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# 2003 UPDATE OF THE STABILITY AND GROWTH PROGRAMME OF GREECE (2003-2006)

## AN ASSESSMENT

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## SUMMARY AND CONCLUSIONS[1]

The updated programme largely complies with the data requirements of the revised "code of conduct" on the content and format of stability and convergence programmes. This update does not provide the breakdown of the budget balances of the sub-sectors of the general government, as it was the case in the previous programmes. There is also no analysis of the long-term sustainability of public finances.

In 2003, the Greek economy has continued to be buoyant despite the less supportive international context. Real GDP growth reached 4.0% after 3.8% in 2002, mainly sustained by a very robust internal demand. Public investment supported by the 3rd Community Support Framework and investment related with the preparation of the 2004 Olympic Games boosted activity, while private investment and consumption continued to increase at a robust rate supported notably by favourable credit conditions. Consequently, employment is estimated to have accelerated in 2003, but the unemployment rate, although declining, still hovers at 9.5%. Consumer prices have been slowly decelerating, but due to demand pressure, their average increase should still reach 3.5%. Despite buoyant and better than expected real output growth, the government deficit is estimated at 1.4% of GDP in 2003, up from 1.2% of GDP in 2002 and against 0.9% of GDP projected in the previous programme. In cyclically-adjusted terms based on Commission calculations according to the commonly agreed methodology, the government deficit deteriorated by 0.4 percentage points, at 1.7% of GDP in 2003.

According to the 2003 update of the stability programme, the economic activity should accelerate further in 2004, real GDP reaching 4.2% and mildly slow down as from 2005 due to faltering boost from the Olympic Games-related investment. Real GDP growth is thus projected to reach 4% in 2005 and 3.8% in 2006. The 2003 update considers that the deceleration in investments, in the period 2005 and 2006, should be relatively limited, as financial flows, in particular those stemming from the 3rd Community Support Framework until 2006, should be directed towards sectors and geographical areas other than those related with the Olympic Games and support investment.

These assumptions seem to hinge on the optimistic side. The Commission Autumn 2003 forecasts project a sharper deceleration in gross capital formation in 2005, to a still rather high pace, as a result of the ending of the Olympic Games-related activities. Private consumption, however, is expected to continue increasing at robust rates. Commission calculations on the basis of real GDP projections provided by the update show that the positive output gap increases throughout the period to 2006. However, projecting such a steady and buoyant real growth in the medium term seems somewhat optimistic and risks are skewed to the downside. Moreover, in a context of such robust demand, pressures on costs and prices can be stronger than expected in the update, putting even more at risk the control of some government expenditure items, such as the wage bill, and endangering the external competitiveness of the economy.

[1] This assessment has been carried out on the basis of information available as of 22.01.2004.

Against such a background of strong economic dynamics, the budgetary adjustment efforts projected in the programme are modest and back-loaded to 2005 and 2006. The update targets a general government deficit of 1.2% of GDP in 2004 as against an expected deficit of 1.4% of GDP in 2003. For 2005 and 2006, the projections are for headline deficits of 0.5% of GDP and balance in 2006. Commission calculations based on the programme growth assumptions and budgetary targets show that the cyclically-adjusted government balance would not improve at all in 2004. It would improve by 0.5% of GDP in 2005 and 0.3% of GDP in 2006. At the end of the programme horizon, the cyclically-adjusted deficit would reach 0.9% of GDP, still far from a close-to-balance position. All in all, in the light of the current and projected growth conditions and the implied inflationary risks, the fiscal stance in the update is inappropriate.

There are several risks associated with the budgetary projections of the update. According to the 2003 update, the slippage in 2003 would proceed mainly from overruns in State expenditure related to the acceleration of the preparation of the Olympic Games and compensation for weather damages. However, the deviation also results from less-than-expected fiscal revenues and more importantly, from higher-than-projected social transfers and public wages. The general government deficit in 2003 is likely to be higher than 1.4% of GDP. Such a worse fiscal situation is likely to affect the outcome for 2004. The overall budgetary cost of the 2002 tax reform and of the 2003 social package was estimated by the Greek authorities at 2.2-2.4% of GDP (of which 0.8%-1.0% of GDP split over 2003 and 2004 for the tax package and 1.4% of GDP for the social measures almost fully in 2004). Such costs can hardly be consistent with a decline of only one percentage point of GDP in the primary surplus of the State budget in the two years, as assumed by the update. Moreover, the impact of these measures may have been underestimated in the budgetary projections of the programme. Finally, expenditures related to the Olympic Games will accelerate in the first half of 2004. According to the Commission Autumn 2003 forecasts, the government deficit for 2004 will be clearly above the programme’s target.

The budgetary strategy of the 2003 update is based on maintaining high primary surpluses consistent with a reduction in the expenditure ratio and an accelerating decline in the debt ratio. The budgetary adjustment is expected to gain momentum in 2005 and 2006 with the primary surplus increasing by 0.6 percentage points to 5.3% of GDP in 2006. This would be mostly the result of lower current primary spending, in particular government consumption. However, for these years no concrete budgetary policy actions are spelled out. It must be noted in this respect that the Code of Fiscal Stability, which was announced in the 2002 update and was welcomed by the Council in its opinion of January 2003, has not been adopted as yet. Such a code was supposed to outline a regulatory framework for improving control over primary expenditure.

The medium-term budgetary adjustment projected by the updated programme needs to be assessed taking particular account of the still very high level of the government debt. The government debt ratio is projected to decline by over 14 percentage points of GDP over the entire period 2003-2006 to 90.5% of GDP in 2006. As a comparison, the 2002 update projected a reduction of more than 17 percentage points of GDP for the same period. The largest part of the reduction is expected to occur after 2004. The debt ratio reduction is expected to result from increasing contribution from the primary surplus and diminishing stock-flow adjustments. The projections for the primary surplus (4.7% in 2003 and 2004, increasing to 5.3% by 2006) seem ambitious in the light of the risks to the proposed budgetary adjustment highlighted above. Moreover, past experience shows that financial transactions (which are not recorded in the deficit), tend to weigh heavily on debt accumulation. In its Opinion on the 2002 update stability programme and the previous programmes, the Council had already urged the Greek authorities to implement stronger and more robust medium-term budgetary adjustment taking into consideration the still very high level of the government debt, as well as its insufficient decline in recent years. Such an effort was also necessitated by the future budgetary costs of ageing population.

Greece has not presented an analysis of long-term sustainability of public finances in its updated stability programme despite previous assessment clearly pointed out the risk of long-term unbalances. The Commission considers that, on the basis of the current policies, there are risks of severe budgetary imbalances emerging in Greece. Pension expenditure is projected to increase to a level that would be well above other EU countries. The Greek budgetary strategy outlined in the programme – which is mainly based on the reduction of the deficit towards close to balance – is not sufficient to improve the sustainability of public finances and more ambitious targets for the budget balance should be pursued. Moreover, the budgetary challenges posed by the ageing population should be tackled through a comprehensive strategy that includes further reform of the pension system.

The economic policies as reflected in the 2003 update are not fully consistent with the recommendations in the broad economic policy guidelines, especially those with budgetary implications. In particular, the projected decline in the debt ratio is subject to risk and there is no clear evidence of effective control of government current primary expenditure, in particular of its inelastic components, like the wage bill and social transfers.

## 1. INTRODUCTION

The 2003 update of the stability programme of Greece was submitted to the Council and the Commission on 1 December 2003. Like its predecessors, the 2003 update was adopted by the Government and made available to the public at the Internet site of the Ministry of National Economy. The 2003 update covers the years to 2006, as the 2002 update. The economic projections for 2004 are based on the State Budget for 2004, which was tabled by Government on 18 November 2003 and was adopted by the Greek Parliament on 23 December 2003.

The current update of the stability programme of Greece stresses that "*economic policy in the medium-term is oriented towards sustaining macroeconomic stability and pursuing real convergence with the EU average per capita income*". Fiscal policies will "*continue to be geared towards reaching a close-to-balance budget position by 2006 and reducing public debt to around 90% of GDP*".

In general terms, the 2003 update largely conforms to the requirements of the code of conduct on the content and format of stability and convergence programmes, which was endorsed by the ECOFIN Council on 10 July 2001. However, the programme does not provide a sectoral breakdown of the general government accounts. More importantly, the programme lacks details about the measures that will be adopted and implemented to reach the stated targets. Such information would be of major importance to reinforce the programme credibility. Finally, the 2003 update does not provide an analysis of the long-term sustainability of public finances.

## 2. MACROECONOMIC ASSESSMENT

### 2.1 External economic assumptions

The medium-term prospects for the Greek economy are based on an improving international environment, as from 2003 throughout to 2006. For the period 2004-2005, the programme relies on the external assumptions underlying the Commission Autumn 2003 forecasts. For 2006, medium-term projections of other international organisations are used, according to which the external conditions would not significantly differ from 2005. Concerning the exchange rate assumptions, a limited appreciation of the euro is forecast.

### 2.2 Domestic macroeconomic outlook

According to available indicators, economic activity in Greece in 2003 continued to be buoyant, despite negative developments in the world economy. Real GDP growth is estimated to have reached 4.0%, well above the EU average, slightly faster than the 3.8% projected in the previous update, owing to more robust consumption spending, both private and public. Net exports gave a negative contribution to real growth since, although exports accelerated, imports of goods and services rose at a faster pace, due to buoyant domestic demand.

For the period 2004-2006, the programme projects real GDP to accelerate in 2004 and progressively slowdown afterwards, broadly following the same trend assumed in the 2002 update (see Table 1). While the increase in real GDP in 2004 broadly corresponds to the Commission Autumn 2003 forecasts, a significant difference emerges concerning the outlook for 2005 – that is the year following the Olympic Games – as the Commission forecasts a significantly less buoyant domestic demand.

