COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

The action taken by Greece in response to the Council decision of 17 February 2005 in accordance to Article 104(9) of the Treaty for the deficit reduction judged necessary in order to remedy the situation of excessive deficit

THE EXCESSIVE DEFICIT PROCEDURE FOR GREECE

The Council, upon the corresponding Commission recommendation, placed Greece in excessive deficit on 5 July 2004 and, according to Article 104(7) of the Treaty, addressed recommendations to Greece with a view to bringing the excessive deficit situation to an end by 2005. On 18 January 2005, the Council decided in accordance to Article 104(8) that Greece had not taken effective action in response to these recommendations.

On 17 February 2005, upon a Commission recommendation in accordance with Article 104(9), the Council decided to give notice to Greece to take measures for the deficit reduction judged necessary to remedy the situation. The Council established the deadline of 21 March 2005 for Greece to take effective action to comply with this Decision. Specifically, the Council decided that '*Greece shall put an end to the present excessive deficit situation as rapidly as possible and the latest by 2006 through: (i) a rigorous implementation of the 2005 budget as approved by its Parliament, and (ii) implementing in 2006 adjustment measures of a permanent nature leading to a correction in the deficit of at least 0.6 percentage point of GDP'*. The Council also required Greece to further pursue the efforts to *'identify and control factors other than net borrowing, which contribute to the change in debt levels'* and *'to improve the collection and processing of general government data'*. The Council urged *'Greece to take the necessary measures to ensure that budgetary consolidation towards the medium term position of government finances close to balance or in surplus is sustained through a reduction in the cyclically-adjusted deficit by at least 0.5% of GDP per year after the excessive deficit has been corrected'*. Finally, the Council required Greece to *'submit, by 21 March 2005 at the latest, a report outlining the decisions to respect the recommendations of this Decision'*.

This communication assesses the decisions taken by the Greek authorities in response to this Council decision.

ACTION TAKEN BY GREECE IN RESPONSE TO THE COUNCIL DECISION

The Greek authorities submitted on 21 March this year a revised update of the stability programme covering the period 2004-2007. The targets in the programme take account of the budgetary impact of a fiscal package communicated to the Commission on the same date and made public by the government on 29 March, to underpin the implementation of the revised programme. The package includes additional measures to be implemented in 2005, on top of those incorporated in the 2005 budget, and confirms the government's commitment to target a deficit below 3% of GDP in the 2006 draft budget. The Commission considers this revised update of the stability programme together with the commitment made public on 29 March as the report required in article 2(1) of the Council decision.

According to the general government data reported by the Greek government in the EDP March notification[1], real GDP grew at 4.2% in 2004 and the deficit attained 6.1% of GDP[2]. These figures reveal the existence of additional tax shortfalls and expenditure overruns in the execution of the 2004 budget, on top of those already unveiled in the September 2004 EDP notification, on the basis of which the deficit had been estimated at 5.3% of GDP.

[1] Such figures for 2004 were not validated by Eurostat on 18 March 2005. They should be considered as provisional and subject to upward revisions. The underlying issues are outlined below in this section.

[2] The figure is 6.0% of GDP on a National Account (ESA95) basis, i.e. excluding swap-related flows.

The revised update of the stability programme assesses the budgetary impact of implemented and announced measures[3] within three different macroeconomic scenarios. In the reference scenario, used for the assessment of the programme[4], real GDP is projected to grow at 2.9% in 2005 and 3% in 2006 and 2007. The deficit is expected to attain 3.7% of GDP in 2005 and would fall to 2.9% in 2006 and to 2.4% in 2007. The cyclically-adjusted deficit is projected to improve by 2.5, 0.9 and 0.5 percentage points of GDP in 2005, 2006 and 2007 respectively. The debt-to-GDP ratio would attain 109.5% of GDP in 2005, subsequently to declining to just below 105% of GDP at the end of the programme period.

Such programme projections assume full implementation of both the 2005 budget and the additional fiscal package made public on 29 March. Specifically, for 2005, the Greek government has announced permanent measures involving an increase of the average VAT rate by 1 percentage point in 2005, which should provide additional revenues of EUR 610 millions, together with an increase in tobacco, alcohol and oil products excise duties, which should amount to EUR 280 millions. The package also includes savings on travel expenses of civil servants (EUR 45 millions) and the reduction in subsidies to urban transport companies (EUR 50 millions). Overall, if fully implemented, the package should lead to a deficit reduction of EUR 985 millions - 0.5% of GDP[5] - in 2005. According to the Greek government, these measures should increase revenues by EUR 1,655 millions in 2006 (around 0.9% of GDP), when they will be in force for the whole year. On 29 March, the government also made public its commitment to include in the 2006 draft budget possible measures needed to bring the deficit below the 3% threshold next year. Such measures would be conditional on growth and mainly concern primary expenditures, especially in the areas of military expenditures, state contributions to social security funds, local administrations and public investments.

