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To: Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union

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**COMMISSION STAFF WORKING DOCUMENT**

**Analysis of the Draft Budgetary Plan of Luxembourg**

*Accompanying the document*

**COMMISSION OPINION**

**on the Draft Budgetary Plan of Luxembourg**

{C(2020) 8512 final}

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## EXECUTIVE SUMMARY

- After a real GDP growth rate of 2.3% in 2019, economic activity is set to contract sharply due to the COVID-19 crisis in 2020. According to the Draft Budgetary Plan by -6% and according to the Commission autumn forecast by -4.5%. For 2021, the Draft Budgetary Plan projects GDP a rebound by 7%. The Commission projects a slower recovery with a real GDP growth of 3.9% in 2021. The difference is largely explained by the less negative (2020) and less positive (2021) net exports contribution to GDP growth in the Commission forecast.
- In the Draft Budgetary Plan, the headline balance is expected to deteriorate sharply in 2020 to reach a deficit of 7.4% of GDP and fall to 2.7% of GDP in 2021. According to the Commission, Luxembourg is projected to have a headline deficit of 5.1% of GDP in 2020 and 1.3% of GDP in 2021. The Draft Budgetary Plan and likewise the Commission forecast do not take into account the implementation of the reforms and investments, and their associated costs, envisaged under the Recovery and Resilient Facility.
- The macroeconomic and fiscal outlook continue to be affected by high uncertainty due to the COVID-19 pandemic. Deficit-increasing measures adopted in 2020 to fight the pandemic and to assuage its adverse socio-economic effects amount to 3.1% of GDP according to the Commission forecast. They comprise, among others, extraordinary healthcare expenditure, expansion of the short-time working scheme to all economic sectors and subsidies to support small and medium-sized enterprises. Liquidity measures and public guarantees aimed to support firms, amount to about 13.4% of GDP and do not entail immediate budgetary impact. Overall, the measures taken by Luxembourg in 2020 were in line with the guidelines of the Commission Communication of 13 March 2020 on a coordinated economic response to the COVID-19 outbreak.
- Planned new measures in 2021 aim at supporting the economic recovery and amount to 0.2% of GDP. They include the introduction of a carbon tax, measures to improve social equity, the acceleration of the environmental and digital transition.
- Public debt stood at 22.0% of GDP at end of 2019. According to the Draft Budgetary Plan, it is projected to rise to 27.4% of GDP in 2020, and to further increase to 29.4% in 2021. In its autumn forecast, the Commission expects the public debt-to-GDP ratio to reach 25.4% of GDP in 2020, and to increase to 27.3% in 2021.
- On 20 May 2020, the Commission has prepared a report under Article 126(3) TFEU analysing whether Luxembourg was compliant with the deficit criterion of the Treaty. Overall, the analysis suggested that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 was not fulfilled. In light of the exceptional uncertainty created by the outbreak of COVID-19 and its extraordinary macroeconomic and fiscal impact, including for designing a credible path for fiscal policy, which will have to remain supportive in 2021, the

Commission considered that a decision on whether to place Member States under the Excessive Deficit Procedure should not be taken. .

- Overall, the Commission considers that most of the measures set out in the Draft Budgetary Plan of Luxembourg are supporting economic activity against the background of considerable uncertainty. At the same time, it is useful to regularly review the use, effectiveness and adequacy of the support measures and stand ready to adapt them as necessary to changing circumstances.

## 1. INTRODUCTION

This document assesses the economic and budgetary projections contained in the 2021 Draft Budgetary Plan of Luxembourg (hereafter called the Plan), which was submitted on 14 October 2020<sup>1</sup> in compliance with Regulation (EU) No 473/2013.

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact and on 23 March 2020 the Ministers of Finance of the EU Member States agreed with the Commission assessment. The clause facilitates the coordination of budgetary policies in times of severe economic downturn. As indicated in the Annual Sustainable Growth Strategy 2021<sup>2</sup> and as communicated in the letter of 19 September 2020 from the Commission to the EU Ministers of Finance<sup>3</sup>, the activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective of each Member State, which should continue to provide targeted and temporary fiscal support in 2021, provided that this does not endanger fiscal sustainability in the medium term. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

Public finances in 2021 are also expected to be influenced by the proposed establishment of the Recovery and Resilience Facility (RRF), alongside the proposal for the reinforced long-term budget of the EU for 2021-2027. RRF is envisaged to provide a total envelope of EUR 672.5 billion in loans and non-repayable financial support (grants) to support the implementation of investments and reforms in the EU Member States. The 2021 Draft Budgetary Plan of Luxembourg does not take into account the implementation of the reforms and investments, and their associated costs, envisaged under the Recovery and Resilience Facility (RRF).

