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NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
No. prev. doc.:	11083/24 - COM(2024) 616 final
Subject:	COUNCIL RECOMMENDATION on the economic, social, employment, structural and budgetary policies of Luxembourg

Delegations will find attached the above-mentioned draft Council Recommendation, as revised and agreed by various Council committees and finalized by the Economic and Financial Committee, based on the Commission Proposal COM(2024) 616 final.

COUNCIL RECOMMENDATION

on the economic, social, employment, structural and budgetary policies 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 Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and on multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97[1], and in particular Article 3(3) 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,

[1] OJ L 2024/1263, 30.4.2024, ELI: http://data.europa.eu/eli/reg/2024/1263/oj.

Whereas:

(1) Regulation (EU) 2021/241 of the European Parliament and of the Council[2], which established the Recovery and Resilience Facility, entered into force on 19 February 2021. The Recovery and Resilience Facility provides financial support to the Member States for the implementation of reforms and investment, entailing a fiscal impulse financed by the EU. In line with the European Semester priorities, it helps achieve the economic and social recovery and implement sustainable reforms and investment, in particular to promote the green and digital transitions and make the Member States' economies more resilient. It also helps strengthen public finances and boost growth and job creation in the medium and long term, improve territorial cohesion within the EU and support the continued implementation of the European Pillar of Social Rights.

(2) The REPowerEU Regulation[3], adopted on 27 February 2023, aims to phase out the EU's dependency on Russian fossil fuel imports. This would help achieve energy security and diversify the EU's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency.

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[2] Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17), ELI: http://data.europa.eu/eli/reg/2021/241/oj.

[3] Regulation (EU) 2023/435 of the European Parliament and of the Council of 27 February 2023 amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulations (EU) No 1303/2013, (EU) 2021/1060 and (EU) 2021/1755, and Directive 2003/87/EC (OJ L 63, 28.2.2023, p. 1), ELI: http://data.europa.eu/eli/reg/2023/435/oj.

(3) On 16 March 2023, the Commission issued a Communication on the 'Long-term competitiveness of the EU: looking beyond 2030'[4], in order to inform policy decisions and create the framework conditions for increasing growth. The Communication frames competitiveness along nine mutually reinforcing drivers. Among these drivers, access to private capital, research and innovation, education and skills, and the single market emerge as paramount policy priorities for reform and investment to address current productivity challenges as well as to build up the long-term competitiveness of the EU and its Member States. On 14 February 2024, the Commission followed this Communication with the Annual Single Market and Competitiveness Report[5]. The report details the competitive strengths and challenges of Europe's Single Market, tracking yearly developments according to the nine competitiveness drivers identified.

(4) On 21 November 2023, the Commission adopted the 2024 Annual Sustainable Growth Survey[6], marking the start of the 2024 cycle of the European Semester for economic policy coordination. The European Council endorsed the priorities of the survey around the four dimensions of competitive sustainability on 22 March 2024. On 21 November 2023, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the 2024 Alert Mechanism Report, in which it did not identify Luxembourg as one of the Member States that may be affected or may be at risk of being affected by imbalances, and for which an in-depth review would be needed. The Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which the Council adopted on 12 April 2024, as well as the proposal for the 2024 Joint Employment Report analysing the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights, which the Council adopted on 11 March 2024.
On 18 April 2024, the Commission adopted an opinion on the 2024 Draft Budgetary Plan of Luxembourg.

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[4] COM(2023) 168 final.
[5] COM(2024) 77 final.
[6] COM(2023) 901 final.

