



HELLENIC REPUBLIC

MINISTRY OF ECONOMY AND FINANCE

**THE 2004 UPDATE OF THE HELLENIC
STABILITY AND GROWTH PROGRAMME:
2004-2007**

- *The update of Greece's Stability and Growth Programme is submitted to the European Commission in accordance to the Article 4 of the European Council Regulation 1466/97.*
- *The programme can be found at the web site of the Greek Ministry of Economy and Finance:
<http://www.mnec.gr>*

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1. Introduction

In March 2004 the new government, immediately after taking office, launched a far reaching fiscal audit, aimed at achieving clarity and transparency in the fiscal balances of the Greek economy. Working in close and fruitful cooperation with Eurostat, the Ministry of Economy and Finance submitted a number of necessary revisions in the public finance data in order to remedy previous data deficiencies. The revision of the deficit and debt data covered the period 1997-2003. A report by Eurostat on these statistical revisions was published on November 22nd, 2004, confirming the final settlement of long-standing open questions on budgetary statistics and compliance with the ESA 95 requirements. The current update of the Greek Stability and Growth Programme (SGP) was prepared after the clarification of the data, taking into consideration all the above mentioned modifications and revisions. It is now finally possible to proceed on solid statistical grounds toward the goal of implementing responsible, transparent and effective fiscal policy. With the statistical issues resolved, the present SGP focuses on bringing the excessive deficit situation to an end in 2005.

Fiscal developments in 2003-2004 were characterized by three major events. The impact of the electoral cycle, the overrun of expenditure related to the Olympic Games, and the impact of statistical revisions on public finance data.

Economic policy in the medium term, i.e. in 2005-2007, faces some major challenges:

- primarily to comply with the Council recommendations under article 104(7) of 5 July 2004 and bring the deficit below the threshold value by the end of 2005,
- to put back in track the public finance aggregates on a downward trend, by allowing a safety margin based on the recommendations in the Broad Economic Policy Guidelines, in the medium term,
- to be consistent with the recommendations in the Broad Economic Policy Guidelines and, in particular, to accelerate the pace of structural reforms.

This SGP update provides for a review of the economic developments in Greece in the 2003-2004 period and for projections concerning the 2005-2007 period. Although there are many risks and uncertainties about the international environment, it seems that the acceleration of oil prices shows signs of abating, and thus fears of a derailing in the global expansion should be allayed, while inflation is expected to remain more or less subdued in the medium term.

For the years 2005-2007, a robust growth rate is projected for the Greek economy, sustained at around 4% on an annual basis. Despite lower public investment (due to the completion of the Olympic Games), investment growth, mainly from the private sector, is expected to continue being a significant contributor to GDP growth. As far as public finance is concerned, a significant reduction of both deficit and debt (as a percentage of GDP) is projected for the 2005-2007 period.

The rest of the Programme is organized as follows. Section 2 presents the economic developments in 2003 and 2004, as well as the medium term projections for the 2005-2007 period. The underlying framework for economic policy and the fiscal policy prospects is presented in the third section. In the fourth section of the Programme, the 2003 SGP is compared with the present one. In the fifth section, an alternative GDP growth scenario is presented, with growth rates well below the baseline scenario. In the sixth section the main structural reform measures and the issue of long run sustainability are briefly outlined.

2. Recent developments and prospects of the Greek Economy

Table 1 presents the main macroeconomic aggregates and projections of the 2004 updated Stability and Growth Program (SGP) of the Greek economy for the 2003-2007 period, as well as the assumptions used for the external environment.

Table 1. Growth and Associated Factors

	2003	2004	2005	2006	2007
GDP GROWTH AT CONSTANT PRICES	4.5%	3.7%	3.9%	4.0%	4.2%
GDP AT CURRENT MARKET PRICES (bn euro)	153.0	164.4	176.5	189.4	203.3
GDP DEFLATOR (% CHANGE)	3.5%	3.6%	3.3%	3.2%	3.0%
PRIVATE CONSUMPTION DEFLATOR (% CHANGE)	3.4%	3.1%	2.9%	2.8%	2.7%
EMPLOYMENT GROWTH	1.3%	2.0%	1.5%	1.5%	1.6%
LABOUR PRODUCTIVITY GROWTH	3.1%	1.6%	2.3%	2.5%	2.6%
UNIT LABOUR COST	0.9%	4.8%	3.4%	2.5%	2.2%
GENERAL GOVERNMENT BALANCE, % OF GDP	-4.6%	-5.3%	-2.8%	-2.6%	-2.5%
GENERAL GOVERNMENT DEBT, % OF GDP	109.9%	112.1%	109.5%	106.0%	102.5%
1. PRIVATE CONSUMPTION EXPENDITURE	4.4%	3.6%	3.5%	3.4%	3.4%
2. GOVERNMENT CONSUMPTION EXPENDITURE	-2.5%	5.5%	1.5%	1.0%	0.8%
3. GROSS FIXED CAPITAL FORMATION	13.7%	5.8%	4.1%	5.6%	6.3%
4. CHANGES IN INVENTORIES (% GDP)	0.1%	0.0%	0.0%	0.0%	-0.1%
5. EXPORTS OF GOODS AND SERVICES	1.0%	7.3%	6.2%	6.4%	7.0%
6. IMPORTS OF GOODS AND SERVICES	4.8%	8.3%	4.1%	4.2%	4.7%
<i>CONTRIBUTION TO GDP CHANGE</i>					
7. DOMESTIC DEMAND (excluding inventories)	6.1%	4.8%	3.8%	4.0%	4.2%
8. CHANGES IN INVENTORIES	-0.3%	-0.1%	0.1%	-0.1%	-0.1%
9. EXTERNAL BALANCE OF GOODS AND SERVICES	-1.3%	-1.1%	0.0%	0.0%	0.1%

	2004	2005	2006	2007
SHORT-TERM INTEREST RATE	2.1%	2.6%	3.5%	3.6%
LONG-TERM INTEREST RATE	4.2%	4.6%	4.8%	5.1%
EURO / USD EXCHANGE RATE	1.23	1.24	1.24	1.24
Total OECD GDP GROWTH	3.6%	2.9%	3.1%	2.9%
EU-25 GDP GROWTH	2.5%	2.3%	2.4%	2.4%
WORLD IMPORT VOLUME, excl. EU	11.6%	8.8%	8.3%	8.0%
OIL PRICES (USD/ barrel)	39.3	45.1	40.1	35.0

Note: Since the 1st quarter of 2004, Labor Force Survey is based on a new sample according to the results of the 2001 Census.

