Council of the European Union

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Subject:	Recommendation for a COUNCIL RECOMMENDATION on the 2017 National Reform Programme of Luxembourg and delivering a Council opinion on the 2017 Stability Programme of Luxembourg

Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission proposal COM(2017) 515 final.

COUNCIL RECOMMENDATION

of…

on the 2017 National Reform Programme of Luxembourg

and delivering a Council opinion on the 2017 Stability Programme of Luxembourg

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies,[1] and in particular Article 5(2) thereof,

Having regard to the Recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

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1 OJ L 209, 2.8.1997, p. 1.

Whereas:

(1) On 16 November 2016, the Commission adopted the Annual Growth Survey, marking the start of the 2017 European Semester for economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 9-10 March 2017. On 16 November 2016, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council[2], the Commission adopted the Alert Mechanism Report, in which it did not identify Luxembourg as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council Recommendation on the economic policy of the euro area, which was endorsed by the European Council on 9-10 March 2017. On 21 March 2017, the Council adopted the Recommendation on the economic policy of the euro area ('Recommendation for the euro area')[3].

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Luxembourg should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in recommendation (2) below.

(3) The 2017 country report for Luxembourg was published on 22 February 2017. It assessed Luxembourg’s progress in addressing the country-specific recommendations adopted by the Council on 12 July 2016, the follow-up given to the country-specific recommendations adopted in previous years and Luxembourg’s progress towards its national Europe 2020 targets.

(4) On 28 April 2017, Luxembourg submitted its 2017 National Reform Programme and its 2017 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

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2 Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (OJ L 306, 23.11.2011, p. 25).

3 OJ C 92, 24.3.2017, p. 1.

(5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council,[4] where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking effectiveness of the ESI Funds to sound economic governance.

(6) Luxembourg is currently in the preventive arm of the Stability and Growth Pact. In its 2017 Stability Programme, the Government plans a decrease in the headline surplus from 1,6 % of GDP in 2016 to 0,2 % of GDP in 2017, followed by a steady increase thereafter, reaching a surplus of 1,2 % of GDP in 2021. The medium-term budgetary objective — a structural deficit of 0,5 % of GDP — continues to be met with a margin throughout the programme period. According to the 2017 Stability Programme, the government debt-to-GDP ratio is expected to remain well below the 60 %-of-GDP Treaty reference value. The macroeconomic scenario underpinning those budgetary projections is plausible, with the exception of 2018, when it is markedly favourable, and 2021, when it is markedly cautious. Based on the Commission 2017 spring forecast, the structural balance is forecast to register a surplus of 0,4 % of GDP in 2017 and 0,1 % of GDP in 2018, broadly in line with the 2017 Stability Programme and above the medium-term budgetary objective. Overall, the Council is of the opinion that Luxembourg is projected to comply with the provisions of the Stability and Growth Pact in 2017 and 2018.

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[4] Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

(7) Long-term fiscal sustainability concerns remain given the projected increase in ageing costs. Under the 2012 pension reform, an exercise to monitor and evaluate the sustainability of the pension system should be carried out every 5 years from the adoption of the reform. The Government advanced the first evaluation to 2016. Although the review concluded that the pension system is still recording a recurrent surplus which allowed sizeable pension reserves to be accumulated, the pension system is expected to record a negative operational balance from 2023 in terms of benefits expenditure in relation to contributions. According to the recent revised Eurostat population projections, the projected increase in population will be less significant than previously expected. This will have an impact on the dependency ratio, which will increase faster than previously expected and lead to a higher projected increase in public expenditure for pensions. There has been no progress in linking statutory retirement age to life expectancy, as previously recommended by the Council in 2016. Luxembourg stands out as the only Member State where no increase of the statutory retirement age has been laid down for the period between 2013 and 2060. Luxembourg has the Union's highest projected increase in the share of dependent population by 2060. Luxembourg has made limited progress on early retirement. In July 2015, a draft law modifying early retirement schemes was presented to Parliament, where it is still pending. Overall, early retirement remains widespread and incentives to work longer remain limited. Following the revision of demographic prospects, Luxembourg faces further risks related to long-term care expenditure. This is already at one of the highest levels among Member States as a share of GDP and is projected to increase from 1,5 % to 3,2 % of GDP by 2060 (more than doubling from the current level). A project of reform of the long-term care insurance is being discussed by the Parliament.

