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# Alternative Financial Regimes and Development Banks in Greece 1963-2002: What Have We Learned?

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## Summary

The recent global financial crisis spurred a renewed interest in development banking because of the countercyclical role many of these banks assumed during the crisis. However, there is no agreement in the literature concerning the nature and efficiency of development banks. This paper focuses on their role as agents of institutional change and the concomitant need for their internal transformation as institutional development goes on. The question posed is how development banks' internal transformation from the traditional development banking model to a modern investment banking model is affected by the political decision on the prevailing financial regime. The paper addresses this question by examining the relationship between development banks and alternative financial regimes in Greece during the period 1963-2002. Useful insights concerning the role of government policy in development banking are drawn.


**Key words:** Development Banks, Financial Regimes, Institutional Change, Greek Economy

**JEL Classification:** B52, G21, N24

## 1. Introduction

One of the consequences of the recent global financial crisis is a renewed interest in development banking, not least because of the countercyclical role many national development banks assumed as financial turbulence unfolded (Lazzarini, Musacchio, Bandeira-de-Mello and Marcon, 2015; De Luna-Martínez and Vicente, 2012; Gutierrez, Rudolph, Homa and Blanco Beneit, 2011; Smallridge and De Olloqui, 2011). Yet, development banking seems to be caught between a rock and a hard place as far as its efficiency and functionality for economic and financial development is concerned. Fry (1995:362-365) stresses development banks' inability to mobilize domestic savings and their poor performance in allocating capital effectively to productive investments. On the contrary, Studart (1995:75) and Chang and Grabel (2005) consider development banks as "compensating mechanisms" to overcome the problem of thin capital markets, according to the idea that a financial system is "functional" as long as it accommodates the financing needs of economic development.

Although there is still no generally accepted definition of development banks (Yeyati, Micco & Panizza, 2004) development banking, and its distinctive characteristics with respect to commercial banking, dates back to 19th century when commercial banks were reluctant to grant long-term loans because of the higher risk

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of this kind of financing and the lack of expertise to assess this risk (Armendáriz de Aghion, 1999). Hence, banks designed to promote economic development such as the Crédit Mobilier in France (Cameron, 1953) or the German Universal Banks (Gerschenkron, 1962:10-11) became the prototypes of the proliferation of development banks in the 20th century. Moreover, the Crédit Mobilier played a special role in promoting financial development, along with industrial development, by transmitting the organizational skills and knowledge it acquired to other European banks (Armendáriz de Aghion, 1999). However, commercial banks did not assume a special role for economic and financial development measured in terms of socioeconomic returns, as was the case for development banks (Bruck, 1998).

Besides their long-term loans, development banks acted as agents of institutional and financial development by offering a variety of services to their clients such as leasing, factoring and securitization services along with their training programs and advisory services. They aimed, as well, at the transformation of existing conditions in an economy through the development of skills and the acquisition of habits and attitudes that would change the way of thinking of the local business community. (De Luna-Martínez and Vicente, 2012; Diamond, 1982c). In addition, development banks were meant to transform themselves and adapt to the changing environment by diversifying their activity towards "universal banking" as financial development went on (Bruck, 1998; Diamond, 1982b). Hence, there was a need for a continuing reevaluation and reorientation of banks' goals based on their growing experience and the evolving national policy objectives (Diamond, 1982a).

We can think of incremental institutional change as the offspring of interaction between the institutional framework of a society on the one hand, and the purposeful action of agents given their perceptions and beliefs, or alternatively, of "organizations as behavioral entities in their own right" on the other hand (North, 2005: viii, 26, 59; North, 1990:73). In this theoretical framework, development banks can be conceived as purposeful entities/organizations whose dynamic nature and transformation *defines* them as reflections of the financial system's development between two financial regimes: repression and liberalization.

However, government policy is crucial in this context since it is the one that decides the long-run viability of financial institutions (North and Shirley, 2008) by setting up the matrix of motives and restrictions in which development banks operate. Hence, the question posed by this paper: How is development banks' internal transformation, from the traditional development banking model to a modern investment banking model, affected by the political decision on the prevailing financial regime? The paper studies the historical example of Greek development banks during the period 1963 – 2002. It is found that changing government policy concerning the preferred financial regime became the ultimate constraint and risk factor which these banks faced. As the financial regime changed from financial repression to financial liberalization, government ownership of a development bank was negatively correlated to its financial viability whilst the closer the control of the government on a development bank the less successful was its transformation.

The argument is presented in the remaining sections of the paper. Section 2 describes the phases of economic and institutional development in the post-war Greek economy. In the context of this periodisation, Section 3 discerns the different patterns of internal transformation of development banks and its success or failure. Finally, Section 4 concludes.

## 2. Alternative Financial Regimes in the post-War Greek Economy

During the post-war period the Greek economy was characterized by a "great cycle" (Drakatos, 1997) which can be decomposed as follows:

i) A phase of "reconstruction" (1945-1952), characterized by a growing demand for economic stabilization and reorganization of production. In 1946, a Monetary Committee was established with the mandate to control the money issue. The Monetary Committee succeeded in curbing inflation and abating monetary instability by 1952.

ii) A "preparation" phase (1953-1956) characterized mainly by the devaluation of 1953, in order to support competitiveness along with a rise in domestic savings in the form of bank deposits as a consequence of the established confidence in currency. Incentives to boost foreign direct investment (LD 2687/1953) and a new incomes tax law (LD 3223/1955) were attempts to modernize the domestic institutional structure.

iii) A remarkable period of development 1957-1972, with emphasis on industrial development and especially in sectors such as aluminum, metal industry, shipyards, petrochemicals and cement. During this period, domestic firms became familiar with foreign know-how especially in management techniques, while macroeconomic stability was entrenched in the context of international monetary stability. In1961, Greece signed a historic association agreement with the EEC. An important breakthrough for institutional development was the establishment of three development banks: the Hellenic Bank of Industrial Development (ETBA), the National Investment Bank of Industrial Development (ETEBA) and the Investment Bank (TE).

iv) The ensuing period 1973-1980 marked a turning point, with two international oil crises in 1973 and 1979 and the meltdown of the Bretton Woods regime. The return of inflation that reached levels ranging from 15.5% in 1973 to 24.9% in 1980, along with growing uncertainty and instability, hurt entrepreneurial activity, investment demand and hence, GDP growth. Despite all these, Greece entered the European Economic Community in 1981 as its 10th member.

v) Eventually, the country passed through a phase of recession (1981-1995) characterized by great macroeconomic imbalances and deindustrialization, especially during the stagflation period 1981-1985, in spite of a short-lived stabilization programme in 1986-87. The time span 1991-1994 was a period of transition from high to moderate inflation rates which paved the way for further disinflation and correction of macroeconomic imbalances until Greece's accession to the Eurozone on the 1/1/2001 (Garganas and Tavlas, 2001).

