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on Greece and Southeast Europe

Paper No. 162

The Evolution of Bank–State Ties under Economic Adjustment Programmes: the case of Greece

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THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

August 2021

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The Evolution of Bank–State Ties under Economic Adjustment Programmes: the case of Greece

Chrysoula Papalexatou*

ABSTRACT

This paper focuses on the evolution of bank-state ties in Greece during the Economic Adjustment Programmes (EAPs). On one hand, the Greek institutional framework points to close "formal and informal ties" between political and banking elites, while at the same time the Troika's pressure to reduce the state's political influence in the banking sector was expected to be high. Indeed, from the very early stages of the crisis, even though the recapitalisation was realised with public funds, the Greek government's actual control of the banking sector was restricted, and "formal links" between the banks and the state were broken. Nonetheless, little was done before 2015 in order to evaluate and restructure the governing bodies of the Greek banks, keeping the "informal links" intact during the first two EAPs. In order to explain this surprising delay, this paper advances a new narrative. Based on 25 in-depth elite interviews with actors involved in the recapitalisations, it demonstrates that preserving these "informal" bank-state ties served as an important crisis management tool and proved useful for safeguarding financial stability at the domestic but also at the EU level. Lastly, evidence suggests that beyond the creation of the Banking Union, it was the international actors' lack of trust in the Greek government, which finally led to aggressive corporate governance reforms of Greek systemic banks breaking the "informal ties" between the bank and the state after the third recapitalisation.

Acknowledgements: I would like to thank the Hellenic Observatory of the London School of Economics and the Hellenic Bank association for the financial support during the Postdoctoral fellowship in Contemporary Greek and Cypriot Studies.

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1. Introduction

Traditionally, states and banks have very close ties. States have been using banks in order to assume control over their economies but also for government debt. At the same time, banks have been benefiting from regulatory privileges (Epstein, 2017). The Eurozone debt crisis can be considered to be a turning point in the transformation of bank–state ties. On the one hand, as banks were about to fail and economic activity was about to collapse, governments around the world made efforts to stabilise their banking sectors with taxpayer-funded bailouts (Woll, 2014). On the other hand, with the creation of the European Banking Union, all Eurozone countries experienced intensified pressure to break their traditional models of domestic political influence over finance (Epstein, 2017). However, this process of transformation of bank–state ties is unique for each member state as, from country to country, the relationships banks establish with their governments are different (Woll, 2014). Moreover, the magnitude and nature of the crisis was also not the same everywhere.

Among the Eurozone member-states that experienced the above dynamic the case of Greece stands apart given the extremity of the crisis. In Greece, funds for recapitalisations came from adjustment programmes with strong conditionality, while at the same time the banking sector desperately needed to shore up its balance sheets (Hardouvelis, 2018). At the same time, the Greek banking system was traditionally characterised by domestic ownership and "formal bank state ties" via direct state ownership or state management were present until 1990's (Pagoulatos, 2014). Moreover, it had a long tradition of close "informal links" between senior bankers, political parties and large companies (Avgouleas, 2015). Thus, the severing of bank–state ties was not a straightforward process.

From the very early stages of the crisis, even though the recapitalisation was realised with public funds, the Greek government's actual control of the banking sector was restricted, and "formal links" between the banks and the state were broken. In particular, while the Troika recognized the problematic nature of bank-state ties and despite its involvement in the recapitalisations, little was done during the first two EAPs to evaluate and restructure the governing bodies of the Greek banks, keeping the "informal links" intact. It was only in 2015 after the third recapitalisation that corporate governance reforms broke the "informal ties" between the bank and the state.

Based on 25 in-depth interviews with actors involved in the recapitalisations, and through an analysis of primary and secondary sources, this paper explores how and why bank–state ties transformed in Greece against the backdrop of the creation of the Banking Union. This paper suggests that the delay in breaking the ''informal links" between the banks and the state, was not only due to the reduced reform capacity of the Greek state and the protection of vested interests as is often claimed in the public discourse, but it was because "informal ties" between the state and the

banks were useful instruments for crisis management during the first stages of the sovereign debt crisis. Further, it is also argued that it was not only the creation of the Banking Union that led to the break of the "informal ties" in 2015 as the existing academic literature suggests, but rather it was also domestic political developments in Greece that led to aggressive reforms in banking sectors' corporate governance.

The remainder of this paper is organised as follows. The next section reviews the literature focusing on the relationship between the banks and the state in general, and in the Eurozone in particular. Section three presents the rationale behind the case selection, followed by a brief overview of the Greek banking system. After the presentation of the methodological approach (Section four), Section five to seven provide flesh to the argument. By reconstructing the negotiating positions of the actors involved in the recapitalisations it explains why "formal bank–state ties" were broken in the during the first two Economic Adjustment programs while "informal ties" remained intact. Section seven explains how domestic politics played a role in breaking the "informal bank-state ties" during the third Economic adjustment programme and the background behind this aggressive reform. The final section concludes the paper by outlining the implications for the Greek political economy but also for the wider academic debate concerning the symbiotic relationship between the banks and the state.

2. Bank-State ties in the EU

The centrality of banks to the politico-economic fortunes of states became very clear during the Global Financial Crisis, particularly within the Eurozone. In particular, Eurozone governments, along with the ECB, provided liquidity and support to financial institutions. By 2013, 1.6 trillion euros of state aid had been given to the financial system by their governments in the EU (Reuters, 2013). The so-called "doom-loop" is the epitome of the symbiosis between the banks and the state (Merler and Pisani-Ferry, 2012). Banks and states transfer the financial vulnerabilities to each other. Domestic banks often lend to national governments to maintain political relationships. While the borrowing costs for governments increase, banks' balance sheets deteriorate since the value of the government bonds they hold decreases. While states risk financial failure because of high borrowing costs, banks also struggle. As Epstein (2017) claims, before the crisis bank–state ties were largely ignored. Nonetheless, "the history of European financial systems reveals the deeply interconnected European financial ecosystems bound by both political and financial relations" (Monnet et al., 2019 p.3).

As is often argued in the literature, the financial industry *makes* policy rather than *takes* policy at the expense of consumers and the general public (Woll, 2014). Various scholars have suggested that the benefits banks gain from national authorities are extensive and systematic, and this is why the term “regulatory capture” is so regularly used in the context of the financial industry. Simultaneously, banks’ political susceptibility is facilitated by bailout guarantees coming from the state. This implies that bank managers can take on a higher risk in order to gain higher returns during periods of euphoria, since the government would back them during crisis periods. At the same time, states can also exploit the financial system for their benefit, in order to overcome their own financial difficulties, or with the objective of directing credit to certain sectors of the economy.

The literature documents that “formal links” such as state management or state ownership of the banking sector, and “informal links” such as revolving doors and friendships between banking and government elites entail costs linked with misallocation of credit and excessive holding of domestic government bonds. Betrand et al (2007) find that liberalisation of the French banking system in 1980’s eliminated intervention of the state in bank lending decisions, making the allocation of capital more efficient and boosting productivity. Barth et al. (2004) suggest that policies that empower private-sector corporate control of banks, work best to promote bank development, performance and stability. Moreover, informal networks such as revolving doors and friendships between banking and government elites are associated with excessive risk-taking for loans granted to entities with minimal creditworthiness (political parties, political firms, media). Khawa and Mian (2005) explore the case of Pakistan and find that firms with political connections borrow 45 per cent more and have 50 per cent higher default rates and preferential treatment occurs exclusively in government banks while private banks provide no political favours.

