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RECAPITALIZATION OF BATTERED GREEK BANKS ENTERING CRITICAL PHASE, NEW LEVY ECONOMICS INSTITUTE REPORT SAYS

EU Supervisors and Creditors Must Avoid Past Recapitalization Mistakes

ANNANDALE-ON-HUDSON, N.Y.— The battered Greek banks will soon face yet another round of recapitalization this November and December. For the banks to have any prospect of returning to their precrisis role as liquidity providers to the Greek economy, it is imperative that the country's EU creditors and supervisors avoid the pitfalls of previous recapitalizations, argues a new report from the **Levy Economics Institute of Bard College**. In their Policy Note *What Should Be Done with Greek Banks to Help the Country Return to a Path of Growth?* Emilios Avgouleas, professor and chair of international banking law and finance at the University of Edinburgh School of Law, and Levy Institute President Dimitri B. Papadimitriou stress that the recapitalization of Greek banks—perhaps the central issue for the Greek state today—has entered its most critical stage.

"Instead of repeating the mistakes of the past, recapitalization should create an environment of hope amidst renewed efforts to repair the Greek economy," write Avgouleas and Papadimitriou. "Any failure of the Greek government, the European supervisors, and, above all, the creditors to do so will have grave consequences for Greek savers, Greek businesses, and the country's euro membership."

Despite direct cash infusions to Greek banks that have so far exceeded €45 billion, with corresponding guarantees of around €130 billion, credit expansion has failed to pick up, Avgouleas and Papadimitriou state, stressing that there are two obvious reasons for this failure: first, the massive exodus of deposits since 2010; and second, the continuous recession—mainly the product of strongly deflationary policies dictated by international lenders. Following the 2012–13 recapitalization, creditors allowed the old, now minority, shareholders and incumbent management (regardless of culpability) to retain effective control of the banks—a decision that did not conform to accepted international practices. Sitting on a ticking time bomb of nonperforming loans (NPLs), Greek banks, rather than adopting the measures necessary to restructure their portfolios, cut back sharply on lending, while the country's economy continued to shrink.

Avgouleas and Papadimitriou suggest that the obvious way to rehabilitate Greek banking is the establishment of a “bad bank” that can assume responsibility for the NPL workouts, manage the loans, and in some cases hold them to maturity and turn them around. “This would allow Greek banks to make new and carefully underwritten loans, resulting in a much-needed expansion of the credit supply,” they write. “Sound bank recapitalization with concurrent avoidance of any creditor bail-in—which under the current circumstances would prove catastrophic—and implementation of robust and sensible corporate governance changes could help the Greek banking sector return to financial health. It would also be an effective first step in returning the country to the path of growth and would eliminate any remaining doubts about Greece’s euro membership.” Supporting their theory, the authors contend, are similar arrangements that have worked well both in Sweden, where it brought to speedy resolution the early 1990s Scandinavian banking crisis, and in the United States post 2008, with the Troubled Asset Relief Program making a small profit for the public purse while winding down.

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Policy Note 2015/6: *What Should Be Done with Greek Banks to Help the Country Return to a Path of Growth?*

To read the full text of this policy paper or to learn more about the Levy Economics Institute of Bard College, please visit www.levyinstitute.org/publications/what-should-be-done-with-greek-banks-to-help-the-country-return-to-a-path-of-growth.

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