EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 8 January 2003
ECFIN/5/03-EN

2002 UPDATE
OF THE CONVERGENCE PROGRAMME OF GREECE
(2002-2006)

AN ASSESSMENT

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SUMMARY AND CONCLUSIONS

The Greek economy has been growing at robust rates in recent years, considerably higher than the EU and the Eurozone average, supported by the effects of eased monetary conditions stemming from interest rate convergence to those prevailing in the euro-area, significant inflow of financial resources from Community structural funds and investments related to the preparation of the Olympic games of 2004. In 2002, real GDP growth decelerated somewhat to 3.8%, as estimated in the updated stability programme or 3.5% in the Commission Autumn forecasts, as compared with 4.1% in 2001. Price developments in 2002 were influenced by a number of factors pointing to opposite directions: bad weather conditions in the first months of the year boosted food prices and the change-over to the euro implied high inflation rates in the first quarters. Inflation as measured by consumer prices stabilised in November but at a high level, among the highest in the euro zone and well above the EU average. The CPI rose 3.6% (year-on-year) in November from 4.4% in January and the HICP rose by 3.9% from 4.8% respectively.

According to the 2002 update, real GDP growth is expected to continue in the period covered by the programme and to average around 3.8% in the years 2003-2006, with a peak of 4% in 2004 and some deceleration as from 2005, reflecting faltering activity-boosting effects from the Olympic Games; however, some durable effects on economic activity can be reasonably expected beyond 2004, mostly related to the continuation of the 3rd Community Support Framework inflows until 2006. For the external environment, the 2002 update relies on the Commission assumptions underlying the Autumn 2002 forecasts until 2004 and on the OECD medium-term projections for the years 2005 and 2006. The projections provided for real GDP growth rates in Greece in the updated programme seem attainable in the medium term; however, uncertainties surround developments beyond 2004, when activity will be less sustained by the above mentioned specific factors. Price increases are expected to gradually slowdown after the second round effects of the oil prices hike are fully absorbed; however, the economy growing above potential allows positive real wage increases; the recent tax reform is having a positive impact on disposable income; demand-led pressures are materializing preventing significant deceleration in price increases. The inflation rate is consequently expected to stabilise to around 3% or slightly above in the entire period covered by the programme. The medium-term outlook for price increases in the update is quite similar to the Commission forecasts for the period until 2004, accompanied, however, by upward risks, mostly related to uncertainty associated with the external assumptions.

Against a background scenario for real GDP growth similar to that of the previous update, the 2002 updated stability programme sets significantly different budgetary targets until 2004. This is largely explained by the fact that the 2002 update incorporates the revised government accounts that resulted from decisions adopted in agreement with the Commission in the course of 2002 in order to ensure compliance with national accounting rules, which led to the reclassification and the correction in the treatment of a number of operations. Following these revisions, the previously estimated government surpluses for 2000 and 2001 turned into deficits, changing thus significantly the starting point of the medium term budgetary projections. In addition, the government debt ratio increased in 2000 and 2001, while a reduction was estimated for these years in the previous update. Overall, in the period 1996-2001, the government debt ratio declined by only 4 percentage points, standing at 107% of GDP in 2001, i.e. by 7.4 percentage points of GDP higher in the 2002 update than in the 2001 updated stability programme. The evolution of the debt ratio was mostly affected by sizeable financial operations, reflected in abnormally high stock flow adjustments, which reached 7.1% of GDP in 2001 and still exceeded 4% of GDP in 2002.

The budgetary developments as portrayed in the revised data, and more particularly the slow pace of reduction in the government debt ratio in a period when the Greek economy has been growing at high rates, is a matter of serious concern. It calls for urgent action from the Greek authorities, necessary in order to undertake a credible and efficient budgetary consolidation leading to a satisfactory pace of debt reduction.
According to the 2002 update, the general government deficit would be declining until 2004, turning into surplus of 0.2% of GDP in 2005, rising to 0.6% in 2006. A reduction in the government debt ratio by 17.4 percentage points during 2003-2006 is projected corresponding to 4.4 percentage points of GDP per year, to 87.9% of GDP in 2006. The budgetary strategy of the programme relies, as in the past, on high and rising primary surpluses and declining interest payments over the time-horizon of the programme. However, the primary surplus, at 4.8% on yearly average, stands at lower levels as compared with the average levels of 6% of GDP projected in the previous update, following the methodological revisions of the government accounts; yet it does not decline over the period as projected in the previous update. Thus, in the current update the contribution over the programme period of the primary balance to the improvement of the government budgetary position almost equals the projected reduction in debt servicing costs.

The budgetary adjustment path of the updated programme is subject to strong uncertainty in the light of the scant measures provided. The reduction in the central government deficit is projected to be higher than the overall improvement in the general government balance as the surpluses of the social security funds are set to gradually decline. However, the central government deficit increased by 0.8 percentage points of GDP in 2002 instead of declining by 1.5 percentage points as projected in the 2001 updated stability programme. Although this was partly due to the data revisions, the possibility of implementing decisive cuts in current primary spending, in particular in the wage bill, in a repetitive way in the next four years which would compensate for lower tax revenues following the implementation of the 2002 tax reform, seems rather disputable; recent experience shows that government consumption has become a quite inelastic category of expenditure, while it may be also influenced in the short-term by the political cycle, as general elections will take place at the latest in April 2004. Thus, the considerable reduction in the central government deficit which underpins the general government budgetary adjustment, might result difficult to achieve under such circumstances.

Moreover, the adjustment effort presented in the updated programme is strongly back-loaded and, in this sense, lacks credibility. The general government deficit is projected to fall by only 0.2% of GDP in 2003 and then, suddenly, by 0.5% of GDP on average in the period 2004-2006. The fact that the expected budgetary adjustment is to a large extent postponed to the years beyond 2003 is one of the weakest aspects of the programme and even more so, taking into account that in the period 2004-2006 uncertainties surround the macroeconomic assumptions on which expenditure and revenue projections are built.

The 2002 update provides estimates of the cyclically adjusted budgetary position applying the production function methodology; they indicate that, while the cyclically-adjusted budgetary balance deteriorates marginally in 2003, it improves considerably in 2004, reaches a balanced position in 2005 and remains unchanged thereafter. However, a different configuration emerges when the production function method using Commission parameters is applied to the projections provided by the 2002 update. The cyclically adjusted balance improves at a slower pace than estimated in the 2002 update, but regularly throughout the period, getting closer to a balance position at the end of the period, although a cyclically-adjusted deficit of the order of 0.6% of GDP, still persists in 2006.

The 2002 updated stability programme contains a section on the sustainability of public finances. It includes national projections for public expenditures on pensions which show an overall increase of some 10 percentage points of GDP between 2005 and 2050; this is somewhat lower than the EPC projection as it takes on board the impact of the "second phase" of the social security reform. On the basis of current policies, the risk of unsustainable public finances in terms of emerging budget imbalances cannot be excluded. This can almost be entirely attributed to the very large projected increase in spending on public pensions. In the strategy presented in the programme to meet the budgetary costs of population ageing no details are provided on future plans to reform the pension system. A comprehensive and ambitious strategy is needed which adequately reflects the seriousness of the policy challenge. Further deep reforms are required without delay to the pension system to avoid an unsustainable increase in public spending.

