# COUNCIL OPINION

## of 4 March 2008

## on the updated stability programme of Greece, 2007-2010

(2008/C 74/08)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies ([1]), and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On 4 March 2008, the Council examined the updated stability programme of Greece, which covers the period 2007 to 2010 ([2]).

(2) Over the recent years, Greece has recorded high growth rates driven by buoyant private consumption and dynamic investment activity, while employment growth accelerated significantly. However, relatively high inflation differentials with the euro area persist, and, in spite of a significant productivity growth, is leading to competitiveness losses.

The high and widening external imbalances, that are partly explained by one of the highest investment *ratios* in the EU, if continued in the medium term, might affect the performance of the economy. In this context, fiscal policy has a crucial role to play in stabilising the economy, improving its efficiency and diminishing the risks associated to overheating and widening external imbalances. Significant progress has been made since 2004 to consolidate public finances in a sustainable manner. On that basis, controlling current primary expenditure, preventing a pro-cyclical stance of fiscal policy and stepping up public spending efficiency are paramount to further securing fiscal discipline and improving the quality of public finances. Given the still high public debt level, the long-term sustainability of public finances greatly depends on achieving and sustaining sound budgetary positions, continuing the on-going reforms in the healthcare system and implementing comprehensive reform of the pension system ([3]).

(3) The macroeconomic scenario underlying the programme envisages that real GDP growth will be sustained at about 4 % on average over the programme period. Assessed against currently available information ([4]), this scenario appears to be based on favourable growth assumptions, in particular in the outer years. In particular, private consumption and investment growth are projected in the stability programme to remain favourable, on the back of somewhat high employment growth and an optimistic assessment of the impact of some implemented measures, such as the second phase of tax reform including further reduction in personal tax rates, legislated in 2006, the investment incentive law and the speeding-up of PPP (public-private partnerships) projects.

([1]) OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). The documents referred to in this text can be found at the following website:
http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm

([2]) The update was submitted 3 weeks beyond the 1 December deadline set in the code of conduct.

([3]) On 15 February 2008, the Greek Prime Minister presented the main pillars of the envisaged pension reform to the General Assembly of the Parliament.

([4]) The assessment takes into account notably the Commission services' autumn 2007 forecast and the Commission assessment of the October 2007 implementation report of the national reform programme.

Moreover, the evolution of labour cost may induce inflationary pressures, despite the wage restraint in the public sector, while competitiveness could deteriorate more than foreseen in the programme. In addition, on recent information, the inflation projection may be subject to upside risks.

(4) According to the programme, the general government deficit for 2007 is estimated to have rebounded to 2,7 % of GDP in 2007 (from 2,5 % in 2006), compared to the target deficit of 2,2 % of GDP set in the previous update ([1]). This deviation of 0,5 percentage point of GDP reflects, in addition to a small negative base effect, an expenditure overrun of some 0,25 percentage point of GDP and a net deficit-increasing impact of one-offs of 0,3 percentage point of GDP ([2]). The projected deficit outturn in the Commission services' autumn 2007 forecast is 2,9 % of GDP, 0,25 of a percentage point higher than in the programme, based on a more prudent assessment of tax revenues. The estimated narrowing of the structural government deficit (i.e. the cyclically-adjusted deficit net of one-off and other temporary measures) in 2007 by some 0,5 percentage point of GDP is partly in line with the invitation in the Council opinion of 27 February 2007 on the previous update of the stability programme ([3]) to 'strengthen the adjustment towards the MTO'. The Council notes that the implementation of the 2007 budget is also not fully consistent with the April 2007 Eurogroup orientations for budgetary policies.

