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COMMISSION OPINION

of 22.11.2022

on the Draft Budgetary Plan of the Grand Duchy of Luxembourg

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(Only the French text is authentic)

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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, to ensure that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact 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 by 15 October, presenting the main aspects of the budgetary outlook of the general government and its subsectors for the forthcoming year.
3. The general escape clause of the Stability and Growth Pact has been active since March 2020.¹ On 23 May 2022, the Commission indicated, in its Communication on the European Semester², that heightened uncertainty and strong downside risks to the economic outlook in the context of war in Europe, unprecedented energy price hikes and continued supply chain disturbances warrant the extension of the general escape clause of the Stability and Growth Pact through 2023 and it considered that the conditions to deactivate it as of 2024 were met. The continued activation of the general escape clause in 2023 will provide the space for national fiscal policy to react promptly when needed, while ensuring a smooth transition from the broad-based support to the economy during the pandemic times towards an increasing focus on temporary and targeted measures and fiscal prudence required to ensure medium-term sustainability.³
4. The Recovery and Resilience Facility, as established by Regulation (EU) 2021/241, provides financial support for the implementation of reforms and investment, notably to promote the green and digital transitions, thereby strengthening the economies' resilience and potential growth. Part of this support is in the form of non-repayable financial support ("grants"), entailing a fiscal impulse financed by the Union. Together with cohesion policy funds and the Just Transition Mechanism, the RRF is supporting a fair and inclusive recovery in the EU in line with the European Pillar of Social Rights. It also boosts growth and job creation in the medium and long term, and thereby strengthens sustainable public finances. According to the Commission

¹ Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, COM(2020) 123 final of 20 March 2020.

² COM(2022) 600 final.

³ On 17 June 2022, the Council agreed its recommendations on the 2022 National Reform Programmes and the opinions on the 2022 Stability and Convergence Programmes, which takes into account the continuation of the Stability and Growth Pact's general escape clause into 2023. (See: <https://www.consilium.europa.eu/en/meetings/ecofin/2022/06/17/>)

proposal of 18 May 2022⁴, the Facility should also aim at increasing the resilience of the Union energy system by reducing dependence on fossil fuels and diversifying energy supplies at Union level ('REPowerEU objectives').

5. On 12 July 2022, in the recommendations delivering Council opinions on the 2022 Stability Programmes⁵, the Council recalled that the overall fiscal stance is currently best measured as the change in primary expenditure (net of discretionary revenue measures and excluding temporary emergency measures related to the COVID-19 crisis), including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other Union funds, relative to medium-term potential growth.⁶ Going beyond the overall fiscal stance, in order to assess whether national fiscal policy is prudent and its composition is consistent with the green and digital transitions, energy security and ensuring social and economic resilience, attention is also paid to the evolution of nationally financed⁷ primary current expenditure (net of discretionary revenue measures and excluding temporary emergency measures related to the COVID-19 crisis) and investment.
6. The shocks unleashed by the Russian invasion of Ukraine are impacting the EU economy both directly and indirectly, setting it on a path of lower growth and higher inflation. Intensifying and broadening inflationary pressures have been prompting faster normalisation of monetary policy in the euro area. Public spending on measures containing the social and economic impact of high energy costs, on security and defence and on humanitarian assistance to the displaced persons from Ukraine is weighing on public finances. The specific nature of the macroeconomic shock imparted by Russia's invasion of Ukraine, as well as its long-term implications for the EU's energy security needs, call for a careful design of fiscal policy in 2023. A broad-based fiscal impulse to the economy in 2023 does not appear warranted. The focus should instead be on protecting the vulnerable, allowing automatic stabilisers to operate and providing temporary and targeted measures to mitigate the impact of the energy crisis and to provide humanitarian assistance to people fleeing from Russia's invasion of Ukraine, while maintaining the agility to adjust, if needed. Fiscal policy should combine higher investment with controlling the growth in nationally financed primary current expenditure. Full and timely implementation of the Recovery and Resilience Plans is key to achieving higher levels of investment. Fiscal policies should aim at preserving debt sustainability as well as raising the growth potential in a sustainable manner, thus also facilitating the task of monetary policy to ensure the timely return of inflation to the ECB's 2% medium-term target. Fiscal plans for 2023 should be anchored by prudent medium-term adjustment paths reflecting fiscal sustainability challenges associated with high debt-to GDP levels that have increased further due to the pandemic as well as reforms and investment challenges associated with the twin transition, energy security and social and economic resilience.

⁴ COM(2022) 231 final.