The choice over the financial regime as the economy was passing through this "great cycle" was dictated by the anxiety of the Greek polity to change the institutional matrix towards the western political and economic paradigm. Pagoulatos (2003:39) states that government's developmental initiatives in the 1950s and 1960s were strongly influenced by the need to defend the Western political and economic structures in the context of the cold war. The model championed by the Governor of the Bank of Greece, Xenophon Zolotas, for the period 1955 – 1967 was based on the idea of mixing price stability and bank-financed industrialization with the helping hand of the government. Monetary stability was important as Greek economic development depended on an export oriented growth rather than increased domestic consumption (Psalidopoulos, 1990:52-53). At the centre of a financial repression regime was a credit policy used at the same time for developmental reasons and for maintaining stable prices by means of quantitative controls on credit and of special bank reserve requirements. Credit rationing was used as a means to limit credit expansion whenever price stability was threatened by excessive liquidity (Pagoulatos, 2003:32-33). The Monetary Committee decided on the economic sectors that should be granted preferential credit according to prescribed percentages, the rates of interest charged, the terms of loans, the procedures that should be followed by banks and the collateral that should be demanded depending on the type of loan (Halikias, 1978:27-29).

However, the dominant feature of the Greek financial structure of that era was a very thin capital market along with an oligopolistic organization of the banking system, predominated by two major commercial banks, the National Bank of Greece and the Commercial Bank of Greece (Psilos, 1964:186; Kostis, 1997:91). Behind the reluctance of large family-owned firms to go public or the inability of small firms to access the capital market, lay institutional shortfalls such as the inadequacies of Greek corporate law to protect shareholders' interests and the lack of competition in the banking industry, all of which resulted in the paradox of excess supply of savings coupled with high cost of capital (Psilos, 1964:246-251). These features that were related to capital market underdevelopment underpinned the justification for state intervention, to channel these funds to uses conducive to economic development through a complex system of rules and controls.

After the oil crises of the early 1970s and the ensuing international economic turbulence and monetary instability, the financial repression regime could no longer guarantee the price stability-economic development policy mix of the 1960s. Although this new inflationary monetary regime prevailed until 1990 (Garganas and Tavlas, 2001), ideas and policies changed gradually from 1982 and especially from 1987 onwards, when financial liberalization proper came into effect. The two major studies of the Greek banking system prepared by the Harissopoulos Committee (1979) and the Karatzas Committee (1987) indicate the policy change under the pressure of developments such as the accession of Greece to the European Community in 1981 and the 1992 milestone of European Market integration. Financial deregulation was concluded in 1995 while an important institutional resolution was the declaration of the Central Bank independence in December 1997, with the specific mandate to pursue price stability (Garganas and Tavlas, 2001). Social groups' (lobby) pressures played a minor role in this change of government policy while the contribution of organizations such as the Bank of Greece was crucial. The Greek state itself was transformed from a "developmental state" into a "stabilization state" in the sense of prioritizing macroeconomic stability over development (Pagoulatos, 2003:160, 203-205).

Based on this historical account of the economic and institutional developments in the post-war Greek economy, this paper proposes the division of the time period from 1962 to 2002 in three sub-periods. According to Table 1 below, the first sub-period (1962-1973) extends over the years of high growth of the Greek economy until the early 1970s and includes a host of initiatives towards both the industrialization of the economy and its financial development. However, the prevailing financial regime during this sub-period was that of financial repression. The second sub-period (1974-1986), which is still characterized by financial repression, is a period of crisis and stagflation and spans from the first oil crisis till the mid-1980s. In this period, development banks were called on to uphold the old industrialization model by assuming the responsibility of rescuing and reorganizing unsuccessful firms. Finally, the last sub-period (1987-2002) was a period of financial liberalization, gradual stabilization and disinflation in which development banks had to assume the new task of reorganizing themselves in a changing financial environment.

*Table 1. Periodisation of economic and institutional development in Greece 1962-2002*

| Time Period | 1962 – 1973 | 1974 – 1986 | 1987 – 2002 |
|---|---|---|---|
| Economic development | High growth rates, macroeconomic stability | Crisis, stagflation | Gradual stabilization, disinflation |
| Institutional framework | Financial repression | Financial repression | Financial deregulation |

*Source: Author's categorization*

The above periodisation can be justified by looking at the structural breaks in the evolution of real GDP data as depicted in Figure 1. There is an evident fall in economic activity in 1974 though real GDP seems to keep rising after this episode until 1979, the second oil crisis. Then a fluctuation follows until 1987 when a new rising trend sets out.

However, if we look at real GDP growth rates the distinction between the three proposed sub-periods becomes clearer. As Figure 2 indicates, fluctuation of GDP growth rates in the region of positive values is characteristic for the period before 1974. This is surely not the case for the subsequent period at least until the late 1980s. Although, there are some values in the negative territory in the early 1990s as well, indicating a fall in growth rates, this decline reverses quickly and a clear pattern of positive and rising growth rates emerges.

