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COMMISSION STAFF WORKING DOCUMENT

Analysis of the draft budgetary plan of Luxembourg

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of Luxembourg

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1. INTRODUCTION

Luxembourg submitted its Draft Budgetary Plan for 2018 on 13 October 2017[1] in compliance with Regulation (EU) No 473/2013 of the Two-Pack. 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.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2017 autumn forecast. The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission 2017 autumn forecast. In particular, it also includes an assessment of the measures underpinning the Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2017-2018 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis on the composition of public finances and on the implementation of fiscal-structural reforms, including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underpinning the Draft Budgetary Plan projects real GDP 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 have been revised downwards. In this context, it is worth to mention 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 due to 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.

[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.

Box 1: The macro economic forecast underpinning the budget in Luxembourg

The macroeconomic forecasts underlying the DBP have been prepared by the Direction "Etudes, prévisions et recherche" of the national statistical office STATEC[2], which also provided the methodology for the calculation of the output gap. STATEC is an autonomous entity placed under the authority of the Ministry of Economy.

The economic momentum is expected to support robust employment creation, which is projected to accelerate from 3.0% in 2016 to 3.2% in 2017 and to drop to 3.1% in 2018. As a consequence of the robust job creation, the unemployment rate is forecast to drop to 5.5% by 2018 from 6.3% in 2016. Potential growth is projected at 3.4% in 2017 and 3.2% in 2018. The GDP deflator is assumed to increase by 1.7% in 2017 and 1.5% in 2018. After being very low at 0.3% in 2016, inflation (according to the national definition) is projected to accelerate to 1.7% in 2017 and to fall back to 1.4% in 2018 largely reflecting the projected developments in oil prices.

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. The Commission 2017 autumn forecast projects real GDP growth 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 2017 autumn forecast explains the difference for the economic outlook in 2018.

[2] Institut national de la statistique et des études économiques du Grand-Duché du Luxembourg.

Table 1. Comparison of macroeconomic developments and forecasts

	2016	2017			2018		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	3.1	4.4	3.4	3.4	5.2	4.4	3.5
Private consumption (% change)	2.4	2.9	2.7	2.6	2.4	3.4	2.5
Gross fixed capital formation (% change)	0.5	12.6	21.2	6.8	8.8	4.5	2.4
Exports of goods and services (% change)	2.7	7.4	5.8	5.0	8.7	7.8	4.8
Imports of goods and services (% change)	2.1	8.3	7.6	5.5	8.8	8.0	4.7
Contributions to real GDP growth:							
- Final domestic demand	1.1	4.0		2.6	2.9		1.7
- Change in inventories	-0.1	0.0		0.0	0.0		0.0
- Net exports	2.0	0.4		0.8	2.3		1.8
Output gap[1]	-0.9	-0.5	-0.6	-0.4	0.8	0.3	0.1
Employment (% change)	3.0	3.2	3.2	3.1	3.4	3.1	3.0
Unemployment rate (%)	6.3	5.6	5.7	6.1	5.3	5.5	5.9
Labour productivity (% change)	0.0	0.9		0.3	1.6		0.5
HICP inflation (%)	0.0	2.4	1.7	2.1	1.5	1.4	1.7
GDP deflator (% change)	-1.3	2.1	1.7	2.3	1.8	1.5	2.3
Comp. of employees (per head, % change)	0.7	3.4	3.2	2.9	2.0	2.0	2.5
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	4.4			4.3			4.4

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Stability Programme 2017 (SP); Draft Budgetary Plan for 2018 (DBP); Commission 2017 autumn forecast (COM); Commission calculations

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

In the October 2017 Excessive Deficit Procedure notification, the general government balance is estimated to have recorded a surplus of 1.6% of GDP in 2016 (unrevised compared to the 2017 Stability Programme). In 2017, the headline budget target is projected to drop as a result of the implementation of the tax reform at the start of the year and of additional losses of e-VAT revenues stemming from a change in the European legislation[3]. According to the DBP, the general government surplus is projected to decline to 0.6% of GDP in 2017, compared with a planned surplus of 0.2% of GDP in the Stability Programme. Higher-than-expected

[3] According to the provision of EC directive 2008/8/EC, VAT revenues from e-commerce related transactions will accrue to the country of residence of the consumer and not any longer to the country of the seller. Under the legislated transitional provisions, Luxembourg will be able to retain a share of 30% of those VAT revenues for the period 2015-2016, the share will drop to 15% for the period 2017-2018 and to 0 thereafter.

revenue growth, especially of taxes on production and imports and current taxes on income and wealth, explain most of the upward revision, despite a concurrent upward revision of expenditure growth. While the government continues its efforts to contain the increase in public expenditure, the higher growth rate of the latter is mostly explained by the effect of inflation. The national authorities also confirmed their commitment to maintain a high level of public investment in order to contribute to the diversification of the economy.