⁵ Council Recommendation of 12 July 2022 on the National Reform Programme of the Grand Duchy of Luxembourg and delivering a Council opinion on the 2022 Stability Programme of the Grand Duchy of Luxembourg, OJ C 334, 16.2022, p. 128.

⁶ The estimates on the fiscal stance and its components in this Opinion are Commission estimates based on the assumptions underlying the Commission 2022 autumn forecast. The Commission's estimates of medium-term potential growth do not include the full positive impact of reforms that are part of the Recovery and Resilience Plan and that can boost potential growth.

⁷ Not financed by grants under the Recovery and Resilience Facility or other Union funds.

7. Russia's war of aggression against Ukraine has resulted in substantial additional increases in and volatility of the prices of energy. The price shock in imported energy implies a substantial terms-of-trade loss to Member States' economies. In parallel, the exceptionally high temperatures in summer 2022 pushed up demand for electricity, while, at the same time, energy production from certain technologies has been significantly below historical levels due to technical and weather-dependant circumstances. All Member States have been negatively affected by the current energy crisis, albeit to a different extent, calling for a rapid and coordinated response.
8. Given that budgetary resources are limited and need to be used in the most efficient way, in order to manage a durable and equitable adjustment across society, the quality and design of the policy response is highly important. Therefore, also in line with the Council Regulation on an emergency intervention to address high energy prices adopted on 6 October 2022, measures should focus on providing temporary support, targeted to households and firms most vulnerable to energy price increases, while maintaining the right incentives to reduce energy demand and increase energy efficiency, in line with the European Green Deal.⁸ Policies should also help reducing the energy consumption and develop the energy autonomy of the Union.

CONSIDERATIONS CONCERNING LUXEMBOURG

9. On 12 October 2022, Luxembourg submitted the Draft Budgetary Plan for 2023. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.
10. On 12 July 2022, the Council recommended that Luxembourg⁹ take action to ensure in 2023 that the growth of nationally financed primary current expenditure is in line with an overall neutral policy stance¹⁰, taking into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. Luxembourg should 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. For the period beyond 2023, Luxembourg should pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions.
11. According to the Commission 2022 autumn forecast, the Luxembourg economy is expected to grow by 1.5% in 2022 and 1.0% in 2023, while inflation is forecast at 8.4% in 2022 and 3.8% in 2023.

According to the Draft Budgetary Plan, the Luxembourg economy is expected to grow by 2.5% in 2022 and 2.0% in 2023, while inflation is projected at 8.0% in 2022 and 2.9% in 2023. The macroeconomic projections underpinning the Draft Budgetary Plan expect a stronger GDP growth in 2022 and 2023, compared to the

⁸ Communication from the Commission, the European Green Deal, COM(2019) 640 final.

⁹ Council Recommendation of 12 July 2022 on the National Reform Programme of the Grand Duchy of Luxembourg and delivering a Council opinion on the 2022 Stability Programme of the Grand Duchy of Luxembourg, OJ C 334, 16.2022, p. 128.

¹⁰ Based on the Commission 2022 autumn forecast, the medium-term (10-year average) potential output growth of Luxembourg, that is used to measure the fiscal stance, is estimated at 6.3% in nominal terms. The Commission's estimates of medium-term potential growth do not include the full positive impact of reforms that are part of the Recovery and Resilience Plan and that can boost potential growth.

Commission 2022 autumn forecast. However, both sets of projections, which are surrounded by high uncertainty, forecast an economic slowdown following the sharp recovery from the COVID-19 crisis in 2021. Nevertheless, the difference for 2022 is mainly explained by higher private consumption and investment projected in the Draft Budgetary Plan, while the difference for 2023 is mainly related to higher net exports and private consumption. In addition, the Commission forecast includes the release of the second quarter growth rate of 2022, which turned out to be more negative than expected, and which was not available at the time of the preparation of the macroeconomic scenario underpinning the Draft Budgetary Plan. Headline inflation is expected to peak in 2022, before decelerating in 2023, supported by the implementation of the energy measure package “Solidariteitspak 2.0” aiming to reduce energy price inflation. However, inflation in 2023 remains relatively high, partly due to a rise in wages stemming from the two wage indexations expected in the first and second quarter of the year (the latter is the postponed indexation from July 2022 to April 2023). Overall, the macroeconomic assumptions underpinning the Draft Budgetary Plan are favourable in both 2022 and 2023.

Luxembourg complies with the requirement of Regulation (EU) No 473/2013 since the draft budget is based on independently produced macroeconomic forecasts.

