EUROPEAN COMMISSION
DIRECTORATE GENERAL
FOR ECONOMIC AND FINANCIAL AFFAIRS
Economies of the Member States
Member States: Bulgaria, Greece, Spain, Cyprus, Portugal

Brussels, 02.07.2009
ECFIN/F3//D(2009)/ARES/154115

SGP-implementation and follow-up to the Eurogroup in Prague (recent measures taken in Greece)

(Note for the Eurogroup)

1. Introduction

In the light of the need to tackle the challenges of the economy's deteriorating competitive position over recent years, the build up of domestic and external imbalances and the persistence of public deficits and high debt levels, the Eurogroup has invited the Greek authorities to set out an ambitious consolidation strategy within the framework of a comprehensive economic reform package. In April Chairman Juncker wrote a letter calling the Greek Minister to report back at the Eurogroup meeting on 8 June 2009 on the additional measures taken or planned by the Greek authorities, on top of those already included in the latest update of the stability programme. Minister Papathanassiou in his reply, confirmed the government's commitment to achieve the budgetary target of 3.7% of GDP in 2009 and bring the deficit below 3% of GDP in 2010, as recommended by the Council in accordance with Article 104(7) of the Treaty.

Minister Papathanassiou presented the additional set of measures to be implemented in 2009, in a press conference on 25 June. The fiscal package mostly consists of revenue enhancing measures, amounting to around 1 percentage point of GDP. The major part of these measures (of around 0.7 of percentage point of GDP) is temporary in nature (one-offs). The Greek government has committed to proceed with implementing permanent deficit-reducing measures and structural reforms in 2010, which will be included in the 2010 budget, although no details have been made public on the concrete measures to be adopted.

2. Economic situation – unsustainable domestic and external imbalances

Greece has experienced strong economic growth at 4% per year over the current decade. In parallel, domestic and external macroeconomic imbalances have widened considerably, having led to a rapid foreign debt accumulation while public debt remains at high levels. With the gradual unfolding of the ongoing economic crisis, especially since the second half of 2008, the heightening uncertainty has proven to be detrimental to both consumer and business confidence, weakening economic activity and future prospects of the Greek economy. As a result, economic growth decelerated to 2.9% in 2008, down from 4% in 2007 (annex, table 1). According to the Commission services' spring 2009 forecast, growth is expected to turn negative in 2009, at around –1%, before recovering only mildly in 2010. This compares with more recent forecasts by the OECD and the IMF, which stand at -1.3% and -1.5% in 2009 respectively and largely confirmed by the flash estimates for the first quarter of 2009. Real GDP in the first quarter grew by just 0.3% (y-o-y), broadly in line with the spring 2009 forecast (0.5%, y-o-y), compared with a growth rate of 2½% (y-o-y) in the fourth quarter of 2008. On 25th June, Minister Papathanassiou stated that real GDP growth in 2009 would be much lower than the central macroeconomic scenario of +1.1% included in the January 2009 update of the stability programme and would hover around zero. However, no official update of the authorities' macroeconomic projections has been provided so far. Compared to the Commission services' spring 2009 forecast, the authorities' macroeconomic scenario in the stability programme entails more favourable growth assumptions, which, in the light of first quarter data, seem clearly outdated.

The combination of high economic growth, deteriorating competitiveness and persistent fiscal imbalances has worsened the external balance of the Greek economy, with the current account deficit reaching 12¾% of GDP in 2008, from a close-to-balance position in the mid-1990s.

According to the spring 2009 forecast, the current account deficit is projected to decline somewhat, while staying high at around 11% of GDP in 2009 and 2010. With portfolio investment remaining the main source of its financing, Greece's external position is becoming more vulnerable over time. Total external gross debt has increased from almost 100% of GDP in 2004 to 150% of GDP in the first quarter of 2009. The cumulated stock of liabilities relative to the rest of the world mainly consists of both capital (shares) and debt instruments (bonds and credits), ¾ of which consists of long-term liabilities, mostly issued by the general government (government securities, bonds).

