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From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
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Subject:	Recommendation for a COUNCIL RECOMMENDATION on the 2018 National Reform Programme of Luxembourg and delivering a Council opinion on the 2018 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(2018) 415 final.

COUNCIL RECOMMENDATION

of …

on the 2018 National Reform Programme of Luxembourg

and delivering a Council opinion on the 2018 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 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council[2], the Commission also 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 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area[3] ('Recommendation for the euro area').

(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 recommendations (1) to (2) below.

(3) The 2018 country report for Luxembourg was published on 7 March 2018. It assessed some progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017[4], the follow-up given to the country-specific recommendations adopted in previous years and Luxembourg's progress towards its national Europe 2020 targets.

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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 179, 25.5 2018, p. 1.

4 OJ C 261, 9.8.2017, p. 1.

(4) On 30 April 2018, Luxembourg submitted its 2018 National Reform Programme and its 2018 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(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[5], 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 the effectiveness of the ESI Funds to sound economic governance.

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5 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).

(6) Luxembourg is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Stability Programme, the Government plans a decrease in the headline surplus from 1,5 % of GDP in 2017 to 1,1 % of GDP in 2018, followed by an almost steady increase thereafter, reaching a surplus of 2,4 % of GDP in 2022. 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 2018 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 favourable for the period up to 2020 and plausible thereafter. Based on the Commission 2018 spring forecast, the structural balance is forecast to register a surplus of 0,8 % of GDP in 2018 and 0,3 % of GDP in 2019, lower, in particular for 2019, than in the 2018 Stability Programme, but still 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 2018 and 2019.

(7) Luxembourg's economy is continuing to grow healthily and has performed better than the euro area average since the 2009 global recession. The financial sector remains the key driver of economic growth and continues to be sound and profitable. This is reflected in strong surpluses in both the services balance and the overall current account balance. The external sector relative contribution to real GDP growth represented 61 % on average in 2013-2016, despite recurrent negative trade balances. Luxembourg is a net creditor to the rest of the world, and at the end of 2016, gross external assets and liabilities reached EUR 10,5 trillion. The national authorities have further implemented macroprudential and oversight measures and concerned financial intermediaries are adjusting to the changing national and Union policy framework.

(8) As indicated in the Recommendation for the euro area, the fight against aggressive tax planning strategies is essential to prevent distortions of competition between firms, provide fair treatment of taxpayers and safeguard public finances. Spill-over effects of taxpayers' aggressive planning strategies between Member States call for a coordinated action of national policies to complement Union legislation. Despite the size of its financial sector, the high level of dividend, interest and royalty payments as a percentage of GDP suggest that the country’s tax rules are used by companies that engage in aggressive tax planning. The majority of foreign direct investment is held by 'special purpose entities'. The absence of withholding taxes on outbound (i.e. from Union residents to third-country residents) interest and royalty payments and the exemption from withholding taxes on dividend payments under certain circumstances may lead to those payments escaping tax altogether, if they are also not subject to tax in the recipient jurisdiction. The Commission takes note of the positive steps taken by Luxembourg (for example the adoption of a patent box regime compliant with international rules). Based on recent exchanges with the Luxembourg authorities, the Commission will continue its constructive dialogue to fight against taxpayers aggressive planning strategies.

(9) The Luxembourg authorities have, for several decades, actively sought to diversify the economy, by developing selected sectors, including the information and communication technologies industry and the space sector. 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. This strategy has been recently strengthened. Large public investment projects, including R&D and market regulations, among other measures, are being implemented to develop these priority sectors. Between 2000 and 2016, Luxembourg has increased its public R&D expenditure fivefold, reaching 0,60 % of GDP. These investments have led Luxembourg to rapidly build a well-performing public research system. However, while public R&D investment is above the euro-area average, private investment in R&D and innovation performance, as measured by the European innovation scoreboard, has continued to decline. The structure of the Luxembourg economy partly explains the lower business R&D intensity in an international comparison, as sectors that account for the bulk of the Luxembourg GDP, namely services and in particular the financial sector, traditionally invest less in R&D. Nevertheless, this trend is more pronounced in Luxembourg as compared to the Union average and business R&D intensity has decreased to 0,64 % of GDP in 2016, from 1,5 % of GDP in 2000. The declining trend of private investment indicates that obstacles remain in this area. This also points to a lack of leverage from public R&D efforts on business investment. Consequently, the building-up of public research capacities needs to be better integrated in a comprehensive approach to the innovation eco-system. In 2017, a new law was adopted to renew the aid schemes for research, development and innovation, broadening the scope of public aid available.