2.1 The Greek Economy in 2003-2004

2.1 The Greek Economy in 2003

In 2003, economic activity in Greece continued to perform quite strongly, with the real GDP growth reaching 4.5%, well above the average of the Euro zone. A decomposition of the growth rate shows that the contribution of total domestic demand to the GDP change amounted to 5.8%, while the external balance of goods and services had a negative contribution of 1.3%. Private consumption and investment spending remained buoyant and contributed more than 6.4% to GDP growth. High public investment spending, linked to the financial flows from the E.U. Structural Funds and the accelerating preparations for the Olympics, was accompanied by strong private investment.

Inflation continued to be higher than the E.U. average. The private consumption deflator rose by 3.4% in 2003 and the average Harmonized Index of Consumer Prices (HICP) was 3.4%, i.e. 1.3 percentage points higher than the Euro area average. This development in the inflation rate can be partly attributed to the stronger growth performance of the Greek economy and, in this respect, a Ballassa-Samuelson effect could be in operation.

Labor market developments were rather positive in 2003. Total employment increased by 1.3%, due to increased labor demand for the Olympic Games projects and, as a result, the unemployment rate fell to 9.5% of the labor force, down from 10.2% in 2002.

On the fiscal front there was a large deviation from the target for the general government deficit and debt. The revised deficit is 4.6% of GDP, which is 3.2% higher than projections included in the 2003 SGP. This deviation from the target is mainly due to the aforementioned statistical revisions. More specifically, the change in the 2003 deficit figure was due to a downward revision of tax revenues in public accounts, a downward revision of payments received from E.U. institutions in the

context of structural fund programmes, a reclassification of a payment from the Postal Savings bank to the government as a financial transaction, an under-recording of military expenditure, an over-estimation of the surplus of social security funds and, finally, an under-recording of interest payments. The fiscal audit also led to an upward revision of data for 2003 debt by 8.2 percentage points compared to what was projected in the 2003 SGP, resulting in debt of 109.9% of GDP. The change in the debt figure was mainly due to the inclusion of previously unrecorded capitalized interest payments and an over-estimation of consolidating assets of social security funds. These revisions led to a significant reduction in the impact of stock flow adjustment in debt accumulation.

Table 2: Selected Economic Indicators 2003-2004

	2003		2004	
	SGP2003	SGP2004	SGP2003	SGP2004
1. GDP GROWTH	4.0%	4.5%	4.2%	3.7%
2. GROSS FIXED CAPITAL FORMATION	9.7%	13.7%	7.0%	5.8%
3. REAL UNIT LABOUR COST	-0.1%	-3.3%	0.2%	0.9%
4. PRIVATE CONSUMPTION DEFLATOR	3.5%	3.4%	3.0%	3.1%
5. GENERAL GOVERNMENT BALANCE (% GDP)	-1.4%	-4.6%	-1.2%	-5.3%
6. GENERAL GOVERNMENT DEBT (% GDP)	101.7%	109.9%	98.5%	112.1%
7. UNEMPLOYMENT RATE	9.0%	9.5%	8.0%	11.1%

2.2 *The Greek Economy in 2004*

GDP growth rate in 2004 is estimated to reach 3.7%. This is a rather plausible forecast given that the economy was growing at 4% on a yearly basis in the first quarter of 2004, at 3.9% in the second quarter and at 3.8% in the third quarter. In the last quarter of the current year a moderate further deceleration of GDP growth is projected, mainly due to the reduction of Olympic Games related investment spending. Investment increased by 3.2% (on a yearly basis) in the third quarter of 2004, contributing to GDP growth by 0.7%. Confidence indicators point to a

slowdown in construction activity in the second half of the year, while private building activity, in the first semester, decreased significantly by 5.2%.

The most recent hard data suggest that consumption growth remained robust in 2004. According to the quarterly national accounts data, final consumption expenditure growth accelerated in the third quarter of 2004 (reaching 4.1%), with other short-term indicators, which can be considered as proxies for the economic activity, supporting the view for a robust growth of private consumption: the volume of retail sales increased by 5.2% (in the January-July period), new private passenger car registrations increased by 19.5% (in the January-September period), and credit to households continued on a rapidly inclining trajectory (during the same period, reaching 28.4% in August 2004).

Based on the trends of the above indicators, private consumption and investment growth are estimated to reach 3.6% and 5.8% respectively.

As far as the external balance is concerned, it is estimated that exports and imports will increase in real terms by 7.3% and by 8.3% respectively. Thus, the contribution of the external sector to the GDP growth will register a negative figure, of 1.1%. Moreover, quarterly national accounts data indicate an increase in exports (6.1%) and imports (4.8%) during the third quarter of 2004. Although for the year 2004 as a whole, exports of goods are estimated to decrease, buoyant shipping receipts and tourism receipts are expected to contribute to a decline of the current account deficit.

In the labour market, the new Labour Force Survey based on a new sample according to the results of the Census of 2001, shows that in the first quarter of 2004 total unemployment increased to 11.2% of the labor force. For the year as a whole, the unemployment rate is estimated at about 11%.

