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COMMISSION OPINION

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on the Draft Budgetary Plan of Luxembourg

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING LUXEMBOURG

3. On the basis of the Draft Budgetary Plan for 2018 submitted on 13 October 2017[1] by Luxembourg, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. Luxembourg is subject to the preventive arm of the Pact and should preserve a sound fiscal position which ensures compliance with its medium-term budgetary objective (MTO) of -0.5% of GDP.

5. The macroeconomic assumptions underpinning the Draft Budgetary Plan are based on a plausible macroeconomic scenario for 2017; by contrast the macroeconomic assumptions for 2018 appear to be favourable. In the macroeconomic scenario underpinning the Draft Budgetary Plan real GDP is estimated to grow by 3.4% in 2017 and by 4.4% in 2018. Compared to the 2017 Stability Programme, where GDP growth was projected at 4.4% and 5.2% for 2017 and 2018, respectively, economic perspectives were revised downwards. In this context, it is worth mentioning that the country's national accounts have been subject to a revision in September 2017. Real GDP growth was revised from 4.0% to 2.9% for 2015 and from 4.2% to 3.1% for 2016, mostly on the basis of a downward revision of the net export contribution to growth. Taking into account the revision, the macroeconomic scenario in the Draft Budgetary Plan represents an acceleration of growth in 2017-18. The Commission 2017 autumn forecast projects real GDP to grow at 3.4% in 2017 and 3.5% in 2018. A stronger forecast for domestic demand in the Draft Budgetary Plan, for both private consumption and gross fixed capital formation, compared to the Commission forecast explains the difference for the economic outlook in 2018.

6. Luxembourg complies with the requirement of Regulation EU No 473/2013 that the draft budget has to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan have

[1] A corrigendum to the annex was submitted on 3rd November 2017. The corrigendum provides complementary information about the macroeconomic scenario underpinning the budgetary trajectory in the Draft Budgetary Plan.

been produced by STATEC, the National Institute of statistics and economic studies of the Grand Duchy of Luxembourg.

7. According to the Draft Budgetary Plan, the general government surplus is projected to decline to 0.6% of GDP in 2017 from 1.6% of GDP in 2016. The target has been revised upwards compared to the last Stability Programme where a surplus of 0.2% of GDP was projected. The upward revision is mostly explained by higher-than-expected revenues, especially from taxes on production and imports and current taxes on income and wealth, which more than compensate the concurrent upward revision of expenditure growth. With regard to 2018, whereas the Stability Programme planned a slight improvement in the headline surplus to 0.3% of GDP (compared to 0.2% of GDP for 2017), the Draft Budgetary Plan projects the general government surplus to remain stable at 0.6% of GDP. Nevertheless, this represents an improvement compared with the budgetary trajectory outlined in the 2017 Stability Programme. In the light of the low level of government debt, savings from interest expenditure due to low interest rates were limited.

8. The Draft Budgetary Plan indicates government plans for additional measures on the spending side. In particular, it reports about: i) the incremental budgetary impact from the reform of the aid schemes to SMEs; ii) the decision to increase the government support in the field of space research and development; iii) the reform of the minimum guaranteed income, with the objective of promoting a higher participation of the beneficiaries to the labour market; iv) the budgetary cost of measures to fight long-term unemployment; and v) the incremental cost of some initiatives to support employment. By contrast it fails to provide an update in relation to the degree of implementation of the previously adopted measures with an impact on the years under examination, including to produce a revised estimation of the likely yields of the measures in the consolidation package (so called 'Zukunftspak' adopted in 2015).

9. The Draft Budgetary Plan’s targets for 2017 are broadly in line with the Commission 2017 autumn forecast, which projects the headline surplus at 0.5% of GDP compared with 0.6% of GDP in the Draft Budgetary Plan. For 2018, the Commission forecast projects a drop in the headline surplus to 0.3% of GDP whereas the Draft Budgetary Plan projects it to remain stable at 0.6% of GDP. The difference stems mainly from the more favourable underlying macroeconomic scenario in the Draft Budgetary Plan. Downside risks to the budgetary trajectory could arise from the strong dependence of the country on the development of the financial sector and the potentially negative implications from the ongoing international initiatives to fight tax avoidance and evasion.

10. Luxembourg's structural balance recorded a surplus of 2.0% of GDP in 2016, well above the country specific MTO of a surplus of 0.5% of GDP. According to the information provided in the Draft Budgetgary Plan, Luxembourg is expected to achieve a structural surplus[2] of 0.9% of GDP in 2017. This is well above its revised MTO of a deficit of 0.5% of GDP. For 2018, based on the information in the Draft Budgetary Plan, the (recalculated) structural balance is expected to decline to a surplus of 0.5% of GDP, still above the MTO. The Commission 2017 autumn forecast broadly points to the same conclusion. Therefore, Luxembourg is assessed to

[2] Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the Draft Budgetary Plan, using the commonly agreed methodology.

be compliant with the requirements under the preventive arm of the Stability and Growth Pact.

11. In light of its fiscal position, the recent decision by the national authorities to use the available fiscal space to implement a tax reform appears appropriate. The Draft Budgetary Plan does not include plans that affect the tax wedge on labour. Nevertheless, the reform of the tax code, adopted in 2016 and implemented at the start of 2017, is expected to affect the tax wedge on labour. The reform lowers the progressivity of the system for the lower income and introduces two new marginal tax rates for the highest incomes. Finally, the Draft Budgetary Plan provides a list of measures adopted or that are to be adopted to ensure an adequate follow-up with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 11 July 2017[3]. The structural part of the fiscal recommendations called to improve the long-term sustainability of the pension system, limit early retirement and increase the employment rate of older people. In this regard, the Draft Budgetary Plan reports on the adopted reform of the long-term care insurance scheme, which will be effective from the start of 2018 and on the new measures to help people in long-term unemployment, which entered into effect in August 2017. It also recalls previously reported measures such as the adopted reform of the professional classification scheme for persons with partial incapacity and the planned reform of early-retirement schemes. However, savings from the implementation of the latter are expected to be limited, as the reform of early-retirement schemes, while suppressing some of them, provides an easing of the restriction on other kinds of early retirement schemes.

12. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Luxembourg, which is currently under the preventive arm, is compliant with the provisions of the Stability and Growth Pact. The Commission invites the authorities to implement the 2018 budget.

    The Commission is also of the opinion that Luxembourg has made limited progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 11 July 2017in the context of the 2017 European Semester and thus invites the authorities to accelerate progress. A comprehensive assessment of progress made with the implementation of the country-specific recommendations will be made in the 2018 Country Reports and in the context of the country-specific recommendations to be adopted by the Commission in May 2018.

Done at Brussels, 22.11.2017

For the Commission
Pierre MOSCOVICI
Member of the Commission

[3] OJ C 261, 9.8.2017.