The major difference between the macroeconomic projections of the programme and the Commission forecasts concerns gross fixed capital formation, the slowdown of which is more pronounced in the Commission forecasts than in the stability programme. Clearly, there is a very wide margin of uncertainty on investment in 2005, after the end of the Olympics-related investments. The stability programme projections for a relatively limited deceleration in non-residential investment (from 12% growth rate in 2004 to 8.7% in 2005 and 8.9% in 2006) and in investment in equipment (from 6% in 2004 to 5.5% in 2005 and 5.0% in 2006)[2] seems to be on the optimistic side. Therefore, the risks seem skewed to the downside.

**Table 1**
**– Macro-economic projections in the 2003 update and the Commission Autumn forecasts (2002–2006)**

| *(Annual growth rate in %, unless otherwise stated)* | | 2003 | | 2004 | | 2005 | | 2006 |
|---|---|---|---|---|---|---|---|---|
| | **2002** | **SP 2003** | **Com.** | **SP 2003** | **Com.** | **SP 2003** | **Com.** | |
| GDP at constant prices | 3.8 | 4.0 | 4.1 | 4.2 | 4.2 | 4.0 | 3.4 | 3.8 |
| Private consumption | 2.8 | 3.1 | 2.7 | 3.2 | 3.0 | 3.3 | 3.0 | 3.2 |
| Government consumption | 5.1 | 0.5 | 3.7 | 1.0 | 4.3 | 0.5 | 2.0 | 0.5 |
| Gross fixed capital formation | 5.7 | 9.7 | 8.7 | 7.0 | 7.1 | 5.7 | 3.5 | 5.5 |
| Exports of goods & services | -7.7 | 1.9 | 1.9 | 6.7 | 5.5 | 5.6 | 5.2 | 5.3 |
| Imports of goods & services | -4.7 | 3.0 | 2.4 | 4.7 | 5.1 | 3.8 | 3.1 | 3.7 |
| GDP deflator | 4.0 | 3.5 | 4.1 | 3.4 | 4.3 | 3.2 | 3.5 | 3.0 |
| Current external balance (% GDP) | -5.8 | -5.8 | -5.2 | -5.1 | -4.6 | -4.7 | -3.9 | -4.2 |
| Employment | 0.1 | 1.5 | 1.0 | 1.7 | 0.8 | 1.3 | 0.5 | 1.1 |
| **Contribution to real GDP growth** | | | | | | | | |
| Domestic demand | 4.0 | 4.6 | 4.4 | 4.2 | 4.3 | 3.8 | 3.1 | 3.7 |
| External trade | -0.4 | -0.5 | -0.3 | 0.1 | -0.3 | 0.1 | 0.2 | 0.1 |

*Sources: The 2003 Update to the Stability and Growth Programme of Greece; Commission services, Autumn 2003 forecasts.*

Buoyant domestic demand has contributed to a considerable deterioration in the external current deficit since 1999. Such a deficit is accounted for by a persistent high deficit on merchandise trade, partly offset by sizeable surpluses in services, mainly driven by tourism receipts. Some improvement in the external accounts is expected for 2003 in the balance of goods as a result of recovery in exports, though overall net exports are expected to give a negative contribution to output growth. For the remaining period, the external sector is expected to start making a small positive contribution to output growth, partly due to temporary factors – the Olympic Games in 2004 are expected to improve the services balance – and partly due to some deceleration in domestic demand. Deceleration in domestic demand is expected to release pressure from imports. However, exports from Greece to its traditional Eastern European markets may be affected by the effective appreciation of the euro and the resulting loss of competitiveness.

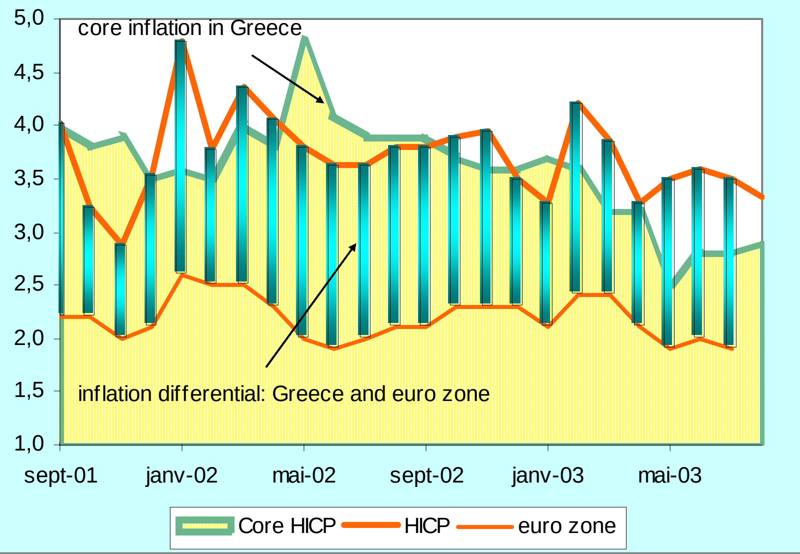
2 In the Commission forecasts, non-residential investment in 2005 is forecast to rise by less than 4%, while equipment investment is projected to grow by 3.0%.

The labour market has been gradually improving in recent years, albeit at a slow pace. The unemployment rate is on a downward trend since 1999, but still stood at 10% in 2002. Employment, which increased by a marginal 0.1% in 2002 after falling in 2000 and 2001, is estimated to rise by 1.5% in 2003 and at a faster pace afterwards bringing the unemployment rate down to 7% in 2006. The Commission forecasts, although somewhat less optimistic, point to the same direction.

Consumer prices are estimated to increase by 3.5% in 2003, decelerating from 3.9% in 2002. For the period 2004-2006, inflation is projected to gradually decline to 2.6% in 2006. Decelerating unit labour costs and an increase in labour productivity rising by an average of 2.5% per year are expected to contribute to a reduction in inflation. The Autumn 2003 Commission forecasts expect a slower deceleration in consumer prices.

Although prices have somewhat decelerated in recent quarters, inflation is still significantly higher than the euro area average. Prices as measured by the HICP, are estimated to increase by 3.7% in yearly average. Weather-related increases in unprocessed food prices, as well as high energy prices, contributed to the increase in inflation in the first half of 2003. Price pressures eased temporarily late in summer, but remained above 3%, due mainly to the considerable increase in service prices. Core inflation also accelerated in recent months. For 2004 and 2005, the Commission forecasts a slower deceleration in consumer prices than projected in the 2003 update, mainly on the basis of less optimistic assumptions for unit labour costs. While the contribution of imported inflation to consumer price inflation should be small, developments concerning private sector wages are quite uncertain. The new collective negotiations, expected to start in 2004, are very likely to be influenced by the announced generous increases in public wages.

CHART 1: The harmonised index of consumer prices: headline and underline measure



# 3. BUDGETARY TARGETS AND MEDIUM-TERM PATH OF PUBLIC FINANCE

## 3.1 Programme overview and assessment

The 2003 updated stability programme sets budgetary targets that are less ambitious than those of the previous update. In part, this is because the estimated outcome for 2003 is less favourable than assumed in the 2002 update. One can also identify some signs of budgetary adjustment fatigue, presumably explained by the political cycle, since the macroeconomic prospects for the entire period are even somewhat better that expected one year ago. Moreover, the path and the composition of the projected adjustment are subject to a number of risks.

The budgetary strategy continues to rely on relatively high primary surpluses (increasing from 4.7% to 5.3% of GDP) contributing to reduce the debt ratio, which in turn will reduce the ratios of interest expenditure and of overall deficit. The budgetary effort is back loaded, as the primary surplus does not increase before 2005. Moreover, as further elaborated in the section on debt developments, the debt ratio declines rather slowly, due to persistently high stock-flow adjustment.

Current revenues are projected to decline by around 1.2 percentage points of GDP (half in tax revenues and half in other current receipts) over the programme horizon. However, total revenues are not expected to fall, as lower current revenues will be offset by higher capital transfers received from the EU budget. Over the same period, primary expenditure is expected to be reduced by 0.8 percentage points of GDP. Half of this reduction concerns current primary spending and half in non-investment capital expenditure, such as debt assumptions. The government investment ratio is projected to remain constant. However, the adjustment on the primary expenditure side is expected to be deferred until 2005 and 2006, and no concrete budgetary consolidation measures are spelled out in the updated programme. The ratio of current primary spending is even expected to increase in 2004 due to the rise in public wages.

The projected adjustment path, in particular with respect to the government balance, is subject to relevant uncertainty in view of the absence of an appropriate description of concrete measures ensuring its respect. The possibility of implementing decisive cuts in current primary spending, in particular in the wage bill, seems uncertain. Government consumption has proved to be quite an inelastic category of expenditure in recent years; it has even increased as a percentage of GDP in the last number of years, although the successive stability programmes were targeting reductions. Moreover, the 2003 outturn will most likely be less favourable than estimated by the programme, accentuating further the downside risks for the budgetary targets for 2004.

