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Proposal for a

COUNCIL DECISION

making public the Recommendation with a view to ending the inconsistency with the broad guidelines of the economic policies in Greece and removing the risk of jeopardising the proper functioning of economic and monetary union

{SEC(2010) 93 final}
{SEC(2010) 94 final}
{SEC(2010) 95 final}

EXPLANATORY MEMORANDUM

1. INTRODUCTION

Greece has experienced strong economic growth at 4% per year over the past ten years, attributed also to expansionary fiscal policies. 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 of the global economic and financial crisis on the Greek economy, the implied re-pricing of risks puts further pressure on these debt burdens.

According to the Commission services' autumn 2009 forecast, real GDP growth slowed down in 2009, to just above 1% and is expected to remain negative in 2010. The downturn has taken a heavy toll on public finances and financing conditions. 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 exceeds 100%. 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.

The situation of the Greek economy combines a fiscal crisis with broader macroeconomic imbalances, which are rooted in deep-seated structural problems. To this respect, a joint deployment of instrument of economic and budgetary surveillance foreseen by the Treaty is appropriate. Besides responding to the objective gravity of the situation in Greece and its possible spill-over to other euro area countries, a simultaneous deployment of the available instruments of surveillance under the Treaty would enhance its effectiveness.

This explanatory memorandum reviews briefly the macroeconomic and budgetary situation in Greece, elaborates on the modalities of application of the instruments and their interplay and presents the scope of addressing recommendations to Greece under Article 121(4) of the Treaty on the Functioning of the European Union (TFEU); to take action under Article 126(9) TFEU; and to address an opinion on the January 2010 update of the stability programme pursuant to Council Regulation (EC) No 1466/97[1]. This represents the first time that a Decision giving notice to take action under Article 126(9) and a Recommendation under Article 121(4) are applied together.

2. MACROECONOMIC DEVELOPMENTS, COMPETITIVENESS AND FISCAL IMBALANCES

2.1. Recent macroeconomic developments

The macroeconomic and budgetary situation and outlook in Greece substantially deteriorated since April 2009 when the Council adopted a decision on the existence of an excessive deficit in Greece and gave recommendations in accordance with Article 104(7) of the Treaty establishing the European Community (TEC). Both consumer and business confidence were hit by the crisis, weakening economic activity since late-2008 and weighing on the medium-term prospects of the economy. Compared to the Commission services' January 2009 interim forecast, underpinning the recommendations by the Council in April 2009, in accordance with

[1] OJ L 209, 2.8.1997, p. 1.

Article 104(7) TEC, growth projections have been revised downwards. Instead of almost flat real GDP growth in 2009 followed by a mild recovery in 2010, real GDP has contracted by around 1% in 2009 and is projected to contract further by ¼% in 2010, under an unchanged policy scenario, according to the Commission services' autumn 2009 forecast[2] (Table 1). Moreover, given latest developments, one cannot exclude that the contraction in economic activity in 2010 will be more severe than projected in the autumn 2009 forecast. The contraction of economic activity weighs also heavily on employment which fell in 2009 by more than 1%, pushing unemployment rate up to around 9%, and according to the Commission forecast, in excess of 10% in 2010.

Macroeconomic developments have led to a sizable correction of the external deficit (net-borrowing/net-lending vis-à-vis the rest of the world) from above 12% of GDP in 2008 to 7½% of GDP in 2009. However, according to the Commission services' forecast, the expected further improvement in the external accounts and competitiveness over the medium term is likely to be much more moderate, given the structural weaknesses of the economy. Notably, the external imbalances, although improving, may still account for almost 8% of GDP by 2011. In a context of weak growth in both real and nominal terms, external constraints are becoming more severe and require substantial adjustment.

Table 1: Macroeconomic developments and forecasts

	2008	2009		2010		2011		2012	2013
	COM	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	2.0	-1.1	-1.2	-0.3	-0.3	0.7	1.5	1.9	2.5
Private consumption (% change)	2.3	-2.5	-1.5	-1.3	-1.0	0.8	0.3	0.8	1.0
Public consumption (% change)	0.6	2.0	11.0	-0.1	-4.4	0.7	-5.9	-5.9	0.7
Gross fixed capital formation (% change)	-7.4	-16.2	-18.8	-3.9	-1.6	1.3	4.5	5.5	8.4
Exports of goods and services (% change)	4.0	-11.8	-16.0	2.7	2.5	3.1	4.0	6.5	7.2
Imports of goods and services (% change)	0.2	-20.3	-24.7	-3.1	-3.0	1.9	2.0	2.8	3.4
GNI (GDP deflator)(% change)	1.6	-1.6	n.a.	-0.7	n.a.	0.7	n.a.	n.a.	n.a.
Contributions to real GDP growth:									
- Final domestic demand	*0.1*	*-4.9*	*-3.3*	*-1.6*	*-1.8*	*0.9*	*0.0*	*0.6*	*2.3*
- Change in inventories	*1.0*	*-0.6*	*-2.9*	*-0.1*	*0.2*	*-0.4*	*1.2*	*0.7*	*-0.5*
- Net exports	*0.8*	*4.4*	*5.0*	*1.5*	*1.3*	*0.1*	*0.3*	*0.7*	*0.7*
Employment (% change)	0.1	-0.9	-1.1	-0.8	-0.5	-0.2	-0.2	0.4	0.6
Unemployment rate (Eurostat definition)	7.7	9.0	9.0	10.2	9.9	11.0	10.5	10.5	10.3
Compensation of employees/head	5.9	2.3	5.7	1.4	1.6	1.8	2.4	2.2	2.7
Unit labour costs (whole economy)	3.9	2.5	n.a.	0.9	n.a.	0.9	n.a.	n.a.	n.a.
Real unit labour costs	0.3	0.8	n.a.	-0.5	n.a.	-1.3	n.a.	n.a.	n.a.
GDP deflator (% change)	3.5	1.7	1.6	1.4	2.0	2.3	2.0	1.9	1.9
Harmonised index of consumer prices	4.2	1.2	1.2	1.4	1.4	2.1	1.9	1.8	1.8
Net-borrowing/net-lending vis-à-vis RoW	-12.4	-7.5	-8.8	-6.8	-6.6	-6.7	-5.9	-4.9	-4.0

Source: AMECO, Commission services, stability programme (January 2010).

Mounting competitiveness losses over the last decade are reflected in the relative evolution of unit labour costs vis-à-vis trading partners. The rapid rise of wage costs and mark-ups in excess of productivity growth, has contributed to the persistence of a positive inflation

[2] European Economic Forecast - autumn 2009, *European Economy*, 10.

differential with the euro area. While nominal compensation per employee has increased by about 2¼% in 2009, HICP inflation remained close to 1% in 2009, resulting in high real wage growth, well above productivity growth. The disconnection between wages and labour-market conditions and productivity developments, including the weak response of wage growth to the current downturn, if extended in the medium-term, would undermine further the competitive position of the economy. Enhancing productivity, together with appropriate wage developments, would help to regain lost competitiveness. Although current inflation rates are low, they are projected to quickly return to an upward trend over the medium-term. Core inflation is also forecast to rise more rapidly than the euro area average. The poor functioning of domestic markets, especially services, is reflected in high mark-ups in sheltered sectors.