(10) Luxembourg is expected to miss its 2020 target for reducing greenhouse gas emissions. Air pollution and traffic congestion at peak-hour are major problems for the country, exacerbating nitrogen dioxide concentrations and greenhouse gas emissions. In 2015, more than half of greenhouse gas emissions came from the transport sector. The low transport fuel taxation, the high number of company cars and the high level of house prices are amongst the main factors stimulating the high levels of car use and increased number of cross-border workers. Transport fuel tax rates are among the lowest in the Union and provide an incentive for increased fuel consumption, including cross-border sales. Nevertheless, recent measures have encouraged the development of a more sustainable mobility, in particular through the 2016 tax reform, but also through significant investment in public transport. The most urgent challenges are in particular to complete and upgrade rail infrastructures.

(11) Luxembourg remains committed to reduce regulatory restrictions in the business services sector. Recent measures particularly focused on the professions of architects and engineers, and additional reforms to further reduce restrictions in these two professions have been announced. In addition, the so-called omnibus law adopted in March 2017 introduced administrative simplification measures (i.e. allowing for horizontal screening for administrative procedures). However, regulatory barriers remain in the business services sector. The absence of a specific equivalence assessment procedure for professional insurance requirements, allowing equivalent insurance coverage by service providers from other Member States may be a source of restrictions. The profession of lawyers is particularly affected by regulations that are highly restrictive compared to the Union average. The wide scope of the reserved activity impacts the provision of legal consultancy services by lawyers or other service providers, in particular for online services. Other restrictions include legal form and shareholding requirements, incompatibility rules and multidisciplinary restrictions.

(12) Concerns remain about the long-term sustainability of public finances due to the projected increase in ageing costs. Luxembourg has a high projected increase in the proportion of the old-age population that will be dependent by 2070 and, according to the 2016 projections of the General Inspectorate of the Social Security, the operational balance of the pension system will be running a deficit by 2023. Nevertheless, past and current surpluses of the pension system have been saved and accumulated reserves would maintain the viability of the system for a further 20 years. According to the 2018 Ageing Report, age-related costs are expected to increase by 13 percentage points of GDP between 2016 and 2070, exceeding the sustainability thresholds and particularly driven by pensions (8,9 percentage points of GDP). Expenditure on long-term care as a proportion of GDP is one of the highest among Member States. In spite of the reform adopted in 2017, such expenditure is projected to increase by 3 percentage points from the current level by 2070.

(13) The employment rate of older people remains particularly low and further measures are needed to improve their employability and labour market opportunities. This is also important to ensure the long-term sustainability of public finances. Early retirement schemes encouraging workers to leave employment remain widespread, with 59,2 % of newly attributed pensions being early old-age pensions. A law suppressing one early retirement scheme was passed in December 2017 but its net impact on the average effective retirement age and on expenditure is uncertain as it eases conditions on other early retirement schemes. This poor labour market outcome can also be partly attributed to financial disincentives to work, which are comparatively high for this group. Encouraging the employment of older workers requires a comprehensive strategy including measures to help workers remain in active employment for longer. The ‘Age Pact’, a draft law submitted to Parliament in April 2014, which aims to encourage firms with more than 150 employees to hire and retain older workers through age management measures, is still pending in Parliament. As regards education, Luxembourg needs to address the strong impact of students' socioeconomic background on their education outcomes. This is also important to respond to the strong demand for highly specialised skills.

(14) Real estate prices have continued to rise. This may undermine Luxembourg's ability to attract and retain a skilled labour force, a large proportion of which is made up of non-nationals. House price pressures emerge from a fundamental supply and demand mismatch. On the supply side, insufficient land availability and lack of incentives for private owners to sell land or buildings seem to represent a bottleneck to the creation of new housing. Further work is needed to encourage housing investment, by increasing incentives to promote real estate sales, improving administrative procedures to grant building permits and providing affordable social housing. The recently adopted tax reform on capital gains on real estate sales and the update of the social housing programme is unlikely to increase the house supply, given the continuous trend towards higher prices. On the demand side, high population and employment growth push prices up. The housing market situation also exacerbates the problem of traffic congestion and pollution. In addition, the increase in house prices has repercussions on household indebtedness, raising concerns about the sustainability of household debt. Household indebtedness has rapidly increased over the last 10 years to reach an estimated 165 % of disposable income in 2016, reflecting real estate inflation, as around 80 % of household debt stems from mortgage loans. However, Luxembourg has already introduced relevant macroprudential measures to reduce significantly potential risks to financial stability. Following the proposals of the national systemic risk committee, the Government has also recently presented a draft law providing a framework for borrower-based measures, to avoid a build-up of household vulnerability, although this draft law still needs to be approved by Parliament.

(15) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Luxembourg’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Luxembourg in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Luxembourg but also the extent to which they comply 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.

(16) In the light of this assessment, the Council has examined the 2018 Stability Programme and is of the opinion[6] that Luxembourg is expected to comply with the Stability and Growth Pact,

HEREBY RECOMMENDS that Luxembourg take action in 2018 and 2019 to:

1. Increase the employment rate of older people by enhancing their employment opportunities and employability while further limiting early retirement, with a view to also improving the long-term sustainability of the pension system.

2. Further reduce regulatory restrictions in the business services sector.

Done at Brussels,

For the Council

The President

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