COMMISSION OF THE EUROPEAN COMMUNITIES

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# COMMISSION OPINION

**on the existence of an excessive deficit in Greece – Application of Article 104(5) of the Treaty establishing the European Community**

# EXPLANATORY MEMORANDUM

On 7 April 2004, the Commission published its spring 2004 forecasts.[1] According to these forecasts, which took into consideration revised data reported by Greece on 30 March 2004 but not validated by Eurostat, the general government deficit in 2003 reached 2.95% of GDP. Following contacts between Eurostat and the Greek authorities at the end of April, the latter submitted on 4 May a further revised notification with a deficit of 3.2% of GDP for 2003, thus exceeding the 3% of GDP Treaty reference value, and substantially higher than the 2002 deficit (1.5% of GDP). Moreover, at 103.0 percentage points the gross debt to GDP ratio remains well above the 60% Treaty reference value. Based on this prima facie evidence, the Commission initiated the Excessive Deficit Procedure for Greece on 19 May 2004, with the adoption of the report as foreseen in Article 104(3) of the Treaty.[2]

The application of the excessive deficit procedure (EDP) is governed by Article 104 of the Treaty and by Council Regulation (EC) No 1467/97 "on speeding up and clarifying the implementation of the excessive deficit procedure", which is part of the Stability and Growth Pact.[3]

The Commission report according to Article 104(3) of the Treaty concluded that the excess of the 3.2% of GDP deficit in 2003 over the 3% of GDP Treaty reference value did not result, in the sense of the Stability and Growth Pact, from an unusual event outside the control of the Greek authorities, nor was it the result of a severe economic downturn, which is defined in the Pact as an annual fall of real GDP of at least 2%. On the contrary, it occurred in a context of strongly positive growth, with real GDP growth at 4.2% in 2003, and a positive output gap of around 1.5% of GDP. The outturn of general government deficit for 2003 compares with a target deficit of 0.9% of GDP set in the December 2002 updated stability programme. The significant slippage is attributed to non recurrent factors (overruns in the expenditure related to the preparation of the Olympic Games and compensation for weather damages), to higher than planned primary spending (social transfers and public sector wages) and to a shortfall of budgetary revenues (VAT, income taxes and reclassification, as a financial transaction, of a payment from the Saving Postal Bank to government). Concerning developments in 2004, the report concluded that the general government deficit would probably increase and remain above 3% of GDP, in the absence of further measures.

The Commission report, based on the Commission Spring forecasts, noted that the debt-to-GDP ratio reached 103% of GDP in 2003, well above the 60% reference value of the Treaty. Moreover, it also noted that the Commission projects the debt ratio to decline only marginally to 102.8% of GDP in 2004, which is above the 98.3% of GDP reported by the Greek authorities on 4 May 2004. The report considered that both the high level of government debt and its slow pace of reduction are a cause of concern, especially in a period of high nominal growth and a positive and widening output gap.

Article 104(4) of the Treaty states that "the Committee provided for in Article 114 (i.e. the Economic and Financial Committee) shall formulate an opinion on the report of the

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[1] The Commission Spring 2004 forecast is available at the following website: http://europa.eu.int/comm/economy_finance/publications/european_economy/2004/ee204en.pdf.

[2] The full text of this report is available at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/procedures_en.htm.

[3] OJ L 209, 2.8.1997.

Commission". The Committee issued its opinion on 2 June 2004, subscribing to the assessment made by the Commission in its report. In particular, the Committee concluded that the budgetary developments in Greece in 2003 indicated the existence of an excessive deficit under both criteria foreseen by Article 104(2) for the identification of such deficits. Consideration of other relevant factors, in particular the medium-term budgetary position and public investment ratio did not change the assessment based on the criteria themselves. The Committee also considered that in the present stage of policy setting and growth prospects, the general government deficit would continue to exceed the Treaty reference value in 2004, and that the general government gross debt would continue to remain well above the Treaty reference value of 60% of GDP in 2004. The Committee considered that both the high level of government debt and its slow pace of reduction are a cause of concern, especially in a period of high nominal growth and positive, widening gaps.

The Commission, having examined all the relevant factors taken into account in its report and having regard to the opinion of the Committee, is of the opinion that an excessive deficit exists in Greece. This opinion, adopted by the Commission on 24 June 2004, is herewith addressed to the Council, according to Article 104(5) of the Treaty. The Commission recommends that the Council shall decide accordingly, in conformity with Article 104(6). In addition, the Commission is submitting to the Council a recommendation for a Council recommendation to be addressed to Greece with a view to bringing the situation of an excessive deficit to an end, according to Article 104(7) of the Treaty.

## COMMISSION OPINION

### on the existence of an excessive deficit in Greece – Application of Article 104(5) of the Treaty establishing the European Community

GENERAL CONSIDERATIONS

According to Article 104 of the Treaty, Member States are to avoid excessive government deficits. Decisions on the existence of an excessive deficit are governed by the excessive deficit procedure (EDP) specified by Article 104 of the Treaty and Council Regulation (EC) No 1467/97 "on speeding up and clarifying the implementation of the excessive deficit procedure", which is part of the Stability and Growth Pact.

Article 104(2) of the Treaty requires the Commission to monitor the development of the budgetary situation and of the stock of government debt in the Member States with a view to identifying gross errors. In particular, the Commission has to examine compliance with budgetary discipline on the basis of two criteria, one for the ratio of the planned or actual government deficit to gross domestic product (GDP) and one for the ratio of government debt to GDP. The statistical data on these variables are provided by the Commission on the basis of reporting by the Member States.

