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**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL**

**Follow-up to the Council Decision 2010/320/EU addressed to Greece, with a view to reinforcing and deepening fiscal surveillance and giving notice to Greece to take measures for the deficit reduction judged necessary to remedy the situation of excessive deficit**

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### **Follow-up to the Council Decision 2010/320/EU addressed to Greece, with a view to reinforcing and deepening fiscal surveillance and giving notice to Greece to take measures for the deficit reduction judged necessary to remedy the situation of excessive deficit**

#### **1. INTRODUCTION**

This Communication assesses the measures implemented by Greece in the period between July and mid November 2010 to comply with the Council Decision 2010/320/EU.<sup>1</sup> Action taken up to July was assessed in the Communication dated 19.8.2010.<sup>2</sup> Together with a companion Commission staff's report, prepared in liaison with the ECB,<sup>3</sup> it also contributes to the assessment of compliance with the MEFP and the MoU,<sup>4</sup> in the context of the loan facility agreement between Greece and the euro-area Member States.

This assessment is based on the report submitted to the Council and the Commission by Greece,<sup>5</sup> and on the mission conducted by European Commission staff together with IMF and ECB in the context of the economic adjustment programme which is being financed by bilateral loans by the euro-area Member States and an IMF's stand-by arrangement. The report submitted by Greece discusses not only the fiscal measures that aim at reducing the government deficit ratio in 2010, but also the wide-ranging structural reforms that are being adopted and implemented by the Greek government.

#### **2. THE COUNCIL DECISION OF 10 MAY 2010**

On 10 May 2010, the Council adopted Decision 2010/320/EU, under Articles 126(9) and 136 TFEU, addressed to Greece, with a view to reinforcing and deepening the fiscal surveillance and giving notice to take measures for the deficit reduction judged necessary to remedy the situation of excessive deficit by 2014.

The Council Decision requires Greece to adopt a number of specific measures with the aim of keeping general government deficit below the following ceilings:

- EUR 18 508 million (7.8 percent of GDP, on the basis of the latest nominal GDP projections) in 2010;

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<sup>1</sup> OJ L 241, 14.9.2010, p. 12.

<sup>2</sup> COM (2010) 439 final

<sup>3</sup> 'The Economic Adjustment Programme for Greece – Second Review,' *European Economy–Occasional Papers*, 72 November. The reader is referred to that document for a more detailed assessment of macroeconomic, financial, fiscal and structural reform developments.

<sup>4</sup> Memorandum of Economic and Financial Policies, and Memorandum of Understanding of Specific Economic Policy Conditionality of 3 May, updated 6 August 2010.

<sup>5</sup> *The Economic Adjustment Programme for Greece – Report submitted in accordance with Council Decision – November 2010*. A first part of the report has been submitted by the Greek government on 15 November 2010; the complete report was submitted on 24 November 2010.

- EUR 17 065 million (7.5 percent of GDP) in 2011;
- EUR 14 916 million (6.4 percent of GDP) in 2012;
- EUR 11 399 million (4.8 percent of GDP) in 2013 and
- EUR 6 385 million (2.6 percent of GDP) in 2014.<sup>6</sup>

The Decision was then amended on 7 September 2010 (Decision 2010/486/EU).<sup>7</sup> However, the aforementioned ceilings for the general government deficit were kept unchanged.

### 3. BUDGETARY EXECUTION

The previous communication assessed budgetary developments until July as broadly on track. However, it also raised attention to state revenue increasing by less than planned, less favourable developments in social security and local government accounts and accumulation of arrears.

Over the last four months, budgetary implementation has become more difficult. From January to October 2010, the state cash deficit fell by 30.2 percent (46 percent up to June) as compared to 2009. Tax revenue disappointed. From January to September 2010, total state revenue increased by 3.4 percent (5.9 percent up to June). The official estimate prepared in May, when the Council Decision was adopted, and the economic adjustment programme for Greece was agreed, was of an increase in revenue for the year as a whole of 15.6 percent. A pick-up in revenue is expected in November and December, as the implementation of the full effect of the VAT and excise increases will feed through, and thanks also a recently-adopted 'tax settlement.'<sup>8</sup> However, the revenue target will not be reached. At this moment, the Greek General Accounting Office (GAO) estimates that state revenue for the year as a whole will increase by 7.4 percent.