(8) The Luxembourg authorities have adopted a comprehensive tax reform, which entered into force in January 2017. The reform introduced changes mostly in the area of direct taxation, both for individuals and corporations, aimed at gradually reducing the corporate income tax rate (with the goal of increasing competitiveness) and increasing the progressivity of personal income tax (with the goal of increasing fairness). At the same time, the increase in certain tax expenditures risks narrowing the tax base. To improve the predictability of tax revenues, there is scope to further broaden the tax base. This could be achieved in particular by revisiting the current low taxation on housing and making greater use of alternative sources. This could include ensuring more coherence between environmental taxation and the diversification objectives of the economy.

(9) The Luxembourg authorities have for several decades actively sought to diversify the economy, acknowledging the risks associated with heavy dependence on the financial sector. Reducing the economy's reliance on the financial sector remains a central long-term challenge. To tackle this, the diversification analysis needs to be translated into specific measures with a clearly defined timeline. Given the country's high labour costs, activities with higher added value offer the potential to unlock alternative sources of growth. The successful diversification of Luxembourg's economy therefore depends to a large extent on sectors that are less sensitive to labour cost levels. These are largely based on research and innovation, which tend to be technology- and knowledge-intensive. Reducing or removing barriers to investment and innovation that limit economic development would unleash the potential for innovation and help diversification. While public investment is above the euro-area average, private investment is underperforming. Sustaining a high level of investment is essential to maintaining growth prospects.

(10) Further expanding the already successful non-financial service sector could also help diversify the economy. High regulatory barriers remain in the business services sector, in particular for accountants, architects, engineers and lawyers. For all these professions, the business turnover rate is lower than both the Union average and the average rate for the overall economy. Restrictions on these professions may thus be harming the competitiveness of businesses in Luxembourg. These barriers include the wide scope of activities reserved for architects; reserving simple tasks such as payroll activities or preparation of tax declarations for highly qualified professionals; reserving legal advice for lawyers; and legal form and shareholding requirements, incompatibility rules and multidisciplinary restrictions for lawyers which may be disproportionate in relation to core principles, such as the independence of the profession, and to the corresponding supervisory arrangements.

(11) Targeted active labour market policies and lifelong learning programmes, in particular for older workers, whose employment rate remains among the lowest in the Union, are necessary to avoid negative impacts. Measures have been adopted to improve their employability and labour market attachment. A law on the reclassification of workers with working disabilities has been implemented since 1 January 2016, increasing the possibilities for such workers to remain longer on the labour market. However, a comprehensive strategy, following consultations with social partners, is yet to be put forward. The ‘age pact’, a draft law submitted to Parliament in April 2014 which aims to encourage firms with more than 150 employees to retain older workers, has still not been adopted. Upskilling opportunities through targeted active labour market policies and lifelong learning to support older workers will remain important for the success of such policies. Investment in skills is crucial to reap the full benefits of digitalisation and to maintain competitiveness.

(12) A substantial package of measures has been enacted to tackle the supply shortage in real estate, but its real impact has yet to be seen. Incapacity to access the land available for construction, which is mostly owned by private individuals, appears to be one of the main obstacles to increasing housing supply. Limited housing supply coupled with solid demand has led to a steady increase in housing prices. This contributes to explaining the trend towards increasing household indebtedness, which is mostly mortgage-related. Moreover, despite substantial investment in transport infrastructure, tackling traffic congestion remains a challenge. This is all the more so as modern work practices, such as teleworking, are discouraged in the case of cross-border workers by the fiscal policies in neighbouring countries. Both housing and mobility challenges are likely to put additional strain on efforts to diversify the economy and increase competitiveness. They could also act as barriers to attracting high-skilled workers into the labour market.

(13) In the context of the 2017 European Semester, the Commission has carried out a comprehensive analysis of Luxembourg's economic policy and published it in the 2017 country report. It has also assessed the 2017 Stability Programme, the 2017 National Reform Programme and the follow-up given to the recommendations addressed to Luxembourg in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Luxembourg, but also their compliance with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(14) In the light of this assessment, the Council has examined the 2017 Stability Programme and is of the opinion[5] that Luxembourg is expected to comply with the Stability and Growth Pact,

5 Under Article 5(2) of Regulation (EC) No 1466/97.

HEREBY RECOMMENDS that Luxembourg take action in 2017 and 2018 to:

1. Strengthen the diversification of the economy, including by removing barriers to investment and innovation. Remove regulatory restrictions in the business services sector.

2. Ensure the long-term sustainability of the pension system, limit early retirement and increase the employment rate of older people.

Done at Brussels,

For the Council
The President