COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 22.12.2004
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Recommendation for a

COUNCIL DECISION

establishing, in accordance with Article 104(8), whether effective action has been taken by Greece in response to recommendations of the Council according to Article 104(7) of the Treaty establishing the European Community

(presented by the Commission)

EXPLANATORY MEMORANDUM

The excessive deficit procedure (EDP) is governed by Article 104 of the Treaty and by Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, which is part of the Stability and Growth Pact. It is completed by the political commitments enshrined in the Resolution of the Amsterdam European Council on the Stability and Growth Pact of 17 June 1997.

The Greek authorities submitted on 4 May a revised EDP notification with a deficit of 3.2% of GDP for 2003. Although it was aware that this figure was provisional because it had not been certified by Eurostat, the Commission, taking into account its spring 2004 forecasts, published on 7 April 2004, considered that this notification provided prima facie evidence for the existence of an excessive deficit in Greece in the sense of Article 104 of the Treaty. The Commission initiated the Excessive Deficit Procedure for Greece on 19 May 2004, with the adoption of the report foreseen in Article 104(3) of the Treaty. The Commission, after examining the relevant factors taken into account in its report and regarding to the opinion formulated by Economic and Financial Committee (EFC) on 2 June 2004, adopted on 24 June 2004 an Opinion stating that an excessive deficit exists in Greece. The Council decided accordingly, in conformity with Article 104(6), on 5 July 2004. At the same time, the Council adopted a recommendation addressed to Greece with a view to bringing the excessive deficit situation to an end, according to Article 104(7) of the Treaty.

The Council recommended the Greek authorities "*to put an end to the present excessive deficit situation as rapidly as possible and by 2005 at the latest*". The Council established "*the deadline of 5 November 2004 for the Greek government to take effective action to this end*". The Council also recommended that "*the Greek authorities should take corrective measures mainly of a structural nature amounting to at least 1% of GDP, cumulated over 2004 and 2005, preferably equally distributed between the two years"*. In addition, the Council recommended that *"the Greek authorities should also ensure that the government gross debt ratio diminishes sufficiently and approaches the reference value at a satisfactory pace"*, while *"particular attention should be paid to factors other than net borrowing which contribute to the change in debt levels"*. Finally, the Greek authorities were recommended to *"ensure, as a matter of urgency, that the serious deficiencies revealed on budgetary statistics be corrected, through the improvement of the collection and processing of general government data"*.

According to Article 4(2) of Regulation (EC) No 1467/97, the Council, when considering whether effective action has been taken in response to its recommendations made in accordance with Article 104(7), shall base its decision on publicly announced decisions by the Government of the Member State concerned.

1. Government data revisions of September 2004

In assessing the action taken by the Greek authorities in response to the Council recommendations, account must be taken of the very substantial revision of the government deficit and debt data for the previous years set out in the September 2004 notification[1]. Specifically (Table 1), nominal deficit figures were revised upwards by 1.5 to 2 percentage points of GDP per year over 2000-2003, while debt figures were also increased by 7 to 9

[1] See Euro-Indicators News Release 117/2004 of 23 September 2004.

percentage points of GDP. The change in the deficit figures from May to September 2004 was mainly due to revisions of expenditure on military equipment and interest payments, which had previously been under-recorded, and the social security surplus, which had been overestimated. The revision of the debt figures related to bonds with capitalised interest, which had previously been under-recorded, and consolidating assets of social security, which had been overestimated. In fact, the September EDP notification showed that Greece had been in excessive deficit at least since 2000. These issues have been analyses and discussed by the Commission and the Council.[2]

Table 1. Statistical revisions between 2000-2003 published by Eurostat

	General Government Deficit (% of GDP)		General Government Debt (% of GDP)	
	Report 104(3)	EDP notification September 2004	Report 104(3)	EDP notification September 2004
2000	-2.0	-4.1	106.2	114
2001	-1.4	-3.7	106.9	114.7
2002	-1.5	-3.7	104.7	112.5
2003	-3.2	-4.6	103.0	109.9

According to the September EDP notification the effect of statistical revisions on the 2004 outturn will amount to 1.1% of GDP, distributed between lower social security fund surpluses (0.3% of GDP) and the correct recording of military spending (0.8%). The Greek authorities expect a deficit figure for 2004 of 5.3% of GDP. The expected debt ratio (112.1% of GDP) is significantly higher than in 2003 (109.9% of GDP).

