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The Experience of Exchange Rate Regimes in Southeastern Europe in a Historical and Comparative Perspective

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Greece

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1. Major Monetary Events

The story of the Greek drachma is a case rich with defaults, multiple switches on and off metallic standards and political and military events. In the past, Greece had tried many times to end histories of macroeconomic instability through participation in the prevailing international monetary system. The country's monetary history before the First World War has been marked by experiments with silver in the very early years of the Greek state, bimetallism in the middle of the 19th century, the classical gold standard in the last quarter of the century and the gold-exchange standard in the interwar period. As an even stronger form of commitment, Greece even joined the Latin Monetary Union (LMU) in the 1867.² The causes of the suspension of convertibility were not only the emergence of some sudden event, such as war, threat of war and financial and banking panics (often due to feared suspensions), but the government's failure to pursue fiscal and monetary policies compatible with its commitment to ensure fixed rates. However, the periodic abandonment of and the subsequent return to metallic standards³ reveal the government's strong commitment to the specie rule. Throughout the period prior to the Second World War, the monetary authorities regarded the suspension of the drachma's convertibility as a reaction to an emergency, such as

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² For a detailed discussion on the monetary history of Greece, see Lazaretou (1995, 2004, 2005a). Lazaretou (2005b) provides historical and empirical evidence that Greece followed a fixed-rate regime with the accepted "escape clauses" for war and financial emergencies.

³ From 1828, when for the first time, a national monetary system based on silver was introduced, to 1936, when the country entered the "Sterling Area", the Greek economy experienced eight episodes of suspension of gold or foreign exchange convertibility.

war. Once hostilities ceased, they made efforts to return to the “natural state”, i.e. convertibility.

2. Variables’ Definitions

We present four key historical time series, namely, the nominal exchange rate; total banknote circulation; total reserves; and the discount rate. All series cover the period prior to the First World War and have an annual frequency. We present the nominal exchange rate of the drachma *vis-à-vis* the French franc (FRF). The FRF was set as the common monetary unit in the LMU countries. By signing the LMU agreement in 1867, Greece accepted the principle of bimetallism and the equivalence of the gold drachma with the gold FRF (parity 1:1).^{4,5}

Until the end of the 1890s the drachma suffered from strong devaluations due to loose fiscal policy and accommodated by loose monetary policy. However, from the turn of the century onwards, the devaluation pressures were reversed by a strong revaluation thanks to restrictive fiscal and monetary policies pursued in the context of the international agreement for foreign debt compromise. As a result, from 1.8 drachmas per FRF in 1898, the exchange rate fell to 1:1 in 1909, which was the par parity according to the LMU agreement.

The data for bank notes in circulation refer to the bank notes issued by the National Bank of Greece and held outside the banking system.⁶ The time series

⁴ However, she only signed the agreement; she did not participate as a full member, at least until 1909. Wartime emergencies prevented the government from introducing the new system. With the exception of an unsuccessful experiment with the gold standard in 1885, Greece credibly adopted gold as late as 1910.

⁵ From 1828 to 1832 Greece was on a silver standard. The legal tender was the silver phoenix. Bimetallism was introduced in 1833. The new legal tender was the silver drachma and the gold drachma, equal to 20 drachmas. The silver drachma was fixed as equal to 4.029 grams of pure silver and the gold drachma as equal to 0.25994 ($\times 20 = 5.199$) grams of pure gold. In other words, the silver drachma contained 15.5 times as many grams of silver as of gold. Thus, the legal ratio was 1:15.5. However, according to the LMU agreement, the members’ currencies should be equal to one other. The gold FRF (20 FRF) was fixed as equal to 0.2903 ($\times 20 = 5.806$) grams of pure gold while one Greek gold drachma was equal to 5.199 grams of pure gold. Thus, the par exchange rate was 1 FRF = 1.1168 drachmas. To achieve the 1:1 parity, the new drachma was minted in November 1882 and was introduced as the new monetary unit. It was fixed as 0.29 grams of pure gold and was equal to 0.8954 of the old drachma.

