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COMMISSION OPINION

of 18.11.2020

on the Draft Budgetary Plan of Luxembourg

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(Only the French version 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 Communication[1] on the activation of the general escape clause[2] of the Stability and Growth Pact. In its 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] As indicated in the Annual Sustainable Growth Strategy 2021[4] and as communicated in the letter of 19 September 2020 from the Commission to the EU Ministers of Finance[5], Member States should continue to provide targeted and temporary fiscal support in 2021 in a context where the general escape clause is activated, while safeguarding fiscal sustainability in the medium term.

4. On 27 May 2020, the European Commission put forward its proposal for the creation of a new recovery instrument Next Generation EU[6], alongside the proposal for the reinforced long-term budget of the EU for 2021-2027.[7] This proposal includes the

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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 on Annual Sustainable Growth Strategy 2021, Brussels, 17.9.2020, COM(2020) 575 final.

5 https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/annual-draft-budgetary-plans-dbps-euro-area-countries/draft-budgetary-plans-2021_en

6 Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions - Europe's moment: Repair and Prepare for the Next Generation, Brussels, 27.5.2020, COM(2020) 456 final.

7 Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions - The EU budget powering the recovery plan for Europe, Brussels, 27.5.2020, COM(2020) 442 final.

establishment of a Recovery and Resilience Facility offering large-scale financial support for both public investments and reforms. By contributing to the economic recovery and by providing financial support to strengthen the economy's long-term growth, the Recovery and Resilience Facility will help public finances to return to more favourable positions in the near term and will contribute to strengthening their sustainability in the medium and long term.

CONSIDERATIONS CONCERNING LUXEMBOURG

5. On 14 October 2020, Luxembourg submitted its Draft Budgetary Plan for 2021. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

6. On 20 July 2020, the Council recommended Luxembourg[8] to take all necessary measures, in line with the general escape clause, to effectively address the pandemic, sustain the economy and support the ensuing recovery. It also recommended Luxembourg to pursue, when economic conditions allow, fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

   On 20 May 2020, the Commission issued a report under Article 126(3) TFEU, as Luxembourg's general government deficit in 2020 was planned to exceed the 3% of GDP Treaty reference value. The report concluded that, after the assessment of all relevant factors, the deficit criterion was not fulfilled. In light of the exceptional uncertainty created by the outbreak of COVID-19 and its extraordinary macroeconomic and fiscal impact, including for designing a credible path for fiscal policy, which will have to remain supportive in 2021, the Commission considered that a decision on whether to place Member States under the Excessive Deficit Procedure should not be taken.

7. According to the Commission 2020 autumn forecast, the economy of Luxembourg is expected to contract by 4.5% in 2020 and recover by 3.9% in 2021. According to the Draft Budgetary Plan, the economy is set to contract by 6.0% in 2020 before rebounding by 7.0% in 2021. Overall, the macroeconomic projections underpinning the 2021 Draft Budgetary Plan project a sharper contraction in 2020 but also a stronger rebound in 2021 compared to the Commission 2020 autumn forecast. It should be noted that the macroeconomic projections from the Commission had the 22nd of October as a cut-off date, while for the Draft Budgetary Plan scenario this was the end of August. The difference is largely explained by the larger negative (2020) and more positive (2021) net exports contribution to GDP growth in the Draft Budgetary Plan. In addition, the fall in domestic demand in 2020 due to the COVID-19 crisis is less pronounced in the Draft Budgetary Plan. The lockdown and continuing restrictions result in a very significant decline of domestic demand in Luxembourg, which is however projected to be partly cushioned by a strong fiscal response. The relatively well-performing financial sector and the lower share in GDP of the most affected sectors by the COVID-19 crisis is projected to result in a less significant economic decline in Luxembourg in 2020 compared to other EU countries.

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[8] Council Recommendation of 20 July 2020 on the National Reform Programme of Luxembourg and delivering a Council opinion on the 2020 Stability Programme of Luxembourg, OJ C 282, 26.8.2020, p 101.

Luxembourg complies with the requirement of Regulation EU No 473/2013 since the draft budget is based on independently produced macroeconomic forecasts produced by the national statistical office (STATEC).