Some progress was achieved in implementing structural reforms in 2002 as announced in the 2001 updated programme, in particular with respect to the reform of the tax and the pension systems. The budgetary cost of the tax reform is embodied in the tax revenue projections for the year 2003 and 2004. Proceeds from privatisation were non-negligible, although the initial plans of the government were not successful, most likely due to unfavourable conditions in the Stock exchange. The government intends to pursue its privatisation efforts in 2003 and to follow a more proactive approach by introducing new methods of privatisation and by lifting the upper privatisation limit for some companies. Significant privatisation proceeds are expected in 2003 as implied by the projected low stock-flow adjustment in this year as compared with previous projections and with the other years. Nonetheless, given the conditions prevailing in the stock exchange and in the absence of a clear new strategy in implementing the privatisation plans, more decisive steps are required to improve the functioning of the markets and to raise funds effectively used to pay-off public debt.

1. INTRODUCTION

The 2002 update of the stability programme of Greece was submitted to the Commission on 2 December 2002[1]. Like its predecessors, the 2002 update was adopted by the government and made available to the public at the internet site of the Ministry of National Economy. The 2002 update extends the period covered to 2006. The projections start from the macroeconomic assumptions included in the 2003 Budget, adopted by the parliament on 23 December 2002.

The current update of the stability programme of Greece stresses that the aim of the Greek government, in the context of the Economic and Monetary Union, is to continue its efforts for stability and real convergence; taking into account the unfavourable external economic environment, it builds on endogenous forces and the intensification of structural reforms which are aimed to sustain a robust GDP growth while fiscal consolidation is shaped by the less favourable budgetary situation and outlook implied by the methodological revisions in the statistical treatment of a number of operations that took place in 2002. However, the programme lacks sufficient detail on the policy measures which are supposed to ensure its full implementation.

The update provides the information asked in the 2001 Council opinion on the implications of the cost of the ageing population as well as on developments in the government debt. Information on the budgetary position in a cyclical context are also provided. In general terms, the update conforms with the requirements of the Code of Conduct on the content and format of the programmes which has been endorsed by the ECOFIN Council on 10 July 2001.

2. IMPLEMENTATION OF THE 2001 UPDATE OF THE STABILITY PROGRAMME

Against an unchanged outlook for real GDP growth in 2001 and 2002, the current update provides significantly different results for both the government balance and the debt ratio. For 2001, the general government balance recorded a deficit of 1.2% of GDP instead of a surplus of 0.1% of GDP (including UMTS receipts equal to 0.5% of GDP), while the government debt ratio was higher by 7.4 percentage points of GDP than estimated in the 2001 updated programme. Nonetheless, these new data are fully due to the statistical revisions decided in 2002 to ensure compliance with ESA accounting rules which implied the reclassification of a number of expenditure (i.e. capital injections, debt assumptions and interest payments) in the government balance and the inclusion of a number of financial operations, previously excluded or incorrectly treated, in the stock of debt.

[1] The first stability programme of Greece was submitted to the Commission in December 2000; the Council issued an opinion on 12 February 2001, OJ C 77, 9.3.2001, p. 1. The first update of the stability programme was submitted in December 2001; the Council issued an opinion on 12 February 2002, OJ C 51, 26.2.2002, p. 5

Table 1: Divergence from the 2001 Stability and Growth Programme				
% of GDP	**2001**	**2002**	**2003**	**2004**
REAL GDP GROWTH				
SGP 2001	4.1%	3.8%	4.0%	4.0%
SGP 2002	4.1%	3.8%	3.8%	4.0%
DIFFERENCE	0.0	0.0	-0.2	0.0
GENERAL GOVERNMENT BALANCE				
SGP 2001	0.1%	0.8%	1.0%	1.2%
SGP 2002	-1.2%	-1.1%	-0.9%	-0.4%
DIFFERENCE	-1.3	-1.9	-1.9	-1.6
GENERAL GOVERNMENT GROSS DEBT				
SGP 2001	99.6%	97.3%	94.4%	90.0%
SGP 2002	107.0	105.3	100.2	96.1%
DIFFERENCE	+7.4	+8.0	+5.8	+6.1

Source: The 2002 update of the stability programme

For 2002, a part of the difference in the general government budget balance is explained by the estimated outcome of the 2002 State Budget which recorded a higher deficit than projected. This was equal to € 817 million (or 0.6% of GDP) and was explained by an overrun in current expenditure (equal to € 739 million or 0.5% of GDP of which € 211million in wages and € 249 million in interest payments) and a shortfall in non-tax revenues (equal to € 764 million) partly offset by higher tax revenues and a lower deficit in the investment budget. The remainder of the difference is the result of the statistical revisions which also implied changes for 2002.

As regards the government debt, the estimate for 2002 incorporates the overshooting in the State budget target and the impact of the statistical changes.

3. MACROECONOMIC ASSESSMENT

3.1 External economic assumptions

The macroeconomic projections of the update for the period 2003-2004 rely on the Commission external assumptions underlying the Autumn 2002 forecasts. For the years 2005 and 2006, OECD medium-term projections are used according to which real GDP growth in the EU should slow down somewhat and interest rates would be higher by 0.4 basis points on 2004. Although the international economic environment is considered to be highly uncertain, the medium-term prospects for the Greek economy remain positive during the entire period covered by the programme.

3.2 Macroeconomic developments

In 2001, economic activity is Greece continued to be buoyant despite negative developments in the world economy. Real output grew by 4.1%, exceeding significantly the EU average, as domestic demand continued to be strong, both consumption and investment. In addition, although export volumes decelerated, imports of goods and services fell at a faster pace, the external balance making consequently a positive contribution to real output growth. However, the unfavourable economic conditions that prevailed in 2001, and in particular after the events of 11 September, seem to have affected economic activity in 2002. Real GDP is estimated in the programme to have increased by 3.8%; the Commission estimates an even stronger slowdown to 3.5%, as a result of both slower increase in domestic demand (mainly investment) and a somewhat stronger worsening in the external balance.

For the period 2003-2004, the update projects real GDP growth to accelerate as from 2004 while in the Commission forecasts an acceleration in the rate of growth of real GDP is expected already in 2003, followed by a slowdown in 2004. For 2003, the difference stems mainly from the domestic demand components, mainly consumption (both private and public). But in 2004, the Commission expects that less buoyant investment activity in the year after the opening of the Olympic Games in the Summer will negatively impact buoyancy in activity.