2.2. Competitiveness and growth potential

According to Eurostat, in 2008 GDP per capita in PPS stood at 94¼% of the EU-27 average, resulting from relatively low hourly productivity levels. In contrast, labour resource utilization is higher than in the EU-27 average, due to high average annual hours worked. At present, Greece faces severe challenges to bridge the gap in income per capita with the euro-area. To begin with, the crisis may hurt the productive capacity of the Greek economy. Commission calculations estimate that by 2020 the cumulated loss of potential GDP may be around 16¼% compared with the 2000-2006 trend. This decline is amongst the highest within the group of euro area countries, though it partly stems from the high rate of potential growth in Greece in the pre-crisis period. In addition, in 2020, Greece will start suffering the negative effects of ageing populations, which will also reduce potential growth rates from 2020 on.

Hence, bringing the Greek economy back to a sustained convergence path calls for correction of imbalances via strong fiscal adjustment and the implementation of a comprehensive reform package. The weaknesses of the Greek economy have been repeatedly highlighted by the Commission. For example, the Commission forecasts have long commented on Greece's price competitiveness problems; in particular, to the appreciating trend of the real effective exchange rate. Moreover, the Lisbon strategy recommendations[3], have also identified specific areas to improve Greece's non-price competitiveness, such as R&D investment, public administration reform, as well as the quality of education. Furthermore, the calculations of the Ageing Working Group of the Economic Policy Committee show that pension reform is a priority[4]. In addition, the Commission's Labour market review[5] has also identified problems in the Greek labour market, namely in terms of its segmentation and wage bargaining regulations. Finally, various indicators show that there is room for improvement in product market functioning, ranging from network industries to professional services. Taken together, these elements undermine Greece's structural competitiveness and give reasons to believe that its large external imbalance is not just due to strong domestic demand. The following paragraphs give a more detailed explanation on the challenges within each policy area.

On price competitiveness, two indicators stand out. First, over the past 10 years Greece has been accumulating inflation differentials of around 1 percentage point per year *vis-à-vis* the euro area. Second, wage growth has been higher than in the euro area and in excess of productivity growth, leading to real unit labour cost rises. Inflation differentials are thought to derive from strong domestic demand (in pre-crisis years), but also, from labour and product

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3 OJ 183, 15.7.2009, p. 1.

4 *European Economy*, 2/2009, 2009: Ageing Report: economic and budgetary projections for the EU-27 Member States (2008-2060).

5 *European Economy*, 8/2009, Labour market and wage developments in 2008.

market imperfections leading to excessive wage and mark-up growth, respectively. Wage growth in excess of productivity is encouraged by the nature of Greece's wage bargaining settings, as well as by the public sector behaviour. Indeed, public wages account for a sizable share of the overall wage bill, have a strong influence on private sector wage setting and have outgrown the latter over the past few years[6].

More generally, enhancing the quality of public administration plays a major role for raising the overall efficiency of the economy. The number of public institutions, organisations, municipalities and local councils has grown over time. The Lisbon strategy recommendations have underscored the need to build effective regulatory, control and enforcement capacities, both in general terms and related to the use of structural funds. The Greek authorities have made commitments to improve the functioning of public administration and an operational programme on 'Administrative Reform' is in place. At present, there is still the need to strengthen the role of impact assessments and the transparency of public consultations, speed up codification work, creating in each ministry specialized units for better regulation, as well as increasing the absorption of structural funds. This last feature will be addressed below.

Pensions are another major reform area. Pension spending by the social security system, as a percentage of GDP, is projected to rise significantly over the next decades, from 11¾% of GDP in 2007 to almost 24% of GDP in 2060. Consequently, the Commission's latest Sustainability Report[7] puts Greece at high risk with respect to public finance sustainability. Demographic developments, with the old-age dependency ratio nearly doubling over the projection period up to 2060 have a large impact on rising pension expenditure throughout the projection period[8]. In addition, the benefit ratio[9] in Greece ranks among the highest in the EU, even if people aged 65 and more are exposed to higher at-risk-of-poverty rates than in the EU on average. Recent reforms –e.g. Law 3655/2008[10] - have addressed some weaknesses of the pension system such as its excessive fragmentation. The 2010 update of the Stability Programme also includes some commitments on pension and healthcare reform. Overall, the pension system remains unsustainable and inequitable. Early retirement schemes provide alternative, but costly, pathways to retirement with a negative impact on incentives to work. Hence, reforms need to curb the substantial increase in age-related expenditure to reinforce the long-term sustainability of public finances. The health care system also needs reform, in

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6 This comparison uses national accounts data comparing public compensation per employee in the public administration to total industry compensation per employee over 2000-2007. The rise in public sector over private sector wages is also higher than in other euro area Member States for which data are available –e.g. Spain or Italy.

7 *European Economy*, 9/2009.

8 Indeed, the demographic challenge in Greece has consistently been projected to be more severe than the EU average and the 2008 Eurostat projections show a rise in the old-age dependency ratio from 27.8% in 2008 to 57.1% in 2060. The relation between insurants and pensioners has reached 1.75:1 instead of 4:1 which is required for a viable pay-as-you-go pension system.

9 The benefit ratio is the average benefit of public pensions, as a share of the economy-wide average wage.

10 Law 3655/2008 addresses some of the administrative weaknesses of the Greek pension system, while introducing a number of parametric adjustments. First, the Law reduces the number of funds from 113 to 13, thus lowering administrative costs and improving monitoring. Second, the Law introduces an individual social security number to improve expenditure control and reduce contribution evasion. Third, it sets up the Insurance Fund for Intergenerational Solidarity to safeguard future pension payments. In addition, the Law gives financial incentives to extend working lives by up to three years past the statutory retirement age and strengthens provisions on maternity leave to increase female participation in the labour market.

particular to improve the quality of services, especially in primary care, efficiency, and its budgetary management as these have been a cause of budgetary overruns[11].

Product market reforms are also present in the Stability Programme update. Several areas warrant attention. First, competition in professional services should be strengthened, a sector which accounts for 2½% of GDP and 7% of employment[12]. In the OECD's Product Market Indicator on professional services ranks Greece poorly, especially for legal services. Second, barriers to competition are amongst the highest within the OECD European group of countries, based on the OECD Barriers to Competition index. Third, the liberalization of network industries (e.g. energy) is lagging behind the EU average[13], as well as the opening of markets in the transport sector, especially in rail[14]. For example, in the gas sector, the first private LNG (liquid natural gas) import was cancelled (December 2009) due to State-controlled grid operator DESFA failing to agree until then contracts providing access to network. This lack of liberalisation has concrete impact on Greek businesses. To illustrate, in the electricity market, the World Bank[15] shows that it takes longer and it costs more to connect a new business to the electrical network than the OECD average.