A positive development is that the Greek government has frontloaded its debt refinancing operations and has already raised more than euro 47bn from the market (almost 100% of total needs budgeted for 2009). This however has happened at higher cost (spreads between the German 10-year Bund and 10-year Greek bond are declining but remain above 160 bps) and shorter maturity. These developments reflect the implied re-pricing of risk and the concerns regarding the financing of large external deficits, which require effective and prompt action to reduce government debt and tackle implicit liabilities.

3. Public finances - Recent budgetary developments

Fiscal imbalances have been high and persistent for many years, in spite of the buoyant economic activity up to 2008, and have structural roots. In particular, public deficits reflect insufficient control of public expenditure, while revenue projections have proven to be systematically overoptimistic. Moreover, shortcomings in statistical governance, especially affecting the recording of Greek government accounts until very recently, have also been detrimental for timely and effective revenue and expenditure control. High deficits have led to one of the highest debt ratio in the EU, which not only remains well above the 60% of GDP reference value, but is on an upward path.

The general government deficit, after having exceeded 3½% of GDP in 2007, reached 5% of GDP in 2008, which is 1¼ percentage point of GDP higher than the estimation included in the latest update of the stability programme and almost 2 percentage points higher that the initial 2008 budgetary target. In spite of the higher than expected budgetary outturn in 2008, the Greek authorities have not revised the deficit target for 2009, set in the stability programme, which remains at 3.7% of GDP. According to the spring 2009 forecast, the public deficit is projected to remain at around 5% of GDP in 2009 and increase further at 5.7% of GDP in 2010, under a no-policy change assumption. This difference of almost 1¼ percentage points of GDP between the official target and the spring forecast for the 2009 deficit, mainly reflects a significantly less favourable growth scenario foreseen by the Commission services and a more prudent assessment of the fiscal measures included in the January 2009 update of the stability programme, including those announced by the Greek government in March 2009 (notably, on the revenue side).

Gross debt is set on an upward path and is projected by the Commission services' spring 2009 forecast, to exceed 103% of GDP in 2009, from 97¾% in 2008. As in the past, a sizeable stock-flow adjustment should contribute to the strong rise in the debt ratio.

On the basis of the most recent budget implementation report for the period January to March 2009 and the related data, some preliminary considerations can be drawn on the 2009 budget execution so far (annex, table 2). The available data are on a cash basis and refer only to the central government's budget implementation. Data on the general government balance (including local government and social security funds) has not been made available. More specifically, the budget implementation for the period January to March 2009 seems to deviate significantly from the annual budgetary targets outlined in the latest update of the stability programme. Should these trends continue over the year the central government deficit would exceed 10% of GDP, which contrasts with the official annual target for the central government deficit of 5% of GDP.

Total revenue (excluding social security contributions) in the first quarter of 2009 has shrunk by 7¾% compared with the respective quarter of 2008, clearly below the budgeted positive annual growth rate of 11¼%. More specifically, net tax revenue (after tax rebates) hardly grew in the first quarter of the year, reflecting the lower-than-anticipated yield of the revenue-enhancing measures included in the 2009 budget. In addition, the decline in capital revenue has been substantially higher than budgeted, while it is expected to return on track in the coming months, mainly due to increased EU funds absorption. Moreover, some of the deficit reducing measures included in the stability programme, as well as the ones announced by the Greek government on a latter stage, had not been implemented in the period January to March 2009 and thus, had no impact on the budgetary outcome of the first quarter of the year. Available soft and hard indicators, point to a more profound economic slowdown than anticipated by the Greek authorities, which could also partly explain the revenue shortfalls vis-à-vis the targets set in the stability programme.

Total expenditure in turn, has grown by almost 40% in the first quarter of 2009, thus overshooting the budgeted annual growth rate of just 7¼% in 2009, mainly due to primary current expenditure overruns and higher-than-budgeted interest expenditures. Capital expenditure has also risen significantly, which was due to the frontloading of investment payments and should be offset by lower spending in the coming months.