According to the latest available data, the average HICP inflation rate was 3.0% in October, remaining higher than the Euro area average, reflecting strong domestic demand, a positive output gap and higher energy prices. The inflation differential

between Greece and Eurozone declined to 0.9%, down from 1.3% in 2003 and 1.6% in 2002.

In the area of public finances, the general government deficit outturn is estimated at 5.3% and the general government debt at 112.1% of GDP. Both figures show a large deviation from the targets set in the 2003 SGP, mainly due to the impact of the statistical revisions and an overshooting of expenditure related to the Olympic Games, as well as other under budgeted items. In July, law 3259/2004 was approved by the Parliament, providing for a tax settlement with an estimated impact on receipts in the order of 400 mio Euros in 2004. Tables 3 and 4 present the data of the 2004 government budget, as submitted to the Parliament last year and estimates for the outturn in 2004 as appearing in the budget for 2005.

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

	2004 BUDGET		
Million euro	BUDGET (1)	ESTIMATE (2)	DIFFERENCE (1)-(2)
1. REVENUES	45540	43747	+1793
(a) ORDINARY (NET REVENUE)	41420	40700	+720
<i>of which</i>			
i. DIRECT TAXES	16385	16710	-325
ii. INDIRECT TAXES	24341	23870	+471
(b) PUBLIC INVESTMENT PROGRAM	4120	3047	+1073
2. EXPENDITURES	51800	55014	-3214
(a) ORDINARY BUDGET	42550	45414	-2864
<i>of which</i>			
i. COMPENSATION OF EMPLOYEES	16404	17285	-881
ii. OTHER EXPENDITURE	16396	18606	-2210
iii. INTEREST PAYMENTS	9750	9523	+227
(b) PUBLIC INVESTMENT PROGRAM	9250	9600	-350
3. CENTRAL GOVERN. BALANCE (1-2+3)	-6260	-11267	+4907
4. PUBLIC ENTITIES SURPLUS AND ESA ADJUSTMENT	4230	2577	+1653
5. GENERAL GOVERNMENT BALANCE (3+4)	-2030	-8690	+6660

Source: Greek Government Budget

Table 4: Contributions to Debt Developments (million Euro)

	2004 BUDGET		
	BUDGET (1)	ESTIMATE (2)	DIFFERENCE (1)-(2)
1. NET BORROWING	6260	11267	-5007
2. CHANGE IN THE DEBT DUE TO FINANCIAL TRANSACTIONS	-310	1067	-1377
3. OTHER (SPECIAL LOANS FOR OLD OBLIGATIONS, AMORTIZATION ON BEHALF OF THIRD PARTIES, OBLIGATIONS OF SOCIAL SECURITY)	2271	3596	-1325
4. MILITARY EXPENDITURE	2345	1798	547
5. PRIVATISATION REVENUES AND CAPITAL TRANSACTIONS	-2800	1361	-4161
6. INCREASE IN DEBT (1+2+3+4+5)	7766	19089	-11323
7. CENTRAL GOVERNMENT DEBT	183205	201479	-18274
8. INTERGOVERNMENTAL DEBT	21649	17143	4506
9. GENERAL GOVERNMENT DEBT (7-8)	161556	184336	-22780

2.2 Basic Growth Scenario 2005-2007

Our baseline scenario for the 2005-2007 period is presented in Table 5 and detailed figures are given in the Annex. This scenario is based on the following assumptions concerning the external environment and the economic policy framework:

- On the external environment, although there are some risks, the overall picture is rather favourable. The economic recovery in the European Union and in the Central Eastern European countries is well underway. European Commission and OECD Secretariat forecasts suggest that oil prices in the forthcoming years will follow a downward path, while inflation will remain more or less subdued. As a working hypothesis, the oil price is assumed to decrease, down from 42\$ per barrel in 2005 to 35\$ in 2007.
- On the fiscal front, the government's target is to reduce the general government deficit to levels below 3% level (in compliance with the Council recommendations under article 104(7) of 5 July 2004) and proceed toward a significant reduction of the debt/GDP ratio. Nominal wage and pension

increases will exceed the inflation rate, thus supporting private consumption growth.

For the years 2005-2007, a robust growth rate is projected, picking up to around 4% on an annual basis. Despite lower public investment due to the completion of the Olympic Games, total gross fixed capital formation growth is expected to continue being a significant contributor to GDP growth, while private consumption expenditure is also expected to be robust. The external trade contribution to GDP growth is projected to be almost neutral, with exports being projected to increase due to the global economic recovery and the improvement in the competitiveness of the Greek economy.

Apart from the positive external economic environment and positive prospects due to the impact of the successful completion of the Olympic Games, the high future growth performance of the Greek economy is reinforced by the following policy factors:

- The Greek government is applying an economic policy mix targeted at the rationalization and simplification of the tax system (recent tax reform), the reduction in red tape and the provision of additional investment incentives (new incentives law) so as to boost private investment activity. In addition, structural adjustments and privatisations, which will contribute to the improvement of the competitiveness of the Greek economy, are being promoted.
- The performance of the business sector in recent years has improved substantially. Capital structure is healthier, financial costs have fallen to very low levels and profitability has ameliorated. Sales and profits (both operational and net) of the companies listed in the Athens Stock Exchange increased at high rates. The ratio of profits to turnover exceeds 10%. Profitability will be substantially enhanced by the reduction of the corporate income tax rate by 10 percentage points (over the next three years) and the significant new investment incentives are expected to contribute to high growth of business investment.

- Average real gross wages and real disposable income will grow by 2.3% and 3.5% respectively, thus supporting robust consumption growth.
- Tourist revenues are expected to increase by 7.5% annually in real terms.
- Credit to the private sector, both households and enterprises, will continue to grow at high rates (the ratio of loans to GDP is currently at about half of the Eurozone average).
- Large investment on infrastructure has created significant positive externalities, which improve the competitiveness and productive capacity of the economy while boosting private investment activity.
- A new legal framework for public private partnerships (PPPs) framework is being prepared.

