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Subject: COUNCIL RECOMMENDATION on the 2023 National reform Programme of Luxembourg and delivering a Council opinion on the 2023 Stability Programme of Luxembourg

Delegations will find attached the above-mentioned draft Council Recommendation, as discussed by the Council and European Council, based on the Commission Recommendation COM(2023) 616 final.

COUNCIL RECOMMENDATION

of ...

**on the 2023 National reform Programme of Luxembourg and delivering a Council opinion
on the 2023 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 Article 121(2) and Article 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 policies¹, and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances², and in particular Article 6(1) 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,

¹ OJ L 209, 2.8.1997, p. 1.

² OJ L 306, 23.11.2011, p. 25.

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) Regulation (EU) 2021/241 of the European Parliament and of the Council³, which established the Recovery and Resilience Facility ('the Facility'), entered into force on 19 February 2021. The Facility provides financial support to the Member States for the implementation of reforms and investments, entailing a fiscal impulse financed by the Union. In line with the priorities of the European Semester, the Facility contributes to economic and inclusive recovery and to the implementation of sustainable and growth-enhancing reforms and investments, in particular reforms and investments to promote the green and digital transitions and to 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 Union and support the continued implementation of the European Pillar of Social Rights. The maximum financial contribution per Member State under the Facility was updated on 30 June 2022, in accordance with Article 11(2) of Regulation (EU) 2021/241.

³ 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).

- (2) On 22 November 2022, the Commission adopted the 2023 Annual Sustainable Growth Survey, marking the start of the 2023 European Semester for economic policy coordination. On 23 March 2023, the European Council endorsed the priorities of the 2023 Annual Sustainable Growth Survey, which are centred around the four dimensions of competitive sustainability. On 22 November 2022, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the 2023 Alert Mechanism Report, in which it identified 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. On the same date, the Commission also adopted an opinion on Luxembourg's 2023 draft budgetary plan. The Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area and a proposal for the 2023 Joint Employment Report, which analyses the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights. The Council adopted the Recommendation on the economic policy of the euro area⁴ ('2023 Recommendation on the euro area') on 16 May 2023 and the Joint Employment Report on 13 March 2023.
- (3) While the Union's economies are showing remarkable resilience, the geopolitical context continues to have a negative impact. As the Union stands firmly with Ukraine, the Union's economic and social policy agenda is focused on reducing the negative impact of energy shocks on both vulnerable households and firms in the short term, and on keeping up efforts to deliver on the green and digital transitions, support sustainable and inclusive growth, safeguard macroeconomic stability and increase resilience in the medium term. It also focuses heavily on increasing the Union's competitiveness and productivity.

⁴ Council Recommendation of 16 May 2023 on the economic policy of the euro area (OJ C 180, 23.5.2023, p. 1).

- (4) On 1 February 2023, the Commission issued a communication entitled 'A Green Deal Industrial Plan for the Net-Zero Age' ('the Green Deal Industrial Plan'). The aim of the Green Deal Industrial Plan is to boost the competitiveness of the Union's net-zero industry and support the fast transition to climate neutrality. It complements ongoing efforts under the European Green Deal and REPowerEU. It also aims to provide a more supportive environment for scaling up the Union's manufacturing capacity for the net-zero technologies and products required to meet the Union's ambitious climate targets, and to ensure access to relevant critical raw materials, including by diversifying sourcing, properly exploiting geological resources in Member States and maximising the recycling of raw materials. The Green Deal Industrial Plan is based on four pillars: a predictable and simplified regulatory environment, faster access to finance, the enhancement of skills, and open trade for resilient supply chains. On 16 March 2023, the Commission issued a further communication entitled 'Long-term competitiveness of the EU: looking beyond 2030', structured along nine mutually reinforcing drivers with the objective of working towards a growth-enhancing regulatory framework. It sets policy priorities aimed at actively ensuring structural improvements, well-focused investment and regulatory measures for the long-term competitiveness of the Union and its Member States. The recommendations below help address those priorities.
- (5) In 2023, the European Semester for economic policy coordination continues to evolve in line with the implementation of the Facility. The full implementation of the recovery and resilience plans remains essential for delivering the policy priorities under the European Semester, as the plans address all or a significant subset of the relevant country-specific recommendations issued in recent years. The 2019, 2020 and 2022 country-specific recommendations remain equally relevant for the recovery and resilience plans revised, updated or amended in accordance with Articles 14, 18 and 21 of Regulation (EU) 2021/241.

