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COMMISSION OPINION

of 20.11.2019

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 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 14 October 2019, Luxembourg submitted the Draft Budgetary Plan for 2020. On that basis, 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 Stability and Growth Pact and should preserve a sound fiscal position, which ensures compliance with its medium-term budgetary objective of a deficit of 0.5% of GDP in 2019 and its revised medium-term budgetary objective of a surplus of 0.5% of GDP as of 2020.[1]

5. According to the Commission 2019 autumn forecast, the Luxembourg economy is expected to grow by 2.6% in both 2019 and in 2020. The Draft Budgetary Plan expects a marginally lower growth in 2019 (2.4%) and in 2020 (2.4%). The composition of growth is different with a somewhat higher contribution of domestic demand to growth in 2019 compared to the Commission forecast. In 2020, the composition of growth is broadly similar in the Draft Budgetary Plan and the Commission forecast. Overall, the macroeconomic scenario underlying the Draft Budgetary Plan is plausible for 2019 and 2020. Luxembourg complies with the requirement of Regulation EU No 473/2013 since the draft budget is based on independently produced macroeconomic forecasts.

6. According to the Draft Budgetary Plan, the general government headline surplus is projected to decline from 2.7% of GDP in 2018 to 2.0% of GDP in 2019 and to 1.2% of GDP in 2020. The Commission 2019 autumn forecast also projects the headline surplus to decline to 2.3% in 2019 and 1.4% in 2020. The difference for 2019 is explained mainly by the higher Commission projection of nominal GDP and lower expenditure growth. In 2020, higher revenue elasticity in the Commission forecast explains the difference. The deterioration of the fiscal position in 2020 is explained by a decline in revenue from direct taxation and an increase in expenditure, only

[1] Council Recommendation of 9 July 2019 on the 2019 National Reform Programme of Luxembourg and delivering a Council opinion on the 2019 Stability Programme of Luxembourg, OJ C 301, 5.9.2019, p. 97.

partially linked to the discretionary fiscal measures adopted by the government. The purchase of a military plane is expected to temporarily increase expenditure by 0.3% of GDP. The recalculated structural balance[2] is estimated at a surplus of 1.3% of GDP in 2019 and of 0.6% of GDP in 2020 in the Draft Budgetary Plan. These projections are broadly in line with the Commission 2019 autumn forecast, which projects a structural surplus of 1.6% in 2019 and of 0.8% in 2020.

7. In 2020, the fiscal stance is expected to be expansionary, based on the structural balance estimates, according to both the Draft Budgetary Plan and the Commission 2019 autumn forecast. Since 2019 several flagship measures have been implemented, in particular the net increase in the minimum social wage by EUR 100 per month since the start of 2019 and a significant increase in investments in areas such as housing, education, research, digitalisation, transportation infrastructure, sustainable energy, culture and social structures. Other measures are aimed at strengthening the competitiveness of the tax framework by lowering the Luxembourg corporate income tax (CIT) rate by one percentage point to 17% and widening the income bracket to which the reduced rate for CIT applies. To keep up with the fight against global warming, an increase in excise duties on diesel and gasoline is also included. These measures combined are expected to lead to a budgetary cost of 0.5% of GDP in 2019. Additional measures are planned in 2020 expected to cost an additional 0.2% of GDP.

Measures to reduce the tax wedge were already introduced by the previous government. The reform of the tax code, which took effect as of 1 January 2017 introduced measures lowering the tax wedge on labour. The reform has made the system more progressive for lower incomes while two new marginal tax rates for the highest incomes have been introduced. Tax credits for employees and pensioners have been increased. The tax measures are expected to preserve competitiveness of the economy and increase households' disposable income and have a positive effect on employment and on growth through higher private consumption.

The Recommendation of 9 July 2019 addressed by the Council to Luxembourg called for an increase of the employment rate of older people with a view to improving the long-term sustainability of the pension system. In order to increase the employment rate of older people, the Council recommendation suggests to enhance their employment opportunities and employability and to further limiting early retirement. In this regard, the Draft Budgetary Plan does not report on new measures compared to those already enumerated in the Draft Budgetary Plan of 5 March 2019.

8. According to the information provided in the Draft Budgetgary Plan, Luxembourg is expected to achieve a recalculated structural surplus of 1.3% of GDP in 2019. This is above its medium-term budgetary objective of a deficit of 0.5% of GDP in 2019. For 2020, based on the information in the Draft Budgetary Plan, the recalculated structural balance is expected to decline to a surplus of 0.6% of GDP, above the revised medium-term budgetary objective of a surplus of 0.5% of GDP. The Commission 2019 autumn forecast broadly points to the same conclusion. Therefore, Luxembourg is expected to be compliant with the requirements under the preventive arm of the Stability and Growth Pact both in 2019 and 2020.

[2] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

9. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Luxembourg is compliant with the provisions of the Stability and Growth Pact. The Commission invites the authorities to implement the 2020 budget.

The Commission is also of the opinion that Luxembourg has made limited progress with regard to the structural part of the fiscal recommendation cointained in the Council Recommendation of 9 July 2019 in the context of the European Semester and thus invites the authorities to accelerate progress. A comprehensive description of progress made with the implementation of the country-specific recommendations will be made in the 2020 Country Reports and assessed in the context of the country-specific recommendations to be proposed by the Commission in spring 2020.

Done at Brussels, 20.11.2019

For the Commission
Pierre MOSCOVICI
Member of the Commission