The cash-based data available for the first quarter of 2009 seems to broadly confirm the Commission services' spring 2009 forecast for both macroeconomic and fiscal developments in 2009. Apart from the worse-than-planned budget execution, the poor performance of tax revenues in the first months of the year might also be reflecting a much more severe slowdown in the economic activity than anticipated by the Greek government. This is also confirmed by the flash estimates for the first quarter of 2009. Real GDP in the first quarter of 2009 grew by just 0.3% (y-o-y), compared with a growth rate of 2½% (y-o-y) in the fourth quarter of 2008, broadly in line with the spring 2009 forecast (0.5%, y-o-y).

In sum, available budgetary and macroeconomic data for the first quarter of 2009 point to a growth scenario worse than anticipated by the Greek government. In addition, budget execution so far, provides strong indications for sizable fiscal slippages.

4. Fiscal measures taken by the Greek government for 2009

4.1. The 2009 budget and the March fiscal package

On 18 February, on the basis of the data notified by the Greek authorities in October 2008 and validated by Eurostat[1], the stability programme content and the Commission services interim forecast, the Commission initiated the excessive deficit procedure for Greece by adopting a

[1] News Release 147/2008 of 22 October 2008 on the provision of data for the excessive deficit procedure.

report in accordance with Article 104(3) of the Treaty. The report concluded that the requirements concerning the deficit criterion were not fulfilled. In particular, it states that the deficit for 2007 is close to the 3% of GDP reference value, but that the excess over the reference value is not exceptional and temporary in the sense of the Treaty.

Taking into consideration the persistent fiscal and macroeconomic imbalances, large public debt accumulation and mounting concerns regarding the financing of large external deficits, the Council made recommendations to Greece in accordance with Article 104(7) of the Treaty, with a view to bringing the situation of excessive deficit to an end by 2010.

The Council required the Greek government to strengthen the fiscal adjustment in 2009 through permanent expenditure-restraining measures and to continue with fiscal consolidation efforts in 2010, also ensuring the reduction of public debt levels, with a view to recovering competitiveness losses and addressing the existing external imbalances. The Council established the deadline of 27 October 2009 for the Greek government to take effective action and to specify the necessary measures to ensure adequate progress, in line with the recommendations. The assessment of the action to consolidate public finances with the view to correct the excessive deficit by 2010, will take into account all the measures implemented or announced before the above-mentioned deadline.

On 18th March 2009 a set of deficit reducing measures was announced by the Greek authorities. These measures were meant to compensate for the higher-than-expected public deficit in 2008 (5% of GDP), and support the fiscal adjustment efforts in 2009. According to the official estimations, the additional budgetary impact of these fiscal measures would stand at some ½ of a percentage point of GDP, and was included in the Commission services' spring 2009 forecast. Almost half of it is temporary in nature.

On the expenditure side, the government announced freezing public wages in 2009. More specifically, no wage increases will be provided to the public sector employees, with monthly earnings exceeding certain threshold (gross monthly wage of €1.500). Instead of a permanent wage increase, a one-off supplementary allowance will be granted to low-income civil servants and public sectors pensioners. According to the authorities, this measure, coupled also with the reduction of the public sector's employment (starting from 2009, for every two retirees, only one new hiring would be made) should induce permanent savings in the wage bill, which is the largest primary expenditure item. The wage freezing is estimated by the authorities to have a permanent deficit-reducing impact of somewhat more than ¼ percentage points of GDP in 2009, which seem realistic. The budgetary impact from this measure has been already implemented and thus, fully included in the spring 2009 forecast deficit of 5.1% of GDP in 2009.

On the revenue side in turn, the Greek authorities announced a one-off supplementary tax contribution to be imposed to the tax-payers with annual income above 60.000 euro (on the basis of the tax declarations for 2008). According to the official estimations, this will have a one-off deficit reducing impact of less than ¼ percentage point of GDP. This official estimation has been fully included in the spring forecast, as a one-off measure.

Moreover, a new system of detection and collection of tax arrears will be introduced in 2009, with a view to improve tax collection, which, according to the authorities, should yield additional revenues in 2009. However, details on the implementation of this measure, of a one-off nature, have not been made available yet. Taking also into account past experience from similar measures, the budgetary impact of this measure has been assessed with prudence.