(5) On 30 April 2024, the EU's new economic governance framework came into force. The framework includes the new Regulation of the European Parliament and of the Council (EU) 2024/1263 on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97. It also includes amended Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure and the amended Directive 2011/85/EU on requirements for the budgetary frameworks of Member States[7]. The objectives of the new framework are to promote sound and sustainable public finances, sustainable and inclusive growth and resilience through reforms and investments, and prevent excessive government deficits. It promotes national ownership and has a greater medium-term focus, combined with more effective and coherent enforcement. Each Member State should submit to the Council and to the Commission a national medium-term fiscal-structural plan. National medium-term fiscal-structural plans contain the fiscal, reform and investment commitments of a Member State, covering a planning horizon of 4 years or 5 years depending on the regular length of the national legislature. The net expenditure[8] path in the national medium-term fiscal-structural plans should comply with the requirements of Regulation (EU) 2024/1263, including the requirements to put or keep general government debt on a plausibly downward path by the end of the adjustment period at the latest, or for it to remain at prudent levels below 60% of GDP, and to bring and/or maintain the government deficit below the 3% of GDP reference value over the medium term.

[7] Council Regulation (EU) 2024/1264 of 29 April 2024 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L, 2024/1264, 30.4.2024, ELI: http://data.europa.eu/eli/reg/2024/1264/oj) and Council Directive (EU) 2024/1265 of 29 April 2024 amending Directive 2011/85/EU on requirements for budgetary frameworks of the Member States (OJ L, 2024/1265, 30.4.2024, ELI: http://data.europa.eu/eli/dir/2024/1265/oj).

[8] Net expenditure as defined in Article 2 of Council Regulation (EU) 2024/1263 of 29 April 2024 (OJ L 2024/1263, 30.4.2024. ELI: http://data.europa.eu/eli/reg/2024/1263/oj). Net expenditure means government expenditure net of (i) interest expenditure, (ii) discretionary revenue measures, (iii) expenditure on programmes of the Union fully matched by Union funds revenue, (iv) national expenditure on co-financing of programmes funded by the Union, (v) cyclical elements of unemployment benefit expenditure, and (vi) one-offs and other temporary measures.

Where a Member State commits to a relevant set of reforms and investments in accordance with the criteria set out in Regulation (EU) 2024/1263, the adjustment period may be extended by 3 years at most. For the purpose of supporting the preparation of those plans, on 21 June 2024, the Commission published guidance on the information to be provided by Member States in their plans and in their annual progress reports. In accordance with Articles 5 and 36 of Regulation (EU) 2024/1263, the Commission transmitted to the Member States reference trajectories and technical information, where applicable. Member States should submit their medium-term fiscal-structural plans by 20 September 2024, unless the Member State and the Commission agree to extend the deadline by a reasonable period of time. In accordance with their national legal frameworks, Member States may debate their draft medium-term plans with their national parliaments, may ask the independent fiscal institutions to issue an opinion, and may conduct a consultation of social partners and other national stakeholders.

(6) In 2024, the European Semester for economic policy coordination continues to evolve in line with the implementation of the Recovery and Resilience Facility. The full implementation of the recovery and resilience plans remains essential for delivering the policy priorities under the European Semester, as the plans help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations issued in recent years. The 2019, 2020, 2022 and 2023 country-specific recommendations remain equally relevant also for recovery and resilience plans in accordance with Articles 14, 18 and 21 of Regulation (EU) 2021/241.

(7) On 30 April 2021, Luxembourg submitted its national recovery and resilience plan to the Commission, in accordance with Article 18(1) of Regulation (EU) 2021/241. Pursuant to Article 19 of Regulation (EU) 2021/241, the Commission assessed the relevance, effectiveness, efficiency and coherence of the recovery and resilience plan, in accordance with the assessment guidelines of Annex V to that Regulation. On 13 July 2021, the Council adopted its Decision on the approval of the assessment of the recovery and resilience plan for Luxembourg[9], which was amended on 17 January 2023 following Article 18(2) of Regulation (EU) 2021/241 to update the maximum financial contribution for non-repayable financial support[10]. The release of instalments is conditional on a decision by the Commission, taken in accordance with Article 24(5) of Regulation (EU) 2021/241, that Luxembourg has satisfactorily fulfilled the relevant milestones and targets set out in the Council Implementing Decision. Satisfactory fulfilment presupposes that the achievement of preceding milestones and targets has not been reversed.

