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COMMISSION OPINION

of 24.11.2021

on the Draft Budgetary Plan of Luxembourg

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(Only the French text is authentic)

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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, to ensure 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 by 15 October, presenting the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.
3. On 20 March 2020, the Commission adopted a Communication¹ on the activation of the general escape clause² of the Stability and Growth Pact. In that Communication, the Commission set out its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the conditions to activate the general escape clause were met. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission.³
4. On 3 March 2021, the Commission adopted a Communication providing further policy orientations to facilitate the coordination of fiscal policies.⁴ In that Communication, the Commission set out its view that the decision on the deactivation or continued application of the general escape clause should be taken on the basis of an overall assessment of the state of the economy, with the level of economic activity in the EU or euro area compared to pre-crisis levels (end-2019) as a key quantitative criterion. On 2 June 2021, on the basis of the Commission's 2021 spring forecast, the Commission considered that the conditions to continue to apply the general escape clause in 2022 and to deactivate it as of 2023 were met.⁵ Country-specific situations will continue to be taken into account after the deactivation of the general escape clause.
5. Next Generation EU, including the Recovery and Resilience Facility, supports a sustainable, inclusive and fair recovery. Regulation (EU) 2021/241 established the

¹ Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, Brussels, 20.3.2020, COM(2020) 123 final.

² The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn.

³ <https://www.consilium.europa.eu/en/press/press-releases/2020/03/23/statement-of-eu-ministers-of-finance-on-the-stability-and-growth-pact-in-light-of-the-covid-19-crisis/>

⁴ Communication from the Commission to the Council on one year since the outbreak of COVID-19: fiscal policy response, Brussels, 3.3.2021, COM(2021) 105 final.

⁵ Communication from the Commission on economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy, Brussels, 2.6.2021, COM(2021) 500 final.

Recovery and Resilience Facility⁶, which provides financing support for the implementation of reforms and investments, notably to promote the green and digital transitions, thereby strengthening the economies' resilience and potential growth. Part of this support is in the form of non-repayable financial support ("grants"), entailing a fiscal impulse financed by the EU budget. By contributing to economic recovery and to strengthening long-term growth, it supports public finances, growth and job creation in the medium and long term.

6. On 2 June 2021, the Commission emphasised in its communication that the coordination of national fiscal policies remains crucial to underpin the recovery. In this context, the Commission set out its view that the overall fiscal stance, taking into account national budgets and the Recovery and Resilience Facility, should remain supportive in 2021 and 2022. Fiscal policy should remain agile and adjust to the evolving situation as warranted, and a premature withdrawal of fiscal support should be avoided. Once health risks diminish, fiscal measures should gradually pivot to more targeted measures that promote a resilient and sustainable recovery. Finally, with economic activity gradually normalising in 2021, Member States' fiscal policies should become more differentiated in 2022, taking into account the state of the recovery, fiscal sustainability and the need to reduce economic, social and territorial divergences. All Member States should preserve nationally financed investment. As the recovery takes hold, fiscal policy should prioritise higher public and private investment, supporting the transition towards a green and digital economy.

In its recommendations on the 2021 Stability Programmes on 18 June 2021, the Council also recommended that, when economic conditions allow, Member States should pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term. At the same time, investment should be enhanced to boost growth potential.

The Council, on 13 July 2021, further recommended to euro area Member States⁷ to take action, individually and collectively within the Eurogroup, in the period 2021–2022 to ensure a policy stance that supports the recovery from the COVID-19 crisis. When the epidemiological and economic conditions allow, emergency measures should be phased out while combatting the social and labour-market impact of the crisis. Recalling the need for prudent medium-term fiscal positions and debt sustainability, while enhancing investment, the Council also called for particular attention to the quality of budgetary measures.