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<sup>6</sup> The ratios to GDP are indicative. In the Council Decision, the ratios-to-GDP refer to the nominal GDP figures available in May: 8.0, 7.6, 6.5, 4.9 and 2.6 percent of GDP for 2010 to 2014, respectively. The adjustment path established by the Decision requires that the annual increase in the general government consolidated gross debt does not exceed: EUR 34 058 million in 2010; EUR 17 365 million in 2011; EUR 15 016 million in 2012; EUR 11 599 million in 2013 and EUR 7 885 million in 2014. Taking into account the revised debt figures at the end of 2009 and the latest nominal GDP projections, this corresponds to debt ratios of 143, 153, 157, 158 and 156 percent of GDP for 2010 to 2014, respectively.

<sup>7</sup> OJ L 145, 11.6.2010, p. 6.

<sup>8</sup> Most taxpayers have the opportunity of making a payment to the tax agency in 2010 (with a second and final instalment in 2011) in exchange of not having their income statements for years up to 2009 (Law 3888/2010).

**Table 1: State budget execution**

<i>cash basis</i> (EUR million)	2009		2010		2010			
	Jan - Oct		% change	Outcome	May- 2010 plans	% change	latest official estimate	% change
<b>Total revenue</b>	40928	42361	3,5	50531	55715	10.3	54280	7,4
Revenue before refunds	43477	44611	2,6	53443	57800	8.2	56488	5,7
Tax refunds	3964	3618	-8,7	4952	5100	3.0	5100	3,0
Capital revenue	1415	1368	-3,3	2040	3015	47.8	2892	41,8
<b>Total expenditure</b>	65761	59695	-9,2	81403	75187	-7.6	74903	-8,0
Primary expenditure	45665	40566	-11,2	57992	52633	-9.2	52798	-9,0
Interest	12074	12742	5,5	12325	13209	7.2	13260	7,6
Capital expenditure	8022	6047	-24,6	9588	9000	-6.1	8500	-11,3
Other	0	340		1498	345	-7.7	345	-77,0
<b>State Budget balance</b>	-24833	-17334	-30,2	-30872	-19472	-36.9	-20623	-33,2

Source: GAO.

Note: This tables does not include spending for military procurement (EUR 500 million up to October, and an estimate of EUR 1 500 million for the year as a whole, declining by 30 percent as compared to 2009).

Concerning the spending side of the state accounts, cash outflows during the first ten months of the year contracted by 9.2 percent (16.9 percent up to June); this compares with plans (of May 2010) of a reduction in state payments for the year as a whole of 7.6 percent. However, the data provision on accounts payable and accumulation of arrears have been only sporadic, resulting in a relatively opaque view of underlying spending.

Monthly data on infra-annual budgetary execution by social security and local government is not as detailed, and of lesser quality, than on the state budget. Available information is derived from banking statistics without expenditure and revenue details. It indicates that social security and local government may register a combined balance in a cash basis that is around 1 billion below the May 2010 plans.

In August, the government had committed to under-execute primary spending by EUR 3.9 billion (revised to EUR 5.9 bn in September) relative to programme projections, with the aim of offsetting slippages in tax collection and the less favourable data in social security and local government. There is evidence that the government may only partially deliver on its commitment to under-execute expenditure plans, in particular concerning spending in investment. Although it is feasible to spend less in the last weeks of the year than currently planned by the GAO, any end-year compression in spending should not be made at the expense of a further increase in arrears.

According to the Commission autumn forecasts<sup>9</sup> the ESA95 deficit for 2010 will be 22.3 billion (9½ percent of GDP, 1¾ percent of GDP above the original programme target). The non observance of the ESA deficit target for the 2010 reflects, to a large extent, the materialization of risks that had been previously identified. These risks are related to (i) a deeper recession and liquidity constraints, which weigh on revenue collection; (ii) delays in improving tax compliance, reflecting shortcomings in the implementation of reforms to improve tax administration, and (iii) some difficulties in controlling expenditure in particular in capital budget and by local government and social security. Moreover, (iv) the revision by

<sup>9</sup> European Economic Forecast - Autumn 2010, *European Economy*, 7, November.

