COUNCIL OF
THE EUROPEAN UNION

Brussels, 16 February 2010

6560/10

UEM 49

NOTE

From:	Secretariat General of the Council
to:	Delegation
Subject:	Council Opinion on the updated Stability Programme of Greece, 2010-2013

Delegations will find attached the Council Opinion on the updated Stability Programme of Greece, 2010-2013, as adopted by the (Ecofin) Council on 16 February 2010.

Encl.:

COUNCIL OPINION

On the updated stability programme of Greece, 2010-2013

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of European Union,

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 coordination of economic policies[1], 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:

(1) On [16 February 2010], the Council examined the updated stability programme of Greece, which covers the period 2010 to 2013.

(2) Greece has experienced strong economic growth at 4% per year over the past ten years. In parallel, domestic and external macroeconomic imbalances have widened considerably, which have led to a rapid accumulation of external debt while government debt remained very high. In the light of the impact on the Greek economy of the global economic and financial crisis, the implied re-pricing of risks puts further pressure on these debt burdens, and raises risk premia on government debt.

[1] OJ L 209, 2.8.1997, p. 1. The documents referred to in this text can be found at the following website: http://ec.europa.eu/economy_finance/sgp/deficit/legal_texts/index_en.htm

(3) According to the Commission services' autumn 2009 forecast, real GDP contracted in 2009 by around 1% and growth is expected to remain negative in 2010. The downturn has taken a heavy toll on public finances. As public revenue depends strongly on indirect taxation, weak consumption, coupled with shortcomings in the tax administration, has translated swiftly into lower tax receipts and significant revenue shortfalls as compared to plans. Major overruns occurred on the expenditure side, notably in the health sector and with regard to public wages. In addition, the economic downturn has burdened social protection expenditure, leading to a further fiscal deterioration. With the general government deficit well above 3% of GDP on average over the past ten years, and recurrently large debt-increasing financial operations, government debt-to-GDP ratio already exceeds 100% of GDP. Greece urgently needs to cut government deficits and reduce government debt through permanent expenditure cuts and revenue increases, and strengthen government's intentions in relation to structural reforms in social security, the budgetary process, tax system, and the compilation of statistics. Greece is facing the challenge to achieve substantial fiscal consolidation, while improving the quality of public finances and correcting the factors behind the large domestic and external imbalances of the economy, under an unfavourable macroeconomic context.

(4) The central macroeconomic scenario underlying the programme envisages that real GDP growth will remain negative in 2010 (-1.1% in 2009; -0.3% in 2010) before picking up again to 2% on average over the rest of the programme period. Assessed against currently available information, the macroeconomic scenario for 2010 and thereafter appears optimistic. In particular real investment growth, although negative, is projected to benefit from a number of government's initiatives to support investment and enhance the absorption of EU structural funds. However, within a context of tighter credit conditions, external financing could prove less benign and so the servicing of Greece's fast-rising external debt might further crowd out investment. Moreover, in spite of the improving Greece's trading partners' economic outlook, the still fragile international trade prospects and the mounting competitiveness losses over the years, entail considerable downside risks to the macroeconomic scenario of the programme, reflecting mainly the vulnerability of the shipping and tourism sectors to the current juncture. The programme's projections for inflation appear to be realistic, while the evolution of the external imbalances in the medium term is somewhat favourable. According to the alternative, and more realistic, macroeconomic scenario, real GDP would contract by 0.8% in 2010, before picking up again and grow by 1% in 2011, 1.5% in 2012 and 2% in 2013.