Concerning 2018, whereas the 2017 Stability Programme planned a slight improvement in the headline surplus to 0.3% of GDP (compared to 0.2% of GDP in 2017) the DBP 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.

The Commission 2017 autumn forecast expects the general government surplus to drop to 0.5% of GDP in 2017, and to 0.3% of GDP in 2018. The 0.3 percentage point of GDP difference in 2018 compared to the 0.6% of GDP surplus in the DBP is to a large extent explained by a less dynamic underlying economic scenario (3.5% compared to 4.4% provided in the DBP).

Euro area sovereign bond yields remain at historically low levels. As a consequence, total interest payments by the general government have continued to decrease as a share of GDP. In line with the low level of government debt, Luxembourg interest expenditure has remained modest at 0.3% of GDP, compared to 1.9% of GDP on average for the euro area as a whole and below the 0.5% recorded back in 2013 at the peak of the euro area sovereign debt crisis. In addition, over the past years Luxembourg has benefitted from stable and favourable financing conditions. The implicit interest rate of government debt is estimated at 1.3% in 2018 compared to 2.2% for the euro area as a whole.

In structural terms, the Draft Budgetary Plan projects the structural balance[4] at 0.9% of GDP in 2017. The surplus is projected to decline to 0.5% of GDP in 2018. By comparison, in the 2017 Stability Programme, the (recalculated) structural balance was estimated to turn from a surplus of 0.4% of GDP in 2017 to a deficit of 0.1% of GDP in 2018. These developments as outlined in the DBP are broadly in line with those in the Commission 2017 autumn forecast, where the structural surplus balance is projected to decline from 0.6% of GDP in 2017 to 0.3% of GDP in 2018.

Risks to the above fiscal outlook are related to the macroeconomic outlook and, in particular, to the financial sector remaining the main engine of the domestic economy. Regulatory and external risks remain and could adversely impact the sector and overall growth perspectives. Additional risks are mostly related to the impact that the ongoing international initiatives to fight tax avoidance and evasion could have on the decisions of multinational corporations to establish in Luxembourg. Finally, the recurrent and sizeable revisions of national accounts risk to undermine the reliability of the overall budgetary exercise.

[4] 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.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2016	2017			2018			Change: 2016-2018
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**43.8**	**41.3**	***44.1***	**43.3**	**40.5**	***43.7***	**43.0**	**-0.1**
of which:								
- Taxes on production and imports	11.9	11.0	*12.0*	11.8	10.8	*11.9*	11.7	0.0
- Current taxes on income, wealth, etc.	15.1	14.3	*15.2*	14.9	13.9	*15.1*	14.8	-0.1
- Capital taxes	0.2	0.1	*0.1*	0.2	0.1	*0.1*	0.2	-0.1
- Social contributions	12.2	11.8	*12.5*	12.2	11.6	*12.4*	12.1	0.2
- Other (residual)	4.3	4.1	*4.3*	4.3	4.1	*4.2*	4.2	-0.2
Expenditure	**42.1**	**41.1**	**43.5**	**42.8**	**40.2**	**43.1**	**42.6**	**1.0**
of which:								
- Primary expenditure	41.8	40.8	43.2	42.5	39.9	42.8	42.4	1.0
of which:								
Compensation of employees	8.8	8.6	9.1	8.9	8.4	9.1	8.7	0.4
Intermediate consumption	3.8	3.5	3.7	3.7	3.4	3.7	3.8	-0.1
Social payments	19.8	19.3	20.2	20.0	18.7	20.0	19.8	0.1
Subsidies	1.3	1.4	1.4	1.3	1.3	1.4	1.3	0.1
Gross fixed capital formation	3.9	4.0	4.3	4.2	3.9	4.1	4.3	0.2
Other (residual)	4.3	4.0	4.5	4.5	4.2	4.5	4.4	0.3
- Interest expenditure	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.0
General government balance (GGB)	**1.6**	**0.2**	**0.6**	**0.5**	**0.3**	**0.6**	**0.3**	**-1.0**
Primary balance	**1.9**	**0.5**	**0.9**	**0.8**	**0.6**	**0.9**	**0.6**	**-1.0**
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GGB excl. one-offs	**1.6**	**0.2**	**0.6**	**0.5**	**0.3**	**0.6**	**0.3**	**-1.0**
Output gap[1]	-0.9	-0.5	-0.6	-0.4	0.8	0.3	0.1	1.0
Cyclically-adjusted balance[1]	2.0	0.4	0.9	0.6	-0.1	0.5	0.3	-1.5
Structural balance (SB)[2]	**2.0**	**0.4**	**0.9**	**0.6**	**-0.1**	**0.5**	**0.3**	**-1.4**
Structural primary balance[2]	2.3	0.7	1.2	0.9	0.2	0.8	0.6	-1.5