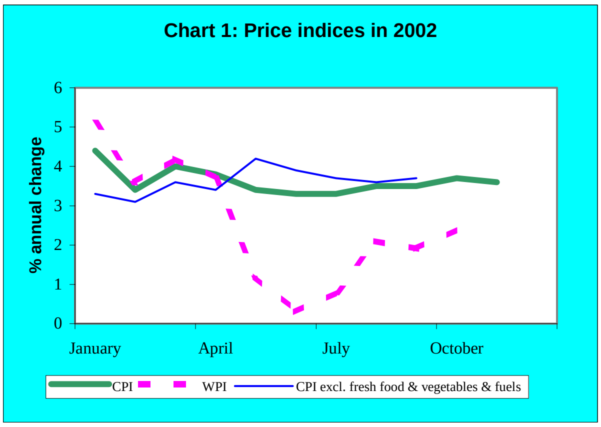
Table 2 – Macro-economic projections in the 2002 update and the Commission Autumn forecasts (2001–2006)

(Annual growth rate in % unless otherwise mentioned)		2002		2003		2004		2005	2006
	2001	**SP 2002**	**Com.**	**SP 2002**	**Com.**	**SP 2002**	**Com.**	**SP 2002**	**SP 2002**
GDP at constant prices	4.1	3.8	3.5	3.8	3.9	4.0	3.7	3.7	3.6
Private consumption	3.2	3.0	3.0	3.1	3.2	3.2	3.3	3.2	3.0
Government consumption	0.5	1.5	1.0	-1.5	0.7	0.0	0.6	0.0	0.0
Gross fixed capital formation	5.9	7.7	7.3	9.5	8.3	7.0	5.6	6.1	5.1
Exports of goods & services	-1.3	1.4	1.0	4.6	4.3	7.6	7.1	6.3	6.3
Imports of goods & services	-1.9	1.9	2.2	4.9	4.6	5.8	5.5	5.2	4.4
GDP deflator	3.4	3.2	3.3	3.1	3.2	3.2	3.2	3.0	3.0
Employment growth	-0.3	0.3	0.3	1.2	0.8	1.2	0.6	1.0	1.0
Contribution to real GDP growth									
Domestic demand	3.7	4.1	4.0	4.3	4.4	4.0	3.8	3.8	3.5
External trade	0.3	-0.3	-0.5	-0.5	-0.4	-0.0	-0.1	-0.1	0.2

Sources: The 2002 Update to the Stability Programme of Greece; Commission services, Autumn 2002 forecasts

The situation in the labour market has been gradually improving since 2001: the unemployment rate is on a downward trend (9.5% in Q3 from 10.9% in the first quarter) and employment increased by 1.3% in Q3 (year-on-year), the largest increase recorded since 1998. The 2002 updated programme assumes a further improvement in coming years, the unemployment rate falling to around 7% at the end of the period covered by the programme.

Price developments in 2002 were influenced by a number of factors pointing to opposite directions: bad weather conditions and roundings following the introduction of the euro in January 2002, implied high inflation rates in the first quarters. In contrast, world and oil prices exerted a positive impact in containing domestic and production prices as evidenced by subdued increases in wholesale prices (WPI). Inflation as measured by consumer prices stabilised in November but at a high level, among the highest in the euro zone and well above the EU average. The CPI rose



3.6% (year-on-year) in November from 4.4% in January and the HICP rose by 3.9% from 4.8% respectively. Core inflation (as measured by the partial index of consumer prices excluding fresh food and vegetables and fuels) is rising faster than the headline rate since May, implying the persistence of inflation pressures.

Price increases are expected to gradually slowdown after the second round effects of the oil prices hike are fully absorbed; however, the economy growing above potential allows positive real wage increases; the recent tax reform is having a positive impact on disposable income; demand-led pressures are materializing preventing significant deceleration in price increases. The inflation rate is consequently expected to stabilise to around 3% or slightly above in the entire period covered by the programme. The medium-term outlook for price increases in the update is quite similar to the Commission forecasts for the period until 2004, accompanied, however, by upward risks, mostly related to uncertainty affecting with the external assumptions.

4. Budgetary targets and medium-term path of public finance

4.1 Programme overview

The 2002 updated stability programme sets significantly different budgetary targets than the previous update until 2004, in spite of an almost unchanged background scenario for real GDP growth (with the exception of the year 2003, see Table 1 above). The new targets are mostly influenced by the statistical reclassification of a number of expenditures, introduced in 2002, which impact both the government balance and the government debt ratio until 2002. Furthermore, although real output growth is broadly the same, there are differences between the two programmes concerning the factors influencing real GDP growth; in particular, the smaller contribution of domestic demand in the entire period 2001-2001 is compensated for by a better performance of the external balance, resulting from faster slowdown in imports than in exports growth (see Table 10 of the 2002 update).

The budgetary targets of the 2002 update for 2003 and 2004 suggest greater fiscal consolidation efforts as compared with the 2001 update: the government balance should improve by 0.7 percentage points against 0.4 percentage points projected previously and the government debt is projected to decline by 9.2 percentage points (against 7.3 percentage points in the 2001 update) although remaining at a higher level. Overall, the current update targets a significant improvement in both the government balance and the debt ratio during the period 2003-2006. The latter is projected to fall by 19.1 percentage points standing at 87.9% of GDP in 2006 while the general government balance, from a deficit of 1.1% of GDP in 2002, would record surpluses as from 2005, improving by 1.7 percentage points until 2006.

The adjustment effort projected in the update strengthens after 2003, as the debt ratio is falling on average by 4.35 percentage points per year to be compared with a debt reduction in 2003 planned to only 1.7 percentage points. Similarly, the government balance improves at a faster pace after 2003 (by an average of 0.5 percentage points in the period 2004-2006) while the reduction in the government deficit in 2003 is only 0.2 percentage points.

The underlying budgetary strategy of the 2002 update for the whole period may be summarised as follows: the progressive lowering of the debt servicing burden is sustained by increasing primary surpluses, the contribution of each factor to the improvement in the government balance being almost equal. In this sense, it differs quite significantly from the 2001 update in which the adjustment was based solely on the interest dividend relief, while the primary surplus was set to diminish. Indeed, based on a cautious macroeconomic scenario, the 2002 updated stability programme proposes more ambitious targets than in the previous programmes in two ways: *first*, the bulk of the adjustment relies on primary spending restrain to allow for more investment and lower tax burden; *second*, the improvement in the central government balance is the core strategy as the surplus of the social security funds is set to gradually diminish.

Table 3: General Government Budgetary Developments ***(in national accounts basis)***

% of GDP	2002	2003	2004	2005	2006	Change 2006-2002
BALANCE BY SUB-SECTORS						
1. GENERAL GOVERNMENT	-1.1%	-0.9%	-0.4%	0.2%	0.6%	+1.7
2. CENTRAL GOVERNMENT	-4.7%	-4.3%	-3.7%	-2.9%	-2.3%	+2.4
3. LOCAL GOVERNMENT	0.05%	0.05%	0.05%	0.05%	0.05%	0
4. SOCIAL SECURITY	3..5%	3..3%	3..3%	3.1%	2..9%	-0.6
GENERAL GOVERNMENT						
5. TOTAL REVENUE	45.7%	45.1%	44.5%	44.4%	44.3%	-1.4
6. TOTAL EXPENDITURE	46.8%	46.0%	44.9%	44.2%	43.8%	-3.0
7. GENERAL GOVERNMENT BALANCE	-1.1%	-0.9%	-0.4%	0.2%	0.6%	+1.7
8. INTEREST	5.5%	5.3%	5.0%	4.8%	4.6%	-0.9
9. GEN. GOVN. PRIMARY SURPLUS (8-7)	4.4%	4.4%	4.6%	5.0%	5.2%	+0.8
COMPONENTS OF REVENUES / EXPENDITURES						
10. TAXES	24.5%	24.2%	24.1%	24.1%	24.0%	-0.5
11. SOCIAL CONTRIBUTIONS	13.6%	13.6%	13.6%	13.7%	13.7%	+0.1
12. OTHER CURRENT RESOURCES	3.7%	3.5%	3.3%	3.1%	2.9%	-0.8
13. TOTAL REVENUE	45.7%	45.1%	44.5%	44.4%	44.3%	-1.4
14. GOVERNMENT FINAL CONSUMPTION EXPENDITURE	15.4%	14.8%	14.5%	14.3%	14.0%	-1.4
15. SOCIAL TRANSFERS OTHER THAN IN KIND	16.1%	16.2 %	16.1%	16.2%	16.2%	+0.1
16. SUBSIDIES	0.2%	0.1%	0.1%	0.1%	0.1%	-0.1
17. INTEREST PAYMENTS	5.5%	5.3%	5.0%	4.8%	4.6%	-0.9
18. OTHER CURRENT EXPENDITURE	1.1%	1.1%	1.1%	1.0%	1.0%	-0.1
19.GROSS FIXED CAPITAL FORMATION	3.7%	3.9%	4.0%	4.0 %	4.0%	+0.3
20. TOTAL EXPENDITURE	46.8%	46.0%	44.9%	44.2%	43.8%	-3.0