(5) For 2009, the official government deficit estimate stands at 12¾% of GDP, compared with the budgetary target of 3.7% of GDP included in the previous update of the stability programme (the 2009 estimate includes a net deficit-increasing impact of temporary nature of 1¼% of GDP). The much higher-than-budgeted 2009 deficit is only partially explained by the unfavourable macroeconomic conditions. According to the estimates in the programme, real GDP growth in 2009 was -1¼%, while the previous programme had projected real growth of 1.1%. However, only a relatively small part of the fiscal slippages in 2009 is attributable to the working of automatic stabilizers as the economy entered a recessionary phase. Another part of the deficit slippage is related to a base effect due to the large upward revision in the 2008 general government deficit (in October 2009, the 2008 deficit ratio was revised upwards by 2¾% of GDP, as compared to data reported in spring)[2]. On top of these factors, the deterioration in the government deficit reflects revenue shortfalls of 2½% of GDP and expenditure overruns of almost 2½%% of GDP, compared to the budgetary target in the January 2009 update of the stability programme. The bulk of the revenue shortfall is a result of deficiencies in the tax collection mechanism. More specifically, indirect taxes shrunk by 1¼% of GDP, while social contributions fell by almost ½% of GDP, confirming also that the initial budgetary revenue projections underpinning the budgetary target were markedly favourable. On the expenditure side, a number of one-off expenditures, amounting to around 1¼% of GDP have contributed to the expenditure overruns. On top, the public wage bill went up by some 0.7% of GDP relative to the target in the previous update of the Greek Stability Programme. These expenditure and revenue slippages more than offset the fiscal consolidation measures announced by the government in June 2009[3], which at the end, have only been partially implemented in the course of the year[4].

---

[2] According to Article 15(1) of Council Regulation (EC) No 479/2009, Eurostat has expressed a reservation on the quality of data reported by Greece, due to significant uncertainties over the figures notified by the Greek statistical authorities (Eurostat News Release 149/2009 of 21 October 2009). The Eurostat's reservation on the Greek government finance statistics has not yet been withdrawn. See also the Commission's Report on Greek Government Deficit and Debt Statistics - COM(2010) 1, 8.1.2010.

[3] The bulk of the planned measures aimed mainly at increasing revenue on a temporary (tax settlement, supplementary tax contribution for high-income earners, levy on buildings with land-use violations, etc.) or permanent (increase in excise duties on tobacco and alcohol, higher tax rate on dividends and stock options, etc.) basis. On the expenditure side, some measures (such as reduction in current expenditure, wage and pension freeze in the public sector, reduction in overseas development aid, etc.) were announced in the course of the year.

[4] For example, the imposition of a levy on buildings with land-use violations (with an estimated budgetary impact of around ½% of GDP) announced in June was not implemented, as it has been declared unconstitutional by Greek courts. Further examples of measures that yielded less than the initially planned amounts included the wage and pension freeze in the public sector, the extension of the deadline for tax settlement, duties on mobile phone use, levies on yacht owners, etc.

(6) According to the update, the deficit target for 2010 is set at 8.7% of GDP. Compared with the budgetary target set in the 2010 budget law, approved by the Parliament on 23 December 2009, the current budgetary target represents a downward revision by ½ % of GDP. The revised general government budgetary target for 2010 implies a reduction in the headline deficit of 4 percentage points of GDP, reflecting an increase in total-to-GDP ratio revenue by 2.6 percentage points of GDP and a reduction in total expenditure-to-GDP ratio of 1.4 percentage point of GDP. Thus, the bulk of the adjustment is planned to be achieved from the revenue side of the budget, on the back of the implementation of temporary revenue enhancing measures of some ¼% of GDP (revenue from the financial sector liquidity scheme, special tax on highly profitable enterprises and large real estate) and a permanent tax revenue-enhancing package, which are expected to be adopted by Parliament in March 2010. On the expenditure side, the foreseen retrenchment reflects the discontinuation of the one-off expenditures of more than 1¼% in 2009, while the impact of a number of permanent spending cuts announced, is actually cancelled out by an increase in education and security spending, health-care services and public investment by a total of ½ % of GDP. The update presents a detailed package of tangible fiscal consolidation measures, providing also the estimated quantification of each one of the measures included, as well as the timeframe of their adoption and implementation, aiming at increasing tax revenue and enhancing collection, and to a lesser extent, constraining primary public expenditure. The overall stance of fiscal policy will be appropriately restrictive in 2010.

(7) On 11 February 2010, the European Council considered the fiscal situation in Greece, supported the Greek government's efforts and commitment to do whatever is necessary, including adopting additional measures, to ensure that the ambitious targets set in the stability programme are met, and called on Greece to implement all measures in a rigorous and determined manner to effectively reduce the fiscal deficit ratio by 4% percentage points of GDP in 2010.