Despite the fact that the problems of state influence in the banking sector are well documented in the literature, there is no doubt that it is beneficial for states to have access to banks that are politically influenced. There are various reasons for this: banks can act as creditors for states, can help in promoting growth, and they are useful for macroeconomic and crisis management (Verdier, 2000; Seabrooke, 2006). Studying the French banking bailout, Jabko and Massoc (2012) depicted an informal consortium’ between French state officials and top bankers, which ‘fostered organic solidarity in the face of a crisis’. These are the reasons that domestic financial interests and many national governments have been a key source of resistance of breaking the links between the banks and the state. However, financial crises, structural changes in the global economy such as intense liberalisations, and the social and financial pressures of international financial institutions (Epstein, 2017; Stein, 2010) have all been sources of transformation of bank–state ties pushing

towards loosening these links. The crisis period constitutes almost a natural experiment for Euro area member state and provides interesting insights regarding its implications for the relationships between governments and banks.

According to Epstein (2017) bank–state ties were weakened in the Euro area. In the Eurozone, the European Banking Union (EBU) centralised bank supervision and introduced a single resolution board at the expense of national authority. Indeed, the establishment of a single supervisory mechanism (SSM) applying a single rulebook, was designed to limit the tendencies of national governments to favor domestic banks at the (Monet et al., 2014). Moreover, EBU has switched the burden of bank bailouts away from taxpayers and onto shareholders, bondholders and big depositors.

A the same time the, 'fit and proper' criteria as defined by the SSM, aim also to uproot the linkages between the banks, politicians, and powerful vested interests, breaking the "informal links" that public officials maintain with financial elites. The importance and fluidity of these networks was recently recognised in the academic debate, and these studies point to the phenomenon of revolving doors and the friendships between senior officials and banking elites. Interestingly, the revolving doors phenomenon does not only mean that public officials will only grant political favours to former colleagues, but it also relates to the production of common worldviews, that develop from common experiences (Tsingou, 2008; Johnson and Kwak, 2010). Focusing on the Netherlands, De Haan and Veltrop (2014) suggest supervisors with previous tenure in the financial sector are more likely to socially identify with the financial sector.

While Epstein (2017) explains how the creation of the Banking Union transformed bank–state ties across the euro area (EA) countries, it needs to be noted that despite EBU's ambition this process remains incomplete and appears far more limited than originally intended. Secondly, the particular pathways to transformation were idiosyncratic—depending on the external constellation of power pushing for transformation and also on specific domestic institutional settings. Not all countries within the EA faced the same external pressure, nor were they similarly exposed to the crisis. In addition, the relationship between banks and the state is not the same across countries.

In the next section, we examine how bank–state ties were transformed in Greece where maintaining clear boundaries between the bank and state has traditionally been a very difficult task. Simultaneously after the crisis, there was intensified pressure to weaken these ties since it was under Economic Adjustment programs and, thus, subject to strong conditionality. These two opposing dynamics allows us

to closely observe the transformation process and the political struggle underpinning it.

3. Bank–state ties in the case of Greece

Essentially, there are two rationales behind the case selection. First, Greece can be referred to as a "least likely case" for transformation: it has a bank-based financial system where the banking sector has traditionally been subject to political influence with formal and informal ties present. In bank-based systems companies and banks tend to be connected through a dense web of cross-shareholdings, banks to monitor the development of companies and allocate credit (Woll, 2014). Companies are dependent on bank credits and their long-term relationships with these banks have traditionally been central to their networks. Banks and entrepreneurs are therefore likely to maintain club-like personal relationships, with close connections to governments (Woll, 2014).

Indeed, there is extensive informal contact between political and banking elites, and the majority of the Greek banking system remained state-controlled until the mid-1990s with the government responsible for appointing the management (Pagoulatos, 2014). There is evidence for this period that having state-controlled banks resulted in a misallocation of credit (Haliassos et al., 2018). This was clear from the large proportion of non-performing loans held by the state-controlled banks. Many of these loans have been effectively directed by the government towards state controlled or other political firms (Haliassos et al., 2018).

Bank privatisations began in the second half of the 1990s. Against the backdrop of the European single market, financial and credit liberalisation occurred. Liberalisation was a source of power for the banking system (Pagoulatos, 2014). Restrictions on lending rates were improved, exchange controls were lifted and the private control of the banking sector grew because of new players entering the market. The newly founded private banks were mostly Greek and foreign presence remained scarce (Haliassos et al., 2018). Furthermore, the managers of state-controlled banks gained power after liberalisation. Despite the fact that they were still appointed by the government and that political pressure continued to exist, their bargaining power in the face of political pressures was relatively strengthened (Pagoulatos, 2014). As an example, banking sectors' strength was reflected in the fact that it would ask for regulatory forbearance or other lucrative agreements in exchange for government lending. Major private banks could also negotiate with the state in order to obtain these beneficial agreements (Pagoulatos, 2014).

Over the next decade, between 1998 and 2008, Greece experienced rapid economic growth. While mortgage and consumer credit was low compared to other EA countries, total credit increased from 76.1% of GDP in 1998 to 122.8% in 2008. The adoption of the euro allowed governments to borrow from abroad, and as a result domestic bank lending to the state. However, there was an increase in loans to the private sector. This credit boom was beneficial for bankers, and the banking sector experienced an increase in its profits and incomes (Haliassos et al., 2018). The banking sector emerged as a powerful player but it remained subject to political influence. Foreign ownership remained very low and triangle deals between banks, businessmen and other banks or political allies ("crony banking") continued to exist (Avgouleas and Papadimitriou, 2015). One potential reason for the continuous political influence in the banking sector is the existence of lax corporate governance norms which permitted Greek banks to appoint businessmen, union leaders and politicians to their boards (Kolliopoulos, 2021). It is reported that loans were granted to political parties and corporations with low creditworthiness but privileged relationships with the banks (EC, 2020). This overview of the banking system suggests that there is a tradition of close "formal and informal" links between the banks and the state. Therefore, one would expect that the severing of these links would be strongly contested.

The second reason for choosing Greece as a case study is that the country experienced by far the most intensive domestic economic crisis in the EA. Interestingly, the Greek crisis followed the global financial crisis and was mainly fiscal in nature with high fiscal deficits and high public debt. At the beginning of the crisis in 2008–2009, Greek banks had a wide enough deposit base and were among the best-capitalised banks in Europe (Louri and Migiakis, 2019). They were also not exposed to toxic products to the same degree as other European banks. Moreover, banking activities in South-Eastern European countries allowed them to have differentiated sources of earnings. Despite their "soundness", banks' problematic lending strategies of 2000's are now well known. Credit expansion in Greece during the 2000s did not efficiently allocate funding in respect of real economic growth (Louri and Migiakis, 2019). Despite these vulnerabilities though, the private debt-to-GDP ratio of around 100% remained significantly lower than the EU average (150%) and at the beginning of the global financial crisis. In the following years, the deteriorating macroeconomic environment, political instability, deposit flight and losses on Greek government bonds (GGBs) inevitably had a disastrous impact on the Greek banking system. With money for the recapitalisations coming from borrowed European and IMF funds, the external pressure for transformation of bank state-ties was expected to be high.

