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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 24.3.2009
SEC(2009) 564 final

Recommendation for a

COUNCIL DECISION

on the existence of an excessive deficit in Greece

EXPLANATORY MEMORANDUM

1. The application of the Stability and Growth Pact in the current crisis situation

Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the deficit as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn. Several factors are at play. First, the economic downturn brings about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan explicated that the stimulus should be timely, targeted and temporary and differentiated across Member States, with more room for manoeuvre for those Member States that have achieved sustainable public finance positions and improved their competitive positions.. The Plan also called for structural reforms that support demand and promote resilience in the short term, while paying special attention to actions in the four priority areas of the Lisbon Strategy. Finally, several countries have taken measures to stabilise the financial sector, some of which impact on the debt position or constitute a risk of higher deficits and debt in the future, although some of the costs of the government support could be recouped in the future.

The Stability and Growth Pact requires the Commission to initiate the excessive deficit procedure (EDP) whenever the deficit of a Member State exceeds the 3% of GDP reference value. The amendments to the Stability and Growth Pact in 2005 aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation and thereby ensuring long-term sustainability of public finances.

2. Previous steps in the excessive deficit procedure

Article 104 of the Treaty lays down an excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 “on speeding up and clarifying the implementation of the excessive deficit procedure”[1], which is part of the Stability and Growth Pact.

According to Article 104(2) of the Treaty, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is

[1] OJ L 209, 2.8.1997, p. 6. Account is also taken of the Opinion of the Economic and Financial Committee on the “Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes”, endorsed by the ECOFIN Council of 11 October 2005, available at: http://ec.europa.eu/economy_finance/other_pages/other_pages12638_en.htm.

only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 104(3) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to “take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State”.

On the basis of the data notified by the Greek authorities in October 2008[2] and subsequently validated by Eurostat[3] and taking into account the Commission services’ January 2009 interim forecast, the Commission adopted a report under Article 104(3) for Greece on 18 February 2009[4].

Subsequently, and in accordance with Article 104(4), the Economic and Financial Committee formulated an opinion on the Commission report on 27 February 2009.

3. THE EXISTENCE OF AN EXCESSIVE DEFICIT

The general government deficit in Greece reached 3.5% of GDP in 2007, thus exceeding the 3% of GDP reference value. The Commission report under Article 104(3) considered that the deficit was close to the 3% of GDP reference value but that the excess over the reference value can not be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact. In particular, the deficit did not result from an unusual event or a severe economic downturn. Real GDP growth reached 4% in 2007, before decelerating to 3% in 2008, posting positive output gaps of 3% and 2¾% of potential GDP, respectively. This output gap profile reflects that Greece has been enjoying good economic times in 2007 and 2008. Furthermore, the excess over the reference value can not be considered temporary. According to the Commission services’ January 2009 interim forecast, the general government deficit net of one-offs is estimated at 3.6% of GDP in 2008 (or 3.4% of GDP including one-offs). This estimate takes account of the latest information on the execution of the 2008 Budget Law. For 2009, the Commission services’ January 2009 interim forecast projects the general government deficit net of one-offs at 4.4% of GDP (3.7% including one-off revenue) on the basis of a prudent assessment of the 2009 Budget Law approved by Parliament on 21 December. Based on the customary unchanged policy assumption and assuming the discontinuation of one-off measures, the 2010 deficit is projected at 4.2% of GDP. Therefore, the deficit criterion in the Treaty is not fulfilled.

General government gross debt stood at 94.8% of GDP in 2007 and 94.6% of GDP in 2008, well above the 60% of GDP Treaty reference value. According to the Commission services'

2 According to Council Regulation (EC) No 3605/93, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of Greece can be found at: http://epp.eurostat.ec.europa.eu/portal/page?_pageid=2373,58110711&_dad=portal&_schema=portal.

3 Eurostat news release No 147/2008 of 22 October 2008.

4 All EDP-related documents for Greece can be found at the following website: http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2.

interim forecast, the general government debt ratio is projected to increase further to 96¼% in 2009 and 98½% of GDP by 2010. Therefore, the debt criterion in the Treaty is not fulfilled.