ELSTAT of Greek fiscal statistics<sup>10</sup>—in particular the reclassification of a number of state-owned enterprises into general government—explains around one third of deviation vis-à-vis the deficit target.

The government debt at the end of 2010 is expected to reach EUR 328 billion, 141 percent of GDP, an increase of EUR 29 billion. This compares with the ceiling for the increase in the debt level of EUR 34 billion in the Council Decision.

### 3. BUDGET FOR 2011 AND PROSPECTS FOR 2012-2014

The Greek Government has confirmed its commitment to meet the fiscal target for 2011 established by the Council Decision. With higher than expected starting deficit and debt levels, and lower than expected GDP, larger consolidation efforts are necessary. The fiscal strategy remains firmly anchored on the consolidation path agreed in May 2010. The Greek Government therefore decided to fully recoup the ground lost in 2010, in order to restore rapidly a sustainable fiscal position, keep financing needs in line with the programme, and support market confidence. The 2011 budget—tabled in Greek Parliament on 18 November – contains 2½ percent of GDP in new deficit-reducing measures.

Most of the new measures are structural and directly address some of Greece's endemic budgetary weaknesses. They will bring total fiscal consolidation measures in 2011 – including those agreed in May – to 5¾ percent of GDP. About two thirds of the new measures agreed in November are on the expenditure side, and most of them are of a structural nature; EUR 0.7 billion, or 0.3 percent of GDP, of measures are temporary. Measures include cuts in unproductive and untargeted spending, a reduction in short-term contracts in the public sector, better targeting of universal household subsidies (like the subsidies for heating fuel and family allowances), and better management and use of state assets, particularly in the collection of taxes in arrears. The 2011 budget also starts tackling two key structural problems – excessive health spending and losses by state owned enterprises:

- *Health expenditure.* Public expenditure on health accounted for 5.9 percent of GDP in 2008, and grew on a per capita basis at an average real rate of 5.4 percent over 2004-08. Public expenditure on pharmaceuticals is 1.9 percent of GDP in Greece, against 1 percent of GDP, on average in the EU. Should past trends continue, the share of health spending in GDP would increase dramatically in the coming years. The government started to introduce reforms in 2010, and these have begun to yield results. Further measures will be implemented in the first half of 2011 to reduce spending on pharmaceuticals, enhance spending control, and reduce hospital operating expenses. These actions are expected to generate about ½ percent of GDP in savings.
- *State-owned enterprises (SOEs).* Several SOEs have been running large losses over many years. The biggest deficits originate in public transport enterprises, where payroll alone in some cases exceeds total revenue. Some progress has been made in 2010, in particular through cuts in operating expenditure and employment, and with the publication of the financial statements (certified by external auditors) of the largest loss-makers. In 2011 the government will further reduce wages in SOEs by 10 percent,<sup>11</sup> limit allowances to 10 percent of basic pay, and introduce a ceiling of EUR 4 000 per month for gross wage (12

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<sup>10</sup> For detailed information see the Eurostat's 'Information Note on Greek Fiscal Data' (15 November 2010), available at the Eurostat website.

<sup>11</sup> On top of the wage cuts decided in the course of 2010 which were applicable both to civil servants and SOEs' employees.

payments per year). In addition, to address the specific problem of transport enterprises, urban transport tariffs will be increased by at least 30 percent. About ½ percentage points of GDP are expected from these measures.

According to the 2011 budget, the government deficit (ESA95) is expected to be 16.8 billion (7.6 percent of GDP), slightly below the ceiling of EUR 17 billion, in the Council Decision. The Commission forecasts are very close to the budget. The reduction in the government ratio in 2011 will therefore be effectively larger than planned in the original programme—2.2 percentage points instead of 0.4 points.