**Table 2: The path and composition of budgetary adjustment**

| % of GDP | 2003 (ratios) | 2004 (change in ratio) | 2005 (change in ratio) | 2006 (change in ratio) | 2004-2006 (total change in ratio) | 2006 (ratios) |
|---|---|---|---|---|---|---|
| GENERAL GOVERNEMNT | | | | | | |
| 5. TOTAL REVENUE | 43.7 | 0 | 0 | -0.2 | -0.2 | 43.5 |
| 6. TOTAL EXPENDITURE | 45.2 | -0.2 | -0.8 | -0.7 | -1.7 | 43.5 |
| 7. GENERAL GOVERNMENT BALANCE | -1.4 | +0.2 | +0.7 | +0.5 | +1.4 | 0.0 |
| 8. INTEREST EXPENDITURE | 6.1 | -0.2 | -0.3 | -0.4 | -0.9 | 5.2 |
| 9. GEN. GOVN. PRIMARY SURPLUS (8+7) | 4.7 | 0 | +0.4 | +0.2 | +0.6 | 5.3 |
| COMPONENTS OF REVENUE /EXPENDITURE | | | | | | |
| 10. TAXES | 23.5 | -0.2 | -0.1 | -0.3 | -0.6 | 22.9 |
| 11. SOCIAL CONTRIBUTIONS | 14.0 | 0 | 0 | 0 | 0 | 14.0 |
| 12. OTHER CURRENT RESOURCES | 3.5 | -0.3 | -0.2 | -0.1 | -0.6 | 2.9 |
| 13. TOTAL CURRENT REVENUE | 41.0 | -0.5 | -0.4 | -0.3 | -1.2 | 39.8 |
| 14. GOVERNMENT CONSUMPTION | 15.1 | -0.2 | -0.2 | -0.3 | -0.7 | 14.4 |
| of which compensation employees | 11.5 | +0.1 | -0.3 | -0.2 | -0.4 | 11.1 |
| 15. SOCIAL TRANSFERS OTHER THAN IN KIND | 16.5 | +0.2 | +0.1 | 0 | +0.3 | 16.8 |
| 16. SUBSIDIES | 0.2 | -0.1 | 0 | 0 | -0.1 | 0.1 |
| 17. INTEREST EXPENDITURE | 6.1 | -0.2 | -0.3 | -0.4 | -0.9 | 5.2 |
| 18. OTHER CURRENT EXPENDITURE | 1.2 | 0 | 0 | -0.1 | -0.1 | 1.1 |
| 19.TOTAL CURRENT EXPENDITURE | 39.0 | 0 | -0.7 | -0.5 | -1.2 | 37.8 |
| of which: primary | 32.9 | +0.2 | -0.4 | -0.1 | -0.3 | 32.6 |
| 20. GFCF | 4.2 | 0 | 0 | 0 | 0 | 4.2 |
| 21.CAPITAL TRANSFERS RECEIVED | 2.7 | +0.5 | +0.3 | +0.2 | +1.0 | 3.7 |
| 22.OTHER CAPITAL EXPENDITURE | 1.9 | -0.1 | -0.2 | -0.1 | -0.4 | 1.5 |
| 23. TOTAL EXPENDITURE | 45.2 | -0.2 | -0.8 | -0.7 | -1.7 | 43.5 |
| of which: primary | 39.1 | 0 | -0.5 | -0.3 | -0.8 | 38.3 |

*Source: The 2003 update of the stability programme (Table 6) and Commission calculations.*

## 3.2 Public finances in 2003

According to the 2003 updated stability programme, the general government deficit is estimated at 1.4% of GDP, as against 0.9% of GDP projected in the 2002 update. This corresponds almost fully to the overshooting in the State budget deficit as estimated in the budget bill for 2004. Therefore, the other government sectors are expected to have respected their budget targets.

The 2003 update claims that the deviation from the budget plans is explained by overruns in ordinary budget expenditure, related to speeding up the preparation of the Olympic Games and to extra compensations for damages caused by bad weather. These overruns are expected to be partly offset by better indirect tax receipts and some cuts in public investment.

The deviation from the projections of the previous update for the debt ratio was much larger, equal to almost 3% of GDP (see Table 4 of the update), due to much higher stock-flow adjustments, notably larger than projected debt assumptions (+1.6% of GDP) and advances paid in relation to the purchase of military equipment (+0.6% of GDP). These factors were only marginally offset by the debt-reducing effect of the appreciation of the euro on the foreign currency-denominated debt.

The estimated outcome for 2003 is subject to uncertainties with respect to both revenues and expenditure. Based on preliminary results for the implementation of the State budget for the first eight months of 2003, the Commission estimated in the Autumn 2003 forecasts a deficit of 1.7% of GDP in 2003, as against 1.4% of GDP estimated by the government. More recent results, including budget monthly data until October are broadly in line with the Commission forecasts and suggest that the estimated overshooting in the State budget deficit may have been underestimated by the national authorities. For example, public wages increased by 6.2% until October, as against an estimated annual increase of 5%. Moreover, if exceptional wage expenditure decided after the adoption of the 2003 State budget (equal to € 220 million) is taken into account, the rate of increase of the public wage bill on the same period of 2002 reaches 8.1%.

### 3.3 Public finances in 2004

The 2004 State Budget was adopted by Parliament on 23 December 2003. It targets a central government deficit that is consistent with a general government deficit of 1.2% of GDP. The improvement in the actual balance is set to be fully the result of lower interest expenditure while the primary surplus should remain at the same level as in 2003. Primary expenditure as a percentage of GDP is expected to remain unchanged, while increased capital receipts offset lower current receipts.

The projection for the general government balance in 2004 reflects the target for a State budget deficit set at 3.8% of GDP from an estimated 4.1% of GDP in 2003 and 3.5% of GDP in 2002. The composition of the adjustment foreseen in the 2004 State budget and that expected by the updated programme for general government are similar. The projected improvement in the overall current primary surplus comes from a lower deficit in the investment budget and smaller interest expenditure, while the current primary surplus is set to shrink. In the period 2002-2004, the reduction in the general government primary surplus (0.2 percentage points) is considerably smaller than for the State (1.0 percentage point). This implies that the already high primary and overall surpluses of social security and of other subsectors are assumed to further increase. However, no explanation is supplied for the implied developments in the sub-sectors accounts.

As far as the 2004 State budget is concerned, relevant uncertainties surround the projections and a number of risks are evident, both on the revenue and the primary expenditure side:

- First, the impact of the fiscal measures adopted in 2002 and 2003 may have been underestimated in the official projections. The overall budgetary cost of the 2002 tax reform and of the 2003 social package was estimated by the government at 2.2-2.4% of GDP (0.8-1.0% of GDP split over two years for the 2002 tax measures, and 1.4% of GDP for the social package almost fully in 2004). These estimates are hardly consistent with a decline of only one percentage point of GDP in the primary surplus of the State for the two years. While the expected acceleration in economic activity could trim down the *ex ante* cost of these measures, its impact seems overstated given the economic growth composition based on investment and net exports, and the usually low sensitivity of the government accounts to the business cycle.

- Second, the estimated overshooting of the 2003 target for the State deficit seems to be on the low side. Larger shortfalls in tax revenues would imply substantial base effects for 2004. Moreover, primary expenditure traditionally accelerates by year-end, while the preparation for the Olympics may not allow for significant cuts in investment spending as assumed by the government.

All in all, the State budget deficit in 2004 is likely to be substantially higher than targeted in the programme and reflected in a higher deficit for the general government.

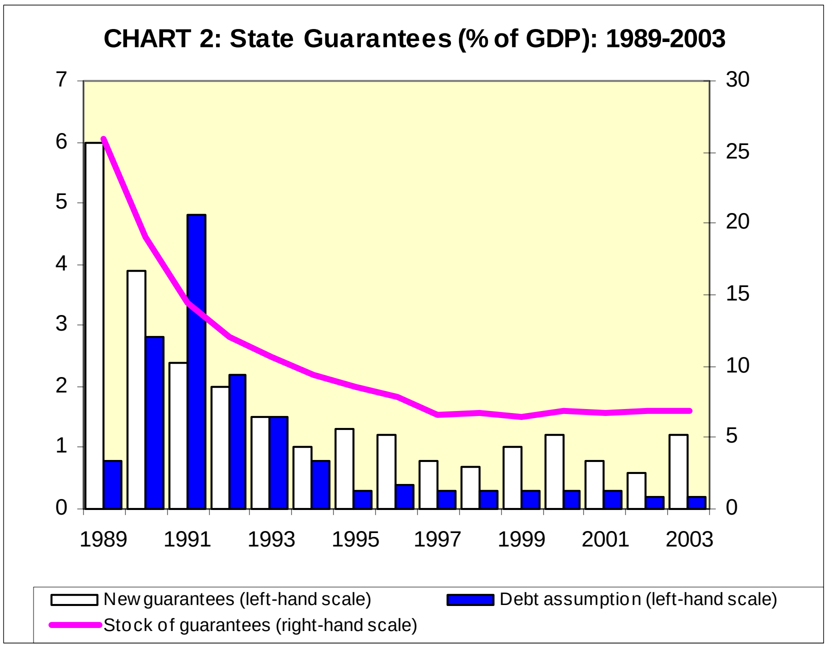
The absence of a sectoral breakdown of the projections for the general government in the 2003 update is a serious drawback for assessing the plausibility of the adjustment structure, and the consistency between the State budget for 2004 and the programme targets. In this respect, one should note that the government sub-sector that has contributed most to government consolidation – that is social security – is that presenting the weakest statistical basis[3]. The previous update showed more clearly the intention of the government to promote credible fiscal adjustment on the basis of lower deficits in the central government accounts and the reduction in the central government deficit was even projected to exceed the improvement in the general government accounts.

## 3.4 Targets and fiscal adjustment in 2005 and beyond

According to the programme, the budgetary adjustment efforts are set to gain momentum in 2005 and 2006. The general government accounts are expected to reach balance in nominal terms and a position of close to balance in cyclically-adjusted terms in 2006. The projected 1.2 percentage point improvement in the general government balance during the years 2005 and 2006 should result, according to the 2003 update, from a 0.6 percentage point increase in the primary balance, reaching 5.3% of GDP in 2006, and lower interest expenditure by 0.7 percentage points. The debt ratio is projected to decline by 8 percentage points in the two years to 2006.