(8) On 26 April 2024, Luxembourg submitted its 2024 National Reform Programme and, on 25 April 2024, its 2024 Stability and Growth Programme, in line with Article 4(1) of Regulation (EC) No 1466/97. In accordance with Article 27 of Regulation (EU) 2021/241, the 2024 National Reform Programme also reflects Luxembourg's biannual reporting on the progress made in achieving its recovery and resilience plan.

[9] Council Implementing Decision of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Luxembourg (10155/2021).

[10] Council Implementing Decision of 17 January 2023 amending the Implementing Decision of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Luxembourg (16022/2022).

(9) The Commission published the 2024 country report for Luxembourg[11] on 19 June 2024. It assessed Luxembourg's progress in addressing the relevant country-specific recommendations adopted by the Council between 2019 and 2023 and took stock of Luxembourg's implementation of the recovery and resilience plan. Based on this analysis, the country report identified gaps with respect to those challenges that are not addressed or only partially addressed by the recovery and resilience plan, as well as new and emerging challenges. It also assessed Luxembourg's progress on implementing the European Pillar of Social Rights and on achieving the EU headline targets on employment, skills and poverty reduction, as well as progress in achieving the UN's Sustainable Development Goals.

(10) Based on data validated by Eurostat[12] Luxembourg's general government deficit increased from 0.3% of GDP in 2022 to 1.3% in 2023, while the general government debt rose from 24.7% of GDP at the end of 2022 to 25.7% at the end of 2023.

(11) On 12 July 2022, the Council recommended that Luxembourg take action to ensure in 2023 that the growth of nationally financed primary current expenditure is in line with an overall neutral policy stance[13] taking into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. Luxembourg was recommended to stand ready to adjust current spending to the evolving situation. Luxembourg was also recommended to expand public investment for the green and digital transitions, and for energy security taking into account the REPowerEU initiative, including by making use of the Recovery and Resilience Facility and other Union funds.

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11 SWD(2024) 616 final.

12 Eurostat-Euro Indicators, 22.4.2024.

13 Based on the Commission Spring 2024 Forecast, the medium-term potential output growth of Luxembourg in 2023, which is used to measure the fiscal stance, is estimated at 5.6% in nominal terms based on the 10-year average real potential growth rate and the 2023 GDP deflator.

In 2023, according to the Commission estimates, the fiscal stance[14] was expansionary, by 3.2% of GDP, in a context of high inflation. The growth in nationally financed primary current expenditure (net of discretionary revenue measures) in 2023 provided an expansionary contribution to the fiscal stance of 2.7% of GDP. The expansionary growth in nationally financed primary current expenditure (net of discretionary revenue measures) was driven by untargeted emergency energy measures, permanent increases in public sector wages and social benefits, higher government investment and the one percentage point reduction in VAT rates in 2023. In sum, the growth of nationally financed primary current expenditure in 2023 was not in line with the Council recommendation. Expenditure financed by Recovery and Resilience Facility grants and other EU funds amounted to 0.1% of GDP in 2023. Nationally financed investment amounted to 4.7% of GDP in 2023, representing an increase of 0.5 percentage points as compared to 2022. Luxembourg financed additional investment through the Recovery and Resilience Facility and other EU funds. Luxembourg financed public investment for the green and digital transitions, such as public transport, energy efficiency and green mobility as well as digital public services, which are partly funded by the Recovery and Resilience Facility and other EU funds.

[14] The fiscal stance is defined as a measure of the annual change in the underlying budgetary position of the general government. It aims to assess the economic impulse stemming from fiscal policies, both those that are nationally financed and those that are financed by the EU budget. The fiscal stance is measured as the difference between (i) the medium-term potential growth and (ii) the change in primary expenditure net of discretionary revenue measures (and excluding temporary emergency measures related to the COVID-19 crisis) and including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other Union funds.