2. Measures announced in response of recommendation 104(7)

Measures announced in 2004

Before the deadline of 5 November set in the Council recommendation under Article 104(7), the Greek authorities announced a number of measures to be undertaken in 2004, namely: (i) a tax amnesty for pending tax returns for the fiscal years 1999-2002; (ii) instructions to all the ministries to restrain discretionary expenditure by 3%; (iii) measures to contain costs in the public sector and reduce government subsidies and guarantees[3].

The nature of such measures makes it difficult to identify and isolate their budgetary impacts. Measures included in (ii) and (iii) are not linked to any particular budget item, but have across-the-board effects. Where measure (i) is concerned, in a letter addressed to Commissioner Almunia on 5 November the Greek Minister of Finances, Mr. Alogoskoufis, stated that the expected impact in 2004 was 0.2% of GDP. However, while this expected impact may have been included in the aggregate figures of tax revenues corresponding to the

[2] According to Regulation (EC) No 3605/93, which governs the EDP reporting, Member States should report data for years t, t-1, t-2, t-3 and t-4. However, in response to a request by the Council, Eurostat also revised the accounts for years 1997, 1998 and 1999. In its report of 22 November on the 'Revision of the Greek government deficit and debt figures', Eurostat concluded that the actual deficits in those years had also been well above 3% (see also the Commission Communication 'Report on the accountability issue related to the revision of Greek budgetary data' - COM(2004) 784 of 1 December 2004).

[3] These measures were announced in a letter by Mr. Alogoskoufis, Greek Minister of Finances, to Commissioner Almunia on 23 June 2004. No other measures for 2004 have been communicated to the Commission since then.

planned outturn notified in September, the actual impact will only be known at the moment of the EDP notification of March 2005 at the earliest.

On top of these uncertainties, in order to assess the fiscal effort carried out by the Greek authorities in accordance with Council's Article 104(7) recommendation the impact of statistical revisions needs to be considered. The final deficit outturn in 2004 will be higher than projected at the time of adopting the Article 104(7) recommendation, partly because of the statistical revisions agreed with Eurostat in September this year, which amount to 1.1% of GDP (Table 2). This factor, which was not known at the moment of adopting the recommendation under Article 104(7), might be considered as not being fully under the control of the Greek government when it was planning the fiscal adjustment for 2004. Therefore, the effectiveness of actions taken by the Greek authorities in 2004 in compliance with the Council recommendations needs to be assessed after netting out the effects of such statistical revisions, as well as those of possible growth surprises between spring and autumn 2004.

Table 2. Major factors determining the deficit outturn in 2004 (*)

	Effect on the deficit (°)	**Deficit in 2004**
Original budget presented by the former government		**1.2**
Main corrections made by the new government before the end of March 2004		
Indirect taxes	+0.4	
Social contributions	-1.1	
Capital transfers received	+1.4	
Consumption (of which public wages)	+0.8 (+0.5)	
Social transfers	+0.4	
End-March notification sent by the new government (1)		**3.0**
Statistical revisions (2)+(3)		
Social security funds (2)	+0.3	
Military expenditures (3)	+0.8	
Intermediate outturn (4)=(1)+(2)+(3)		**4.1**
Notification September 2004 (5)		**5.3**
Overruns (6)=(5)-(4)		**1.2**
Discrepancies in interest payments (7)	*+0.2*	
Autumn Commission forecasts (5)+(7)		**5.5**

(*) The table summarises, in % of GDP, the main revisions, corrections and discrepancies in the 2004 budget since its adoption by the (former) Greek government at the end of 2003, and the Commission forecasts.
(°) a '+' indicates deficit-increasing, while a '–' means deficit-decreasing.

According to the September notification, the Greek authorities project a deficit outturn of 5.3% in 2004 (5.5% according to the Commission; see Table 2)[4], while between the end-March and September notifications the deficit increased from an estimated 3.0%[5] to 5.3% (from 3.2% to 5.5% according to the Commission Spring and Autumn forecasts). Therefore,

[4] The figure is 0.2% of GDP lower than the Commission forecast (5.5%), in which a more realistic assessment of interest payments is made.