The contribution of revenues should continue to be quite neutral, as lower current revenues (both taxes and other revenue) should be almost fully offset by increasing capital transfers. In contrast, the contribution of primary spending to adjustment is more significant, since wages and capital spending are projected to decelerate by 0.8 percentage points. Finally, investment spending should remain constant at around 4% of GDP, after strong increases in recent years, partly associated with the organisation of the Olympic Games.

3 The Greek government intends to improve the social security accounts by the Summer 2004, following the method of data collection agreed with Eurostat.




*Source: The 2004 Draft State budget, Ministry of Finance*

The main risks concerning the proposed adjustment pattern after 2004 are associated with the decline in primary expenditure. In addition to the already mentioned uncertainty for reducing the wage bill by a significant proportion, reduction in capital transfers paid is a perspective subject to doubt. Debt assumption is one of the components of this category of public expenditure and has been mostly the result of State guarantees that were called and had to be honoured by government. Despite announced efforts to limit the issue of new guarantees in recent years, new State guarantees have amounted to 1% of GDP per annum since the mid-1990s and have even increased in 2003. The outstanding stock of State guarantees still represents around 7% of GDP – from over 25% in 1989. Since 1995, debt assumptions still add around 0.3% of GDP per year to the government deficit.

### 3.5 Cyclically-adjusted balances

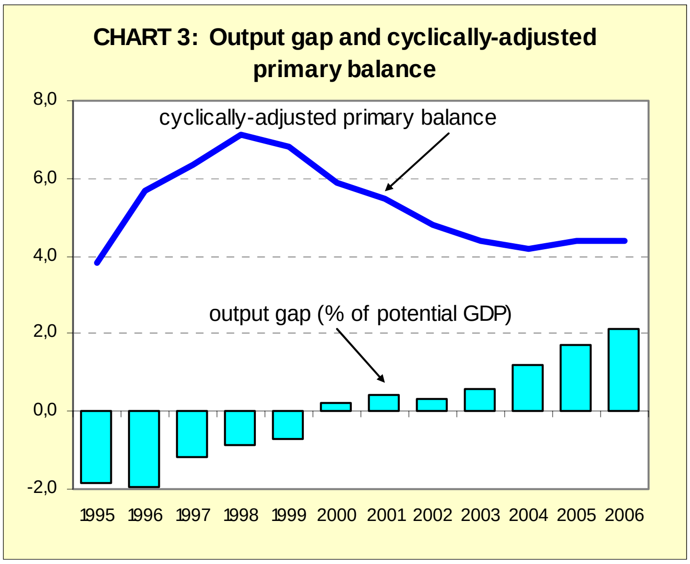
The 2003 update provides estimates for the government balances adjusted for the impact of the cycle on the basis of potential GDP growth. Projected growth is expected to remain above potential growth until 2004, while the output gap would start narrowing again as from 2005. According to these estimates, the government cyclically-adjusted budgetary deficit would gradually improve from a deficit of 2% of GDP in 2003 to 0.5% in 2006, reaching a position that would correspond to close-to-balance. The adjustment path suggested by the cyclically-adjusted balance is quite similar to that of the nominal balance and largely back loaded to the years 2005 and 2006. Moreover, a close-to-balance position is postponed by one year when compared with the previous update, which was targeting this position in 2005.

Figures calculated by the Commission services using the commonly agreed methodology, on the basis of the actual GDP growth and the budgetary projections of the programme, show a quite different picture (see Table 3). This is almost exclusively attributed to significantly different results obtained for potential GDP growth, which, according to the Commission, would be slower and decelerating over the programme period. Indeed, the output gap would continue to widen until 2006. Moreover, given the expected buoyant growth, the fiscal stance may turn out to be pro-cyclical (see Chart 3).

**Table 3. Cyclically-Adjusted Budget Balance**

| % GDP | Source | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|
| 1. GDP growth at constant prices | 2003 SP | 4.0% | 4.2% | 4.0% | 3.8 % |
| 2. Net borrowing | 2003 SP | -1.4% | -1.2% | -0.5% | 0.0% |
| 3. Interest expenditure | 2003 SP | 6.1% | 5.9% | 5.6% | 5.2% |
| 4. Potential GDP growth | 2003 SP | 3.8% | 4.0% | 4.2% | 4.0% |
| | COM | *3.7%* | *3.7%* | *3.5%* | *3.3%* |
| 5. Output gap | 2003 SP | 1.4% | 1.6% | 1.4% | 1.2% |
| | COM | *0.6%* | *1.2%* | *1.7%* | *2.1%* |
| 6. Cyclical budgetary component | 2003 SP | 0.6% | 0.6% | 0.6% | 0.5% |
| | COM | *0.3%* | *0.5%* | *0.7%* | *0.9%* |
| 7. Cyclically-adjusted balance | 2003 SP | -2.0% | -1.8% | -1.1% | -0.5% |
| | COM | *-1.7%* | *-1.7%* | *-1.2%* | *-0.9%* |
| 8. Cyclically-adjusted primary | 2003 SP | 4.1% | 4.1% | 4.5% | 4.7% |
| balance | COM | *4.4%* | *4.2%* | *4.4%* | *4.3%* |

*Note: **2003 SP**=data provided in the 2003 stability programme. **COM**=data calculated by the Commission services on the basis of the programme projections for GDP growth and government accounts.*




Source: *Commission services; for the period after 2002, estimates on the basis of data provided in the 2003 update of the stability programme.*

According to the Commission estimates, the cyclically-adjusted balance would not improve at all in 2004. The whole consolidation effort would take place in 2005 and 2006. The cyclically-adjusted balance would improve by 0.5 percentage point of GDP in 2005 and 0.3 percentage point in 2006. At the end of the programme horizon, the cyclically-adjusted balance would stand at 0.9% of GDP, still far, by a significant margin, from a close-to-balance position. In addition, the cyclically-adjusted primary balance would only marginally increase until 2006. This means that the projected budgetary adjustment is back-loaded and insufficient.

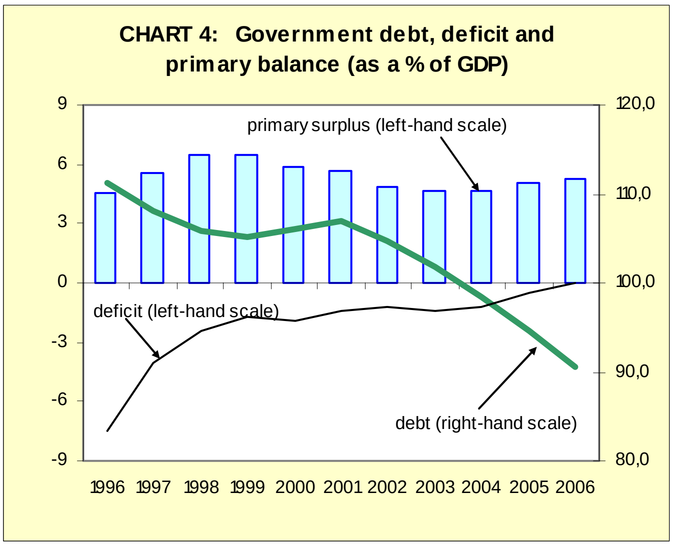
### 3.6 Sensitivity analysis

The 2003 update presents an alternative growth scenario based on a less optimistic outlook for the world and the EU economies, which deteriorates the external balance of Greece. Compared to the main scenario, real GDP growth in the period 2003-2006 should be lower by 0.7 percentage points on average and inflation by 0.2 percentage points. Assuming the baseline scenario elasticity of revenue to GDP, the general government actual balance would be in a deficit of 0.5% of GDP in 2006 and the debt/GDP ratio will be higher by 3.0 percentage points.

Given that growth projections as from 2005 look optimistic, the indications of the alternative scenario need to be taken into account for adapting the fiscal adjustment path in order to achieve the goal of bringing the government deficit into balance in the specified time horizon.

### 3.7 The debt ratio

In recent years, developments in the debt ratio have been hardly reflecting the development in the general government budgetary balance and in the overall performance of the economy. In a context of strong real GDP growth, outpacing the EU average for a number of years, of falling interest expenditure and improving primary balances, the debt ratio has been reduced by only 6.6 percentage points. in the period 1996-2002. The debt ratio even increased in both 2000 and 2001 (see Chart 4). Developments in the debt ratio are therefore crucial for the assessment of the overall sustainability of public finance in the short and the medium term.




*Source: Commission services; for the period 2003-2006 data from the 2003 updated stability programme*

The 2003 update targets a progressive acceleration in the reduction of the debt-to-GDP ratio, which should be the combined result of increasing primary surpluses and diminishing stock-flow adjustments, partly offsetting a somewhat lower nominal growth dividend (which makes the “snow-ball” effect negative although smaller over time). The projected decline in the government debt ratio in the entire period 2003-2006 equals 14.2 percentage points. Compared with the recent past, this is an ambitious target but less so when compared with the projected reduction in the previous update for the same period (17.4 percentage points). The downward revision stems from the estimated higher outturn for 2003 and a slower reduction projected for 2004 while the years 2005 and 2006 are unchanged with respect to both the overall amounts and the composition of the debt change.

For 2003, the current update gives a breakdown of the reasons that prevented a reduction in the debt ratio as projected (a fall of 3 percentage points instead of 5.1 percentage points in the 2002 update). This was only partly due to the overshooting in the budget deficit (0.6 percentage points) while financial operations (mostly debt assumptions and capital injections to public enterprises)[4] and advances in relation to military expenditure[5] overshot the targets by significant amounts (1.6 and 0.6 percentage points, respectively). In contrast, privatisation proceeds used to pay-off public debt reached broadly the projected amounts (around 2% of GDP).