4. Methodology

In order to investigate how bank–state ties changed during the crisis, I focus on three rounds of recapitalisation of Greek banks (between 2013 and 2015). This is because recapitalisations would have been the exemplary moment to break the traditional bank ties. The reason is that recapitalisations were not an outcome of negotiations between only the banks and the government, because neither had the influence to determine unilaterally the terms of rescue packages since money was coming from borrowed funds. The negotiations were tripartite in nature and the main actors were banks, the government and the Troika. Thus, I explore how the multiple actors affected the bailout calculus, and how they shaped and changed the traditional links between the banks and the state, given that all this unfolded against the backdrop of the creation of the Banking Union.

In the remainder of this paper, the term "banking sector" refers to the four systemic banks (Eurobank, Alpha Bank, Piraeus Bank and the National Bank of Greece). While each bank was acting for its own "survival" and had its own strategy, overall one can identify common interests when it comes to private ownership/state interference. The Troika is conceptualized as a single actor despite the fact that, as the following analysis will demonstrate, there were disagreements within it. When these disagreements regarding the bailouts become relevant to this analysis, they will be considered. Meanwhile, the term "government" refers to the governments between 2009 and 2015. Once again, disagreements regarding state interference in the banking sector did exist, especially in the coalition governments, and they will be taken into account when necessary. Finally, the role played by domestic and international investors who invested at the Greek banking system that were not part of the negotiation process is considered because their influence was very clear on issues linked with state interference in the banking sector. There is also a focus on the Bank of Greece as the national regulator, which had a leading role in restructuring the banking system.

Part of the qualitative analysis is based on an examination of policy documents, newspaper accounts, speeches and public statements from bankers and private investors, along with the publications of the systemic banks but also those of the Bank of Greece, the European Central Bank and EU institutions. Due to the fact that these issues were salient, there was also extensive media coverage.

However, for sensitivity reasons, not everything is publicly available. Thus, and to put the primary documents into perspective, I have conducted 25 interviews with senior members of the Greek governments and banking sector, officials from the Troika and the Bank of Greece, international investors, lawmakers and other key players involved in the three recapitalisations. A number of the public officials I interviewed

have left the positions they held at the time, but they still hold different positions, which means that they tend to be concerned about the publicity that might arise from information they provide to scholars. Thus, the interviews were conducted on the basis of in-depth background, with complete confidentiality assured to encourage openness. The interviews followed a semi-structured style and my list of questions changed depending on the profile of the interviewee. On the majority of occasions, the interviews were conducted on a one-to-one basis, but I also had group discussions in order to gain multiple perspectives on the same topic depending on the different expertise of the participants. Interviews are subject to certain limitations and biases. Hence, the qualitative analysis builds on the combination of accounts from interviews, primary sources and secondary literature, which are all used to triangulate the information given in any one of the individual sources. Further details about the interviews can be found in the annex.

5. The first two recapitalisations: The break of "formal" banks state-ties and the maintenance of "informal-ties"

In the next section, the transformation of banks state ties during the first and the second Economic adjustment programmes is presented. More precisely, the analysis that follows demonstrates that the ''formal links" between the banks and the state were significantly weakened, but the "informal links" remained intact. To begin, the sovereign debt crisis hit the Greek banking system very hard. Private sector involvement (PSI) massively reduced the value of Greek government bonds that banks were holding in their portfolios.

The primary aim of the recapitalisation and resolution plan that followed was to restore the capital base of the four systemic banks and resolve all other non-systemically important banks that were unable to recapitalise themselves through private capital (ECA, 2017). The first bank recapitalisation mainly utilised borrowed European and IMF funds, which came from the Economic Adjustment Programme 2012–2014. The_recapitalisation was supervised by the Hellenic Financial Stability Fund (HFSF), a newly established institution that was under the control of the Greek state and its creditors. It was decided that four banks (Eurobank, Alpha Bank, Piraeus Bank and the National Bank of Greece) were systemic and would be recapitalised using public funds (Hardouvelis, 2018). The agreed procedure was that the state and private investors would buy shares, but free warrants would be given only to private investors for each share they purchased. The warrants were a sweetener to encourage private investors to become involved in the recapitalisation (EC, 2020). It became clear that the introduction of warrants allowed private investors to enter

the recapitalisation process on better terms than the state. Moreover, the creditors placed strict limitations on the HFSF and its voting rights so it would only receive "B Shares" with suspended voting rights (EC, 2020). This procedure was in line with the strategy of increasing business autonomy and ensuring that the banking sector would not be managed by the Greek state. Only when a bank could not raise the required 10% would the HFSF have full voting rights. This happened only in the case of Eurobank which became fully controlled by the state (EC, 2020). The remaining three systemic banks managed to raise more than the required 10% (Alpha 12%, NBG 11.1% and Piraeus 19.7%) (Haliassos, 2018). The total amount of public funds used was €25.5 billion (€4 billion for Alpha, €5.8 billion for Eurobank, €8.7 billion for NBG and €7 billion for Piraeus). The remaining banks were recapitalised with private funds or resolved, recapitalised and then transferred to the four large banks. This process was completed by July 2013 (ECA, 2017).

In 2014, the four banks proceeded to a second round of recapitalisation after a follow-up stress test conducted by the Bank of Greece in cooperation with Blackrock. A second recapitalisation was necessary due to the projected increased losses on the private sector loans due to the economic crisis (Hardouvelis, 2018). The economic atmosphere was very different in comparison to the first recapitalisation. By 2014, there were positive growth projections and the dependence of banks on expensive Emergency Liquidity Assistance (ELA) funding from their central bank was back to zero. In this more positive climate, no public funds were used for this second recapitalisation. More particularly, €8.3 billion was raised entirely through the private sector (ECA, 2017). It is worth noting that the conditions in the second programme (and third programme) allowed the HFSF to be used only as a last-resort source of support in the recapitalisation of 2014. This meant that it could not participate in the bank recapitalisations in case there was private sector interest. The objective was to minimise further injections of public funds and further public control. With banks raising only private capital, the HFSF's participation was significantly diluted.

The first recapitalisation resulted in a highly concentrated banking system (the five largest banks in Greece held 94% of the banking system's assets) in which business autonomy was ensured as the HFSF held shares with suspended voting rights, despite the enormous amount of public funds (€38.9 billion) that were used for recapitalisation and resolutions. The second recapitalisation resulted in significant dilution of the HFSF's shares in the banking sector, minimising further public control. Thus, it is clear that effort had been exerted after the first EAP to minimise state involvement in the banking sector and break the "formal" bank state ties.

This rationale is easily explained as the costs of state control of the banking system are well documented in the literature. For example, La Porta et al. (2002) highlight

how in countries where state ownership of banks is more extensive, lending decisions are poor, and productivity and GDP grow more slowly. Moreover, the Greek crisis is unique. In other Eurozone countries, the banks' problems spilled over to the states. In the case of Greece, the opposite happened as the problems of the sovereign spilled over to the banking sector (Louri and Migiakis, 2019). Between 2009 and 2012, banks lost almost 40% of their deposits, mainly to banks abroad. Simultaneously, with weaknesses in interbank lending, the Greek public debt crisis stimulated a series of intentional rating downgrades (Louri and Migiakis, 2019). This peculiarity in the Greek case is reflected in the credit rating downgrades: due to the Greek banks' good fundamentals, their ratings were higher compared to the Greek state between 2010 and 2013. This demonstrates in the early phase of the Greek crisis that these rating downgrades were mostly the result of the negative outlook on the state's fiscal sustainability risk rather than worsening bank-specific or sector-specific factors (Louri and Migiakis, 2019).

