IOBE/FEIR Notes on Economic Facts

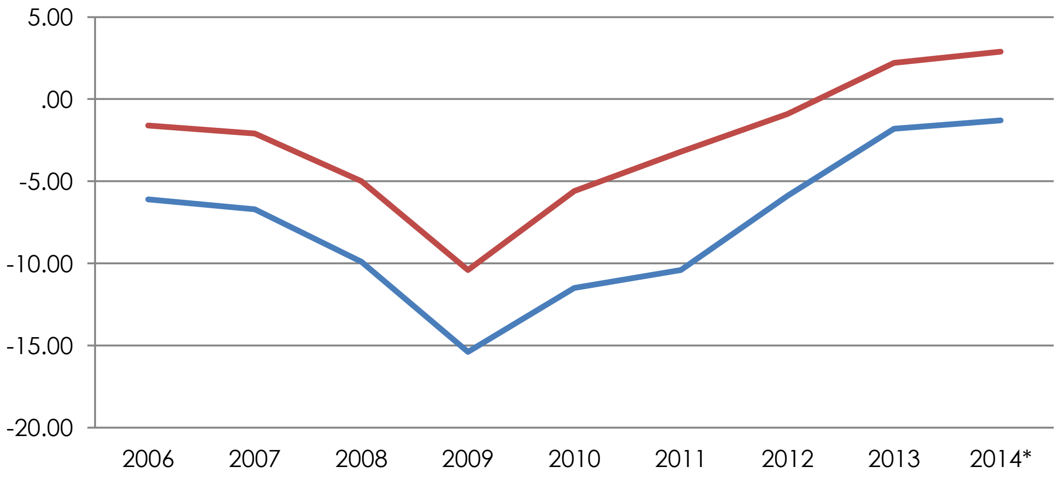
Fiscal consolidation, 2010-2014

April 7th, 2015

This IOBE Note briefly presents the recent fiscal developments and provides definitions of the relevant terminology. Between 2010 and 2013, a significant fiscal adjustment was achieved. This adjustment was carried out up until the third quarter of 2014 and has ceased ever since.

In response to amplification of fiscal imbalances in 2008 and 2009, **substantial progress has been made since 2010 in correcting these imbalances** (see Figure 1). According to the revised ELSTAT data (ESA 2010) featured below, **the General Government deficit on a national accounts basis was reduced from 15.4% of GDP in 2009 to 1.8% in 2013** (Table 1).

Figure 1: Balance and primary balance of the General Government (%GDP)



* Provisional data, Explanatory Budget Report 2015, Ministry of Finance, November 2014
Source: The Greek Economy, ELSTAT

As captured in the figure above, **the 2009 General Government primary deficit, which amounted to 10.4 % of GDP, was transformed into a primary surplus of 2.2 % of GDP in 2013**. It is noteworthy to mention that 2013 was the first year a primary surplus was achieved since 2003.

In light of the fact that the recession of the Greek economy had started in 2008, it becomes evident that the fiscal adjustment of the first Adjustment Programme. which aimed to reduce fiscal imbalances and improve the competitiveness of the Greek economy, was **undertaken under adverse macroeconomic conditions**. It is also significant to note that the Greek economy plunged into recession despite the primary deficit of €24.3 billion in 2009. The fiscal

The bulletin series "IOBE /FEIR notes on Economic Facts" aims to the presentation and interpretation of significant quantitative data with regard to economic developments. It is coordinated by a team of IOBE research associates and cooperating economists: Michalis Vassiliadis, Nikos Vettas, Manolis Galegianos, Christos Genakos, Svet Danchev, Nikos Zonzilos, Stavros Ioannides, Vassilis Manessiotis, Dafni Nikolitsa, Grigoris Pavlou, Aggelos Tsakanikas, Dimitris Christellis. Contact details: email: info@iobe.gr, telephone number: 210 9211200-211, www.iobe.gr

expansion of 2009 was therefore unable to trigger a recovery, since Greece's GDP declined by 4.4% that same year (compared to a 0.4% decrease in GDP in 2008).

Given that the recession made tax collection and deficit reduction more difficult, the improvement in the structural primary deficit during the period 2007-2013 had a magnitude of 17.2% of potential GDP. During the same period, the primary balance improved merely by 12.6% of GDP (Table 1).

In the 2015 Budget Report released in November 2014, a further reduction of the 2014 budget deficit on a national accounts basis was projected at 1.3 % of GDP, with a simultaneous increase of the primary surplus to 2.9% of GDP. However, the achievement of these targets for 2014 is considered extremely difficult, if not impossible, for the following reasons:

The 2014 primary surplus of the State Budget (S.B.) on a modified cash basis[1], which was projected at €4.9 billion in the Budget Report, ultimately totalled €1.9 billion. Similarly, the Budget Deficit, projected at merely €0.8 billion, totalled €3.7 billion. These aforementioned deviations, the majority of which emerged last December, have made the achievement of national accounts deficit and primary surplus targets for the year 2014 extremely difficult.