(8) After targeting 8.7% of GDP in 2010, the headline deficit is projected to decline over the programme period to 5.6% of GDP in 2011, 2.8% of GDP in 2012 and 2% by 2013. Similarly, the primary balance will reach a surplus of 3.2% of GDP by 2013, which compares with a deficit of 3.5% in 2010. The budgetary strategy aims at reducing the structural deficit from 11½% of GDP in 2009 to 7¾% in 2010, 4¾% in 2011, 2¼% in 2012 and 2% by 2013. The medium-term objective (MTO) of a balanced budget in structural terms is not projected to be attained within the programme horizon. Budgetary consolidation in 2011 to 2013 is mainly based on an ambitious revenue enhancement and expenditure retrenchment plan, which is however, not fully backed with concrete measures so far.

(9) Government gross debt, estimated at 113.4% of GDP at the end of 2009, is projected to exceed 120% of GDP at the end of 2010, before returning to a downward path in 2012. Apart from the rise in the deficit and the decline in GDP growth, a significant stock-flow adjustment contributed to the rise in the debt ratio in 2009, because of financial transactions related to the financial sector liquidity scheme and the settlement of expenditure arrears. For the outer years in the programme, the factors other than the deficit which contribute to increase the debt are estimated to shrink markedly, amounting to 0.2% of GDP per year.

(10) The budgetary outcomes are subject to substantial downside risks. In particular, the underlying central macroeconomic scenario is based on favourable growth assumptions. Risks in the implementation of the revised 2010 budgetary target are large, especially when taking into account that the expected gains from the fight against tax evasion are optimistic. Moreover, the demand composition may be less tax-rich than anticipated by the programme. From 2011 onwards, risks stem from the lack of detailed information on the measures to support the envisaged consolidation, particularly on the expenditure side, while the envisaged cuts in some expenditure categories appear, *prima facie*, ambitious. Risks associated with the projected evolution of the debt-to-GDP ratio mirror the risks attached to the deficit and GDP projections. These risks may be compounded by uncertainty about the stock-flow adjustments in which, although significantly lower compared to the past, the programme does not provide information on components (including privatizations). The alternative macroeconomic scenario with lower growth over the programme horizon is more prudent and appears more plausible. Nevertheless, the annual fiscal targets over the programme horizon do not differ from the central scenario, implying that the Greek government would take the necessary additional, for the time being unspecified, fiscal consolidation measures, even in the case of less favourable macroeconomic developments.

(11) The lack of a medium-term budgetary framework for a time-consistent fiscal planning has contributed to the poor track record in terms of budgetary outcomes. The recurrent deviation of budgetary developments from the initial fiscal plans was also aggravated by the scant centralisation of the budgetary process, a weak monitoring of public expenditure and lack of accountability at the level of line ministries. These shortcomings coupled with systematic upbeat revenue projections have repeatedly led to miss the envisaged fiscal targets. Moreover, structural and endemic problems related to the recording of Greek government accounts, have also been detrimental for timely and effective revenue and expenditure control. The programme envisages the acceleration of the ongoing budgetary reform and further progress with the implementation of programme budgeting, with a view to improving the public expenditure monitoring and management, increasing transparency and introducing a multi-year planning perspective in the budgetary process. The budgetary process reform is planned to be legislated already in 2010 and partly implemented in the 2011 budget, but with full implementation in 2012. Moreover, a number of interventions with a view to improve budgetary process and execution are also foreseen and planned to be legislated already in 2010. The programme also envisages the much necessary overhaul of the Greek statistical system (including the General accounting Office) and the independence of the national statistical authorities.

(12) According to the programme, fiscal policy is geared towards restoring investor confidence and addressing macroeconomic and fiscal imbalances. The programme puts forward a wide package of structural reforms, which are part of the longer-term strategy for improving the quality and sustainability of public finances. More specifically, the government has already submitted to Parliament the draft law to render the statistical service independent, and plans to set up budget execution monitoring office under the auspices of Parliament and adopt binding fiscal rules for the effective medium-term preparation and execution of the budget. In the medium-term and no later than 2011, the Greek authorities commit to launch the programme (or activity-based) budgeting which by 2012 will fully substitute the current system. This will also be framed in a binding multi-year budget framework and based on a double-entry accounting system. In addition, a pension reform is expected to be implemented by June 2010. However, given the ongoing social dialogue, which will be concluded by April 2010, only limited information on the details of the envisaged reform is provided in the update. Moreover, a wide reform package is also presented in the programme, putting forward policies in the areas of promoting environmentally friendly investment projects, and revising the current Investment Law, promoting Public Private Partnerships and establishing a Hellenic Development Fund, containing inflationary pressures through better market regulation, implementing active labour market policies, improving public administration, increasing transparency and accountability, reducing the number of municipalities and local councils, supporting investment in research, technology and innovation. These measures are related to the medium-term reform agenda and the country-specific recommendations adopted by the Council on 25 June 2009[5].