On 20 May 2020, the Commission issued a report under Article 126(3) TFEU, as Luxembourg's general government deficit in 2020 was planned to exceed the 3% of GDP Treaty reference value. The report concluded that, after the assessment of all

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<sup>1</sup> An English translation of the 2021 Draft Budgetary Plan was submitted on 21 October 2020.

<sup>2</sup> Communication from the Commission on Annual Sustainable Growth Strategy 2021, Brussels, 17.9.2020, COM(2020) 575 final.

<sup>3</sup> [https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/annual-draft-budgetary-plans-dbps-euro-area-countries/draft-budgetary-plans-2021\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/annual-draft-budgetary-plans-dbps-euro-area-countries/draft-budgetary-plans-2021_en)

relevant factors, the deficit criterion was not fulfilled. In light of the exceptional uncertainty created by the outbreak of COVID-19 and its extraordinary macroeconomic and fiscal impact, including for designing a credible path for fiscal policy, which will have to remain supportive in 2021, the Commission considered that a decision on whether to place Member States under the Excessive Deficit Procedure should not be taken.

## **2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN**

The Luxembourg economy is deeply impacted by the COVID-19 pandemic. The government introduced a lockdown on March 15<sup>th</sup> and gradually started relaxing the measures from the end of April. However, the lockdown and the ongoing restrictions are expected to have a large negative impact on economic activity. This is reflected in the macroeconomic scenario included in the 2021 Draft Budgetary Plan that expects a real GDP contraction of 6% in 2020. For 2021, the Plan projects a rebound of 7% real GDP growth. The macroeconomic scenario underlying the Plan was prepared by the National Statistical Office (STATEC) at the end of August 2020. The headline GDP projections for 2020 and 2021 are the same as in the 2020 Stability Programme, however the GDP components are quite different. For 2020, the contraction in private consumption and investments is larger and the external sector performs better than anticipated in the Stability Programme. For 2021, the Plan forecast a higher rebound in domestic demand and a smaller recovery in net exports versus the Stability Programme. In any case, in the current juncture, the macroeconomic and fiscal outlook continue to be affected by high uncertainty due to the COVID-19 pandemic and its economic consequences.

In the Draft Budgetary Plan, the decline in economic activity in 2020 is mainly driven by the negative contribution of net exports, as exports of goods and services are expected to decline more than imports. In addition, a sharp contraction in domestic demand is projected, as the strong decline in private consumption and gross fixed capital formation due to the impact of the COVID-19 crisis is only partially cushioned by the strong fiscal response. The two economic support programmes launched by the government, to tackle the impact of the COVID-19 crisis on the economy, are expected to lead to higher government consumption and investments in 2020. For 2021, a strong rebound in all GDP components is projected, again supported by fiscal policy, resulting in a recovery of 7% of real GDP growth. The decline in economic activity in 2020 causes a slowdown in the labour market where employment growth is expected to slow down from 3.6% to 1.9% and the unemployment rate to increase from 5.6% to 7.1% between 2019 and 2021.

The Commission autumn 2020 forecast projects a smaller real GDP decline of 4.5% in 2020 followed by a lower rebound of 3.9% in 2021 versus the Plan. This is mainly the results of a lower decline and rebound in international trade. This leads in the Commission autumn forecast to a smaller negative contribution to GDP growth from net exports in 2020 and a lower positive one in 2021. The relatively well performing financial sector and the lower share in GDP of the most affected sectors by the COVID-19 crisis is projected to result in a less significant economic decline in Luxembourg in 2020 compared to other EU countries. The macroeconomic scenario in the Plan had a cut-off date of end of August, while the Commission forecast was finalised in October and therefore could incorporate the second quarter GDP data

and the balance of payment data up to August 2020. In particular, figures from the balance of payments shows that trade in financial services held up well as the financial sector is performing relatively well in the current economic environment.

The macroeconomic forecast used in the Draft Budgetary Plan is independently produced by the national statistical office (STATEC).