Lastly, on business environment, firms are faced with complex, burdensome, lengthy procedures and legal uncertainty in their relations with the public administration. Despite progress made, Greece is the worst EU and OECD performing country in the 2009 World Bank Doing Business indicators. This is explained by the time and cost needed to start a business, the overall rigidity in employment, the little protection given to investors as well as difficulties in accessing to finance. Greece has adopted the target of reducing 25% of administrative burdens by 2013, though implementation needs to move beyond the initial stages. In short, reforms in these areas, along the lines of the EU Small Business Act, could increase private investment and employment, at little public finance cost. They could also help the implementation of labour market reforms, by reducing cost pressures.

Over and above attempts to reform public sector employment, Greece's labour market is also in need of reform in line with the common principles of flexicurity. The Greek labour market is strongly segmented in gender (more than in any other EU country), age (with young people having difficulties to enter the labour market), type of contract (with relatively more stringent employment protection legislation (EPL) for temporary contacts than for regular contracts) and skills (with higher EPL for white collar than for blue collar workers). At the same time, there is much scope to improve the qualification of the labour force, as well as labour market matching through improvements in the quality of secondary and tertiary education, the efficiency of public employment services and active labour market policies (ALMP). Some of these issues have been addressed in the latest update of the Stability Programme. Lastly, the definition of collective dismissals is extremely wide, as it applies to firms between 20 to 200 employees when 4 workers are dismissed. Collective dismissals are cumbersome, so the current regulation in Greece hinders employment creation. It is also a hurdle to firms' growth.

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11 OECD (2009), *Economic Survey of Greece 2009*, chapter 3: Chapter 3 Improving the performance of the health care system.

12 Source: EU KLEMS 2005.

13 This is shown in the 2007 OECD indicators of regulation of energy, transport and communication. Greece's regulation indicator in electricity is 2.1 and 3.5 in gas, compared to 1.5 and 2.5 in the EU OECD countries.

14 2007 OECD index of 5.3 compared to 3.4 in the OECD EU countries.

15 Getting Electricity. A pilot indicator set from the Doing Business project. World Bank. 2010

Finally, the faster and more effective absorption of EU funds could play a critical role in the success of efforts to restore competitiveness and sustainable public finances. Since 2007, Greece has submitted relatively few payment claims to the Commission. This shows a low level of absorption at the beginning of the fourth year of the 2007-2013 programming period, compared to most Member States. By aligning national investment priorities to the goals of structural and cohesion policy and working with the Commission to improve the implementation of operational programmes, Greece could finance key public investments that support long-term growth potential whilst at the same time allowing budgetary consolidation to proceed. Particular attention should be paid to the operational programme on 'Administrative Reform' and 'Digital Convergence' which support essential reforms in the public administration, as well as human resources development' and 'education and lifelong learning which support labour market and educational reforms, as all are central to the reform and growth strategy outlined in the January 2010 update of the stability programme. EU funds could be relied on to increase the efficiency of the public administration and supporting reforms of the health care system, public employment services, life-learning reforms, plus the building up of effective regulatory control and enforcement capacities

2.3. Banking sector

Greek banks remain relatively robust from a solvency perspective, with an average capital adequacy ration of 11.7% and continued profitability. Banks received state support in the form of guarantees and capital injections, but less than in most other EU Member States. Nonetheless, the ongoing performance will be conditioned by the structural weaknesses in the economy, as it emerges from the current downturn with subdued credit growth as a consequence.

Despite having a relatively low loan-to-deposit ratio, the Greek banking sector has experienced difficulties in accessing liquidity on wholesale markets, leaving it substantially reliant on Eurosystem lending[16]. Currently, Greek banks hold approximately 8% of their assets in government securities, mainly from Greece. If a further sovereign rating downgrade were to occur, the continued willingness of Greek banks and other investors to hold Greek government securities could be in doubt. This would potentially apply further constrain on the capacity of the government to finance itself.

As regards the wider financial sector and more specifically the insurance sector, a weakness related to the default of one major and four smaller companies is in the process of being addressed by the Greek supervisor.[17]

2.4. Public finances imbalances

In 2009, the Greek public finances have worsened much beyond what could have been expected to result from the downturn and the financial-sector support measures. According to the official estimation included in the 2010 budget, the government deficit has reached 12¾% of GDP in 2009 (this estimate includes a net deficit-increasing impact of temporary nature of

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16 Access to Eurosystem lending has been accommodated by changes to the ECB collateral rules. However, the Eurosystem is expected to restore its pre-crisis criteria for collateral eligibility at the end of 2010.

17 Aspis Pronoia S.A. licence was withdrawn on 21 September 2009 together with that of the other four smaller insurance companies of Aspis Group operating in Greece. This was mainly due to the very fragile state of the balance sheet of these companies. However, the amount that the Greek government might be called upon to sustain in order to preserve stability in the sector is small.

1¼% of GDP[18]). This is in line with the Commission services' autumn 2009 forecast and compares with the budgetary target of 3.7% of GDP in 2009, set in the January 2009 update of the stability and growth programme (Table 2)[19]. The currently estimated deficit outturn for 2009 is substantially higher than expected when the Council adopted the recommendation according to Article 104(7) TEC in April 2009.

Table 2: Revised estimations of economic growth and budgetary outcome

	Real GDP growth (% change)					Net lending/Net borrowing general government (% GDP)				
	2009	**2010**	**2011**	**2012**	**2013**	**2009**	**2010**	**2011**	**2012**	**2013**
Budget 2009	2.7	n.a.	n.a.	n.a.	n.a.	-2	n.a.	n.a.	n.a.	n.a.
COM 2009 Jan forecast	0.2	0.7	n.a.	n.a.	n.a.	-3.7	-4.2	n.a.	n.a.	n.a.
SP 2009 Jan	1.1	1.6	2.3	n.a.	n.a.	-3.7	-3.2	-2.6	n.a.	n.a.
EDP notification (2009 Apr)	n.a.	n.a.	n.a.	n.a.	n.a.	-3.7	n.a.	n.a.	n.a.	n.a.
COM 2009 Spring forecast	-0.9	0.1	n.a.	n.a.	n.a.	-5.1	-5.7	n.a.	n.a.	n.a.
EDP notification (2009 Oct)	n.a.	n.a.	n.a.	n.a.	n.a.	-12.5	n.a.	n.a.	n.a.	n.a.
COM 2009 Autumn forecast	-1.1	-0.3	0.7	n.a.	n.a.	-12.7	-12.2	-12.8	n.a.	n.a.
Budget 2010	-1.2	-0.3	n.a.	n.a.	n.a.	-12.7	-9.1	n.a.	n.a.	n.a.
SP 2010 January	-1.2	-0.3	1.5	1.9	2.5	-12.7	-8.7	-5.6	-2.8	-2

Source: Commission services, updates of the stability programme

The much higher-than-budgeted 2009 deficit is only partially explained by the unfavourable macroeconomic conditions (Table 3). According to the Greek authorities' latest official estimates, real GDP growth is estimated at -1¼% in 2009, broadly in line with the Commission services' autumn 2009 forecast. However, only a small part of the fiscal slippages in 2009 (around 1½% of GDP) 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)[20].