Table 1: General Government fiscal results of (% GDP)
(National Account Data)

	2006	2007	2008	2009	2010	2011	2012	2013	2014*
General Government Result[1] (-deficit,+ surplus)	-6.1	-6.7	-9.9	-15.4	-11.5	-10.4	-5.9	-1.8	-1.3*
General Government Primary Result (-deficit, +surplus)	-1.6	-2.1	-5.0	-10.4	-5.6	-3.2	-0.9	2.2	2.9*
Structural primary result	-	-	-	-13.6	-8.9	-5.1	-0.7	3.6	4.0

Sources: The Greek economy, ELSTAT, March 2015, Table 11. Data for the structural result are from the "Report of the Governor for the Year 2014", Bank of Greece, February 2015, page 129
*Provisional data, Budget Report 2015, November 2014
1. Without the State aid to the financial institutions

The deterioration of the Budget Balance is primarily due to the fact that the Ordinary Budget revenue fell short of the **2015 Budget Report projections by €3.3 billion**. Deviations in net revenues (after the subtraction of tax refunds) were even higher (€3.5 billion), because tax refunds exceeded projections by €234 million. Conversely, **budget expenditures were reduced by €0.8 billion more than the projected amount, thus slightly compensating for the negative consequences associated with the shortfall in the Ordinary Budget revenue.**

The analysis of data published in the monthly Budget execution bulletin indicates that the budget plan for 2014 was executed up until September 2014 with no substantial deviation from the targets. In the first nine months of 2014, the cumulative revenue fell short by only €0.3 billion. This was not the case in the final months of 2014, since delays in the final settlement of

[1] At the time of publication of this memo, General Government data on national accounts basis was not available.

overdue tax obligations, coupled with the extension of installment payments for the real property tax, triggered a deviation from the targets in October and November. Up until the end of November, tax revenues lagged behind the target by €0.7 billion. Yet, the political uncertainty in December, in combination with the loosening of the tax collecting mechanism (a phenomenon observed during election campaigns), led to a shortfall of tax revenues by €0.6 billion. Therefore, it becomes evident that **the deviation from targets in only one month was equal to the cumulative deviations in the first eleven months of 2014.** As a result, the total annual deviation totaled €1.34 billion.

In addition to the shortfall in tax revenue, one must also take into account the **postponement of approximately €1.92 billion in revenue from the capital gains on Greek Government bonds that Eurozone national central banks hold in their portfolios (SMP's).** These revenues were expected to be collected in December under the condition that the evaluation of the Greek program would be completed in a timely manner. **Thus, 77% of the total shortfall in revenues (both tax and non-tax) emerged in December.**

Moreover, delaying the completion of the evaluation of the Greek Program resulted in the postponement of the last tranche from the EFSF, amounting to €1.8 billion, as well as an instalment from IMF that totaled €3.5 billion. **As a result, a total amount of €7.2 billion is currently still pending,** which under normal circumstances, would have been collected last December. **If the aforementioned parameters were implemented, the cash balance of the Treasury at the end of 2014 would exceed €5 billion.**

Available data for 2015 indicates that the deterioration of fiscal figures persisted in the first two months of the current year. Budget revenues during the January-February 2015 period were reduced, both with respect to projections and compared to the revenue for the corresponding months in 2014. Despite the significant expenditure restraint in the first two months of 2015, the State Budget deficit totalled €189 million. For the corresponding period in 2014, the State Budget ran a surplus of €487 million. **Similarly, the State Budget's primary surplus decreased when compared to last year's surplus as well as the corresponding target for the first two months of 2015. It becomes evident that if these trends persist for the remainder of 2015, the likelihood of a re-emergence of fiscal imbalances is high.**

Definition of fiscal variables

General Government: The monitoring of fiscal developments in the European Union (Stability and Growth Pact, Excessive Deficit Procedure, etc.) is conducted at the general government level. The general government includes: (a) the central government, (b) the social security funds, (c) local-regional administration and (d) exceptionally, the public enterprises whose revenues from product sales do not cover 51 % of their costs.

Budget Balance (general government): The difference between general government revenue and expenditure (as defined by the European System of Accounts 2010). A positive difference (revenue - expenditure > 0) implies a surplus, whereas a negative difference implies a deficit.

Primary Balance (general government): The difference between general government revenue and expenditure, after subtracting public debt interest payments. The primary balance is a useful indicator for monitoring fiscal developments (more useful than the overall result of the Budget Balance), because it offers information about: (a) the current fiscal policy, excluding burdens of the past (interest payments), and (b) the future evolution of the debt to GDP ratio. Thus, a primary balance surplus weakens debt dynamics and ceteris paribus, leads to a reduction of the debt ratio.

Structural primary balance (general government): The (general government) structural balance can be estimated by removing the cyclical component (i.e. the effect of the economic cycle on the budget) as well as the impact of lump-sum payments or temporary fiscal measures (through the use of potential output and of the output gap) from the general government balance. According to the above definition of the primary balance, the structural primary balance can be estimated by subtracting public debt interest payments from the structural balance.