[5] The exact figure was 2.95%, here rounded to 3%. It should be kept in mind that this figure of 2.95% was the result of a significant revision of the 2004 draft budget carried by the new government in March. This revision introduced more realistic projections of current revenues (lower direct taxes and EU transfers, but higher social contributions) and expenditure (higher public wages, social transfers) much more in line with the 2.4% projected by the Commission in its forecasts of autumn 2003. The revision was included in the end-March notification, which was not validated by Eurostat.

the statistical revisions (1.1% of GDP) do not fully explain the budgetary deterioration of 2.3% of GDP. Furthermore, the remaining 1.2% cannot be attributed to the effect of lower growth. The difference in real growth projections between the spring (4.0%) and autumn (3.8%) figures is only 0.2%, which might increase the deficit, but by less than 0.1% of GDP. Overall, in nominal terms, the fiscal effort is negative by more than 1% of GDP.

The fiscal effort in 2004 with respect to 2003, the year in which first appeared that the country had breached the 3% of GDP reference value, must be calculated by comparing the cyclically-adjusted balances (CAB) in the two years, after excluding the effects of statistical revisions. Also this approach shows that the fiscal effort is negative in cyclically-adjusted terms. With the exclusion of the unexpected statistical revisions, the CAB in 2003 would have been -3.7% of GDP (it was actually -5.1%), while that of 2004 would have been -5.1% of GDP (it was actually -6.2%). This indicates that the fiscal effort in 2004 amounts to -1.4%. In terms of the primary balance, the fiscal effort also results negative (-1.6%).

Table 3. The fiscal effort in 2004
Netting out statistical revisions (% of GDP)

	2003	**2004**	**'Effort' (*)**
Cyclically-adjusted balances (CAB)	-5.1	-6.2	-1.1
CAB excluding revisions	-3.7	-5.1	-1.4
Cyclically-adjusted primary balance (CAPB)	0.7	-0.6	-1.3
CAPB excluding revisions	2.0	0.4	-1.6

(*) The fiscal effort is the entry in column '2004' minus the corresponding entry in column '2003'; figures rounded up to the first decimal.

As a general principle, overruns in one or several items of the budget should be offset by compensatory measures. This also holds for events such as the organisation of the Olympic Games in Greece. Moreover, even allowing for such overruns, the fiscal effort would result negative in the current year. According to the information provided by the Greek authorities[6], the overruns linked to the organisation of the Olympic Games amount to 0.7% of GDP, distributed between public investment programmes (0.5% of GDP) and government consumption (0.2%).

After excluding the effects of statistical revisions and the overruns linked to the Olympic Games, the CAB in 2004 would have been -4.4% of GDP (it was actually -6.2%), which, compared with the CAB in 2003, after netting out the effects of statistical revisions (-3.7%), leads to a fiscal effort of -0.7%. In terms of the primary balance, the fiscal effort would also be negative (-0.9%).

In sum, the measures implemented in 2004 have not been effective in reducing the deficit in 2004. Over and above statistical revisions, the fiscal policy stance further worsened in a situation of buoyant economic activity and large, positive output gaps[7].

6 This information has been disclosed by the Greek authorities in their draft budget 2005. Compared with planned expenditures linked to the Olympic Games of 0.94% of GDP in 2004, the final outturn should be 1.6%.

7 Between the two 2004 forecasting exercises the output gap actually widened from 1.2% in spring to 1.5% in autumn, while potential output growth remained high at 3.4%.

The 2005 draft budget

The specific measures to be implemented in 2005 were announced in the draft State budget presented in September, which set as its target a general government deficit of 2.8% for 2005. This would represent a nominal adjustment by 2.5% of GDP compared with the deficit figure of 5.3% planned by the Greek authorities for 2004.