- (6) Regulation (EU) 2023/435 of the European Parliament and of the Council⁵ (the 'REPowerEU Regulation'), which was adopted on 27 February 2023, aims to rapidly phase out the Union's dependence on Russian fossil-fuel imports. This will contribute to energy security and the diversification of the Union's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency. The REPowerEU Regulation enables Member States to add a new REPowerEU chapter to their national recovery and resilience plans in order to finance key reforms and investments that will help achieve the REPowerEU objectives. Those reforms and investments will also help boost the competitiveness of the Union's net-zero industry as outlined in the Green Deal Industrial Plan and address the energy-related country-specific recommendations issued to the Member States in 2022 and, where applicable, in 2023. The REPowerEU Regulation introduces a new category of non-repayable financial support, made available to Member States in order to finance new energy-related reforms and investments under their recovery and resilience plans.

⁵ 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).

(7) On 8 March 2023, the Commission adopted a communication providing fiscal policy guidance for 2024 ('the communication of 8 March 2023'). It aims to support the preparation of Member States' stability and convergence programmes and thereby strengthen policy coordination. The Commission recalled that the general escape clause of the Stability and Growth Pact will be deactivated at the end of 2023. It called for fiscal policies in 2023–2024 that ensure medium-term debt sustainability and raise potential growth in a sustainable manner and invited Member States to set out in their 2023 stability and convergence programmes how their fiscal plans will ensure that the Treaty reference value of 3 % of gross domestic product (GDP) is adhered to and to ensure plausible and continuous debt reduction, or for debt to be kept at prudent levels in the medium term. The Commission also invited Member States to phase out national fiscal measures introduced to protect households and firms from the energy price shock, starting with the least targeted ones. It indicated that, if support measures needed to be extended because of renewed energy price pressures, Member States should better target such measures at vulnerable households and firms. The Commission stated that the fiscal recommendations would be quantified and differentiated. Moreover, as proposed in its communication of 9 November 2022 on orientations for a reform of the EU economic governance framework, the fiscal recommendations would be formulated on the basis of net primary expenditure. It recommended that all Member States continue to protect nationally financed investment and ensure the effective use of the Facility and other Union funds, in particular in light of the green and digital transitions and resilience objectives. The Commission indicated that it will propose to the Council to open deficit-based excessive deficit procedures in spring 2024 on the basis of the outturn data for 2023, in line with existing legal provisions.

- (8) On 26 April 2023, the Commission presented legislative proposals to implement a comprehensive reform of the Union's economic governance rules. The central objective of the proposals is to strengthen public debt sustainability and promote sustainable and inclusive growth in all Member States through reforms and investments. In its proposals, the Commission aims to improve national ownership, simplify the framework and move towards a greater medium-term focus, in combination with effective and more coherent enforcement. According to the Council conclusions of 14 March 2023 on orientations for a reform of the EU economic governance framework, the objective is to conclude the legislative work in 2023.
- (9) On 21 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 set out in Annex V to that Regulation. On 13 July 2021, the Council adopted its Implementing Decision on the approval of the assessment of the recovery and resilience plan for Luxembourg⁶. The release of instalments is conditional on the adoption of a decision by the Commission, in accordance with Article 24(5) of Regulation (EU) 2021/241, stating 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.

⁶ ST 10155/21 INIT; ST 10155/21 ADD 1.

- (10) On 28 April 2023, Luxembourg submitted its 2023 National Reform Programme and, on 27 April 2023, its 2023 Stability Programme, in line with Article 4(1) of Regulation (EC) No 1466/97. To take account of their interlinkages, the two programmes have been assessed together. In accordance with Article 27 of Regulation (EU) 2021/241, the 2023 National Reform Programme also reflects Luxembourg's biannual reporting on the progress made in achieving its recovery and resilience plan.
- (11) On 24 May 2023, the Commission published the 2023 country report for Luxembourg. It assessed Luxembourg's progress in addressing the relevant country-specific recommendations adopted by the Council between 2019 and 2022, and took stock of Luxembourg's implementation of the recovery and resilience plan. On the basis of that analysis, the country report identified gaps with regard 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 in implementing the European Pillar of Social Rights and in achieving the Union headline targets on employment, skills and poverty reduction, as well as progress in achieving the United Nations Sustainable Development Goals.