On top of these factors, the deterioration in the government deficit reflects revenue shortfalls of around 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 by almost ½% of GDP following rising unemployment, confirming also that the initial budgetary revenue projections underpinning the budgetary target were markedly favourable (with regard to both direct and indirect taxes). On the expenditure side as stated above, a number of one-off expenditures[21],

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18 This can be further disentangled to a deficit increasing impact of one-off expenditure of 1¼% of GDP and one-off revenue of some ¼% of GDP. The latter includes one-off revenue from the special income to high income households and the tax amnesty measures implemented in 2009.

19 http://ec.europa.eu/economy_finance/publications/publication_summary16053_en.htm

20 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). 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.

21 A special allowance paid to low-income households (EUR 203 million euro), administrative cost related to the October 2009 snap elections (EUR 244 million) and payment of hospital-related arrears (EUR

amounting to around 1¼% of GDP have contributed to the expenditure overruns. On top, public wage bill went up by some 0.7% of GDP, mostly due to the increase in short-term public employment contracts and public wages raises. In addition, the debt servicing cost increased by 0.5% of GDP, given the large increase in debt ratio. These expenditure and revenue slippages more than offset the fiscal consolidation measures announced by the government in June 2009[22], also because they were only partially implemented in the course of the year[23].

Table 3: Major factors determining the government deficit outturn in 2009 (*)

	Effect on the deficit (°)	Deficit in 2009
Initial target in the 2009 budget law		**2.0**
January 2009 update of the Stability programme		**3.7**
Base year effect	1.4	
Automatic stabilisers	1.5	
One-off expenditure	1.5	
Impact of revenue enhancing measures	-1.0	
Impact of expenditure restraining measures	-0.3	
Revenue shortfalls	3.5	
Expenditure overruns	2.2	
Difference in swaps	0.2	
January 2010 update of the Stability programme		**12.7**

(*) The table summarises, in % of GDP, the main revisions, corrections and discrepancies in the 2009 budget since its adoption by the (former) Greek government at the end of 2008, and the new stability programme.

(°) a '+' indicates deficit-increasing, while a '–' means deficit-decreasing.

In conclusion, although macroeconomic conditions have worsened beyond what was anticipated, the rapid deterioration of fiscal imbalances can only in part be attributed to the worse-than-expected macroeconomic conditions.

2.5. Fiscal statistics

As regards the Greek statistical system, the shortcomings in government finance statistics remain a recurrent issue and a serious concern. On 22 October 2009, Eurostat expressed a general reservation over the figures notified by the Greek authorities, "*due to significant uncertainties over the figures reported*" and thus, did not validate the data. More specifically,

975 million), subsidies and grants to other public entities (EUR 394 million), payment of a penalty following a court decision on the national air-transport company and other (EUR 541 million). The total is EUR 3 228 million or 1¼% of GDP.

22 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.

23 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 2009 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.

substantial revisions of the government deficit and debt data for the previous years were set out in the October 2009 notification.

The general government deficit for 2008 was revised to almost 7¾% of GDP, up by 4 points compared to the January 2009 update of the stability programme and 2¾ points of GDPs compared to the April 2009 notification. The recent Commission report on the Greek government deficit and debt statistics[24] has found evidence of "*severe irregularities in the EDP notifications of April and October 2009, including submission of incorrect data, and non-respect of accounting rules and of the timing of the notification; poor cooperation between the national services involved in the compilation of EDP figures, as well as lack of independence of the National Statistical Service of Greece and the General Accounting Office from the Ministry of Finance; an institutional setting and a public accounting system inappropriate for a correct reporting of EDP statistics, especially non-transparent or improperly documented bookkeeping, which has lead to several, and in some cases significant, revisions of data by the Greek authorities over an extended period of time; lack of accountability in the individual provision of figures used in EDP notifications, (e.g. absence of written documentation or certification in some cases, exchange of data by phone); unclear responsibility and/or lack of responsibility of the national services providing source data or compiling statistical data, combined with ambiguous empowerment of officials responsible for the data*". Therefore, further efforts are needed to improve the collection and processing of general government data. Given the persistent failures of Greece in providing adequate government deficit statistics for the implementation of the SGP, fiscal consolidation efforts in future years need to be monitored not only on the basis of the government deficit figures but also through an assessment of developments in the government debt levels.

Structural and endemic problems related to the recording of Greek government accounts, have been detrimental for timely and effective revenue and expenditure control. Moreover, a number of interventions with a view to improve budgetary process and execution, as well as the quality of fiscal data are also paramount, in the context of the much necessary overhaul of the Greek statistical system (including the General Accounting Office) and the professional independence of the national statistical authorities.

The Commission is initiating an infringement procedure in relation to the non-compliance with a series of EU legal acts, concerning the compilation and reporting of fiscal statistics in Greece.

3. THE JANUARY 2010 UPDATE OF THE STABILITY PROGRAMME OF GREECE

Council Regulation (EC) No 1466/97, on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies, stipulates that countries adopting the single currency shall submit updated stability programmes annually. In accordance with Article 5(3) of this Regulation, the Council may examine the updated stability programmes based on the assessments prepared by the Commission and the Economic and Financial Committee. In its assessment, the Council shall also include an examination of whether economic policies are consistent with the broad economic policy guidelines.

[24] http://epp.eurostat.ec.europa.eu/portal/page/portal/product_details/publication?p_product_code=COM_2010_report_greek

The 2010 budget was adopted by Parliament on 23 December 2009 setting a general government deficit target of 9.1% of GDP in 2010. In the meantime, the Greek authorities announced the need to step up the fiscal adjustment already in 2010, setting a more ambitious budgetary target for 2010 at 8.7% of GDP. The January 2010 update of the stability programme, which was submitted on 15 January 2010 covers the period 2010-2013 and, confirmed the revised budgetary target for 2010 at 8.7% of GDP. To ensure meeting the revised targets, the updated stability programme envisages a number of measures, on top of those announced in the 2010 budget law. The programme presents a detailed package of fiscal consolidation measures for 2010, aiming at enhancing tax revenue collection and, to a lesser extent, constraining and rationalizing primary public expenditure. It provides also the estimated quantification of each one of the main fiscal measures for 2010, as well as the timeframe of their adoption and implementation. Some of these measures have already been submitted to Parliament and will be implemented in the first months of 2010. The plans for 2011, 2012 and 2013 include a wide range of structural reforms but are less detailed and do not include a precise calendar of implementation.