**Table 4 - Decomposition of changes in the government debt ratio**

( as percentage of GDP )

| | 2003 | 2004 | 2005 | 2006 | Total |
|---|---|---|---|---|---|
| Change in government debt ratio: | -3.0 | -3.2 | -4.0 | -4.0 | -14.2 |
| - Contribution of primary balance | -4.7 | -4.7 | -5.1 | -5.3 | -19.8 |
| - Interest and nominal GDP contribution | -1.3 | -1.4 | -1.2 | -0.8 | -4.7 |
| - Stock –flow adjustment | 3.0 | 2.9 | 2.3 | 2.1 | 10.3 |
| Level of government debt | 101.7 | 98.5 | 94.6 | 90.5 | |

Note: The decomposition of changes in the gross debt ratio is based on the following equation for the budget constraint:

$$\frac{Dt}{Yt}-\frac{Dt-1}{Yt-1}=\frac{PDt}{Yt}+\frac{Dt-1}{Yt-1}\bullet\frac{i-yt}{1+yt}+\frac{SFt}{Yt}$$

with Dt=government. debt, PDt=primary deficit, Yt=GDP at current market prices; i=implicit interest rate on government debt; yt=nominal GDP growth rate and SFt="stock-flow adjustment". The second component of the right-hand side is the so-called "snow-ball" effect.

*Source: Commission estimates based on nominal GDP growth rate and budgetary projections given in the2003 update of the stability programme.*

The stock-flow adjustment, which reached almost 7% of GDP in 2001, was still high in 2002, exceeding 4% of GDP and is estimated at 3% of GDP in 2003 and 2004, a level which is much above the EU average. As from 2005, the stock-flow adjustment is projected to decline albeit at a slow pace (see Table 4). In particular, for 2004, according to information provided in the State budget, the projected decline in the debt ratio (by 3.2 percentage points) is based on two fundamental assumptions: capital

4 It is not fully clear to which extent the debt assumptions and the capital injections of 2003 have been recorded as government expenditure and added to the government deficit, or why are they eligible to be recorded as stock-flow adjustment.

5 Greece has recorded expenditure on military equipment when equipment is delivered by producers and enters into service. However, very often, the respective payments take place in advance of the deliveries, when equipment is ordered or during its construction. This means that the purchase of military equipment impacts the government debt before the deficit. The very high level of spending on military equipment in Greece has, therefore, been one relevant component of stock-flow adjustment.

injections will be zero (down from 0.6% of GDP in 2003) and privatisation proceeds would reach approximately the same amounts as in 2003 (see Table 5). If these assumptions do not materialise and if in addition the State budget in 2004 was overshoots the target by the usual amount of ½% of GDP, the debt ratio, *ceteris paribus*, could remain at broadly the same level as at the end of 2003. This scenario may be qualified as extreme but it illustrates the vulnerability underlying the projected reduction in the debt ratio, and the need for achieving as from 2004 a better budgetary position and a more sparing use of the financial transactions that increase the debt.

**Table 5: Central government debt: targets and outcome**

| *% of GDP* | 2002 | | 2003 | | 2004 |
|---|---|---|---|---|---|
| | **target** | **outcome** | **target** | **outcome** | **target** |
| State budget deficit | 2,9% | 3,4% | 3,5% | 4,1% | 3,8% |
| Military borrowing | 1,6% | 2,3% | 0,8% | 1,4% | 1,4% |
| Privatisation | -1,6% | -1,4% | -2,0% | -2,0% | -1,8% |
| Exchange valuation | 0,0% | 0,2% | -0,3% | 0,2% | -0,2% |
| Capital injection | 0,1% | 0,8% | 0,0% | 0,6% | 0,0% |
| Other debt increasing items | 2,8% | 1,6% | 1,4% | 1,8% | 1,5% |
| **Increase in the stock of debt** | **5,8%** | **7,1%** | **3,4%** | **6,1%** | **4,7%** |

*Source: Ministry of Finance, State budget documents*

## 4. THE QUALITY OF PUBLIC FINANCES

The programme states that fiscal policy for the coming years will continue to aim at bringing down to balance the general government deficit and at reducing the debt-to-GDP ratio. Nonetheless, the programme is not providing information about the measures that would ensure the achievement of these targets.

On the primary expenditure side, while last year's update had already recognised the necessity of improving control over primary government spending, the regulatory framework has not yet been put in place. The Code of Fiscal Stability which is part of a broader draft law is now before the Parliament for adoption in 2004. In addition, the content of these regulations does not represent a full guarantee that current primary spending will follow a clear and binding norm as requested by the Council in its opinions on all previous programme. On the other hand, the reduction in interest expenditure is assumed to continue to be the main contributor to the overall deficit reduction.

On the revenue side, the maintenance of a high level of tax receipts is expected to be achieved through measures for better tax auditing and for enhancing the efficiency of tax administration.

The path and the composition of the proposed fiscal adjustment for the period covered by the 2003 update suggest that Greece is postponing once again decisive consolidation efforts for at least another year. The rigid and high level of the State deficit is an issue of concern, in particular because the annual targets are constantly overshot (by no less than 0.5-0.6% of GDP each year), mainly as result of a lower than targeted primary surplus. Moreover, from a sub-sectoral perspective, most consolidation effort is estimated to come from the lower government sub-sectors, notably social security.

## 5. THE SUSTAINABILITY OF GREEK PUBLIC FINANCES

Greece has not presented an analysis of long term sustainability of public finances in its updated stability programme despite previous assessment having clearly pointed out to the risk of long term unbalances. Also, this is not in line with the increasing focus on long term sustainability envisaged by several recent European and ECOFIN Councils.

The Commission considers that, on the basis of the current policies, there are risks of unsustainable public finances in Greece. The budgetary strategy outlined in the programme is not sufficient to improve the sustainability of public finances and more ambitious targets for the budget balance should be pursued. The strategy is mainly based on the reduction of the deficit towards the close to balance but the budgetary challenges posed by ageing population should be tackled through a comprehensive strategy that includes pension reform. Pension expenditure is projected to increase to a level that would be well above that observed in other EU countries.

### 5.1 Quantitative indicators

The assessment of the sustainability of XX public finances is based on both quantitative and qualitative indicators. The quantitative indicators are run on the basis of a commonly agreed methodology by the Economic Policy Committee[6]. The purpose of the indicators is to signal possible unbalances on the basis of current policies and projected age-related expenditure trends. However, the limitations of this exercise are clear and results of these quantitative indicators need to be interpreted with caution. Being a mechanical, partial equilibrium analysis, projections are in some cases bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels is not a forecast of possible or even likely outcomes and should not be taken at face value. Instead, the indicators are a tool to facilitate policy debate and at best provide an indication of the timing and scale of emerging budgetary challenges that could occur on the basis of “no policy change”.

The quantitative indicators project debt and budget balance development according to two different scenarios, to take into account uncertainties over the medium term. The “programme” scenario is calculated on the following basis:

- Macroeconomic assumptions on GDP growth from 2007 onwards, interest rates and inflation are based on the agreed assumptions used in the EPC;
- The projections for age-related expenditures come from last year stability programme, complemented with the Economic Policy Committee harmonised projections.
- The projections for government revenues come from the programme. They are kept constant at the (cyclically adjusted) level in 2006.
- The starting point for gross debt and the primary balance are the 2006 levels reported in the programme.

A “2003 position” scenario is based on the budgetary data for 2003 in the programme. Debt levels are extrapolated from 2007 to 2050 assuming that no budgetary consolidation is achieved, i.e. the cyclically adjusted primary balance in 2006 remains the same as the 2003 level and zero stock-flow adjustments.

[6] See the Report “The impact of ageing populations on public finances: overview of analysis carried out at EU level and proposals for a future work programme” (October 2003), available at http://europa.eu.int/comm/economy_finance/epc/documents/2003/pensionmaster_en.pdf

Table 6 below presents the debt and the budget balance development according to the two different scenarios. Projections are based on national projections on pensions, while health care, education and unemployment benefits projections rely on the EPC common exercise. Overall, age-related expenditure is foreseen to increase by 11.8% of GDP between 2007 and 2050. Compared with last year assessment some small savings are foreseen in education expenditures and in unemployment benefits.

It is possible to verify whether the projected level of debt respects the requirement to stay below 60% of GDP reference value for public debt at all times. Failure to do so would *a priori* indicate that there may be a risk of budgetary imbalances emerging in light of ageing population and that measures may be required to place public finances on a more sustainable footing. In the case of Greece, the debt-to-GDP ratio should be preliminary run down to reach the 60% reference value.

According to the quantitative indicators, there are risks of budget imbalances in the future. Under current policies, debt is expected to fall below 60% within the next 15 years. However, once the impact of ageing takes fully place, debt could start increase again. The situation will deteriorate further if the cyclically adjusted primary balance remains constant over the programme period. A failure to consolidate budgetary positions in the medium term can put Greece on an unsustainable path.

A sustainability gap therefore arises. Under current policies, a gap of around 1.5% of GDP emerges in order to fulfil the SGP requirement on budget balance; it becomes 2.0% of GDP if Greece fails to consolidate (see indicator S1). Also, the present value of revenues is not sufficient to balance the future expenditure plus the current stock of debt (see indicator S2).