Source: The 2002 update of the stability programme

In the period 2003-2006, government revenues are projected to fall by 1.4 percentage points of GDP, mostly current revenues; this would be gradually compensated for by a fall in current equal to 3.4 percentage points of GDP (while investment expenditure should increase by 0.3 percentage points). Interest payments are expected to decline by 0.9 percentage points of GDP implying that primary spending should decline by 2.1 percentage points of GDP. The central government balance is projected to remain in deficit in the entire period but its improvement (equal to 2.4 percentage points of GDP in the period 2003-2006) is higher than projected for the general government. This is a common feature with the 2001 update.

The proposed adjustment path is subject to relevant uncertainty, in particular in view of the absence of a detailed description of concrete measures ensuring its implementation. The possibility of implementing decisive cuts in current primary spending, in particular in the wage bill, in a repetitive way in the next four years seems uncertain; government consumption has become a quite inelastic category of expenditure, while it may be also influenced in the short-term by the political cycle, as general elections will take place before April 2004. Moreover, on the basis of recent experience, the considerable reduction in the central government deficit underlying the projections may be considered difficult to achieve; indeed, the central government deficit increased in 2002 by 0.8 percentage points of GDP while it was set to decline by 1.5 percentage points in the 2001 updated stability programme. Although the budgetary targets of the two updates are not fully comparable following the recent reclassification of expenditure items[2], risks of overshooting in the budgetary projections should not be ruled out.

4.2 Public finance in 2003

The 2003 State Budget was adopted on 23 December 2002. It targets a deficit for the central government consistent with a general government deficit of 0.9% of GDP from an estimated 1.1% of GDP in 2002. It incorporates the impact of the 2002 tax reform which is estimated at 0.8 to 1.0% of GDP split into 2003 and 2004. The crucial issue is the projected deceleration in government consumption, in absolute terms but also relative to the previous programme: consumption on the general government is set to increase by 2.5% in nominal terms (6% was assumed in the 2001 updated programme) as against 6.7% in 2001. This expected reduction corresponds to 0.6% of GDP and should fully offset lower budget revenues. Interest payments should fall by 0.2 percentage points of GDP (increasing by 2.2% instead of falling by 0.8% as projected previously), reflecting most likely the higher level of debt. Finally, investment expenditure should increase by 0.2 percentage points after having slightly declined in 2002.

The central government deficit which increased to 4.7% of GDP in 2002 from 3.9% of GDP in 2001, is projected to fall by 0.4 percentage points; this should be partly offset by the surplus of the local authorities and social securities funds (equal to 3.4% of GDP).

The general government primary balance is projected to remain at 4.4% of GDP in 2003 as in 2002 but declining from 5.1% achieved in 2001. However, the government debt ratio is expected to post a spectacular decline as compared with the past and

2 The most important cases were the reclassification of capital injections by the government to public companies and debt assumption operations which involved large amounts but of a similar size in both years, 2001 and 2002; thus, the observed discrepancy cannot be explained by the accounting revisions, or at least not fully.

exceeding the level of the primary surplus (at 5.1% of GDP). Besides the positive impact of real GDP growth, this projection reflects the significantly lower level of stock-flow adjustment factors projected to reach only 0.9% of GDP, as against 4.4% and 7.1% of GDP respectively in 2002 and 2001. Presumably, this should be the result of expected high privatisation receipts and limited use of financial operations in debt management.

The Commission forecasts project a higher deficit in 2003, at 1.1% of GDP from an estimated 1.3% of GDP in 2002. This is mostly due to a lower decline in government consumption, mainly wages, in real terms given the uncertainty underlying this particular category of expenditure and the reasons mentioned above. Furthermore, the debt ratio is projected to decline at a slower pace, by 3.8 percentage points, standing at 102% of GDP at the end of 2003, as a result of higher stock-flow-adjustment factors (or lower debt-reducing factors) than assumed in the 2002 update.

4.3 Targets and fiscal adjustment in 2004 and beyond

According to the 2002 update, the budgetary adjustment efforts are set to continue at a stronger pace in the rest of the period covered by the programme as the improvement in the central government balance is expected to accelerate: the deficit is set to be reduced by 2 percentage points in the period 2004-2006 (by 0.6-0.7 percentage points per year), thus, faster than in previous years. Despite a progressive reduction in the other sectors surpluses, the general government balance is projected to improve by around 0.5 percentage points per annum, being in surplus as from 2005.

The projected 1.5 percentage points improvement in the general government balance during the period will result from a 0.8 percentage points increase in the primary balance, which should reach 5.2% of GDP in 2006, and lower debt servicing costs by 0.7 percentage points of GDP. The debt ratio is projected to decline by 12.3 percentage points in the three years to 2006.

Budget revenues should continue to decelerate albeit at a slower pace, while the contribution of primary spending cuts continues to be important. Investment spending should remain constant at 4% of GDP, after the strong increases in recent years, partly associated with the organisation of the 2004 Olympic Games.

4.4 Cyclically-adjusted budget balances

The 2002 update provides estimates of budgetary balances adjusted for the impact of the economic cycle on the basis of potential GDP growth as derived from the production function approach. According to the update, the government cyclically-adjusted budgetary position would gradually improve from a 1.5% of GDP in 2002 to 0.8% of GDP in 2004, then reaching balance in 2005 and remaining in balance in 2006. The adjustment suggested by the structural balance follows a somewhat different path from the nominal balance: in the period 2004-2006, the government actual balance is projected to improve gradually by around 0.5 percentage points of GDP each year while the cyclically-adjusted balance is suddenly improving by 0.8 percentage points of GDP in 2004 and 2005. Similarly, the cyclically-adjusted primary balance, after deteriorating in 2003, improves significantly in 2004 and 2005.

On the basis of the projections provided in the 2002 update and using the results of the Commission production function approach (Table 4) a different picture emerges. The cyclically adjusted balance is improving gradually throughout the period to 2006. The improvement is slower than expected in the 2002 update, reaching 0.3 percentage point of GDP per year on average in the period 2004-2006, following a very mild reduction of 0.1 percentage point of GDP in 2003. The cyclically-adjusted primary balance does not show any improvement until 2005, remaining well below the level achieved in 2001 in the entire period covered by the programme.