4.2. Additional fiscal measures announced in June 2009

On 25 June 2009, the Council of Ministers, chaired by Prime Minister Karamanlis, decided on an additional set of fiscal measures to be implemented in 2009. Minister Papathanassiou presented the details of the deficit reducing measures to the press and outlined the government's strategy to address the widening fiscal imbalances, underlining the deteriorating economic situation and the need for timely and decisive action. Further fiscal consolidation measures and a structural reform package were also decided to be included in the 2010 budget. The draft 2010 budget will be presented in October 2009. Although, according to the Minister, the 2009 fiscal target of 3.7% of GDP would be extremely difficult to achieve, the government remains committed to pursue it, in spite of the lower than expected real GDP growth in 2009.

The announced measures for 2009 are broadly in line with the ones already outlined by the Minister at the Eurogroup meeting on 8th June. More specifically, the additional fiscal measures to be implemented in the course of the year are mostly revenue enhancing measures with a total budgetary impact of some 1 percentage point of GDP. Almost ¾ of a percentage point of GDP are temporary in nature (one-offs).

The set of revenue enhancing measures in 2009 (annex, table 3), which would have a permanent budgetary impact, consists of:

- increases in the excise duties for oil products,
- increases in the usage-fee for cellular phones,
- increases in the tax on lottery and betting winnings,
- the introduction of a usage-fee for large cars and yachts.
- the rapid collection of lawsuit and court fees

The budgetary impact of these measures is assessed by the authorities at around ¼ of a percentage point of GDP, which appears realistic, based also on the experience of similar measures implemented in the past. On top of these revenue enhancing measures, the authorities are committed to intensify their efforts to fight tax evasion.

The one-off measures include (i) the imposition of a capital-levy on buildings with land-use violations, (ii) the sale-and-lease-back of public buildings and (iii) the reduction of the overseas development aid. Concerning the first one-off measure the details of which have not been made public yet, it is extremely difficult to assess its effectiveness. First of all, the imposition of the capital-levy will not be based on a buildings census and a list of detected violations. On the contrary, the building owners who have violated the related legal framework should go on a voluntary basis to the tax offices and declare their violation, by paying a one-off levy, in order to avoid penalties. Thus, it is not clear whether the voluntary nature of the measure should yield the expected revenues. The effectiveness of the second one-off measure is also difficult to be assessed, due to the lack of more concrete information (both qualitative and quantitative), such as the number and the value of the public buildings to be involved in the transaction. It will also depend on the timing of its implementation, which has not been made available yet. In addition, this measure has not been made public by the authorities.

4.3. *A first assessment*

The additional fiscal consolidation measures announced by the Greek government after the submission of the January 2009 update of the stability programme, including also the most recent package announced on 25th June, amount to around 1.5 percentage points of GDP. Some 1 percentage point of GDP is of temporary nature (one-offs). The measures included in the first package announced in March 2009 (of somewhat less than ½ of a percentage point of GDP) have been incorporated in the Commission services' spring 2009 forecast, which projects a general government deficit of 5.1% of GDP in 2009.

In the light of the downward revision of the official macroeconomic scenario, the most recent set of additional fiscal measures for 2009 announced by Mr Papathanassiou's which would have an estimated budgetary impact of 1 percentage point of GDP, does not seem to be in line with the Council's recommendations, according to which: *"...the Greek authorities should strengthen the fiscal adjustment in 2009 through permanent measures, mainly on the expenditure side restraining measures…"*. On the contrary, the Greek government presented an additional deficit reducing plan for 2009 based predominantly on revenue enhancing measures and one-offs. Moreover, the measures do not seem enough to bring the deficit close to the budgetary target of 3.7% of GDP in 2009, especially in view of the deteriorating situation of the macroeconomic outlook of the Greek economy. Available budgetary and macroeconomic data for the first quarter of 2009 point to a worse growth scenario, than anticipated by the Greek government. In addition budget execution so far, provides strong indications for sizable fiscal slippages.