- (12) The Commission carried out an in-depth review under Article 5 of Regulation (EU) No 1176/2011 for Luxembourg and published its results on 24 May 2023. The Commission concluded that Luxembourg is not experiencing macroeconomic imbalances. In particular, vulnerabilities relating to high house prices and high household debt have recently increased but overall seem to be contained so far and are expected to ease over the medium term. Strong population growth alongside increased mortgage credit, incentivised by fiscal support, has pushed up demand for housing, while supply has been restricted by the limited land available for construction and by land hoarding. The widening gap between housing demand and supply has resulted in strong house price increases with growing risks of house prices overvaluation and deteriorating affordability. House prices clearly decreased in late 2022, and the number of housing transactions declined sharply, as the rise in interest rates have led to a turn in the market. However, a sharp correction in house prices is not expected as incomes are holding up well and the supply shortage is expected to continue. Household debt is very high in terms of disposable income and has been increasing, while borrowing cooled somewhat in late 2022. Households' financial assets are also substantial, indebtedness increases towards the higher levels of income and wealth, and the banking sector is sound, which overall mitigates macrofinancial risks. Additional policy efforts, such as stepping up and prioritising the adoption and implementation of recent measures, including recurrent taxes to increase the supply of buildable land, combined with the ongoing reform of land-use planning, could help boost housing supply, in particular through the supply of affordable and social housing targeted to those most in need. The efficiency of the rental market could be improved too. In addition, reducing the mortgage interest deductibility, which was recently significantly increased, would reduce the fiscal incentives to borrow which support high house prices.

- (13) According to data validated by Eurostat, Luxembourg's general government surplus decreased from 0,7 % of GDP in 2021 to 0,2 % in 2022, while general government debt rose slightly from 24,5 % of GDP at the end of 2021 to 24,6 % at the end of 2022.
- (14) The general government balance has been impacted by the fiscal policy measures taken to mitigate the economic and social impact of the increase in energy prices. In 2022, such fiscal policy revenue-decreasing measures included a reduction in taxes on products to lower consumer prices for petrol, diesel and heating oil by 7,5 ct per litre, while such fiscal policy expenditure-increasing measures included the introduction of an energy tax credit⁷, aid for companies affected by rising energy prices and limiting gas price increases. The Commission estimates the net budgetary cost of those measures at 0,5 % of GDP in 2022. The general government balance has also been impacted by the budgetary cost of offering temporary protection to displaced persons from Ukraine, which is estimated at 0,1 % of GDP in 2022. At the same time, the estimated cost of temporary emergency measures related to the COVID-19 crisis dropped to 0,2 % of GDP in 2022, from 1,0 % in 2021.
- (15) On 18 June 2021, the Council recommended that in 2022 Luxembourg⁸ pursue a supportive fiscal stance, including from the impulse provided by the Facility, and preserve nationally financed investment.

⁷ Payable tax credits can exceed the tax liability and affect non-taxpayers as well as taxpayers; therefore, they are classified as expenditure in national accounts (ESA 2010, Articles 20.167 and 20.168).

⁸ Council Recommendation of 18 June 2021 delivering a Council opinion on the 2021 Stability Programme of Luxembourg (OJ C 304, 29.7.2021, p. 73).

(16) According to the Commission estimates, the fiscal stance⁹ in 2022 was supportive, at -0,9 % of GDP, as recommended by the Council. As recommended by the Council, Luxembourg continued to support the recovery with investments financed by the Facility. Expenditure financed by grants under the Facility and other Union funds amounted to 0,1 % of GDP in 2022 (0,1 % of GDP in 2021). Nationally financed investment provided a neutral contribution to the fiscal stance¹⁰. Luxembourg therefore preserved nationally financed investment, as recommended by the Council. At the same time, the growth in nationally financed primary current expenditure (net of new revenue measures) provided an expansionary contribution of 1,3 percentage points to the fiscal stance. That significant expansionary contribution included the additional impact of measures taken to mitigate the economic and social impact of the increase in energy prices (additional net budgetary cost of 0,5 % of GDP), as well as the cost of offering temporary protection to displaced persons from Ukraine (0,1 % of GDP). At the same time, subsidies, other current expenditure and intermediate consumption also contributed (0,3 % of GDP) to the growth in net primary current expenditure. Luxembourg therefore did not sufficiently keep under control the growth in nationally financed current expenditure. The significant expansionary contribution of nationally financed current expenditure was only partially due to the measures to address the economic and social impact of the increase in energy prices, as well as the cost of offering temporary protection to displaced persons from Ukraine.