(12) The key projections in the 2024 Stability Programme can be summarised as follows. The macroeconomic scenario underpinning the budgetary projections foresees real GDP growth at 2.0% in 2024 and 3.0% in 2025, while it projects HICP inflation at 1.9% in 2024 and 3.2% in 2025. The general government deficit is expected to increase to 1.2% of GDP in 2024 and remain stable at 1.2% of GDP in 2025, while the general government debt-to-GDP ratio is set to increase to 26.5% by the end of 2024 and 26.9% by the end of 2025. After 2025, the general government deficit is projected to decrease gradually to 0.9% of GDP in 2026, and remain stable in 2027. Therefore, the general government balance is planned to remain below the 3% of GDP deficit reference value over the programme horizon. In turn, after 2025, the general government debt-to-GDP ratio is projected to increase gradually to 27.3% in 2026, and remain stable in 2027.

(13) The Commission Spring 2024 Forecast projects real GDP to grow by 1.4% in 2024 and 2.3% in 2025, and HICP inflation to stand at 2.3% in 2024 and 2.0% in 2025.

(14) The Commission Spring 2024 Forecast projects a government deficit of 1.7% of GDP in 2024, while the general government debt-to-GDP ratio is set to increase to 27.1% by the end of 2024. The increase of the deficit ratio in 2024 mainly reflects continued high spending on compensation of public employees and social benefits due to the automatic indexation and lower revenues mainly due to discretionary measures e.g. adjusting upward the personal income tax brackets and compensating companies for the third 2023 wage index tranche via a reduction of the employers social contributions in 2024. Based on the Commission's estimates, the fiscal stance is projected to be expansionary by 0.4% of GDP in 2024.

(15) Expenditure amounting to 0.1% of GDP is expected to be financed by non-repayable support ("grants") from the Recovery and Resilience Facility in 2024, compared to less than 0.1% of GDP in 2023, according to the Commission Spring 2024 Forecast. Expenditure financed by Recovery and Resilience Facility grants will enable high-quality investment and productivity-enhancing reforms without a direct impact on the general government balance and debt of Luxembourg.

(16) On 14 July 2023, the Council recommended[15] that Luxembourg ensure a prudent fiscal policy, in particular by limiting the nominal increase in net nationally financed primary expenditure[16] in 2024 to not more than 4.8%. When executing their 2023 budgets and preparing their Draft Budgetary Plans for 2024, Member States were invited to take into account that the Commission would propose to the Council the opening of deficit-based excessive deficit procedures based on the outturn data for 2023. According to the Commission Spring 2024 Forecast, Luxembourg's net nationally financed primary expenditure is projected to increase by 6.8% in 2024, which is above the recommended maximum growth rate. This excess spending over the recommended maximum growth rate in net nationally financed primary expenditure corresponds to 0.9% of GDP in 2024. This risks being not in line with what was recommended by the Council.

15 Council Recommendation of 14 July 2023 on the 2023 National Reform Programme of Luxembourg and delivering a Council opinion on the 2023 Stability Programme of Luxembourg, OJ C 312, 1.9.2023, p. 145.

16 Net primary expenditure is defined as nationally financed expenditure net of (i) discretionary revenue measures, (ii) interest expenditure, (iii) cyclical unemployment expenditure, and (iv) and one-offs and other temporary measures.

(17) Moreover, the Council recommended that Luxembourg take action to wind down the emergency energy support measures in force, using the related savings to reduce the government deficit, as soon as possible in 2023 and 2024. The Council further specified that, should renewed energy price increases necessitate new or continued support measures, Luxembourg should ensure that these were targeted at protecting vulnerable households and firms, fiscally affordable, and preserve incentives for energy savings. According to the Commission Spring 2024 Forecast, which assumes the measures to limit the increase in gas and electricity prices and the subsidies to contain heating costs remain in force in 2024 and in 2025, the net budgetary cost[17] of energy support measures is estimated at 0.9% of GDP in 2023 and projected at 0.5% in 2024, and 0.3% in 2025[18].