## Table 6: Long-term sustainability: summary results

| **Main assumptions - baseline scenario (as % GDP)** | **2007** | **2010** | **2020** | **2030** | **2040** | **2050** | **changes** |
|---|---|---|---|---|---|---|---|
| *Total age-related spending* | 21.1 | 20.8 | 23.5 | 26.5 | 29.5 | 32.6 | 11.6 |
| Pensions | 12.3 | 12.2 | 14.7 | 17.3 | 19.9 | 22.6 | 10.3 |
| Health care* | 5.1 | 5.2 | 5.5 | 5.9 | 6.2 | 6.6 | 1.6 |
| Education* | 3.3 | 3.0 | 3.0 | 3.0 | 3.1 | 3.2 | -0.1 |
| Unemployment benefits* | 0.4 | 0.4 | 0.3 | 0.3 | 0.3 | 0.2 | -0.1 |
| *Total primary non age-related spending*** | 17.2 | | | | | | |
| *Total revenues*** | 43.0 | | | | | | |

* EPC projections

** constant

| **Results (as % GDP)** | **2007** | **2010** | **2020** | **2030** | **2040** | **2050** | **changes** |
|---|---|---|---|---|---|---|---|
| *Programme scenario* | | | | | | | |
| Gross debt | 86.3 | 75.1 | 41.1 | 42.2 | 77.5 | 151.3 | 64.9 |
| Net borrowing | -0.4 | 0.6 | 0.1 | -2.8 | -7.6 | -14.6 | -14.2 |
| *2003 scenario* | | | | | | | |
| Gross debt | 81.7 | 72.2 | 44.0 | 52.4 | 97.0 | 181.2 | 99.5 |
| Net borrowing | -0.7 | 0.2 | -0.7 | -3.9 | -9.2 | -16.8 | -16.1 |

| **Sustainability gap** | **S1*** | **S2**** |
|---|---|---|
| Programme scenario | 1.9 | 3.3 |
| 2003 scenario | 2.3 | 3.8 |

* S1 measures the difference between the current tax ratio and the tax ratio that would ensure a debt level in 2050 as resulting from a balance budget position over the projection period. A positive sustainability gap indicates that there is a financing gap to reach this debt level in 2050. P.m. debt to GDP ratio at the end of the period: 18.6%

** S2 indicates the change needed in tax revenues as a share of GDP that guarantees the respect of the intertemporal budget constraint of the government, i.e., that equates the actualized flow of revenues and expenses over an infinite horizon.

## 5.2 Additional qualitative features

As underlined in the EPC report on “The impact of ageing populations on public finances: overview of analysis carried out at EU level and proposals for a future work programme”[7] (October 2003), several qualitative factors should be taken on board to avoid a mechanistic interpretation of the quantitative indicators. On the positive side, the government announced a strategy that aims at boosting the economy, in particular in the long run (the “Convergence Charter”). However, the outstanding level of debt is a matter of concern. A strategy based on a position of budget balance appears to be not sufficient to ensure long term sustainability of public finances. In addition, Greece will be faced with a very large projected increase of pension spending. A comprehensive strategy that tackles also the pension issue seems necessary.

Finally, stock-flow adjustments will continue to affect the debt development in the medium term. These financial operations are expected to run down the debt slower than projected from the pure development of the budget balance. Should these operations continue in the future, imbalances in the long term would most likely materialise.

[7] Available at http://europa.eu.int/comm/economy_finance/epc/documents/2003/pensionmaster_en.pdf

## ANNEX: Main tables of the 2003 updated stability programme

## Table 1. Growth and Associated Factors

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|
| SELECTED ECONOMIC INDICATORS | | | | | | |
| GDP GROWTH AT CONSTANT PRICES | 4.0% | 3.8% | 4.0% | 4.2% | 4.0% | 3.8% |
| GDP LEVEL AT CURRENT MARKET PRICES (bn euro) | 131.0 | 141.3 | 152.2 | 163.9 | 175.9 | 188.1 |
| GDP DEFLATOR CHANGE | 3.5% | 4.0% | 3.5% | 3.4% | 3.2% | 3.0% |
| PRIVATE CONSUMPTION DEFLATOR CHANGE | 3.3% | 3.6% | 3.5% | 3.0% | 2.8% | 2.6% |
| EMPLOYMENT GROWTH | -0.3% | 0.1% | 1.5% | 1.7% | 1.3% | 1.1% |
| LABOUR PRODUCTIVITY GROWTH | 4.4% | 3.7% | 2.5% | 2.5% | 2.7% | 2.7% |
| UNIT LABOUR COSTS | 1.1% | 4.6% | 3.5% | 3.9% | 2.3% | 2.0% |
| GENERAL GOVERNMENT BALANCE, % OF GDP | -1.5% | -1.2% | -1.4% | -1.2% | -0.5% | 0.0% |
| GENERAL GOVERNMENT DEBT, % OF GDP | 106.9% | 104.7% | 101.7% | 98.5% | 94.6% | 90.5% |
| ***SOURCES OF GROWTH: PERCENTAGE CHANGES AT CONSTANT PRICES*** | | | | | | |
| 1. PRIVATE CONSUMPTION | 2.9% | 2.8% | 3.1% | 3.2% | 3.3% | 3.2% |
| 2. GOVERNMENT CONSUMPTION | -1.0% | 5.1% | 0.5% | 1.0% | 0.5% | 0.5% |
| 3. GROSS FIXED CAPITAL FORMATION | 6.5% | 5.7% | 9.7% | 7.0% | 5.7% | 5.5% |
| 4. CHANGES IN INVENTORIES (% GDP) | 0.0% | 0.1% | 0.0% | 0.0% | 0.0% | 0.0% |
| 5. EXPORTS OF GOODS AND SERVICES | -1.1% | -7.7% | 1.9% | 6.7% | 5.6% | 5.3% |
| 6. IMPORTS OF GOODS AND SERVICES | -3.4% | -4.7% | 3.0% | 4.7% | 3.8% | 3.7% |
| ***CONTRIBUTION TO GDP GROWTH*** | | | | | | |
| DOMESTIC DEMAND (excluding inventories) | 3.5% | 4.0% | 4.6% | 4.2% | 3.8% | 3.7% |
| 8. CHANGES IN INVENTORIES | -0.4% | 0.1% | -0.2% | 0.0% | 0.0% | 0.0% |
| 9. EXTERNAL BALANCE OF GOODS AND SERVICES | 0.9% | -0.4% | -0.5% | 0.1% | 0.1% | 0.1% |
| ***BASIC ASSUMPTIONS ON THE EXTERNAL ECONOMIC ENVIRONMENT*** | | | | | | |
| | **2001** | **2002** | **2003** | **2004** | **2005** | **2006** |
| SHORT-TERM INTEREST RATE | 4.3% | 3.3% | 2.3% | 2.3% | 3.2% | 3.3% |
| LONG-TERM INTEREST RATE | 5.0% | 4.9% | 4.1% | 4.4% | 4.8% | 5.0% |
| EURO / USD EXCHANGE RATE | 0.90 | 0.95 | 1.13 | 1.16 | 1.15 | 1.15 |
| WORLD GDP GROWTH, excl. EU | 2.4% | 3.2% | 4.0% | 4.6% | 4.6% | 4.5% |
| EU-15 GDP GROWTH | 1.7% | 1.1% | 0.8% | 2.0% | 2.4% | 2.3% |
| WORLD IMPORT VOLUMES, excl. EU | 0.0% | 3.2% | 6.3% | 8.3% | 8.6% | 8.5% |
| OIL PRICES (USD/ barrel) | 25.0 | 25.0 | 28.3 | 25.6 | 24.1 | 24.0 |

## Table 2: Selected Economic Indicators 2002-2003

| | 2002 | | 2003 | |
|---|---|---|---|---|
| | *SGP2002* | *SGP2003* | *SGP2002* | *SGP2003* |
| 1. GDP GROWTH | 3.8% | 3.8% | 3.8% | 4.0% |
| 2. GROSS FIXED CAPITAL FORMATION | 7.7% | 5.7% | 9.5% | 9.7% |
| 3. REAL UNIT LABOUR COST | -0.4% | 0.1% | -1.2% | -0.1% |
| 4. PRIVATE CONSUMPTION DEFLATOR | 3.1% | 3.6% | 2.7% | 3.5% |
| 5. GENERAL GOVERNMENT BALANCE (% GDP) | -1.1% | -1.2% | -0.9% | -1.4% |
| 6. GENERAL GOVERNMENT DEBT (% GDP) | 105.3% | 104.7% | 100.2% | 101.7% |
| 7. UNEMPLOYMENT RATE | 10.0% | 10.0% | 9.1% | 9.0% |

## Table 3: Central Government Revenues and Expenditures (million Euro)

| | 2003 BUDGET | | |
|---|---|---|---|
| Million euro | BUDGET (1) | ESTIMATE (2) | DIFFERENCE (1)-(2) |
| **1. REVENUES** | **43000** | **42205** | **+795** |
| (a) ORDINARY (NET REVENUE) | 38900 | 39000 | -100 |
| *of which* | | | |
| i. DIRECT TAXES | 15510 | 15457 | +53 |
| ii. INDIRECT TAXES | 22035 | 22608 | -573 |
| (b) PUBLIC INVESTMENT PROGRAM | 4100 | 3205 | +895 |
| **2. EXPENDITURES** | **48303** | **48410** | **-107** |
| (a) ORDINARY BUDGET | 39385 | 39810 | -425 |
| *of which* | | | |
| i. COMPENSATION OF EMPLOYEES | 15130 | 15236 | -106 |
| ii. OTHER EXPENDITURE | 14855 | 15224 | -369 |
| iii. INTEREST PAYMENTS | 9400 | 9350 | +50 |
| (b) PUBLIC INVESTMENT PROGRAM | 8918 | 8600 | +318 |
| **3. CENTRAL GOVERN. BALANCE (1-2=3)** | **-5303** | **-6205** | **+902** |
| 4. PUBLIC ENTITIES SURPLUS AND ESA ADJUSTMENT | **3935** | **4015** | -80 |
| **5.GENERAL GOVERNMENT BALANCE (3+4), % OF GDP** | **-1368** | **-2190** | **+822** |