The recovery of the European economy has been strengthening, thanks to the improved health situation and easing of pandemic control restrictions. The volume of output in the euro area is expected to return to its pre-pandemic level by the end of the year. However, bottlenecks in global supply and rising energy and commodity prices have been increasingly weighing on activity in the EU. This together with production bottlenecks, due to the shortage of some input components and raw materials, and capacity constraints vis-à-vis booming demand both in the EU and internationally have been putting upward pressure on consumer prices.

7. On 18 June 2021, in its recommendations on the 2021 Stability Programmes, the Council highlighted that the established indicators of fiscal adjustment set out in

⁶ OJ L57, 18.2.2021, p.17

⁷ Council Recommendation of 13 July 2021 on the economic policy of the euro area, OJ C 283, 15.7.2021, p. 1.

Regulation (EC) No 1466/97 need to be considered in the context of the current circumstances. Specifically, the assessment of the overall fiscal stance at the current juncture should take into account the transfers from the EU budget (such as those from the Recovery and Resilience Facility). Furthermore, the assessment also needs to take into account the phasing-out of crisis-related temporary emergency measures that were designed to support health systems and compensate workers and firms for the losses in income due to lockdowns and supply chain disruptions, while their withdrawal is accompanied by the easing of lockdown restrictions that will support growth.

Accordingly, the fiscal stance in 2021 and 2022 is measured by the change in primary expenditure (net of discretionary revenue measures), excluding crisis-related temporary emergency measures but including expenditure financed by grants under the Recovery and Resilience Facility and other EU funds, relative to medium-term potential growth⁸. Going beyond the overall fiscal stance, in order to assess whether national fiscal policy is prudent and its composition is conducive to a sustainable recovery consistent with the green and digital transitions, attention is also paid to the evolution of nationally financed primary current expenditure (net of discretionary revenue measures and excluding crisis-related temporary emergency measures) and investment.

CONSIDERATIONS CONCERNING LUXEMBOURG

8. On 14 October 2021, Luxembourg submitted the Draft Budgetary Plan for 2022. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.
9. On 18 June 2021, the Council recommended that in 2022 Luxembourg⁹ maintains a supportive fiscal stance, including from the impulse provided by the Recovery and Resilience Facility, and preserves nationally financed investment.

The Council also recommended Luxembourg to pay particular attention to the composition of public finances, on both the revenue and expenditure sides of the national budget, and to the quality of budgetary measures in order to ensure a sustainable and inclusive recovery; to prioritise sustainable and growth-enhancing investment, in particular investment supporting the green and digital transition; and to give priority to fiscal structural reforms that will help provide financing for public policy priorities and contribute to the long-term sustainability of public finances, including, where relevant, by strengthening the coverage, adequacy and sustainability of health and social protection systems for all.

On 2 June 2021, the Commission issued a report under Article 126(3) TFEU.¹⁰ This report discussed the budgetary situation of Luxembourg, as its general government deficit in 2020 exceeded the 3% of GDP Treaty reference value. The report concluded that the deficit criterion was not fulfilled.

⁸ The Commission's estimates of medium-term potential growth do not include the positive impact of reforms that are part of the Recovery and Resilience Plan and can boost Luxembourg's potential growth.

⁹ Council Recommendation of 18 June 2021 delivering a Council opinion on the 2021 Stability Programme of Luxembourg, OJ C 304, 29.7.2021, p. 73.

¹⁰ Report from the Commission prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union, Brussels, 2.6.2021, COM(2021) 529 final.

