COMMISSION OF THE EUROPEAN COMMUNITIES

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Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Article 5 of Council Regulation (EC) n°1466/97 of 7 July 1997 on the updated stability programme of Greece, 2001-2004

(presented by the Commission)

EXPLANATORY MEMORANDUM

Council Regulation (EC) No. 1466/97, on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[1], stipulated that countries participating in the single currency were to submit stability programmes to this Council and the Commission by 1 March 1999. In accordance with Article 5 of the Regulation, the Council had to examine each stability programme based on the assessments prepared by the Commission and the Committee set up by Article 114 of the Treaty (the Economic and Financial Committee). The Commission adopted a recommendation on each programme. On the basis of this recommendation and after having consulted the Committee set up by Article 114, the Council delivered an opinion, following its examination of the programme.

The first stability programme of Greece covering the period 2000-2004 was submitted in December 2000 and assessed by the Council on 12 February 2001[2].

According to the Regulation, the updated stability programmes, to be presented annually, may be examined by the Council in accordance with these same procedures.

Greece submitted its updated stability programme, covering the period 2001-2004, in December 2001. The Commission services have carried out a technical evaluation of this updated programme, which warrants the following assessment.

> The first update of the stability programme of Greece was submitted in December 2001 and covers the same period as the initial stability programme, from 2001 to 2004. The update highlights the main objective of the Greek authorities that is achieving real convergence, in the new context created by participation in the euro zone. However, the deceleration in the world economy has entailed some downward revision of the projections for the period to 2004. This explains – but only to a certain extent – that the compliance with the Broad economic policy guidelines has been partial. The update provides the information asked in the 2001 Council opinion on the implications of the cost of ageing population, as well as on developments in the government debt. In general terms, the update conforms with the requirements of the Code of Conduct on the content and format of the programme.
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> In 2001, the economic performance of Greece was negatively influenced by the deteriorating external environment; nevertheless, real GDP growth is estimated to have reached 4.1%, boosted by dynamic domestic demand, in particular strong investment related to the Olympic Games of 2004, and supported by a considerable flow of EU financial resources; private consumption was also buoyant supported by an unprecedented expansion in consumer credit; in contrast, the external balance provided a negative contribution to the economic growth. In 2002, real GDP growth is projected to reach 3.8% and close to 4.0% in 2003 and 2004. These medium-term projections represent a downward revision of those included in the 2000 stability programme, embodying a persisting negative contribution from external trade, but also more realistic medium term prospects for domestic demand, particularly investment.

1 OJ L 209, 2.8.1997
2 OJ C 77, 9.3.2001

Inflation resurgence was identified as a main area of concern in the 2000 stability programme. In fact, the effects of surging energy prices in 2000 have been progressively reabsorbed since the Summer 2001 and consumer prices increases have been decelerating since then; second round inflationary effects are still affecting underlying inflation which is nonetheless moderating as well as wholesale prices[3]. The collective two years wage agreement for the private sector of May 2000 has indeed limited wage increases until now; however, adjustment of wages for inflation in early 2002 as well as the renegotiation of the agreement in 2002 may result in some acceleration in compensations. Under these circumstances, inflation will continue to require close attention, particularly in a context of buoyant activity.

The budgetary adjustment projected in the 2000 stability programme for the years 2001 and 2002 was negatively affected by the cyclical conditions; in 2001, the general government accounts reached a surplus of 0.1% of GDP, - including non-budgeted receipts from the UMTS licences equal to 0.4% of GDP -, instead of a projected surplus of 0.5% of GDP. This was due to both a shortfall in tax revenues and to an overrun in primary expenditure (mainly wages and transfers). In 2002, the government surplus is expected to increase to 0.8% of GDP while it was previously projected to reach 1.5% of GDP. In 2003 and 2004, the projected surplus is almost halved as against the level expected in the 2000 stability programme: it should average 1.1% of GDP instead of 2% of GDP. At the same time the decline forecast for the government gross debt ratio is also decelerated compared with the projections included in the 2000 stability programme: the debt ratio is currently expected to decline from 99.6% of GDP in 2001 to 90% of GDP instead of 84.0% of GDP in 2004.

The budgetary projections included in the 2001 update were close to balance in 2001 and turn into a surplus from 2002, both in nominal and cyclically adjusted terms. They are in compliance with the requirements of the Stability and Growth Pact.

However, these projections underlie a pattern of adjustment which raises some concern. It is to be reminded that the government debt ratio to GDP is still very high, its reduction slow and persistently affected by autonomous factors (large stock-flow adjustments, averaging 4% of GDP in the period 2001-2004); a more robust policy of debt reduction would be welcome. Yet, from 2002 to 2004 no further genuine budgetary adjustment results from the projections as, basically, the improvement in the government surplus almost mirrors the steady decrease in interest payments. Moreover, the recent persistence of the high stock-flow adjustment in debt developments raises doubts about the quality of the budgetary adjustment.

The level of the general government primary surplus – lowered to the 6% of GDP area from 7% of GDP in the 2000 stability programme - is progressively declining from 6.4% of GDP in 2002 to 6.0% of GDP in 2004 and practically no retrenchment in current primary expenditure is projected throughout the period covered by the 2001 update. High primary surpluses are, however, indispensable to secure a fast

3 The rate of growth of the CPI (national definition) accelerated in the first half of 2001, reaching 3.9% in June-July, but decelerated since then, to 3.0% in December 2001. The underlying index (consumer prices excluding fresh food and fuels) rose by 3.3% in December 2001 from 4.1% in June 2001 (its highest annual rate since early 1999), thus, marginally exceeding the headline rate by 0.3 percentage points. Wholesale prices rose by an annual rate of 0.2% in November 2001, from a high of 5.4% in June 2001.

decline in the debt ratio, a necessary condition to cope with the consequences of the ageing population.

