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Athens hopes deep cuts will restore confidence

By Dimitris Kontogiannis in Athens
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Government officials in Athens were arguing last night that Greece's new fiscal efforts were, at least on some measures, larger than those of Ireland - seen since last year as the pace-setter on deficit-cutting measures among the crisis-hit countries of the eurozone.

In Greece, yesterday's measures will lead to cuts in government nominal wages and allowances of about 8 per cent. With Greek inflation seen at 1.5 to 2 per cent, the hit in purchasing power will be equivalent to a 10 per cent drop, officials said.

The Irish wages were cut by about 7 per cent on average in the first year but faced deflation of 4.5 per cent, softening the blow on purchasing power, they added.

The comparison with Ireland underlines the significance of yesterday's package, the toughest in decades, and reflects how confident bankers and analysts in Greece are that the new measures will help reduce the budget deficit and restore confidence in the government's ability to put public finances in order.

"The package should put an end to any discussion regarding the government's capacity to implement the significant adjustment in its fiscal deficit of 4 per cent of GDP [this year] and should increase its credibility significantly," said Paul Mylonas, chief economist and chief strategist at NBG Group.

Asked what the impact of all restrictive measures taken so far would be on the economy, Mr Mylonas said it was estimated they would contribute to a decline of gross domestic product by 1.5 to 2 per cent in 2010.

The government's forecast sees Greek GDP decline by 0.3 per cent in 2010 but it is widely viewed as baseless.

Yesterday's package outpaced the demands of the European Commission, in a bid to ensure this year's budget deficit reduction target of 8.7 per cent of GDP was reached, and restore market confidence to help borrow more than €40bn ($55bn, £36bn) by the end of the year.

"The fiscal adjustment is bigger than what we were asked for," said George Zanias, chairman of the council of economic advisers at the finance ministry who is responsible for the negotiations with the EU.

The government aims to raise €1.3bn by increasing the three value added tax rates by 0.5 to 2 percentage points, with the highest rate set at 21 per cent from 19 per cent previously. It also targets a €1.1bn increase in revenues from additional increases in excise taxes on petrol and diesel, cigarettes and alcohol, the introduction of excise tax in electricity and the increase in the excise tax for luxury goods.

Analysts think the risk in implementing these rises is small because they are indirect taxes and can be collected easily and immediately although their damping effect on demand may produce a limited shortfall.

On the expenditure side, the biggest cuts come from a reduction in nominal wages and pensions equal to €1.7bn or 0.7 per cent of GDP. It breaks down to a 60 per cent reduction in the 14th salary, a special bonus, of civil servants and an additional reduction of 2 per cent in wage supplements, upping the total cut to 12 per cent.

It also cuts wages in public enterprises by 7 per cent and reduces the 14th salary by 60 per cent. It also freezes all private and public sector pensions, eliminating the announced increases incorporated in the budget.

Gikas Hardouvelis, chief economist at Eurobank EFG in Athens, expressed hope the new package would help avert another downgrade in the country's credit rating.

"Greece has signalled to the financial markets and its European partners it is serious about addressing its earlier fiscal deterioration and now views the crisis as an opportunity for a new beginning," Mr Hardouvelis said.