The fact that the Greek crisis was mainly fiscal in nature justifies the position of the actors involved in the negotiations regarding the banks' business autonomy. More precisely, the Troika clearly wanted to avoid state control of the banking sector. According to IMF Country Report No. 11/351:

For the core of the banking system, public recap support will likely prove necessary, but can be implemented while preserving private management and some private control. Concerning full public recap, the government of Greece has a poor track record of properly managing state-owned banks and managing its own finances. This suggests that an effort needs to be made to keep a part of the core banking system in private hands, run by competent managers (IMF, 2011).

At the same time, the interests of Greek banks collided with the interests of the Troika. According to Culpepper and Reinke (2014), banks first choice is generally to raise private money to avoid the government being a shareholder. In the case of Greece where the crisis was perceived as fiscal, and especially because economic recovery was expected, they wanted to preserve the business autonomy they had gained in the 1990s.[2]In particular, they did not want to return to government control and state intervention, as this would discourage the participation of private investors in the recapitalisations.[3]

The position of the Greek state was more complex. Initially, the socialist PASOK party under George Papandreou supported public funds being injected into banks but the HFSF would receive common stocks with voting rights (To Vima, 2012). When Papandreou formally resigned as Prime Minister of Greece in 2011, he was

[2] Interview 25, Interview 10
[3] Interview 8, Interview 5, Interview 10

succeeded by a coalition government comprised of PASOK (socialist party), New Democracy (conservative party) and LAOS (right-wing party) with former ECB vice president Lucas Papademos as Prime Minister. Kolliopoulos (2020a) argues that it was not only the pressure coming from the Troika that made the idea of common shares with full voting rights unfeasible (full voting rights would mean that the state would have control over the banking sector) but it was also the heterogeneity of views regarding this issue within the coalition government that played a role. The government was provisional and signed the second adjustment programme and also the PSI (Hardouvelis, 2018). It did not have the political support to implement the recapitalisation, as this issue was highly salient[4]. However, Papademos seemed to share the views of the international lenders and was openly in favour of banks' private management (Vima, 2012).

Nonetheless, one may argue that statements in favour of shares with full voting rights could also serve as "signalling politics". According to a public opinion poll from 2008, only 11% of Greeks wanted banks to be supported with taxpayer money (Pagoulatos, 2014). Thus, injecting money into the banks would be politically unpopular. Moreover, as Venizelos (Finance Minister at the time) stated in: *"The negotiations with the troika are very hard regarding the issue of recapitalisation*" (Kathimerini, 2012). With the Troika having a very clear policy regarding public management of the banking sector, it comes as a surprise that Greek politicians did not know that achieving a deal with full voting rights was out of reach. Moreover, state's involvement would discourage private investors, if private investors were not attracted, recapitalisation would be even more costly during a period when the economic environment was deteriorating.

To conclude, the first and second programmes had an impact on bank–state ties. While banks were rescued with public funds, business autonomy was the priority. "Formal links", regarding state bank ownership and state management, were weakened either by encouraging the private investors to participate or by placing strict limitations on the voting rights associated with the HFSF's possession of shares in the banks (EC, 2010). What is surprising is that the programme itself did not include conditions to enhance bank governance and break "informal bank state ties". While the recapitalisations occurred mainly through the HFSF, sufficient scrutiny of their private management of banks was not ensured. In contrast to other country cases, while public funds were used for the recapitalisations, HFSF was not entitled to assess the members of banks' boards regarding their experience and independence (ECA, 2017).

[4] Interview 5

Some economists attribute this reform postponement to the fact that the programmes had other priorities due to the severe fiscal problems that the country was facing.[5] Hence, the focus of the first programme was mainly on the immediate and critical fiscal policies, while the banking sector was considered relatively sound at the time (EC, 2020). Nonetheless, despite the fact that banks suffered mainly due to the solvency channel, there were underlying vulnerabilities (Haliassos et al., 2018). Credit expansion in Greece during the 2000s mainly involved consumer loans and loans to households (Louri and Migiakis, 2019). Greek banks had become increasingly dependent on interbank loans in the latter stage of the credit boom. This is why the Greek banks received 28 billion euro in 2008 from the Greek state. Initially, the banks appeared unwilling to accept the terms and requirements New Democracy government's "financial crisis reaction plan", which they claimed would limit their autonomy regarding management and banking policies. This reluctance, however, served a specific purpose: by insisting that they did not need the plan, the banks were attempting to avoid the emergence of concerns about their robustness and capital adequacy (Pagoulatos and Triantopoulos, 2009). Nonetheless, behind closed doors these considerations were cast aside given the banks' actual capital needs[6]. Moreover, there were also "governance-related problems (e.g., banks lending to related parties on non-market terms) that existed well before the crisis, as Greek banks' corporate governance was, on average, considerably inferior to that of their European counterparts from the outset" (ECA, 2017). Given the vulnerabilities of the Greek banking system and crony banking and the high levels of NPLs (31.9% in 2013) it is surprising that bank management was not replaced and continued as normal. As a result, "informal bank–state ties" were not weakened as they would have been if a stringent fit and proper test for board members was implemented in the first two EAPs.

There is extensive and flourishing literature after the crisis on the low reform capacity of the Greek state. Kolliopoulos (2020b) suggests that the inertia of the authorities and the bankers resulted in full foreign-ownership and control of the banking system in the third EAP, something he calls "de-hellenization". Avgouleas (2015) explains that in contrast to international practices, recapitalisation in Greece benefited the banking sector that received considerable amounts of state aid and ended up being highly concentrated. Yet, as discussed above, international lenders had a substantial say in the design of the recapitalisation policies. Thus, it seems that attributing the post-rescue approach and the delay in corporate governance reforms purely to the low reform capacity of the Greek state, and the protection of vested interests, does not paint the full picture.

[5] Interview 4, Interview 18

[6] Interview 1

6. Bank-state ties as a crisis management tool

The following section explains that "informal bank–state ties" remained intact in the first stages of the crisis because they served as a crisis management tool, and this was recognised by all actors involved in the recapitalisations. In the period when financial stability was threatened and banking activity was on the verge of collapse, the banks and state were holding each other's hands tightly in order to minimise systemic risk.[7] This is not a unique phenomenon for the Greek case. As an example, Massoc and Jacob (2012) have demonstrated that Sarkozy in France relied on close informal ties between the state and the banks to handle smoothly the banking crisis. What makes the Greek case of particular interest is, that paradoxically enough, keeping these links intact in the first phase of the sovereign debt crisis was also in line the interest of international lenders. These links helped to reduce systemic risk and risk of contagion at the EU level, reduced the cost of the recapitalisation, and helped to avoid full nationalisation of the banking sector in the long run, which would have been problematic for the ECB (Musevar, 2016). More particularly, there were at least three ways that the delay in corporate governance reforms and the maintenance of "informal bank–state ties" served as a crisis management tool during the sovereign debt crisis: the purchase of Greek government bonds before the PSI, the raising of 10% of private capital in the first recapitalisation which helped to preserve business autonomy, and the resolution process.