**Table 1. Comparison of macroeconomic developments and forecasts**

	2019	2020			2021		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	2.3	-6.0	-6.0	-4.5	7.0	7.0	3.9
Private consumption (% change)	2.8	-1.6	-5.3	-9.4	3.2	6.6	6.0
Gross fixed capital formation (% change)	3.9	2.7	-8.3	-15.5	0.7	9.1	9.6
Exports of goods and services (% change)	0.8	-7.6	-5.8	-3.3	11.9	7.8	2.0
Imports of goods and services (% change)	0.9	-4.9	-4.8	-3.7	10.4	6.9	2.3
<i>Contributions to real GDP growth:</i>							
- Final domestic demand	2.3	0.7	-2.6	-4.1	1.5	3.2	3.7
- Change in inventories	-0.2	0.1	0.0	0.0	0.0	0.0	0.0
- Net exports	0.2	-6.8	-3.4	-0.4	5.5	3.8	0.2
Output gap <sup>1</sup>	0.0	-5.5	-7.3	-6.3	-0.7	-2.7	-4.7
Employment (% change)	3.6	0.7	1.9	2.0	1.0	1.9	2.0
Unemployment rate (%)	5.6	6.7	6.5	6.6	7.3	7.2	7.1
Labour productivity (% change)	-1.3	0.0	-7.8	-6.3	0.0	5.0	1.9
HICP inflation (%)	1.6	-0.5	0.1	0.2	1.9	1.5	1.5
GDP deflator (% change)	3.4	-0.6	-1.1	-0.2	2.2	1.9	1.4
Comp. of employees (per head, % change)	1.7	0.0	-5.8	-5.3	0.0	6.3	2.3
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1.5	n.a.	n.a.	0.1	n.a.	n.a.	0.6

Note:

<sup>1</sup>In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Stability Programme 2020 (SP); Draft Budgetary Plan for 2021 (DBP); Commission 2020 autumn forecast (COM); Commission calculations

### 3. RECENT AND PLANNED FISCAL DEVELOPMENTS

On 20 July 2020 the Council addressed recommendations to Luxembourg in the context of the European Semester. In the area of public finances and in line with the general escape clause, the Council recommended Luxembourg to take all necessary measures to effectively address the pandemic, sustain the economy and support the ensuing recovery. When economic conditions allow, Luxembourg should pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

#### 3.1. Deficit developments

The Draft Budgetary Plan projects a headline deficit of 7.4% of GDP in 2020. In the Stability Programme of May 2020, the deficit was planned at 8.5% of GDP. With similar economic underlying assumption, the upward revision is to a large extent explained by an upward revision of revenues. In turn, the Commission 2020 autumn

forecast projects a lower deficit, of 5.1% of GDP, partly explained by less negative growth projections.

The revenue-to-GDP ratio in the Plan is similar to the one in the Commission forecast, although resulting from a slightly different composition of revenue categories. In particular, given a more negative macroeconomic outlook, compared to the Commission forecast, the Draft Budgetary Plan posts a deeper drop in proceeds from direct taxation, compensated by more dynamic receipts from indirect taxation, social contributions and other residual sources.

The lower deficit projected by the Commission is due to lower projection for current expenditure, in particular compensation of employees and intermediate consumption and as well lower projection for capital expenditure, notably public investment. In any case, similarly to the macroeconomic forecasts, any budgetary projections in the current circumstances are subject to a high degree of uncertainty.

Reflecting the lower headline deficit in the Commission forecast, the structural balance is expected to experience a milder deterioration than the recalculated structural balance<sup>4</sup> based on data from the Plan. The more negative output gap in the Plan only partially offset the difference in the headline balance between the Plan and the Commission forecast. Both the Draft Budgetary Plan and the Commission forecast do not consider the measures adopted to combat the effects of the COVID-19 pandemic as one-offs.<sup>5</sup>

For 2021, the Draft Budgetary Plan projects a deficit at 2.7% of GDP. It includes new measures to support the recovery and the twin transition, both on revenue and expenditure side, equivalent in total to 0.2% of GDP. The improvement in the headline balance with respect to 2020 is explained by the expected economic rebound and the phasing out of the temporary measures implemented to contain the economic effects of the pandemic. In line with its no-policy change assumption, the Commission forecast includes revenues and expenditure which are sufficiently detailed and credibly announced in the Draft Budgetary Plan. The Plan does not take into account the implementation of the reforms and investments, and their associated costs, envisaged under the Recovery and Resilience Facility (RRF)<sup>6</sup>. Likewise, in line with its no-policy change assumption, the Commission forecast includes no expenditure related to the Recovery and Resilience Facility.