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/programme as recalculated by Commission on the basis of the DBP/programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:
Stability Programme 2017 (SP); Draft Budgetary Plan for 2018 (DBP); Commission 2017 autumn forecast (COM); Commission calculations

3.2. Debt developments

In the Draft Budgetary Plan, the public debt-to-GDP ratio is projected to increase from 20.8% in 2016 to 23.5% in 2017 and to decline to 22.7% of GDP in 2018, well below the Treaty threshold of 60% and under the 30% threshold set by government. The increase is expected to occur despite the general government balance remaining positive throughout the period covered by the Draft Budgetary Plan. According to the national law, the surpluses of the social security sector are allocated to a reserve fund (the so-called "*Fonds de compensation* *commun au régime général de pension*") with the aim to cover future pension expenditure. They cannot be used to finance the needs of the central government[5], which is expected to remain in deficit. These results are broadly in line with the Commission 2017 autumn forecast.

Table 3. Debt developments

(% of GDP)	2016	2017			2018		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**20.8**	**22.2**	**23.5**	**23.7**	**22.4**	**22.7**	**23.0**
Change in the ratio	-1.2	1.4	2.7	2.9	0.3	-0.8	-0.6
Contributions[2] :							
1. Primary balance	**-1.9**	**-0.5**	**-0.9**	**-0.8**	**-0.6**	**-0.9**	**-0.6**
2. "Snow-ball" effect	**-0.1**	**-1.0**	**0.0**	**-0.8**	**-1.1**	**-0.1**	**-1.0**
Of which:							
Interest expenditure	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Growth effect	-0.7	-0.9	-0.7	-0.7	-1.1	-1.0	-0.8
Inflation effect	0.3	-0.4	0.4	-0.4	-0.4	0.7	-0.5
3. Stock-flow adjustment	**0.8**	**2.9**	**3.6**	**4.5**	**2.0**	**0.2**	**1.0**

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual

Source:

Stability Programme 2017 (SP); Draft Budgetary Plan for 2018 (DBP); Commission 2017 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the Draft Budgetary Plan

The 2018 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 to the labour market of the beneficiaries; 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 of the degree of implementation of the previously adopted measures with an impact on the years under examination, including a revised estimation of the likely yields of the measures in the consolidation package (so called 'Zukunftspak' adopted in 2015).

[5] The breakdown of the general government balance shows that, while the social security sector traditionally posts a surplus of more than 1% of GDP, the central government records a deficit, and the balance of the local government sector is broadly neutral. As a consequence, the central government needs to issue debt even in case of a balanced or in surplus budget.

Table 4. Main discretionary measures reported in the DBP

Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2017	**2018**
Compensation of employees	n.a	0.00
Intermediate consumption	n.a	0.00
Social payments	n.a	0.02
Interest Expenditure	n.a	0.00
Subsidies	n.a	0.01
Gross fixed capital formation	n.a	0.04
Capital transfers	n.a	0.00
Other	n.a	0.00
Total	n.a	0.07

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.

Source: Draft Budgetary Plan for 2018

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Luxembourg is subject to the preventive arm of the Pact. Box 2 reports the latest country-specific recommendations in the area of public finances.

Box 2: Council Recommendations[6] addressed to Luxembourg

On 11 July 2017, the Council addressed recommendations to Luxembourg in the context of the European Semester. In particular, in the area of public finances the Council recommended to Luxembourg to ensure the long-term sustainability of the pension system, limit early retirement and increase the employment rate of older people.

According to the information provided in the Draft Budgetary Plan, Luxembourg is expected to achieve a (recalculated) structural surplus of 0.9% of GDP in 2017. This is well above its MTO of a deficit of 0.5% of GDP[7]. 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.

