Greece's 2009 draft budget
Main targets & assessment

Earlier this week, Greece unveiled its draft budget for fiscal year 2009, which is expected to get parliamentary approval by the end of the year. The new budget is framed on a relative benign domestic macroeconomic environment and foresees a drop in the general government budget deficit to 1.8%-of-GDP from 2.3%-of-GDP expected this year. The 2008 budget initially targeted a shortfall of just 1.6%-of-GDP, while the new budget draft revealed an upward revision to the 2007 deficit to 3.4%-of-GDP, from a previously reported 2.7%-of-GDP. Commenting on the 2007 deficit revision, a European Commission spokesman said that the Commission will receive the official data from Eurostat by the end of the month and if the 2007 deficit indeed turns out to be above 3%-of-GDP, they will write a report to the council of EU finance ministers. Such a report would effectively constitute the start of an EU excessive deficit procedure (EDP), but will not necessarily lead to further disciplinary steps against Greece, provided that the Commission estimates the 2008 and 2009 Greek deficits to be below 3%-of-GDP. In more detail, the 2009 budget draft predicts: i. a rise of 14.4% YoY in net ordinary revenues compared to a downwardly-revised growth forecast of 10.9% YoY this year ii. a 8.6% YoY rise in ordinary budget spending, from 8.2% YoY in 2008 iii. a €950mn cut back in public investment to €8.5bn and iv. a further reduction in the public debt-to-GDP ratio to 88.4% from 91.8% expected this year. The main macro assumptions underling the new budget include: i. a small deceleration in real GDP growth 3.0% from 3.4% in 2008 and ii. a fall in the average annual consumer price inflation to 3.2% in 2009 from 4.5% this year. Debt serving in 2009 is projected to amount to €11.9bn (4.5%-of-GDP) compared to an estimated amount of €11.3bn (4.5%-of-GDP) this year. From the funding side, Greece's borrowing plan for next year will include T-bills, 3-, 5- and 10-year benchmark bonds and the reopening of long-term government paper beyond 30 years. The finance ministry will aim to maintain the ratio of fixed to floating rate debt issues at 75/25 percent and keep duration at 4.0-4.5 years. According to the Greek debt management agency, total borrowing this year is expected to reach €41-43bn.

Table A shows the 2009 budget's main figures expressed in € million and %-of-GDP terms, respectively, while table B reveals the main contributors to the targeted fiscal adjustment i.e., an expected decline in the general government budget deficit by 0.5ppts-of-GDP to 1.8%-of-GDP. As illustrated in table B, a 1.7ppts-of-GDP rise in ordinary budget revenue is expected to be the sole contributor to the projected decline in the general government budget deficit next year. On the other hand, a lower surplus in the overall balance of public utilities & and other adjustments i.e., the so-called *while whole* of the budget, higher primary expenditure and a further rise in the deficit of the public investment budget (PIB) budget are expected to hinder fiscal consolidation. Although the latest data on budget execution show an underperformance of revenue collection relative to budget targets, the government expects budgetary receipts to improve in the later part of this year and in 2009, as the new unified tax framework on real estate transactions and the equalization of a special consumption tax rates on heating oil and motor fuels will start to bring additional revenues to state coffers.

Net ordinary budget revenues grew by 4.3% YoY in January-June 2008, compared to a *downwardly revised* full-year growth target of 10.9% YoY and a projected rise of 14.4% YoY in 2009. The revenue target for next year is based on a 6.3% YoY forecast for nominal GDP growth and is expected to be achieved despite lower corporate and personal income tax rates and the abolished inheritance taxes on property. More specifically, direct tax revenues are projected to grow by 18.1% YoY in 2009, after rising by an estimated 14.9% YoY this year, and 6.0% y/y in 2006. Indirect tax receipts are expected to increase by 10.4% y/y next year, bringing the ratio of indirect-to-direct taxes to around 1.29, from 1.38 in 2008 and 1.41 in 2007. Finally, non-tax revenues are projected to drop by 6.5% y/y in 2009, following growth of 4.2% y/y in 2008 as a result of certain non-recurring revenue items realized in the prior two years and an expected decline in dividends from public corporations.

On the spending side, the 2009 draft budget targets a slight deceleration in primary expenditure growth to 8.1% YoY from an *upwardly revised* estimate of 9.3% YoY this year. Yet, in percentage-of-GDP-terms, primary outlays are projected to rise by 20.2%, from 19.9% in 2008, thus exerting a negative contribution to next year's overall fiscal adjustment. Interest expenditures are expected to amount to 4.54%-of-GDP next year, boosted by higher the cost of government funding as a result of the global credit crunch. Pension and wage-related costs are expected to rise by 7.6% YoY, reaching 46% of primary expenditure in 2009, while social security and health-related costs are projected to increase by 11% YoY or 26.5% of primary expenditure. Finally, central government operating and consumption costs are budgeted to grow by 9.3% YoY next year *(after falling by an estimated 1.6% YoY in 2008)*, a rather worrying proposition given that this discretionary category of primary expenditure has consistently overshot budgetary targets in recent years.