As far as debt dynamics is concerned, the revised update of the stability programme provides information on the sources and developments of the stock-flow adjustment (SFA). Specifically, the SFA in 2004 would amount to around 2.9% of GDP. Since this includes privatisation proceeds amounting to 0.5 percentage points of GDP, the debt-increasing operations represent 3.4 percentage points of GDP. This figure encompasses an increase in deposits (1.5 pp), cash-accrual differences (1.4 pp), and increases in shares and other minor adjustments (0.5 pp). SFAs are projected on a downward path, from 1.9% of GDP in 2005, when privatisation proceeds would amount to 0.6 percentage point of GDP, to 0.9% of GDP in 2007, when privatisation proceeds are projected at a marginal 0.1% of GDP.

There are still pending issues in the collection and processing of government data as indicated in by Eurostat in its press release of 18 March. Eurostat did not validate the deficit figures in the Greek EDP notification of March this year because of an inconsistent recording of flows between Greece and the EU budget. Eurostat also noted that healthcare -and Olympics-related expenditure for past years is not yet final. Therefore, the government deficit figures for 2004 and earlier years may have to be revised upwards.

[3] Including those made public on 29 March.

[4] See Commission recommendation for a Council Opinion ‘On the updated stability programme of Greece, 2004-2007’ - SEC(2005) 440, 6.4.2005.

[5] On the basis of the nominal GDP in the reference scenario used to assess the programme, as projected in the Commission services spring 2005 forecast, the actual figure should be close to 0.55% of GDP.

ASSESSMENT OF THE DECISIONS TAKEN

The assessment of compliance of the measures above with the Council decision under Article 104(9) is carried out on the basis of the Commission services spring 2005 forecast, released on 4 April, which take account of the March EDP notification and of the revised update stability programme covering the period 2004-2007. The assessment should also take into account the budgetary impact of the additional fiscal package, which could not be incorporated by the Commission services spring 2005 forecast, because it was made public after the forecast cut-off date.

The Commission services spring 2005 forecasts project a deficit of 4.5% of GDP for 2005, and 4.4% for 2006. The debt ratio is expected to attain 110.5% of GDP in 2005 and 108.9% of GDP in 2006. These projections are based on GDP growth at 2.9% in 2005 and assume that the 2005 budget is fully implemented. For 2006, growth is projected at 3.1%. The deficit figure of 4.4% in 2006 is based on a no-policy-change scenario, in which the 2005 deficit outcome is set at 4.5% of GDP and it is assumed that no discretionary measures are implemented. The deficit projections in the revised update of the stability programme (3.7% of GDP in 2005 and 2.9% in 2006) and those in the Commission services spring 2005 forecast (4.5 and 4.4% respectively) differ because, as indicated above, the forecast does not include the budgetary impact of the additional fiscal package. In addition, the spring forecasts are based on a more cautious assessment of developments in social security contributions and some primary expenditures. These differences are outlined in the table below.

Budgetary assessment of announced measures

	2005	**2006**
Deficit (% of GDP)		
Spring forecasts (1)	**4.5**	**4.4**
Impact of additional measures (2)=(2a)+(2b)	0.5	0.9
Revenues (2a)	*0.4*	*0.8*
Expenditures (2b)	*0.1-*	*0.1*
Differences in assessment of other measures (3)=(3a)+(3b)+(3c)-(3d)	0.3	0.6
Lower SSC (3a)	*0.1*	*0.4*
Higher current primary expenditures (mainly health care and public wages; 3b)	*0.2*	*0.3*
Lower capital transfers received (3c)	-	*0.1*
Lower interest payments (3d)		*0.2*
Target in the programme (1) -(2) -(3)	**3.7**	**2.9**

Debt (% of GDP)		
Programme	**109.5**	**107.2**
Spring forecasts	**110.5**	**108.9**

Where 2005 is concerned, the spring 2005 forecasts do not take account of the additional measures in the revenue side made public after the forecast cut-off date. According to the Greek government, the full implementation of the measures, would lead to an improvement of the projected deficit by around 0.5 percentage points of GDP in 2005. Furthermore, according to the Commission services spring 2005 forecast, the revised update of the stability programme seems to project too high an increase in social security contributions relative to compensation of employees in 2005, which does not seem warranted either on the basis of measures spelled out in the programme or on the basis of past trends[6]. Moreover, the programme projections of public consumption, in particular health care and wages, appear too optimistic[7]. However, such divergences between the Greek authorities and the Commission services on the impact of the 2005 budget do not put into question a rigorous implementation of the measures envisaged in the 2005 budget and, thus, the compliance with Article 1, indent (i) of the Council decision. In addition, the Greek government is committed not only to apply the 2005 budget with rigour but also to implement additional measures, worth half a point of GDP in 2005, which would partly offset the base-year effects of the additional slippage recorded in 2004.