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[6] OJ C 261, 9.8.2017

[7] MTOs are to be revised every 3 years. Based on a agreed methodology, the Commission computes a minimum MTO for each country. The minimum MTOs a provide a lower bound for the national structural balance targets, which ensure the sustainability of the public finances, including the projected impact of ageing, or rapid progress towards sustainability, while providing a safety margin with respect to the 3% of GDP treaty reference value. Due to the more favourable estimation in the 2015 Ageing report of its sustainability components (age-relate expenditure, debt) the new minimum MTOs for Luxembourg declined significantly, from a structural balance surplus of 0.5% of GDP to a deficit of 1% of GDP. However, given that Luxembourg is bound by the provisions of the Fiscal Compact a deficit of 0.5% of GDP is considered as a general minimum MTO requirement. With the 2016 Stability Programme Luxembourg decided to revise its MTO to a deficit of 0.5% of GDP for the period 2017-2019 from a surplus of 0.5% of GDP.

These conclusions are confirmed by the Commission 2017 autumn forecast.

Table 5. Compliance with the requirements of the preventive arm

(% of GDP)	2016	2017		2018	
Initial position[1]					
Medium-term objective (MTO)	0.5	-0.5		-0.5	
Structural balance[2] (COM)	2.0	0.6		0.3	
Structural balance based on freezing (COM)	2.2	0.6		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	**2016**	**2017**		**2018**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	Compliance				
Required adjustment corrected[5]					
Change in structural balance[6]					
One-year deviation from the required adjustment[7]					
Two-year average deviation from the required adjustment[7]					
Expenditure benchmark pillar					
Applicable reference rate[8]					
One-year deviation adjusted for one-offs[9]					
Two-year average deviation adjusted for one-offs[9]					
PER MEMORIAM: One-year deviation[10]					
PER MEMORIAM: Two-year average deviation[10]					
Conclusion					
Conclusion over one year	Compliance	Compliance	Compliance	Compliance	Compliance
Conclusion over two years	Compliance	Compliance	Compliance	Compliance	Compliance

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2016) was carried out on the basis of Commission 2017 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

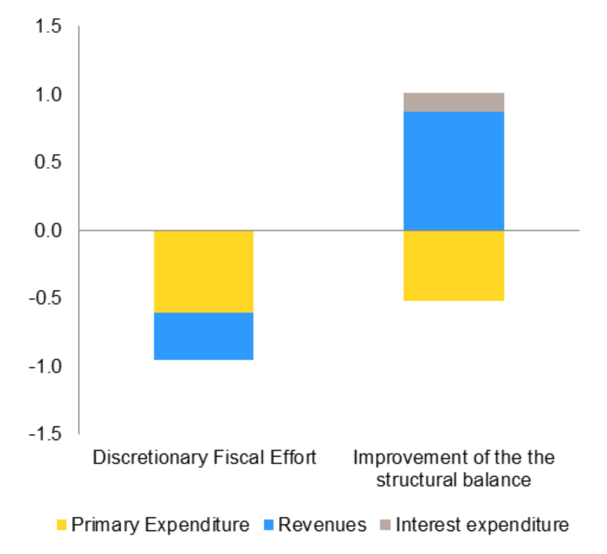
Source :

Draft Budgetary Plan for 2018 (DBP); Commission 2017 autumn forecast (COM); Commission calculations.

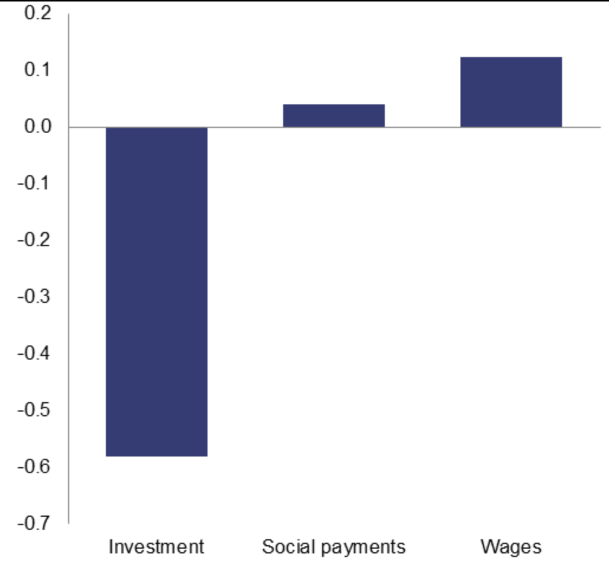
5. Composition of public finances and Implementation of fiscal structural reforms