Table 4. Cyclically-Adjusted Budget Balance[1]

% GDP	2001	2002	2003	2004	2005	2006
1. GDP growth at constant prices	4.1%	3.8%	3.8%	4.0%	3.7%	3.6%
2. Net borrowing	-1.2%	-1.1%	-0.9%	-0.4%	0.2%	0.6%
3. Interest payments	6.3%	5.5%	5.3%	5.0%	4.8%	4.6%
4. Potential GDP growth	3.2% (3.3%)	3.4% (3.1%)	3.6% (3.3%)	3.5% (3.3%)	3.3% (3.3%)	3.2% (3.4%)
5. Output gap	0.9% (1.0%)	1.3% (1.2%)	1.5% (1.8%)	2.0% (2.4%)	2.4% (1.2%)	2.8% (1.0%)
6. Cyclical budgetary component	0.4% (0.8%)	0.5% (0.4%)	0.6% (0.6%)	0.8% (0.4%)	1.0% (0.2%)	1.1% (0.6%)
7. Cyclically-adjusted balance	-1.6% (-2.1%)	-1.6% (-1.5%)	-1.5% (-1.6%)	-1.2% (-0.8%)	-0.8% (0.0%)	-0.6% (0.0%)
8. Cyclically-adjusted primary balance	4.7% (4.2%)	3.9% (3.9%)	3.8% (3.5%)	3.8% (4.2%)	4.0% (4.8%)	4.1% (4.6%)

Source: Commission services calculations using the production function method on the basis of the projections of the 2002 updated stability programme; in parenthesis, the estimates provided in the 2002 update..

The differences result from different estimates for potential output and the output gap, both levels and trends, in particular for the years 2005 and 2006. The output gap is in fact estimated by the Commission to increase until the end of the period covered by the update while the latter projects the output gap to decrease considerably in 2005 and to continue falling in 2006. The government cyclically-adjusted deficit still reaches 0.6% of GDP in 2006 in the Commission calculations.

4.5 The debt ratio

Until 2001, developments in the debt ratio have been hardly reflecting the improvement in the general government budgetary balance and in the overall performance of the Greek economy. In a context of strong real output growth, outpacing the EU average for a number of years, of falling interest rates and clearly improving primary balances, the debt ratio has been reduced by only four percentage points in the period 1996-2001; in addition, the debt ratio increased both in 2000 and 2001. This is also crucial for the assessment of the overall sustainability of public finance in the short and the medium-term. In fact, the recent evolution in the debt ratio was mostly the result of massive debt management financial operations, reflected in the abnormally high stock-flow adjustments, although the impact of exchange rate movements on external debt was not negligible during that period. Until 2002, a large amount of financial operations have been either incorrectly recorded in the government accounts or even excluded in the past and in the previous update of the stability programme; in collaboration with the Commission services, major revisions of reported data took place in the course of 2002 and resulted in a significantly different outlook of public finance as suggested in particular by the debt ratio. This makes difficult the comparison of the projections for the government debt ratio in the current update with those included both in the initial and in the 2001 update of the stability programme of Greece but has increased considerably the transparency of the Greek accounts and, thus, the credibility of the fiscal adjustment strategy.

Nonetheless, in this new context, the debt ratio is projected to decline by 10.9 percentage points in the four-year period 2001-2004, from 9.6 percentage points projected in the 2001 update for the same period; furthermore, in the four-year period 2003-2006, the debt ratio is projected to be reduced by 17.4 percentage points (or 4.4 percentage points per year), thus, at a much faster pace than planned in the previous programmes and clearly more than the actual developments[3].

Table 5: General Government Debt Developments

% of GDP	2001	2002	2003	2004	2005	2006
GEN. GOVN CONSOLIDATED GROSS DEBT	107.0%	105.3%	100.2%	96.1%	92.1%	87.9%
CHANGE	0.8%	-1.7%*	-5.1%	-4.1%	-4.0%	-4.2%
CONTRIBUTION TO CHANGES IN GENERAL GOVERNMENT CONSOLIDATED GROSS DEBT						
PRIMARY SURPLUS	5.1%	4.4%	4.4%	4.6%	5.0%	5.2%
INTEREST	6.3%	5.5%	5.3%	5.0%	4.8%	4.6%
NOMINAL GDP	7.6%	7.1%	7.0%	7.3%	6.8%	6.7%
OTHER FACTORS AFFECTING THE GENERAL GOVERNMENT CONSOLIDATED DEBT						
ADJUSTMENT FACTORS & PRIVATISATION PROCEEDS	7.1%	4.4%*	0.9%	2.3%	2.3%	2.1%
IMPLICIT INTEREST RATE (General Government)	6.3%	5.5%	5.4%	5.4%	5.3%	5.3%

*Source: The 2002 update of the stability programme; *the figures in the SP were wrong (-2.3% and 3.7% respectively)*

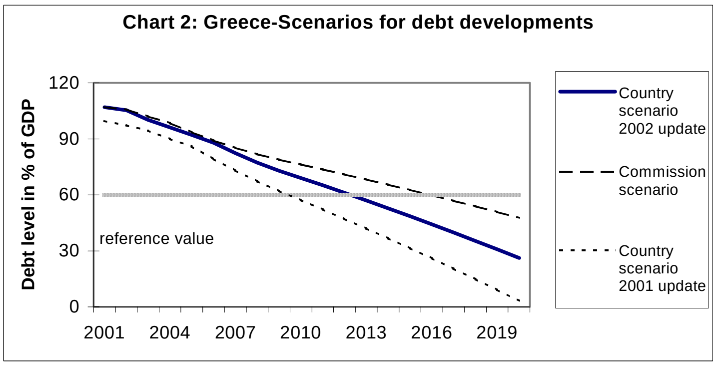
The stock-flow adjustment, which reached 7.1% of GDP in 2001, was still high in 2002, exceeding 4% of GDP; however, it is projected to represent no more than 2% of GDP on average per year in the period 2003-2006. In particular, in 2003, the stock-flow adjustment is projected to be 0.9% of GDP, reflecting, *first*, limited financial operations and, *second*, the use of privatisation proceeds to pay-off significant amounts of public debt. While the latter is subject to uncertainty given the situation prevailing in the stock market (see also section 6 hereafter), the former suggests the government's commitment to greater transparency in the budgetary consolidation strategy underlying this year's update of the stability programme. Indeed, as from 2003, the change in the debt ratio should correspond better to the projected level of the primary surplus.

[3] Following the recent statistical revisions, the debt ratio declined by 4.3 percentage points of GDP in the period 1996-2001 while it increased both in 2000 and in 2001.

Chart 2 compares the two scenarios for the reduction in the debt ratio according to the 2001 and the 2002 updates with the Commission scenario[4]. It shows that the 60% of GDP reference value would be reached faster under the strategy outlined in the 2001 update than in the 2002 update (three years earlier) while according to the Commission scenario, the reference value would be reached three years later than the projections of the 2002 update would imply. There are, nevertheless, some important limitations in the comparisons:

- *first*, the comparability of the two updated stability programmes is quite limited due to the recent methodological revisions which resulted in a higher starting point for the debt ratio (by 7.4 percentage points) and a lower level of primary balance in 2001 (by almost 1.4 percentage points of GDP). Against this background, while the 2002 update projects a faster annual reduction in the debt ratio and an increase in the primary surplus as compared with a decline in the 2001 update, the gap is not fully absorbed at the end of the period for which there are projections;

- *second*, there is also a significant limitation in the comparison of the results from the Commission and the 2002 updated programme's scenarios as the main difference stems from the primary surplus forecast for the year 2004 (end of the Commission forecasting period). Based on the unchanged policy assumption, the Commission Autumn 2002 forecasts have broadly translated the strategy underlying the 2001 updated stability programme as the 2002 update was not yet presented and the State budget for 2003 was not yet tabled to Parliament. Thus, the primary surplus in 2004 would decline to 4% of GDP according to the Commission forecast, remaining at that level thereafter, while the 2002 update provides for an higher primary balance of 4.6% of GDP in 2004 and increasing to 5.2% of GDP in 2006.



