Yannis Stournaras: The birth of inter-war central banks - building a new monetary order

Welcome remarks by Mr Yannis Stournaras, Governor of the Bank of Greece, at the Bank of Greece Economic History Conference "The birth of inter-war central banks: building a new monetary order", Athens, 2 November 2018.

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Ladies and Gentlemen,

It is my great pleasure to welcome you to this international conference, devoted to the *Birth of inter-war central banks*, organised by the Bank of Greece, itself one of the offspring of this institutionally fertile period.

It was 1926 when the Greek government first approached the Financial Committee of the League of Nations, seeking its help to settle old debts and raise a new loan on international markets. The money was needed quite urgently. After a decade of wars, which had culminated in the abortive Asia Minor campaign and the forced population exchange of 1922, the Greek economy needed an injection of capital to heal its wounds, settle its refugees and build up its economic infrastructure. Yet its international credit standing lay in tatters; wartime obligations remained unsettled; expenditures far outstripped public revenues; inflation was soaring, and the drachma had lost more than 90% of its value.

The League of Nations, relying heavily on input from the Bank of England and the Treasury, promptly dispatched a group of experts to study the Greek situation and report back to Geneva. Their report was published in 1927. Along the inevitable admonitions about fiscal prudence and administrative reform, the foreign experts highlighted the absence of a modern central bank: an institution charged solely with the conduct of monetary policy, free from political or business interference. The sole note-issuing authority at the time was the National Bank of Greece (or *Ethniki*, as most in this audience know her). But *Ethniki* also happened to be the country's largest commercial bank, with strong ties to business and politics. If Greece were to re-join the gold standard and thus return to the fold of 'stable' countries, the National Bank would have to give up its commercial operations and focus exclusively on central banking – or so the League argued, at least.

The report was not well received. Neither by Greek politicians, who lamented foreign interference in the country's domestic affairs; nor by the National Bank itself, which faced the prospect of giving up its most profitable line of business. After several months of acrimonious negotiations, a compromise was finally struck: the National Bank would maintain its commercial activities and cede responsibility for monetary policy – along with all corresponding assets and liabilities – to a new institution, which would simply be called the *Bank of Greece*.

And so it was. With a League of Nations Protocol as its birth certificate, the new bank began its operations in the spring of 1928. The product of an unpalatable deal to obtain much needed foreign credit, the bank was greeted with scepticism, if not outright animosity at first. As Horace Finlayson, the British consultant appointed to monitor the agreement in Athens would explain in a letter to Sir Otto Niemeyer, the Director of the Bank of England:

"the private banks still assume an attitude of sullen hostility […]. This is bound to continue so long as the Bank of Greece continues to work in a position of semi-complete isolation. For the time being, it is nobody's child and its real activities are little more than those of a rather pretentious exchange-shop."[1]

Those lines were written in October 1928. A year later, stock markets in the City of London and

Wall Street would crash, heralding a series of events that would bring inter-war central bank cooperation and the gold standard crashing down with them. Greece's stabilisation proved short-lived: by 1932, the country was off gold and back in default. As a newly born orphan, the Bank thus took its first steps in the years of the Great Depression. It spent its early childhood navigating the treacherous waters of the thirties, tangled in the web of barter agreements and foreign exchange controls that had become the norm.

Interestingly enough, it was these very dire circumstances that helped transform the "rather pretentious exchange-shop" into a powerful agent of economic policy. On the one hand, the advent of the crisis forced commercial banks to come knocking to the door of their lender of last resort. On the other, the sudden retreat of the economic liberalism signalled the triumph of discretion over automaticity: as economic policy became more interventionist, the authority of the Bank of Greece expanded. On the eve of the Second World War, the orphan had emerged as a fully-fledged banking institution, albeit one closer to the state than originally envisaged.

The war brought further loss of independence, along with crippling hyperinflation, before stability was gradually restored in the fifties and sixties. Yet through these many trials – if not because of them – the Bank of Greece gradually regained its independence and earned its place at the heart of the financial system, only to become one of the principal pillars of economic stability in the country. This was the very role it was called upon to confirm during the recent financial crisis, whilst maintaining its independence from political or business interference.

Today, safeguarding the independence of central banks from undue political and business influence is once again an issue that draws much attention. Defending the independence of Central Banks is not only an issue of price stability but also long-term economic sustainability and financial stability. I am sure that all those here today participating in the Conference are keenly aware and sensitive to this issue.

Such had been the founding principles of the Bank of Greece back in 1928. 90 years have passed since those principles were first laid down. The Bank of Greece is no longer young. More importantly, however, it is no longer an orphan – despite the occasional attempts to make it appear so. It belongs to a large European family with strong institutional ties and a common purpose.

On this, the 90th anniversary since we first opened our doors to the public, we are revisiting our past and contemplating our future. But we have chosen to do this through a comparative and international lens.

For the Greek experience was hardly unique: the 1920s and 1930s witnessed the creation of a string of new central banks, across several countries. More often than not, their birth was midwifed by 'money doctors' from the Bank of England, the Banque de France or the Federal Reserve: people such as Niemeyer, Siepmann or Strakosh, whose names litter the archives of many inter-war central banks, including that of the Bank of Greece. Some of the new institutions were established to exorcise wartime inflation and restore access to credit; others were born out of the dissolution of empires, or the weakening of ties to imperial colonies; all of them reflected an attempt to 'return to normalcy', by rebuilding an international monetary order and restoring cooperation in the aftermath of a devastating world war.

This 'return to normalcy' proved an illusion. The Great Depression soon challenged the viability of this order and forced many of the new-born institutions to re-evaluate their priorities and their relationship to the state and with each other. The questions facing each one were similar; the answers they gave – less so. Over the next two days, fifteen prominent scholars from eleven countries will present their work on different institutional or national experiences in the inter-war years; I thank them for being here and look forward to listening to their contributions.

I would also like to thank the Centre for Culture, Research and Documentation of the Bank of

Greece, and its Director, Mr. Panagiotis Panagakis. Our economic historian and Scientific Advisor to the Historical Archive, Mr. Andreas Kakridis, who is the heart and soul of the conference. The staff at my Office, our valuable Communication Section, the security officers, as well as numerous other colleagues at the Bank of Greece, without whom this conference would not be possible.

The Bank of Greece is committed to promoting historical research, particularly research in economic history. Yet the past is most interesting when it informs our understanding of the present and future. Policy reactions to the recent financial crisis were shaped by perceptions – and often misperceptions – of the past, particularly the inter-war years. In this context, I am also pleased to welcome several of my esteemed colleagues from other European central banks, who are joining us for this conference. Their presence honours us and underlines the connection to the present and future of central banking. We will have much more time to talk about this later today, during our panel discussion.

But first, let us turn our gaze to the past and start our journey through the inter-war years. I wish everyone a fruitful conference and look forward to stimulating discussions!

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[1] Page 8 of memorandum by H. Finlayson, Relations between the State and the Central Bank of issue, dated 10.10.1928, as found in the Bank of England Archive, Niemeyer Papers, OV9-206/2.