⁹ The fiscal stance is measured as the change in primary expenditure (net of discretionary revenue measures), excluding temporary emergency measures related to the COVID-19 crisis but including expenditure financed by non-repayable support (grants) from the Facility and other Union funds, relative to medium-term potential growth. For more details see Box 1 in the Fiscal Statistical Tables.

¹⁰ Other nationally financed capital expenditure provided a contractionary contribution of 0,4 percentage points of GDP, due to a decline in 'Other capital transfers' mainly related to phasing out of business support and recovery assistance in the context of the COVID-19 pandemic (Recovery and solidarity fund for businesses).

- (17) The macroeconomic scenario underpinning the budgetary projections in the 2023 Stability Programme is more favourable than the Commission's 2023 spring forecast for 2023 and thereafter. The government projects real GDP to grow by 2,4 % in 2023 and 3,8 % in 2024. By comparison, the Commission's 2023 spring forecast projects a lower real GDP growth of 1,6 % in 2023 and 2,4 % in 2024, mainly due to lower growth contributions from net exports in 2023 and domestic demand in 2024¹¹.
- (18) In its 2023 Stability Programme, the government expects that the general government balance will deteriorate to a deficit of 1,5 % of GDP in 2023. The deterioration in 2023 mainly reflects additional measures to support household and corporate incomes in the wake of high energy prices and inflation. According to the 2023 Stability Programme, the general government debt-to-GDP ratio is expected to increase from 24,6 % at the end of 2022 to 26,1 % at the end of 2023. The Commission's 2023 spring forecast projects a government deficit of 1,7 % of GDP for 2023. This is slightly higher than the deficit projected in the 2023 Stability Programme, mainly due to somewhat lower tax revenue, according to the Commission's 2023 spring forecast. The Commission's 2023 spring forecast projects a slightly lower general government debt-to-GDP ratio of 25,9 % at the end of 2023. The difference is due to higher nominal GDP growth in 2023, according to the Commission's 2023 spring forecast.

¹¹ For nominal GDP the picture is slightly different; the 2023 Stability Programme forecasts nominal GDP growth rates of 4,7 % in 2023 and 6,0 % in 2024, while the Commission's 2023 spring forecast projects a higher rate of 7,1% in 2023, and a comparable rate of 5,9 % in 2024.

- (19) The general government balance in 2023 is expected to continue to be impacted by the measures taken to mitigate the economic and social impact of the increase in energy prices. They consist of measures extended from 2022, in particular, limiting gas price increases by subsidising household energy costs and network charges, stabilising electricity prices through subsidies to households, and measures to support businesses, as well as new measures. The net budgetary cost of the support measures is projected in the Commission's 2023 spring forecast at 1,1 % of GDP in 2023¹². Some measures in 2023 are targeted at the most vulnerable households or firms, while most measures do not preserve the price signal to reduce energy demand and increase energy efficiency. As a result, the amount of targeted support measures, to be taken into account in the assessment of compliance with the Council Recommendation of 12 July 2022¹³, is estimated in the Commission's 2023 spring forecast at 0,6 % of GDP in 2023 (compared to 0,4 % of GDP in 2022).
- (20) In its Recommendation of 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 stance¹⁴, 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 Facility and other Union funds.

¹² That figure represents the level of annual budgetary cost of those measures, including current revenue and expenditure as well as, where relevant, capital expenditure measures.

¹³ Council Recommendation of 12 July 2022 on the National Reform Programme of Luxembourg and delivering a Council opinion on the 2022 Stability Programme of Luxembourg (OJ C 334, 01.09.2022, p. 128).

¹⁴ On the basis of the Commission's 2023 spring forecast, the medium-term (10-year average) potential output growth of Luxembourg, which is used to measure the fiscal stance, is estimated at 7,8 % in nominal terms.