[4] For the period after 2006, the assumptions underlying the three scenarios are the same except for the primary surplus where the last available figure is used; thus, real GDP growth after 2006 should converge to the 2010 rate (as reported in the Economic Policy Committee) and then remain constant; the inflation rate should converge after 2006 to the value of 2% in 2010 and then remain constant; and from 2010 onwards the nominal implicit interest rate should be equal to average EU growth rate (1.7%) plus inflation (2%) plus 2%, i.e. 5.7%; therefore, implicit interest rates should converge to this value until 2010. Therefore, differences between the updated programmes and the Commission scenarios are due to the last available figure for the primary balance.

4.6 Sensitivity analysis

The 2002 update provides an alternative, less optimistic, scenario for real output growth resulting from the materialisation of some of the risks underlying the current assumptions, namely higher oil prices and worsening conditions in the stock exchange; these should impact on domestic demand and the external balance, contributing in lowering GDP growth by an average of 0.7% per annum. The upward pressure on prices following higher oil prices is assumed to be fully offset by the lower domestic demand growth implying that projected inflation is broadly unchanged. Assuming unchanged budget revenue and expenditure elasticity to GDP, the adjustment in the government balance would be slower but a surplus of 0.2% of GDP would still be recorded in 2006. Subsequently, as a result of lower primary balances and due also to level effects, the government debt to GDP ratio would be higher than in the baseline scenario by 3.3 percentage points in 2006.

5. THE SUSTAINABILITY OF PUBLIC FINANCES

The 2002 updated stability programme contains a section on the sustainability of public finances. It includes national projections for public expenditures on pensions which show an overall increase of some 10 percentage points of GDP between 2005 and 2050: this is somewhat lower than the Economic Policy Committee projection as it takes on board the impact of the “second phase” of the social security reform. When account is taken of the impact of ageing populations on health care, age-related spending is projected to grow by some 12 percentage point of GDP over the same period.

It is first necessary to consider whether current budget polices can ensure that the SGP will be respected in the future in light of the budgetary implications of ageing populations. The Commission considers that on the basis of current policies, the risk of unsustainable public finances in terms of emerging budget imbalances cannot be excluded (see Annex 2). This can almost be entirely attributed to the very large projected increase in spending on public pensions.

A second issue is whether the budgetary strategy outlined in the programme is compatible with improving the sustainability of public finances. If achieved, the planned move from a deficit in 2002 to a small surplus in 2006, would contribute towards meeting the budgetary costs of ageing population. At the same time, a fast pace of debt reduction must also occur: this implies that the projected reduction in the debt ratio due to nominal GDP growth and the primary surplus is not offset by unwarranted debt increasing operations, which has been the case in recent years. Moreover, sustainability will require securing a balanced budget position in underlying terms over the very long run: this will imply running large primary surpluses for many years.

A strategy to meet the budgetary costs of ageing populations based on debt reduction alone will not suffice. It needs to be accompanied with reforms that tackle the budgetary problem at source, i.e. further reform of the pension system which substantially reduces the projected growth in public spending on pensions. Overall, the strategy presented in the programme is complacent and piecemeal. No details are provided on future plans to reform the pension system, or on reforms to raise employment rates especially amongst women

Table 6: Long-term Sustainability of Public Finances					
% of GDP	**2000**	**2005**	**2010**	**2030**	**2050**
Total expenditure	48.9%	44.2%	41.0%	48.5%	49.0%
Old age pensions	12.6%	12.4%	12.2%	17.3%	22.6%
Health care (not-including care for the elderly)	4.8%	5.0%	5.2%	5.9%	6.6%
Interest payments	6.9%	4.8%	1.8%	1.0%	0.5%
Total revenues	47.2%	44.4%	41.5%	48.5%	49.0%
***of which*: from pensions contributions**	7.9%	8.3%	8.4%	9.0%	8.8%
Assumptions					
Labour productivity growth	4.4	2.5	2.5	1.75	1.75
Real GDP growth	4.2	3.7	3.7	0.73	0.85
Participation rate males (aged 20-64)	84.1	84.0	83.4	81.1	82.1
Participation rates females (aged 20-64)	51.1	53.4	55.3	61.0	71.9
Total participation rates (aged 20-64)	67.6	68.7	69.4	71.3	77.1
Unemployment rate	11.1	7.1	7.0	6.7	5.5

Source: European Commission and Ministry of Economy and Finance of Greece.

Finally, it is necessary to consider the type and scale of the budgetary challenges that will emerge in coming years to ensure sustainable public finances. First and foremost, a comprehensive and ambitious strategy is needed which adequately reflects the seriousness of the policy challenge. Budgetary objectives need to be more ambitious. As a minimum, a position of underlying budget balance should be attained no later than the deadlines set down in the stability programme, and a fast pace of debt reduction must materialise in practice. At the same time, further deep reforms are required without delay to the pension system to avoid an unsustainable increase in public spending.

.6. Structural measures and other reforms with likely budgetary impact

The 2002 update outlines the economic policy objectives underlying the structural reforms and measures undertaken in 2002. In the broader context of the Lisbon strategy, structural policy is aimed at enhancing productivity growth, competitiveness and the potential of the Greek economy for growth and job creation.

Among the structural policy measures having a budgetary impact, the update mentions: the reform of the tax and the pension systems in 2002 and the continuation of the privatisation programme despite worsening conditions in the Stock Exchange. Some institutional initiatives with no direct budgetary cost are also presented: the law on corporate governance and internal auditing and the Parliamentary lodgement of Law concerning the application of International Accounting Standards (September 2002).

The reform of the pension system entered into force as scheduled in last year's update (Law 3029/2002 voted in June 2002)[5]. It concerns the rationalisation and homogenisation of the pension system as well as the safeguarding of the financial sustainability of IKA (the fund for most of the private sector employees). The reform focuses on correcting structural inadequacies, preparing for population ageing and rebuilding confidence and trust in the system. The update provides no estimate of the budgetary cost of the pension system reform; however, according to Law 3029/02, the financing of IKA as from 2003 to create a reserve should be equal to 1% of GDP per year.

The draft Law concerning the first wave of tax reform is tabled to parliament in November 2002. According to the 2002 update the overall budgetary cost of the tax reform equals 0.8 to 1.0% of GDP to be split in two years (in 2003 and 2004).

Total revenues from privatisation were € 2.25 billion (or 1.6% of GDP), compared with € 4.4 billion in 2001 (or 3.4% of GDP, including revenues from privatisation certificates and exchangeable bonds equal to € 1.94 billion or 1.5% of GDP). In the period 1998-2001, the total amount raised from privatisation reached € 11.8 billion. For the forthcoming period, the 2002 update lists (Table 16 of the update) the companies and the envisaged shares that would be sold but no estimate of the expected amounts is provided. Besides the traditional flotation of shares in the Stock Exchange, the government intends to introduce new methods of privatisation and to lift the upper privatisation limit for some companies.

