COUNCIL RECOMMENDATION

of 12 July 2016

on the 2016 National Reform Programme of Luxembourg and delivering a Council opinion on the 2016 Stability Programme of Luxembourg

(2016/C 299/24)

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,

Whereas:

(1) On 26 November 2015, the Commission adopted the Annual Growth Survey, marking the start of the 2016 European Semester for economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 17-18 March 2016. On 26 November 2015, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council ([2]), the Commission adopted the Alert Mechanism Report, in which Luxembourg was not identified as one of the Member States for which an in-depth review would be carried out. On the same day, the Commission adopted a recommendation for a Council Recommendation on the economic policy of the euro area. That Recommendation was endorsed by the European Council on 18-19 February 2016 and adopted by the Council on 8 March 2016 ([3]). As a country 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.

(2) The country report for Luxembourg was published on 26 February 2016. It assessed Luxembourg's progress in addressing the country-specific recommendations adopted by the Council on 14 July 2015 and Luxembourg's progress towards its national Europe 2020 targets.

([1]) OJ L 209, 2.8.1997, p. 1.
([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 96, 11.3.2016, p. 1.

(3) On 29 April 2016, Luxembourg submitted its 2016 National Reform Programme and its 2016 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds for the 2014-2020 period. As foreseen in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council ([1]), 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 this provision in guidelines on the application of the measures linking the effectiveness of the European Structural and Investment Funds to sound economic governance.

(5) Luxembourg is currently in the preventive arm of the Stability and Growth Pact. In its 2016 Stability Programme, the Government plans to achieve a balanced budget in 2017 and small surpluses thereafter, reaching 0,4 % of GDP by 2020. The medium-term budgetary objective will continue to be met throughout the programme period. However, in its Stability Programme, Luxembourg announces that the medium-term budgetary objective will change from a structural surplus of 0,5 % of GDP until 2016 to a structural deficit of 0,5 % of GDP as from 2017. According to the Stability Programme, the government debt-to-GDP ratio is expected to gradually increase to 23,5 % of GDP in 2020. The macroeconomic scenario underpinning these budgetary projections is plausible, with the exception of 2017 and 2018 when it is favourable. Based on the Commission 2016 spring forecast, the structural surplus is projected to decrease to 1,4 % of GDP in 2016 and further to 0,3 % of GDP in 2017, thereby remaining above the medium-term budgetary objective. Possible future deviations would be assessed against the requirement to maintain the structural balance at the medium-term budgetary objective, bearing in mind the need to ensure the long-term sustainability of public finances, in particular in the area of pensions. Based on its assessment of the Stability Programme and taking into account the Commission 2016 spring forecast, the Council is of the opinion that Luxembourg is expected to comply with the provisions of the Stability and Growth Pact.

(6) The Luxembourg authorities have announced the main lines of a comprehensive tax reform that should enter into force in 2017. The reform foresees amendments mostly in the area of direct taxation, both for individuals and corporations. It aims at a gradual reduction in the corporate income tax rate (with the aim of increasing competitiveness) and increased progressivity of personal income tax (with the aim of increasing fairness). At the same time, the increase of certain tax expenditures, in particular with regard to housing, risks narrowing the tax base. Some international developments may also affect the design of the Luxembourg tax system and highlight the fragility of at least a share of the fiscal revenues. To ensure their predictability, there is scope for further broadening of the tax base, in particular by revisiting the currently low taxation on housing property and making greater use of alternative sources, including environmental taxation. In that respect, the repeal of the intellectual property box allows some broadening of the corporate tax base. The adoption and implementation of the tax reforms will continue to be monitored closely under the European Semester.

(7) The Luxembourg authorities have sought to diversify the economy, acknowledging the risks associated with heavy dependence on the financial sector. Given the high level of labour costs in the country, 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 those sectors that are less sensitive to labour cost levels. They are largely based on research and innovation, which tend to be technology- and knowledge-intensive. Further expansion of the already successful non-financial service sector could also help diversify the economy. Reducing or removing existing barriers to investment and innovation that limit economic development would unleash the potential for innovation and help diversification. While public investment is above the euro area average, private investment is underperforming. Sustaining a high level of investment is essential to maintaining growth prospects. The analysis in the country report shows that Luxembourg is the country with the most restrictive regulation in the Union for business services and retail establishment. The main restrictions concern shareholding requirements, voting rights and multidisciplinary limitations in the business services sector as well as operational and establishment requirements in the retail sector.

([1]) 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).