The 'employment content' of growth, which was limited in the previous years, is expected to improve. For the years 2005-2007, employment is forecasted to rise by 1.5% annually and the unemployment rate is expected to decrease to 8.9% in 2007, down from 11.1% in 2004.

In 2005 a large scale fiscal consolidation effort will take place. Based on the 2005 Budget, expected to be approved by the Greek parliament on December 22nd, the general government deficit will drastically decline to 2.8% of GDP, while the public debt will be reduced to 109.5% of GDP. A significant curtailment of the primary current expenditure and reduced Public Investment Program expenditure, after the completion of the Olympic Games, will contribute to this target. As a reference, the one-off costs related to the Olympic Games amounts to 1.6% of GDP in 2004. For the 2006-2007 period, a further decline of the deficit and debt is foreseen. Despite the gradual reduction of the tax burden for enterprises and households after 2005, the high growth rate (driven by high investment activity and strong private consumption) and measures taken to limit tax evasion will retain robust general government revenues as percent of GDP. The general government deficit will decline further to 2.6% of GDP in 2006 and 2.5% in 2007. Primary surplus is estimated to be in the order of around 2.5% of GDP per year. The general government debt, as a ratio to GDP, will fall to 102.5% in 2007, down from 109.5% in 2005.

The deceleration of unit labor cost growth by 0.6% annually and lower oil prices will help inflation to decelerate, from 3.1% in 2004 to 2.7% in 2007.

Table 5: Selected Economic Indicators 2005-2007

	2005		2006		2007	
	<i>SGP2003</i>	<i>SGP2004</i>	<i>SGP2003</i>	<i>SGP2004</i>		<i>SGP2004</i>
1. GDP GROWTH	4.0%	3.9%	3.8%	4.0%		4.2%
2. GROSS FIXED CAPITAL FORMATION	5.7%	4.1%	5.5%	5.6%		6.3%
3. REAL UNIT LABOUR COST	-1.0%	0.0%	-1.0%	-0.7%		-0.8%
4. PRIVATE CONSUMPTION DEFLATOR	2.8%	2.9%	2.6%	2.8%		2.7%
5. GENERAL GOVERNMENT BALANCE (% GDP)	-0.5%	-2.8%	0.0%	-2.6%		-2.5%
6. GENERAL GOVERNMENT DEBT (% GDP)	94.6%	109.5%	90.5%	106.0%		102.5%
7. UNEMPLOYMENT RATE	7.4%	10.5%	7.0%	9.8%		8.9%

3. Economic Policies for 2005 - 2007

Economic policy in the medium term (2005-2007) faces the following major challenges:

- primarily to comply with the Council recommendations (under article 104(7) of 5 July 2004) to bring the deficit below the threshold value by the end of 2005 as well as achieving the gradual reduction in the public debt ratio,
- to put back in track the public finances aggregates on a downward trend, by allowing a safety margin based on the recommendations in the Broad Economic Policy Guidelines, in the medium term,
- to be consistent with the recommendations in the Broad Economic Policy Guidelines and, in particular, to accelerate the pace of structural reforms.

The fiscal strategy to pursue the above goals will be based on maintaining high primary surpluses, consistent with the reduction of the expenditure ratio and the increase in current revenues, mostly through incentives for higher profitability, higher investment activity and enhanced growth. Some of the measures already announced or included in the 2005 Budget are:

Corporate tax reforms. The tax rate for corporate income is set to remain on a downward trend until 2007. Firms will also be able to deduct half of their R&D expenses from their net earnings, so as to promote targets compatible with the Lisbon strategy.

Current revenue measures. In July, law 3259/2004 was approved by Parliament, providing for a tax settlement (including delinquent obligations to the state, repatriation of capital and unsettled tax accounts for professionals and enterprises). For the year 2004 the expected impact on receipts is approximately 400 mio euros (0.2% of GDP), while the largest part of the receipts from this law (approximately 1,200 mio euros or 0.70%) will be cashed in during 2005. Following a cautious scenario, the 2005 State Budget has budgeted for 600 mio euros (or 0.35% of GDP), treating the remainder as a “cushion” against unexpected shortfalls in revenues, in case that economic growth proves to be lower than forecast. The replacement of the Financial Crimes Squad (SDOE) with a new organization which will focus on investigating tax evasion, illegal trade and financial crime is expected to further increase public revenue.

Expenditure curtailment. Measures included in the 2005 State Budget are mostly of a structural nature. The largest single part of the savings on outlays stems from the reduction of expenditure following the completion of the Olympic Games (down from 1.37% of GDP to 0.34% of GDP, a saving of 1.03% of GDP). A reduction in grants in the investment budget will further contribute an additional net 0.43% of GDP.

Measures have been taken to ensure a significant slowdown of the growth in nominal current general government expenditure from a projected rate of 11.2% in 2004 down to 6.0% in 2005. These measures include a policy of moderate increases in wages and

pensions, an extremely restrictive hiring policy in the public sector, and significant nominal reductions (by 6.5%) in current operating expenditure.

As a result, total primary expenditure of the general government will fall by 0.29% of GDP. Interest payments on public debt will be lower by 0.24% of GDP, due to the incorporation of capitalized interest payments (which renders servicing of debt cheaper) into debt, along with actions leading to the extension of the redemption schedule.

Social security reforms. There will be a further saving of 0.40% of GDP, which stems from the completion in 2004 of the settlement of overdue debt from the State to social security funds as well as the continued application of social security reforms that reduce evasion of social security revenues.

3.1 Fiscal Policy and Prospects for 2005-2007

Fiscal developments in 2003-2004 were characterized by three major events: the impact of the electoral cycle, the acceleration of expenditure related to the Olympic Games and the corrected reporting of the public finance figures, which resulted in substantially higher deficit and debt figures from 1997 onwards.