Despite the amounts raised from privatisation in 2002, it should be noted that no one of the companies listed in last year's update privatisation programme was effectively privatised in 2002 and they are all listed in the privatisation plans for 2003 and afterwards. The 2002 update admits that the continuing deterioration of the Stock exchange has affected the privatisation momentum. Thus, revenues in 2002 were mostly the result of additional offerings of companies already listed in the stock market (Hellenic Telecommunications and Football prognostics Organisation), the sale of an additional 67% of the Hellenic Industrial Bank and the acquisition of 49% of the Athens Casino by a strategic partner (belonging to Hellenic Tourist Properties under State control). Among the most important companies still under 100% control by the State, Olympic Airways, the Piraeus Port Authority, the Postal services and the Postal Savings Bank remain in the plans for the forthcoming period.

7. Overall assessment of compliance with the stability and growth pact

The current stability programme is projecting further fiscal adjustment over the next four years but from a considerably worsened starting position than projected in the previous update. Indeed, the general government accounts were in deficit of 1.2% of GDP and the government debt ratio at 105.3% of GDP. The programme is projecting a steady improvement in the general government balance to a surplus of 0.6% of GDP in 2006. The projected underlying budgetary position would remain still in deficit of 0.6% of GDP in 2006 according to Commission calculations, while the updated programme is estimating a balanced position at the end of the period. The government

5 A brief description is provided under Section 6 "Fiscal implications of Population Ageing" of the update.

debt ratio is projected to decline by 17.4 percentage points to 87.9% of GDP in 2006. However, the projected budgetary adjustment is subject to serious uncertainties. Therefore, Greece will move close to satisfying the stability and growth pact requirements at the end of the period covered by the programme.

The updated programme is projecting a gradual improvement in the general government accounts. In view of the recent budgetary developments and the uncertainties surrounding the projected fiscal consolidation, there is urgent need for action to ensure a credible and faster budgetary adjustment and reduction of the government debt ratio over the period covered by the programme. A sufficiently fast fiscal consolidation is also necessary in order to ensure the sustainability of public finances in the medium to long term.

ANNEX 1: Main tables of the 2002 updated stability programme

Table 1. Growth and Associated Factors						
	2001	**2002**	**2003**	**2004**	**2005**	**2006**
SELECTED ECONOMIC INDICATORS						
GDP GROWTH AT CONSTANT PRICES	4.1%	3.8%	3.8%	4.0%	3.7%	3.6%
GDP LEVEL AT CURRENT MARKET PRICES (bn euro)	130.9	140.2	150.1	161.1	172.1	183.6
GDP DEFLATOR CHANGE	3.4%	3.2%	3.1%	3.2%	3.0%	3.0%
HCPI CHANGE	3.7%	3.9%	3.9%	3.2%	3.0%	2.9%
EMPLOYMENT GROWTH	-0.3%	0.3%	1.2%	1.2%	1.0%	1.0%
LABOUR PRODUCTIVITY GROWTH	4.4%	3.5%	2.6%	2.8%	2.7%	2.6%
UNIT LABOUR COSTS	0.9%	2.6%	2.3%	2.5%	2.3%	2.3%
GENERAL GOVERNMENT BALANCE	-1.2%	-1.1%	-0.9%	-0.4%	0.2%	0.6%
GENERAL GOVERNMENT DEBT	107.0%	105.3%	100.2%	96.1%	92.1%	87.9%
SOURCES OF GROWTH: PERCENTAGE CHANGES AT CONSTANT PRICES						
1. PRIVATE CONSUMPTION EXPENDITURE	3.2%	3.0%	3.1%	3.2%	3.2%	3.0%
2. GOVERNMENT CONSUMPTION EXPENDITURE	0.5%	1.5%	-1.5%	0.0%	0.0%	0.0%
3. GROSS FIXED CAPITAL FORMATION	5.9%	7.7%	9.5%	7.0%	6.1%	5.1%
4. CHANGES IN INVENTORIES (% GDP)	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%
5. EXPORTS OF GOODS AND SERVICES	-1.3%	1.4%	4.6%	7.6%	6.3%	6.3%
6. IMPORTS OF GOODS AND SERVICES	-1.9%	1.9%	4.9%	5.8%	5.2%	4.4%
CONTRIBUTION TO GDP GROWTH						
7. DOMESTIC DEMAND (excluding inventories)	3.7%	4.1%	4.3%	4.0%	3.8%	3.5%
8. CHANGES IN INVENTORIES	0.1%	-0.1%	0.0%	0.0%	0.0%	0.0%
9. EXTERNAL BALANCE OF GOODS AND SERVICES	0.3%	-0.2%	-0.5%	0.0%	-0.1%	0.1%
BASIC ASSUMPTIONS ON THE EXTERNAL ECONOMIC ENVIRONMENT						
	2001	**2002**	**2003**	**2004**	**2005**	**2006**
SHORT-TERM INTEREST RATE	4.4%	3.3%	2.8%	3.2%	3.5%	3.6%
LONG-TERM INTEREST RATE	5.0%	4.8%	4.4%	4.7%	5.0%	5.1%
EURO / USD EXCHANGE RATE	0.90	0.94	0.98	0.97	0.97	0.97
WORLD GDP GROWTH, excl. EU	2.2%	3.0%	3.9%	4.2%	4.2%	4.2%
EU-15 GDP GROWTH	1.5%	1.0%	2.0%	2.6%	2.3%	2.3%
WORLD IMPORT VOLUMES, excl. EU	0.0%	3.2%	6.8%	7.4%	7.5%	7.5%
OIL PRICES (USD/ barrel)	24.9	25.5	24.1	22.5	22.5	22.5

Table 2: General Government Budgetary Developments (in national accounts basis)						
% of GDP	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
BALANCE BY SUB-SECTORS						
1. GENERAL GOVERNMENT	-1.2%	-1.1%	-0.9%	-0.4%	0.2%	0.6%
2. CENTRAL GOVERNMENT	-3.9%	-4.7%	-4.3%	-3.7%	-2.9%	-2.3%
3. LOCAL GOVERNMENT	0.05%	0.05%	0.05%	0.05%	0.05%	0.05%
4. SOCIAL SECURITY	2.7%	3..5%	3..3%	3..3%	3.1%	2..9%
GENERAL GOVERNMENT						
5. TOTAL REVENUE	46.1%	45.7%	45.1%	44.5%	44.4%	44.3%
6. TOTAL EXPENDITURE	47.3%	46.8%	46.0%	44.9%	44.2%	43.8%
7. GENERAL GOVERNMENT BALANCE	-1.2%	-1.1%	-0.9%	-0.4%	0.2%	0.6%
8. INTEREST	6.3%	5.5%	5.3%	5.0%	4.8%	4.6%
9. GEN. GOVN. PRIMARY SURPLUS (8-7)	5.1%	4.4%	4.4%	4.6%	5.0%	5.2%
COMPONENTS OF REVENUES / EXPENDITURES						
10. TAXES	24.5%	24.5%	24.2%	24.1%	24.1%	24.0%
11. SOCIAL CONTRIBUTIONS	13.5%	13.6%	13.6%	13.6%	13.7%	13.7%
12. OTHER CURRENT RESOURCES	4.3%	3.7%	3.5%	3.3%	3.1%	2.9%
13. TOTAL REVENUE	46.1 %	45.7%	45.1%	44.5%	44.4%	44.3%
14. GOVERNMENT FINAL CONSUMPTION EXPENDITURE	15.5%	15.4%	14.8%	14.5%	14.3%	14.0%
15. SOCIAL TRANSFERS OTHER THAN IN KIND	15.9%	16.1%	16.2 %	16.1%	16.2%	16.2%
16. SUBSIDIES	0.2%	0.2%	0.1%	0.1%	0.1%	0.1%
17. INTEREST PAYMENTS	6.3%	5.5%	5.3%	5.0%	4.8%	4.6%
18. OTHER CURRENT EXPENDITURE	1.1%	1.1%	1.1%	1.1%	1.0%	1.0%
19.GROSS FIXED CAPITAL FORMATION	3.8%	3.7%	3.9%	4.0%	4.0 %	4.0%
20. TOTAL EXPENDITURE	47.3%	46.8%	46.0%	44.9%	44.2%	43.8%