A clear distinct pattern in terms of average growth rates among the three sub-periods is corroborated by the summary statistics depicted in Table 2. The period up to 1973 is

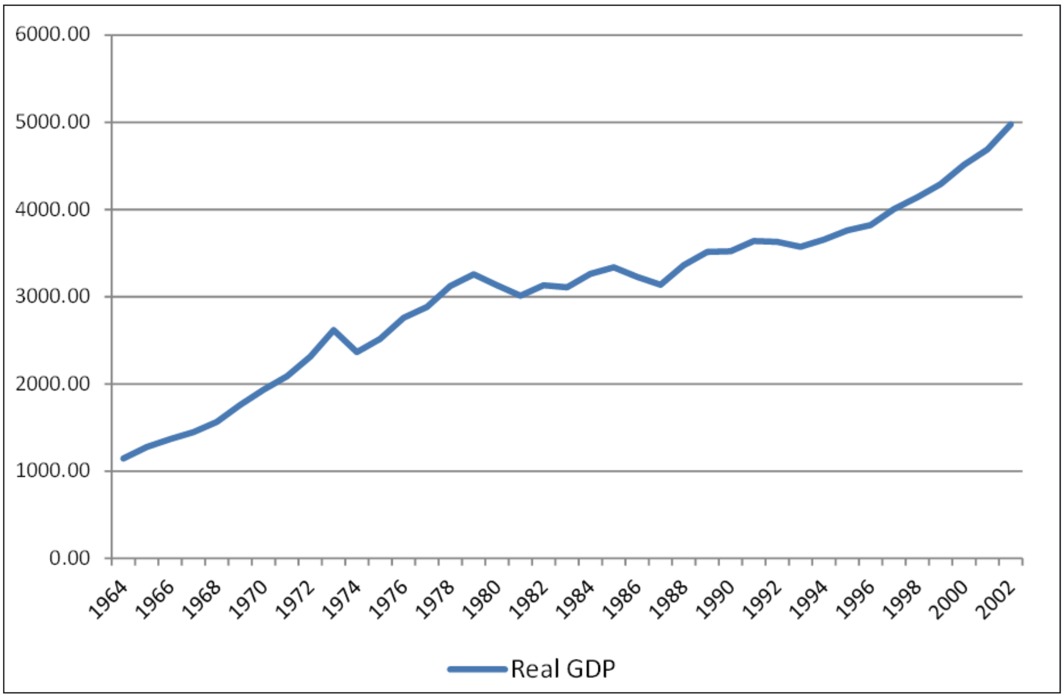


*Fig. 1. Greek GDP (Constant 1982 Prices)*

*Source: Author's Calculations and Ministry of National Economy (2001, 2002)*

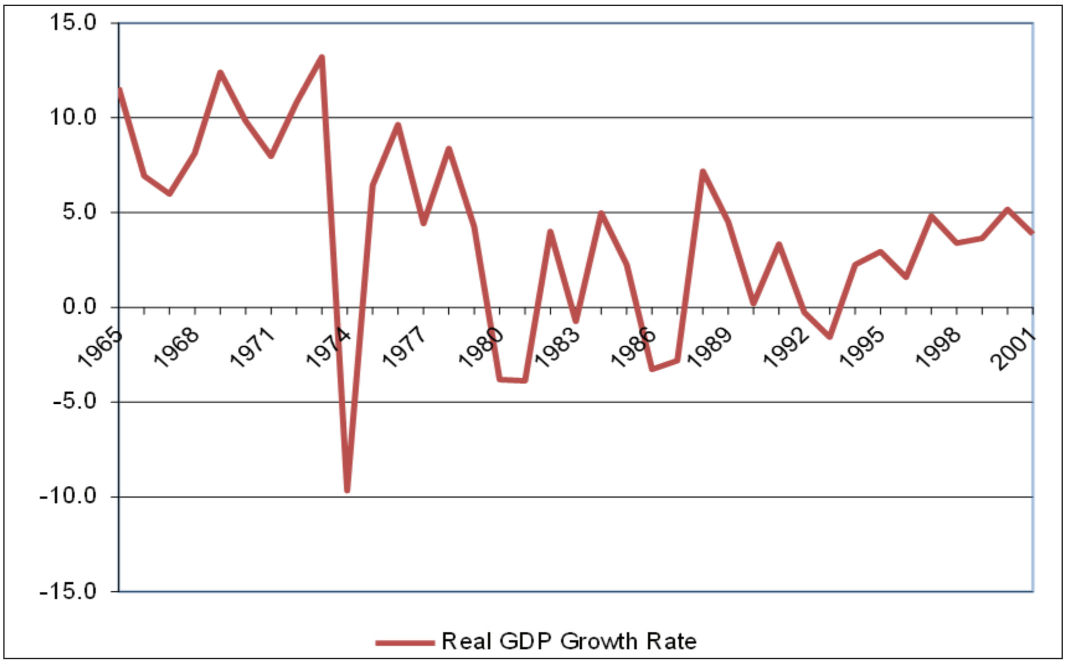


*Fig. 2. Real GDP Growth Rate*
*Source: Author's Calculations and Ministry of National Economy (2001, 2002)*

clearly the high-growth period of the post-war Greek economy. The second period 1974-1986 is characterized by both a sharp decline in average growth and a much larger variability around this mean value. Finally, the last period 1987-2001 seems to depict a stabilization of the economy around an average growth rate which is higher than the crisis years but much lower than the 1965-1973 period. Besides, this last sub-period coincides with the change in the financial regime from financial repression to financial liberalization.

*Table 2: Real GDP Growth Rate: Summary Statistics*

| | 1965- 1973 | 1974-1986 | 1987-2001 |
|---|---|---|---|
| Mean | 9.64 | 1.77 | 2.55 |
| Median | 9.80 | 4.00 | 3.30 |
| Std. Dev. | 2.53 | 5.64 | 2.71 |
| Min | 6.00 | -9.70 | -2.80 |
| Max | 13.20 | 9.60 | 7.20 |

*Source: Author's Calculations and Ministry of National Economy (2001, 2002)*

The above periodisation in economic and institutional development implies the role of development banks as agents of *incremental* change in the sense of North (1990) in the Greek economy, i.e. of a blend of deliberate (formal) and evolutionary (informal) rules changes (Kingston and Caballero, 2009). However, it is not clear how government policy and the prevailing financial regime affected development banks' business model. This interaction between government policies and development banks' business model is analyzed in the next section in the context of the three-period classification of Greek economic and institutional development.

## 3. Development Banks and Financial Regimes in Greece 1963-2002: Patterns of Institutional Transformation

The three Greek Development Banks, ETBA, ETEBA and TE, which were established during the period 1962-64 had as major objectives the facilitation of industrial development, the appraisal and support of investment and the development of the capital market (Xanthakis, 1995:177-178). During their operation, development banks extended on average 30-40% of total long term loans offered by the banking system to Greek firms (Karatzas Committee, 1987:60). The state-owned ETBA was the dominant development bank of the country as its long-term financing ranged by some estimates between 64-70% (Xanthakis, 1995: 179) of the total lending extended by development banks. On the other hand, ETBA disregarded more often than not the pure financial return of projects sponsored by the government placing more emphasis on their socioeconomic returns (Xanthakis, 1995:179), perhaps because its management was more vulnerable than the other two banks to political pressures (Halikias, 1978: 246-247).

