COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 6.4.2005
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Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Art. 5 of Council Regulation (EC) No 1466/97 of 7 July 1997

on the updated stability programme of Greece, 2004-2007

(presented by the Commission)

EXPLANATORY MEMORANDUM

Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1] stipulates that participating Member States, that is, those which have adopted the single currency, have to submit stability programmes to the Council and the Commission. In accordance with Article 5 of this Regulation, the Council has to examine each stability programme based on assessments prepared by the Commission and the Committee set up by Article 114 of the Treaty (the Economic and Financial Committee). On the basis of a recommendation from the Commission and after consulting the Economic and Financial Committee, the Council is required to deliver an opinion, following its examination of the programme. According to the Regulation, Member States need to submit annual updates of their stability programmes, which may also be examined by the Council in accordance with these same procedures.

In view of a general government deficit of 3.2% of GDP and a debt ratio of 103.0% of GDP recorded in 2003, the Council decided that Greece was in excessive deficit on 5 July 2004 and recommended that the excessive deficit be corrected by 2005 at the latest. On 18 January 2005, the Council decided that Greece had not taken effective action in response to these recommendations. On 17 February 2005, also upon a Commission recommendation in accordance with Article 104(9), the Council decided to give notice to Greece to take measures for the deficit reduction below the 3% of GDP threshold by 2006 at the latest. The Greek authorities were also required to identify and control factors other than net borrowing, which contribute to the change in debt levels, and to improve the collection and processing of general government data.

The first stability programme of Greece, covering the period 2000-2004, was submitted on 19 June 2000 and assessed by the Council on 12 February 2001. Updates were presented every following year. Greece submitted the update of its stability programme covering the period 2004-2007 on 17 December 2004. The Commission did not assess it. A revision of the update of the stability programme was submitted on 21 March 2005. A fiscal package including additional measures was made public on 29 March. The Commission services have carried out a technical evaluation of this update, taking into account the results of the Commission services spring 2005 economic forecasts, and having regard to the code of conduct[2], the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances, the recommendations in the broad economic policy guidelines for the period 2003-2005 and the principles laid down in the Communication from the Commission to the Council and the European Parliament of 27 November 2002 on strengthening the coordination of budgetary policies[3]. This evaluation warrants the following assessment:

– The Greek 2004 revised update of the stability programme was submitted on 21 March 2005 and covers the years 2004 to 2007. The targets in the programme take into account the budgetary impact of a fiscal package, made public by the government on 29 March, to underpin the implementation of the revised programme, including a public commitment to target a deficit below 3% of GDP in the 2006 draft budget. The programme partly complies

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[1] OJ L 209, 2.8.1997. All the documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm.

[2] Revised Opinion of the Economic and Financial Committee on the content and format of stability and convergence programmes, endorsed by the ECOFIN Council on 10.7.2001.

[3] COM(2002) 668, 27.11.2002.

with the data requirements of the "the code of conduct on the content and format of stability and convergence programmes". The programme does not provide detail of the measures behind the targets for 2007. Price developments are presented in terms of the deflator of private consumption expenditure and not in terms of Harmonised Index of Consumer Prices. As regards the basic external assumptions the programme does not provide data on world GDP growth excluding EU nor the growth rate of relevant foreign markets as required by the code of conduct.

– The programme considers three different macroeconomic scenarios. The so-called baseline scenario essentially coincides with the macroeconomic framework provided in the 2005 budget. It optimistically assumes that the Greek economy will manage to sustain the economic momentum gathered until 2004 thanks to strong domestic demand. This scenario is clearly outside the current range of forecasts. In a second, less buoyant scenario, which is in line with the already outdated Commission services autumn 2004 forecast, GDP growth is projected at 3.3% over the programme period. Finally, in the third scenario, real GDP is projected to grow at 2.9% in 2005 and marginally accelerate to 3% in 2006 and 2007, which is essentially in line with the Commission services spring 2005 forecast. Consequently, based on the latest available information, this third scenario should be considered as the most plausible and used as reference for assessing the programme. The data in the scenario imply a rate of potential output growth that gradually eases over the programme period from around 3.3% in 2005 to 3% in 2007. This is also broadly in line with the estimates derived from the Commission services 2005 spring forecast. The deceleration in the underlying rate of growth is estimated to result from total factor productivity. The sizeable positive output gap recorded in 2004 is set to narrow somewhat up until 2007.

