COMMISSION OPINION

of 16.11.2016

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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 for 2017 submitted on 14 October 2016 by Luxembourg, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. The Commission opinion is to be seen in light of the latest economic and budgetary data. In this context, as indicated in the Commission recommendation for a Council Recommendation on the economic policy of the euro area as well as in the Commission Communication 'Towards a positive fiscal stance in the euro area', it is important that the aggregate fiscal stance of the euro area is positive and supports the ongoing recovery, while ensuring the long-term sustainability of national public finances.

5. Luxembourg is currently subject to the preventive arm of the Pact and should preserve a sound fiscal position ensuring compliance with its medium-term objective (MTO), of a structural deficit of 0.5% in 2017.

6. The macroeconomic assumptions underlying the budgetary projections in the Draft Budgetary Plan can be assessed as cautious for 2016 and favourable in 2017. According to the macroeconomic scenario underpinning the Draft Budgetary Plan, economic prospects would nevertheless remain robust in 2016 and 2017, with real GDP growth estimated at 3.1% and 4.6% respectively. Those rates compare with a 2.9% and 4.5% growth rate projected respectively for 2016 and 2017 in the 2016 Stability Programme. The Commission 2016 autumn forecast projects a stronger growth of 3.6% in 2016 in view of higher-than-expected growth in the first half of 2016. In 2017, based on a less benign assumption about the evolution of financial markets, economic output is projected to expand by 3.8%, 0.8 percentage points lower than the authorities' forecast. The Draft Budgetary Plan projects inflation to turn negative, falling to -0.2% in 2016 from 0.1% in 2015, before accelerating to 1.3% in 2017. According to the Commission 2016 autumn forecast, inflation will increase from 0.0% in 2016 to 1.6% in 2017.

7. Luxembourg complies with the requirement of Regulation (EU) No 473/2013 that the draft budget must be based on independently endorsed or produced
The macroeconomic forecasts underlying the Draft Budgetary Plan have been produced by STATEC, the National Institute of statistics and economic studies of the Grand Duchy of Luxembourg, which also provided the methodology for the output gap calculation. STATEC is an autonomous administration placed under the authority of the Ministry of Economy. Its statutes contain provisions supporting the independence of the institution as a body producing macroeconomic forecasts.

8. According to the Draft Budgetary Plan, the general government surplus is projected to decline to 1.2% of GDP in 2016 from 1.6% of GDP in the previous year. The target has been revised upwards compared to the last Stability Programme where a surplus of 0.8% of GDP was set for 2016. The difference is mainly explained by a base effect as the surplus for 2015 has been revised from 1.3% of GDP in the Stability programme to 1.6% of GDP in the DBP. With regard to 2017, the Draft Budgetary Plan expects the surplus to drop to 0.3% of GDP, mostly as a result of the implementation of the tax reform and the additional losses in revenue from the VAT on e-commerce transactions, as the share of revenues that is retained by Luxembourg will decline from 30% to 15% as of 2017. The surplus planned for 2017 represents an improvement compared with the budgetary trajectory outlined in the 2016 Stability Programme, where a balanced budget was expected. In the Draft Budgetary Plan, the debt-to-GDP ratio is expected to increase to 23.2% in 2016 and to 23.6% in 2017 broadly in line with the Commission 2016 autumn forecast. In the light of the low level of government debt, savings from interest expenditure due to low interest rates were limited.

9. Luxembourg's authorities have engaged in a reform of the tax code. The tax reform is expected to enter into effect in 2017. It entails the introduction of a significant number of new tax measures concerning both corporate and individual taxpayers in the field of direct and indirect taxes. Its overall budgetary impact is deficit increasing and is estimated by the national authorities at around 0.7% of GDP in 2017. In particular, with respect to personal income taxation, the reform aims at making the system more progressive, by adding tax brackets including two new marginal tax rates for the highest incomes. Moreover, the 0.5% contribution levied on personal income, introduced in 2015, will be repealed. Concerning the corporate income taxation, the reform provides for a gradual decrease of the tax rate from 21% to 19% in 2017 and to 18% in 2018. In addition, the tax rate applicable to smaller companies is to be reduced from 20% to 15%, while the scope of eligible companies has been enlarged. Risks exist however that the cost of the reform could finally turn out higher than projected.

10. The 2016 surplus of 1.2% of GDP envisaged in the Draft Budgetary Plan is broadly in line with the Commission 2016 autumn forecast, which projects the headline surplus at 1.3% of GDP. For 2017, the Commission forecast projects a stronger drop in the headline balance (to 0.0% of GDP) than the Draft Budgetary Plan, which projects a headline surplus of 0.3% of GDP. The difference stems mainly from more favourable underlying macroeconomic scenario in the Draft Budgetary Plan. Risks to the budgetary trajectory in the Draft Budgetary Plan are related to potentially higher-than-expected cost of the tax reform. Moreover, medium-term budgetary risks could arise from the strong dependence of the country on the evolution of the financial sector and the potentially negative implications from the ongoing initiatives to fight tax avoidance strategies by multinationals.
11. Luxembourg's structural balance recorded a surplus of 2.2% of GDP in 2015, well above the then applicable country specific medium-term objective (MTO) of a structural surplus of 0.5% of GDP. According to the information provided in the Draft Budgetary Plan, with a (recalculated) structural surplus of 1.9% in 2016, the structural balance is projected to remain well above the MTO in 2016. In 2017, the (recalculated) structural balance is projected to drop to a surplus of 0.5% of GDP, still well above the revised MTO of a deficit of 0.5% of GDP. This is confirmed by the Commission 2016 autumn forecast. Therefore, Luxembourg is assessed to be compliant with the requirements under the preventive arm of the SGP.

12. Luxembourg's Draft Budgetary Plan provides a description of measures, in the context of the announced reform of the tax code, that affect the tax wedge on labour. In particular, it concerns a reduction of the personal income tax. A non-exhaustive list of the measures includes: (i) the repeal of the 0.5% temporary contribution levied on personal incomes introduced in 2015, (ii) a revision of the personal income tax introducing more progressivity by adding tax brackets including the introduction of two new marginal tax rates for the highest incomes, and (iii) an increase of tax credits for employees, pensioners, self-employed and single parents. The reform is expected to take effect as of 1 January 2017. All in all, the reform is deficit-increasing with its impact in the first year estimated at 0.7% of GDP. The tax measures are expected to increase households' disposable income and have a positive effect on growth by higher private consumption. Finally, the Draft Budgetary Plan provides a list of measures adopted or that are to be adopted to ensure an adequate follow-up of the 2016 country specific recommendations (CSRs). As regards the fiscal structural recommendation, the recommendation called for an improvement in the long-term sustainability of the public finances. To that effect, the Draft Budgetary Plan mentions measures such as the reform of the professional classification scheme for persons with partial incapacity for work and the planned reform of the early retirement system. However, savings from the implementation of those measures are expected to be limited.

13. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Luxembourg, which is currently under the preventive arm, is compliant with the provisions of the SGP. In line with the Commission Communication ‘Towards a positive fiscal stance for the euro area’, Luxembourg's budgetary situation could provide some scope to ensure a supportive budgetary stance, while preserving the long-term sustainability of national public finances.

The Commission is also of the opinion that Luxembourg has made limited progress with regard to the structural part of the fiscal country-specific recommendations issued by the Council in the context of the 2016 European Semester and thus invites the authorities to accelerate progress. A comprehensive assessment of progress made with the implementation of the country-specific recommendations will be made in the 2017 Country Reports and in the context of the country specific recommendations to be adopted by the Council in 2017.

Done at Brussels, 16.11.2016

For the Commission
Pierre MOSCOVICI
Member of the Commission