According to the Commission services spring 2009 forecast, which has not incorporated the June fiscal measures, the 2009 deficit would reach 5.1% of GDP. Even taking at face-value the measures presented by the authorities of some 1 percentage point of GDP, the 2009 deficit would be higher than 4% of GDP (annex, table 4). In structural terms, the impact of the recent set of measures will be 0.3 percentage points of GDP on the structural deficit, which from 6½% of GDP in 2008 is now estimated at around 5½% of GDP in 2009 (instead of 5¾% of GDP projected in the Commission services' spring 2009 forecast). Thus the additional improvement in the structural adjustment provided by the June package of measures will be ¼ of percentage point of GDP (from 1¾ points before the measures, to 2 points including the measures).

Beyond 2009, the Greek government plans to implement a set of permanent deficit-reducing measures and structural reforms, with a view to correct the excessive deficit by the end 2010, put the debt-to-GDP ratio on a downward path and address the external imbalances. According to the authorities, the set of measures to be adopted in 2010 will be in line with the Council's recommendations and focused on the permanent reduction of the primary current expenditures and public consumption. The details of this strategy will be spelled out in the coming months and included in the draft 2010 budget to be presented on 5th October 2009.

ANNEX I: Tables

Table 1: Economic and budgetary projections

		2007	2008	2009	2010
Real GDP (% change)	**SP Jan 2009**	**4.0**	**3.0**	**1.1**	**1.6**
	COM spring 2009	4.0	2.9	-0.9	0.1
	SP Dec 2007	*4.1*	*4.0*	*4.0*	*4.0*
HICP inflation (%)	**SP Jan 2009**	**3.0**	**4.3**	**2.6**	**2.5**
	COM spring 2009	3.0	4.2	1.8	2.3
	SP Dec 2007	*2.9*	*2.8*	*2.7*	*2.6*
Net lending/borrowing vis-à-vis the rest of the world	**SP Jan 2009**	**-12.1**	**-12.8**	**-11.4**	**-10.8**
	COM spring 2009	-12.1	-11.0	-9.8	-10.2
	SP Dec 2007	*-12.8*	*-12.7*	*-12.5*	*-12.2*
General government revenue (% of GDP)	**SP Jan 2009**	**39.9**	**40.0**	**41.0**	**41.1**
	COM spring 2009	40.0	39.9	40.2	39.5
	SP Dec 2007	*39.9*	*41.1*	*41.7*	*42.3*
General government expenditure (% of GDP)	**SP Jan 2009**	**43.4**	**43.7**	**44.7**	**44.3**
	COM spring 2009	44.0	44.9	45.3	45.2
	SP Dec 2007	*42.6*	*42.7*	*42.5*	*42.3*
General government balance (% of GDP)	**SP Jan 2009**	**-3.5**	**-3.7**	**-3.7**	**-3.2**
	COM spring 2009	-3.6	-5.0	-5.1	-5.7
	SP Dec 2007	*-2.7*	*-1.6*	*-0.8*	*0.0*
Primary balance (% of GDP)	**SP Jan 2009**	**0.6**	**0.3**	**0.80**	**1.2**
	COM spring 2009	0.4	-0.7	-0.5	-0.9
	SP Dec 2007	*1.2*	*2.4*	*3.1*	*3.8*
Cyclically-adjusted balance (% of GDP)	**SP Jan 2009**	**-4.4**	**-4.5**	**-3.8**	**-2.8**
	COM spring 2009	-4.7	-6.1	-4.9	-4.7
	SP Dec 2007	*-3.4*	*-2.4*	*-2.3*	*n.a.*
Structural balance (% of GDP)	**SP Jan 2009**	**-4.4**	**-4.5**	**-4.3**	**-2.8**
	COM spring 2009	-4.5	-6.5	-5.7	-4.7
	SP Dec 2007	*-3.1*	*-2.4*	*-2.3*	*n.a.*
Government gross debt (% of GDP)	**SP Jan 2009**	**94.8**	**94.6**	**96.3**	**96.1**
	COM spring 2009	94.8	97.6	103.4	108.0
	SP Dec 2007	*93.4*	*91.0*	*87.3*	*82.9*