8. For 2020, the Draft Budgetary Plan expects the general government balance to turn into a deficit of 7.4% of GDP. Compared to the surplus of 2.4% of GDP recorded in 2019, the deterioration in the general government balance of almost 10 percentage points results from both the drop in economic activity and the normal working of automatic stabilisers, which led to a contraction in revenue and in an increase of cyclical expenditure, and from discretionary COVID-19-related measures. According to the 2021 Draft Budgetary Plan, the deficit ratio is expected to narrow to 2.7% of GDP in 2021, helped by the rebound in economic activity and a phasing out of the temporary measures implemented to contain the economic effects of the pandemic. The Draft Budgetary Plan does not take into account the implementation of the reforms and investments, and their associated costs, envisaged under the Recovery and Resilience Facility (RRF). . Since the submission of the Recovery and Resilience Plans and their subsequent approval are expected to take place in 2021, the Commission forecast assumes in the budgetary projections for 2021 the 10% pre-financing of Recovery and Resilience Facility grants. In the case of Luxembourg is equivalent to EUR 10 million in 2021.[9] It is treated as a financial transaction with no impact on the budget balance, but with a public debt-reducing impact. On the expenditure side, in line with its no-policy change assumption, the Commission forecast includes no expenditure related to the Recovery and Resilience Facility, as the corresponding measures were not sufficiently specified at the cut-off date of the forecast. [10] Compared to the Draft Budgetary Plan, the Commission 2020 autumn forecast expects a smaller deficit of 5.1% of GDP in 2020, based on lower projections for current expenditure, in particular for compensation of employees and intermediate consumption, as well as for public investment. For 2021, the Commission forecast projects the deficit to decline to 1.3% of GDP. Compared to the Plan, the Commission forecast projects a higher revenue-to-GDP ratio in 2021. The higher revenue-to-GDP ratio is explained by differences in underlining revenue elasticities, and thus higher proceeds from direct taxation in the Commission's projections than in the Draft Budgetary Plan.

The Draft Budgetary Plan indicates that the government debt-to-GDP ratio will increase from 27.4% at the end of 2020 to 29.4% in 2021, whereas in the Commission's projection public debt increases to 25.4% and 27.3%, respectively.

9. The Draft Budgetary Plan reports discretionary fiscal measures with a direct budgetary impact in 2020 in response to the COVID-19 outbreak and its related

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[9] Indicative number based on the Council Presidency compromise proposal for the RRF regulation (11538/20) of 7 October 2020, on which the Council Presidency obtained a mandate for conducting the negotiations with the European Parliament.

[10] The treatment of the Recovery and Resilience Facility (RRF) in the Commission's 2020 autumn forecast is explained in detail in Box I.4.3 of the European Commission's Economic Forecast Autumn 2020 (https://ec.europa.eu/info/sites/info/files/economy-finance/ip136_en.pdf). In line with the customary no policy-change assumption, the forecast only incorporates those measures that are credibly announced and sufficiently detailed in the Draft Budgetary Plans, irrespective of whether they are planned to be part of the Recovery and Resilience Plans. No financing from the RRF has been included on the revenue side of the budgetary projections. Only the pre-financing of RRF grants is included in the forecast for 2021. The assumptions on expenditure measures linked to the RRF in the Commission forecast are without prejudice to the assessment of the Recovery and Resilience Plans.

economic effects of around EUR 3 billion (about 5.1% of GDP). Expenditure measures in 2020 include extraordinary healthcare spending, funding of a broad partial unemployment scheme and subsidies to support small and medium-sized enterprises. The Commission 2020 autumn forecast has taken on board the measures reported in the Draft Budgetary Plan, which are assessed to be temporary, but with a lower estimate of their budgetary cost (3.1% of GDP). The Commission 2020 autumn forecast considers a large share of the expenditure on short-term work schemes as part of the operation of the automatic stabilisers, whereas the Plan appears to report the gross impact of these schemes. In addition, in the Commission 2020 autumn forecast, and contrary to the Draft Budgetary Plan, the granting of repayable advances (0.7% of GDP) is not considered as a discretionary measure with a direct budgetary impact. Beyond the measures that have a direct impact on the deficit, the Draft Budgetary Plan also indicates liquidity support measures in 2020 of EUR 8 billion (13.4% of GDP), in the form of tax deferrals (EUR 4.6 billion or 7.7% of GDP) and public loan guarantees (with a ceiling of EUR 3.4 billion or 5.7% of GDP). Overall, the measures taken by Luxembourg in 2020 were in line with the guidelines of the Commission Communication of 13 March 2020 on a coordinated economic response to the COVID-19 outbreak.

10. For 2021, the Draft Budgetary Plan presents a set of additional measures aimed at supporting the economic recovery. These include measures estimated at 0.2% of GDP to support the green and digital transition, to favour social equity and to safeguard and improve the long-term competitiveness of the economy. These measures are also included in the Commission 2020 autumn forecast, with a similar budgetary impact. In addition, the Commission forecast factors in an impact of 0.1% of GDP from the prolongation of measures in support of employment.

11. The Commission is of the opinion that the Draft Budgetary Plan of Luxembourg is overall in line with the recommendation adopted by the Council on 20 July 2020. Most of the measures set out in the Draft Budgetary Plan of Luxembourg are supporting economic activity against the background of considerable uncertainty. 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.

It is anticipated that Luxembourg will submit its Recovery and Resilience Plan in 2021. The Regulation establishing a Recovery and Resilience Facility will set out how the Commission is to assess that the reforms and investments included in the Recovery and Resilience Plan are coherent with the policy priorities of the Union and the challenges identified in the context of the European Semester. This assessment by the Commission will inform the approval of the Plan by the Council and the information to the European Parliament.

Done at Brussels, 18.11.2020

For the Commission
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Member of the Commission