(5) The budgetary strategy outlined in the programme aims at speeding up fiscal consolidation towards the medium-term objective (MTO) of a balanced position in structural terms, by reducing the structural deficit by more than 0,5 percentage point of GDP per year, in line with the invitation of Council opinion of 27 February 2007 on the previous update of the stability programme 'to strengthen the adjustment towards the MTO'. In particular, the MTO is planned to be achieved earlier than the target year set in the previous update (2012), although still beyond the programme horizon (2010). The programme aims at attaining a balanced position in nominal terms by 2010, from a deficit of 2,75 % of GDP in 2007. The primary surplus is projected to improve to 3,75 % of GDP in 2010 from 1,25 % in 2007. The planned adjustment is mainly revenue-based, stemming partly from the implementation of discretionary measures in indirect taxes and real estate taxation and partly from improving the tax system and intensifying the fight against tax evasion and fraud. While overall expenditure declines only marginally in terms of GDP, its composition is planned to shift, with social payments rising by 1 percentage point of GDP, broadly offset by cuts in intermediate consumption. Taking into account the mechanical impact of the recent GDP revision, the budgetary target presented in the programme is broadly similar to the one in the previous update for 2008 and improved for 2009 against a broadly comparable macroeconomic scenario. Government gross debt, estimated at 93,4 % of GDP in 2007, clearly above the 60 % of GDP Treaty reference value, is projected to decline by over 10 percentage points over the programme period.

(6) The budgetary outcomes could be worse than projected in the programme. The increase in tax revenues planned for 2008 is based on slightly favourable assumptions and reflects a possibly optimistic assessment of the efforts to avoid tax evasion and fraud. However, the effective implementation of revenue-enhancing discretionary measures in 2008 and the envisaged reforms to improve the institutional setting and transparency of the budgetary process based on the performance/programme budgeting on a multi-annual basis, are expected to generate positive effects on the budgetary outcome in the medium-term, although the precise budgetary impact remains uncertain. For 2009 and 2010, the programme does not underpin budgetary targets with corresponding measures, while it assumes a favourable macroeconomic scenario. In view of these risks to the budgetary targets, which are compounded by uncertainty about sizable future stock-flow adjustments, the evolution of the debt *ratio* could be less favourable than projected in the programme, especially after 2008.

(7) In view of this risk assessment, the budgetary stance in the update may not be sufficient to ensure that the MTO is achieved just after the end of the programme period, as implied by the programme. In addition, a sufficient safety margin against breaching the 3 % of GDP deficit threshold with normal

([1]) Due to the recent upward revision of the Greek GDP series by 9,6 % from 2000 onwards, the update's targets are not directly comparable to the ones in the previous update. In order to allow for a meaningful comparison, the figures from the previous update quoted here have been recalculated to take account of the denominator effect introduced by the GDP revision.

([2]) This net one-off impact is the combination of deficit-increasing one-offs of 0,7 percentage point (mainly related to arrears to the EU budget following the GDP revision, but also to expenditures related to the summer forest fires) and deficit-reducing measures of 0,4 percentage point of GDP (deferred payments by banks to the pension funds).

([3]) OJ C 70, 27.3.2007, p. 11.

macroeconomic fluctuations may not be provided before 2010. The update plans an adjustment towards the MTO above 0,5 percentage point of GDP per year, in line with the Stability and Growth Pact and higher compared with the previous update. However, the adjustment should be backed up with measures from 2009 onwards, in view of the risks identified above. The Council notes that as the structural adjustment planned for 2008 is higher than foreseen in the previous update, the plans for 2008 are consistent with the April 2007 Eurogroup orientations for budgetary policies. However the risks identified above should be addressed. Finally, taking into account these risks, the debt *ratio* seems to be sufficiently diminishing towards the reference value over the programme period. However it remains much higher than the reference value of 60 % throughout the update horizon. In addition, the adjustment path has slowed down and is conditional on ambitious deficit targets.

(8) Greece appears to be at high risk with regard to the sustainability of public finances. The long-term budgetary impact of ageing cannot be duly assessed as long as commonly agreed long-term projections of pension expenditure are not available. However, it is likely to be well above the EU average. According to the latest available information dating from the 2002 stability programme update, a substantial increase in pension expenditure as a share of GDP is projected over the long-term. The budgetary position in 2007 as estimated in the programme, which is similar to the starting position of the previous programme, constitutes a risk to sustainable public finances even before considering the long-term budgetary impact of an ageing population. Moreover, the current level of gross debt is well above the Treaty reference value. Reducing it requires achieving high primary surpluses for a long period of time. Consolidating the public finances as planned together with continuing the on-going reform in the healthcare system and reforming the pension system aiming at containing the likely significant increase in age-related expenditures would contribute to reducing risks to the long-term sustainability of public finances.