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<sup>4</sup> Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology. The estimates of the structural budget balance are affected by high uncertainty due to the economic consequences of the COVID-19 pandemic.

<sup>5</sup> The Commission has not classified COVID-19-related measures as one-off in its autumn 2020 forecast because the one-off classification does not appear to be the best suited for several of the measures taken in response to the COVID-19 pandemic. The Commission has a well-developed set of principles for defining what is a one-off measure for the purpose of fiscal surveillance. That methodology is relatively restrictive, for example excluding compensatory payments to households or businesses not directly triggered by the pandemic and for which the government has a larger degree of discretion. Moreover, given the large uncertainties on the duration and the impact of certain measures, most measures would not qualify as one-off in an ex ante assessment. The Commission favours taking into account such measures as part of its application of the Stability and Growth Pact under the activation of the General Escape Clause.

<sup>6</sup> The statistical treatment of the financial support provided by the Recovery and Resilience Facility is subject to ongoing discussions between Eurostat and the Member States.



The Commission 2020 autumn forecast projects the headline deficit to decline to 1.3% of GDP. This mainly reflects, on top of the different starting point from the 2020 deficit projection compared to the DBP, the significant expected rebound in economic growth and the phasing out of the temporary measures implemented to contain the economic effects of the pandemic. However, some of the measures are expected to still have an impact in 2021. In particular, the Commission forecast factors in an impact equivalent at 0.1% of GDP from the prolongation of measures in support of jobs. For the time being, since the submission of the Recovery and Resilience Plans and their subsequent approval are expected to take place in 2021, the Commission forecast assumes, in its budgetary projection for 2021, the 10% pre-financing of Recovery and Resilience Facility grants<sup>7</sup> as a financial transaction with no impact on the budget balance in 2021, but a public debt-reducing impact.

Compared to the Plan, the revenue-to-GDP ratio in 2021 is higher in the Commission forecast. The higher revenue-to-GDP ratio is explained by differences in underlining revenues elasticities, thus higher proceeds from direct taxation in the Commission's projections than in Draft Budgetary Plan.

The Plan projects the re-calculated structural balance to notably improve. However, a mechanical reading of traditional indicators is not well suited at the current juncture to assessing the fiscal stance. The introduction and subsequent withdrawal of sizeable temporary emergency measures distort the picture, as the corresponding changes in the level of public spending from one year to the next affect the indicators used to assess the fiscal stance. Excluding the temporary emergency measures from the calculation of the fiscal stance indicators provides a more representative assessment of the underlying fiscal support to economic activity.<sup>8</sup>

Risks related to the sizeable amount of public guarantees issued in response to the crisis appear to be minor, as their take up have been modest (equivalent to 0.2% of GDP) so far. The possibility that some of these guarantees could be called represents then a limited downward risk to the government balance in 2021 and subsequent years.

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<sup>7</sup> The amount of pre-financing is based on the Council Presidency compromise proposal for the RRF regulation (11538/20) of 7 October 2020, on which the Council Presidency obtained a mandate for conducting the negotiations with the European Parliament

<sup>8</sup> The measure of the output gap is complicated in the face of a sharp economic turnaround and very high level of economic uncertainty.

