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Recommendation for a

COUNCIL RECOMMENDATION TO GREECE

with a view to bringing an end to the situation of an excessive government deficit

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(7) thereof;

Having regard to the recommendation from the Commission;

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 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.

(4) The Council has decided on 24 April 2009, in accordance with Article 104(6), that an excessive deficit exists in Greece in 2007 – revealed by the October 2008 correction of notified data – and 2008.

(5) In accordance with Article 104(7) of the Treaty and Article 3 of 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), the Council is also required to make recommendations to the Member State concerned with a view to bringing the situation of excessive deficit to an end within a given period. The recommendation has to establish a deadline of six months at the most for effective action to be taken by the Member State concerned to correct the excessive deficit 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, and to request the achievement of a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other

1 OJ L 209, 2.8.1997, p. 6.

temporary measures, of 0.5% of GDP as a benchmark. In deciding whether special circumstances exist, "relevant factors" as clarified in Article 2(3) of Regulation (EC) No 1467/97 should be taken into account..

(6) 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 excessive 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.

(7) 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 in 2009. 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 Art. 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.

(8) The budgetary strategy outlined in the January 2009 update of the stability programme of Greece and the addendum[2], 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.

(9) 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

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[2] 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.

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"*.

(10) 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.

(11) 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.

(12) Structural and endemic problems related to the recording of Greek government accounts have led to exceptionally large revisions of the public finance figures[3] 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.

(13) In general, in the view of the Council, budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances and reinforcing the growth potential of the economy.

HEREBY RECOMMENDS:

(1) On the basis of the macroeconomic outlook of the Commission services' January 2009 interim forecast, the Greek authorities should put an end to the present excessive deficit situation by 2010.

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

(2) The Greek authorities should bring the general government deficit below 3% of GDP in a credible and sustainable manner. Specifically, to this end, the Greek authorities should:

(a) strengthen the fiscal adjustment in 2009 through permanent expenditure restraining measures;

(b) implement additional permanent measures in 2010 in order to bring the headline deficit clearly below the 3% of GDP reference value by the end of the year with a view to recovering competitiveness losses and addressing the existing external imbalances.

(3) The Greek authorities should continue efforts to control factors other than net borrowing, which contribute to the change in debt levels, with a view to ensuring that the government gross debt ratio diminishes sufficiently and approaches the reference value at a satisfactory pace, in line with the correction of the excessive deficit.

(4) The Greek authorities should continue efforts to improve the collection and processing of national accounts data and in particular general government data, notably by enhancing the mechanisms that ensure the prompt and correct supply of the general government data required by the existing legal framework.

(5) The Council establishes the deadline of [24 October 2009] for the Greek government to take effective action to strengthen the fiscal consolidation path already in 2009 and to specify the measures that seem sufficient to ensure adequate progress towards the correction of the excessive deficit within the time limit set above under point 1. The assessment of effective actions will take into account economic developments compared to the economic forecasts in this recommendation.

(6) The Greek authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the Greek stability programme which will be prepared between 2009 and 2010.

In addition, the Council invites the Greek authorities to ensure that budgetary consolidation towards the medium-term objective for the budgetary position of a balanced position is sustained after the excessive deficit will have been corrected. Moreover, with a view to recovering competitiveness losses and addressing the existing external imbalances, the Greek authorities should adopt permanent measures to control current primary expenditure including public wages and urgently implement structural reforms. In particular, the Greek authorities should ensure that fiscal consolidation measures are also geared towards enhancing the quality of public finances within the framework of a comprehensive reform programme, while strengthening the binding nature of its budgetary framework, improving monitoring of the budget execution and swiftly implementing policies to reform the tax administration. In view of the mounting level of debt and the projected increase in age-related expenditure, the Greek authorities should improve the long-term sustainability of public finances, by continuing the on-going reforms in the healthcare and pension system.

This recommendation is addressed to the Hellenic Republic.

Done at Brussels,

For the Council
The President