The change of financial regime during the 1980s reflected the significant role of development banking in institutional and financial development. Indeed, all three development banks contributed in the development of the capital market by underwriting securities, offering their own portfolio of shares and their own securities for trading, establishing holding companies and mutual funds and catering for fund management and advising services in mergers and takeovers (Xanthakis, 1995:179-180; Karatzas Committee, 1987:60). Business know-how definitely improved after a growing number of firms benefited from development banks' services. These banks helped in business development and management techniques through their participation in boards of directors of specific companies and through their consulting services. They also introduced up-to-date methods of project appraisal and conducted numerous studies on the development possibilities of various sectors of the Greek economy (Karatzas Committee, 1987:60).

Initiatives for economic development and institutional change left their footprint in banks' balance sheets. The changing composition of their portfolios in loans and securities was an indicator of the changing nature of development banks, as the financial regime was changing, towards a business model akin to merchant and investment banking. However, the success of this transformation was greatly affected by their ability to survive the "crisis years" and to respond effectively to the requirements of the subsequent liberalization period.

Inspecting, from Figure 3 and Table 3, the evolution of loans[1] extended, it appears that ETEBA tried to support its clients during the oil crisis years of the 1970s by keeping lending high. However, the falling pattern during the 1980s might be the result of: i) ETEBA's attempt to shun lending of failed firms during the 1980s and ii) financial deregulation by the mid-1980s onwards which opened new and more profitable opportunities for the bank's operation. Indeed, while long term loans fell consistently from the early 1980s through 1991, placements in securities exhibited a rising trend at least as of 1986. Hence, it seems that there was substitution of indirect financing of industry through share or bond holdings for direct long-term lending. Furthermore, as the capital market grew substantially during the 1990s, ETEBA increased this activity in unprecedented levels – a rise of 153.47% during 1997-2001. The above is evidence of the gradual transformation of ETEBA from a traditional development bank to a modern merchant bank.

[1] Because of a new set of accounting standards introduced that year, data on long-term loans is not available beyond 1991.

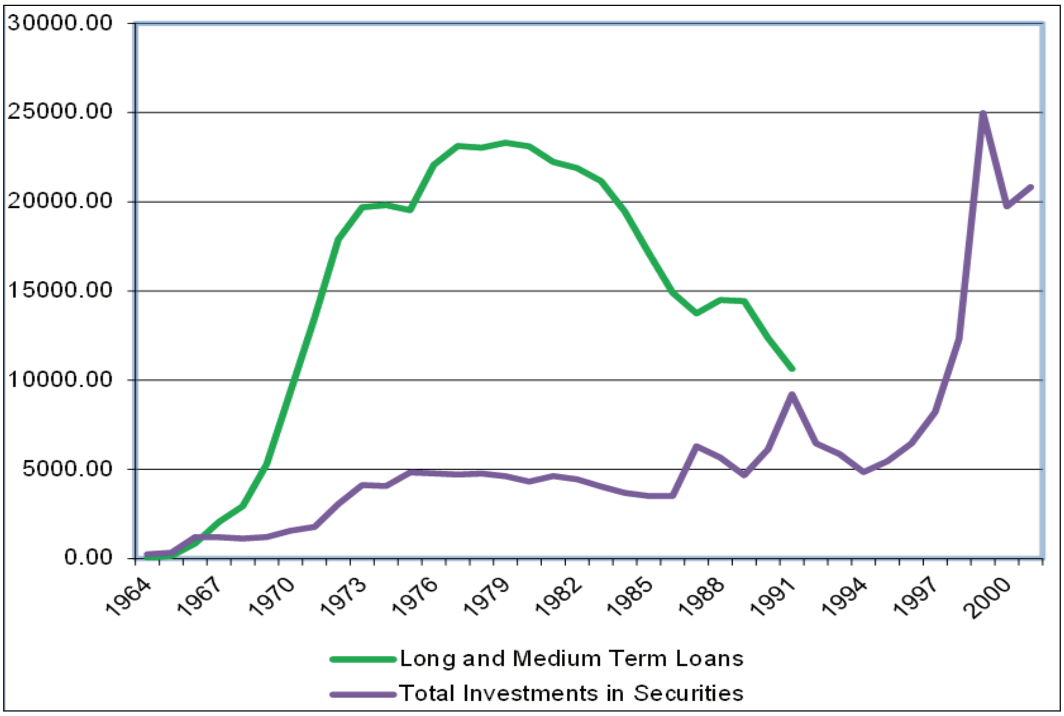


*Fig. 3. ETEBA: Loans and Placements in Securities (Constant 1982 million Drs)*
*Source: ETEBA Annual Reports and author's calculations*

The change in ETEBA's business model, was facilitated by the 554/3/1995 Resolution of the Bank of Greece which permitted ETEBA to accept all kinds of deposits, extend credit for working capital to all types of enterprises and raise funds on the interbank market. Besides, ETEBA increased its activity in consulting, mergers/acquisitions and portfolio management. This process of internal transformation of

*Table 3. National Investment Bank of Industrial Development (ETEBA) Summary statistics in constant 1982 million Drs.*[2]

| | | Mean | Median | Standard deviation | Min | Max |
|---|---|---|---|---|---|---|
| Long-term Loans | *1964-1974* | 8,330.50 | 5,297.00 | 8,059.25 | 53.33 | 19,817.21 |
| | *1975-1986* | 20,916.90 | 21,978.78 | 2,668.97 | 14,914.18 | 23,314.10 |
| | *1987-1991* | 13,130.60 | 13,741.11 | 1,640.42 | 10,631.31 | 14,494.39 |
| Placements in Securities | *1964-1974* | 1,808.71 | 1,207.35 | 1,353.20 | 245.07 | 4,126.91 |
| | *1975-1986* | 4,318.20 | 4,528.59 | 505.75 | 3,507.89 | 4,831.09 |
| | *1987-2001* | 9,809.95 | 6,451.19 | 6,603.57 | 4,673.99 | 24,978.58 |
| Net Profits | *1964-1974* | 145.84 | 89.94 | 127.57 | 16.58 | 387.88 |
| | *1975-1986* | 521.86 | 485.83 | 177.77 | 250.83 | 874.36 |
| | *1987-2001* | 946.54 | 811.53 | 665.52 | 241.79 | 2,569.03 |

*Source: ETEBA Annual Reports and author's calculations*

[2] Summary statistics have been calculated with EViews ver. 3.1. quantitative micro software.

the bank lasted until its absorption by the National Bank of Greece at the end of 2002 (ETEBA Annual Reports, various years).