The national authorities carried out an overall expansionary fiscal policy over the period 2011-2016 as measured by the discretionary fiscal effort (see Graph 1). Over the period 2011-2016, expenditure as share of GDP increased by around ½ percentage point of GDP, while the share of revenues shrunk, due to some extent to the change in EU legislation, enacted in 2015. This resulted in a loss of VAT revenues related to e-commerce activities and only partially compensated by the contextual increase of 2 percentage points of all VAT rates decided by the government. Overall, the discretionary fiscal effort indicator shows that over the period examined fiscal policy was loosened by around 1 percentage point of GDP. By contrast, according to the change in structural balance showing an improvement of around 1 percentage point of GDP, Luxembourg tightened its fiscal stance. The difference between the two indicators reflects, to a large extent, revenue windfalls and only residually a decrease in interest payments (see Graph 1). From the analysis of the composition of public expenditure it appears that the absence of indexation between October 2013 and the beginning of 2017 contributed to moderating the increase of some expenditure items as social payments and public wages. Graph 2 also shows that despite recent government efforts to increase investment, the latter remains below its level in 2011, mostly as results of the government consolidation efforts carried out in 2012 and 2013.

Graph 1: Composition of the fiscal effort (2011-2016), Luxembourg (% GDP)



Graph 2: Change in the share in total expenditure of selected expenditure items (2011-2016), Luxembourg (change)



<u>Source</u>:

The Discretionary Fiscal Effort (DFE) combines a top-down approach on the expenditure side with a bottom-up or narrative approach on the revenue side. In a nutshell, the DFE consists of the increase in primary expenditure net of cyclical components relative to economic potential on the one hand, and of discretionary revenue measures on the other hand. See European Commission (2013): Measuring the fiscal effort, Report on Public Finances in EMU, part 3 http://ec.europa.eu/economy_finance/publications/european_economy/2013/pdf/ee-2013-4.pdf

The Draft Budgetary Plan provides a list of measures already adopted or planned in order 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.

The fiscal recommendation (see Box 2) called to improve the long-term sustainability of the pension system, limit early retirement and increase the employment rate of older people. As regards the implementation, the Draft Budgetary Plan reports on the adopted new reform of the long-term care insurance scheme, which will take effect from the start of 2018 and on the new measures to help people in the 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 for easing of restriction on other kinds of early retirement schemes.

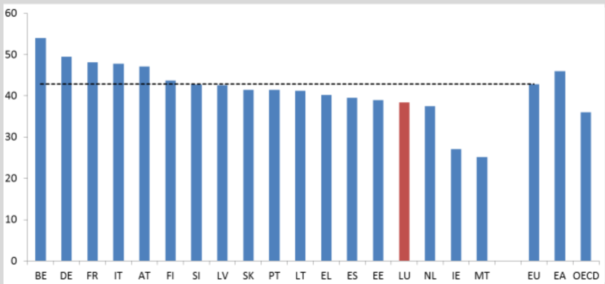
A comprehensive assessment of progress made with the implementation of the country-specific recommendations will be made in the 2018 Country Reports and in the context of the country-specific recommendations to be proposed by the Commission in May 2018.

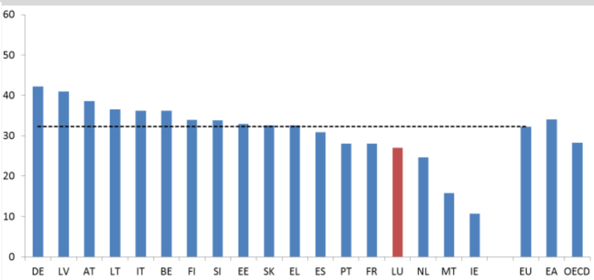
Box 3: Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to benchmark euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker’s net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in Luxembourg for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

The tax burden on labour in Luxembourg at the average wage and at low wage (2016)





Notes: No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.
Source: European Commission Tax and Benefit Indicator database based on OECD data.

Benchmarking is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

The reform of the tax code, which took effect as of 1st January 2017 has 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. Tax credits for employees and pensioners have been increased. The tax measures are expected to preserve the competitiveness of its economy and increase households' disposable income and have a positive effect on employment and on growth through higher private consumption. No new measures were included in the Luxembourg's Draft Budgetary Plan affecting the tax wedge on labour.

6. OVERALL CONCLUSION

According to both the information provided in the Draft Budgetary Plan and the Commission 2017 autumn forecast, the structural balance is expected to remain above the MTO in 2017 and 2018.