*Source: Greek Government Budget*

## Table 4: Contributions to Debt Developments (million Euro)

| | 2003 BUDGET | | |
|---|---|---|---|
| | BUDGET (1) | ESTIMATE (2) | DIFFERENCE 1)-(2) |
| 1. NET BORROWING REQUIREMENTS | 5303 | 6205 | -902 |
| 2. BURDEN FROM FOREIGN EXCHANGE | -220 | -290 | +70 |
| 3. DEBT ASSUMPTIONS | 1980 | 4347 | -2367 |
| 4. MILITARY BORROWING | 1139 | 2060 | -921 |
| 5. PRIVATISATION PROCEEDS (DEKA) | 2990 | 3000 | -10 |
| 6. INCREASE IN DEBT (1+2+3+4-5) | 5212 | 9322 | -4110 |
| 7. CENTRAL GOVERNMENT DEBT | 171054 | 175439 | -4385 |
| 8. INTERGOVERNMENTAL DEBT | 20624 | 20624 | 0 |
| **9. GENERAL GOVERNMENT DEBT (7-8)** | **150430** | **154815** | **-4385** |

## Table 5: Selected Economic Indicators 2004-2006

| | 2004 | | 2005 | | 2006 | |
|---|---|---|---|---|---|---|
| | *SGP2002* | *SGP2003* | *SGP2002* | *SGP2003* | *SGP2002* | *SGP2003* |
| 1. GDP GROWTH | 4.0% | 4.2% | 3.7% | 4.0% | 3.6% | 3.8% |
| 2. GROSS FIXED CAPITAL FORMATION | 7.0% | 7.0% | 6.1% | 5.7% | 5.1% | 5.5% |
| 3. REAL UNIT LABOUR COST | -0.7% | +0.2% | -0.7% | -1.0% | -0.7% | -1.0% |
| 4. PRIVATE CONSUMPTION DEFLATOR | 2.8% | 3.0% | 2.6% | 2.8% | 2.6% | 2.6% |
| 5. GENERAL GOVERNMENT BALANCE (% GDP) | -0.4% | -1.2% | 0.2% | -0.5% | 0.6% | 0.0% |
| 6. GENERAL GOVERNMENT DEBT (% GDP) | 96.1% | 98.5% | 92.1% | 94.6% | 87.9% | 90.5% |
| 7. UNEMPLOYMENT RATE | 8.4% | 8.0% | 7.7% | 7.4% | 7.1% | 7.0% |

## Table 6: General Government Budgetary Developments (on a national accounts basis)

| % of GDP | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|
| GENERAL GOVERNEMNT | | | | |
| 5. TOTAL REVENUE | 43.7% | 43.7% | 43.7% | 43.5% |
| 6. TOTAL EXPENDITURE | 45.2% | 45.0% | 44.2% | 43.5% |
| 7. GENERAL GOVERNMENT BALANCE | -1.4% | -1.2% | -0.5% | 0.0% |
| 8. INTEREST | 6.1% | 5.9% | 5.6% | 5.2% |
| 9. GEN. GOVN. PRIMARY SURPLUS (8-7) | 4.7% | 4.7% | 5.1% | 5.3% |
| COMPONENTS OF REVENUES /EXPENDITURES | | | | |
| 10. TAXES | 23.5% | 23.3% | 23.2% | 22.9% |
| 11. SOCIAL CONTRIBUTIONS | 14.0% | 14.0% | 14.0% | 14.0% |
| 12. OTHER CURRENT RESOURCES | 3.5% | 3.2% | 3.0% | 2.9% |
| 13. TOTAL CURRENT REVENUE | 41.0% | 40.5% | 40.1% | 39.8% |
| 14. GOVERNMENT FINAL CONSUMPTION EXPENDITURE | 15.1% | 14.9% | 14.7% | 14.4% |
| 15. SOCIAL TRANSFERS OTHER THAN IN KIND | 16.5 % | 16.7% | 16.8% | 16.8% |
| 16. SUBSIDIES | 0.2% | 0.1% | 0.1% | 0.1% |
| 17. INTEREST PAYMENTS | 6.1% | 5.9% | 5.6% | 5.2% |
| 18. OTHER CURRENT EXPENDITURE | 1.2% | 1.2% | 1.2% | 1.1% |
| 19.GROSS FIXED CAPITAL FORMATION | 4.2% | 4.2% | 4.2% | 4.2% |
| 20. TOTAL EXPENDITURE | 45.2% | 45.0% | 44.2% | 43.5% |

## Table 7: General Government Debt Developments

| % of GDP | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|
| GEN. GOVN CONSOLIDATED GROSS DEBT | 101.7% | 98.5% | 94.6% | 90.5% |
| CHANGE | -3.0% | -3.2% | -3.9% | -4.1% |
| CONTRIBUTION TO CHANGES IN GENERAL GOVERNMENT CONSOLIDATED GROSS DEBT | | | | |
| PRIMARY SURPLUS | 4.7% | 4.7% | 5.1% | 5.3% |
| INTEREST | 6.1% | 5.9% | 5.6% | 5.2% |
| NOMINAL GDP | 7.6% | 7.7% | 7.3% | 6.9% |
| OTHER FACTORS AFFECTING THE GENERAL GOVERNMENT CONSOLIDATED DEBT | | | | |
| ADJUSTMENT FACTORS & PRIVATISATION PROCEEDS | 3.0% | 2.9% | 2.3% | 2.1% |
| IMPLICIT INTEREST RATE (General Government) | 6.3% | 6.3% | 6.0% | 5.9% |

## Table 8. Cyclical Adjusted Budget Balance (1)

| % GDP | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|
| 1. GDP growth at constant prices | 4.0% | 4.2% | 4.0% | 3.8 % |
| 2. Net borrowing | -1.4% | -1.2% | -0.5% | 0.0% |
| 3. Interest payments | 6.1% | 5.9% | 5.6% | 5.2% |
| 4. Potential GDP growth | 3.8% | 4.0% | 4.2% | 4.0% |
| 5. Output gap | 1.4% | 1.6% | 1.4% | 1.2% |
| 6. Cyclical budgetary component | 0.6% | 0.6% | 0.6% | 0.5% |
| 7. Cyclically-adjusted balance (2-6) | -2.0% | -1.8% | -1.1% | -0.5% |
| 8. Cyclically-adjusted primary balance (7-3) | 4.1% | 4.1% | 4.5% | 4.7% |

*(1) Percentages of GDP, the data are based on estimations of the Ministry of Economy and Finance. The estimated output gap used in the above Table differs from that published in the autumn of 2003 by the European Commission. The reason behind this is the difference in the GDP growth and potential growth.*

## Table 9: Divergence from the 2002SGP

| % of GDP | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|
| **REAL GDP GROWTH** | | | | |
| | | | | |
| **SGP 2002** | 3.8% | 4.0% | 3.7% | 3.6% |
| **SGP 2003** | 4.0% | 4.2% | 4.0% | 3.8% |
| **DIFFERENCE** | 0.2 | 0.2 | 0.3 | 0.2 |
| **GENERAL GOVERNMENT BALANCE** | | | | |
| **SGP 2002** | -0.9% | -0.4% | 0.2% | 0.6% |
| **SGP 2003** | -1.4% | -1.2% | -0.5% | 0.0% |
| **DIFFERENCE** | -0.5 | -0.8 | -0.7 | -0.6 |
| **GENERAL GOVERNMENT GROSS DEBT** | | | | |
| **SGP 2002** | 100.2 | 96.1 | 92.1 | 87.9 |
| **SGP 2003** | 101.7 | 98.5 | 94.6 | 90.5 |
| **DIFFERENCE** | 1.5 | 2.4 | 2.5 | 2.6 |

**Table 10: Factors Influencing GDP Growth**
**(Differences between SGP 2003 and SGP 2002 in growth rates)**

| | | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|
| GDP | SGP 2002 | 3.8% | 4.0% | 3.7% | 3.6% |
| | SGP 2003 | 4.0% | 4.2% | 4.0% | 3.8% |
| | DIFFERENCE | **0.2** | **0.2** | **0.3** | **0.2** |
| 1. PRIVATE CONSUMPTION | SGP 2002 | 3.1% | 3.2% | 3.2% | 3.0% |
| | SGP 2003 | 3.1% | 3.2% | 3.3% | 3.2% |
| | DIFFERENCE | **0.0** | **0.0** | **0.1** | **0.2** |
| 2. PUBLIC CONSUMPTION | SGP 2002 | -1.5% | 0.0% | 0.0% | 0.0% |
| | SGP 2003 | 0.5% | 1.0% | 0.5% | 0.5% |
| | DIFFERENCE | **2.0** | **1.0** | **0.5** | **0.5** |
| 3. GROSS FIXED CAPITAL FORMATION | SGP 2002 | 9.5% | 7.0% | 6.1% | 5.1% |
| | SGP 2003 | 9.7% | 7.0% | 5.7% | 5.5% |
| | DIFFERENCE | **0.2** | **0.0** | **-0.4** | **0.4** |
| 4. FINAL DOMESTIC DEMAND | SGP 2002 | 4.0% | 3.7% | 3.6% | 3.2% |
| | SGP 2003 | 4.2% | 3.8% | 3.6% | 3.5% |
| | DIFFERENCE | **0.2** | **0.1** | **0.0** | **0.3** |
| 5. EXPORTS OF GOODS AND SERVICES | SGP 2002 | 4.6% | 7.6% | 6.3% | 6.3% |
| | SGP 2003 | 1.9% | 6.7% | 5.6% | 5.3% |
| | DIFFERENCE | **-2.7** | **-0.9** | **-0.7** | **1.0** |
| 6. IMPORTS OF GOODS AND SERVICES | SGP 2002 | 4.9% | 5.8% | 5.2% | 4.4% |
| | SGP 2003 | 3.0% | 4.7% | 3.8% | 3.7% |
| | DIFFERENCE | **-1.9** | **-1.1** | **-1.4** | **-0.7** |
| 7. EXTERNAL BALANCE, (contribution to GDP change) | SGP 2002 | -0.45 | -0.01 | -0.12 | 0.15 |
| | SGP 2003 | -0.49 | 0.07 | 0.09 | 0.10 |
| | DIFFERENCE | **-0.04** | **0.08** | **0.21** | **-0.05** |