This is not the case for TE as Figure 4 and Table 4 indicate[3]. The adverse economic conjuncture during the 1970s and 1980s is the main cause for a steady fall in long-term lending from 1977 onwards, whilst securities' holdings also dwindled as of 1979. Hence, no clear substitution between the two kinds of assets can safely be established. It seems that TE could not follow the example of ETEBA in exploiting the new opportunities of the financial market deregulation during the 1990s. Yet, TE, despite its enduring financial problems as of the mid-1980s, did not abandon attempts to modernize, reorganize and extend its operation to more

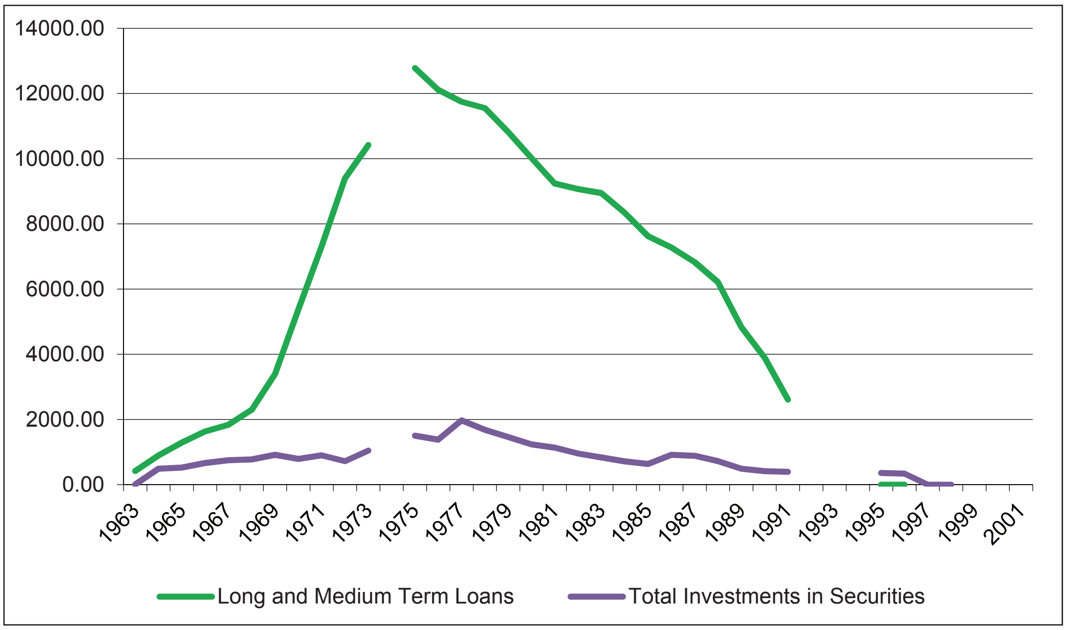


*Fig. 4. TE: Loans and Placements in Securities (Constant 1982 million Drs)*

*Source: TE Annual Reports and author's calculations*

*Table 4. Investment Bank (TE) Summary statistics in constant 1982 million Drs.*

| | | Mean | Median | Standard deviation | Min | Max |
|---|---|---|---|---|---|---|
| Long-term Loans | *1963-1974* | 3,694.63 | 2,069.25 | 3,577.98 | 73.36 | 10,417.57 |
| | *1976-1986* | 10,202.45 | 10,016.26 | 1,697.89 | 7,622.95 | 12,777.85 |
| | *1987-1992* | 5,274.69 | 5,524.75 | 1,816.78 | 2,607.66 | 7,273.80 |
| Placements in Securities | *1963-1974* | 632.34 | 737.06 | 332.42 | 0.00 | 1,047.43 |
| | *1976-1986* | 1,227.72 | 1,235.91 | 421.08 | 632.31 | 1,971.66 |
| | *1987-1997* | 564.84 | 453.04 | 239.22 | 339.10 | 915.77 |
| Net Profits | *1963-1974* | 67.63 | 50.10 | 64.35 | -23.22 | 201.59 |
| | *1976-1986* | 9.20 | 20.45 | 74.47 | -194.09 | 98.03 |
| | *1987-1997* | -13.52 | -47.08 | 264.52 | -295.58 | 522.15 |

*Source: TE Annual Reports and author's calculations*

[3] The gaps in Figures 4 and 7 for TE are due to the lack of data for 1975 and 1993-1995.