Table 4. Assessment of the adjustment in the 2005 budget

% of GDP	Official (1)	Commission (2)	Difference (3)=(1)-(2)
Taxes	23.20	23.19	0.01
Contributions	16.33	16.26	0.07
Government consumption *(of which public wages)*	16.18 *(12.10)*	16.44 *(12.34)*	0.26 *(0.24)*
Social transfers	18.43	18.55	0.12
Interest payments	5.07	5.27	0.20
Capital transfers received	2.62	2.54	0.08
Net borrowing	-2.8	-3.6	0.8
Debt ratio	109.5	111.9	2.4
memo items			
Real GDP growth (%)	*3.9*	*3.3*	*0.6*
Nominal GDP growth (%)	*7.3*	*6.5*	*0.8*

The Commission autumn 2004 forecasts project a nominal deficit of 3.6% of GDP in 2005. The difference between the official target in the draft budget and the Commission forecasts is due to three factors (Table 4): *First*, according to the Commission, the initial level of interest payments in 2004 is 0.2% of GDP higher than assumed by the Greek authorities. *Second*, while the draft budget is built upon a macroeconomic scenario leading to real GDP growth at 3.9% in 2005, the Commission projects a much less optimistic growth rate of 3.3%. *Third*, the expected budgetary impact of some of the measures announced by the Greek authorities appears to have been overestimated. On the revenue side, this applies particularly to social contributions, owing to an over-optimistic projection of employment growth (2% compared with 1% in the Commission forecasts), and to capital transfers received, which are projected to remain at high levels, while the significant reduction of public investment will also lower the already low absorption capacity of EU funds by Greece. On the expenditure side, the draft budget projects a large decline of the wage bill and social transfers, in clear divergence with the recent past.

According to the Commission Autumn 2004 Forecast, the fiscal effort in 2005, as measured by the change in the cyclically-adjusted balance, is 1.9% (2.5% according to the 2005 draft budget). Consequently, according to the Commission, the fiscal adjustment accumulated over 2004 and 2005 amounts to only 0.8% (1.6% according to the 2005 draft budget).[8]

Overall, the measures presented in the draft budget appear insufficient to bring the nominal deficit below the 3% threshold in 2005 as recommended by the Council in July 2004.

8 The finalisation of the Games has an automatic effect on the fiscal position through savings worth of 1.2% (of which 0.7% 2004 overruns). The carry over effect in 2005 associated to the Olympic Games only amounts to €600 million (around 0.5% of GDP).

Debt developments

Taking into account the revisions of debt levels included in the September EDP notification, the Commission forecasts do not project a significant fall of the debt-to-GDP ratio in 2005. After attaining 109.9% of GDP in 2003, debt is expected to increase further to 112.2% in 2004, while falling only marginally in 2005 to 111.9%. Leaving aside the effects of statistical revisions, debt developments in 2004 and 2005 are reflecting not only low primary balances, but also other factors. While such low primary surpluses, coupled with high nominal GDP growth, should result in a significant reduction of the debt ratio, projections for 2004 and 2005 indicate that debt levels are also driven by large stock-flow adjustments. This provides evidence that the government has taken no effective action on below-the-line operations.

Collection and processing of government data

Data revisions from May to September 2004 were mainly determined by corrections in transactions that had been identified by Eurostat as not being fully in line with the accounting rules. Greece has tackled a number of issues raised by Eurostat. However, as explained by the Commission in the letter giving formal notice of the infringement procedure No 2004/2234, open to Greece on 1 December, there are a number of elements which, in the view of the Commission, questioning the adequacy of the mechanisms to ensure the prompt and correct supply of the information required by the existing legal framework.

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According to the provisions of Article 104(8) of the Treaty and of Article 4(1) of Regulation (EC) No 1467/97, if the Council considers that no effective action has been taken in response to the recommendations addressed under Article 104(7) within the deadline of 5 November 2004, it shall decide accordingly immediately after the expiry of the deadline.

In the light of these findings, the Commission is of the opinion that there has been no effective action in response to the Council recommendations according to Article 104(7) within the period laid down in the recommendation, and it recommends the Council to decide accordingly.

Article 104(8) states that when the Council establishes that there has been no effective action in response to its recommendation according to Article 104(7), it may decide to make this recommendation public. However, Greece has already made this recommendation public in July, in line with Amsterdam Resolution of the European Council on the Stability and Growth Pact of 17 June 1997.[9]

As to further steps of the procedure, if the Council is of the opinion that no effective action has been taken in response to the recommendations addressed under Article 104(7), it may according to Article 104(9) decide, on the basis of a Commission recommendation, to give notice to Greece to take, within a specified time-limit, measures for the deficit reduction

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9 Council document 11216/04 of 6 July 2004, available in Council's public register of documents, entitled "Council Recommendation to Greece with a view to bringing an end to the situation of an excessive government deficit –Application of Article 104(7) of the Treaty".

which it judges necessary to remedy the situation. Any Council decision to give such a notice to Greece shall be taken within one month of its decision establishing that no effective action has been taken in accordance with Article 104(8).