(8) The continuous increase in house prices in recent decades, together with projected strong population and employment dynamics over the coming years, could become an obstacle to the envisaged increase in population and labour force. That prospect is all the more likely as the economy depends largely on the input of high-skilled workers from the neighbouring countries, who represent around one-third of overall employment. The dynamism of residential real estate prices is driven by a mismatch between demand and supply, in particular the lack of available and affordable housing. Insufficient availability of land for new construction and suboptimal administrative performance regarding procedures to grant building permits hinder the flexibility of housing supply. An important part of the tax subsidies available under current policies are also likely to be capitalised into house prices, given the rigid housing supply. Efforts aimed at providing social housing at affordable prices could also be stepped up. The current housing market not only deters households from establishing their residence in Luxembourg but also exacerbates the problem of traffic congestion and pollution. The new demographic projections in the 2015 ageing report also add pressure to remove bottlenecks to investment in the fields of transport and housing and should be reflected in the four forthcoming sectoral plans on housing, transport, economic activity zones and green landscapes.

(9) Achievement of economic diversification may be constrained by the fact that wage developments in some sectors may not be in line with productivity developments. This further limits the sectors that can be targeted, mainly to those with high added value. Over the last decade, unit labour costs in Luxembourg have grown faster than in most euro area Member States. Economy-wide automatic wage indexation plays a role in limiting wage variation across sectors and may prevent labour productivity differentials from being taken into account. However, the protracted low inflation environment has delayed the triggering of the automatic wage adjustment and contributed to moderate wage developments. In parallel with weak wage developments and the surge in output, cost-competitiveness losses have abated. In that context, monitoring of wage developments is warranted.

(10) Age-related liabilities remain a risk in the long term, in particular as regards pension costs. Luxembourg has made limited progress in relation to closing the gap between the statutory and effective retirement age, by limiting early retirement. In July 2015, a draft law modifying early retirement schemes was presented to the Parliament. However, while one scheme will be abolished, accessibility conditions for other pre-retirement schemes will be partially eased. A law on the reclassification of workers with working disabilities was adopted in July 2015 and has been implemented since 1 January 2016. The law increased the possibilities for workers with working disabilities to remain in the labour market and consequently implies a reduction in the number of people entering an early retirement scheme. Early retirement remains widespread and incentives to work longer are limited. A complete strategy on age policy to keep older workers longer in employment and provide incentives and skills to get them back to work is still missing. The 'age pact', aiming at fostering retention of older workers by firms with more than 150 employees, is still being discussed in the Parliament.

(11) According to the 2012 pension reform, an exercise to monitor and evaluate the sustainability of the pension system should be carried out every five years from the adoption of the reform. The Government confirmed its intention to advance the evaluation to 2016, rather than 2017 as originally planned, and created a Pension Working Group tasked with carrying out the evaluation. There has been no progress in linking statutory retirement age to life expectancy, as previously recommended by the Council. Luxembourg stands out as the only Member State where no further raising of the statutory and early retirement ages has been laid down for the period between 2013-2060. In the 2015 Ageing Report, the projected increase in age-related expenditure is revised downward, but the revision is almost exclusively explained by more favourable demographic projections, in a context where no new reforms have been adopted. Even after the revision, the projected increase in pension expenditure remains the highest in the Union. Moreover, Luxembourg faces risks related to the expected increase of long-term care expenditure, one of the highest as a share of GDP of all Member States. This, in turn, seems to be driven by the highest projected increase in the share of dependant population in the Union by 2060. Preparatory work on a reform to ensure the long-term sustainability of the long-term care insurance has been carried out.

(12) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Luxembourg's economic policy and published it in the 2016 country report. It has also assessed the Stability Programme and the National Reform Programme and the follow-up given to the recommendations addressed to Luxembourg in previous years. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Luxembourg but also their compliance with EU rules and guidance, given the need to

strengthen the EU's overall economic governance by providing EU-level input into future national decisions. The recommendations under the European Semester are reflected in recommendations (1) and (2) below.

(13) In the light of this assessment, the Council has examined the Stability Programme and is of the opinion [1] that Luxembourg is expected to comply with the Stability and Growth Pact,

HEREBY RECOMMENDS that Luxembourg take action in 2016 and 2017 to:

1. Ensure the long-term sustainability of public pensions by increasing the effective retirement age, by limiting early retirement and increasing incentives to work longer, and by aligning the statutory retirement age to changes in life expectancy.

2. Remove barriers to investment and innovation that limit economic development in the business services sector. Address bottlenecks that hamper housing investment.

Done at Brussels, 12 July 2016.

For the Council

The President

P. KAŽIMÍR

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