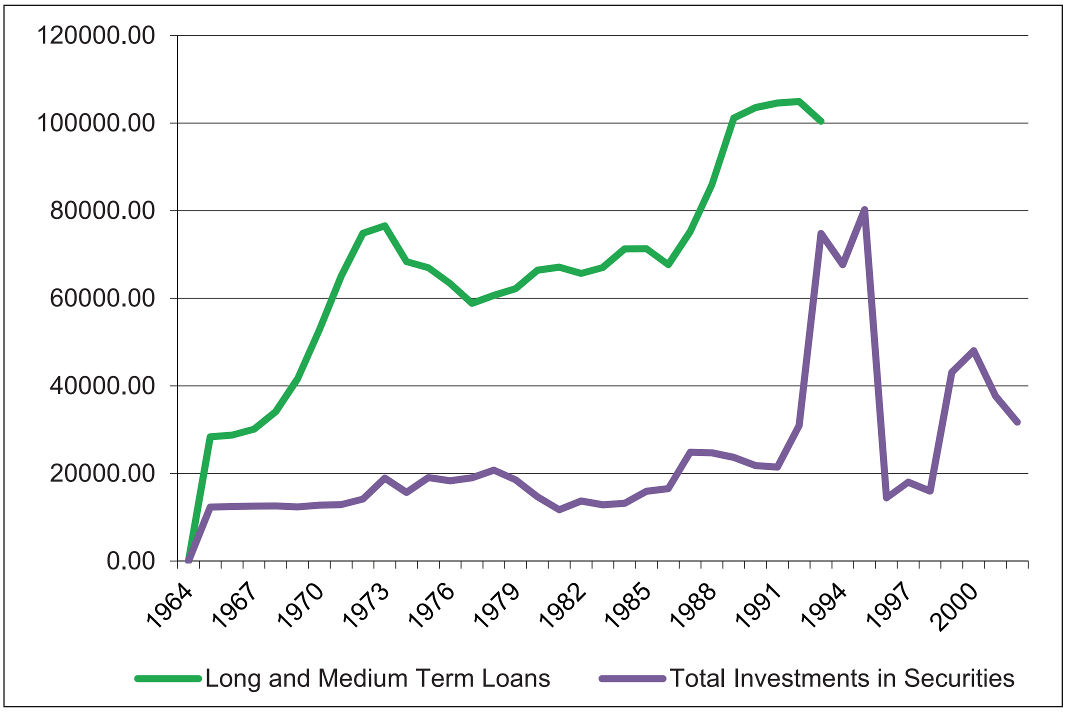


*Fig. 5. ETBA: Loans and Placements in Securities (Constant 1982 million Drs)*

*Source: ETBA Annual Reports and author's calculations*

profitable activities. Hence, it acted as a manager in syndicated loans, underwriter in major firms' share floating on the Athens Stock Exchange and consultant in Greek state bond issues. Despite these efforts its investment banking activity proved anaemic and the bank ceased its regular operation in the mid-1990s (TE Annual Reports, various years; Xanthakis, 1995:195).

The fact that ETBA was a state-owned bank justifies the pattern depicted in Figure 5 which differs from the one observed

*Table 5. Hellenic Bank of Industrial Development (ETBA) Summary statistics in constant 1982 million Drs.*

| | | Mean | Median | Standard deviation | Min | Max |
|---|---|---|---|---|---|---|
| Long-term Loans | *1965-1974* | 50,059.66 | 47,200.85 | 19,806.01 | 28,359.68 | 76,534.98 |
| | *1975-1986* | 65,719.35 | 66,690.55 | 3,848.37 | 58,839.77 | 71,325.38 |
| | *1987-1993* | 96,553.49 | 101,178.70 | 11,450.15 | 75,257.23 | 104,931.40 |
| Placements in Securities | *1965-1974* | 13,662.50 | 12,672.06 | 2,132.58 | 12,328.06 | 18,939.26 |
| | *1975-1986* | 16,198.30 | 16,229.15 | 2,957.96 | 11,700.81 | 20,766.73 |
| | *1987-2002* | 36,197.08 | 27,892.42 | 21,157.23 | 14,419.74 | 80,227.56 |
| Net Profits | *1967-1974* | 534.36 | 427.00 | 520.50 | 0.00 | 1,330.91 |
| | *1975-1986* | 322.72 | 168.22 | 587.78 | 15.25 | 2,168.75 |
| | *1987-2002* | -5,615.87 | -3,711.68 | 7,819.66 | -21,299.90 | 4,340.59 |

*Source: ETBA Annual Reports and author's calculations.*

in ETEBA and TE. Both placements in securities and long term loans exhibited a rising trend until the early 1990s. Long-term financing rose until 1973, fell during the period 1974 – 1977 only to rise again from 1978 onwards, initially smoothly (1978 – 1986) and then more sharply (1987 – 1992). ETBA followed a policy of persistent support of Greek firms during the turbulent decades of falling growth in the 1970s and 1980s. On the other hand, holdings of securities fluctuated widely, after reaching a peak in 1995, while the lack of data does not permit us to establish any trend for long and medium term loans for the same period.

In any case, financial liberalization affected the bank's operation as the sizable fluctuation of securities' holdings during the 1990s and early 2000s reveals. Besides, ETBA responded to the new challenges of the deregulation era by establishing the ETBA Leasing SA and upgrading the role of Hellenic Investment Company SA as of 1988. ETBA Insurance Brokers SA was added to the ETBA Group in 1991while the bank became more active in consulting and underwriting. Finally, in 1994, ETBA participated in ETBA-Natwest Mutual Fund Management and in DANUBE Fund (Venture Capital). Eventually, by the end of 2001, the bank had been transformed into a universal bank with separate branches in corporate banking, retail banking, investment banking and treasury services. In 2002 the bank was absorbed by the Piraeus Bank (ETBA Annual Reports, various years).

The reshaping of development banks as financial organizations in parallel with the changing financial regime is also confirmed by the increased variability of securities' holdings during the deregulation era. Standard deviations, as depicted in the reported summary statistics, rise between the periods 1975 – 1986 and 1987 – 2002 by about 1,206% for ETEBA (Table 3), 615% for ETBA (Table 5) and fall by 43% only for TE (Table 4). This variability depicts the instability of this source of income as opposed to the previous financial repression period. Indeed, during 1987 – 2002 holdings of portfolios of securities were related to active trading on the market to exploit opportunities for capital gains more so than was the case in the previous periods where securities were mainly held as a form of financing, supplementary to that of long-term loans.

However, development banks' profitability and solvency during this process of transformation was greatly affected by government policy. Their financial position deteriorated especially after 1983 due to losses from loans extended to failed enterprises in the 1980s and the high cost of their funding as the government cut off its interest rate subsidization of banks' bond issues (Xanthakis, 1995:180). Bond rate subsidization was phased out as of 1988 and was abolished completely in 1991. In addition, banks' bond issues were taxed – as opposed to government's securities – adding up to disincentives for investors to hold these bonds in their portfolios (TE Annual Report, 1988 and ETBA Annual Report, 1990). We should note that in the mid-1980s bond issues constituted 64% of financing sources for ETBA, 69% for ETEBA and 42% for TE (Karatzas Committee, 1987:59). This fact points to their importance as a funding source for development banks.

The evolution of net profits is, of course, the ultimate indicator of how successfully ETEBA, TE and ETBA accomplished their developmental goals until the mid-1980s and changed their business models during the subsequent period.