⁶ Until 1927, the National Bank of Greece, created as a universal bank, enjoyed the note monopoly for bank notes circulating nationwide. Three other commercial banks were also allowed to issue bank notes, but their notes were permitted to circulate only in an extremely limited geographical area and, as a result, the quantity of their banknotes in circulation was very small. In 1928 a central bank – named the Bank of Greece – was first established. All the other banks became pure commercial banks.

labeled “reserves” is the sum of metallic and foreign exchange holdings. Metallic denotes silver plus gold that the Bank used to hold in its Treasury in the form of barren metal. From 1877 onward, metallic stock consisted mainly of gold. Specie came mainly from trade and a small portion came from direct investment in residential and commercial property as well as portfolio investments. From 1869 onwards, the Bank also used to hold gold convertible interest bearing deposits denominated in foreign currencies. In the periods of fiat money standards (1869–1870, 1877–1884, 1886–1909) the upward movement of note circulation was accompanied by a downward movement of total reserves so that the reserve-banknote ratio was reduced to very low levels. Conversely, in the periods of metallic standards, note circulation varied positively with gold and foreign exchange reserves. Both moved in a way so that the reserve-banknote ratio increased and remained close to unity.⁷

The discount rate presented was imposed by the Bank on short term advances to traders (such as bills of exchange with a three-month maturity). The Bank used to impose this rate on advances to the government, too. The Bank lent to the government short term capital, setting very high risk premiums (an interest rate of 7-8%, compared with interest rates in the international capital markets of 2.5–4.5%).⁸

3. Data Sources

The data for the banknotes in circulation and total reserves are from the *Annual Report* of the Governor of the National Bank of Greece (1842–1914, various issues) and the annual and semi-annual *Balance Sheets*. In his *Annual Report*, the Governor describes in a particular section the developments of the Bank’s asset items. In this section, a table presenting the monthly data can be found (end-of-month). The minimum and the maximum values throughout a specific year are also presented, and the annual averages as well. The historical data for the nominal exchange rate of the drachma against the French franc (spot rates, year averages, fixing) are from the *Annual Report* of the Governor and the Greek National Statistical Service, *Monthly Bulletin* (1885–1914, various issues). Valaoritis (1902) and Zolotas (1929) are additional sources. The data for the discount rate have been

⁷ According to the National Bank’s statute, no less than 25% of banknotes in circulation should be covered by metallic or/and foreign exchange reserves.

⁸ Since the international capital markets of London and Paris were closed to Greece (till 1878) due to her bad reputation as a borrower, the only option for the government to cover pressing finance requirements was short term domestic debt issues by the Bank at a very high rate. According to the law of 1836, the lending rate on trade advances should not exceed 12%. However, the market rate was more than 20%; in the provinces it was even higher. Thanks to the beneficial impact of the Bank’s operation from 1842 onward, lending became much cheaper.

collected (dates of change) from the *Annual Report* of the Governor (various issues). Particularly, see that part in which the Governor discusses the progress of the Bank's lending activity over the previous year.

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Table 1: Greek Historical Time-Series, 1842–1914

	Exchange Rates drachma/French franc	Reserves: metallic stock and foreign exchange reserves	Banknotes in circulation
Year	<i>(Annual averages)</i>	<i>(End-of-year values in thous. new drachma)</i>	<i>(End-of-year values in thous. new drachma)</i>
	<i>(1)</i>	<i>(3)</i>	<i>(2)</i>
1842		397.50	274.60
1843		345.90	601.40
1844		535.90	799.00
1845		762.30	1,511.30
1846		771.80	2,079.70
1847		620.10	1,699.50
1848		964.00	1,101.90
1849		1,205.80	1,397.70
1850		1,114.70	1,978.60
1851		1,218.20	1,561.10
1852		1,473.80	1,839.10
1853		1,822.70	1,949.30
1854		3,424.80	2,575.40
1855		3,835.30	3,373.10
1856		5,191.40	5,333.40
1857		4,656.90	7,190.90
1858		4,717.40	6,983.30
1859		3,625.10	6,932.90
1860		4,411.00	7,487.60
1861		4,749.60	9,491.80
1862		6,105.40	11,355.20
1863		7,232.70	14,390.30
1864		6,461.40	15,633.80
1865		6,437.30	15,877.70
1866		6,101.60	15,206.20
1867		8,487.20	17,970.90