– According to the March 2005 reporting of deficit and debt levels in accordance with Council Regulation (EC) No 3605/93 (henceforth EDP notification), the general government balance is estimated to have recorded a deficit of 6.1% of GDP (6.0% of GDP according to ESA95 definition, i.e. excluding swap-related flows). This deficit is 0.8 percentage points higher than the figure of 5.3% of GDP estimated by the Greek government at the time of the September 2004 EDP notification. The EDP March 2005 notification presents an additional slippage, which includes, besides 0.3 percentage point of GDP higher interest payments, tax shortfalls and expenditure overruns worth an additional half a point of GDP, on top of those already unveiled in the September 2004 EDP notification. On 18 March 2004 Eurostat did not validate the deficit figures for Greece because of an inconsistent recording of flows between Greece and the EU budget. Eurostat also noted that healthcare- and Olympics-related expenditure for past years is not yet final. Therefore the government deficit figures for 2004 and earlier years may have to be revised upwards.

– The reference scenario used for the assessment of the programme targets a reduction of the nominal general government budget deficit by 3.6 percentage points over the programme period, from the outturn of 6.1% of GDP in 2004 to 2.4% in 2007. The fiscal adjustment is frontloaded and concentrated in 2005 and, to a lesser extent in 2006, while in 2007 the adjustment amounts to just 0.5 percentage point of GDP. The strategy aims at reducing the deficit to below the 3% of GDP reference value by 2006, in line with the Council decision under Article 104(9). To achieve the targets the programme relies on a mix of revenue-enhancing measures and expenditure retrenchment, which should result in increasing primary surpluses. The primary balance is projected to move from a deficit of 0.4% in 2004 to a surplus of 1.8% of GDP in 2005, rising to 3.3% of GDP at the end of the period.

In cyclically-adjusted terms, based on Commission services calculations carried out in accordance with the commonly agreed methodology applied to the data in the programme, the deficit would fall from 7.0% of GDP in 2004 to 4.4% of GDP in 2005, to 3.5% of GDP in 2006, and 3% in 2007.

– The deficit targets of the reference scenario are lower than those projected in the Commission services spring 2005 forecast, which projects deficits of 4.5% of GDP in 2005 and of 4.4% of GDP in 2006. A significant part of the difference is explained by the budgetary impact in 2005 and carryover effects in 2006 of additional fiscal measures to be implemented in 2005, which were announced after the cut-off date of the Commission forecast and amount to around 0.5 percentage point of GDP in 2005 and 0.9 percentage point of GDP in 2006. In addition, there are negative risks to the budgetary outlook for 2005 and beyond on both the revenues and expenditure side. Specifically, the trend projections for social security contributions appear on the high side while those for public consumption, especially health care and public wages, might be underestimated. Therefore, in line with their commitment announced on 29 March, the Greek authorities may have to implement additional measures in 2006, on top of those already announced for 2005, to effectively bring the deficit below the 3% threshold. Net of cyclical factors, the Commission services' forecast for the 2005 and 2006 deficit is above 5%. It stays above 3% of GDP even after taking into account the additional measures taken in March. Hence, the budgetary stance in the programme does not provide a sufficient margin against breaching the 3% of GDP reference value with normal cyclical fluctuations nor does it achieve the Stability and Growth Pact's medium term objective of a budgetary position of close-to-balance or in surplus throughout the programme period.