(21) In 2023, the fiscal stance is projected in the Commission's 2023 spring forecast to be expansionary (-1,5 % of GDP), in a context of high inflation. This follows an expansionary fiscal stance in 2022 (-0,9 % of GDP). The growth in nationally financed primary current expenditure (net of discretionary revenue measures) in 2023 is projected to provide an expansionary contribution of 1,3 percentage points to the fiscal stance. This includes the increased cost of the targeted support measures to households and firms most vulnerable to energy price hikes by 0,3 % of GDP. The expansionary contribution of nationally financed net primary current expenditure is therefore only partly due to the targeted support to households and firms most vulnerable to energy price hikes. The expansionary growth in nationally financed primary current expenditure (net of discretionary revenue measures) is also driven by, among other factors, social benefits other than in kind, subsidies related to untargeted energy measures, permanent increases in public sector wages, a one-time contribution to the Union budget, and the reduction in VAT rates. In sum, the projected growth of nationally financed primary current expenditure is not in line with the Council Recommendation of 12 July 2022. Expenditure financed by grants under the Facility and other Union funds is projected to amount to 0,2 % of GDP in 2023, while nationally financed investment is projected to provide an expansionary contribution to the fiscal stance of 0,1 percentage points. Luxembourg plans to finance additional investment through the Facility and other Union funds, and it is projected to preserve nationally financed investment¹⁵. It plans to finance public investment for the green and digital transitions, and for energy security, such as electrification of public transport, reinforcement of the tram and rail network, a climate and energy fund to support the acquisition of photovoltaic panels, digitalisation of public services and digital communication security (quantum technology), which are partly funded by the Facility and other Union funds.

¹⁵ Other nationally financed capital expenditure is projected to provide a neutral contribution to GDP.

- (22) According to the 2023 Stability Programme the general government deficit is expected to increase to 1,7 % of GDP in 2024. The increase in 2024 mainly reflects the extension of support measures to cushion households and corporate incomes against the effects of the inflationary surge. According to the 2023 Stability Programme, the general government debt-to-GDP ratio is expected to increase to 27,5 % at the end of 2024. On the basis of policy measures known at the cut-off date of the forecast, the Commission's 2023 spring forecast projects a government deficit of 1,5 % of GDP in 2024. This is slightly lower than the deficit projected in the 2023 Stability Programme, mainly due to a smaller increase in compensation of employees and social transfers, according to the Commission's 2023 spring forecast. The Commission's 2023 spring forecast projects a lower general government debt-to-GDP ratio, of 27,0 % at the end of 2024.
- (23) The 2023 Stability Programme envisages the extension of the energy support measures until the end of 2024. The Commission currently assumes the net cost of energy support measures at 0,5 % of GDP in 2024¹⁶, compared to 1,1 % of GDP in 2023. Those estimates are based on the assumption of no renewed energy price increases. The energy support measures that are currently planned to remain in place in 2024 do not appear to be targeted at vulnerable households or firms. Most of them do not fully preserve the price signal to reduce energy demand and increase energy efficiency.

¹⁶ The Commission's definition of energy measures only includes fiscal policy measures directly affecting energy prices or providing temporary income support for energy consumption. General inflation support measures are not classified as energy measures, which explains a difference in the estimated budgetary cost of energy support measures between the 2023 Stability Programme and the Commission's 2023 spring forecast.

- (24) Regulation (EC) No 1466/97 calls for an annual improvement in the structural budget balance toward the medium-term budgetary objective, with 0,5 % of GDP as a benchmark¹⁷. Taking into account fiscal sustainability considerations, an improvement in the structural balance of at least 0,3 % of GDP for 2024 would be appropriate, according to the Commission. To ensure such an improvement, and in accordance with the Commission's methodology, the growth in net nationally financed primary expenditure¹⁸ in 2024 should not exceed 4,8 %, as reflected in this Recommendation. At the same time, the remaining energy support measures (currently estimated by the Commission at 1,1 % of GDP in 2023) should be phased out in 2023, if energy-market developments so permit and starting with the least targeted measures, and the related savings should be used to reduce the government deficit. According to Commission estimates, this would lead to a growth in net primary expenditure below the recommended maximum growth rate for 2024. However, according to the Commission's 2023 spring forecast, the growth in net national financed primary current expenditure in 2023 is not in line with the Council Recommendation of 12 July 2022. If this is confirmed, lower growth in net primary expenditure in 2024 would be appropriate.
- (25) Assuming unchanged policies, the Commission's 2023 spring forecast projects net nationally financed primary expenditure to grow at 2,9 % in 2024, which is below the recommended growth rate.

¹⁷ Article 5 of Regulation (EC) No 1466/97 also requires an adjustment of more than 0,5 % of GDP for Member States with a government debt exceeding 60 % of GDP, or with more pronounced debt sustainability risks.