## Table 11: Factors Influencing General Government Balance and Debt (Differences between SGP 2003 and SGP 2002 in growth rates)

| | | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|
| 1. TOTAL CURRENT RESOURCES | SGP 2002 | 5.8% | 6.2% | 6.4% | 6.3% |
| | SGP 2003 | 5.5% | 6.4% | 6.3% | 6.1% |
| | DIFFERENCE | **-0.3** | **0.2** | **-0.1** | **-0.2** |
| of which | | | | | |
| TAXES ON PRODUCTION AND IMPORTS | SGP 2002 | 5.8% | 7.0% | 6.8% | 6.7% |
| | SGP 2003 | 7.7% | 7.7% | 7.1% | 6.7% |
| | DIFFERENCE | **1.9** | **0.7** | **0.3** | **0.0** |
| TAXES ON INCOME AND WEALTH | SGP 2002 | 4.9% | 5.5% | 6.7% | 6.5% |
| | SGP 2003 | 4.3% | 6.0% | 5.2% | 5.0% |
| | DIFFERENCE | **-0.6** | **0.5** | **-1.5** | **-1.5** |
| SOCIAL CONTRIBUTIONS | SGP 2002 | 7.3 % | 7.3% | 7.0% | 6.8% |
| | SGP 2003 | 7.5% | 7.7% | 7.3% | 7.2% |
| | DIFFERENCE | **0.2** | **0.4** | **0.3** | **0.4** |
| 2. TOTAL CURRENT EXPENDITURE | SGP 2002 | 4.8% | 5.6% | 5.3% | 5.4% |
| | SGP 2003 | 6.5% | 7.5% | 5.6% | 5.3% |
| | DIFFERENCE | **0.7** | **1.9** | **0.3** | **-0.1** |
| of which | | | | | |
| GOVERNMENT CONSUMPTION | SGP 2002 | 2.5% | 5.5% | 5.0% | 4.7% |
| | SGP 2003 | 4.5% | 6.7% | 5.6% | 5.0% |
| | DIFFERENCE | **2.0** | **1.2** | **0.6** | **0.3** |
| SOCIAL TRANSFERS THAN IN KIND | SGP 2002 | 7.7% | 7.0% | 7.0% | 7.0% |
| | SGP 2003 | 8.0% | 9.5% | 7.6% | 7.4% |
| | DIFFERENCE | **0.3** | **2.5** | **0.6** | **0.4** |
| INTEREST | SGP 2002 | 2.2% | 1.9% | 2.0% | 3.3% |
| | SGP 2003 | 2.4% | 4.3% | 1.0% | 0.8% |
| | DIFFERENCE | **0.2** | **2.4** | **-1.0** | **-2.5** |
| 3. GROSS FIXED CAPITAL FORMATION | SGP 2002 | 13.0% | 9.5% | 8.0% | 7.0% |
| | SGP 2003 | 20.0% | 7.0% | 8.2% | 7.0% |
| | DIFFERENCE | **7.0** | **-2.5** | **0.2** | **0.0** |
| 4. CAPITAL TRANSFERS RECEIVED | SGP 2002 | 4.2% | 3.2% | 8.0% | 9.7% |
| | SGP 2003 | 27.6% | 29.0% | 17.5% | 11.7% |
| | DIFFERENCE | **23.4** | **25.8** | **9.5** | **2.0** |
| 5. PRIMARY SURPLUS (% GDP) | SGP 2002 | 4.4% | 4.6% | 5.0% | 5.2% |
| | SGP 2003 | 4.7% | 4.7% | 5.1% | 5.3% |
| | DIFFERENCE | **0.3** | **0.1** | **0.1** | **0.1** |
| 6. GENERAL GOVERNMENT BALANCE (% GDP) | SGP 2002 | -0.9% | -0.4% | 0.2% | 0.6% |
| | SGP 2003 | -1.4% | -1.2% | -0.5% | 0.0% |
| | DIFFERENCE | **2.3** | **-0.8** | **-0.8** | **-0.6** |
| 7.GENERAL GOVERNMENT DEBT (% GDP) | SGP 2002 | 100.2% | 96.1% | 92.1% | 87.9% |
| | SGP 2003 | 101.7% | 98.5% | 94.6% | 90.5% |
| | DIFFERENCE | **1.5** | **2.4** | **2.5** | **2.6** |
| 8. NOMINAL GDP GROWTH | SGP 2002 | 7.0% | 7.3% | 6.8% | 6.7% |
| | SGP 2003 | 7.6% | 7.7% | 7.3% | 6.9% |
| | DIFFERENCE | **0.6** | **0.4** | **0.5** | **0.2** |

## Table 12: Comparison of the Two Alternative Growth Scenarios for the Greek Economy

| | | Baseline Scenario | | | Alternative Scenario | | |
|---|---|---|---|---|---|---|---|
| | Annual Average Rates of Change | Annual Average rates of Change | % GDP (except as indicated) | | Annual Average rates of Change | % GDP (except as indicated) | |
| | 2003/1995 | 2006/2003 | 2003 | 2006 | 2006/2003 | 2003 | 2006 |
| **A. DEMAND AND OUTPUT** (CONSTANT PRICES 1995) | | | | | | | |
| GDP | 3.6% | 4.0% | | | 3.3% | | |
| PRIVATE CONSUMPTION | 2.7% | 3.2% | | | 2.9% | | |
| GOVERNMENT CONSUMPTION | 1.8% | 0.7% | | | 0.7% | | |
| GROSS FIXED CAPITAL FORMATION | 8.3% | 6.0% | | | 5.0% | | |
| TOTAL DOMESTIC DEMAND | 3.7% | 3.6% | | | 3.2% | | |
| EXPORTS OF GOODS AND SERVICES | 6.4% | 5.9% | | | 4.5% | | |
| IMPORTS OF GOODS AND SERVICES | 5.9% | 4.1% | | | 3.6% | | |
| **B. PRICES** | | | | | | | |
| PRIVATE CONSUMPTION DEFLATOR | 4.3% | 2.8% | | | 2.6% | | |
| GDP DEFLATOR | 4.6% | 3.2% | | | 3.0% | | |
| MERCHANDISE OF EXPORT PRICES | 3.4% | 1.9% | | | 1.7% | | |
| MERCHANDISE OF IMPORTS PRICES | 3.4% | 1.5% | | | 1.5% | | |
| **C. PRODUCTIVITY, INCOME AND EMPLOYMENT** | | | | | | | |
| LABOUR PRODUCTIVITY | 3.1% | 2.6% | | | 2.1% | | |
| REAL COMPENSATION PER EMPLOYEE | 3.1% | 2.5% | | | 2.2% | | |
| NOMINAL UNIT LABOUR COST | 4.3% | 2.7% | | | 2.7% | | |
| EMPLOYMENT | 0.5% | 1.4% | | | 1.2% | | |
| UNEMPLOYED | 0.4% | -7.7% | | | -5.3% | | |
| **D. PUBLIC FINANCES** | | | | | | | |
| *TOTAL CURRENT RESOURCES OF WHICH* | | | 41.0% | 39.8% | | 41.0% | 40.2% |
| DIRECT TAXES | 11.3% | 5.4% | | | 4.9% | | |
| INDIRECT TAXES | 9.1% | 7.2% | | | 6.4% | | |
| *TOTAL CURRENT EXPENDITURE OF WHICH* | | | 39.0% | 37.8% | | 39.0% | 38.7% |
| SOCIAL TRANSFERS OTHER THAN IN KIND | 9.6% | 8.2% | | | 8.1% | | |
| INTEREST | -1.2% | 2.0% | | | 2.3% | | |
| GENERAL GOVERNMENT BALANCE | | | -1.4% | 0.0% | | -1.4% | -0.5% |
| GENERAL GOVERNMENT DEBT | | | 101.7 | 90.5% | | 101.7 | 93.5% |
| **E. CURRENT EXTERNAL TRANSACTIONS** | | | | | | | |
| TRADE BALANCE | | | -14.5% | -13.6% | | -14.5% | -13.9% |
| CURRENT EXTERNAL BALANCE | | | -5.8% | -4.2% | | -3.8% | -3.4% |

**Table 13: Privatisation of State-owned Enterprises in 2003**

| Company | Method of Privatization & % sold | Total amount raised (in m €) |
|---|---|---|
| AGNO | Trade sale (99.99%) | 12 |
| KAE | Trade sale (40%) | 174 |
| Hellenic Petroleum | Trade sale (16.65%) | 326 |
| Parnitha Casino (Mont Parnes SA) | Trade sale (49%) | 90 |
| Hellenic Industrial Bank | Third instalment | 70 |
| Football Prognostics Organization (OPAP) | Additional Offering (24.61%) | 736 |
| Hellenic Exchanges S.A | Trade sale (33.4%) | 89 |
| Piraeus Port Corporation | Initial Public Offering (25%) | 55 |
| National Bank of Greece | Trade Sale to institutional investors (11%) | 490 |
| Public Power Corporation III | Additional Offering (15.57%) | 636 |
| Total | | 2,678 |