**Table 2. Composition of the budgetary adjustment**

(% of GDP)	2019		2020		2021			Change: 2019-2021	
	COM	DBP	SP	DBP	COM	SP	DBP	COM	DBP
<b>Revenue</b>	<b>44.6</b>	<b>44.6</b>	<b>44.1</b>	<b>45.4</b>	<b>45.6</b>	<b>43.5</b>	<b>44.5</b>	<b>46.2</b>	<b>-0.1</b>
<i>of which:</i>									
- Taxes on production and	11.4	11.4	11.0	11.3	11.2	11.1	11.5	11.4	0.1
- Current taxes on income,	16.5	16.5	15.0	15.8	16.5	15.2	15.4	16.7	-1.1
- Capital taxes	0.2	0.2	0.4	0.2	0.2	0.4	0.2	0.2	0.0
- Social contributions	12.1	12.1	13.1	13.5	13.4	12.3	12.9	13.5	0.8
- Other (residual)	4.4	4.4	4.6	4.6	4.3	4.5	4.5	4.5	0.1
<b>Expenditure</b>	<b>42.2</b>	<b>42.2</b>	<b>52.6</b>	<b>52.8</b>	<b>50.8</b>	<b>46.5</b>	<b>47.2</b>	<b>47.5</b>	<b>5.0</b>
<i>of which:</i>									
- Primary expenditure	41.9	41.9	52.4	52.6	50.5	46.4	47.0	47.3	5.1
<i>of which:</i>									
Compensation of employees	10.0	10.0	11.6	11.6	11.2	11.1	11.2	11.1	1.2
Intermediate consumption	4.1	4.1	4.8	5.2	4.6	4.5	4.6	4.6	0.5
Social payments	18.2	18.2	22.7	22.8	22.8	19.7	20.3	20.5	2.1
Subsidies	1.2	1.2	1.3	1.4	1.3	1.2	1.3	1.4	0.1
Gross fixed capital formation	4.0	4.0	5.5	5.9	5.2	4.7	4.6	4.9	0.6
Other (residual)	4.5	4.5	6.5	5.7	5.3	5.2	5.0	4.9	0.5
- Interest expenditure	0.3	0.3	0.2	0.2	0.3	0.1	0.2	0.3	-0.1
<b>General government balance (GGB)</b>	<b>2.4</b>	<b>2.4</b>	<b>-8.5</b>	<b>-7.4</b>	<b>-5.1</b>	<b>-3.0</b>	<b>-2.7</b>	<b>-1.3</b>	<b>-5.1</b>
<b>Primary balance</b>	<b>2.7</b>	<b>2.7</b>	<b>-8.2</b>	<b>-7.2</b>	<b>-4.8</b>	<b>-2.9</b>	<b>-2.6</b>	<b>-1.0</b>	<b>-5.3</b>
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>GGB excl. one-offs</b>	<b>2.4</b>	<b>2.4</b>	<b>-8.5</b>	<b>-7.4</b>	<b>-5.1</b>	<b>-3.0</b>	<b>-2.7</b>	<b>-1.3</b>	<b>-5.1</b>
Output gap <sup>1</sup>	0.0	0.3	-5.5	-7.3	-6.3	-0.7	-2.7	-4.7	-3.0
Cyclically-adjusted balance <sup>1</sup>	2.4	2.3	-6.0	-4.0	-2.2	-2.7	-1.4	0.8	-3.7
<b>Structural balance (SB)<sup>2</sup></b>	<b>2.4</b>	<b>2.3</b>	<b>-6.0</b>	<b>-4.0</b>	<b>-2.2</b>	<b>-2.7</b>	<b>-1.4</b>	<b>0.8</b>	<b>-3.7</b>
Structural primary balance <sup>2</sup>	2.7	2.6	-5.8	-3.8	-1.9	-2.6	-1.2	1.1	-3.8

**Notes:**

<sup>1</sup> Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/Programme as recalculated by Commission on the basis of the DBP/Programme scenario using the commonly agreed methodology.

<sup>2</sup> Structural (primary) balance corresponds to cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

**Source:**

Stability Programme 2020 (SP); Draft Budgetary Plan for 2021 (DBP); Commission 2020 autumn forecast (COM); Commission calculations

### 3.2. Debt developments

In the Draft Budgetary Plan, the public debt-to-GDP ratio is planned to rise by 5.4 percentage points, to reach 27.4% of GDP at the end 2020, still well below the Treaty threshold of 60% and under the 30% threshold set by government. The increase is mostly explained by the need to finance the deficit of the central government, while the social security sector is still expected to post a surplus. According to the national law, the surpluses of the social security sector are allocated to a reserve fund ("Fonds de compensation commun au régime général de pension") so as to cover future pension expenditure and they cannot be used to finance the needs of the central government. The stock-flow adjustment contributes to decreasing the debt, mainly as a result of the EUR 2.5 billion debt matured in May 2020 and already partially financed in 2019. Furthermore, a 'sustainability' bond for EUR 1.5 billion has been issued to finance green and social projects. For 2021, the Draft Budgetary Plan projects the debt ratio to increase further to 29.4% of GDP, still due to the need to finance the deficit of the central government.

The debt projections in the Plan are somewhat lower than in the Stability Programme due to the lower primary deficits projected in the Draft Budgetary Plan. Compared to the Stability Programme, the growth rates for the headline GDP have not been reviewed in the Plan, although the composition of GDP growth is different.