In line with the provisions in the Treaty and the Stability and Growth Pact, the Commission also analysed in its report "relevant factors". According to the Stability and Growth Pact, these can only be taken into account in the steps leading to the decision on the existence of an excessive deficit if the deficit satisfies the double condition of closeness and temporariness. In the case of Greece, the double condition is not met. Considered on their own merit, the relevant factors in the current case on balance do not seem favourable.

The opinion of the Economic and Financial Committee in accordance with Article 104(4) of the Treaty is consistent with the assessment in the Commission report under Article 104(3).

The Commission, having taken into account its report under Article 104(3) and the opinion of the Economic and Financial Committee under Article 104(4), is of the opinion that an excessive deficit exists in Greece. This opinion, adopted by the Commission on 24 March 2009, is herewith addressed to the Council according to Article 104(5). 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).

4. RECOMMENDATIONS TO END THE EXCESSIVE DEFICIT SITUATION

According to Article 3(4) of Council Regulation (EC) No 1467/97, the Council recommendation under Article 104(7) has to establish a deadline of six months at most for effective action to be taken by the Member State concerned as well as a deadline for the correction of the excessive deficit, which "should be completed in the year following its identification unless there are special circumstances". Article 2(6) of the Regulation implies that the "relevant factors" considered in the Commission report under Article 104(3) of the Treaty have to be taken into account in deciding whether special circumstances exist. Article 3(4) of the Regulation specifies that the Council has to recommend that the Member State achieves a "minimum annual improvement of at least 0.5% of GDP as a benchmark, in its cyclically adjusted balance net of one-off and temporary measures, in order to ensure the correction of the excessive deficit within the deadline set in the recommendation".

In the case of the Greece, the consideration of relevant factors, as clarified in Article 2(3) of Regulation (EC) No 1467/97 and examined in the Commission's report under Article 104(3) does not seem favourable and does not suggest the existence of special circumstances warranting a departure from the standard deadline for correcting the deficit. With potential growth rates estimated at around 2½% over 2009-2010, the Commission services' January 2009 interim forecast project headline growth at ¼% and ¾% in 2009 and 2010, respectively, which would narrow the still positive output gap, from 3% in 2007 and 2¾% of potential GDP in 2008 to ½% in 2009, while in 2010 it will turn negative. This output gap profile reflects that Greece has been enjoying good economic times in 2007 and 2008. Although economic conditions are projected to worsen, it does not constitute a severe economic downturn in the sense of the SGP.

According to the Commission services' January 2009 interim forecast, the general government deficit would rise by ¼ of a percentage point in 2009 and by another ½ of a percentage point of GDP in 2010 under unchanged policies assumptions, reaching 4¼% of GDP in 2010. However, a worse-than-projected budgetary outturn in 2008 should entail, *ceteris paribus*, a more pronounced negative base effect in 2009. In view of the widening macroeconomic imbalances and the mounting level of public debt, Greece should pursue a strong fiscal adjustment process based on permanent measures curbing current expenditure and bringing the nominal deficit below the 3% of GDP Treaty reference value by 2010. To this end, fiscal consolidation needs to be initiated already in2009. The necessary overall fiscal adjustment over 2009-2010 amounts to at least 1¼ percentage points in order to bring the nominal deficit clearly below the 3% of GDP Treaty reference value and correct the excessive deficit in a credible and sustainable manner. This adjustment path would be consistent with Article 3(4) of Council regulation (EC) No 1467/97. Beyond 2010, the fiscal adjustment should remain strong, in view of speeding up the achievement of the medium term objective of a balanced budget by 2013.

The budgetary strategy outlined in the January 2009 update of the stability programme of Greece and the addendum[5], aims at bringing the headline deficit below 3% of GDP threshold by 2011. After targeting 3.7% of GDP in 2009, the headline deficit is planned to decline over the programme period to 3.2% of GDP in 2010 and 2.6% by 2011. This would amount to a permanent improvement of less than ¼ percentage point of GDP in 2009 and ¾ of a percentage point of GDP on average thereafter.