Article 104(3) of the Treaty requires the Commission to prepare a report if the requirements under one or both of the criteria of Article 104(2) are not fulfilled or if, notwithstanding the fulfilment of the requirements under the criteria, the Commission is of the opinion that there is a risk of an excessive deficit in a Member State. The Commission report also takes into account whether the government deficit exceeds government investment expenditure and all other relevant factors, including the medium-term economic and budgetary position of the Member State, as required by Article 104(3) of the Treaty. Based on data for the year 2003 reported by the Greek authorities on 4 May 2004, and on the outcome of the Commission's Spring 2004 forecast, the Commission has adopted such a report for Greece on 19 May 2004.

Subsequently, and in accordance with Article 104(4), the Economic and Financial Committee has formulated an opinion on the report of the Commission on (2 June 2004).

Article 104(5) of the Treaty requires the Commission to address an opinion to the Council if the Commission considers that an excessive deficit in a Member State exists or may occur. In order to reach a conclusion on whether an excessive deficit exists or may occur, the Commission considers that account should be taken of: (i) the conclusions of its own report, namely whether the requirements under one or both of the criteria of Article 104(2) of the Treaty are not fulfilled, and the relevance of all other factors mentioned in Article 104(3) and (ii) the opinion of the Economic and Financial Committee on the report of the Commission. On the basis of these elements, the Commission has established a number of considerations for Greece.

CONSIDERATIONS CONCERNING GREECE

1. The general government deficit amounted to 3.2% of GDP in 2003, therefore exceeding the 3% of GDP reference value of the Treaty, while it increased substantially relative to the 2002 deficit (1.5% of GDP). The deterioration in the

general government balance in 2003 from a year earlier was the result of a sharp worsening in the balance of the central government.

2. The excess of the deficit over the 3% of GDP reference value in 2003 does not result, in the sense of the Stability and Growth Pact, from an unusual event outside the control of the Greek authorities, nor does it result from a severe economic downturn, which is defined in the Pact as a fall in annual real GDP of at least 2%. On the contrary, it occurred in a context of strongly positive growth, with real GDP growth at 4.2% in 2003 and a positive output gap of around 1.5% of GDP.

3. The outcome for the general government deficit in 2003 is 2.3% of GDP above the value planned in November 2002 when the budget for 2003 was adopted. This significant slippage is attributed, first to extraordinary factors (overruns in the expenditure related to the preparation of the Olympic Games, and compensation for weather damages), secondly, to higher than planned primary spending (social transfers and public sector wages) and finally to a shortfall of budgetary revenues (VAT, income taxes and reclassification, as a financial transaction, of a payment from the Saving Postal Bank to government). With a positive output gap of 1.5% in 2003, up from 0.8% in 2002, the sharp deterioration of the government balance cannot be attributed to cyclical factors. The estimated cyclically-adjusted deficit rose from 1.7% of GDP in 2002 to 3.9% of GDP in 2003, and the primary surplus fell from 4.7% to 2.5% respectively. The sharp rise in the cyclically-adjusted deficit indicates a pro-cyclical, expansionary fiscal stance.

4. Gross fixed government investment as a share of GDP has remained above the deficit ratio over the last six years and has been higher than the EU average of 2.3% of GDP reaching 4.2% of GDP in 2003. Thus, it is worth noting that the general government investment to GDP ratio did not fall during this period and that it has remained much higher than the headline deficit to GDP ratio until 2003. It is projected to remain so during 2004-2005.

5. According to the reporting by the Greek authorities on 4 May 2004, the general government deficit in Greece is expected to fall to 2.9% of GDP in 2004. In its Spring 2004 forecasts, based on the assumption of no-policy change and a deficit figure for 2003 of 2.95% of GDP notified at the end of March, the Commission projects the general government deficit in Greece to reach 3.2% of GDP in 2004. Hence, the worsening of the general government balance projected in the Commission spring 2004 forecasts, in combination with an expected further rise in the positive output gap (to 2.2% of potential GDP), reflects the continuation of a pro-cyclical, expansionary fiscal stance. According to the Commission Spring 2004 forecasts, the cyclically-adjusted deficit in 2004 will deteriorate to 4.1% of GDP, indicating a move further away from the position of close to balance or in surplus. The deficit will remain above the 3% of GDP Treaty reference value again in 2004, in the absence of further measures.

6. At the end of 2003, the government debt-to-GDP ratio reached 103.0% of GDP, down from the year-earlier level of 104.7% of GDP, well above the reference value of 60% of GDP. This figure for 2003, validated by Eurostat in May, had already been notified in March and was used by both the Greek authorities and the Commission to project the debt ratio for 2004. According to the reporting by the Greek authorities on 4 May 2004, the debt ratio in Greece is expected to decline to 98.3% of GDP in

2004. According to the Commission Spring 2004 forecasts, the debt ratio is projected to decline only marginally to 102.8% of GDP in 2004, thus still well above the Treaty reference value of 60% of GDP.

7. At present the quality of public finance data remains uncertain. The deficit figure in the notification of 4 May compares with the 1.7% of GDP notified in early March, which was modified to 2.95% of GDP at the end of the same month, following the new government's initiative for a far-reaching auditing of public finances. Since open questions remained about the underlying data, the Greek authorities are committed to resolve most pending issues promptly in close collaboration with Eurostat. Moreover, although Eurostat validated the figures of the May notification, there are firm indications that there will be significant further, and as regards deficits almost certainly upwards, revisions for 2003 and earlier years, when the customary notification is made in September 2004. Such revisions are indeed expected to have an upward impact on the deficit figure for 2004.

CONCLUSION

The monitoring of the budgetary situation in Greece and, in particular, the examination of compliance with the criteria laid down in Article 104(2) has led the Commission to prepare a report in accordance with Article 104(3) of the Treaty. The Commission, having examined the relevant factors taken into account in this report and having regard to the opinion of the Economic and Financial Committee, is of the opinion that an excessive deficit exists in Greece.