Only ETEBA seems to have been systematically profitable as its net profits remained positive during the period 1970-1997 while they reached much higher levels during the next period 1998-2001 with a peak in 1999 (Figure 6). As Table 3 depicts, on

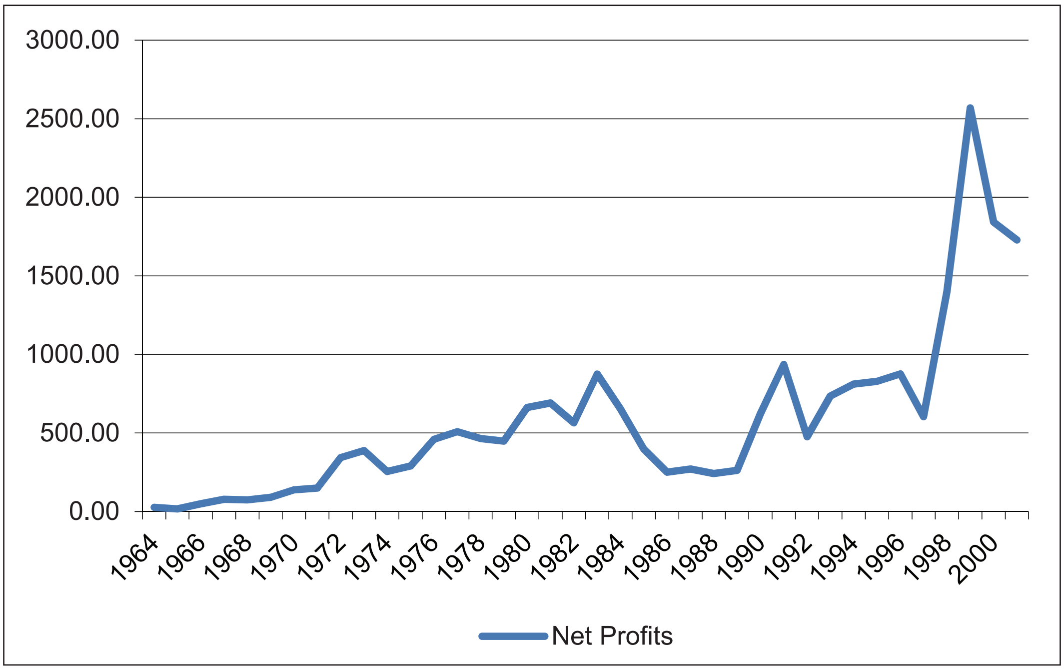


*Fig. 6. ETEBA: Net Profits (Constant 1982 million Drs)*

*Source: ETEBA Annual Reports and author's calculations*

average, net profits before taxes for ETEBA followed a rising trend throughout the three periods of growth, crisis and deregulation.

TE and ETEBA exhibit a clearly different pattern. From Figure 7 we observe that TE's net profits fluctuated initially at positive values for the period 1965 – 1984 and then turned negative. Because of the lack of data for the period 1993-1995 and the paradoxical outlier in 1996 we cannot reach a safe conclusion for the bank's financial condition during its last years of operation. However, looking at the summary statistics in Table 4 we can conclude that due to a prolonged and possibly unsuccessful period of reorganization TE exhibited a falling trend in mean profits from the mid-1970s to the mid-1990s.

The pattern for ETBA is depicted in Figure 8 below[4]. Except for the period 1990-1997 and 2001, net profits are positive. However, the losses during the 1990s outstrip by far, in absolute values, any positive value in profits before and after this period. Table 5 which presents the summary statistics in the context of our periodisation provides a more meaningful picture. The bank's net profits fall on average as we move from period to period so as to present losses during the deregulation period 1987 – 2002.

Hence, both TE and ETBA were less successful in carrying out their developmental role at a profit, particularly when the financial regime called for a change in their business model. Finally, it seems that financial deregulation increased the risk that these banks faced as they were trying to adapt to the new conditions. Indeed, the substantial rise in the respective standard deviations indicates that the riskiness of ETBA's and TE's operation rose along with a fall in their

[4] Unfortunately, data for ETBA's net profits is not available for 1964-1966 and 1969.

