COUNCIL OPINION

of 27 February 2007

on the updated stability programme of Luxembourg, 2006-2009

(2007/C 70/07)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

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(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On 27 February 2007 the Council examined the updated stability programme of Luxembourg, which covers the period 2006 to 2009.

(2) The macroeconomic scenario underlying the programme envisages that real GDP growth will decelerate from 5,5 % in 2006 to 4,3 % on average over the rest of the programme period. Assessed against currently available information, this scenario appears to be based on plausible growth assumptions. The programme's projections for inflation also appear realistic.

(3) For 2006, the general government deficit is estimated at 1.0 % of GDP in the Commission services' autumn 2006 forecast, against a target of 1,8 % of GDP set in the previous update of the stability programme. This is partly explained by the downward revision of the 2005 deficit outcome, from 2,3 % of GDP in the previous programme to 1,0 % according to the most recent data. The 2006 deficit outturn may also be better than estimated in the new programme (1,5 % of GDP) due to favourable cyclical conditions and buoyant tax revenues, notably in the last quarter.

(4) In April 2006, following the 14 February 2006 Council opinion, the government and social partners agreed upon a reform and budget consolidation package which was subsequently implemented. In line with this 'Tripartite agreement', the main goal of the programme's medium-term budgetary strategy is to regain a balanced position within the programme horizon. This is to be achieved through a progressive improvement of the general government balance from an estimated deficit of 1,5 % of GDP to a small surplus in 2009 (0,1 % of GDP). The reduction in the primary balance would be parallel to the decrease in the headline deficit. The adjustment relies on a reduction in the expenditure ratio amounting to 3,8 percentage points of GDP, which would more than compensate for a 2,1 point of GDP decrease in the revenue ratio. This strategy is similar to that described in the 2005 programme, which, against the background of a broadly similar macroeconomic outlook, projected the deficit to reach its peak in 2005 rather than 2006 and a broadly balanced position to be achieved in 2008 instead of 2009.

(5) The structural balance (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) calculated according to the commonly agreed methodology is planned to improve from a deficit of around 1¼ % of GDP in 2006 to a surplus of about 1 % at the end of the programme period. As in the previous update of the stability programme, the medium-term objective (MTO) for the budgetary position presented in the programme is a structural deficit of 0,8 % of GDP. The programme aims to achieve the MTO by 2007, one year earlier than in the previous update. As the MTO is (slightly) more demanding than the minimum benchmark (estimated at a deficit of around 1 % of GDP), achieving it should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. The MTO lies within the range indicated for euro-area and ERM II Member States in the Stability and Growth Pact and the code of conduct and adequately reflects the debt ratio and average potential output growth in the long term.

([1]) OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). The documents referred to in this text can be found at the following website:
http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

(6) The budgetary outcomes could be better than projected in the programme. In particular, tax projections seem rather cautious, especially for 2007. Indeed, budgetary outcomes have very often been better than projected in Luxembourg in recent years, generally because of significantly higher-than-expected revenues. However, the programme justifies the generally cautious tax projections by the fact that due to the smallness and openness of the economy, economic growth and thus tax revenues are highly volatile.

(7) In view of this risk assessment and assuming that expenditure targets are adhered to strictly and that no new measures having an adverse effect on the budget balance are adopted, the budgetary stance in the programme seems sufficient to ensure that the MTO is achieved by 2007, as envisaged in the programme. In addition, it seems to provide a sufficient safety margin against breaching the 3 % of GDP deficit threshold with normal macroeconomic fluctuations from 2007 onwards. The pace of the adjustment towards the MTO implied by the programme is fully in line with the Stability and Growth Pact, which specifies that, for euro-area and ERM II Member States, the annual improvement in the structural balance should be 0,5 % of GDP as a benchmark and that the adjustment should be higher in good economic times and could be lower in bad economic times. After the achievement of the MTO, the fiscal policy stance implied by the programme is also fully in line with the Pact.

(8) Government gross debt is estimated to have reached 7,5 % of GDP in 2006, well below the 60 % of GDP Treaty reference value. The programme projects the debt ratio to rise slightly to 8,5 % of GDP by the end of the programme period.

(9) The long-term budgetary impact of ageing in Luxembourg is among the highest in the EU, influenced notably by a very considerable increase in pension expenditure, by 7½ percentage points of GDP, and in total age-related public spending, by 8¼ points, from 2004 to 2050 (compared to EU average increases of 2¼ and 3½ percentage points of GDP, respectively). The current level of gross debt is very low and considerable assets have been accumulated by the social security system. However, while the current size of these assets (estimated at around 25 % of GDP) contributes significantly to public finance sustainability, it will not be sufficient to offset the impact on the debt ratio in the long term resulting from the sizeable increase in age-related expenditure. Therefore, while keeping a strong budgetary position will help to alleviate part of the cost of ageing, as recognised by the authorities, some changes to the pension scheme are necessary so as to contain the future increase in public expenditure and reduce the risks to the long-term sustainability of public finances. Overall, Luxembourg appears to be at medium risk with regard to the sustainability of its public finances.