With regard to the public investment budget (PIB), revenues are projected to decline by 29% YoY in 2009 after rising by an estimated 1.2% YoY this year, mainly on the back of lower inflows from the EU structural funds. Public investment expenditures are also expected to decline next year, leading to a 10.7% YoY rise in the overall PIB deficit. In percentage-of-GDP terms, the latter is projected to come in at 1.91% next year, up from 1.83% expected in 2008, thus placing an estimated burden of 0.1ppts to the projected budget consolidation next year.

Meeting the 2009 budget targets appears to be a challenging proposition, in view of past fiscal performance and an exceptionally adverse external environment. First, reaching the admittedly ambitious revenue growth target envisioned in the 2009 budget will need a significant strengthening of efforts to reduce widespread tax aviation and contain discretionary budget expenditures. As we noted earlier, the overall fiscal consolidation projected for next year is expected to be exclusively driven by a sharp rise in ordinary budget revenue. The latter are projected to rise by 1.7ppts-of-GDP relative to 2008, after recording a cumulative increase of only 0.9ppts-of-GDP in the three-year period 2006-2008. The 14.4% YoY projected growth in 2009 net ordinary budget receipts implies a much higher elasticity to nominal GDP than that realized in recent years. It is also expected to take place in an environment of slowing economic activity and reduced tax rates for domestic households and businesses. We see downside risks to the new budget´s projection of 3.0% GDP growth next year in view of the expected softening of domestic demand growth and a highly adverse external environment. Third, the target for primary expenditure growth needs to be respected, with particular emphasis given to the containment of central government operating expenditure.

From a more inter-temporal perspective, the 2009 budget, if successfully executed, constitutes a step forward in the direction of attaining a balanced budget position in the medium-term. Yet, important challenges to this goal remain, including: (i) expenditure pressures due to large interest payments and amortization costs *(public debt-to-GDP ratio remains amongst the highest in Euro zone in a trajectory of persisting upward pressures in funding costs)*, (ii) the need to run sizeable public investment budgets (PIBs) in the years ahead as a means of facilitating the absorption of EU structural funds, (iii) widespread tax evasion hindering efforts to maintain a strong pace of revenue growth without resorting to additional indirect taxation, and (iv) the need to generate the necessary surpluses for implementing a long-due overhaul of the country's social security system. An intensification of efforts to broaden the tax base and reduce tax avoidance, renewed emphasis on containing budgetary expenditure and social security and public administration reforms need to be the local authorities´ response to the challenges facing fiscal consolidation in the period ahead.

TABLE A: 2009 draft budget (in EUR mn)				% GDP		
1. Ordinary Budget	**2008b**	**2008f**	**2009b**	**2008b**	**2008f**	**2009b**
a. Gross ordinary revenue	58,070	57,690	64,850	23.7%	23.4%	24.7%
a1. Tax reinbursements	2,550	3,200	3,300	1.0%	1.3%	1.3%
a2. Special revenue			760	0.0%	0.0%	0.3%
a3. Net revenue (a-a1+a2)	55,520	54,490	62,310	22.6%	22.1%	23.8%
b. Expenditure	59,058	60,297	65,509	24.1%	24.5%	25.0%
b1. interest	10,500	11,300	11,900	4.3%	4.6%	4.5%
b2. Primary expenditure (b-b1)	48,558	48,997	52,949	19.8%	19.9%	20.2%
2. Ordinary budget balance (1a3-b)	-3,538	-5,807	-3,199	-1.4%	-2.4%	-1.2%
3. Public Investment Budget						
a. Revenue	4,532	4,932	3,500	1.8%	2.0%	1.3%
b. Expenditure	9,300	9,450	8,500	3.8%	3.8%	3.2%
4. PIB balance (3a-3b)	-4,768	-4,518	-5,000	-1.9%	-1.8%	-1.9%
5. Central government balance (2+4)	-8,306	-10,325	-8,199	-3.4%	-4.2%	-3.1%
5a. Primary balance (5+1b1)	2,194	975	3,701	0.9%	0.4%	1.4%
6. Public sector surplus & adjustment	4,280	4,705	3,540	1.7%	1.9%	1.4%
6a. Public utility & other surpluses	7,165	8,405	4,925	2.9%	3.4%	1.9%
6b. Transfers to social security	-3,013	-3,453	-575	-1.2%	-1.4%	-0.2%
6c. Diffence expenditure	-1,400	-1,800	-2,200	-0.6%	-0.7%	-0.8%
6d. Adjustments	1,528	1,553	1,390	0.6%	0.6%	0.5%
7. General govnt balance (5+6)	-4,026	-5,620	-4,659	-1.6%	-2.3%	-1.8%
Nominal GDP (EUR bn)	245,449	246,520	262,051			

Contributions to the adjustment in the general gvnt budget balance (ppts of GDP)
In ppts-of-GDP

	Cummulative (2006-08)	2009 budget
Net ordinary budget revenue	0.9%	1.70%
Ordinary budget expenditure	-2.1%	-0.54%
PIB balance	0.6%	-0.08%
Public sector surpluses & adjustments	0.7%	-0.60%

Source: 2009 draft budget, Eurobank EFG Research