First, the crisis was triggered when the newly elected government of Papandreou in October 2009 revealed that the budget deficit would be around 12.5, twice as much as was previously reported. In May 2010, Greece was the first country to lose access to capital markets. There is an extensive argument among economists about whether Greece's debt could have been restructured sooner and how 2010 would have been an ideal time. However, it is questionable whether this would have been politically feasible given the impact on banks' balance sheets in core countries, notably France and Germany (Xafa, 2014). According to the IMF (2013), the programme served as a "holding operation" that allowed private creditors to reduce exposures.

The exposure of core euro area banks, especially French and German banks, was a key reason for delaying the PSI, because there was the fear that their losses would have significant implications for systemic instability (Xafa, 2014). In contrast to foreign banks, Greek banks did not benefit from the opportunity presented by the ECB Security Market Programme (SMP) to offload the GGBs prior to the PSI. This was a sovereign bond buying operation launched by the ECB on 9 May 2010 and maintained until September 2012 (EC, 2020). In essence, exposure of Greek banks

[7] Interview 2

was on the rise from mid-2009, while that of foreign banks was declining (EC, 2010). The exposure of Greek banks to GGBs in December 2011 was 9.4% of the total banking assets, almost 70% higher than in May 2008. While there was a similar trend of domestic banks increasing their portfolio of government bonds during the initial stages of the crisis in other programme countries as well (Merler and Pisani-Ferry, 2012), Greek banks were holding a much greater proportion of domestic government debt compared to the rest of the Eurozone countries. Bank for International Settlements data on cross-country bond holdings suggests that foreign banks held €25 billion of Greek Government Bonds at the end of June 2011 when the PSI was being negotiated, Greek banks €60 billion and the ECB €50 billion (Xafa, 2014).

As a consequence, Greek banks suffered the largest losses in the PSI. In principle, they could have avoided default by holding fewer GGBs. Besides deriving profits on spreads, profit-oriented banks have no commercial interest in keeping Greek bonds. Evidence suggests that government pressure must have played a role. One reason for this is that in general the banking sector's survival also depends on the sovereign's survival, meaning that in times of crisis the banks and state are strongly united in their desire to avoid an economic collapse.[8] Moreover, banks that had strong ties with the government were pressured to buy government bonds and this pressure was stronger during the crisis when the government had difficulty refinancing itself.[9] The authorities were concerned about the potential rise in spreads on GGBs in the case of a sell-off by Greek banks, and therefore they encouraged them not to go ahead. This is evident as the domestic exposure was indeed greater for state-controlled banks than for those controlled privately (EC, 2020). Holdings for GGBs and other loans to the Greek state were 303% of capital for the aggregate of state-controlled banks and 171% for the aggregate of privately controlled banks (Haliassos et al., 2018). Hence, it can be easily demonstrated that the long-term relationship between the banks and the state was of particular help in that moment that Greek state that had no other alternative way of financing itself.

However, it is important to bear in mind that the banks complied with their government's request because they trusted they would be repaid some day in the future. This is explained by the uneven distribution of losses in the restructuring. Whereas pension funds and other domestic bondholders suffered losses of around 65% of the present value of their claims, only the banks were compensated in full through the mechanism of bank recapitalisation (Musevar, 2016).

As described above, all recapitalisations and resolutions under the three EAPs aimed to maximise the involvement of private investors and minimise the state's control of

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[8] Interview 2

[9] Interview 9

the banking sector (EC, 2020). This approach stemmed from a general mistrust of the state's capacities, given the government's mismanagement of the economy prior to the crisis. This is why in the first recapitalisation was that if private investors could buy at least 10% of the shares in a bank, then they could exert full control, despite the state (via the HFSF) holding the majority of the shares. It is very important to underline that under the first recapitalisation banks had negative equity. This is why the design of the first recapitalisation was extremely challenging due to the fact that finding 10% would be critical in a period when private investors had only limited appetite for investing in Greek banks.

This was the second way by which personal contacts and the maintenance of old management was an important crisis management tool. According to interviews, foreign investors expressed only limited interest in Greek banks.[10] Thus, with foreign investors shying away and domestic investors having limited capacity, finding this 10% was a very challenging task.[11] Characteristically, bank managers exerted huge efforts; telephone calls and personal visits to clients and Greek businessmen were taking place on a daily basis. This was a period when mutual trust and the long-term personal relationships between banking and business elites were of major importance. Therefore, replacing the management at that time, or after the recapitalisation, would have almost certainly created problems in terms of raising the required private capital. If the managers knew that they would be replaced, they would not have the incentive to utilise their networks. Moreover, their knowledge of the structure of the Greek economy their links with business elites were also very useful during this period.[12]

According to a European Commission report (2020), based on interviews with representatives of three institutions who were directly involved in the process, the goal of maximising the involvement of private shareholders was driven by the fact that the institutions had anticipated that more stress tests would be needed, with the possibility of further recapitalisations. Limiting state involvement was therefore a way of preserving state funds. According to the IMF (2013b) the private sector's participation in the first recapitalisation was stronger than envisaged. The existing banking elites seemed to have played a decisive role in finding and attracting private investors. Had this not been the case, the state's financial injections could have been greater, increasing the final bill and complicating subsequent privatisation. Paradoxically, the bank managers' efforts to raise the 10% to avoid state intervention was in line with the interests of international lenders but also of the Greek state that was struggling to keep the final bill to a minimum.

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[10] Interview 8 and Interview 9
[11] Interview 8
[12] Interview 8, Interview 15

The final and very important way that bank–state ties served as a crisis management tool and helped safeguard financial stability concerns the process of resolutions. The Ministry of Finance, in cooperation with the Bank of Greece, set up the institutional framework (Laws 4021/2011 and 4051/2012) for the resolution of credit institutions. In all these cases, the resolved credit institutions were considered non-viable and concurrently not systemically important. The public funds used for these banks amounted to €13.4 billion. The forms of resolution that were selected were either the establishment of a transitional credit institution (Proton, Hellenic Postbank) or the transfer of assets (or part of the assets) to another credit institution (T-Bank, the Agricultural Bank of Greece, FBB, Probank and the other cooperative banks). The process of resolution for credit institutions was accompanied by a series of takeovers and transfers, including branches of Cypriot banks. The resolutions completely altered the banking landscape (Triantopoulos, 2014). The total number of credit institutions in Greece in 2013 was limited to 41 (from 66 in 2000). The ratio of the share of the five largest banks in the whole banking system amounted to 97% in 2013 from 70% in 2008, while in the EA the same ratio was kept to just below 50% (Triantopoulos, 2014).

The main priority for the Bank of Greece was to safeguard financial stability and protects deposits in the entire domestic banking system. In the economic environment of the time, withdrawing the authorisation of even a small bank entailed a systemic risk (Bank of Greece, 2014). It is important to underline that between February 2010 and June 2012, the Bank of Greece had to deal with successive incidents of sizeable cash outflows. According to the breakdown of demand on a weekly basis, 11 weeks with cash outflows of over €1 billion were recorded. Characteristically, on 14 June 2012 the Cash Processing and Distribution Centre in Halandri served 76 cash-carrier vehicles for the delivery of cash to credit institutions, against a daily average of 20 vehicles for cash dispatches and receipts (BoG, 2014). Considering the timing of resolutions when the bail-in and the bank holiday in the Cypriot banking system took place (first semester of 2013), such dangers were highly elevated (Bank of Greece, 2014).

