking elites (Pagoulatos 2001c).
14. See Halikias (1976, 1978), Harissopoulos Committee (1981), and Courakis (1981).
15. Classical (as distinguished from neoclassical) in the way Keynes used the term in his *General Theory*.
16. The monetarist prescriptions drew on the classical theory of monetary neutrality. The idea that (even in the short run) money is neutral is founded on three simultaneous precepts: market-clearing (full price flexibility), rational expectations, and symmetric information (Lucas 1972, 1996).
17. The laissez-faire monetarist view has been confronted by the powerful argument that asymmetric information and adverse selection of risk make competitive pricing of credit prone to default since high interest rates are likely to attract high-risk loans. Credit rationing at below-equilibrium rates may therefore be the policy solution (Stiglitz 1989).
18. The main monetarist argument for the ineffectiveness of fiscal policy draws on a classical insight: a fiscal stimulus provided through tax cuts or deficit financing would fail to increase consumer demand, as people would raise their saving, expecting higher taxes in future. The rise of private saving would thus fully offset the stimulus (Barro 1989). The argument's elegance notwithstanding, it has not been supported by empirical evidence.

5 Central Bank, Government, and the Politics of Financial Liberalization

1. Some sections of this and Chapter 6 have appeared in Pagoulatos (2000a).
2. In terms of formal political independence, Grilli et al. (1991) ranked the BoG over the CBs of Britain, Portugal, Japan, Belgium, and New Zealand and at the same level as those of France and Spain (with Germany, the Netherlands, Switzerland, and the US having the highest degree of formal political independence), but in overall pre-1994 formal independence the BoG was outranked by all, save Portugal and New Zealand.
3. For example, the BoG's Economic Research Department, in the early 1990s, employed a tenured personnel of around 110 economists, nearly half of whom held a postgraduate degree; over 20 of them were PhDs, 9 out of 10 from American or British universities.
4. There is, however, a convincing argument that liberalization complicates effective monetary control. By allowing banks to market credit aggressively liberalization is usually accompanied by rapid growth of monetary aggregates, which in the interventionist regime were strictly controlled. At the same time the demand for money tends to become unstable, which makes it rather difficult to use monetary aggregates as indicators of the monetary stance. Excellent discussion is provided in Gibson and Tsakalotos (1994).
5. See Chapter 4, note 13.
6. An economist of the neo-Keynesian variant known as the structuralist school, Arsenis professed extensive economic state intervention and a policy of subordinating monetary policy to the goal of industrial and agricultural protection, restructuring, and development.
7. For Greece to qualify for its declared objective of joining the EMU in its second stage beginning in 2001 it should have completed two years inside the EMS without devaluing. In other words, Greece had to enter the EMS by the end of 1998, and had to do so, more or less, at the parity at which the drachma would enter the EMU. In March 1998, the government agreed with the EU that the drachma would enter the ERM with a central rate of GDR357 : ECU1, effectively a 12.1 percent devaluation. Subsequently, the authorities allowed the drachma to appreciate by as much as 9 percent against the central parity to counter inflationary pressure caused by large capital inflows. (Appreciation created expectations of drachma depreciation back to its central rate before EMU entry; this limited capital inflows.) During the Russian financial crisis, however, which generated downward speculation, the drachma fell back to an appreciation of 4 percent; but in February 1999 it was up 9 percent against its central euro parity of GDR353.11 : ECU1 in the ERM-II established at the launch of the EMU (Economist Intelligence Unit 1999: 33). The authorities initially anticipated they would allow the drachma to depreciate toward the central parity in the run-up to joining the EMU. But as its strength continued, and in an attempt to reduce the inflationary impact of the inevitable monetary loosening associated with the falling interest rates toward Eurozone levels, the drachma was finally revalued before entry, and was irrevocably fixed to the euro at 340.75.
8. Net capital inflows for portfolio investment rose from EUR 1433 m. in 1997 to a record EUR 10,700 m. in 1998.