[17] The figure represents the level of the annual budgetary cost of those measures, including revenue and expenditure and, where applicable, net of the revenue from taxes on windfall profits of energy suppliers.

[18] Measures that, according to Luxembourg, remain in place until the end of 2024 are, in principle, assumed in the Commission Spring 2024 Forecast as having a budgetary impact also in 2025. On the 11th of June, the Prime Minister announced that most energy support measures will be phased out as of the 1st of January 2025, except for the electricity price cap (half of the price increase as of the 1st of January 2025 will still be compensated) and three targeted measures for lower income households and nursing homes.

(18) If the related savings were used to reduce the government deficit, as recommended by the Council, these projections would imply a fiscal adjustment of 0.5% of GDP in 2024, whereas net nationally financed primary expenditure[19] provides an expansionary contribution to the fiscal stance of 0.3% of GDP in that year. The emergency energy support measures are not projected to be wound down as soon as possible in 2023 and 2024. This risks being not in line with what was recommended by the Council. Moreover, the related savings are not projected to be fully used to reduce the government deficit. This also risks being not in line with the Council recommendation. The budgetary cost of emergency energy support measures targeted at protecting vulnerable households and firms is estimated at 0.1% of GDP in 2024 (0.4% in 2023), of which less than 0.1% of GDP preserve the price signal to reduce energy demand and increase energy efficiency (0.3% in 2023).

(19) In addition, the Council also recommended that Luxembourg preserve nationally financed public investment and ensure the effective absorption of Recovery and Resilience Facility grants and other EU funds, in particular to foster the green and digital transitions. According to the Commission Spring 2024 Forecast, nationally financed public investment is projected to decrease marginally to 4.6% of GDP in 2024 (from 4.7% of GDP in 2023). This is mainly caused by the delay in a military satellite delivery, which is now expected to take place in 2025. Taking into account this additional factor and given that Luxembourg's public investment-to-GDP ratio is expected to remain stable and at a high level over the forecast horizon in the Commission spring forecast, public investment in 2024 is assessed as respecting the Council recommendation. In turn, public expenditure financed from revenues from EU funds, including Recovery and Resilience Facility grants, is expected to increase to 0.2% of GDP in 2024 from 0.1% of GDP in 2023.

[19] This contribution is measured as the change in general government primary expenditure, net of (i) the incremental budgetary impact of discretionary revenue measures, (ii) one-offs, (iii) cyclical unemployment expenditure and (iv) expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to the medium-term (10-year) average potential nominal GDP growth rate, expressed as a ratio to nominal GDP.

(20) Based on policy measures known at the cut-off date of the forecast and on a no-policy-change assumption, the Commission Spring 2024 Forecast projects a government deficit of 1.9% of GDP in 2025. The general government debt-to-GDP ratio is set to increase to 28.5% by the end of 2025. The increase of the deficit ratio in 2025 is mainly driven by higher expenditure on compensation of public employees, social benefits and public investment.

(21) The projected demographic shift towards an ageing population, coupled with a reduction in net migration, is projected to significantly increase government pension spending in the decades ahead. Pension spending is projected to exceed the income from contributions in the second half of this decade, with this deficit gradually widening after that. This imbalance can be largely attributed to an increasing number of pensioners per worker, a consequence of an ageing population, which leads to a higher old-age dependency ratio. In the Commission's 2024 Ageing Report, without policy adjustments, the reserve designated to protect the pension system's financial balance is projected to fall below the threshold envisaged by national legislation by the early 2040s. Projections suggest that once this threshold is reached, the reserve will be depleted within 5 or 6 years. In the longer term, the increase in pension spending is expected to double, reaching approximately 17% of GDP by 2070 – potentially the highest proportion within the EU. This would put the financial sustainability of Luxembourg's pension system at risk, while increasing government debt. Measures to encourage longer working lives and higher participation rates among older workers would help address this issue and support economic growth.