In these adverse circumstances, entry by foreign banks was very difficult to achieve due to the high sovereign risk and economic uncertainty. Thus, with limited entry by foreign banks, it was the systemic four banks that absorbed the resolved institutions. Meanwhile, the idea was that resolutions would help the systemic banks obtain satisfactory capital adequacy, improve their liquidity margins and enhance their efficiency through the achievement of synergies and economies of scale. It is unquestionable that the four systemic credit institutions significantly expanded in size. The share was as follows: Piraeus Bank had a 26% share (from 11% in 2008), the National Bank of Greece had a 24% share (from 18% in 2008), EFG Eurobank had

23% (from 20% in 2008) and Alpha Bank had 19% (from 14% in 2008) (Triantopoulos, 2014).

While the high concentration of the banking system is what is mainly discussed with reference to the recapitalisation process, it is very important to understand that if any of these banks collapsed, it could have potentially lead to a bank run.[13] Moreover, finding a potential buyer for the good parts of the non-systemic institutions was a difficult task because the remaining banks' loan books were of ambiguous quality,[14] given that as the recession deepened they were expecting more of their loans to become non-performing.

Banking elites were particularly helpful during this crucial period of the resolution process, sometimes absorbing banks literally overnight, preventing deposit outflows and decreasing the financial stability risks.[15] In order to demonstrate how "the banks and state once again held each other's hands", we focus on the Cypriot bank branches in Greece where the risk of contagion was extremely high, and also the case of ATEbank that suffered from chronic structural problems. Both were absorbed by Piraeus, which was the bank that increased its share more than any of the other four institutions. In both cases, it was not easy to find a prospective acquirer in a short time frame.

The second reason for focusing on these particular cases relates to the profile of the bank's chairman, Mr. Michalis Sallas, as articles in the international press have often associated his name with "crony banking".[16] According to an article published by The New York Times (2013): *"Mr. Sallas has pushed the boundaries of proper banking too far and […] his manoeuvring in the murky world of Greek finance, where the interests of bankers, the media and politicians often commingle, should be more closely scrutinised."* On the other hand, Sallas's supporters say that he claimed *"he should be hailed for his entrepreneurial expertise and robust appetite for risk"* (FT, 2018). There is no doubt that Sallas had been actively involved in politics. In 1974, he was a founding member of PASOK, Papandreou's party. In successive Papandreou governments, he served as General Secretary of the Ministry of Commerce, Governor of the Hellenic Industrial Development Bank, economic advisor to the Prime Minister and chairman of the committee for the modernisation of the Greek banking system, among other positions. At the same time, Piraeus, under the management of Sallas, had been adopting quite an aggressive strategy regarding mergers and acquisitions. Besides the state-owned Agricultural Bank and Cypriot

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[13] Interview 15, Interview 16, Interview 14

[14] Interview 15, Interview 13

[15] Interview 15

[16] Reuters (2012); New York Times (2013).

banks in Greece, Piraeus also took over operations of France's Societe General and Millennium BCP and the Greek assets of Laiki and the Bank of Cyprus.

Some commentators suggest that given the lack of entry and competition, it is possible that the large banks earned rent by absorbing the remaining banks at a price below their true value (Haliassos et al., 2018). Nonetheless, with the benefit of hindsight one can argue that the rents could not be too large as otherwise the banks would have been able to attract more private capital in June 2013 (Haliassos et al., 2018). Finding a timely acquirer of ATEbank and Cypriot branches when investment appetite was so low was critical for the Greek government and for safeguarding financial stability.[17] This was recognised by the Bank of Greece, the Greek government and the four systemic banks.[18]

As a result of its close entanglement with the state, ATEbank's assets were of poor quality. Proof of its major weaknesses was the fact that it ranked last among 91 large banks in the EU-wide stress-testing exercise conducted by the European Banking Authority in 2011. Following the PSI, capital adequacy ratio decreased by 26% at the end of 2011 and the bank's own funds turned out to be negative (-€3 billion) (BoG, 2014). Indeed, in view of all these weaknesses and the bank's long-standing poor performance, some representatives of the troika were of the opinion that ATEbank should be closed (BoG, 2014). However, closing it would add thousands to the unemployment roll. Over €20 billion would be needed for the compensation of depositors and the return of the euro system's financing (BoG, 2014). Thus, only two options remained: either transfer the bank's sound part to another credit institution, if a prospective acquirer could be found, or re-establish the bank as an interim credit institution and sell it within a short time frame. As for the path taken, in early May 2012 the Bank of Greece invited the four largest Greek banks (the National Bank of Greece, Alpha Bank, Eurobank and Piraeus Bank), which were considered to be systemically important and were recapitalised by the HFSF, to consider acquiring ATEbank's sound assets and liabilities. The Bank assigned two international investment banks to explore any interest from foreign investors (BoG, 2014).

These investment banks informed the Bank of Greece that no such interest had been expressed from abroad. Piraeus was the only bank to submit a binding proposal; the price quoted in its bid was €95 million, which would accrue to the "bad bank" (Bank of Greece, 2014). While it is extremely difficult to assess the counterfactual scenario, it has been stated many times that the view of the Bank of Greece and the Greek

[17] Interview 15, Interview 13
[18] Interview 16, Interview 13

government was that if ATEbank closed, it would be a threat to systemic stability and incur costs for the taxpayers.[19]

As a result of the resolution options for unsustainable credit institutions, the main objectives of BoG were the protection of depositors, the retaining of employment in credit institutions and the assurance of systemic stability.[20] According to one former cabinet member, in this sense: *"Sallas[21] was very helpful at a critical time for the government. If those banks had gone under in Greece, it could have sparked a disastrous bank run"* (Financial Times, 2015).

This was even more obvious in the case of Cypriot banks. The Eurogroup's decision on Cyprus in March 2013 was the most important threat to financial stability in Greece at the time. It was necessary to ensure the smooth transfer of the assets and liabilities of the Cypriot banks to Piraeus via a tendering process. This task was extremely complicated, and it needed to be done in short time in order to ensure that deposits with Greek branches of Cypriot banks would be excluded from the bail-in and that the Cypriot branches would continue to serve their clients efficiently (BoG,2014). This was necessary in order to minimise the risk of contagion to the Greek banking system.[22] In an interview at Fortune on 9/3/2020, when asked about the most critical moment of his career, Mr. Sallas answered: *"The most critical day was the 26 March 2013 when the board of directors decided to absorb the Cypriot branches. We understood that if we didn't intervene there, the country wouldn't be able to avoid default, and the banks would be closed."*

In interviews conducted with senior members of the central bank, senior members of the government and banking elites, there was a common understanding that close cooperation between banking elites was necessary to safeguard financial stability. While, it has been often discussed that Piraeus's strategy at the time was to become "too big to fail"[23], there is no doubt that the acquisition of Cypriot banks by Piraeus was very important for "saving" banking activity. The sovereign's fate was linked with the fate of banks and close links helped to act sometimes "overnight" despite the importance of the decisions taken.