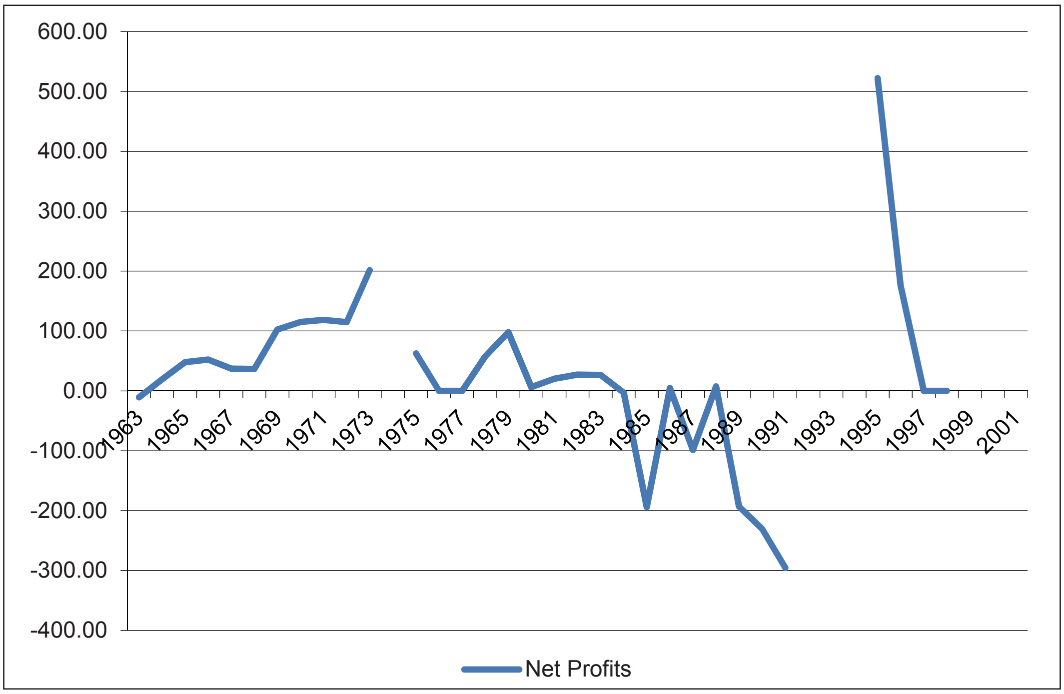


*Fig. 7. TE: Net Profits (Constant 1982 million Drs)*

*Source: TE Annual Reports and author's calculations*

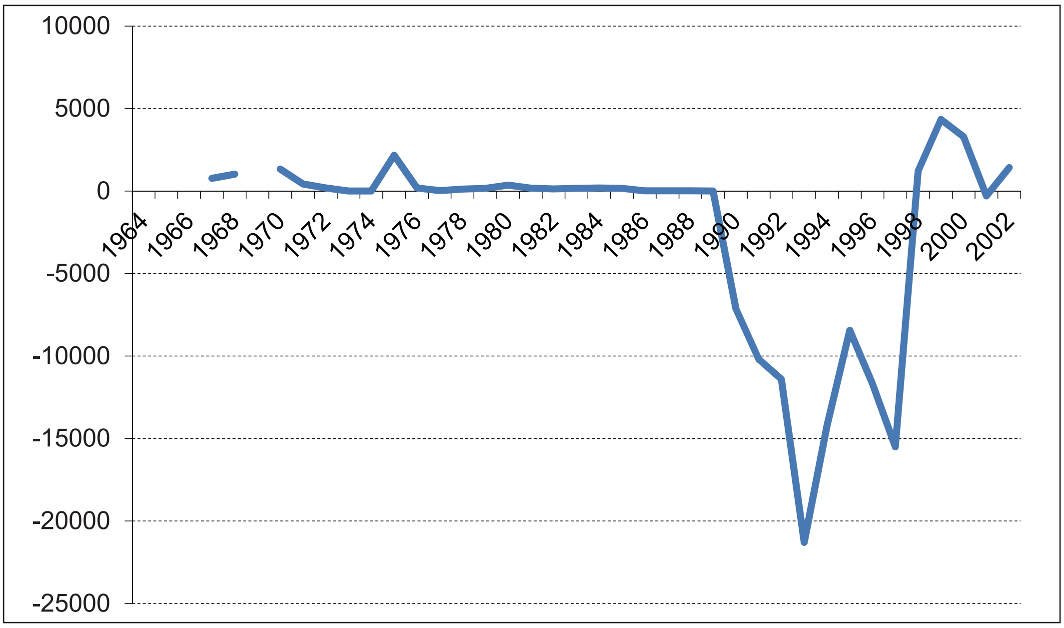


*Fig. 8. ETBA: Net Profits (Constant 1982 million Drs)*

*Source: ETBA Annual Reports and author's calculations* average profits during the deregulation era (Tables 4 and 5). Even ETEBA, the most successful bank in profitability terms, had to cope with a rise in the riskiness of its activity during the deregulation period. Indeed, as depicted in Table 3, along with an average increase in net profits by about 81% between 1975 – 1986 and 1987 – 2001, ETEBA had an enormous rise in their variability by about 274%. For the sake of comparison, the same figures for the periods 1964 – 1974 and 1975 – 1986 were 258% (net profits increase) and 39% (variability increase) respectively.

## 4. Conclusions

Conventional approaches to development banks highlight criteria of "functionality" or "efficiency" without providing a comprehensive understanding of the institutional connotations of development banking. This paper takes a different stance by considering development banks within their institutional environment, as organizations promoting and being affected by institutional change. Using as a historical example the three development banks that operated in Greece from the early 1960s until the early 2000s, this paper attempted to explain the patterns found in development banks' financial data by relating them to government's decision on the prevailing financial regime. Internal transformation was an imperative for development banks as the government turned from supportive – during the financial repression years – into indifferent – during the deregulation years.

Empirical findings were not homogeneous among the three Banks. ETEBA seemed to be the more successful on financial grounds while TE suffered great losses and entered a prolonged but less successful period of reorganization. On the other hand, ETBA as a state-owned bank followed a different path in many respects and seemed to have disregarded criteria of private profitability in favor of developmental goals set by the government. Although the results for TE are not clear, two issues stand out from the comparison between ETEBA and ETBA. Firstly, government ownership of a development bank, such as ETBA, was not conducive to its financial viability. In addition, the closer was the control of the government on a development bank, the less successful had been its transformation as the financial regime changed.

Hence the need for change in development banks' business model, which was the inevitable outcome of financial regime change, had rendered government policy on the prevailing financial regime the ultimate risk factor for these banks. The way this policy was implemented was crucial since development banks were pushed to support failed firms during the last period of financial repression and had to cope with the competition from the tax-exempt government bonds after the change in the financial regime. In this sense, government policy became a political risk factor that preceded of any other financial or economic risk factor which might have affected the success or failure of these banks' internal transformation.

Ultimately, development banking did not survive in Greece. However, this was not the case in other parts of Europe or across the world. Development banks, which promoted economic development in Europe and elsewhere, still play an important role in modern economies. Banks in developed economies such as the German KfW, the Japan Development Bank and the Business Development Bank of Canada or in developing ones such as Brasil's BNDES and China's Development Bank are the most characteristic examples (Lazzarini et al., 2015, De Luna-Martínez and Vicente, 2012). The survival of development banking in such diverse economic and institutional environments proves its ability to adapt successfully to changing economic conditions and financial regimes. However, as this paper argues, the role of government policy concerning the change of financial regime is a crucial parameter. Hence, a promising path for future research might be a comparative study of the relationship between different government policies and the respective performance of development banks among countries with similar economic or institutional characteristics such as those of Southern or Southeastern Europe.

Useful policy implications can be drawn as the paper corroborates the complex relationship between government policy and these financial institutions. One might say that a possible use of development banking to alleviate the woes of the Greek economy in the current period of deep recession should take into account the two characteristics of development banks outlined above: Firstly, that they should be treated predominantly as a means to instill institutional change in the sense of new attitudes, perceptions and norms in the entrepreneurial community as the economy is looking for a new developmental model. Secondly, that political risk precedes of any financial risk these institutions face and hence, government policy should not compromise their status as financial institutions but rather it should seek to benefit from their dynamic nature and ability to cater to the needs of the economy under alternative financial regimes.

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