(22) Rapid population growth and an increase in mortgage lending outpaced supply growth in the housing market in the decade before the recent energy shock. The rigidity of the housing supply is primarily due to land retention practices. This has led to a significant housing shortage, rising costs, and risks of market overvaluation and reduced affordability – issues that disproportionately affect vulnerable populations and may also affect Luxembourg's attractiveness to both workers and businesses. In 2023, the housing market saw a sharp downturn due to the lagging effects of higher energy prices and monetary tightening, which eroded consumer confidence. The ensuing drop in new housing and land supply, reaching record lows, has hindered necessary price corrections and precipitated a marked decrease in construction activity. Long-standing efforts to stabilise market prices have not succeeded, partly because the tax system raises more revenue from real estate sales and purchases than from property ownership, contributing to price inflexibility and cyclical increases. Although recent fiscal measures have eased the financial strain in households and the construction industry, subsidies for home ownership have inflated pre-tax housing prices, mainly benefiting wealthy owners and investors.

(23) Luxembourg is a small and open economy with a large international financial sector, where many multinational groups channel large financial flows in and out as part of their business activities. However, a significant share of this activity takes place between entities within multinational groups. They may be in a position to exploit loopholes in Luxembourg's tax system that reduce taxable income. Concerns persist about measures that are too narrow in their scope, allowing for low or no withholding taxes on interest and royalty payments to low and zero tax jurisdictions[20]. The Pillar 2 Directive entered into force on 1 January 2024 in Luxembourg, introducing a minimum effective corporate tax rate of 15% for multinationals active in the country. Due to its scope, the Directive is expected to address the outbound payment issue only partially given that it is limited to large multinational corporates and excludes certain sectors.

[20] Low or zero-tax jurisdictions beyond those countries included in the Union list of non-cooperative jurisdictions.

(24) In accordance with Article 19(3), point (b), and Annex V, criterion 2.2 of Regulation (EU) 2021/241, the recovery and resilience plan includes an extensive set of mutually reinforcing reforms and investments to be implemented by 2026. These are expected to help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations. Within this tight timeframe, proceeding swiftly with the effective implementation of the plan, including the REPowerEU chapter when adopted, is essential to boost Luxembourg's long-term competitiveness through the green and digital transition, while ensuring social fairness. To deliver on the commitments of the plan by August 2026, it is essential for Luxembourg to continue the implementation of reforms and investments. The systematic involvement of local authorities, social partners, civil society and other relevant stakeholders remains essential to ensure broad ownership for the successful implementation of the recovery and resilience plan.

(25) As part of the mid-term review of the cohesion policy funds, in accordance with Article 18 of Regulation 2021/1060, Luxembourg is required to review each programme by March 2025, taking into account, among other things, the challenges identified in the 2024 country-specific recommendations, as well as its national energy and climate plan. This review forms the basis for the definitive allocation of the EU funding included in each programme. While Luxembourg has made some progress in implementing cohesion policy programmes and the European Pillar of Social Rights, challenges remain. Luxembourg also continues to display considerable socio-economic disparities between cities, towns, suburbs and non-urban areas. It is important to accelerate cohesion policy implementation, and the priorities agreed in the programmes remain relevant. It is particularly important to see fast implementation of investments related to the green and digital transition. Investment in skills to facilitate career transitions and professional mobility in line with labour market needs, with special attention to older workers and people with low qualifications as well as the activation and social integration of vulnerable people, in particular those with a migrant background, remains a priority. The implementation of the European Child Guarantee, especially the integration of disadvantaged pupils through quality education and training, continues to be important. Luxembourg could also make use of the Strategic Technologies for Europe Platform initiative to support industrial transformation, in particular by investing in strategic value chains like net-zero industry, decarbonisation of energy-intensive industries and digital innovation.