According to the government, the carryover effects in 2006 of the additional measures to be implemented in 2005 should reduce the deficit by 0.9 percentage points of GDP. This does not include potential measures associated with the government's commitment to bring the deficit below 3% of GDP in 2006, since they have not been outlined in detail, and their budgetary impact is made conditional to the growth outturn. In the light of the Commission services spring 2005 forecasts of a deficit of 4.4% of GDP for 2006 and of the Eurostat remarks in its press release of 18 March, such measures might be unavoidable in order to correct the excessive deficit in 2006 even within favourable growth scenarios. Under the usual no-policy-change scenario, the spring 2005 forecast are based on a more cautious Commission's assessment of the developments in some budget items, such as social contributions, public wages, and EU grants[8], although, in the Commission view, the interest payments might be somewhat lower than projected in the programme[9]. Overall, the deficit in 2006 might turn out 0.6 percentage points of GDP higher than projected by the Greek authorities. On top of that, the Eurostat press release of 18 March indicates that the deficit figures for 2004 may have to be revised upwards. Since the Greek authorities have not foreseen compensatory measures to be implemented in 2005 to offset such additional slippages, potential carryover effects of statistical revisions would result in a higher deficit outturn in 2005 and thus in 2006.

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6 Specifically, the programme projections imply an increase of the effective social contributions rate (the ratio between social security receipts and total compensation of employees) of more than one percentage point. The programme seems to project the high increases recorded in the past to the future, which does not seem to be justified.

7 The large decline, in terms of GDP, of the wage bill and intermediate consumption projected in the draft budget would be in stark contrast with developments recorded in the recent past, when such items exhibited strong resilience and were the source of significant budgetary slippages.

8 On social contributions and wages, the divergences between the Greek government and the spring 2005 forecasts arise from the same factors as in 2005 (see footnotes 4 and 5 above), amplified, in the case of social contributions, by the carryover effects of the divergence in 2005. Where EU grants are concerned, the issues raised by Eurostat, coupled with the low absorption capacity recorded in the past, warrant this more cautious Commission's assessment.

9 According to the programme, interest payments should grow by more than 9% in nominal terms in 2006. Such an increase does not seem supported by the projected debt and interest rate developments. Therefore, in terms of GDP, the outcome might be below the figure in the programme.

Overall, the Commission considers that there exist risks in the form of revenues shortfalls, expenditure overruns and statistical revisions that, if materialised, would result in deficit outturns for 2005 and 2006 higher than projected in the stability programme. While such slippages in 2005 would not affect compliance with the Council notice addressed to Greece on 17 February 2005, their occurrence in 2006 would require additional measures, in line with the commitment by the Greek government. Whether the announced additional 2006 package would be enough to ensure that the deficit is effectively reduced below the 3% reference value next year should be assessed on the basis of the 2006 draft budget.

Where debt is concerned, it appears that significant steps have been taken to identify the different sources of the SFAs. According to the Commission services spring 2005 forecasts the information provided in the revised update of the stability programme indicates that SFAs, albeit still significant in 2005 and 2006, are declining compared to 2004. This seems to confirm the commitment of the Greek authorities to further pursue efforts to identify and control below-the-line operations.

Compared with the March 2004 notification, the pending issues on the collection and processing of government data, as outlined by Eurostat in the press release of 18 March, seem to be better identified and, in some cases, circumscribed to problems of a one-off nature, such as the recording of Olympic Games' expenditures. In addition, a number of statistical revisions have been carried out at the initiative of the Greek authorities, within a framework of close cooperation with Eurostat. Nevertheless, the existence of such pending issues indicates that further efforts appear necessary with a view to improve the mechanisms that ensure the prompt and correct supply of the general government data.

CONCLUSIONS

On current information, the Greek government has taken, by the deadline of 21 March 2005, decisions consistent with the recommendations in the Council decision in accordance with Article 104(9). Specifically, besides implementing with rigour the 2005 budget, as required by the decision, the government has also taken additional measures to reduce the deficit further. As to 2006, information provided indicates that the implementation of additional measures may be needed within the 2006 budget to bring the deficit below the 3% of GDP. However, the government's commitment made public on 29 March, to ensure the correction of the excessive deficit by 2006 if necessary by undertaking additional measures, is in line with the recommendations of the Council. Where debt developments and general government data are concerned, additional efforts appear necessary to better identify and control the factors, other than net borrowing, that contribute to the change in debt levels and to improve the collection and processing of general government data.

Based on this assessment, the Commission considers that no further steps in the excessive deficit procedure of Greece are needed at present. The EDP notification of September this year, the presentation of the draft budget for 2006, and the Commission services autumn 2005 forecasts, together with the report to be presented in October by the Greek authorities, as foreseen in the Council decision of 17 February 2005, will provide additional information on the basis of which a new assessment of compliance with this decision will be made before the end of the year.