The measures in the 2011 budget are not enough to durably reduce the deficit and ensure the deficit target for 2012 to 2014 are met. The Greek government has committed to specify fiscal structural measures to achieve the 2012-14 targets. These measures will be part of a strategic paper to be prepared in the first quarter of 2011. Present estimates suggest a need to identify at least 5 percent of GDP in additional structural measures on top of those already announced in May 2010. These measures need to come from durable revenue and spending adjustments in several fields: improvements in tax administration and fight against tax evasion; reduction in the public workforce through a strict implementation of a rule of 1 recruitments for 5 exits, without sectoral exceptions; reforms of the healthcare and education systems; structural cuts in military spending and a multi-year reform of state-owned enterprises including the merger and closure of units.

## **6. PROGRESS WITH STRUCTURAL REFORMS**

The structural reform agenda in Greece is wide. Progress has been achieved in structural fiscal reforms, though in several cases slower than planned. There has been progress in improving tax administration and controls, enhance the timely provision of reliable fiscal data, strengthening budgetary institutions and the new organic budget law providing for multi-year budgeting. A first phase of the pension reform was adopted before the summer recess and will be completed in 2011. Preparations are starting for comprehensive reforms of the health care system and education. The functional review of central administration and social programme and the simplified remuneration system for the public sector have faced delays. After a first wave of labour market reforms before the summer, there have been delays in a second wave concerning the wage bargaining mechanisms and the system of mediation and arbitration.

The privatisation plan announced during the summer is not ambitious enough, as privatisations are planned to be conducted mostly through concession agreements, with outright sales playing a smaller role. However, the Government committed to increase privatisation proceeds (including sales of real estate) from EUR 1 billion in 2011 to EUR 3 billion per year in 2012 and 2013. The Government has committed to use the privatisation proceeds are to be used to redeem debt and not to reduce the fiscal consolidation efforts.

## **7. COMPLETENESS OF REQUIRED INFORMATION**

The report submitted by Greece, and data regularly transmitted to the Commission includes most of the information requirements established by the Council Decision. In particular, the report contains detailed information on concrete measures implemented (and to be implemented) in order to comply with the Decision and their respective budgetary impact.

Data on the monthly state budget execution have been timely provided by the General Accounting Office.

The report also contains the required information in relation to debt issuance and reimbursements, and on the financial situation of the largest public enterprises. However, monthly data on the budgetary implementation by social security funds, extra-budgetary bodies and local government, information on public sector employment, expenditure pending of payment (including arrears) are still incomplete. Moreover, the report contains a wealth of information concerning the implementation of structural reforms in response to the Council Recommendation of 16 February 2010<sup>12</sup> and to comply with the MEFP and MoU.

## **8. CONCLUSION**

The government deficit (ESA95 basis) ceiling for 2010 established by Council Decisions is going to be missed by around 4.2 billion, as it is planned to reach 9½ percent of GDP. This amounts to a reduction in the deficit ratio of almost six points as compared to 2009. The government debt ratio is expected to increase from 127 percent of GDP at the end 2009 to 141 percent in 2010. The increase in debt is in line with the Council Decision.

For 2011, the budget tabled in Parliament is in line with the Council decision ceilings. However further durable measures will be necessary to keep reducing the deficit in subsequent years and put an end to the excessive deficit by 2014.

Greece has been adopting the specific measures indicated in the Council Decision, though there are delays in a number of areas and the reform rhythm appears to have slowed down from before to after the summer recess.

Therefore, the Commission concludes that Greece is satisfactorily complying with the Council Decision of 10 May 2010, responding to the Council Recommendation of 16 February 2010 and implementing the measures outlined in the updated MEFP and MoU of 6 August 2010.

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<sup>12</sup> Council Recommendation (2010/190/EU) to Greece 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 the economic and monetary union (OJ L 83, 30.3.2010, p. 63).