In the absence of the 2010 budget, which was made available after the cut-off date of the autumn 2009 forecast, the Commission services projected the government deficit to remain above 12% of GDP in both 2010 and 2011. According to the macroeconomic scenario underlying the 2010 budget law, confirmed also by the January 2010 update of the stability programme, real GDP growth is projected at -0.3% in 2010, broadly in line with the Commission services' autumn 2009 forecast. The latter however, had been made under a no-policy scenario assumption and before recent financial market reactions and thus, the central macroeconomic scenario for 2010 included in the updated programme is optimistic.

According to the January 2010 update of the stability programme, the general government budgetary target for 2010 implies a fiscal adjustment, measured by the change in headline deficit ratio of 4 percentage points of GDP, reflecting an increase in total revenue-to-GDP ratio of 2.6 percentage points of GDP and a reduction in total expenditure-to-GDP ratio of 1.4 percentage point of GDP. Thus, the main bulk of the adjustment in 2010 is planned to be achieved from the revenue side of the budget, on the back of the implementation of temporary revenue enhancing measures (one-offs) of some ¼% of GDP[25] and a permanent tax revenue-enhancing package, which is 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 1% in 2009, while the impact of a number of permanent spending cuts announced is actually cancelled out by an increase in education spending, health-care services and public investment.

More specifically, the programme presents a number of permanent revenue-side consolidation measures, to be implemented in 2010, amounting to around 2½% of GDP. It provides the description of tax revenue enhancing measures including the implementation of a progressive taxation scheme for all household incomes and the elimination of tax exemptions (with an estimated budgetary impact of 0.4% of GDP), the reform of the real estate taxation regime (with an estimated budgetary impact of 0.2% of GDP), the rise on excise duties on tobacco and alcohol products (already submitted to Parliament, with an estimated budgetary impact of

[25] This would be the net budgetary impact of one-off revenues of ½% of GDP (fees collected in relation to the financial sector liquidity scheme, and a special tax on highly profitable enterprises and large real estate) and one-off expenditure of ¼% of GDP (related to the second instalment of the social solidarity benefit paid to poor households).

0.4% of GDP) and the rise on mobile telephony usage fees and excise duties on fuel[26] (with an estimated budgetary impact of 0.4% of GDP). However, a significant part (some 1% of GDP) of the total projected permanent revenue increase in 2010, relies on the intensification of the fight against tax evasion. The programme presents a number of policy interventions with regard to improving the tax collection mechanism, widening the tax base and increasing tax compliance[27]. It is important that the legislative amendments necessary for the implementation of most of the outlined tax measures, and which are planned to be submitted to Parliament in March, be adopted without delay for the measures to have the expected impact still in 2010. Moreover, given past experience, the planned measures to fight against tax evasion must be forcefully implemented for the expected gains to materialize..

On the expenditure side, the decrease foreseen in 2010, results mainly from the discontinuation of one-off expenditure in 2009. Although effort has been given to reduce the public sector wage bill, operational cost and defence spending (by around ¾% of GDP), increased spending in education and public investment (by some ¾% of GDP) actually offsets any deficit reducing budgetary impact and thus, the net budgetary impact should be negligible. More specifically, the updated programme provides for measures in view of achieving efficiency gains in hospital procurement (with estimated permanent budgetary impact of 0.3% of GDP), the government's commitment to restrain operational cost by 0.1% of GDP, to cut military procurement by 0.2% of GDP, to cut public servants allowances[28] by 0.3% of GDP, to freeze recruitment in 2010 in the public sector and implement the rule of 1 hiring for every 5 retirements thereafter. However, the nominal wage bill is estimated to remain around the levels of 2009, on the back of wage drift.

On top of these measures and without including any budgetary impact in the budgetary target, the Ministry of Finance has set up a contingency reserve and frozen all budgetary appropriations per ministry by 10% (other than wages, pensions and interest payments). Depending on the expenditure outturn of the first six months of 2010, the budgetary appropriations blocked in this way may not be fully reallocated among the spending ministries securing a further reduction in related expenditures by year-end.

Overall, on the basis of the detailed information included in the update, and in spite of several risks, the 2010 budgetary target seems within reach, provided that there is a timely and successful implementation of all measures announced. A large part of the correction in the

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[26] The rise on mobile telephony usage fees and on excise duties on fuel has already been legislated by the previous Parliament, prior to the October general elections.

[27] Unification of the tax collection and the social security collection systems, adoption of a risk-based approach in the audit process, the imposition of legal obligation for enterprises to maintain professional accounts with commercial banks and settling payments through the banking system, review of existing cross-matching checks, shift focus from formal checks on books and documents into in-depth audits, collect data from utility companies (power, phone, water) and use them for performing cross-matching, collect details of all issued receipts, eliminate bargaining in the penalty assessment process and shift to a point-system based on objective criteria, establish and use an IT-based audit case management system, amnesty for individuals or companies that assist in bringing corrupt officials to justice, remove the regional tax office directors from the dispute resolution process by handling such disputes in a centralized location, reduce the number of regional tax offices by adopting other means for obtaining forms, getting help, and filing returns (web-based, postal and call center) etc.

[28] Monthly allowances to civil servants, on top of their nominal wage are not streamlined across the several government departments. There are allowances in ministries exceeding the 100% of the nominal statutory wage that actually double the ministry's employees' monthly earnings, while there are other ministries and public entities, where monthly allowances do not exceed the 30% of the nominal statutory wage.

headline deficit planned in the updated stability programme reflects on the one hand, the discontinuation of one-off deficit-increasing measures in 2009 and on the other hand, the implementation of one-off deficit-reducing measures in 2010. The discontinuation of one-off expenditure, as presented in the update, will have an automatic deficit reducing budgetary impact of somewhat more than 1% of GDP in 2010, while the one-off revenue-enhancing measures will have a total net budgetary impact of some ¼% of GDP. Thus, the overall deficit reducing budgetary impact of temporary factors in 2010 stands at just below 1½% of GDP (almost one-third of the total 4 percentage points of GDP consolidation projected for 2010). The reduction in the headline deficit not relying on one-off measures in 2010 is expected to be in the order of 2½% of GDP.