12. The Draft Budgetary Plan assumes that expenditure amounting to 0.02% of GDP in 2022 and 0.04% in 2023 will be financed by non-repayable financial support (grants) from the Recovery and Resilience Facility. Expenditures financed by Recovery and Resilience Facility grants will enable high-quality investment and productivity-enhancing reforms without a direct impact on the general government deficit and debt of Luxembourg. The Commission 2022 autumn forecast includes a similar amount of expenditures financed by Recovery and Resilience Facility grants.
13. In its 2023 Draft Budgetary Plan, Luxembourg’s general government deficit is planned to increase from 0.4% of GDP in 2022 to 2.2% of GDP in 2023, mainly due to the less favourable macroeconomic circumstances, the budgetary cost of measures to compensate households and companies for the rise in energy prices as well as in consumer prices in general, and higher public investment. The general government debt ratio is planned to increase from 24.6% of GDP in 2022 to 26.3% in 2023. These projections are higher than the Commission 2022 autumn forecast, mainly due to a stronger increase in expenditure for social transfers, subsidies and gross fixed capital formation.

The outlook for public finances continues to be subject to the high uncertainty that surrounds the macroeconomic projections, including macroeconomic risks related to the Russian invasion of Ukraine, energy price hikes and continued supply chain disturbances.

14. The government deficit is impacted by the measures adopted to counter the economic and social impact of the exceptional increases in energy prices, which aggravated over the course of the summer. The budgetary cost of these measures is projected in the Commission 2022 autumn forecast to amount to 1.2% of GDP in 2022 and 1.0% of GDP in 2023.¹¹ They consist of measures reducing government revenue, namely a

¹¹ Deficit developments in 2023 are also affected by the complete phasing-out of COVID-19 emergency temporary measures, which are estimated in the Commission 2022 autumn forecast at 0.1% of GDP in 2022. The definition of the measures adopted to counter the economic and social impact of the exceptional increases in energy prices of the Commission does not include the discretionary fiscal measures for the reduction in the VAT rate by one percentage point (0.4% of GDP), and a few other

reduction in the selling price of petroleum products, and increasing expenditure, such as through supporting the purchasing power of households (via income support, limiting the increase in gas prices and freezing the electricity price), providing aid to energy intensive-companies, and accelerating the energy transition. These measures have been announced as temporary, expiring by the end of 2023. Most measures appear targeted to vulnerable households or firms in 2022 but not in 2023¹², and most of them do not fully preserve the price signal to reduce energy demand and increase energy efficiency.¹³ As a result, the amount of temporary and targeted support to households and firms most vulnerable to energy price hikes, that can be taken into account in the assessment of compliance with the fiscal country-specific recommendation for 2023, is estimated in the Commission 2022 autumn forecast at 0.8% of GDP in 2022 and 0.4% of GDP in 2023.

The government deficit is impacted by the costs of offering temporary protection to displaced persons from Ukraine, which in the Commission 2022 autumn forecast are projected at 0.1% of GDP in both 2022 and 2023.

15. Based on the Commission 2022 autumn forecast and including the information incorporated in Luxembourg's 2023 Draft Budgetary Plan, government gross fixed capital formation is expected to amount to 4.2% of GDP in 2022 and 4.4% of GDP in 2023, compared to 4.1% of GDP recorded in 2021. This includes investment for the green and digital transitions, such as those to protect biodiversity, promote decarbonisation of mobility and renewable energy sources, support renovation to improve energy efficiency, enhance public transport infrastructure, and expand the digitalisation of public services, which are partly funded by the Recovery and Resilience Facility and other EU funds.
16. In 2023, the fiscal stance is projected in the Commission 2022 autumn forecast to be expansionary (-1.2% of GDP¹⁴). This follows an expansionary fiscal stance in 2022 of (-1.0% of GDP).

The growth in nationally financed primary current expenditure (net of new revenue measures) in 2023 is projected to provide an expansionary contribution of 0.9 percentage points of GDP.¹⁵ This includes the reduced impact from the support measures adopted to counter the economic and social impact of the exceptional increases in energy prices by 0.2% of GDP¹⁶, with the temporary and targeted support measures to households and firms most vulnerable to energy price hikes accounting for 0.4% of GDP of this reduction. Therefore, the expansionary contribution of nationally financed primary current expenditure is not due to the temporary and targeted support to households and firms most vulnerable to energy

smaller measures (0.1% of GDP). This explains the difference in the projected budgetary impact of these measures, which amounts to 2.2% of GDP in the Commission forecast, compared to 2.7% of GDP in the Draft Budgetary Plan (2022 and 2023 combined).