In turn, the Commission 2020 autumn forecast projects a lower increase for the debt ratio for both years. The main difference between the two sets of projections mostly stems from the higher primary deficit planned by the Luxembourg authorities in both 2020 and 2021.

**Table 3. Debt developments**

(% of GDP)	2019	2020			2021		
		SP	DBP	COM	SP	DBP	COM
<b>Gross debt ratio<sup>1</sup></b>	<b>22.0</b>	<b>28.7</b>	<b>27.4</b>	<b>25.4</b>	<b>29.6</b>	<b>29.4</b>	<b>27.3</b>
Change in the ratio	1.0	6.7	5.4	3.4	0.9	2.0	1.9
Contributions <sup>2</sup> :							
<b>1. Primary balance</b>	<b>-2.7</b>	<b>8.2</b>	<b>7.2</b>	<b>4.8</b>	<b>2.9</b>	<b>2.6</b>	<b>1.0</b>
<b>2. “Snow-ball” effect</b>	<b>-0.8</b>	<b>1.9</b>	<b>1.9</b>	<b>1.4</b>	<b>-2.3</b>	<b>-2.1</b>	<b>-1.0</b>
<i>Of which:</i>							
Interest expenditure	0.3	0.2	0.2	0.3	0.1	0.2	0.3
Real growth effect	-0.5	1.4	1.4	1.0	-1.8	-1.8	-0.9
Inflation effect	-0.7	0.2	0.3	0.1	-0.6	-0.5	-0.3
<b>3. Stock-flow adjustment</b>	<b>4.6</b>	<b>-3.3</b>	<b>-3.6</b>	<b>-2.8</b>	<b>0.3</b>	<b>1.6</b>	<b>1.9</b>
<i>Of which:</i>							
Cash/accruals difference		n.a.	n.a.		n.a.	n.a.	
Net accumulation of financial		n.a.	n.a.		n.a.	n.a.	
of which privatisation proceeds		n.a.	n.a.		n.a.	n.a.	
Valuation effect & residual		n.a.	n.a.		n.a.	n.a.	

Notes:

<sup>1</sup> End of period.

<sup>2</sup> The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source:

Stability Programme 2020 (SP); Draft Budgetary Plan for 2021 (DBP); Commission 2020 autumn forecast (COM); Commission calculations

#### **4. MEASURES UNDERPINNING THE DRAFT BUDGETARY PLAN**

The Draft Budgetary Plan focuses on the policy response undertaken in the context of the COVID-19 outbreak in 2020 and the measures planned to sustain the recovery in 2021. Supportive fiscal measures should be tailored to the specific situation of each Member State, but as a rule, they should be well targeted and temporary. Their use and effectiveness should be regularly reviewed by the Luxembourg national authorities. Depending on the development of the pandemic, emergency fiscal measures should be adjusted and combined with other measures that improve economic fundamentals, support the green and digital transition and have a positive impact on demand.

#### **4.1. Measures in 2020**

In response to the COVID-19 pandemic, and as part of a coordinated Union approach, Luxembourg adopted in 2020 timely budgetary measures to increase the capacity of its health system, contain the pandemic, and provide relief to those individuals and sectors that have been particularly affected. According to the 2020 Draft Budgetary Plan, those budgetary measures amount to 5.1% of GDP in 2020. Those measures include the funding of the expansion of the short-time working scheme to all economic sectors, a special leave for family reason and the coverage for the first day of incapacity to work together equivalent to 2.9% of GDP. Additional expenditure of 0.4% of GDP has been allocated to strengthen healthcare services, health insurance allowances and compensation of healthcare personnel. The remaining, measures aims at providing support to the sector hardest hit from the crisis, and in particular to small and very small enterprises as well as self-employed. The Commission 2020 autumn forecast has taken on board the measures reported in the Draft Budgetary Plan, however with a lower estimate of their budgetary impact (3.1% of GDP). The Commission forecast considers a large share of the expenditure on short-term work schemes as part of the operation of the automatic stabilisers, whereas the Plan appears to report the gross impact of these schemes. In addition, in the Commission forecast, the granting of repayable advances (0.7% of GDP) is not considered as a discretionary measure with a budgetary impact contrary to the Plan.

In addition, Luxembourg has adopted measures that, while not having a direct impact on the deficit, contributed to provide liquidity support to businesses, which the 2021 Draft Budgetary Plan estimates at 13.4% of GDP. These measures include tax and social charges deferrals for companies; accelerated refund of tax and VAT credit (equivalent at 7.7% of GDP) and loan guarantees (5.7% of GDP). According to the data annexed to the Draft Budgetary Plan the take-up of liquidity guarantees is estimated at 0.2% of GDP at the time of the submission of the Plan.