Since Greece joined EMU in 2000, despite previous SG programmes showing a gradual decline of the general government deficit (as a ratio to GDP), this improvement was not followed by a corresponding gradual reduction of public debt. Public debt remained persistently above the 100% of GDP threshold, hindered by unspecified factors grouped under the item “stock-flow adjustments”. These developments signaled the fact that various financial transactions were recorded incorrectly in the public sector’s accounting system.

Fiscal auditing and bilateral discussions between Eurostat and the Greek authorities necessitated a number of revisions in order to reduce previous data distortions. These revisions mainly include:

- a downward revision of tax revenue estimates (mainly VAT) in public accounts;
- a downward revision of payments received from E.U. institutions in the context of structural fund programs;
- the reclassification, as a financial transaction, of a payment from the Postal Savings Bank to the government;
- the correction of under-recorded government expenditure for the procurement of military equipment;
- the provision of reliable information for recent years, concerning the surplus notified for the sub-sector Social Security Funds;
- the addition of capitalized interest to the government deficit and debt;
- a reclassification of the amount of capital injections undertaken by the Greek government as capital transfers instead of acquisition of shares for the state-owned companies;
- debt assumption.

After the clarification of the data, the 2005 State Budget, taking into consideration all the above mentioned revisions, was submitted to the Parliament, thus rendering fiscal policy reliable, transparent and effective.

Given the forecast for GDP growth, total revenues at the level of general government are projected to increase slightly in 2005 and remain almost stable from there-on as a ratio to GDP (40.8% in 2004, 41.2% in 2005 and 41.4% in 2007). Total expenditure is expected to decline from 48.5% in 2004 to 46.3% in 2007.

The 2005 State Budget provides for a general government deficit of 2.8% of GDP (vs 5.3% in 2004). The largest part of this reduction of 2.5% pertains to the central government deficit (2.1%, down from 6.9% to 4.8% of GDP). It is also projected that the primary surplus will increase to 2.2% of GDP as compared to a projected 0% for 2004.

For the coming years, the general government deficit is expected to decline to 2.5% of GDP by 2007. At the same time the primary balance will increase gradually to 2.65% of GDP by 2007.

The privatisation program, amounting to 1,600 mio euros (about 1% of GDP) has already been announced, contributing to the significant reduction of the stock-flow adjustment to 2.2% of GDP in 2005, expected to fall to 1.3% in 2007. Already in the last months the government proceeded for the following privatizations: ELPE (with revenues of 562 mio euros) and National Bank of Greece (with revenues of 192 mio euros). The debt-to-GDP ratio is expected to fall to 102.5% of GDP in 2007; the progressive reduction of the debt-to-GDP ratio will be a combined result of increasing primary surpluses, diminishing stock-flow adjustments, privatisation injections and strong nominal GDP growth.

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

% of GDP	2004	2005	2006	2007
BALANCE BY SUB-SECTORS				
GENERAL GOVERNMENT	-5.3%	-2.8%	-2.6%	-2.5%
CENTRAL GOVERNMENT (*)	-6.9%	-4.8%	-4.4%	-4.1%
LOCAL GOVERNMENT, SOCIAL SECURITY, PUBLIC ENTITIES AND ADJUSTMENTS	1.6%	2.0%	1.8%	1.6%
GENERAL GOVERNMENT				
1. TOTAL REVENUE	43.2%	43.7%	43.8%	43.8%
2. TOTAL EXPENDITURE	48.5%	46.5%	46.3%	46.3%
3. GENERAL GOVERNMENT BALANCE	-5.3%	-2.8%	-2.6%	-2.5%
4. INTEREST	5.3%	5.1%	5.1%	5.0%
5. GEN. GOVN. PRIMARY SURPLUS (8-7)	0.0%	2.2%	2.5%	2.6%
COMPONENTS OF REVENUES /EXPENDITURES				
6. TAXES	23.5%	23.6%	23.4%	23.2%
7. SOCIAL CONTRIBUTIONS	15.6%	16.1%	16.5%	16.9%
8. OTHER CURRENT RESOURCES	1.7%	1.6%	1.4%	1.3%
9. TOTAL CURRENT REVENUE	40.8%	41.2%	41.3%	41.4%
10. GOVERNMENT FINAL CONSUMPTION EXPENDITURE	16.4%	16.0%	15.4%	14.9%
11. SOCIAL TRANSFERS OTHER THAN IN KIND	17.9 %	18.2%	18.5%	18.9%
12. SUBSIDIES	0.1%	0.1%	0.1%	0.1%
13. INTEREST PAYMENTS	5.3%	5.1%	5.1%	5.0%
14. OTHER CURRENT EXPENDITURE	2.4%	2.3%	2.2%	2.2%
15. GROSS FIXED CAPITAL FORMATION	4.1%	3.2%	3.3%	3.4%
16. TOTAL EXPENDITURE	48.5%	46.5%	46.3%	46.3%

(*) Budget basis

Table 7: General Government Debt Developments

% of GDP	2004	2005	2006	2007
GEN. GOVN CONSOLIDATED GROSS DEBT	112.1%	109.5%	106.0%	102.5%
CHANGE	+2.2%	-2.6%	-3.5%	-3.5%
CONTRIBUTION TO CHANGES IN GENERAL GOVERNMENT CONSOLIDATED GROSS DEBT				
PRIMARY SURPLUS	0.0%	2.2%	2.5%	2.6%
INTEREST	5.3%	5.1%	5.1%	5.0%
NOMINAL GDP	7.4%	7.3%	7.3%	7.3%
OTHER FACTORS AFFECTING THE GENERAL GOVERNMENT CONSOLIDATED DEBT				
ADJUSTMENT FACTORS & PRIVATISATION PROCEEDS	4.6%	2.2%	1.4%	1.3%
IMPLICIT INTEREST RATE (General Government)	5.2%	4.8%	5.0%	5.1%

4. Comparison of the 2004 SGP with the 2003 SGP

Deviations of the current program's data from those in the 2003 update are presented in Table 9.