(10) The stability programme contains a qualitative assessment of the overall impact of the October 2006 implementation report of the national reform programme within the medium-term fiscal strategy. In addition, it provides some information on the direct budgetary costs or savings of the main reforms envisaged in the national reform programme and its budgetary projections seem to take into account the public finance implications of the actions outlined in the national reform programme. The measures in the area of public finances envisaged in the stability programme seem consistent with those foreseen in the national reform programme. In particular, the government's intention, confirmed by the programme, to keep public investment at a high level seems to reflect the identification as priority actions by the NRP of the increase in R&D, the encouragement of the sustainable use of resources and the improvement of the rail connections with neighbouring countries.

(11) The budgetary strategy outlined in the programme is partly consistent with the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008. In particular, no significant pension reforms have been undertaken to date.

(12) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme has some gaps in the required and optional data ([1]). In addition, it deviates on some material points from the model structure specified in the code of conduct ([2]).

([1]) In particular, the data on sectoral balances are missing (except for the general government).
([2]) The section on the institutional features of public finance is missing.

The Council welcomes that, in a context of strong growth prospects, the programme is making rapid progress towards the MTO, which should be achieved from 2007 onwards, and envisages a further narrowing of the deficit thereafter. However, most of the expenditure-curbing measures recently decided are only temporary (i.e. until 2009).

Taking into account the above assessment and in view of the projected increase in age-related expenditure, the Council invites Luxembourg to improve the long-term sustainability of public finances by implementing structural reform measures (especially in the area of pensions).

Comparison of key macroeconomic and budgetary projections

		2005	2006	2007	2008	2009
Real GDP (% change)	**SP Nov 2006**	**4,0**	**5,5**	**4,0**	**5,0**	**4,0**
	COM Nov 2006	4,0	5,5	4,5	4,2	n.a.
	SP Nov 2005	*4,0*	*4,4*	*4,9*	*4,9*	*n.a.*
HICP inflation (%)	**SP Nov 2006**	**3,8**	**2,9**	**1,4**	**2,0**	**2,0**
	COM Nov 2006	3,8	3,2	2,2	1,8	n.a.
	SP Nov 2005	*3,7*	*2,6*	*2,0*	*1,8*	*n.a.*
Output gap (% of potential GDP)	**SP Nov 2006** (1)	**– 1,6**	**– 0,3**	**– 0,8**	**– 0,5**	**– 1,6**
	COM Nov 2006 (5)	– 2,2	– 0,9	– 0,7	– 0,9	n.a.
	SP Nov 2005 (1)	*– 1,7*	*– 1,3*	*– 0,7*	*– 0,6*	*n.a.*
General government balance (% of GDP)	**SP Nov 2006**	**– 1,0**	**– 1,5**	**– 0,9**	**– 0,4**	**0,1**
	COM Nov 2006	– 1,0	– 1,0	– 0,5	– 0,3	n.a.
	SP Nov 2005	*– 2,3*	*– 1,8*	*– 1,0*	*– 0,2*	*n.a.*
Primary balance (% of GDP)	**SP Nov 2006**	**– 0,8**	**– 1,3**	**– 0,8**	**– 0,2**	**0,3**
	COM Nov 2006	– 0,8	– 0,8	– 0,3	– 0,1	n.a.
	SP Nov 2005	*– 2,1*	*– 1,7*	*– 0,7*	*0,1*	*n.a.*
Cyclically-adjusted balance (% of GDP)	**SP Nov 2006** (1)	**– 0,2**	**– 1,3**	**– 0,5**	**– 0,1**	**0,9**
	COM Nov 2006	0,0	– 1,1	– 0,2	0,1	n.a.
	SP Nov 2005 (1)	*– 1,5*	*– 1,2*	*– 0,6*	*0,1*	*n.a.*
Structural balance (2) (% of GDP)	**SP Nov 2006** (3)	**– 0,2**	**– 1,3**	**– 0,5**	**– 0,1**	**0,9**
	COM Nov 2006 (4)	0,0	– 1,1	– 0,2	0,1	n.a.
	SP Nov 2005	*– 1,5*	*– 1,2*	*– 0,6*	*0,1*	*n.a.*
Government gross debt (% of GDP)	**SP Nov 2006**	**6,1**	**7,5**	**8,2**	**8,5**	**8,5**
	COM Nov 2006	6,0	7,4	7,3	7,1	n.a.
	SP Nov 2005	*6,4*	*9,6*	*9,9*	*10,2*	*n.a.*

Notes:
(1) Commission services calculations on the basis of the information in the programme.
(2) Cyclically-adjusted balance (as in the previous rows) excluding one-off and other temporary measures.
(3) There are no one-off and other temporary measures in the programme.
(4) There are no one-off and other temporary measures in the Commission services' autumn 2006 forecast.
(5) Based on estimated potential growth of 4,1 %, 4,1 %, 4,4 % and 4,7 % respectively in the period 2005-2008.

Source:
Stability programme (SP); Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations