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COMMISSION OPINION

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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 for 2015 submitted on 15 October 2014 by Luxembourg, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. Luxembourg is subject to the preventive arm of the Stability and Growth Pact and should preserve a sound fiscal position ensuring compliance with its medium-term budgetary objective (MTO). On 8 July 2014, the Council recommended that Luxembourg should preserve a sound fiscal position in 2014 and significantly strengthen the budgetary strategy in 2015 to ensure that the MTO is achieved and remain at the MTO thereafter.

5. According to the macroeconomic scenario underpinning the Draft Budgetary Plan, economic prospects would remain favourable both in 2014 and 2015, with real GDP growth projected at 2.8% and 2.7% respectively. This represents a slightly downward revision in comparison with the 3.2% growth rate projected for both 2014 and 2015 in the 2014 Stability Programme. Less optimistic assumptions on external economic developments, notably in the euro area, explain the difference. However, the macroeconomic scenario underpinning the Draft Budgetary Plan was established before the national accounts data for the second quarter of 2014 were released, which point to a better-than-expected economic performance in the first half of 2014. On these grounds, the Commission 2014 autumn forecast expects GDP to grow by 3% in 2014, which is slightly higher than envisaged in the Draft Budgetary Plan. In contrast, the Commission forecasts a growth rate of 2.4% for 2015, slightly lower than in the Draft Budgetary Plan, based on more moderate assumptions on the external economic environment.

6. Regulation (EU) No 473/2013 requires the draft budget to be based on independently endorsed or produced macroeconomic forecasts. 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 the output gap calculation. STATEC is an autonomous entity 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.

7. According to the Draft Budgetary Plan, the surplus of the general government balance is projected to decline from 0.6% of GDP in 2013 to 0.2% in 2014, the positive base effect of the higher surplus in 2013 being almost completely offset by expenditure overruns. This deterioration represents a slightly better outcome compared with the target surplus of 0.1% of GDP set in the Stability Programme. Concerning 2015, the Draft Budgetary Plan projects the general government balance to turn into a deficit of 0.2% of GDP, mostly as a result of the expected decrease in VAT revenues linked to a change in e-commerce legislation, estimated at around 1½% of GDP and only partially compensated by the consolidation measures specified in the Draft Budgetary Plan. This compares to a deficit of 0.5% of GDP contained in the most recent Stability Programme. The difference is largely explained by a base effect of 0.1% of GDP from 2014 and a slight upward revision of the consolidation package by 0.1% of GDP.

8. The Commission 2014 autumn forecast projects the headline deficit at 0.4% of GDP in 2015, the difference from the government forecast being largely due to a weaker underlying macroeconomic scenario. Moreover, in the Draft Budgetary Plan the apparent elasticity of revenues to GDP, notably for taxes on income and wealth, is slightly higher than the one used in the Commission forecast.

9. The main risk to the fiscal outlook as projected in the Draft Budgetary Plan and the Commission forecast relates to the actual size of the decrease in e-VAT revenue. The current estimation, factored in both by the national and Commission forecast and amounting to about EUR 700 million (1½% of GDP), is based on a central scenario, where the majority of companies concerned by the change in legislation will remain registered in Luxembourg for all their services. In the worst-case scenario, where all concerned companies would choose to leave the country, the losses could exceed 2% of GDP.

10. In the Draft Budgetary Plan, the general government debt for 2014 is projected at 23% of GDP, in line with the level projected in the Commission 2014 autumn forecast. For 2015, the Draft Budgetary Plan projects the general government debt to increase to 24.1% of GDP, compared to a debt projection of 24.4% of GDP in the Commission forecast, the difference being mostly explained by a lower primary balance in the Commission forecast. In spite of its increasing trend, the level of the general government gross debt remains well below the threshold of 60% of GDP set in the Stability and Growth Pact.

11. In the Draft Budgetary Plan, consolidation measures equivalent to EUR 560 million (1.1% of GDP) have been specified, with the bulk of the package consisting of revenue measures (0.8% of GDP). In particular, they include the increase by 2 pps. in all VAT rates from 1 January 2015, except the super reduced rate of 3%, as already announced in the Stability Programme. In addition, a new contribution of 0.5% levied on personal income, worth around EUR 120 million or 0.25% of GDP, will also be introduced on 1 January 2015 to contribute to the financing of education expenditure. On the expenditure side, measures introducing savings for an amount of around 0.4% of GDP have been specified. These envisaged savings are the result of the spending review launched by the government in early spring and carried out by 19 working groups, which submitted over 250 proposals to the government.

12. As Luxembourg attained its MTO in 2013, the country does not face specific requirements beyond the maintenance of its structural balance at the MTO in 2014. The (recalculated) structural balance is planned to decline from 2% of GDP in 2013 to 1.2% of GDP in 2014, a level still well above the country-specific MTO of 0.5 % of GDP. These results are in line with the Commission 2014 autumn forecast, which expect a surplus of 1.1% of GDP. Given its position in 2014, the country does not face specific requirements beyond the maintenance of its structural balance at the MTO level in 2015. According to the information in the Draft Budgetary Plan, in 2015 Luxembourg is expected to make use of its margin with respect to the MTO as the structural surplus is set to decrease by 0.7% of GDP and drop from 1.2% of GDP in 2014 to 0.5% of GDP in 2015, just in line with the MTO. The Commission 2014 autumn forecast envisages a marginally lower structural surplus of 0.4% of GDP in 2015, while projecting Luxembourg to broadly remain at its MTO. On the basis of this assessment, it appears that Luxembourg is expected to comply with the requirements of the preventive arm of the SGP.

13. 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 2014 country-specific recommendations (CSRs). As regards the fiscal recommendation, which called, among others, for a reinforcement of fiscal governance, the Draft Budgetary Plan indicates that the law transposing the provisions of the Fiscal Compact was finally adopted by the Parliament on 12 July 2014. The law contains also provisions about the set-up of a newly created body, called "*Conseil National des Finances Publiques*", in charge of ensuring the independent monitoring of the implementation of fiscal rules. However, the related secondary legislation is still to be adopted. Moreover, the Draft Budgetary Plan stresses that the above-mentioned increase in VAT rates ensures an adequate follow-up to the Council recommendation to broaden the tax base, in particular on consumption.

14. 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 Stability and Growth Pact. In particular, in 2015 Luxembourg plans to make use of its buffer with respect to the MTO as the structural surplus is set to deteriorate, while still respecting the country-specific MTO. The reduction in the structural surplus is mostly related to the decrease in VAT revenues linked to the change in e-commerce legislation (around 1½% of GDP), which is only partially compensated by the new measures planned in the Draft Budgetary Plan. However, the VAT revenues losses could turn out to be larger than expected. The Commission therefore invites the authorities to stand ready to take additional measures in case these risks should materialise.

The Commission is also of the opinion that Luxembourg made some progress with regard to the structural part of the fiscal recommendations issued by the Council in the context of the 2014 European Semester and invites the authorities to make further progress.

Done at Brussels, 28.11.2014

For the Commission
Pierre MOSCOVICI
Member of the Commission