At this stage, the uncertainty surrounding the 2010 budgetary target of 8.7% of GDP remains high and the risk of fiscal slippages, stemming mainly from the favourable macroeconomic assumptions underlying the programme and the optimistic official estimation of the results from the fight against tax evasion is large. Although there is detailed information on the measures (and their estimated budgetary impact) underpinning the budgetary target, the prompt and rigorous implementation of the announced policies is crucial. Apart from uncertainties concerning the impact of the envisaged consolidation measures, the revenue and expenditure projections underpinning the 2010 budgetary target are subject to risks. In particular, given the projected increase in the debt-to-GDP ratio by 7 percentage points of GDP in 2010 and the increase in interest rates on new debt (or debt with variable rates), the interest expenditure projection in the update for 2010 appears to be on the optimistic side. Moreover, the 2008 budgetary outcome has not been validated by Eurostat. Any revision in the data for past years may have carry-over effects for 2010. Similarly, any government deficit for 2009 in excess of the estimate of 12¾% of GDP would imply a less favourable starting point for 2010[29]. Therefore, it is of key importance that the measures presented in the stability programme (including their estimated budgetary impact) underpinning the budgetary target, be promptly and rigorously implemented and that Greece stands ready to announce and implement further measures, if such risks materialise.

Over the medium term, the general government deficit is set by the programme to decrease further to 5.6% of GDP in 2011, 2.8% of GDP in 2012 and 2% of GDP in 2013. Similarly, the primary balance will reach a surplus of 3.2% of GDP by 2013, which compares with a primary deficit of 7.7% in 2009. The budgetary strategy outlined aims at reducing the structural deficit (as recalculated by the Commission services based on the commonly agreed methodology) from 11½% of GDP in 2009 to 7¾% of GDP in 2010 and 1½% by 2013, while the medium term objective (MTO) of a balanced budget in structural terms (i.e. in cyclically-adjusted terms net of one-off and other temporary measures) is not projected to be attained within the programme horizon. Budgetary consolidation in 2011 to 2013 is based on both revenue enhancement and expenditure retrenchment, details of which, however, have not been yet disclosed. Thus, the budgetary outcomes in 2011 and afterwards, are subject to risks. Moreover, the underlying central macroeconomic scenario is based on favourable growth assumptions, implying that real GDP growth will return to the positive territory in 2011 at 1.5% and in 2012 at 1.9%, reaching 2.5% in 2013. All in all, risks attached to the medium-term adjustment path are large.

[29] So far, available incomplete indicators suggest that a slippage in 2009 budgetary outcome, on top of the 12.7% of GDP, if any, should be small. As required by Council Regulation (EC) No 479/2009, the first fiscal outturn for 2009 will be notified by the National Statistical Service of Greece by 1 April 2010.

Government gross debt, estimated at 113.4% of GDP in 2009, is projected by the stability programme to exceed 120% of GDP in 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 arrears. Risks associated with the projected evolution of the debt-to-GDP ratio also appear to be on the upside, stemming from 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 shrunk compared to the past (0.2% of GDP for each of the years covered by the programme), the programme does not provide information on components.

The January 2010 update of the stability programme provides also information on a wide range of structural reforms, to be launched or implemented in the course of 2010. According to the update, the timely and successful implementation of these reforms will have a positive impact on the quality of public finances and address structural home-made weaknesses of the Greek economy. More specifically, the government has already submitted to Parliament the draft law to render the Statistical Service independent, and plans to set up a 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 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. 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 (ALMP), improving public administration, increasing transparency and accountability, reducing the number of municipalities and local councils, supporting investment in research, technology and innovation.

4. EU SURVEILLANCE IN THE CURRENT JUNCTURE

4.1. The combination of instruments of surveillance

Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the deficit, as well as, in the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn. Several factors are at play. First, the economic downturn brings about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP)[30], endorsed by the European Council in December[31]. The Plan explicated that the stimulus should be timely, targeted and temporary and differentiated across Member States to reflect their different positions in terms of public finance sustainability and competitiveness and should be reversed when the recovery becomes

[30] 'A European Economic Recovery Plan,' Communication from the Commission to the European Council - COM(2008) 800, 26.11.2008.

[31] See Presidency Conclusions of the Brussels European Council, 11 and 12 December 2008, reference 17271/1/08 REV 1.

self-sustaining. Finally, several countries have taken measures to stabilise the financial sector, some of which have impacted on the government debt position or constitute a risk of higher deficits and debt in the future[32], although some of the costs of the government support could be recouped in the future.

While in Greece the current deterioration in public finances must also be seen in the same context, fiscal imbalances have been high and persistent for many years, in spite of the buoyant economic activity up to 2008, thus suggesting structural roots. In particular, government deficits reflect insufficient control of government expenditure, while revenue and GDP growth projections have proven to be systematically overoptimistic. Moreover, structural and endemic deficiencies related to the recording of Greek government accounts in the recent past, have also been detrimental for timely and effective revenue and expenditure control, and macroeconomic surveillance. High deficits have led to one of the highest government debt ratio in the EU, which is not only substantially above the 60% of GDP reference value, but remains on an unsustainable upward path.

Greece's situation of combining a fiscal crisis with broader macroeconomic imbalances which are rooted in deep-seated structural problems requires a joint deployment of instrument of economic and budgetary surveillance foreseen by the Treaty and relevant secondary legislation. To this end, the simultaneous application of instruments to attain fiscal durable consolidation and proceed with necessary structural reforms in the wider area of economic activity is paramount. A recommendation under Article 121(4), a notice to take action under Article 126(9) and an opinion on the January 2010 update of the stability programme pursuant to Regulation (EC) No 1466/97 (the so-called preventive arm of the Stability and Growth Pact) and their joint deployment should strengthen the scope of EU surveillance.

4.2. The Application of Article 121 of the Treaty on the Functioning of the European Union

Article 121(2) TFEU requires the Council to adopt a recommendation for the broad guidelines of the economic policies for the Member States and the Community, acting on a recommendation from the Commission and a conclusion from the European Council. Article 121(3) of the Treaty requires the Council to monitor economic developments in each Member States and in the Union, as well as the consistency of economic policies with the broad guidelines of the economic policies, on the basis of reports by the Commission. In the case it has been established that economic policies are not consistent with the broad guidelines of the economic policies, or that they risk jeopardising the proper functioning of the economic and monetary union, Article 121(4) establishes that the Commission may address a warning to the Member State concerned and may recommend the Council to make the necessary recommendations to the Member State concerned. Given the gravity of the situation in Greece, and in order to ensure consistency with the Decision under Article 126(9), it is appropriate that the Council adopts the necessary recommendation. In addition, the Council may, acting on a proposal from the Commission, decide to make its recommendations public.

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[32] See the Eurostat decision on the statistical recording of public interventions to support financial institutions and financial markets during the financial crisis, Eurostat News Release No 103/2009 of 15 July 2009, and 'Accounting for Bank Rescues' *in* Public Finances in EMU-2009, *European Economy*, 5, p. 59-63.