¹⁸ Net primary expenditure is defined as nationally financed expenditure net of discretionary revenues measures and excluding interest expenditure and cyclical unemployment expenditure.

- (26) According to the 2023 Stability Programme, government investment is expected to remain stable at 4,5 % of GDP in 2023 and 2024. The 2023 Stability Programme refers to reforms and investments, that are expected to contribute to sustainable and inclusive growth. Those reforms and investments include investments to foster the energy and digital transitions, which are also part of the recovery and resilience plan.
- (27) The 2023 Stability Programme outlines a medium-term fiscal path until 2027. According to the 2023 Stability Programme, the general government deficit is expected to gradually decline to 1,0 % of GDP in 2025 and to 0,8 % by 2026, before slightly increasing to 0,9 % in 2027. Therefore, the general government deficit is planned to remain below 3 % of GDP over the Programme horizon. According to the 2023 Stability Programme, the general government debt-to-GDP ratio is expected to increase from 27,5 % at the end of 2024 to 29,0 % by the end of 2027.

(28) The impact of demographic trends on government spending will become more acute in the coming decades, as the number of pensioners per worker is expected to rise steadily due to the ageing population and the slowdown in net migration flows. In a scenario where there is no policy change, Luxembourg will face one of the Union's sharpest increases in pension spending as a share of GDP, which is projected to double to around 18 % of GDP by 2070, the highest in the Union. This will lead to a significant increase in government debt, putting the sustainability of government finances at risk. The recovery and resilience plan does not address the long-term sustainability of the pension system. Specifically, that plan does not address the negative effects of early retirement schemes and financial incentives to leave the labour market early, which contribute to the low rate of employment among older workers. Raising the effective retirement age would have a beneficial macroeconomic impact and the potential to reduce spending on pensions, since a higher rate of older workers in employment would support economic growth. The fight against aggressive tax planning in the Union is essential to: i) prevent distortion of competition between firms; ii) ensure fair treatment of taxpayers; and iii) safeguard government finances. Luxembourg is a small, open economy, with a large international financial sector, which to a significant extent explains the large financial flows. However, those flows also reflect the presence of many foreign-owned companies in the country, which are involved in intra-group treasury activities. A particular point of concern is the absence of withholding taxes, or equivalent measures on interest and royalty payments made to low or zero-tax jurisdictions beyond those countries included in the Union list of non-cooperative jurisdictions¹⁹. Outbound payments of interest and royalties from Luxembourg-based companies to third-country jurisdictions could be subject to little or no taxation if these payments are not taxed or taxed at a low level in the recipient jurisdiction. Luxembourg has taken some steps to fight aggressive tax planning. However, so far these measures have been insufficient to address those features of the tax system, which can be used by multinationals to engage in aggressive tax planning.

¹⁹ Council Conclusions on the revised EU list of non-cooperative jurisdictions for tax purposes (OJ C 64, 21.2.2023, p. 17).

(29) In accordance with Article 19(3), point (b), of Regulation (EU) 2021/241 and criterion 2.2 of Annex V to that Regulation, the recovery and resilience plan includes an extensive set of mutually reinforcing reforms and investments to be implemented by 2026. The implementation of Luxembourg's recovery and resilience plan is underway. Luxembourg submitted its first payment request on 28 December 2022, corresponding to 26 milestones and targets in the Council Implementing Decision, for the disbursement of EUR 20 million under the Facility. The Commission published its positive preliminary assessment on 28 April 2023. The Council is discussing the payment request. The milestones and targets concerned include the entry into force of the 'Housing Pact 2.0' reform, aimed at increasing the supply of affordable rental housing offered by municipalities, investments for the digitalisation of the public sector and for the development of ultra-secure communication, the upskilling of the workforce with the launch of the 'FutureSkills' programme, as well as a reform on the procurement of clean vehicles. Luxembourg submitted an amendment to its recovery and resilience plan on 11 November 2022, which was approved by the Council on 17 January 2023. Luxembourg is expected to submit a REPowerEU chapter and has already decided to transfer 128,5 million EUR from the Brexit Adjustment Reserve to the Facility to finance its implementation. The swift inclusion of the new REPowerEU chapter into the recovery and resilience plan will allow additional reforms and investments to be financed in support of Luxembourg's strategic objectives in the field of energy and the green transition. The systematic and effective involvement of local and regional authorities, social partners and other relevant stakeholders remains important for the successful implementation of the recovery and resilience plan, as well as other economic and employment policies going beyond that plan, in order to ensure broad ownership of the overall policy agenda.