Table 3: General Government Debt Developments						
% of GDP	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
GEN. GOVN CONSOLIDATED GROSS DEBT	107.0%	105.3%	100.2%	96.1%	92.1%	87.9%
CHANGE	0.8%	-2.3%	-5.1%	-4.1%	-4.0%	-4.2%
CONTRIBUTION TO CHANGES IN GENERAL GOVERNMENT CONSOLIDATED GROSS DEBT						
PRIMARY SURPLUS	5.1%	4.4%	4.4%	4.6%	5.0%	5.2%
INTEREST	6.3%	5.5%	5.3%	5.0%	4.8%	4.6%
NOMINAL GDP	7.6%	7.1%	7.0%	7.3%	6.8%	6.7%
OTHER FACTORS AFFECTING THE GENERAL GOVERNMENT CONSOLIDATED DEBT						
ADJUSTMENT FACTORS & PRIVATISATION PROCEEDS	7.1%	3.7%	0.9%	2.3%	2.3%	2.1%
IMPLICIT INTEREST RATE (General Government)	6.3%	5.5%	5.4%	5.4%	5.3%	5.3%

Table 4: D Divergence from the 2001 SGP				
% of GDP	2001	2002	2003	2004
REAL GDP GROWTH				
SGP 2001	4.1%	3.8%	4.0%	4.0%
SGP 2002	4.1%	3.8%	3.8%	4.0%
DIFFERENCE	0.0	0.0	-0.2	0.0
GENERAL GOVERNMENT BALANCE				
SGP 2001	0.1%	0.8%	1.0%	1.2%
SGP 2002	-1.2%	-1.1%	-0.9%	-0.4%
DIFFERENCE	-1.3	-1.9	-1.9	-1.6
GENERAL GOVERNMENT GROSS DEBT				
SGP 2001	99.6%	97.3%	94.4%	90.0%
SGP 2002	107.0	105.3	100.2	96.1%
DIFFERENCE	+7.4	+8.0	+5.8	+6.1

Table 5: Long-term Sustainability of Public Finances					
% of GDP	2000	2005	2010	2030	2050
Total expenditure	48.9%	44.2%	41.0%	48.5%	49.0%
Old age pensions	12.6%	12.4%	12.2%	17.3%	22.6%
Health care (not-including care for the elderly)	4.8%	5.0%	5.2%	5.9%	6.6%
Interest payments	6.9%	4.8%	1.8%	1.0%	0.5%
Total revenues	47.2%	44.4%	41.5%	48.5%	49.0%
of which: from pensions contributions	7.9%	8.3%	8.4%	9.0%	8.8%
Assumptions					
Labour productivity growth	4.4	2.5	2.5	1.75	1.75
Real GDP growth	4.2	3.7	3.7	0.73	0.85
Participation rate males (aged 20-64)	84.1	84.0	83.4	81.1	82.1
Participation rates females (aged 20-64)	51.1	53.4	55.3	61.0	71.9
Total participation rates (aged 20-64)	67.6	68.7	69.4	71.3	77.1
Unemployment rate	11.1	7.1	7.0	6.7	5.5

ANNEX 2: The quantitative assessment of the sustainability of public finances

This is the second assessment of the sustainability of Greek public finances as part of the Stability and Growth Pact. The quantitative indicators are similar to those used last year, but have been adjusted in line with the recommendations of the Ageing Working Group to the EPC.[6]

The Greek stability programme contains national budgetary projections for public expenditures on pensions and health care. As these projections take on board the recent reform of the pension system, the Commission used the data submitted by the Greek authorities when running the sustainability indicators.

The table below presents the debt and budget balance development according to two different scenarios, a "programme scenario" and a "2002 situation scenario". The "programme scenario" is calculated on the following basis:

- the projections for age-related expenditures come from the stability programme;
- government revenues are held constant at the ratio projected for 2006;
- the starting point for gross debt and the primary surplus are the 2006 levels reported in the programme.

The "2002 situation scenario" is based on the budgetary data for 2002 in the programme. It is assumed that no budgetary adjustment occurs during the time frame of the stability programme: in other words the primary balance remains unchanged at its 2002 level until 2006. This allows one to gauge the impact on the sustainability of public finances of the proposed change in the underlying budget position during the programme.

The risk of unsustainable public finances, measured in terms of continued compliance with SGP requirements, is apparent under both scenarios as debt levels rise to levels well above the 60% of GDP reference value.

Budgetary consolidation planned over the time horizon of the stability programme will help improve the sustainability of public finances. However, a position of budget balance in 2006 on its own will not secure the sustainability of public finances. A substantial financing gap remains (see positive tax gaps) which needs to be closed. Reform the pension system so as to limit the projected increase in public spending is the key element in the overall strategy

[6] 'How the sustainability of public finances was assessed using the 2001 updates of stability and convergence programmes: recommendations for improvements in future years', Note from the AWG to the EPC, EPC/ECFIN/396-02 of 23 July 2002.

Quantitative indicators on the sustainability of public finances

Main assumptions - baseline scenario (as % GDP)	2006	2010	2020	2030	2040	2050	change 2000-50
Total age-related spending	17,4	17,4	20,2	23,2	26,1	29,2	11,8
Pensions	12,4	12,2	14,7	17,3	19,9	22,6	10,2
Health care	5,0	5,2	5,5	5,9	6,2	6,6	1,6
Other age related expenditures	0,0	0,0	0,0	0,0	0,0	0,0	0,0
*Total non age-related spending**	21,8						
*Total revenues**	44,3						

* constant during the projection period

Results (as % GDP)	2006	2010	2020	2030	2040	2050	change 2000-50
Programme scenario							
Debt	87,9	70,5	45,5	48,0	85,0	159,8	71,9
Net borrowing	0,6	1,0	-0,2	-3,2	-8,0	-15,0	-15,6
2002 situation scenario							
Debt	84,3	69,6	52,0	63,7	112,5	200,5	116,3
Net borrowing	-0,3	0,4	-1,2	-4,7	-10,1	-17,8	-17,6

Tax gaps	T1*	T2**	T3***
Programme scenario	2,0	1,7	4,8
2002 situation scenario	2,6	2,3	5,5

* it expresses the constant difference between projected revenues and the revenues required to reach in 2050 the same debt to GDP ratio as the close to balance position holds for the whole projection period. P.m. debt to GDP at the end of the period: 18,1%,

** it expresses the constant difference between projected revenues and the revenues required to reach in 2050 a debt to GDP ratio equals to 40%.

*** It indicates the change in tax revenues as a share of GDP that guarantees the respect of the interteporal budget constraint of the government, i.e., that equates the actualized flow of revenues and expenses over an infinite horizon.

Source: EPC, and 2002 Updated stability programme of Greece. Commission calculations