[5] OJ L 183, 15.7.2009, p. 1

(13) The Greek public finances are at high risk in relation to their long-term sustainability in view of the very large projected increase in age-related public expenditure and the fact that measures taken to date in order to address this issue have been insufficient in tackling the problem: the long-term budgetary impact of ageing is among the highest in the EU, influenced notably by a very considerable projected increase in pension expenditure. Achieving high primary surpluses over the medium term and, as recognised by the authorities, implementing measures aimed at curbing the substantial increase in age-related expenditures, including by increasing the effective pension age, and a change in the pension award formula to better reflect contributions paid during the whole working life and improve generational fairness would contribute to reducing the high risk to the sustainability of public finances.

(14) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme has some gaps in the optional data[6].

The overall conclusion is that the programme displays an appropriate degree of ambition given the sheer size of the consolidation need and is frontloaded. The fiscal consolidation in 2010 focuses more on public revenue enhancement and to a lesser extent, on public spending retrenchment, while the composition of the fiscal adjustment is planned to be more balanced between revenues and expenditures in the outer years. The programme presents a package of concrete fiscal consolidation measures for 2010, providing also the estimated quantification of each one of the measures included, as well as the timeframe of their adoption and implementation. Some of these measures have already been submitted to Parliament and are to be implemented shortly. However, the plans for 2011, 2012 and 2013 are much less detailed. The programme provides a wide range of budgetary measures and structural reforms in order to address the structural imbalances of the Greek economy and to reverse the upward trend of public debt. Potential delays in rigorously implementing these measures remain a source of risk. Moreover, the budgetary strategy is also subject to significant downside risks, with the growth assumptions underlying the central macroeconomic scenario of the programme being favourable.

[6] In particular, general government expenditure by function and information on debt developments and the components of stock-flow adjustment (differences between cash and accruals, net accumulation of financial assets, valuation effects and other), liquid financial assets and net financial debts are not provided.

Consolidation relies also, on the results from the improvement of the tax collection mechanism, widening of the tax base and increase of tax compliance. The proceeds from the fight against tax evasion constitute a large component of the overall consolidation effort in 2010 and are subject to large risks. Given the several risks bearing on budgetary implementation, ensuring the fiscal consolidation path by implementing promptly and rigorously the measures presented in the stability programme and standing ready to adopt sufficient additional measures, appears necessary. In addition, the structural nature of the factors underlying competitiveness losses and the widening external imbalances urgently requires the prompt implementation of bold structural reforms, including the ones presented in the programme. In the long term, the level of debt which remains among the highest in the EU, coupled with the projected increase in age-related spending, affects negatively the long-term sustainability of public finances.

The Council is also addressing to the Hellenic Republic a recommendation under Article 121(4) and a notice to take action under Article 126(9) on 16 February 2010.