– The debt ratio is projected to decline from 110.5% of GDP in 2004 to only 109.5% in 2005 and then to 107.2% in 2006 and 104.7% in 2007. The increasing primary surplus and high nominal GDP growth would be the main driving forces behind the projected path of debt-reduction. A faster pace of debt reduction is hampered by significant debt increasing stock-flow adjustments (SFA), which, while declining compared to 2004, are expected to remain significant in spite of planned privatisation proceeds. The programme provides a detailed account of the operations behind the SFA in 2004. Therefore, it seems that some progress has been made in identifying the sources of the SFA. However, the programme does not provide details on the origin of the projected SFA over 2005-2007. The evolution of the debt ratio may be less favourable than projected given the risks to the budgetary targets mentioned above.

– The programme reviews the government's structural reform programme, which focuses on the re-orientation of public expenditures towards more productive uses. It also outlines measures to reduce business start-ups costs and to further open up markets to competition, especially network industries. On health-care, the government is preparing a reform aiming at ensuring financial sustainability and addressing some of the weaknesses of the system. However, while the programme does not give much detail of the corresponding measures, the plans for a far-reaching reform are still in a very preliminary stage. On the restructuring of expenditures, the 2005 budget foresees a reduction of consumption expenditure by over 16% in nominal terms. Such spending cuts appear optimistic since they affect certain components of the budget (wages, social transfers), the trends of which have always exhibited strong resilience to spending control measures.

– Greece appears to be at serious risk with regard to the long-term sustainability of public finances, also on account of the very important projected budgetary costs of an ageing population. The considerable increase projected in age-related spending suggests that additional measures to control public pension expenditures, including the resolute implementation of reform measures enacted, are necessary. The strategy outlined in the programme is mainly based on the implementation of legislated pension reforms and the necessary consolidation of public finances in the medium-term. Nevertheless, gross debt-to-GDP, while projected to fall, remains above 100% of GDP throughout the programme period. Even if the planned budgetary consolidation should materialise over the programme period, a considerable sustainability gap emerges, pointing to the need for a broad-based approach to ensure the sustainability of the public finances. These results show that a strategy based exclusively on fiscal consolidation does not seem to be feasible.

– Overall, the economic policies outlined in the update are partly consistent with the country-specific Broad Economic Policy Guidelines, in the area of public finances. In particular, the programme does not outline sufficiently effective action towards the close-to-balance-or-in-surplus position. The cyclically-adjusted deficit, calculated by the Commission services according to the commonly agreed methodology applied to the data of the reference scenario, although projected to improve by at least 0.5% of GDP per year, would remain above 3% of GDP throughout the programme period. However, within the framework of the Council notice given to Greece on 17 February in accordance to Article 104(9), the Commission[4] has concluded that this budgetary strategy is consistent with the Council recommendations in the notice and that no further steps in the excessive deficit procedure are needed at present. A new assessment of compliance with such recommendations will be carried out on the basis of the report to be presented by the Greek authorities in October, as foreseen in the Council decision.

– In view of the above assessment it would be appropriate for Greece to (i) implement the necessary permanent measures leading to the correction of the excessive deficit by 2006 at the latest; (ii) reduce the cyclically-adjusted deficit by at least 0.5% of GDP from 2007 onward, preferably through primary spending control measures, leading to a close-to-balance-or-in-surplus position in the medium term; (iii) enhance the efforts to identify and control factors other than net borrowing, which contribute to the change in debt levels; in order to ensure a reduction in the government gross debt ratio so as to approach the reference value at a faster pace; (iv) control public pension expenditures and resolutely implement the enacted reforms to ensure the sustainability of public finances and (v) improve the collection and processing of general government data in collaboration with Eurostat, notably by enhancing the mechanisms that ensure a prompt and correct supply of this data.

Based on this assessment, the Commission has adopted the attached recommendation for a Council Opinion on the revised update of the stability programme of Greece and is forwarding it to the Council.

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4 Commission communication on 'The action taken by Greece in response to the Council decision of 17 February 2005 in accordance to Article 104(9) of the Treaty for the deficit reduction judged necessary in order to remedy the situation of excessive deficit - SEC(2005) 443, 6.4.2005.

Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Art. 5 of Council Regulation (EC) No 1466/97 of 7 July 1997

on the updated stability programme of Greece, 2004-2007

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[5], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On 12 April 2005 the Council examined the updated stability programme of Greece, which covers the period 2004 to 2007. The programme partly complies with the data requirements of the "code of conduct on the content and format of stability and convergence programmes". The programme does not provide detail of the measures behind the targets for 2007. Price developments are presented in terms of the deflator of private consumption expenditure and not in terms of Harmonised Index of Consumer Prices. As regards the basic external assumptions the programme does not provide data on world GDP growth excluding EU nor the growth rate of relevant foreign markets as required by the code of conduct. Accordingly Greece is invited to achieve full compliance with the data requirements.

(2) The programme considers three different macroeconomic scenarios. On the basis of the latest available information, incorporated in the Commission services spring forecast, the second alternative scenario, and not the baseline one, is taken as the reference for assessing the programme because it seems to reflect plausible macroeconomic assumptions. In this reference scenario used for the assessment of the programme, real GDP is projected to grow at 2.9% in 2005 and marginally accelerate to 3% in 2006 and 2007. Potential output growth is expected to gradually ease over the

[5] OJ L 209, 2.8.1997, p. 1. The documents referred to in this text can be found at the following website http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm.

programme period from around 3.3% in 2005 to 3% in 2007, while the sizeable positive output gap recorded in 2004 is set to narrow somewhat up until 2007.

(3) On 5 July 2004, the Council decided that Greece was in excessive deficit and recommended its correction by 2005 at the latest. On 18 January 2005, the Council decided that Greece had not taken effective action in response to these recommendations. On 17 February 2005, the Council decided in accordance to Article 104(9) to give notice to Greece to take measures for the deficit reduction below the 3% of GDP threshold by 2006 at the latest. The Greek authorities were also required to identify and control factors other than net borrowing, which contribute to the change in debt levels, and to improve the collection and processing of general government data.

(4) According to the March 2005 EDP notification, the general government balance of 2004 is estimated to have recorded a deficit of 6.1% of GDP. This deficit is 0.8 percentage points higher than the figure of 5.3% of GDP estimated by the Greek government in autumn 2004 at the time of the September 2004 EDP notification, reflecting further tax shortfalls and expenditure overruns worth half a point of GDP. On 18 March 2005 Eurostat decided not to validate the deficit figures for Greece, noting that due to some outstanding issues the government deficit figures for 2004 and earlier years may have to be revised upwards.

(5) The budgetary strategy of the Greek government aims at reducing the deficit below the 3% of GDP reference value by 2006, in line with the Council decision under Article 104(9), through a mix of revenue-enhancing measures and expenditure retrenchment, which should result in increasing primary surpluses. To that end, the Greek government has adopted a package of fiscal measures for 2005, in addition to those included in the 2005 budget, which have lasting effects on subsequent years. The reference scenario targets a reduction of the nominal general government budget deficit by 3.6 percentage points over the programme period, from the outturn of 6.1% of GDP in 2004 to 2.4% in 2007. The primary balance is projected to improve substantially from a deficit of 0.4% in 2004 to a surplus of 1.8% of GDP in 2005 increasing to 3.3% of GDP at the end of the period.

(6) There is a risk that the budgetary outcome for 2005 and beyond may be worse than in the programme. In particular, trends in social security contributions and public consumption expenditure may have been projected favourably, while the envisaged adjustment measures, especially in the outer years of the programme, are not sufficiently indicated. Moreover, no measures have been envisaged in the programme to offset the potential carryover effects of the new statistical revisions for 2004 and earlier years. The Greek authorities have announced that they stand ready to implement additional measures in 2006, on top of those already adopted in 2005, in order to effectively bring the deficit below the 3% reference value in 2006 as required by the Council. The budgetary stance in the programme does not provide a sufficient safety margin against breaching this threshold with normal cyclical fluctuations nor does it achieve the Stability and Growth Pact's medium term objective of a budgetary position of close-to-balance or in surplus throughout the programme period.