Table 9: Divergence from the 2003SGP

	2004	2005	2006	2007
REAL GDP GROWTH				
SGP 2003	4.2%	4.0%	3.8%	
SGP 2004	3.7%	3.9%	4.0%	4.2%
DIFFERENCE	-0.5	-0.1	+0.2	
GENERAL GOVERNMENT BALANCE (% of GDP)				
SGP 2003	-1.2%	-0.5%	0.0%	
SGP 2004	-5.3%	-2.8%	-2.6%	-2.5%
DIFFERENCE	-4.1	-2.3	-2.6	
GENERAL GOVERNMENT GROSS DEBT (%of GDP)				
SGP 2003	98.5%	94.6%	90.5%	
SGP 2004	112.1%	109.5%	106.0%	102.5%
DIFFERENCE	13.6	14.9	15.5	

In the following sections the above mentioned deviations between the two programs are analyzed and explained:

1. Real GDP Growth

GDP growth rate is estimated to reach 3.7% in 2004, 0.5 % lower than projected in the 2003 SGP. This is attributed to differences between the two programs concerning the factors influencing GDP growth. The estimated higher growth of domestic demand is offset by a negative contribution of net exports of goods and services.

GDP growth projections for the period 2005-2006, included in the present SGP, are quite similar with those of the previous program. The higher projection on the exports is due to the expected stronger world trade and GDP growth, as well as to the improvement in competitiveness.

**Table 10: Factors Influencing GDP Growth
(Differences between SGP 2004 and SGP 2003 in growth rates)**

		2004	2005	2006	2007
GDP	SGP 2003	4.2%	4.0%	3.8%	
	SGP 2004	3.7%	3.9%	4.0%	4.2%
	DIFFERENCE	-0.5	-0.1	0.2	
1. PRIVATE CONSUMPTION	SGP 2003	3.2%	3.3%	3.2%	
	SGP 2004	3.6%	3.5%	3.4%	3.4%
	DIFFERENCE	0.4	0.2	0.2	
2. PUBLIC CONSUMPTION	SGP 2003	1.0%	0.5%	0.5%	
	SGP 2004	5.5%	1.5%	1.0%	0.8%
	DIFFERENCE	4.5	1.0	0.5	
3. GROSS FIXED CAPITAL FORMATION	SGP 2003	7.0%	5.7%	5.5%	
	SGP 2004	5.8%	4.1%	5.6%	6.3%
	DIFFERENCE	-1.2	-1.6	0.1	
4. FINAL DOMESTIC DEMAND	SGP 2003	3.8%	3.6%	3.5%	
	SGP 2004	4.3%	3.5%	3.6%	3.8%
	DIFFERENCE	0.5	-0.1	0.1	
5. EXPORTS OF GOODS AND SERVICES	SGP 2003	6.7%	5.6%	5.3%	
	SGP 2004	7.3%	6.2%	6.4%	7.0%
	DIFFERENCE	0.6	0.6	1.1	
6. IMPORTS OF GOODS AND SERVICES	SGP 2003	4.7%	3.8%	3.7%	
	SGP 2004	8.3%	4.1%	4.2%	4.7%
	DIFFERENCE	3.6	0.3	0.5	
7. EXTERNAL BALANCE, (contribution to GDP change)	SGP 2003	0.07	0.09	0.10	
	SGP 2004	-1.06	0.00	0.03	0.05
	DIFFERENCE	-1.13	-0.09	-0.07	

2. General Government Balance and Debt

In the 2004 SGP, the 2004-2007 estimates and projections for public finance data are based on a transparent methodology, which is consistent with the ESA-95 regulations and the EDP methodology, following data revisions for the 2000-2003 period. Moreover, the 2004 deficit was revised upwards, due to an overshooting of the expenditure (both current and investment) for the Olympic Games.

**Table 11: Factors Influencing General Government Balance and Debt
(Differences between SGP 2004 and SGP 2003 in growth rates)**

		2004	2005	2006	2007
1. TOTAL CURRENT RESOURCES	SGP 2003	6.4%	6.3%	6.1%	
	SGP 2004	8.9%	8.4%	7.5%	7.6%
	DIFFERENCE	2.5	2.1	1.4	
of which					
TAXES ON PRODUCTION AND IMPORTS	SGP 2003	7.7%	7.1%	6.7%	
	SGP 2004	11.1%	7.2%	7.5%	7.5%
	DIFFERENCE	3.4	0.1	0.8	
TAXES ON INCOME AND WEALTH	SGP 2003	6.0%	5.2%	5.0%	
	SGP 2004	8.5%	8.6%	4.8%	4.8%
	DIFFERENCE	2.5	3.4	-0.2	
SOCIAL CONTRIBUTIONS	SGP 2003	7.7%	7.3%	7.2%	
	SGP 2004	10.0%	10.5%	10.0%	10.0%
	DIFFERENCE	2.3	3.2	2.8	
2. TOTAL CURRENT EXPENDITURE	SGP 2003	7.5%	5.6%	5.3%	
	SGP 2004	11.2%	6.0%	6.7%	6.6%
	DIFFERENCE	3.7	0.4	1.4	
of which					
GOVERNMENT CONSUMPTION	SGP 2003	6.7%	5.6%	5.0%	
	SGP 2004	10.0%	4.5%	3.9%	3.7%
	DIFFERENCE	2.3	-1.1	-1.1	
SOCIAL TRANSFERS THAN IN KIND	SGP 2003	9.5%	7.6%	7.4%	
	SGP 2004	11.5%	9.0%	9.2%	9.5%
	DIFFERENCE	2.0	1.4	1.8	
INTEREST	SGP 2003	4.3%	1.0%	0.8%	
	SGP 2004	-1.4%	2.6%	7.9%	6.0%
	DIFFERENCE	-5.7	1.6	7.1	
3. GROSS FIXED CAPITAL FORMATION	SGP 2003	7.0%	8.2%	7.0%	
	SGP 2004	12.4%	-15.0%	10.0%	11.0%
	DIFFERENCE	5.4	-23.2	3.0	
4. CAPITAL TRANSFERS RECEIVED	SGP 2003	29.0%	17.5%	11.7%	
	SGP 2004	38.1%	10.0%	6.8%	4.3%
	DIFFERENCE	9.1	-7.5	-4.9	
5. PRIMARY SURPLUS (% GDP)	SGP 2003	4.7%	5.1%	5.3%	
	SGP 2004	0.0%	2.2%	2.5%	2.6%
	DIFFERENCE	-4.7	-2.9	-2.8	