The adjustment path for bringing the deficit below 3% of GDP by 2011, outlined in the update should be strengthened. In its opinion of 10 March 2009, the Council summarised its assessment of the programme. While the programme does not plan any fiscal consolidation for 2009, it also does not spell out concrete measures to back the planned budgetary adjustment from 2010 onwards. In addition, the programme's budgetary strategy is also subject to significant downside risks, with the growth assumptions underlying the macroeconomic scenario of the programme being favourable. In view of this assessment, the Council invited Greece to *"strengthen significantly the fiscal consolidation path already in 2009, through well-specified permanent measures curbing current expenditure, including a prudent public sector wage policy, thereby contributing to necessary reduction in the debt-to-GDP ratio"*.

In the long term, the level of debt which remains among the highest in the EU, coupled with the projected increase in age-related spending, will also affect negatively the long-term sustainability of public finances. According to the Commission services' January 2009 interim forecasts, the general government gross debt is projected to increase from 94.8% of GDP in 2007 to 98½% of GDP in 2010, thus still well above the Treaty reference value of 60% of GDP. Strengthening the fiscal adjustment path already in 2009 will also contribute to the necessary reduction in the debt-to-GDP ratio. In addition, albeit decreasing, factors other than net borrowing have contributed to the public debt accumulation in the past years, thus preventing the debt ratio from declining at a satisfactory pace. Consequently, it is necessary that the Greek government takes further action in order to control factors other than net borrowing which contribute to the rise in the debt level.

[5] On 6 February 2009 the Greek authorities submitted an addendum to the programme, providing clarifications on changes on the budgeted tax enhancing measures and the planned budgetary process reform. Although it refers to expenditure-cutting measures amounting to more than 0.2 percentage points of GDP, they have not been included in the budgetary projections. Thus, the addendum does not introduce any change in the budgetary strategy outlined in the stability programme nor to the underlying macroeconomic scenario.

The budgetary framework has been inadequate to ensure the achievement of the fiscal targets set in Budget Laws. In line with the Council opinion of 10 March 2009, Greece should implement swiftly the policies to improve the functioning of the budgetary process by increasing its transparency, spelling out the budgetary strategy within a longer time perspective and set up mechanisms to monitor, control and improve the efficiency of primary current expenditure. In addition, and in view of the mounting level of debt and the projected increase in age-related expenditure, the improvement of the long-term sustainability of public finances is a matter of urgency. The on-going reforms in the healthcare and pension system need to be fully implemented.

Structural and endemic problems related to the recording of Greek government accounts have led to exceptionally large revisions of the public finance figures[6] in the past. They have been also detrimental for timely and effective revenue and expenditure monitoring. In line with the Council opinion of 10 March 2009, Greece should proceed with measures to improve statistical governance and the quality of its statistical data.

Comparison of key macroeconomic and budgetary projections

		2007	**2008**	**2009**	**2010**	**2011**
Real GDP (% change)	**SP Jan 2009**	**4.0**	**3.0**	**1.1**	**1.6**	**2**
	COM Jan 2009	4.0	2.9	0.2	0.7	n.a.**.3**
Output gap[1] (% of potential GDP)	**SP Jan 2009**	**2.2**	**1.9**	**0.3**	**-0.8**	**-1.0**
	COM Jan 2009[2]	3.0	2.8	0.5	-1.2	n.a.
General government balance (% of GDP)	**SP Jan 2009**	**-3.5**	**-3.7**	**-3.7**	**-3.2**	**-2.6**
	COM Jan 2009	-3.5	-3.4	-3.7	-4.2	n.a.
Primary balance (% of GDP)	**SP Jan 2009**	**0.6**	**0.3**	**0.8**	**1.2**	**1.7**
	COM Jan 2009	0.6	0.6	0.6	0.0	n.a.
Cyclically-adjusted balance[1] (% of GDP)	**SP Jan 2009**	**-4.4**	**-4.5**	**-3.8**	**-2.8**	**-2.2**
	COM Jan 2009	-4.8	-4.7	-3.9	-3.7	n.a.
Structural balance[3] (% of GDP)	**SP Jan 2009**	**-4.4**	**-4.5**	**-4.3**	**-2.8**	**-2.2**
	COM Jan 2009	-4.6	-5.0	-4.7	-3.7	n.a.
Government gross debt (% of GDP)	**SP Jan 2009**	**94.8**	**94.6**	**96.3**	**96.1**	**94.7**
	COM Jan 2009	94.8	94.0	96.2	98.4	n.a.