10. According to the Commission 2021 autumn forecast, the Luxembourg economy is expected to grow by 5.8% in 2021 and by 3.7% in 2022, while inflation is forecast at 3.2% in 2021 and 2.2% in 2022. According to the Draft Budgetary Plan, the economy is set to grow by 6.0% in 2021 and by 3.5% in 2022, following a return to normality regarding economic activity and a dynamic international environment. In the Draft Budgetary Plan, inflation is forecast at 3.1% in 2021 and 1.9% in 2022. As such, the macroeconomic projections underpinning the 2022 Draft Budgetary Plan are very similar to those in the Commission 2021 autumn forecast. However, in 2021 there is a difference in the drivers of real GDP growth, with the Draft Budgetary Plan scenario expecting a roughly one-percentage point higher contribution from domestic demand and lower contribution from net exports compared with the Commission 2021 autumn forecast. Overall, the macroeconomic assumptions underpinning the Draft Budgetary Plan are plausible in both 2021 and 2022. Luxembourg complies with the requirement of Regulation (EU) No 473/2013 since the draft budget is based on independently produced macroeconomic forecasts by the national statistical office (STATEC).
11. Luxembourg submitted its Recovery and Resilience Plan on 30 April 2021. The Council approved the assessment of Luxembourg's Recovery and Resilience Plan on 13 July 2021. A pre-financing payment of Recovery and Resilience Facility grants of 0.018% of GDP was made to Luxembourg in August 2021. The Draft Budgetary Plan assumes that expenditure amounting to less than 0.1% of GDP in 2020, 2021, and 2022 is to be funded by non-repayable financial support (grants) from the Recovery and Resilience Facility. Expenditures financed by Recovery and Resilience Facility grants will contribute to enabling high-quality investment and productivity-enhancing reforms without a direct impact on the general government deficit and debt. The Commission 2021 autumn forecast includes a similar amount of expenditures financed by Recovery and Resilience Facility grants in its budgetary projections. Simulations by the Commission services show that the Recovery and Resilience Plan, together with the rest of measures of the European Union Recovery Instrument, has the potential to increase the GDP of Luxembourg by between 0.5% and 0.8% by 2026, not including the possible positive impact of structural reforms, which can be substantial.¹¹
12. In its 2022 Draft Budgetary Plan, Luxembourg's general government deficit is planned to decrease from 0.6% of GDP in 2021 to 0.2% of GDP in 2022, mainly due to the recovery in economic activity and the phasing out of support measures related to the health crisis. The general government debt ratio is planned to increase from 25.8% of GDP in 2021 to 26.6% of GDP in 2022. This increase is mainly driven by the financing needs related to the deficit of the central government, which has to be financed by new debt as the surplus of the social security fund sector cannot be used for this purpose. These projections are in line with the Commission 2021 autumn forecast. The Commission forecasts a slightly lower general government deficit of 0.2% in 2021 and a small surplus of 0.2% in 2022. The better government balance in the Commission 2021 autumn forecast for 2021 and 2022 is mainly explained by lower government expenditure while revenue projections are broadly similar. The Draft Budgetary Plan envisages for both years higher primary expenditure in social benefits, in line with the higher unemployment forecast versus the Commission 2021

¹¹ These simulations reflect the overall impact of NGEU, which also includes funding for ReactEU, and increased funding for Horizon Europe, InvestEU, JTF, Rural Development and RescEU.

autumn forecast. In addition, the Commission forecasts transfers, both current and capital, to remain stable in 2021, as a percentage of GDP, compared to their level in 2020, while an increase is projected in the Draft Budgetary Plan. In 2022, both forecasts project a decline in expenditure for transfers, with the difference between the two remaining almost unchanged. Finally, in 2022 a slightly lower level of public investment is factored in the Commission forecast. The debt forecast for 2021 in the Draft Budgetary Plan is similar to the Commission 2021 autumn forecast of 25.9% of GDP. However, for 2022 the Draft Budgetary Plan expects a further increase in debt while Commission expects a small decline in the ratio to 25.6%. This difference is mainly explained by a combination of a lower primary balance and higher stock-flow adjustment in the Draft Budgetary Plan.

The outlook for public finances continues to be subject to the high uncertainty that surrounds the macroeconomic projections, including risks related to the evolution of the pandemic and possible scarring effects.