The Council adopted their most recent broad economic policy guidelines for the Member States and the Community on 14 May 2008[33]. The broad guidelines of the economic policies for 2008-2010 include policy guidance that Member States should "*respect their medium-term budgetary objectives*" and should "*take effective action in order to ensure a prompt correction of excessive deficits*". In addition, Member States with external imbalances should correct them "*by implementing structural reforms, boosting external competitiveness and* (…) *contributing to their correction via fiscal policies*". On this basis, on 25 June 2009[34], the Council in its structural recommendations noted that for Greece it is *"imperative to intensify efforts to address the macro-economic imbalances and structural weaknesses of the Greek economy"* and directed country-specific recommendations to Greece including that it should pursue with fiscal consolidation; increase competition in professional services, reform to increase investments in R&D; use structural funds more efficiently; reform public administration and take a broad range of labour market measures within an integrated flexicurity approach. At the same time, as a member of the euro area, Greece was recommended by the Council to secure the sustainability of public finances; improve the quality of public finances including modernising public administration as well as implementing the EU common principles of flexicurity.

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, raises risk premia on government debt and may raise issues concerning the solvency of the Greek economy, with possible spill over to other euro area economies.

4.3. The Application of Article 126 of the Treaty and Previous Steps in the Excessive Deficit Procedure in Relation to Greece

Article 126 TFEU lays down an excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure[35], which is part of the Stability and Growth Pact.

According to Article 126(2) TFEU, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to GDP exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 126(3) TFEU (ex 104(3) TEC) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to "take into account whether the government deficit exceeds government

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33 Council Recommendation 2008/390/EC (OJ L 137, 27.5.2008, p. 13).

34 OJ L 183, 15.7.2009, p. 1.

35 OJ L 209, 2.8.1997, p. 6. Account is also taken of the Opinion of the Economic and Financial Committee on the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 20 November 2009, available at: http://ec.europa.eu/economy_finance/sgp/deficit/legal_texts/index_en.htm

investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

On the basis of the actual deficit and debt data notified by the Greek authorities in October 2008[36] and subsequently validated by Eurostat[37] and taking into account the Commission services' January 2009 interim forecast, the Commission adopted a report under Article 104(3) TEC for Greece on 18 February 2009[38]. Subsequently, and in accordance with Article 104(4) TEC, the Economic and Financial Committee (EFC) formulated an opinion on the Commission report on 27 February 2009. On 24 March 2009 the Commission, having taken into account its report under Article 104(3) TEC and the opinion of the EFC, addressed to the Council, in accordance with Article 104(5) TEC, its opinion that an excessive deficit existed in Greece.

On 27 April 2009, upon a recommendation by the Commission, the Council decided, in accordance with Article 104(6) TEC that an excessive deficit existed in Greece[39]. At the same time, and in accordance with Article 104(7) TEC the Council, addressed recommendations to Greece to put an end to the excessive deficit situation by 2010, by bringing the general government deficit below 3% of GDP in a credible and sustainable manner. The Council further recommended "*that to this end, the Greek authorities should (i) strengthen the fiscal adjustment in 2009 through permanent measures, mainly on the expenditure side, including by implementing the measures already announced; (ii) implement additional permanent measures in 2010, in order to bring the headline deficit clearly below the 3 % of GDP reference value by the end of the year; (iii) continue efforts to control factors other than net borrowing, which contribute to the change in debt levels, with a view to ensuring that the government gross debt ratio diminishes sufficiently and approaches the reference value at a satisfactory pace; and (iv) continue efforts to improve the collection and processing of statistical data and in particular general government data*". The Council established a deadline of 27 October 2009 for Greece to take effective action to strengthen the fiscal consolidation path already in 2009 and to specify the measures that seem sufficient to ensure adequate progress towards the correction of the excessive deficit by 2010.

On 11 November 2009, the Commission assessed the action taken by Greece to correct the excessive deficit by 2010 in response to the Council recommendation of 27 April 2009, and concluded that the action taken by Greece was inadequate and addressed a recommendation for a decision to the Council[40]. The Council decided accordingly on 2 December 2009 under Article 126(8) TFEU.

According to Article 5(1) of Council Regulation (EC) No 1467/97, "*Any Council decision to give notice to the participating Member State concerned to take measures for the deficit reduction in accordance with Article 104(9) of the Treaty (126(9) TFEU) shall be taken*

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36 According to Council Regulation (EC) No 3605/93 (which in the meantime has been replaced by Council Regulation (EC) No 479/2009), Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notifications of Greece can be found at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/procedure/edp_notification_tables

37 Eurostat news release No 147/2008 of 22.10.2008.

38 All EDP-related documents for Greece can be found at the following website: http://ec.europa.eu/economy_finance/sgp/deficit/countries/index_en.htm

39 Council Decision 2009/415/EC (OJ L 135, 30.5.2009, p. 21).

40 http://ec.europa.eu/economy_finance/publications/publication_summary16243_en.pdf

within two months of the Council decision establishing that no effective action has been taken in accordance with Article 104(8) (126(8) TFEU)", that is "*give notice to the Member State to take, within a specified time-limit, measures for the deficit reduction which is judged necessary by the Council in order to remedy the situation*".

5. THE NEED FOR FISCAL ADJUSTMENT IN 2010 AND BEYOND AND EXTENSION OF THE DEADLINE FOR CORRECTING THE EXCESSIVE DEFICIT

On the basis of the autumn 2009 Commission services' macroeconomic projections and potential growth estimates, the structural deficit in 2009 stands at 11½% of GDP. Therefore the total structural adjustment necessary for Greece, to bring the headline deficit below the reference value of 3% of GDP is more than 9% points of GDP. Therefore, a correction of the excessive deficit in 2010, as previously recommended by the Council is no longer realistic.

A frontloaded and credible structural budgetary consolidation is indispensable to improve the medium-term growth prospects in Greece, but such a large effort in a single year is obviously not feasible, while an adjustment of this magnitude in a three-year period will be challenging. Nevertheless, the high and persistent fiscal imbalances, coupled with the high and rapidly increasing level of debt and the available longer-term sustainability indicators are matters of serious concern and require determined action in the short-term. According to the Commission services' 2009 Sustainability Report[41], Greece is at high long-term risk with regard to the long-term sustainability of public finances. The long-term budgetary impact of ageing is well above the EU average, mainly as a result of a relatively high increase in pension expenditure as a share of GDP over the coming decades, if the pension system is not reformed. The budgetary position in 2009 compounds the budgetary impact of population ageing on the sustainability gap. Achieving primary surpluses over the medium term and especially a further reform of the pension system aimed at curbing the substantial increase in age-related expenditures would contribute to reducing risks to the long-term sustainability of public finances. If Greece's budgetary imbalances are not corrected promptly, they will weigh on economic agents' expectations and be detrimental to growth prospects not only in a longer-term prospect, but already in the near future.