Notes:
[1] Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.
[2] Based on estimated potential growth of 3.2%, 2.7%, 2.8% and 2.5% respectively in the period 2008-2011.
[3] Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.4% of GDP in 2008 and 0.5% in 2009 (all deficit-reducing) according to the most recent programme and 0.4% of GDP in 2008 and 0.8% in 2009 (all deficit-reducing) in the Commission services' January interim forecast.
Source:
Stability programme (SP); Commission services' January 2009 interim forecasts (COM); Commission services' calculations.

6 For further details, see Section 2 of Macro Fiscal Assessment of the December 2007 update of the Stability Programme of Greece.

Recommendation for a

COUNCIL DECISION

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(6) thereof,

Having regard to the recommendation from the Commission,

Having regard to the observations made by Greece,

Whereas:

(1) According to Article 104 of the Treaty Member States shall avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) The excessive deficit procedure (EDP) under Article 104, as clarified by Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure[7] (which is part of the Stability and Growth Pact), provides for a decision on the existence of an excessive deficit. The Protocol on the excessive deficit procedure annexed to the Treaty sets out further provisions relating to the implementation of the EDP. Council Regulation (EC) No 3605/93[8] lays down detailed rules and definitions for the application of the provision of the said Protocol.

(4) The 2005 reform of the Stability and Growth Pact sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run. It aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

(5) 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. Having taken into account its report in accordance with Article 104(3)

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[7] OJ L 209, 2.8.1997, p. 6.
[8] OJ L 332, 31.12.1993, p. 7.

and having regard to the opinion of the Economic and Financial Committee in accordance with Article 104(4), the Commission concluded that an excessive deficit exists in Greece. The Commission therefore addressed such an opinion to the Council in respect of Greece on 24 March 2009[9].

(6) Article 104(6) of the Treaty states that the Council should consider any observations which the Member State concerned may wish to make before deciding, after an overall assessment, whether an excessive deficit exists. In the case of Greece, this overall assessment leads to the following conclusions.

(7) The general government deficit in Greece reached 3.5% of GDP in 2007, thus exceeding the 3% of GDP reference value. According to the Commission services' January 2009 interim forecast, the general government deficit net of one-offs is estimated at 3.6% of GDP in 2008 (or 3.4% of GDP including one-offs). This estimation is based on a real GDP growth rate of 2.9% in 2008 and takes account of the latest information on the execution of the 2008 Budget Law. For 2009, the Commission services' January 2009 interim forecast projects the general government deficit net of one-offs at 4.4% of GDP (3.7% including one-off revenues) based on a real GDP growth projection of 0.2% and on the basis of a prudent assessment of the 2009 Budget Law approved by Parliament on 21 December. Based on the customary unchanged policy assumption and assuming the discontinuation of one-off measures, the 2010 deficit is projected at 4.2% of GDP. Therefore, the deficit criterion in the Treaty is not fulfilled.

(8) General government gross debt stood at 94.8% of GDP in 2007 and 94.6% of GDP in 2008, well above the 60% of GDP Treaty reference value. According to the Commission services' January 2009 interim forecast, the general government debt ratio is projected to increase further to 96¼% in 2009 and 98½% of GDP by 2010. The current deficit levels and estimates of medium-term growth are not compatible with a debt ratio converging to a level below 60% of GDP. The debt ratio cannot be considered as diminishing sufficiently and approaching the reference value at a satisfactory pace within the meaning of the Treaty and the Stability and Growth Pact.

(9) According to Article 2(4) of Council Regulation (EC) No 1467/97, "relevant factors" can only be taken into account in the steps leading to the Council decision on the existence of an excessive deficit in accordance with Article 104(6) if the double condition - that the deficit remains close to the reference value and that its excess over the reference value is temporary - is fully met. In the case of Greece, this double condition is not met. Therefore, relevant factors are not taken into account in the steps leading to this decision.

HAS ADOPTED THIS DECISION:

Article 1

From an overall assessment it follows that an excessive deficit exists in Greece.

[9] All EDP-related documents for Country can be found at the following website: http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2.

Article 2

This decision is addressed to Hellenic Republic.

Done at Brussels,

For the Council
The President