Moreover, the sectoral structure of the government balance is evolving: the social security surplus tends to decrease in line in particular with the ageing population, and declines from 2.4% of GDP in 2001 to 1.3% of GDP in 2004,while the bulk of the budgetary improvement falls on the central government. In this respect, it must be noted that the central government accounts are the most sensitive to cyclical conditions. It is acknowledged that the Greek economy is experiencing a phase of fast medium term growth in the framework of a real convergence process; however, current high real GDP growth rate are related to very specific conditions, that is, high investment for the preparation of the Olympic Games in 2004 and falling interest rates. In such a context, the Greek authorities should take advantage of the current strong economic performance to improve further the budgetary situation, in order to prepare for less favourable conditions which might materialize in the medium term, to ensure the reduction of the sizeable debt burden and to face the costs of the ageing population.

From the projections provided in the update concerning the long-term sustainability of public finances, it results that a very serious risk of budgetary imbalances may emerge in the future due to ageing population; large primary surpluses will have to be sustained for a long time in order to accelerate debt reduction and provide sufficient margins for the increasing budgetary costs implied. Clearly, continued compliance with the Stability and Growth Pact in the long-term does not allow any relaxation in the budgetary adjustment effort.

The 2001 update summarises the reforms under way aimed at improving the functioning of product, services, capital and labour market. The issue of the social security reform is mentioned as a top priority in the government agenda; indeed, such reform is also needed to ensure the sustainability of public finances. However, the social dialogue which should launch the reform has been considerably delayed with respect to the 2000 stability programme plans.

Based on this assessment, the Commission has adopted the attached recommendation for a Council opinion on the updated stability programme of Greece and is forwarding it to the Council.

Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Article 5 of Council Regulation (EC) n°1466/97 of 7 July 1997 on the updated stability programme of Greece, 2001-2004

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[4], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On [12 February 2002] the Council examined the 2001 update of the stability programme of Greece, which covers the period 2001-2004.

Real GDP growth remained robust in 2001, at 4.1%, although lower than projected in the 2000 stability programme, as a result of the deterioration in the external environment. Inflation resurgence under the impact of increasing energy prices in 2000 started to decelerate since the Summer 2001 but the improvement might weaken in the coming months. The general government accounts are estimated by the updated programme to reach a 0.1% of GDP surplus in 2001 (including non budgeted UMTS receipts of 0.4% of GDP) instead of 0.5% of GDP as projected in the 2000 stability programme.

The updated stability programme projects annual real GDP growth of around 4% in yearly average for the period 2002-2004 as against 5.4% in the 2000 stability programme. The Council considers the projected real GDP growth, which should be underpinned by high private and public investment, as attainable. The Council notes that the budgetary projections remain in surplus throughout the period of the programme in both actual and cyclically-adjusted terms and that they respect the close to balance or surplus requirement of the Stability and Growth Pact.

The Council notes that the government debt ratio is currently expected to decline from 99.6% of GDP in 2001 to 90.0% of GDP in 2004 instead of 84.0% of GDP as projected in the 2000 stability programme. The Council also notes that the improvement in the government balance in the period from 2002 to 2004 primarily relies on the steady reduction in interest payments; in contrast, no retrenchment in current primary expenditure is expected. Furthermore, the ratio

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4 OJ L 209, 2.8.1997

of the general government primary surplus to GDP, although reaching a high level until 2004, progressively declines throughout the period. The Council regrets that no clear binding norm for current primary expenditure has been defined by the Greek authorities as it was recommended in its opinion on the 2000 stability programme[5].

The Council regrets the absence of further budgetary adjustment effort until 2004. In the short-term, vigilance should be maintained regarding price developments in particular if the forthcoming wage negotiations will not lead to wage moderation. Furthermore, taking into consideration the still very high level of the government debt ratio, as well as the perspective of increasing budgetary costs stemming from the ageing population, the Council urges the Greek government to take advantage of the current favourable macroeconomic situation to reduce the government debt as fast as possible. The Council notes that the debt reduction foreseen in the programme is much slower than what would be warranted by expected GDP growth and the projected primary surplus. The Council urges the Greek government to limit the use of financial operations which are not recorded in the budget.

The Council notes that strengthening structural reforms is a key economic policy objective of the updated programme; the Council considers that although considerable progress has been made in recent years in this area, implementation of structural reforms must continue in the product, services and labour markets in order to enhance the efficiency of markets and the competitiveness of the economy; the Council encourages the government to proceed to the necessary reforms rapidly. The Council welcomes the intention of the government to implement reforms in the area of budgeting and management of expenditure in the public sector.

The Council welcomes the information provided in the updated programme on long-term sustainability of public finances. The Council considers that there is a serious risk of budgetary imbalances emerging in the future due to the ageing population and that there is a need to reform the public pension system. The Council notes that no progress was made in this area in 2001 and that the updated programme does not include any specific plans or timetable for pension reform. The Council recommends that the government proceeds to the reform of the pension system with no further delay.

5 OJ C 77, 9.3.2001