Table 1 continued: Greek Historical Time-Series, 1842–1914

	Exchange Rates drachma/French franc	Reserves: metallic stock and foreign exchange reserves	Banknotes in circulation
<i>Year</i>	<i>(Annual averages)</i>	<i>(End-of-year values in thous. new drachma)</i>	<i>(End-of-year values in thous. new drachma)</i>
1868		7,386.50	20,507.90
1869		10,955.30	23,608.00
1870		14,342.70	23,613.50
1871		14,207.10	25,180.00
1872		18,259.90	28,389.30
1873		18,359.50	33,380.90
1874		17,042.60	35,472.40
1875		17,959.80	32,278.70
1876	1.032	16,318.30	32,173.40
1877	1.026	13,270.80	38,985.50
1878	1.107	7,342.50	54,023.40
1879	1.048	18,591.80	45,991.90
1880	1.025	18,706.60	58,294.50
1881	1.048	15,041.30	84,948.30
1882	1.097	16,036.90	91,807.20
1883	1.141	15,712.50	96,429.40
1884	1.048	47,968.20	69,648.70
1885	1.058	13,735.90	76,968.00
1886	1.233	8,840.30	101,646.60
1887	1.263	9,519.00	101,859.90
1888	1.273	11,514.00	86,791.50
1889	1.230	13,123.60	90,425.30
1890	1.235	9,868.10	103,655.50
1891	1.298	10,549.90	120,870.80
1892	1.436	11,390.10	118,611.80
1893	1.608	10,129.00	110,936.10
1894	1.749	9,274.90	106,769.80
1895	1.802	9,559.80	108,954.00
1896	1.739	10,863.50	110,799.80

Table 1 continued: Greek Historical Time-Series, 1842–1914

	Exchange Rates drachma/French franc	Reserves: metallic stock and foreign exchange reserves	Banknotes in circulation
<i>Year</i>	<i>(Annual averages)</i>	<i>(End-of-year values in thous.new drachma)</i>	<i>(End-of-year values in thous.new drachma)</i>
1897	1.676	13,075.70	130,656.80
1898	1.474	11,750.30	121,235.20
1899	1.565	14,956.80	128,927.30
1900	1.644	19,268.40	137,754.20
1901	1.658	21,118.30	137,720.90
1902	1.625	19,084.90	143,305.90
1903	1.565	18,578.10	137,236.00
1904	1.378	23,172.50	132,697.00
1905	1.231	28,040.20	126,084.20
1906	1.100	37,587.40	129,219.50
1907	1.087	37,178.00	135,612.50
1908	1.081	44,723.40	127,667.30
1909	1.030	44,324.00	134,422.30
1910	1.000	72,940.20	132,997.30
1911	0.999	109,735.90	135,347.60
1912	0.999	173,993.30	196,746.00
1913	1.000	254,132.30	234,473.00
1914	1.002	212,113.00	252,206.00

Note: Column (1): nominal exchange rate of the drachma against the French franc (1876–1914). Data prior to 1876 do not exist. Spot rates, year averages. Column 2: total banknotes in circulation (1842–1914). Banknotes of low denomination (of one and two drachmas) are also included while coins are not included due to lack of data. End-of-year data, no seasonally adjusted, in thousand new drachmas. Column 3: total reserves (metallic plus foreign exchange, 1842–1914), end-of-year data, no seasonally adjusted, in thousand new drachmas.

Source: Column 1: National Bank of Greece, Annual Report of the Governor (various issues); Greek National Statistical Service, Monthly Bulletin, 1885–1925 (various issues); Valaoritis (1902); and Zolotas (1929). Column 2: National Bank of Greece, Balance Sheets (various issues). Column 3: National Bank of Greece, Balance Sheets (various issues).

Table 2: Discount Rate, 1841–1914

Year	Day	Month	%
1841	30	3	8
1847	1	4	7.2
1853	22	8	8
1869	1	4	7.5
1871	20	10	8
1878	1	11	7
1888	24	2	7
1890	1	1	6.5
1898	28	9	6
1901	1	7	6
1902	1	1	6.5
1908	1	7	5.5
1909	1	1	5.5
1910	1	1	6
1914	19	7	8

Source: National Bank of Greece.