(26) Beyond the economic and social challenges addressed by the recovery and resilience plan and other EU funds, Luxembourg faces several additional challenges related to weaknesses in the education system that add to inequality and issues related to business investment, including R&D, energy policy and the green transition, including potential obstacles to the transition from fossil fuels and issues with the transport network.

(27) Pupils' basic skills and overall performance depend largely on their socio-economic and linguistic background. Average levels in key knowledge and skills at age 15, as measured by the Programme for International Student Assessment (PISA) in the latest 2018 survey that Luxembourg participated in, are significantly lower than the EU average. The gap between advantaged students and their disadvantaged peers is bigger in Luxembourg than in any other EU country. The education system does not equip all pupils with the necessary basic skills to meet the country's labour market needs. The national competence tests show that, when pupils start school, they have the essential basic skills to begin acquiring literacy, even though there are significant differences in their initial skills. However, by the time they start year 3 in primary school, aged 8, the skills gap widens. Pupils' performance in German reading comprehension and mathematics falls noticeably, particularly the performance of pupils from a disadvantaged background or of those whose first language is neither German nor Luxembourgish. The green transition implies structural changes within the labour market. In this context, upskilling and reskilling in declining and transforming sectors has increased, and further measures are being planned to close skills gaps by creating labour-market relevant continued vocational training. Yet, risks of skills mismatches persist.

(28) Participation in training over the last 12 months is above the EU average (50% vs 46.6%), but remains uneven across groups. Although it is very high among the unemployed, it lags for people with low skills (24.2%) and for older workers (32.5%). Sectoral studies of occupations and skills conducted by the Public Employment Service in partnership with the business federation (*Union des entreprises luxembourgeoises*) show that, across all sectors, there are ever-increasing demands on skills required in all areas, in particular the importance of cross-disciplinary skills (behavioural, digital, management, languages, etc.) and the ability to adapt to change. While the OECD confirmed Luxembourg's high performance in skills in 2023, it also highlighted major challenges such as talent shortages, low participation in adult learning among the most disadvantaged and the lack of reliable data on skills needs. Despite numerous initiatives over the last few years to promote vocational training among jobseekers, address the challenges of digitalisation and strengthen the capacity to anticipate future skill needs, effective solutions are still needed to improve access to lifelong learning for the less skilled and older workers.

(29) Labour productivity in Luxembourg remains one of the highest in the EU. However, it has experienced a marked decline since the global financial crisis, and this has accelerated recently. For decades, business investment has been among the lowest in the EU, especially in R&D. The traditionally low investment levels, justified by the reduced needs of Luxembourg's service-oriented economy, may no longer suffice in light of the emerging challenges of the green and digital transition, on top of pre-existing ones. A shortage of workers is a major obstacle to investment, and this issue could worsen due to high house prices, long commutes and road congestion, reducing Luxembourg's attractiveness as a workplace. The three consecutive wage indexations triggered by high inflation in 2023 – the first time this has happened – have affected affected firms' competitiveness across various sectors, with non-financial business sectors, particularly the less productive ones, feeling the most impact despite the government's partial compensation for companies for the third wage indexation. If this trend persists, it might hinder greenfield investment and sway firms' relocation decisions.

(30) Public support for business innovation in Luxembourg is currently limited compared to other countries, which often provide indirect support through tax credits for R&D. The government currently dedicates 25% of its R&D budget to specific projects, some of which involve private partners, while the majority, 75%, support institutions. Business R&D receives a relatively small portion of its funding from the government, at 6%. To support innovation more effectively, Luxembourg could consider strengthening its funding model to include more collaborative projects with the private sector. By directly investing in business-led innovation, the country has the potential to stimulate private R&D efforts and increase its overall productivity.