"Informal bank–state ties" served as a crisis management instrument and helped to avoid extraordinary losses for the state, ensured financial stability and the sovereign's fiscal and debt position. It needs to be underlined, that this analysis does

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[19] Interview 14

[20] Interview 17, Interview 14

[21] Interview (In Greek) at fortune in 9/03/2020: Retrieved from https://www.fortunegreece.com/interview/michalis-sallas-i-trapezes-i-ikonomia-i-schesis-me-ton-gianni-stournara-ke-i-pio-krisimi-mera-tis-epichirimatikis-diadromis-tou/

[22] Interview 15

[23] Interview 11

not imply that the absence of bank state ties cannot also help in crisis times. In Eastern Europe the high level of foreign ownership made it possible for the Eastern markets to rely on foreign banks' willingness to maintain their credit exposure during the crisis. Instead of cutting and running during the crisis, Epstein argues (2017) that foreign banks worked together with the European Bank for Restructuring and Development and the International Monetary Fund to maintain their presence and their market share, and, more importantly, the stability of Eastern markets.

7. The third recapitalisation: The break of "informal" bank–state ties

Bank–state ties were transformed completely after the third recapitalisation. The third programme provided stricter selection criteria with regard to the qualification and experience of banks' board members. However, these criteria were stricter compared to international standards, restricted the candidates to banking and financial expertise. In January 2015, the left-wing party Syriza and the right-wing party ANEL formed the government and both opposed the provisions of a bailout plan. The Syriza-led government's long negotiations with the Troika and the announcement of a referendum regarding the new bailout agreement intensified deposit flight and Grexit fears returned. Moreover, the ECB did not increase the loan limit.

In these circumstances, banks were again in extensive need of capital, given the six-month run-on deposits, the imposition of capital controls and the large number of non-performing loans. The SSM decided to conduct a new Asset Quality Review (AQR) and perform new stress tests on the four systemic banks despite the fact that a similar exercise had been conducted one year earlier on all large European banks. While banks were not required to raise new capital as a result of the previous AQR, after this AQR they had to acknowledge an additional combined capital loss of €9.6 billion. They were required to raise €13.7 billion. Alpha bank and Eurobank managed to raise their required capital needs from the private market (ECA, 2017) and HFSF's participations decreased from 66,2% to 11%, and from 35,4% to 2,3% respectively. HFSF became the major shareholder with full voting rights in the National Bank of Greece and Piraeus Bank.

However, this did not mean that state would have an influence in the banking sector. After the third recapitalisation, significant changes were applied with the third Economic Adjustment Programme regarding corporate governance in the banking sector. Firstly, the government's say in the HFSF was reduced. According to Law No. 4340/2015, which was based on the provisions of the MoU between the ESM and

Greece, a new procedure for the selection of members of both the Executive Board and the General Council was added to the HFSF law. More specifically, a selection panel was established, comprising six members, three of whom were appointed by the EU institutions (including the Chair, who held the deciding vote in split votes), two by the Ministry of Finance and one by the Bank of Greece. Thus, with the third EAP, Eurozone representatives gained most of the decision-making power.[24]

Moreover, the creation of the EBU had already enhanced bank's governance and weakened bank state ties. The Single Supervisory Mechanism (SSM) had to approve the banks' senior appointments, now regulated the four large banks. Within the SSM, the ECB and the national competent authorities (NCAs) jointly assess the "fit and proper" of new board members against five criteria: experience, reputation, conflicts of interest and independence of mind, time commitment, and collective suitability. However, when applying these criteria, the ECB's Banking Supervision adopted a case-by-case approach, taking account of the specificities of national law.

According to a provision of the MoU between the ESM and Greece in August 2015, the HFSF would introduce a process to review the board and committee members of the four systemic banks, with the help of an independent international consultant. Law No.4340/2015 (and its amendment No.4346/2015) established the following reviewing criteria for the members of boards of directors: They must have at least ten years of senior management experience in the areas of banking, auditing, or risk management, which should include, especially for non-executive members, a past tenure of at least three years as a member of a board of directors at an international financial institution. Moreover, individuals who had served in senior civil servant, public corporation or partisan positions over the previous four years were excluded from board membership. Independent, non-executive experts should have fifteen years' international banking experience and at least three years' experience as a board member or in a senior managerial position (which should have been acquired in institutions not operating in the Greek credit market). In addition, at least one member should have expertise and at least five years' international experience in risk management and distressed asset management (ECA, 2020).

HFSF conducted a tendering process according to which Spencer Stuart was selected as the preferred consulting firm for the evaluation procedure. By the end of 2016, 44% of the total board headcount and 58% of all non-executive directors were replaced (HFSF, 2017). It is clear that this reform was aiming to replace management teams in order to break the linkages between banks, politicians and business elites.[25] The objective was to ensure complete independence of banks that were recapitalised by the Greek government but also to stop poor lending practices.

[24] Interview 21

[25] Interview 22

Additionally, the requirement for three independent international experts with no affiliation to any Greek credit institution over the previous ten years is indicative of the intention to remove part of the long-term management of the banks. According to surveys conducted by the European Commission (2020) there was a widespread view, that weak corporate governance and loose credit conditions played a role in contributing to the build-up of NPLs. The NPL ratio rose from 4.6% in 2007 to 9.1% in 2010 and to 31.9% in 2013 before surging to 47.5% in 2016 (Siokis,2019).

While many representatives of the banking sector thought that the reforms were proceeding in the right direction, these criteria have been characterised as being overly strict (ECA, 2017; Katseli, 2020). The reason for this is that the criteria restricted the candidates to banking and financial expertise.[26] Also entrepreneurs with deep knowledge of the structure of the Greek economy were excluded.[27] It has been suggested that this requirement was not fully aligned with international practices and EU/SSM requirements, which, in principle, promote board diversity and collective knowledge (Katseli, 2020). More specifically, as stated in Article One paragraph 1 of the EU DIRECTIVE 2013/36/EE (CRD, IV),

"Members of the management body shall at all times be of sufficiently good repute and possess sufficient knowledge, skills and experience to perform their duties. The overall composition of the management body shall reflect an adequately broad range of experiences."

Given the uniqueness of the Greek case, and how aggressive the changes were, attributing the weakening of informal bank–state ties purely to the creation of the EBU is rather misleading. One should also explore other simultaneous political developments. The background behind the decisions regarding the criteria is not publicly available (Katseli, 2020). According to Katseli (2020), who was Chair of the Board of Directors of the National Bank of Greece and Hellenic Bank Assocation, changes in corporate governance were strongly pushed by the Troika. The IMF (2017) had expressed its views about a stringent fit and proper test for board members multiple times.

"Post-2013, imposition of a stringent fit and proper standard for board members and management, and other strict governance rules immediately after the PSI, might have accelerated the improvement in banks' governance, avoiding the need to police problems on a case-by-case basis (IMF, 2017)".