In view of the above, the Commission considers that, by extending to 2012 the deadline for the elimination of the excessive deficit in Greece as outlined in the January 2010 update of the stability programme, it would set up the conditions for a balanced and lasting consolidation (demanding correction afterwards to reach a medium-term objective of close to balance or in surplus). To reach such a target, the Greek government should rigorously implement the deficit-reducing measures and structural reforms included in the January 2010 update of the stability programme, and stand ready to adopt further measures in case the adjustment would not suffice to attain the target. This would contribute to the credibility of the target of reducing the government deficit to below 3% of GDP in 2012.

If the 2010 headline general government deficit ratio is brought to a level of 8.7% of GDP based on the envisaged permanent measures, a credible adjustment path with a view to

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[41] According to the projections included in the 2009 Sustainability Report (*European Economy*, 9), government expenditure in age-related expenditure could increase, on unchanged policies, by 16% points of GDP from 2010 to 2060, of which 12.5 points refer to pensions. See also Commission's Communication to the European Parliament and the Council 'Long-term Sustainability of Public Finances for a Recovering Economy' - COM(2009) 545, 14.10.2009.

bringing the deficit durably below 3% of GDP by 2012 at the latest would also require a significant improvement in the structural balance (cyclically-adjusted balance net of one-off and temporary measures), also in 2011 and 2012. Thus, for those two years the structural fiscal effort should be of at least 3½% of GDP in 2010 and 2011 and 2½% of GDP in 2012.

If revenue performance in 2010 turns out better-than-expected, the Greek authorities should use the additional room for manoeuvre to reduce deficit further on in order to contribute to a sustained downward correction in public debt levels. In the opposite case, the Greek government should take necessary measures to compensate for the revenue shortfalls by cutting current expenditure.

Albeit decreasing, the contribution of factors affecting the debt-ratio other than net borrowing and nominal GDP growth (i.e. financial operations and other components of the so-called stock-flow adjustment), which have driven up the debt ratio in the past years, is projected to decrease in 2010. Although this planned development of the stock-flow adjustment represent an improvement with respect to the past, their contribution to overall increase in the debt level still remains a source of concern. Consequently, it is necessary that the Greek government takes further action in order to control debt-increasing transactions other than the deficit.

The annual change in general government debt levels in 2010 to 2012 should not exceed the increase implied by the nominal deficit targets of not above 8.7% of GDP in 2010, 5.6% of GDP in 2011 and 2.8% of GDP in 2012, and the debt issuance required for the settlement of arrears and normal liquidity management. Thus, the change in the gross debt level should not exceed EUR 22.240 billion in 2010, EUR 11.320 billion in 2011 and EUR 4.510 billion in 2012. This corresponds to a total stock-flow adjustment of ¼% of GDP per year, in 2010, 2011 and 2012.

Once the excessive deficit has been corrected, Greece shall take the necessary measures to ensure that a balanced budget in structural terms is achieved quickly in order to attain a sufficient and sustained reduction in debt levels. Achieving a balanced budget for appropriate budgetary management of economic downturns remains a key issue.

Over the last several years, the external accounts of the Greek economy have deteriorated significantly, with the high and persistent external imbalances mirroring to a large extent, the marked deterioration of the country's fiscal position. The net international position has markedly worsened since 2004. The negative net international investment position already exceeds 115% of GDP in 2009. Consequently, the government sector is not only absorbing the main part of the available external financing, but also crowding out private-sector access to financing. Thus, bold fiscal consolidation is also crucial for recovering competitiveness losses and addressing the existing external imbalances. Structural measures and wage moderation would also be crucial for restoring price competitiveness and correcting external imbalances.

Fiscal consolidation is also crucial for recovering competitiveness losses and addressing the existing external imbalances. To this end, the Greek authorities should implement permanent measures to control current primary expenditure, including the wage cost in the public sector; and urgently implement structural reforms. In particular, the Greek authorities should ensure that fiscal consolidation measures are also geared towards enhancing the quality of public finances within the framework of a comprehensive reform programme, while swiftly implementing policies to further reforming the tax administration.

The Commission recommends that Greece submits by 16 March 2010 a report spelling out the measures and the calendar for implementation, to achieve the 2010 budgetary targets. Greece should also submit a report by 15 May 2010 (and thereafter on a quarterly basis), outlining measures to be implemented in compliance with the Council Recommendation under Article 121(4) and Decision under Article 126(9). In particular, the report should contain detailed information on concrete measures implemented by the date of the report to comply with this Decision; concrete measures planned to be implemented after the date of the report to comply with this Decision; the calendar of the adoption of the structural measures, outlined in the January 2010 update of the stability programme; monthly State budget execution; infra-annual data on budgetary implementation by social security, local government and extra budgetary funds; government debt issuance and reimbursement; information on permanent and temporary public sector employment developments, government expenditure pending payment (cumulated arrears); and financial situation in public enterprises and other public entities (with yearly frequency).

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In view of the above assessment, the Commission recommends the Council (i) to give recommendations to Greece with a view to ending the inconsistency with the broad guidelines of the economic policies and removing the risk of jeopardising the proper functioning of economic and monetary union, in accordance with Article 121(4) of the Treaty on the Functioning of the European Union, (ii) to give notice to Greece in accordance with Article 126(9), to take the necessary measures the Council judges necessary, in order to remedy the situation of excessive government deficit and (iii) to deliver an opinion on the updated stability programme. Moreover, the Commission considers that making public this Council Recommendation under Article 121(4) will facilitate the co-ordination of economic policies of Member States and the Community and will contribute to a better understanding among economic agents, facilitating the implementation of the recommended measures. Therefore, the Commission also proposes to the Council to decide to make the attached Recommendation public; the other recommendations and decision are also public.

2010/0031 (NLE)

Proposal for a

COUNCIL DECISION

making public the Recommendation with a view to ending the inconsistency with the broad guidelines of the economic policies in Greece and removing the risk of jeopardising the proper functioning of economic and monetary union

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of European Union, and in particular Article 121(4) thereof,

Having regard to the proposal of the Commission,

Whereas:

(1) On [16 February 2010], the Council adopted Recommendation [No. ...] with a view to ending the inconsistency with the broad guidelines of the economic policies in Greece and removing the risk of jeopardising the proper functioning of economic and monetary union.

(2) Making public the Recommendation should facilitate the co-ordination of economic policies of Member States and the Union and should contribute to a better understanding among economic agents, facilitating the implementation of the recommended measures,

HAS DECIDED AS FOLLOWS:

Article 1

Recommendation [No. ... of 16 February 2010] with a view to ending the inconsistency with the broad guidelines of the economic policies in Greece and removing the risk of jeopardising the proper functioning of economic and monetary union shall be published in the *Official Journal of the European Union.*

Article 2

This Decision shall take effect on [16 February 2010].

Done at Brussels, [16 February 2010].

For the Council,
The President