(31) Maintaining Luxembourg's role as a global financial hub while ensuring a robust domestic economy presents a significant challenge. The financial sector, which contributes nearly one-third of GDP, has greatly benefited from international integration. However, the sector's value added per worker dropped by 15% from 2021 to 2023, a decline that has doubled since 2007, indicating diminished gains from global participation. With productivity in decline, diversification could help to reduce exposure to global trade and finance shifts. Additionally, the gap between GDP and national income is now at 30% of GDP, a disparity that has grown since the global financial crisis. Encouraging investment in local high-value R&D projects could narrow the GDP-GNI gap and support national wealth and equity.

(32) Luxembourg's energy system is characterised by its high import dependence and reliance on fossil fuels (77% of the energy mix in 2022). The country is a large net importer of energy. It is almost entirely dependent on primary energy imports, with a dependency rate of 91% in 2022. The total installed capacity of renewable energy production reached 782 MW in 2023, an increase of 13.5% since 2022. However, the share of renewable energy in gross final energy consumption remains among the lowest in the EU.

(33) Luxembourg has made significant progress in reaching the 2030 EU targets for energy efficiency, although most of the schemes are still grant-based and the use of financial instruments is still very limited, in particular for businesses and industry. The best results are in the service sector, while the residential sector still needs to catch up: its final energy consumption has remained stable since 2015. Further increases in ambition for reducing greenhouse gas emissions and increasing renewable energy and energy efficiency will be needed for Luxembourg to reach its 2030 energy targets – obtaining 25% of energy from renewables and reducing final energy consumption by 40% to 44% compared to 2007. Labour and skills shortages in sectors and occupations key for the green transition, including manufacturing and the deployment and maintenance of net-zero technologies, are creating bottlenecks in the transition to a net-zero economy. To unlock untapped labour supply, these measures need to be accessible, in particular for individuals and in sectors most affected by the green transition.

(34) Road traffic congestion weighs on the economy and on environmental sustainability. Road transport remains Luxembourg's largest contributor to greenhouse gas emissions and remains key to decarbonisation. Luxembourg's transition to sustainable transport is advancing, with the share of light duty electric vehicles exceeding the EU average. However, further investments are needed to increase the share of passenger and freight transport by rail, as road is used for 86% of passenger and freight transport, including in border regions to enhance cross-border connectivity.

(35) In view of the close interlinkages between the economies of euro area Member States and of their collective contribution to the functioning of the Economic and Monetary Union, in 2024 the Council recommended that the euro area Member States take action, including through their recovery and resilience plans, to implement the recommendation on the economic policy of the euro area. For Luxembourg, recommendations (1), (2), (3) and (4) help implement the first, second, third and fourth euro area recommendations.

HEREBY RECOMMENDS that Luxembourg take action in 2024 and 2025 to:

1. Submit the medium-term fiscal-structural plan in a timely manner. Wind down the emergency energy support measures before the 2024/2025 heating season. Address the long-term sustainability of the pension system, in particular by limiting early retirement options and by increasing the employment rate for older workers. Accelerate the adoption of a comprehensive land use policy and a property tax reform and prioritise the development of large-scale district projects on government-owned land. Increase action to effectively tackle aggressive tax planning, in particular by ensuring sufficient taxation of outbound payments of interest and royalties to zero/low-tax jurisdictions.

2. Continue with the swift and effective implementation of the recovery and resilience plan, including the REPowerEU chapter once adopted, ensuring completion of reforms and investments by August 2026. Accelerate the implementation of cohesion policy programmes. In the context of the mid-term review, continue focusing on the agreed priorities, while considering the opportunities provided by the Strategic Technologies for Europe Platform initiative to improve competitiveness.

3. Improve the performance and equity of the school education system, including by adapting teaching to the needs of disadvantaged students and those from various linguistic backgrounds. Address labour shortages and skills mismatches in particular for the green transition.

4. Boost competitiveness by supporting business and greenfield investment, in particular in high R&D intensive activities. Reduce reliance on fossil fuels by investing in energy efficiency and renewable energy. Further promote the electrification of transport and invest in public transport networks and infrastructure.

Done at Brussels,

For the Council

The President