Hence the question remains why they were only implemented under the third EAP. According to Katseli (2017) some claim that if Syriza was not in power, these

[26] interview 10, Interview 12

[27] Interivew 10

measures would never have been implemented. The election of a left-wing Syriza-led coalition government and the fear of interference in the banking sector seem to have played a pivotal role in completely transforming the bank–state ties. In interviews conducted with government officials, it is clear that there was a widespread fear that, under Syriza, banks would be susceptible to political interference.[28] These views are also confirmed by Troika officials and by articles in the international press.[29] Characteristically, a Wall Street Journal (2014) article describes how threats from members of Syriza to nationalise bank "spooked some investors". Indeed, the election of Syriza triggered a fresh wave of Grexit fears and deposit runs as the government came to power with anti-austerity rhetoric. This political uncertainty combined with fears of political interference in the banking sector would be something that would discourage private investors' participation.[30]

Private sector's participation in the third recapitalisation was crucial. There is an extensive discussion about how the state, the Troika and also the banks were in favour of raising private capital and speeding up the bank recapitalisation process in order to avoid triggering new "burden-sharing" rules that came into effect on January 1, 2016. Bank share prices, sunk to new low ahead of the November offering. The idea to impose a haircut on unsecured deposits in excess of 100.000 Euro, would also Greek corporations and this have further affected negatively economic activity.[31] Asking all four systemic banks to raise funds at the same time in a risky market environment before the government had shown a dedication to the programme appeared to be difficult to achieve.[32] In this political turmoil, corporate governance needed to be enhanced as well. The implementation of strict measures was necessary to limit the state's interference in the financial sector. According to the Wall Street Journal (2016), *"European Regulators argue that boards must be gutted if the banks are to attract foreign capital to clean up their balance sheets"*.

In 2015, it is quite remarkable that despite the losses, many of the private investors decided to participate in the new offering. Many argue that private investors, would not be inclined to participate in the new offering if they had not acquired control of the banks at fire-sale prices (Xafa, 2016). Another potential reason that explains why investors were still eager to invest is that the ones that had invested previously (2nd recapitalisation), they want to avoid making it a failed investment, thereby giving the Greek banking systems another opportunity.[33] Moreover, there was a consensus that the need for recapitalisation had nothing to do with the banks themselves as they were found to have sufficient capital in the comprehensive assessment that was

[28] Interview 6, Interview 22
[29] interview 20
[30] Interview 21, Interview 23
[31] Interview 7
[32] Interview 8
[33] Interview 23, Interview 21

conducted before the ECB took over the supervision of the EA banks in November 2014. In the end, foreign private funds participation was of major importance in the third recapitalization Foreign investors' presence increased and formal and informal ties between the banks and the states were weakened via, changes in HFSF governance and corporate governance reforms.

To summarize, while in the first phases of the crisis bank–state ties were considered to be a useful crisis management tool, under the Syriza-led movement, the banks' political susceptibility was seen as an obstacle to attracting private capital at a time when banks were thirsty for it.[34] The links between the state and the banks had to be weakened this time in order to safeguard financial stability. In this sense, it can be concluded that, beyond the creation of the EBU, it was mainly that foreign investors lacked trust in Syriza led government that pushed for far-reaching corporate governance reforms and for breaking "formal and informal ties" between the Greek banking sector and the state.

8. Conclusion

Focusing on the Greek institutional context, the paper analysed the dynamics surrounding the breaking of bank-state ties in an extreme case and under crisis conditions. Namely, in Greece formal and informal relationships between political and banking elites were traditionally present, while at the same time the pressure for transformation coming from international lenders was expected to be quite high.

Yet, the analysis provided a more nuanced narrative. In the first two EAPs business autonomy was preserved, the state had shares with no voting rights and the "formal ties" between the banks and the state were broken. At the same time, there were no substantial measures in the first two EAPs to evaluate and restructure the governing boards of Greek banks- preserving in that way the informal links between the banking and political elites. The most important changes to the management of the Greek banks came at the beginning of the third EAP, through the HFSF review of the boards and committees of the four systemic banks, with newly established and strict criteria.

The article argues that the delayed breaking of bank-state ties in Greece should be attributed to the latter's use as a crisis-management tool. In particular, the government's ties with the management of the systemic banks facilitated a relatively efficient handling of a crisis, which was the most severe in the Euro-area and in the country's recent history. Greece managed to respond to the crisis and to the threat

[34] Interview 5

of a systemic collapse of the banking sector, thanks to a close network between state and its banks. At the same time, international lenders benefitted indirectly from these informal links, hence turning a “blind eye”. Given the high risk of contagion these links limited the financial risk within the country’s borders.

Of course, the downside of this phenomenon is that the overlap between private and public spheres prevents a pluralistic debate among different actors. More specifically, the interests of ordinary citizens are not represented, despite the fact that it is taxpayers that undertake the burden of the bailouts (Massoc and Jacob, 2012). Moreover, the existence of these links is thought to have negatively affected the banks’ ability to attract long-term strategic investors and deal with the problem of rising NPLs earlier.[35]

Lastly, this study demonstrated that the break of bank state ties that came only with the third EAP was very radical and was a result of domestic political developments. In particular, investors’ and creditors’ lack of trust in the Syriza-led government, led to a complete break of bank-state ties. This final break occurred when these links were not considered anymore “useful” for crisis management neither at the domestic nor in the international level. On the contrary, they constituted an obstacle for attracting private capital in the banking sector in a period that it was needed the most. Once again, the implications of these measures will be evaluated in the long run. If one thinks optimistically, the experience of Eastern European countries with the recent crisis demonstrates that the presence of foreign banks and the weakening of bank state ties do not lead necessarily to inability to handle the crisis and financial instability. On the other hand due to the radical nature of these measures, experts with valuable and diversified knowledge of the Greek economy and its different sectors will be excluded from the management of the financial sector. In post-pandemic word, some argue that this can affect the country’s growth strategy.

[35] Interview 20

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Annex 1

In the occasions that interviewees had moved from the positions they held during the crisis to new roles, the list reflects the stakeholder group they belonged at the time of the recapitalizations.

Stakeholder Group: Greek Government

1. Senior Government Official, 02/02/2020, Athens
2. Senior Government Official, 11/03/2019, on-line communication
3. Senior Government Official, 16/03/2020, on-line communication
4. Senior Government Official, 30/01/2019, Athens
5. Senior Government Official, 03/02/2020, Athens
6. Senior Government Official, 05/02/2020, Athens

Stakeholder Group: Greek Systemic Banks and Bank of Greece

7. Bank senior executive, 04/02/2020, Athens
8. Bank senior executive, 29/01/2020, Athens
9. Bank senior executive, 30/01/2020, Athens
10. Bank senior executive, 06/02/2020, Athens
11. Bank expert, 30/01/19, Athens
12. Bank senior executive, 28/11/19, Athens
13. Bank official, 31/01/2020, Athens
14. Bank official, 30/01/2020, Athens
15. Bank official, 29/11/2019, Athens
16. Bank official, 29/11/2019, Athens
17. Bank official, 27/11/2020, Athens

Stakeholder Group: Troika

18. Troika officials-Group interview, 16/06/20 on-line communication
19. Troika official, 20/03/2020, Telephone interview
20. Troika official, 06/02/20, Telephone Interview

Stakeholder group: Others

21. Financial sector expert, consultant to the Greek Government, 24/03/2020 on-line communication)

22. Lawyer, involved in recapitalizations consultant to Greek Government, 5/02/2020, Athens
23. Financial sector expert, 7/02/2020, Athens
24. Lawyer with expertise in banking and finance, 03/02/2020 Athens
25. HFSF official, 28/01/2020, Athens

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