6. GENERAL GOVERNMENT BALANCE (% GDP)	SGP 2003	-1.2%	-0.5%	0.0%	
	SGP 2004	-5.3%	-2.8%	-2.6%	-2.5%
	DIFFERENCE	-4.1	-2.3	-2.6	
7. GENERAL GOVERNMENT DEBT (% GDP)	SGP 2003	98.5%	94.6%	90.5%	
	SGP 2004	112.1%	109.5%	106.0%	102.5%
	DIFFERENCE	13.6	14.9	15.5	
8. NOMINAL GDP GROWTH	SGP 2003	7.7%	7.3%	6.9%	
	SGP 2004	7.4%	7.3%	7.3%	7.3%
	DIFFERENCE	-0.3	0.0	0.4	

5. Sensitivity Analysis

The projections are subject to uncertainties. This section provides a sensitivity analysis that accommodates uncertainties with reference to the growth rate. Moreover, the alternative growth scenario presents a less optimistic scenario for the outlook of the world and European economic activity. Uncertainties around a prolonged asthenic domestic demand in some economies within the Euro area clearly pose certain downwards risks, mitigating the prospects of a strong economic recovery for the Euro area over the next years. Other sources of uncertainty include interest rate and exchange rate developments, while we continue to receive mixed signals for the prospects of the world economy. In the case that some of the above risks materialize, thereby leading to a weak economic growth performance in the Euro area in particular and E.U. economy in general, the Greek economy could be adversely affected. Table 12 presents the projections on the basis of this scenario and compares them with the results of the baseline scenario.

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

	Baseline Scenario			Alternative Scenario		
	Annual average rates of change (except as indicated)			Annual average rates of change (except as indicated)		
	2005	2006	2007	2005	2006	2007
A. DEMAND AND OUTPUT (CONSTANT PRICES 1995)						
GDP	3.9%	4.0%	4.2%	3.3%	3.3%	3.3%
PRIVATE CONSUMPTION	3.5%	3.4%	3.4%	3.3%	3.1%	3.1%
GOVERNMENT CONSUMPTION	1.5%	1.0%	0.8%	1.5%	0.7%	0.7%
GROSS FIXED CAPITAL FORMATION	4.1%	5.6%	6.3%	3.3%	4.1%	4.6%
TOTAL DOMESTIC DEMAND	3.5%	3.6%	3.8%	3.1%	3.1%	3.1%
EXPORTS OF GOODS AND SERVICES	6.2%	6.4%	7.0%	5.0%	5.0%	5.0%
IMPORTS OF GOODS AND SERVICES	4.1%	4.2%	4.7%	3.7%	3.7%	3.9%
B. PRICES						
PRIVATE CONSUMPTION DEFLATOR	2.9%	2.8%	2.7%	2.8%	2.7%	2.6%
GDP DEFLATOR	3.3%	3.2%	3.0%	3.1%	3.0%	3.0%

C. PRODUCTIVITY, INCOME AND EMPLOYMENT						
LABOUR PRODUCTIVITY	2.3%	2.5%	2.6%	2.1%	2.1%	2.1%
REAL COMPENSATION PER EMPLOYEE	2.8%	2.1%	2.0%	2.9%	1.8%	1.7%
EMPLOYMENT	1.5%	1.5%	1.6%	1.2%	1.2%	1.2%
UNEMPLOYMENT RATE	10.5%	9.8%	8.9%	10.8%	10.4%	9.8%
D. PUBLIC FINANCES						
TOTAL RESOURCES	8.5%	7.4%	7.4%	7.6%	6.8%	6.7%
TOTAL EXPENDITURE	2.9%	6.8%	7.2%	2.9%	5.8%	6.3%
GENERAL GOVERNMENT BALANCE (% of GDP)	-2.8%	-2.6%	-2.5%	-3.2%	-2.8%	-2.6%
GENERAL GOVERNMENT DEBT (% of GDP)	109.5%	106.0	102.5	110.5%	108.3%	105.8%

The simulation results of the alternative scenario compared to the baseline scenario provide a slower annual GDP growth rate of 3.3%. Due to lower domestic demand, as private and government consumption along with gross fixed capital formation growth rates will be lower than the baseline scenario, inflation (measured by the private consumption deflator) is also projected to be lower by 0.1% each year.

Based on the alternative growth scenario, a slower growth of general government current resources is simulated, in the order of 0.7% each year. Also, exports, imports and employment will remain below the reference values of the baseline scenario. The sensitivity analysis presents a projection of the general government deficit of 3.2% of GDP in 2005, thereafter falling below the 3% threshold. The debt to GDP ratio declines, but at a slower pace.

6. Sustainability of Public Finances

The implementation of Law 3029/2002 still lies at the heart of efforts to reform the pension system, with an emphasis on the introduction of new instruments that add credibility and flexibility to the system. For example, according to the provisions of the aforementioned law, the first Occupational Fund has already been established and amendments to the legislation for atypical forms of employment have been introduced. Also, provision has been made for the transfer of social security rights when moving from one fund to another and motives have been provided for the prolongation of working life beyond the statutory limit of 35 years. Distinguishing auxiliary from primary pensions, through the creation of separate auxiliary Funds and the consolidation of various funds remains a major priority and specific steps have

been taken in this direction. New legislation (law 3232/2004) aimed at amending various aspects of existing legislation, particularly as far as persons with disabilities, farmers, professionals and civil servants are concerned. Considerable effort is being made to combat the evasion of contributions through the establishment of a special force (YPEDYFKA), which monitors health-care payments made by social insurance institutions.