Recommendation for a

COUNCIL DECISION

Establishing, in accordance with Article 104(8), whether effective action has been taken by Greece in response to recommendations of the Council according to Article 104(7) of the Treaty establishing the European Community

THE COUNCIL OF THE EUROPEAN UNION

Having regard to the Treaty establishing the European Community, and in particular Article 104(8) thereof;

Having regard to the recommendation from the Commission;

Whereas:

(1) In stage three of Economic and Monetary Union (EMU), Member States according to Article 104 of the Treaty are to 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. The Stability and Growth Pact includes Council Regulation (EC) No 1467/97[10] on speeding up and clarifying the implementation of the excessive deficit procedure set out in Article 104 in order to further the prompt correction of excessive general government deficits.

(3) The Amsterdam Resolution of the European Council on the Stability and Growth Pact of 17 June 1997[11] solemnly invites all parties, namely the Member States, the Council and the Commission, to implement the Treaty and the Stability and Growth Pact in a strict and timely manner;

(4) By Decision 2004/XXX/EC of 5 July 2004[12], the Council decided, in accordance with Article 104(6), that an excessive deficit exists in Greece.

(5) The Council, in accordance with Article 104(7) of the Treaty and Article 3(4) of Regulation (EC) No 1467/97, has adopted a Recommendation establishing the deadline of 5 November 2004 for the Greek government to take measures to bring the existence of an excessive deficit to an end in 2005 at the latest. In the same document the Council recommended Greece to put an end to the present excessive deficit situation as rapidly as possible and by 2005 at the latest in accordance and to take corrective measures mainly of a structural nature amounting to at least 1% of GDP,

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10 OJ L 209, 2.8.1997, p.6.
11 OJ C 236, 2.8.1997, p.1.
12 Not yet published in the OJ.

cumulated over 2004 and 2005, and preferably equally distributed between the two years. In addition, the Council recommended that Greece ensures that the government gross debt ratio diminishes sufficiently and approaches the reference value at a satisfactory pace, while paying particular attention to factors other than net borrowing which contribute to the change in debt levels. Finally, as a matter of urgency, the Council also recommended Greece to correct the serious deficiencies revealed on budgetary statistics, through the improvement of the collection and processing of general government data.

(6) According to Article 4(2) of Regulation (EC) No 1467/97, the Council, when considering whether effective action has been taken in response to its recommendations made in accordance with Article 104(7), shall base its decision on publicly announced decisions by the Government of the Member State concerned.

(7) An assessment of the publicly announced decisions taken by Greece since the Recommendation according to Article 104(7) was issued by the Council and until the deadline set in that Recommendation leads to the following conclusions:

– in spite of restraining measures announced for 2004, fiscal policy has been clearly expansionary, partly due to expenditure overruns associated to the organisation of the Olympic Games, in contrast with what was requested by the Council;

– the budgetary measures announced for 2005, while more than offsetting the slippage in 2004, do not ensure that the general government deficit is brought below 3% of GDP in 2005;

– not only is the general gross debt-to-GDP ratio not falling at a satisfactory pace, but the large stock-flow adjustment projected in 2004 also indicates that the government has taken no effective action on below-the-line operations contributing to further rises in the debt.

– Greece has improved the collection and processing of budgetary data, notably in relation to expenditure on military equipment, interest payments, and social security accounts. However, better mechanisms, to ensure the prompt and correct supply of the general government data required by the existing legal framework, are still necessary .

(8) Article 104(8) states that when the Council establishes that there has been no effective action in response to its recommendation according to Article 104(7), it may decide to make this recommendation public. However, in line with the Stability and Growth Pact Resolution of the European Council, Greece already made this recommendation public in July.

HAS DECIDED AS FOLLOWS:

Article 1

No effective action has been taken in response to the Council Recommendation according to Article 104(7) addressed to Greece on 5 July 2004 within the deadline set in that Recommendation.

Article 2

This decision is addressed to the Hellenic Republic.

Done at Brussels, .

For the Council