Comparison of key macroeconomic and budgetary projections

		2008	2009	2010	2011	2012	2013
Real GDP (% change)	**SP Jan 2010**	**2.0**	**-1.2**	**-0.3**	**1.5**	**1.9**	**2.5**
	SP Jan 2010 (alternative)	2.0	-1.2	-0.8	1.0	1.5	2.0
	COM Aut 2009	2.0	-1.1	-0.3	0.7	n.a.	n.a.
	SP Jan 2009	**3.0**	**1.1**	**1.6**	**2.3**	n.a.	n.a.
HICP inflation (%)	**SP Jan 2010**	**4.2**	**1.2**	**1.4**	**1.9**	**1.8**	**1.8**
	COM Aut 2009	4.2	1.2	1.4	2.1	n.a.	n.a.
	SP Jan 2009	**4.3**	**2.6**	**2.5**	**2.4**	n.a.	n.a.
Output gap([1]) (% of potential GDP) ([2])	**SP Jan 2010**	**2.5**	**-0.5**	**-2.6**	**-2.7**	**-2.1**	**-1.2**
	COM Aut 2009	2.8	-0.2	-2.1	-2.9	n.a.	n.a.
	SP Jan 2009	**1.9**	**0.3**	**-0.8**	**-1.0**	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**SP Jan 2010**	**-12.4**	**-8.8**	**-6.6**	**-5.9**	**-4.9**	**-4.0**
	COM Aut 2009	-12.4	-7.5	-6.8	-6.7	n.a.	n.a.
	SP Jan 2009	**-12.8**	**-11.4**	**-10.8**	**-10.0**	n.a.	n.a.
General government revenue (% of GDP)	**SP Jan 2010**	**40.6**	**39.3**	**42.4**	**44.0**	**45.4**	**45.7**
	COM Aut 2009	40.6	37.3	37.2	37.0	n.a.	n.a.
	SP Jan 2009	**40.0**	**41.0**	**41.1**	**41.2**	n.a.	n.a.
General government expenditure (% of GDP)	**SP Jan 2010**	**48.3**	**52.0**	**51.1**	**49.6**	**48.2**	**47.7**
	COM Aut 2009	48.3	50.0	49.5	49.9	n.a.	n.a.
	SP Jan 2009	**43.7**	**44.7**	**44.3**	**43.8**	n.a.	n.a.
General government balance (% of GDP)	**SP Jan 2010**	**-7.7**	**-12.7**	**-8.7**	**-5.6**	**-2.8**	**-2.0**
	COM Aut 2009	-7.7	-12.7	-12.2	-12.8	n.a.	n.a.
	SP Jan 2009	**-3.7**	**-3.7**	**-3.2**	**-2.6**	n.a.	n.a.
Primary balance (% of GDP)	**SP Jan 2010**	**-3.2**	**-7.7**	**-3.5**	**-0.2**	**2.6**	**3.2**
	COM Aut 2009	-3.2	-7.7	-6.6	-6.7	n.a.	n.a.
	SP Jan 2009	**0.3**	**0.8**	**1.2**	**1.7**	n.a.	n.a.
Cyclically-adjusted balance([1]) (% of GDP)	**SP Jan 2010**	**-8.8**	**-12.5**	**-7.6**	**-4.4**	**-1.9**	**-1.5**
	SP Jan 2010 (alternative)	-9.1.	-12.8.	.-7.7	-.4.5	-1.9.	-1.5.
	COM Aut 2009	-8.9	-12.6	-11.3	-11.6	n.a.	n.a.
	SP Jan 2009	**-4.5**	**-3.8**	**-2.8**	**-2.2**	n.a.	n.a.
Structural balance([3]) (% of GDP)	**SP Jan 2010**	**-8.9**	**-11.4**	**-7.9**	**-4.4**	**-1.9**	**-1.5**
	SP Jan 2010 (alternative)	-9.2	-11.7.	-7.8	-4.5	-1.9	-1.5
	COM Aut 2009	-8.1	-11.3	-11.3	-11.6	n.a.	n.a.
	SP Jan 2009	**-4.5**	**-4.3**	**-2.8**	**-2.2**	n.a.	n.a.
Government gross debt (% of GDP)	**SP Jan 2010**	**99.2**	**113.4**	**120.4**	**120.6**	**117.7**	**113.4**
	COM Aut 2009	99.2	112.6	124.9	135.4	n.a.	n.a.
	SP Jan 2009	**94.6**	**96.3**	**96.1**	**94.7**	n.a.	n.a.

Notes:

([1]) Output gaps and cyclically –adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

([2]) Based on estimated potential growth of 1.6%, 1.5%, 1% and 1.1% respectively in the period 2010-2013.

([3]) Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 1¼%% of GDP in 2009 (deficit increasing) and ¼% of GDP in 2010 (deficit-reducing) according to the most recent programme.

Source: *Stability programme (SP); Commission services' Autumn 2009 forecasts (COM); Commission services' calculations.*