As the government needs to have a clearer picture of the situation, national projections by the Actuarial Authority are already underway incorporating the latest demographic data along with the effects of the 2002 intervention. Also, there are many measures included in the 2002 law yet to be implemented and evaluated before new elements are brought to the system.

Demographic trends are placed in the core of long-term economic policy challenges, as population ageing poses risks in all E.U. countries. Alleviating the pressure on age-related spending, without menacing its social sustainability, is the basic prerequisite for a sound macroeconomic performance in the years to come. According to the Eurostat projections, Greece is about to face profound changes in its population structure. Table 13 offers an assessment of the long-term sustainability of public finances based on the projections of the Hellenic Actuarial Unit as reported in 2002 and the European Commission. An update round of projections, which takes into account updated information on population and demographic trends, is planned for 2005.

Table 13: 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.

7. Structural reforms completed or underway

The government prioritizes the improvement in the quality of public finances, i.e. **the change in the composition of public expenditure** and its re-orientation towards more productive uses. This issue is currently under scrutiny by a Taskforce headed by a member of the Council of Economic Advisers. To this end and recognizing structural deficiencies of the present system, the government has requested technical assistance from the IMF on tax administration and expenditure control.

In the direction of altering the expenditure mix, cutting down on operating expenditure is a priority of the 2005 Budget (operating expenditure will be down by 6.5% in nominal terms and, in particular, consumption expenditure will decrease by 16.2% - again in nominal terms). Saving on operating expenditure will be more pronounced in the years to come, in an attempt for a more efficient resource allocation.

The government is also planning the implementation of a more effective **fiscal auditing system**. So far, auditing only refers to the legitimacy and regularity of expenditure included in the budget (eg, legal documentation for every item of expenditure). The establishment of an Independent Body of Fiscal Inspectors is contemplated, along with internal auditing services in every Ministry or local authority and public entities in general (with a budget exceeding €3 mio).

A new framework has also been designed for the operation of **Public Enterprises and Entities (DEKO)**, based on the strict implementation of business plans, wage

moderation (according to specific rules), control of borrowing requirements and allowing borrowing for investment purposes only (along with debt servicing).

As far as **revenue** is concerned, the tax reform already announced includes provisions for more transparent and efficient tax audits and controls for professionals and enterprises. Audits for SMEs and professionals with turnover (gross revenue) up to a certain limit will be greatly simplified. A list of deductible outlays will soon be published, thus reducing the degree of arbitrariness from the part of auditors and the need to court recourses. Apart from equity issues, lowering the administrative burden on enterprises and fighting corruption are expected to result to a broader tax base.

The legal framework for **opening markets to competition** (especially network industries) is essentially in place. In telecommunications, alternative operators have already gained a total share of 15% of the total fixed telephony market lost to the incumbent firm (OTE); this share is almost 30% as far as international calls are concerned. In the electricity market, a new law was adopted in 2003 providing, among others, for asymmetric measures against the incumbent Public Power Corporation (PPC) as far as capacity availability agreements for new generation capacity are concerned. Secondary legislation is pending and the same holds for the accounting unbundling of PPC. In the natural gas market, the government is opting for a faster opening of the market, and, according to recent legislation, all electricity generators, including cogenerators with consumption above 25 million m³/year, are becoming eligible consumers starting from July 1st, 2005. In both the electricity and the natural gas markets, the systems have already been (or very soon will be) interconnected to these of neighbouring countries, thus providing a natural counterpart to having alternative providers domestically.

Business start-ups. New legislation has been prepared and will soon be presented before the Parliament, aiming at cutting red tape for business start-ups and at reducing the time required and cost paid while prioritizing the protection of the environment along with public health and safety. Relevant legislation (laws 2516/97, 2965/01, numerous Ministerial Decisions) will be simplified and updated in order to tackle the

lack of legislative codification, reduced coordination between public services and the labyrinth of joint competences.

A new legal framework for **public-private partnerships (PPPs)** is being prepared as well.

Health care reform. The government has prepared a far-reaching health care reform (soon to be submitted for public consultation). The main objective of the proposed reform is securing financial viability in the short-run and sustainability in the long-run (through cost containment) while addressing specific weaknesses of the present system and guaranteeing an adequate level of services for all Greek citizens.

The pressing problem in the short-run is the accumulation of debt to hospital suppliers. Currently, the restructuring of this debt is planned, while other measures are in the pipeline to prevent its reoccurrence in the future: a centralized administrative system of public procurement procedures, a new management system for public hospitals (based on operational devolution to the local hospital level) and a new computerized accounting system for all NHS hospitals and health centers which at the end of each financial year will present balance-sheets.

As far as **containing costs in the medium and long-run**, the MHSS is planning:

- To use Information Technologies extensively. The long-term goal of the MHSS is the operation of ERP systems (Enterprise Resource Planning) in all NHS,
- The application of modern management methods in NHS Hospitals as described above,
- New pricing and costing mechanisms,
- Increased auditing of Social Services.

The MHSS is also counting on Public – Private Partnerships (PPPs), and more specifically on collaborations between public hospitals and private health insurance companies in the field of hospitalization services offered by the NHS. The possibility

of opening-up of the new (so-called "Olympic") health infrastructure is being explored with a view to making the best possible use of new wings constructed mainly in general NHS hospitals of the greater Athens area. Pilot PPP/PFI projects for the construction of public hospitals are also planned. This initiative will help ease the financial burden on the Public Investment Budget which today is the only source of financing social infrastructure.

Appendix

Detailed tables 2003-2007