¹² Targeted measures amount to 0.8% of GDP in 2022 and 0.4% of GDP in 2023, while untargeted measures amount to 0.4% of GDP in 2022 and 0.6% of GDP in 2023.

¹³ Income measures amount to 0.5% of GDP in 2022 and 0.3% of GDP in 2023, while price measures amount to 0.7% of GDP in 2022 and 0.7% of GDP in 2023.

¹⁴ A negative (positive) sign of the indicator corresponds to an excess (shortfall) of primary expenditure growth compared with medium-term economic growth, indicating an expansionary (contractionary) fiscal policy. The fiscal stance includes the fiscal impulse funded by the Union.

¹⁵ This follows an expansionary contribution from this component of 0.9 percentage points in 2022.

¹⁶ The budgetary impact of targeted price and income measures are projected to decrease both by 0.2% of GDP respectively, while the budgetary impact of untargeted price and income measures is projected to increase by 0.2% of GDP and remain stable respectively.

price hikes and to people fleeing Ukraine. The expansionary growth in nationally financed primary current expenditure (net of new revenue measures) is driven by increases in compensation of employees, social transfers, and other expenditure¹⁷, as well as the budgetary cost of the temporary support measure to reduce VAT rates by one percentage point.

The contribution to economic activity of expenditure financed by Recovery and Resilience Facility grants and other EU funds is projected remain stable in 2023 compared to 2022. Nationally financed investment is projected to provide an expansionary contribution to the fiscal stance of 0.2 percentage points in 2023.¹⁸

17. The Draft Budgetary Plan does not include budgetary projections beyond 2023. However, a multi-year budget is published as part of Luxembourg's budgetary framework, which includes medium-term budgetary projections until 2026. The general government deficit is projected to decrease to 1.1% of GDP in 2024 and 2025, and to 0.9% in 2026. In turn, general government debt is envisaged to increase to 27.7% of GDP in 2024, 28.8% in 2025, and to 29.5% in 2026.
18. On 12 July 2022 the Council also recommended Luxembourg to improve the long-term sustainability of the pension system, in particular by limiting early retirement and by increasing the employment rate of older workers. In addition, the Council recommended Luxembourg to take action to effectively tackle aggressive tax planning, including by ensuring sufficient taxation of outbound payments of interests and royalties to zero and low-tax jurisdictions. According to the Plan, no recent reforms were adopted nor are planned to address the sustainability of the pension system, while limited progress was observed in effectively tackling aggressive tax planning concerns.
19. In 2023, based on the Commission's forecast and including the information incorporated in the Draft Budgetary Plan, the overall fiscal policy stance is estimated to be expansionary in a situation of high inflation. This includes an expansionary contribution to the overall fiscal stance from nationally financed current expenditure. This expansionary contribution is not the result of temporary and targeted support to households and firms most vulnerable to energy price hikes and the cost to assist people fleeing Ukraine. Overall, the growth of nationally financed primary current expenditure is not in line with the recommendation of the Council. Luxembourg plans to finance additional investment through the RRF and other EU funds and it also preserves nationally financed investment. It plans to finance public investment for the green and digital transitions.

Overall, the Commission is of the opinion that the Draft Budgetary Plan for Luxembourg is partly in line with the fiscal guidance contained in the Council recommendation of 12 July 2022. The Commission invites Luxembourg to take the necessary measures within the national budgetary process to ensure that the 2023 budget is consistent with the recommendation adopted by the Council on 12 July 2022.

While Luxembourg rapidly deployed energy measures as part of the emergency policy response to the exceptional energy price hikes, a prolongation of existing and/or an enactment of new support measures in response to high energy prices

¹⁷ Other expenditure includes an extra contribution to the EU budget (around EUR 247 million) following the upward revision of the 2010-2020 gross national income.

¹⁸ Other nationally financed capital expenditure is projected to provide an expansionary contribution of 0.1 percentage points of GDP.

would contribute to higher growth in net nationally financed current expenditure and to an increase in the projected government deficit and debt in 2023. Therefore, it is important that Member States better focus such measures to the most vulnerable households and exposed firms, to preserve incentives to reduce energy demand, and to be withdrawn as energy price pressures diminish.

The Commission is also of the opinion that Luxembourg has made limited progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 12 July 2022 in the context of the European Semester and thus invites the authorities to accelerate progress. A comprehensive description of progress made with the implementation of the country-specific recommendations will be made in the 2023 Country Report and assessed in the context of the country-specific recommendations to be proposed by the Commission in spring 2023.

Done at Brussels, 22.11.2022

For the Commission
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