9. Initially, the money market was exclusively an interbank market of a very restricted form, essentially an overnight market. A secondary market for the sale of government securities to the nonbank public (mostly under repurchase agreements) began to develop after 1986. Until 1996 the Treasury issued only short-term securities with a maturity of less than a year, on which the yield was fixed administratively, and floating-rate three-, five- and seven-year notes, which paid a fixed-rate premium over the rate of inflation. Short-term debt had the disadvantage of increasing the interest servicing substantially, since competitive interest rates had to be paid after 1994. Following the Asian financial crisis in the last quarter of 1997, the government began to auction its debt, letting the market set the rate. Since 1996 it began to issue fixed-rate bonds, starting with three-year bonds, and in 1998 it issued the first 15-year bond.
10. That is, the volume of household deposits exceeded that of credit.
11. I owe this point to Heather Gibson.

6 Banks and Socioeconomic Interests: Winners and Losers of Financial Reform

1. These remarks refer mainly to the period of the 1980s up to the early 1990s; banking became significantly more liberalized and competitive following deregulation, and especially from the second half of the 1990s.
2. On the details of EMU entry, see Chapter 5, note 7.
3. Salary and wage-earners in 1990 represented just over 51 percent of the total economically active population, as opposed to 82 percent EC average and 70 percent in the next closest country (Portugal). Of the remaining 49 percent, 3 percent were employers and 46 percent self-employed and nonpaid assisting family members, a percentage unrivaled by any developed country.
4. In 1988, only 1 percent of total manufacturing firms employed over 50 people, and 85 percent listed between 0 and 4 persons (basically self-employed or family business units).
5. Information for this chapter was collected through confidential interviews with officials of the BoG and collective associations.
6. Post-1974 and until the end of the 1980s industrial relations were highly adversarial, and governments systematically sought to appoint friendly trade union leaderships by referring intra- and inter-union conflicts to the courts. Under the officially legalistic guise of centralized bargaining until the end of the 1980s, decentralized company-level bargaining operated despite being legally proscribed. After 1990, collective bargaining was liberalized, and consecutive two-year National General Collective Agreements were signed, accepting wage restraint, and expanding to issues such as vocational training, health and safety at work, pay-productivity schemes, and antiunemployment measures. Most collective agreements in the 1990s took place at industry and company level, with traditional occupational agreements decreasing. With the part exception of unions of – sheltered – public utilities subject to privatization, there was a considerable decline of labor militancy in the 1990s. After 1989 and into the 1990s there were strong and steadily increasing signs of independence of the General Confederation of Greek

Labor (GSEE) leadership from government. As the social partners' autonomous role gained significant momentum after 1990, a number of bipartite bodies and processes were institutionalized, as well as a tripartite Economic and Social Committee to promote social dialogue and tripartite collaboration (Ioannou 1989, 1996).

7. Contrary to Greek and Portuguese authoritarianism collapsing under conditions of disastrous foreign policy failure (Cyprus in the Greek case, Angola and Mozambique in that of Portugal), Spain's was a case of transition in continuity, prompted by a crisis of obsolescence and not failure (Alvarez-Miranda 1996). This meant that in Spain the new democratic elites felt a strong need – much stronger than in Greece or Portugal – for a symbolic rupture with the country's Franquist past (Díaz 1998: 32–3). This was indeed demonstrated in the broad embracing of Europeanization (in contradistinction to the Franquist isolationist tradition) by a wider range of political forces than in Greece.
8. In the early PASOK period, Papandreou denounced, among others, European social democracy as the 'genteel mask of capitalism' (Verney 1996).