(9) The stability programme is consistent to some extent with the October 2007 implementation report of the national reform programme (NRP). While the measures in the area of public finances envisaged in the stability programme are consistent with those foreseen in the NRP, the stability programme contains only a partial qualitative assessment of the overall impact of the NRP within the medium-term fiscal strategy. According to the programme, the majority of the measures and actions planned for 2008, included in the implementation report of the NRP, and the relevant budgetary provisions have been included in the 2008 Budget Law. However, no systematic information on the direct budgetary costs or savings of the main reforms envisaged in the national reform programme is provided and, excluding 2008, budgetary projections do not explicitly take into account the public finance implications of the actions outlined in the implementation report of the NRP.

(10) The budgetary strategy in the programme is broadly consistent with the country-specific broad economic policy guidelines and the guidelines for euro area Member States in the area of budgetary policies issued in the context of the Lisbon strategy.

(11) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme provides some gaps in the required and optional data ([1]). However, it deviates on some material points from the model structure specified in the code of conduct ([2]).

The overall conclusion is that the programme envisages speeding up the reduction of the budget deficit, in a context of strong growth, to achieve a nominal budget balance in 2010, although the MTO is not planned to be achieved in structural terms within the programme period. This consolidation, which relies on a prompt implementation of the 2008 budget and a significant increase in tax revenues throughout the

([1]) In particular, general government expenditure by function, long-term sustainability of public finances and information on debt developments (differences between cash and accruals, net accumulation of financial assets, valuation effects and other, liquid financial assets, net financial debt) are not provided.
([2]) In particular, Section 6 ('Long-term sustainability of public finances') provides limited information on pensions and refers to the projections included in the December 2002 update of the stability programme.

programme horizon, is subject to risks as the underlying macroeconomic scenario is favourable and the revenue-enhancing measures are not fully spelled out after 2008. Moreover, there are uncertainties about sizeable projected stock-flow adjustments. Also, the reliance on results from the fight against tax evasion is significant and only partly backed up with reforms in tax collection. In addition, the planned cutbacks in some expenditure items (as a share of GDP) are not substantiated by specific measures and partly offset by plans to increase social payments. Ensuring a strong fiscal consolidation path would help address the imbalances of the Greek economy, notably persistent inflation, competitiveness losses and a large external deficit. The level of debt which remains among the highest in the euro area, coupled with the projected increase in age-related spending, will affect negatively the long-term sustainability of public finances, which remains at high risk.

In view of the above assessment, Greece is invited to:

(i) carry out the envisaged adjustment towards the MTO, reduce the debt-to-GDP *ratio* accordingly, and use any budgetary overperformance to speed up the consolidation process to reach the MTO within the programme period;

(ii) pursue the ongoing reforms of tax administration and continue improving the budgetary process by further increasing its transparency, spelling out the medium-term budgetary framework and effectively implementing mechanisms to monitor, control and improve the efficiency of primary expenditure;

(iii) in view of the level of debt and the projected increase in age-related expenditure, improve the long-term sustainability of public finances by achieving the MTO, continuing the on-going reforms in the health-care system and reforming the pension system; updated long-term projections for age-related expenditure should be produced as soon as possible.

The Council also notes that such policy actions would be consistent with the April 2007 Eurogroup orientations for fiscal policies.

Greece is also invited to improve compliance with the submission deadline for stability and convergence programmes specified in the code of conduct.

**Comparison of key macroeconomic and budgetary projections** (1)

| | | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| Real GDP (% change) | **SP Dec 2007** | **4,2** | **4,1** | **4,0** | **4,0** | **4,0** |
| | COM Nov 2007 | 4,3 | 4,1 | 3,8 | 3,7 | n.a. |
| | *SP Dec 2006* | *4,0* | *3,9* | *4,0* | *4,1* | *n.a.* |
| HICP inflation (%) | **SP Dec 2007** | **3,3** | **2,9** | **2,8** | **2,7** | **2,6** |
| | COM Nov 2007 | 3,3 | 2,8 | 3,1 | 3,1 | n.a. |
| | *SP Dec 2006* | *3,3* | *3,3* | *2,8* | *2,6* | *n.a.* |
| Output gap (2) (% of potential GDP) | **SP Dec 2007** | **0,8** | **0,8** | **0,8** | **0,9** | **1,1** |
| | COM Nov 2007 (3) | 1,1 | 1,3 | 1,2 | 1,2 | n.a. |
| | *SP Dec 2006* | *1,0* | *0,9* | *1,1* | *1,5* | *n.a.* |

| | | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| Net lending/borrowing *vis-à-vis* the rest of the world (% of GDP) | **SP Dec 2007** | **– 12,3** | **– 12,8** | **– 12,7** | **– 12,5** | **– 12,2** |
| | COM Nov 2007 | – 9,6 | – 9,4 | – 9,5 | – 9,4 | n.a. |
| | *SP Dec 2006* | *– 8,9* | *– 7,9* | *– 7,6* | *– 7,3* | *n.a.* |
| General government balance (% of GDP) | **SP Dec 2007** | **– 2,5** | **– 2,7** | **– 1,6** | **– 0,8** | **0,0** |
| | COM Nov 2007 | – 2,5 | – 2,9 | – 1,8 | – 1,8 | n.a. |
| | *SP Dec 2006* | *– 2,6* | *– 2,4* | *– 1,8* | *– 1,2* | *n.a.* |
| | *SP Dec 2006 adj* | *– 2,4* | *– 2,2* | *– 1,6* | *– 1,1* | *n.a.* |
| Primary balance (% of GDP) | **SP Dec 2007** | **1,6** | **1,2** | **2,4** | **3,1** | **3,8** |
| | COM Nov 2007 | 1,6 | 1,0 | 2,1 | 2,0 | n.a. |
| | *SP Dec 2006* | *2,0* | *2,0* | *2,4* | *2,9* | *n.a.* |
| Cyclically-adjusted balance (2) (% of GDP) | **SP Dec 2007** | **– 2,8** | **– 3,1** | **– 1,9** | **– 1,2** | **– 0,5** |
| | COM Nov 2007 | – 3,0 | – 3,4 | – 2,4 | – 2,3 | n.a. |
| | *SP Dec 2006* | *– 3,0* | *– 2,8* | *– 2,3* | *– 1,8* | *n.a.* |
| Structural balance (4) (% of GDP) | **SP Dec 2007** | **– 3,2** | **– 2,8** | **– 2,0** | **– 1,2** | **– 0,5** |
| | COM Nov 2007 | – 3,5 | – 3,1 | – 2,4 | – 2,3 | n.a. |
| | *SP Dec 2006* | *– 3,4* | *– 2,8* | *– 2,3* | *– 1,8* | *n.a.* |
| Government gross debt (% of GDP) | **SP Dec 2007** | **95,3** | **93,4** | **91,0** | **87,3** | **82,9** |
| | COM Nov 2007 | 95,3 | 93,7 | 91,1 | 88,8 | n.a. |
| | *SP Dec 2006* | *104,1* | *100,1* | *95,9* | *91,3* | *n.a.* |
| | *SP Dec 2006 adj* | *95,0* | *91,3* | *87,5* | *83,3* | *n.a.* |

*Notes:*

(1) The December 2007 update uses the official revised GDP (upward revision by 9,6 %), according to the Eurostat press release of 22 October 2007 and are therefore not directly comparable with the figures of the December 2006 update. In order to allow for a meaningful comparison, the rows 'SP Dec 2006 adj.' show the targets in the December 2006 update as recalculated to take into account the denominator effect of the revised GDP. The Commission services' autumn 2007 forecast is based on an estimation of the revised GDP components, due to the lack of official statistical data on National Accounts by the cut-off date of the forecast.

(2) Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

(3) Based on estimated potential growth of 3,9 %, 3,8 % and 3,7 % respectively in the period 2007-2009.

(4) Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0,4 % of GDP in 2006, 0,3 % in 2007 and 0,1 % in 2008, deficit-reducing in 2006 and 2008, but deficit increasing in 2007, according to the most recent programme and 0,4 % of GDP in 2006 and 0,3 % in 2007, deficit-reducing in 2006 and deficit increasing in 2007 according to the Commission services' autumn forecast.

*Sources:*

*Convergence programme (SP); Commission services' autumn 2007 economic forecasts (COM); Commission services' calculations.*