(7) The debt ratio is projected to decline from 110.5% of GDP in 2004 to only 109.5% in 2005 and then to 107.2% in 2006 and 104.7% in 2007. A faster pace of debt reduction is hampered by significant debt-increasing stock-flow adjustments, which, while

declining compared to 2004, are expected to remain significant in spite of planned privatisation proceeds. The evolution of the debt ratio may be less favourable than projected given the risks to the budgetary targets mentioned above.

(8) Greece appears to be at serious risk with regard to the long-term sustainability of public finances, also on account of the very important projected budgetary costs of an ageing population. The considerable increase projected in age-related spending suggests that additional measures to control public pension expenditures, including the resolute implementation of reform measures enacted, are necessary.

(9) The economic policies outlined in the update are partly consistent with the country-specific Broad Economic Policy Guidelines in the area of public finances. In particular, the programme does not outline sufficiently effective action towards the close-to-balance-or-in-surplus position. The cyclically-adjusted deficit calculated by the Commission services according to the commonly agreed methodology applied to the data of the reference scenario, although projected in the programme to improve by 0.5% of GDP per year, would remain above 3% of GDP throughout the programme period. However, considering the steps taken towards correcting fiscal imbalances, this budgetary strategy is consistent with the Council recommendations in its notice given to Greece on 17 February in accordance with Article 104(9), and no further steps in the excessive deficit procedure are needed at present. A new assessment of compliance with such recommendations will be carried out on the basis of the report to be presented by the Greek authorities in October, as foreseen in the Council notice.

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In view of the above assessment, the Council is of the opinion that Greece should:

– implement the necessary permanent measures leading to the correction of the excessive deficit by 2006 at the latest;

– reduce the cyclically-adjusted deficit by at least 0.5% of GDP from 2007 onward, preferably through primary spending control measures, leading to a close-to-balance-or-in-surplus position in the medium term;

– enhance the efforts to identify and control factors other than net borrowing, which contribute to the change in debt levels, in order to ensure a reduction in the government gross debt ratio so as to approach the reference value at a faster pace;

– control public pension expenditures and resolutely implement the enacted reforms to ensure the sustainability of public finances;

– further improve the collection and processing of general government data in collaboration with Eurostat, notably by enhancing the mechanisms that ensure a prompt and correct supply of this data.

Comparison of key macroeconomic and budgetary projections

		2004	2005	2006	2007
Real GDP (% change)	**SP Mar 2005**	**4.2**	**2.9**	**3.0**	**3.0**
	COM Mar 2005	4.2	2.9	3.1	
	SP Dec 2003	4.2	4.0	3.8	n.a.
HICP inflation (%)	**SP Mar 2005**	**3.0**	n.a	n.a	n.a
	COM Mar 2005	3.0	3.2	3.2	
	SP Dec 2003	3.0	2.8	2.6	n.a.
General government balance (% of GDP)(*)	**SP Mar 2005**	**-6.1**	**-3.7**	**-2.9**	**-2.4**
	COM Mar 2005	-6.1	-4.5	-4.4	
	SP Dec 2003	-1.2	-0.5	0.0	n.a.
Primary balance (% of GDP)(*)	**SP Mar 2005**	**-0.4**	**1.8**	**2.7**	**3.3**
	COM Mar 2005	-0.4	1.0	1.0	
	SP Dec 2003	4.7	5.1	5.3	n.a.
Cyclically-adjusted balance (% of GDP)(*)	**SP Mar 2005[1]**	**-7.0**	**-4.4**	**-3.5**	**-3.0**
	COM Mar 2005	-7.1	-5.5	-5.3	
	SP Dec 2003	-1.2	-0.5	0.0	n.a.
Government gross debt (% of GDP)	**SP Mar 2005**	**110.5**	**109.5**	**107.2**	**104.7**
	COM Mar 2005	110.5	110.5	108.9	
	SP Dec 2003	98.5	94.6	90.5	n.a.

Note:

[1] Commission services calculations on the basis of the information in the programme.

(*) The Commission projections do not take into account the measures announced on 29 March.

Sources:

Stability programme March 2005 revised update (SP); Commission services spring 2005 economic forecasts (COM); Commission services calculations.