## ANNEX I: MEASURES REQUIRED BY THE COUNCIL DECISION, TO BE ADOPTED BY END-SEPTEMBER 2010

Measures (as required by Article 2(2) of the Council Decision)	State of progress
<p>“Greece shall adopt the following measures before the end of September 2010:</p> <p>(a) fiscal consolidation measures amounting to at least 3,2 % of GDP (4,3 % of GDP if carryovers from measures implemented in 2010 are considered) to be included in the draft budget for 2011: a reduction in intermediate consumption of the general government by at least EUR 300 million compared to the 2010 level (on top of savings stemming from the reform of public administration and of local government referred to in this paragraph); a freeze in the indexation of pensions (with the aim of saving EUR 100 million); a temporary crisis levy on highly profitable firms (yielding at least EUR 600 million in additional revenue per year in 2011, 2012 and 2013); a presumptive taxation of professionals (with a yield of at least EUR 400 million in 2011 and increasing returns by at least EUR 100 million per year in 2012 and 2013); a broadening of the VAT base by including certain services currently exempted and by moving 30 % of goods and services from the reduced rate to the main rate (with a yield of EUR 1 billion); a phased- in green tax on CO 2 emissions (with a yield of at least EUR 300 million in 2011); the implementation by the Government of the legislation reforming the public administration and a reorganisation of local government (with the aim of reducing costs by at least EUR 500 million in 2011, and additional EUR 500 million in each year 2012 and 2013); a reduction in domestically-financed investments (by at least EUR 500 million) by giving priority to investment projects financed by EU structural funds, incentives to regularise land-use violations (yielding at least EUR 1 500 million from 2011 to 2013, of which at least EUR 500 million in 2011); a collection of revenue from the licensing of gaming (at least EUR 500 million in sales of licences and EUR 200 million in annual royalties); an expansion of the base of the real estate tax by updating asset values (to yield at least EUR 400 million additional revenue); an increased taxation of wages in kind, including by taxing car lease payments (by at least EUR 150 million); an increased taxation of luxury goods (by at least EUR 100 million); a special tax on unauthorised establishments (to yield at least EUR 800 million per year) and a replacement of only 20 % of retiring employees in the public sector (central government, local governments, social security funds, public companies, state agencies and other public institutions). Measures yielding comparable budgetary savings may be considered after consultation with the Commission;</p>	<p><b>Observed.</b></p> <p>The 2011 budget was submitted to Parliament on 18 November.</p> <p>The yield of several measures (including incentives to regularise land-use violations, green tax, the expansion of the base for the real estate tax, a special tax on unauthorised establishments, and taxes on luxury goods) is expected to be lower than initially estimated.</p> <p>The broadening of the VAT base by moving 30 percent of goods and services from the reduced rate to the main rate will not be implemented, but replaced by an increase in reduced VAT rates to almost all goods in that category.</p> <p>Total measures in the budget for 2011, as well as other measures announced prior to the budget are expected to yield (5¾ percent of GDP), more than required by the Council Decision.</p>

<p>(b) a reinforcement of the role and resources of the general accounting office and the establishment of safeguards against possible political interferences in data projection and accounting;</p>	<p><b>Observed.</b> The strengthening of GAO is part of the new organic budget law (Law 3871/2010). The Ministry of Finance has commissioned a comprehensive study for the reorganisation of the General Accounting Office to a private consulting company, the results of which will be available by early 2011.</p> <p>The pre budget (of October) for 2011 was built on optimistic macroeconomic projections and revenue projections that were not properly underpinned by concrete measures. The draft budget for 2011 is based on plausible assumptions similar to those prepared by Commission and takes into account the latest fiscal developments.</p>
<p>(c) a draft reform of wage legislation in the public sector, including notably the creation of a Single Payment Authority for the payment of wages, the introduction of unified principles and timetable to establish a streamlined unified public sector wage grid to apply to the State sector, local authorities and other agencies;</p>	<p><b>Partially observed.</b> The single payment authority has been established but is not yet fully active.</p>
<p>(d) a legislation improving the efficiency of the tax administration and controls;</p>	<p><b>Observed.</b> Laws 3842/2010 and 3888/2010 have been adopted. Task forces have been established to prepare measures and reforms to fight tax evasion. The government will implement these actions in January 2011, and set quantitative performance indicators to hold the revenue administration accountable, e.g. in the area of tax arrears collection, controls over largest taxpayers, and tax return filing and payments. In parallel, the government will strengthen the legislative framework to fight tax evasion: the administrative tax dispute and judicial appeal processes will be simplified, impediments to the exercise of core tax administration functions (indirect audit methods, tax returns processing) removed, and the status of personnel in charge of tax administration reformed to punish breach of duty.</p>
<p>(e) the launch of independent reviews of central administration and of existing social programmes;</p>	<p><b>Partially observed.</b> Technical meetings with the EC, IMF and ECB, and OECD (which will conduct the reviews) have started. Contract not yet signed.</p>

