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COMMISSION OPINION

of 15.11.2013

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 (DBP) for 2014 submitted on 15 October 2013 by Luxembourg, the Commission has adopted the following opinion in accordance with Article 7 of the Regulation (EU) No 473/2013.

4. Luxembourg is subject to the preventive arm of the SGP and should preserve a sound fiscal position which ensures compliance with the medium term objective.

5. The macroeconomic scenario underlying the Draft Budgetary Plan is almost unchanged compared to that presented in the 2013 Stability Programme. Only some marginal adjustments have been introduced, such as a revision of GDP growth in 2014 from 2.2% to 2.3%. According to the projections in the Draft Budgetary Plan, economic prospects would remain sluggish in 2013 with real GDP growth estimated at 1.0%. However, the macroeconomic scenario underpinning the Draft Budgetary Plan was established before the national account data for the second quarter of 2013 were released, which point to a sharp economic improvement in the second quarter of 2013. In contrast, the Commission 2013 Autumn Forecast does incorporate that strong rebound and, therefore, projects economic activity to expand by 1.9%. For 2014 the Draft Budgetary projects output to expand by 2.3% which is more optimistic than the Commission forecast of 1.8%. The difference with the Draft Budgetary Plan is mainly explained by a lower contribution of net exports, with domestic demand pushing up imports more than in the Draft Budgetary Plan scenario.

6. The macroeconomic forecast underlying the Draft Budgetary Plan has been produced by STATEC, the National Institute of statistics and economic studies of the Grand Duchy of Luxembourg, which also provided the methodology for output gap calculation. STATEC is an autonomous administration placed under the authority of the Ministry of Economy and External Trade. Based on the information available to the Commission at this stage, the statutes of STATEC contain provisions supporting independence of the institution as a body producing macroeconomic forecasts.

7. According to the Draft Budgetary Plan, the general government deficit is projected to deteriorate to 0.9% of GDP in 2013, in line with the Commission 2013 Autumn

Forecast. This compares with the target of a deficit of 0.7% of GDP set in the Stability Programme, the divergence mostly due to expenditure overruns. Concerning 2014, the Draft Budgetary Plan, rather than setting out an explicit target for the general government balance, presents a no-policy-change scenario, prepared in the form of a technical update of the medium-term forecast provided in the April 2013 Stability Programme. The no-policy-change scenario points to a nominal general government deficit of 0.5% of GDP. According to the Commission forecast, the general government balance is expected to increase to 1.0% of GDP in 2014. The divergence with the Draft Budgetary Plan is almost evenly explained by the difference in the growth scenarios and by the different underlying assumptions about the evolution of certain expenditure items.

8. In the Draft Budgetary Plan the general government debt for 2013 is projected at 24.9% of GDP, slightly above the level projected in the Commission 2013 Autumn Forecast (24.5% of GDP). The difference between the two forecasts is largely explained by the denominator effect associated with the nominal GDP, more dynamic in the Commission forecast. For 2014, the Draft Budgetary Plan projects the general government debt to increase to 26.1% of GDP, compared to a debt projection of 25.7% in the Commission forecast. Despite its increasing trend, the level of the general government gross debt remains low.

9. The Draft Budgetary Plan, having been drafted using a no-policy-change scenario, does not contain information on new measures. The budgetary figures indicated therein should be interpreted with caution, given that they do not represent a budgetary policy target, but rather the result of the mechanical implementation of the assumptions retained.

10. In 2013 the recalculated structural balance[1] is projected to deteriorate from 0.8% of GDP to 0.2%, below the country's medium term objective (MTO) of a surplus of 0.5% of GDP, according to both the Draft Budgetary Plan and the Commission forecast. The risks for Luxembourg to depart from the MTO are thus confirmed by the Commission Forecast. In 2014 the recalculated structural balance linked to the Draft Budgetary Plan and the structural balance associated with the Commission forecast are both expected to deviate further from the MTO, to a deficit of 0.4% of GDP. Concerning the expenditure benchmark, according to the information provided in the Draft Budgetary Plan, government expenditure in 2013 is expected to increase at a slower pace than the reference rate that would ensure compliance with the MTO. In 2014, according to the information provided in the Draft Budgetary Plan, the expenditure benchmark rule would not be respected, as expenditure is expected to grow at a rate above -0.07%, calculated as the maximum change under the expenditure benchmark. The deviation is estimated at 0.7% of GDP and can be considered as significant since it is above 0.5%. This conclusion is confirmed by the Commission 2013 Autumn Forecast. Overall, following the assessment of the Luxembourg’s Draft Budgetary Plan, with the structural balance as a reference, including an analysis of expenditure net of discretionary revenue measures, there is a risk of departure from the MTO in 2013, as signalled by the deterioration in the structural balance. For 2014 a significant deviation from the adjustment path towards the MTO is also expected, putting at risk the compliance with the requirements of the

[1] 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.

preventive arm of the SGP, as indicated both by the deterioration in the structural balance and the non-compliance with the expenditure benchmark rule.

11. The Draft Budgetary Plan provides a list of the measures that have been already adopted or are planned to be adopted, in order to ensure an adequate follow-up of the Council recommendations addressed to Luxembourg on 9 July 2013 in the context of the European Semester. In order to ensure a full follow-up of the fiscal recommendation, which called for a strenghening of Luxembourg's fiscal governance through the adoption of a medium-term budgetary framework covering the general government, the Draft Budgetary Plan indicates that a draft bill has been tabled in Parliament just before the summer. The adoption of the draft bill, also designed to transpose the provisions of the Fiscal compact, is planned for the end of the year. Several measures with regard to other recommendations issued under the European Semester have been adopted in previous years or their adoption has been planned. However, so far no measures have been reported to address the debt-bias in corporate taxation and the widespread application of reduced VAT rate. Still, the political standstill due to the governement resignation and anticipative elections blocked the reform process.

12. Overall, based on the 2013 Autumn Forecasts forecast, the Commission is of the opinion that there is a risk that the Draft Budgetary Plan sent on 15 October will not fulfil the requirements of the preventive arm. In particular, the Commission forecast points to a non-compliance with respect to the adjustment path towards the MTO in 2014. The Commission is also of the opinion that Luxembourg has made some progress with regard to the structural part of the fiscal recommendations issued by the Council in the context of the European Semester. The Commission invites the authorities to ensure full compliance with the SGP within the national budgetary process for the 2014 budget and to make further progress towards implementation of the fiscal recommendations under the European Semester.

13. As soon as a new government takes office, national authorities are invited to submit to the Commission and to the Eurogroup an updated Draft Budgetary Plan, taking into account the present Opinion .

Done at Brussels, 15.11.2013

For the Commission
Olli REHN
Vice-President