- (30) The Commission approved all Luxembourg's cohesion policy programming documents in 2022. Proceeding with the swift implementation of the cohesion policy programmes in complementarity and synergy with the recovery and resilience plan, including the REPowerEU chapter, is key to achieving the green and digital transitions, increasing economic and social resilience, and achieving balanced territorial development in Luxembourg.
- (31) Beyond the economic and social challenges addressed by the recovery and resilience plan and cohesion policy programmes, Luxembourg faces a number of additional challenges, in particular the long-term sustainability of public finances mainly stemming from the pension system, legal loopholes that could be used by multinationals engaging in aggressive tax planning, vulnerabilities related to high house prices and household debt, weaknesses in the education system that add to inequality and issues related to energy policy and the green transition, including potential obstacles to the transition from fossil fuels and issues with the transport network.

(32) Pupils' basic skills and overall performance depend largely on their socioeconomic and linguistic background. Average levels in key knowledge and skills at age 15, as measured by the OECD Programme for International Student Assessment (PISA), are significantly lower in Luxembourg than the Union average. The gap between advantaged students and their disadvantaged peers is bigger in Luxembourg than any other Union country. The education system does not equip all pupils with the basic skills necessary to meet the country's labour market needs. The language spoken in the national school system at primary level is Luxembourgish, while pupils learn to read and write in German. All subjects (except for French) are taught in German. This constitutes a very high demand for language skills in a country where only one in three pupils speaks Luxembourgish as their first language. The share of young people 18-24 who left education and training without completing upper secondary education increased from 6,3 % in 2018 to 8,2 % in 2022. In September 2022, Luxembourg launched a pilot project in four primary schools, where pupils start learning first in French and then in German. If extended to more schools, this approach could help improve the performance of pupils whose first language is not French. Luxembourg also increased its supply of public international schools: as of 2022/2023, 4 % of the pupils at pre-primary and primary levels are enrolled in such schools, where they can choose between English, French or German as the language of instruction. If this option of teaching through one main language were extended to cover a larger part of the school population, it could substantially improve pupils' chances of attaining better learning outcomes.

(33) Luxembourg's energy system is characterised by high import dependence and reliance on fossil fuels. The country is a large net importer of energy. It is almost entirely dependent on primary energy imports, with a dependency rate of 92 % in 2021. Oil provided 69 % of Luxembourg's energy mix, and natural gas 18 %, while 12 % came from renewable energy sources, reaching a capacity of 572 MW in 2022. Luxembourg imports no oil from Russia. As regards gas, dependency on Russia is limited, as nearly 100 % of the gas Luxembourg consumed was imported by pipelines from Belgium and Germany, flowing from Norway and the Netherlands. Luxembourg's consumption of natural gas dropped by 26 % in the period August between 2022 and March 2023, compared with the average gas consumption over the same period in the preceding five years, beyond the 15 % reduction target laid down in Council Regulation (EU) 1369/2022²⁰. Luxembourg could keep pursuing efforts to temporarily reduce gas demand until 31 March 2024 pursuant to Council Regulation (EU) 2023/706²¹.

²⁰ Council Regulation (EU) 2022/1369 of 5 August 2022 on coordinated demand-reduction measures for gas (OJ L 206, 8.8.2022, p. 1).

²¹ Council Regulation (EU) 2023/706 of 30 March 2023 amending Regulation (EU) 2022/1369 as regards prolonging the demand-reduction period for demand-reduction measures for gas and reinforcing the reporting and monitoring of their implementation (OJ L 93, 31.3.2023, p. 1).

(34) While Luxembourg is highly interconnected in terms of both power and gas, further investment will be needed in anticipation of growing renewable generation and power demand. Luxembourg has to address the challenge of insufficient housing supply while achieving its energy and climate targets. There is also a need to renovate the existing building stock. With 20,8 % of the total energy saving potential (in terms of GWh), the residential building and renovation sector represents the second-largest source of cumulative energy saving potential by 2030. Around 89 % of residential building stock uses heating systems based on fossil fuels (heating oil and natural gas). Municipalities will have a key role in this respect. Road traffic congestion weighs on the economy and on environmental sustainability. Transport accounts for a significant share of oil consumption and for 59 % of total greenhouse gas emissions, which compares to an Union average of 24 % in 2019. While Luxembourg adopted some relevant measures to improve sustainable transport, additional, more targeted interventions would substantially help reduce oil dependence and greenhouse emissions. This is reflected in Luxembourg's national energy and climate plan (NECP), which sets a target of 40 % of electric and plug-in vehicles for its vehicle fleet by 2030. Luxembourg has set itself the target of becoming climate neutral by 2050. It has made considerable progress in recent years on renewable energies but remains one of the Member States with the lowest share of those energies. 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.