7 The New Political Economy of Financial Integration, Globalization, and the EMU

1. Many firms and investors in the bull market days borrowed funds for the purchase of stock, whose fallen price subsequently left them in the red and the banks with a volume of bad loans. The Greek banking system in 2001–2 also confronted such a problem of yet unidentifiable proportions.
2. Such was the example of the recession in Britain or Sweden in the early 1990s, following a large rise in private sector debt in the late 1980s, but also probably the US too in the early 2000s, following the 'roaring' late 1990s.
3. A series of regulatory reforms of the Greek capital market framework in the 1990s underlies this development. Apart from the establishment of the Capital Market Committee, successive reforms facilitated underwriting services and initial public offerings, allowed pension and insurance funds to invest in stock, streamlined financial and capital market transactions, allowed government to issue and sell securities convertible into equity, allowed the introduction of new financial institutions, and so on.
4. In the single European financial market the exact function and coordination of banking supervision remain an open issue. The EU has not as yet assigned the prudential supervision of credit institutions to the ECB.
5. Except for 1988–90.
6. For example, during a 1994 speculative attack on the drachma, the NBG incurred significant losses assisting the BoG and government in defending the national currency.
7. On the other hand, one may argue, an economic slowdown tends to increase the volume of savings directed to banks in the form of short-term deposits (instead of other types of investment) which allows deposit rates to drop, raising the banks' net interest revenue.
8. The minority view holds that, by at least some measures, capital market integration is no higher now than it was in the nineteenth century (Obstfeld and Taylor 1998; Krasner 1999: 220ff).

9. In 2000, 33 out of the 45 members of the General Council of the General Confederation of Greek Labor (GSEE) came from the wider public sector. This may be claimed to erode the representational legitimacy of the GSEE, especially if combined with the fact that private sector unionism does not exceed 15 percent of private sector employees, total trade union density in Greece estimated at 24 percent in 1995, a 34 percent fall from its 1985 levels (International Labor Organization data, cited in *To Vima*, 28 July 2001).
10. After a 2001 law, SCB and public enterprise administrations would be elected by their General Assembly of shareholders (instead of being appointed by the government) to which the administrations would be fully accountable for their policies (instead of being subject to government authorization and control).
11. On this process in Southern Europe, see Puhle (2001) and Pappas (2001). Among the political-theory and ideological forerunners of the centripetal trend, Gray (1993) and Giddens (1994) have been influential.
12. This period was marked by the ND leadership of Constantine Mitsotakis, a pragmatic politician of centrist, liberal origins, who encouraged neoliberal party proclamations and policies seeking to capitalize on the widespread public dissatisfaction with poor economic performance, an extensive state sector, and widespread (in 1988–89) phenomena of government corruption.
13. For a brief period between 1993 and 1996, the discourse of the ND Party in opposition could even be characterized as nationalistic and populist.
14. At the same time, societal opening and cultural globalization obfuscate the left–right division by generating new tensions and debates that do not adhere to the vertical left–right partisanship. A range of new issues have entered the public agenda, issues of civic or cultural liberalism that cut across the party system traditionally structured along the left–right axis: national identity versus cultural cosmopolitanism, civil liberties, immigration policy, separation of church and state, foreign and Balkan policy. Over such issues the two main parties in Greece seem to be internally and horizontally divided, between a liberally minded, extrovert, Europeanist and reformist constituent on the one side, and a socially conservative, economically protectionist, more hostile toward supranational integration, nationalistic-leaning constituent on the other. Diamandouros (1994) has elegantly conceptualized this horizontal cleavage cutting across the party-political domains of Left and Right as one between a 'reformist' versus an 'underdog' culture. With the help of an electoral system of reinforced proportional representation, horizontal dualism becomes absorbed by vertical partisan dualism, as both main catch-all parties (PASOK and ND) rush to suppress the intensity of the horizontal divisions by dodging ideological pronouncements and hedging policy practices, and by accommodating voices and followers of both ideologico-cultural streams.
15. During the 1990s, only the orthodox Communist Party (KKE) sustained constant parliamentary representation (usually ranging around 5–6 percent of the national vote). The second major party of the Left, the Coalition of the Left (SYN), ranging closer to the 3 percent threshold, was represented in Parliament after all national elections but one during the 1990s. Other small parties, splinter groups from the ND (in the center-right) and PASOK (to its populist left) have been short-lived.

16. This trend is not offset by a stake of the rapidly expanding number of mortgage, business, and consumer borrowers in higher inflation rates which reduce the real value of their debt. Though this was the case before deregulation, in a liberalized financial system banks are able and flexible (with few exceptions) to adjust their credit rates to take account of inflation.
17. The debate on rational behavior is long and intense. See Elster (1984), Przeworski (1991), essays contained in Monroe (1991) and Friedman (1996), and Baumgartner and Leech (1998).