13. Overall, according to the Draft Budgetary Plan, expenditure and revenue measures imply a budgetary cost of 0.3% of GDP in 2022. On the revenue side these measures are of a rather technical nature and are expected to have an overall neutral budgetary impact. On the expenditure side, measures include an increase in expenditure related to intermediate consumption, subsidies and transfers and investments, amongst others in digitalisation of the government, environmental protection, infrastructure and public transport. The size of these measures is in line with the Commission 2021 autumn forecast.

Based on the Commission 2021 autumn forecast, the crisis-related temporary emergency measures are expected to decrease from 2.8% of GDP in 2020 to 0.8% in 2021 and to be phased out completely by the end of 2021. These measures mainly consist of health care costs to fight the pandemic and income and liquidity support for households and companies.

According to the Draft Budgetary Plan, gross fixed capital formation is expected to reach 4.3% of GDP in 2021 and 4.4% in 2022. This is part of a government investment plan to bolster the transition to a more sustainable and digital economy and includes investment in public transport and infrastructure, such as tram and railway, as well as investment in the digitalisation of government services. These projections are in line with the Commission 2021 autumn forecast.

Some of these measures contribute to achieving the objectives of the National Energy and Climate Plan (NECP) and amount to EUR 1.9 billion in 2022. This includes for example protection of biodiversity via the Climate Pact. In addition, with the introduction of the carbon tax in 2021 and its increase in 2022, the green objective is also addressed via a taxation measure. Moreover, with the measures aiming to enhance the digitalisation of government services, the Draft Budgetary Plan supports the green and digital transition as recommended by the Council on 18 June 2021. A complete assessment of the fiscal-structural reforms implemented by Luxembourg will be performed in the context of the assessment of the implementation of the Recovery and Resilience Plan and the 2022 Country Report.

14. The fiscal stance, which excludes crisis-related temporary emergency measures, while including the impact on aggregate demand from investment financed by both the national and the EU budgets, notably the Recovery and Resilience Facility, is

projected in the Commission 2021 autumn forecast at -0.7% of GDP in 2022.¹² Luxembourg is projected to use the Recovery and Resilience Facility in 2022 to finance additional investment in support of the recovery. The positive contribution to economic activity of expenditure financed by Recovery and Resilience Facility grants and other EU funds is projected to remain unchanged, as a percentage of GDP in 2022 compared to 2021. Nationally financed investment is projected to provide a neutral contribution to the fiscal stance in 2022.¹³ The growth in nationally financed primary current expenditure (net of new revenue measures) in 2022 is projected to provide an expansionary contribution of 0.7% of GDP to the overall fiscal stance.

15. The Draft Budgetary Plan does not include budgetary projections beyond 2022, although it refers to the government's multiannual budgetary programme covering the period 2021-2025 which foresees full compliance with the medium-term objective (MTO) for the budgetary position from 2023 onwards.
16. In 2022, based on the Commission's forecast and including the information incorporated in Luxembourg's Draft Budgetary Plan, the fiscal stance, including the impulse provided by the Recovery and Resilience Facility, is projected to be supportive, as recommended by the Council. Luxembourg plans to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. As recommended by the Council, Luxembourg plans to preserve nationally financed investment.

The Commission recalls the importance of the composition of public finances and the quality of budgetary measures, including through growth-enhancing investment, notably supporting the green and digital transition. In this regard, measures contained in the Luxembourg Draft Budgetary Plan contribute to fulfilling the Council recommendation of ensuring a sustainable and inclusive recovery, while prioritising the green and digital transition, as well as the adequacy and sustainability of health and social protection systems for all.

Taking into account the strength of the recovery, Luxembourg is invited to regularly review the use, effectiveness and adequacy of the support measures and stand ready to adapt them as necessary to changing circumstances.

Done at Brussels, 24.11.2021

For the Commission
Paolo GENTILONI
Member of the Commission

¹² A negative sign of the indicator corresponds to an excess of primary expenditure growth compared with medium-term economic growth, indicating an expansionary fiscal policy.

¹³ Other nationally financed capital expenditure is projected to provide a contractionary contribution of 0.1 percentage point of GDP.