- (35) Labour and skills shortages in sectors and occupations key for the green transition, including manufacturing, deployment and maintenance of net-zero technologies, are creating bottlenecks in the transition to a net-zero economy. High quality education and training systems that respond to changing labour market needs and targeted upskilling and reskilling measures are key to reducing skills shortages and promoting labour inclusion and reallocation. To unlock untapped labour supply, those measures need to be accessible, in particular for individuals and in sectors most affected by the green transition. While Luxembourg has increased its efforts to upskill and reskill workers in declining and transforming sectors, labour shortages persist in some occupations, including policy and planning managers. Those labour shortages might lead to a possible bottleneck in the green transition and in the implementation of REPowerEU.
- (36) In the light of the Commission's assessment, the Council has examined the 2023 Stability Programme and its opinion²² is reflected in recommendation (1).

²² Under Article 5(2) of Regulation (EC) No 1466/97.

(37) In view of the close interlinkages between the economies of euro-area Member States and their collective contribution to the functioning of the economic and monetary union, the Council recommended that the euro-area Member States take action, including through their recovery and resilience plans, to (i) preserve debt sustainability and refrain from broad-based support to aggregate demand in 2023, better target fiscal measures taken to mitigate the impact of high energy prices and reflect on appropriate ways to wind down support as energy price pressures diminish; (ii) sustain a high level of public investment and promote private investment to support the green and digital transitions; (iii) support wage developments that mitigate the loss in purchasing power while limiting second-round effects on inflation, further improve active labour-market policies and address skills shortages; (iv) improve the business environment and ensure that energy support to companies is cost-effective, temporary and targeted to viable firms and that it maintains incentives for the green transition; and (v) preserve macro-financial stability and monitor risks while continuing to work on completing the banking union. For Luxembourg, recommendations (1), (2) and (4) contribute to the implementation of the first, second, third, fourth and fifth recommendations set out in the 2023 Recommendation on the euro-area,

HEREBY RECOMMENDS that Luxembourg take action in 2023 and 2024 to:

1. 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. Should renewed energy price increases necessitate new or continued support measures, ensure that such support measures are targeted at protecting vulnerable households and firms, are fiscally affordable, and preserve incentives for energy savings.

Ensure prudent fiscal policy, in particular by limiting the nominal increase in nationally financed net primary expenditure in 2024 to not more than 4,8 %²³.

Preserve nationally financed public investment and ensure the effective absorption of grants under the Facility and of other Union funds, in particular to foster the green and digital transitions.

For the period beyond 2024, continue to pursue a medium-term fiscal strategy of gradual and sustainable consolidation, combined with investments and reforms conducive to higher sustainable growth, in order to achieve a prudent medium-term fiscal position.

Reduce risks related to the housing market, in particular by reducing mortgage interest deductibility and by taking measures to increase the supply of buildable land. 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. 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.

²³ Which is estimated to correspond to an annual improvement in the structural budget balance of at least 0,3% of GDP for 2024, as described in recital 24.

2. Proceed with the steady implementation of its revised recovery and resilience plan and swiftly finalise the REPowerEU chapter with a view to rapidly starting the implementation thereof. Proceed with the swift implementation of cohesion policy programmes, in close complementarity and synergy with the recovery and resilience plan.
3. Improve the performance of the school education system and promote equal opportunities for all students, in particular by adapting teaching to the needs of disadvantaged students and those from various linguistic backgrounds.
4. Reduce reliance on fossil fuels by accelerating the deployment of renewable energy, increasing electricity transmission capacity, easing permitting procedures and investing in energy efficiency in both the residential and non-residential sectors. Support municipalities in developing detailed local plans for deploying renewable energy, including wind power and photovoltaics, and for district heating and cooling systems. Further promote the electrification of transport and invest in public transport networks and infrastructure. Step up policy efforts aimed at the provision and acquisition of skills and competences needed for the green transition.

Done at Brussels,

For the Council

The President