Table 2: Budget implementation in January to March 2009, central government

	2008	2009			2008	2009	
on cash basis (m. euro)	**Jan-Mar**	**Jan-Mar**	***%Δ***		**EDP Notif.**	**SGP target**	***%Δ***
Total revenues	**12395**	**11444**	***-7.7%***		**56638**	**62987**	***11.2%***
Tax revenue (net)	11032	11014	*-0.2%*		51660	59287	*14.8%*
Capital revenue	1363	430	*-68.5%*		4978	3700	*-25.7%*
Other	0	0			0	0	
Total expenditures	**13166**	**18391**	***39.7%***		**70549**	**75678**	***7.3%***
Primary expenditure	10934	13021	*19.1%*		49715	54778	*10.2%*
Interest	1447	2443	*68.8%*		11210	12100	*7.9%*
Capital expenditure	785	2927	*272.9%*		9624	8800	*-8.6%*
Other	0	0				0	
Central Gvt balance	**-771**	**-6947**	***801.0%***		**-13911**	**-12691**	***-8.8%***
% GDP	*-1.3%*	*-11.6%*			*-5.7%*	*-5.0%*	

Table 3: Fiscal measures announced on 25th June 2009

	2009	
Revenue side	*mn euro*	*% GDP*
Tax on gasoline	200	0.08
Tax on GSM use	140	0.06
Tax on lottery and betting	180	0.07
Surcharge on large cars and yachts	150	0.06
Lawsuit and court fees	40	0.02
Expenditure side		
Cost-cutting in public sector operational cost	27	0.01
sub-total	***737***	***0.30***
One-offs		
Levy on buildings with land-use violations	1150	0.47
Sale-and-lease-back of public buildings	500	0.20
Reduce of Overseas Development Aid	120	0.05
sub-total	***1770***	***0.72***
TOTAL (% of GDP)	**1.02**	

Table 4: Updated estimation of public finances

	2008	2009			
	EDP	**GR Official projections**	**COM Spring 2009**	**Impact of the June 2009 measures**	**Updated estimation**
% GDP	*1*	*2*	*3*	*4*	*(3+4)*
TOTAL REVENUES	**39.9**	**41.5**	**40.2**	**0.96**	**41.2**
Taxes on production and imports (1)	12.3	12.7	12.7	0.27	13.0
Current taxes on income and wealth, etc (2)	7.7	9.2	8.1	0.47	8.6
Social contributions (3)	14.0	14.0	14.2		14.2
Other current resources (4)	2.5	2.2	2.0		2.0
Capital transfers received	2.0	2.0	1.8	0.22	2.0
Sales	1.4	1.4	1.4		1.4
TOTAL EXPENDITURE	**44.9**	**45.2**	**45.5**	**-0.06**	**45.4**
Intermediate consumption	*4.6*	*4.2*	*4.8*	*-0.01*	*4.8*
Compensation of employess	11.2	11.6	11.8		11.8
Social transfers other than in kind	18.4	19.4	19.1		19.1
Interest	4.4	4.6	4.8		4.8
Subsidies	0.1	0.1	0.1		0.1
Other current expenditure	1.7	1.1	1.1	-0.05	1.1
Gross fixed capital formation	2.9	2.6	3.0		3.0
Other capital expenditure	1.6	1.5	0.8		0.8
General Government balance (ESA95)	-5.0	-3.7	-5.3		-4.3
General Government balance (EDP)	**-5.0**	**-3.7**	**-5.1**		**-4.1**
One offs	***0.4***	***0.5***	***0.7***		***1.4***
General Government balance (EDP) net of one-offs	**-5.4**	**-4.2**	**-5.8**		**-5.5**
Structural balance	**-6.5**		**-5.7**		**-5.4**

Pro-memoria					
Nominal GDP		*248.6*	*245.7*		*245.7*
Gross debt	*97.6*		*103.4*		*102.3*