8 State, Finance, and Growth: Beyond the New Political Economy

1. The argument on the 'stabilization state' draws on Pagoulatos (1999c, 2000c). Dyson (2000) employs the same term.
2. The Stability and Growth Pact requires a balanced budget or surplus in the medium term. This target has been interpreted as the structural deficit, which will allow automatic stabilizers to work in a recession. Thus, if all Eurozone countries had reached the medium-term target, they could stabilize the economy by using fiscal policy while respecting the Stability and Growth Pact in a normal recession. (If the recession is more severe, the penalty envisaged in the Stability and Growth Pact does not apply anyway.) However, most member states have not reached this level of fiscal consolidation as yet (Artis and Buti 2000).
3. Article 3a of the Treaty on the EU specifies the guiding principles of economic policy as 'stable prices, sound public finances and monetary conditions, and a sustainable balance of payments'.
4. On monetary targeting versus inflation targeting, see Bernanke et al. (1998). A chief argument against money supply targeting is that financial market liberalization and innovation have rendered M3 an unreliable indicator. Over the 1990s a number of CBs (including New Zealand, UK, Canada, Australia, Sweden, Finland, Spain, and Greece) shifted to inflation targeting. Germany remained the only major EU country committed to monetary targeting. Monetary targets had been set in Greece since 1979 (two years after Spain and Portugal), but they were usually grossly overshot until eventually, into the 1990s, they were abandoned implicitly for exchange rate targeting, which (in the few years until full EMU entry) evolved into a loose form of inflation targeting.
5. The ECB has specified that price stability is to be pursued in the medium term, meaning that deviations from the inflation target due to exogenous disturbances or other factors will not have to be directly confronted by monetary policy.
6. The Federal Reserve Reform Act of 1977 requires the Fed to 'promote effectively the goals of maximum employment, stable prices and moderate long-term interest rates' (Palley 1998: 124). In contrast, the ECB has the primary objective of maintaining price stability and supporting the general economic framework for growth and employment only to the extent that this does not compromise price stability (ESCB Statute, article 2).
7. As Friedman (1968: 7) argued, 'low interest rates are a sign that monetary policy *has been* tight…; high interest rates are a sign that monetary policy

has been easy.... Paradoxically, the monetary authority could assure low nominal rates of interest – but to do so it would have to start out in what seems like the opposite direction, by engaging in a deflationary monetary policy' [emphasis in the original].

8. In 1999 overall productivity in Greece was 59 percent of the EU average, with manufacturing productivity being the lowest (42 percent). Only financial services and business activities productivity was above the EU average (101 percent) (European Commission 2000b: 98).
9. Decreases compared to the previously controlled range of state instruments, but is certainly not abolished. The literally 'powerless' state may indeed be a myth (Weiss 1998; cf. Wade 1990, 1996), but this is not to say that its power has not been significantly eroded under the forces of world economic integration.
10. Lowi's (1964) classic typology distinguishes between distributive, regulatory, and redistributive policies. He views distributive policies as characterized by 'the ease with which they can be disaggregated and dispensed unit by small unit', 'highly individualized decisions that only by accumulation can be called a policy', a virtual synonym for 'patronage'. Regulatory policies, on the other hand, are also specific and individual in their impact, but incapable of the disaggregation typical of distributive policies. Regulatory decisions cumulate among all the individuals affected by the law in roughly the same way, and are cumulative largely along sectoral lines. Finally, redistributive policies are like regulatory policies in that they involve relations among broad categories of individuals, but there the categories of impact are much broader, approaching social classes (contra Greenberg et al. 1977).
11. Crisis frequency since 1973 has been double that of the Bretton Woods and classical gold standard periods, and matched only by the 1920s and 1930s (Bordo et al. 2001).
12. Measures could entail: the imposition of minimum stay or noninterest bearing reserve requirements upon short-term 'hot' money inflows, or a Tobin transaction tax to 'throw sand to the wheels' of short-term financial capital. Any such measures of course would only make sense if imposed at a global level, otherwise capital would move to countries opting out of the tax.

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