<p>(f) the publication of monthly statistics (on a cash basis) on revenue, expenditure, financing and spending arrears for the available general government and its sub entities;</p>	<p><b>Partially observed.</b> Commitment registers have been introduced in all general government units in November and the government published data on arrears by general government entities. At the same time, accounting beyond state level remains below par and prevents and adequate monitoring of intra-year budgetary developments. While the situation has somewhat improved in the social security sector and reclassified state-owned enterprises, data on local governments remain very limited.</p>
<p>(g) an action plan to improve collection and processing of general government data, notably by enhancing the control mechanisms of statistical authorities and the General accounting office and ensuring effective personal responsibility for cases of misreporting, in order to ensure the prompt supply of high quality general government data required by regulations (EC) 2223/96, 264/2000, 1221/2002, 501/2004, 1222/2004, 1161/2005, 223/2009 and 479/2009;</p>	<p><b>Observed.</b> Ongoing cooperation with Eurostat in the framework of the Joint Statistical Action Plan. An appropriate trail of provision of source data on public finances to ELSTAT has been established. The quarterly public finance data are being compiled for 2010 on the basis of direct data sources. Fiscal statistics for 2006-09 have been revised by ELSTAT and validated by Eurostat.</p>
<p>(h) a regular publication of information on the financial situation in public enterprises and other public entities not classified in the general government (including detailed income statements, balance sheets and data on employment and the wage bill)."</p>	<p><b>Observed.</b> The first release of data on the eleven largest public enterprises took place in October 2010</p>
<p>(i) the establishment of a comprehensive central registry for public enterprises;</p>	<p><b>Observed.</b> The registry is expected to be fully operational during the first quarter of 2011.</p>
<p>(j) an action plan with a timetable for concrete actions leading to the creation of a central procurement authority;</p>	<p><b>Observed.</b> An action plan has been agreed with the Commission services.</p>
<p>(k) an act establishing an upper limit of EUR 50 million for the annual public service obligation contribution from the general government to railway operators for the period 2011-2013 and establishing the principle that the State provides no additional explicit or implicit support to railway operators;</p>	<p><b>Partially observed.</b></p>
<p>(l) a business plan for the Greek railways. The business plan specifies how operational activities will be made profitable, including covering depreciation costs, as from 2011, including by closing loss-making lines, by increasing tariffs and by reducing wages and staffing; provides a detailed sensitivity analysis on the implication for wage costs of various scenarios for the outcome of collective agreement and provides information on several options concerning staff; and provides for the restructuring of the holding company, including the sale of land and other assets;</p>	<p>New railway law adopted on 26 October 2010. The business plan was delivered to EC/IMF/ECB for consultation on 30 September 2010. Clarifications and negotiations are in process. The required state aid notification has not yet taken place.</p>

<p>(m) a law to reform the wage bargaining system in the private sector, which should provide for a reduction in pay rates for overtime work, enhanced flexibility in the management of working time and allow local territorial pacts to set wage growth below sectoral agreements;</p>	<p><b>Delayed.</b> Overtime work's pay rates have been reduced under Law 3863/2010. Other draft laws transmitted for consultation to the European Commission on 14.11.2010.</p>
<p>(n) a reform of employment protection legislation to extend the probationary period for new jobs to one year, and to facilitate greater use of temporary contracts and part-time work;</p>	
<p>(o) an amendment of the regulation of the arbitration system to allow each of the parties to resort to arbitration if they disagree with the proposal of the mediator;</p>	
<p>(p) a reform of the arbitration procedure to ensure that it operates according to transparent objective criteria, with an independent committee of arbitrators with decision making capacity free from government influence.</p>	