Overall, the measures taken by Luxembourg in 2020 were in line with the guidelines of the Commission Communication of 13 March 2020 on a coordinated economic response to the COVID-19 outbreak.

#### **4.2. Measures in 2021**

For 2021, the Plan presents a set of new measures aiming at supporting the economic recovery. The package is equivalent to 0.2% of GDP and includes measures both on the revenue and the expenditure side.

On the revenues side, the package of fiscal measures is expected to promote social equity, ecological transition and safeguard and improve the long-term competitiveness of the national economy. Amongst these measures, the introduction of a carbon tax is planned. It is expected that the measure will have a negative impact on the public finances of around EUR 40 million. The projected increase in fuel prices, decreasing the price differential with the neighbouring countries, will eventually lead to a reduction in the fuel sales, the impact of which will be larger than the additional revenues from higher fuel prices. Other measures include the abolition of the stock option regime, the revision of the taxation regime for real estate investment by Specialised Investment Fund and measures aiming at lower taxation of

labour income. These measures are expected to have an overall neutral budgetary impact.

On the expenditure side measures aim at supporting the strategic policy objectives of the European Green Deal and the Digital Agenda for Europe. The overall cost of these measures is estimated at around EUR 61 million (0.1% of GDP).

All the measures are presented in sufficient detail in the Draft Budgetary Plan and thus included in the Commission forecast, with no difference in their assessment.

Based on the information presented in the Draft Budgetary Plan and taking into account the Commission 2020 autumn forecast, the measures planned by Luxembourg in 2021 are supporting the recovery of economic activity against the background of considerable uncertainty. At the same time, it is useful to regularly review the use, effectiveness and adequacy of the support measures and stand ready to adapt them to changing circumstances.

It is anticipated that Luxembourg will submit its Recovery and Resilience Plan in 2021. The Regulation establishing a Recovery and Resilience Facility will set out how the Commission is to assess that the reforms and investments included in the Recovery and Resilience Plan are coherent with the policy priorities of the Union and the challenges identified in the context of the European Semester. This assessment by the Commission will inform the approval of the Plan by the Council and the information to the European Parliament.

**Table 4.1.a. Main discretionary measures reported in the Draft Budgetary Plan**

List of measures	Description	ESA Code (Expenditure / Revenue component)	Adoption Status	Budgetary impact (% of GDP - change from previous year - positive sign for deficit-increasing measures)	
				2020	2021
1	Implementation of a CO2 tax	D2/Revenue	Planned		0.1
2	Package of fiscal measures in favour of social equity, ecological transition and long-term competitiveness	D2-D5/Revenue	Planned		0.0
3	Increase in certain public expenses	P2/Expenditure	Planned		0.0
4	Investment to support the twin transition	P.51/Expenditure	Planned		0.0
5	Measures in the field of education	D62/Expenditure	Planned		0.0
6	Different kind of transfers	D7/Expenditure	Planned		0.0
7	Housing pact 2.0	D9/Expenditure	Planned		0.0
				<b>Total</b>	<b>0.2</b>

**Table 4.1.b. Guarantees adopted/announced in response to COVID-19 outbreak**

List of measures	Description	Adoption status	Maximum guarantee framework available* (% of GDP)	Current take-up (actual contingent liabilities, % of GDP)
1	State – Guarantee scheme for new bank loans	Adopted	4.2	0.2
	SNCI - Special anticrisis financial instrument	Adopted	0.7	<0.1
	SNCI – SME guarantees	Adopted	0.3	<0.1
	Office du Ducroire	Adopted	0.3	<0.1
	BEI - Luxembourg contribution	Adopted	0.1	n.a.
	SURELuxembourg contribution	Adopted	0.1	n.a.
	<b>Total</b>		<b>5.7</b>	<b>0.2</b>

\*Any budgetary impact related to expected losses or actual calls should be provided in the standard table 5.1 Description of discretionary measures included in the draft budget (see Code of Conduct, [https://ec.europa.eu/economy\\_finance/economic\\_governance/sgp/pdf/coc/2014-11-7\\_two\\_pack\\_coc\\_amended\\_en.pdf](https://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/coc/2014-11-7_two_pack_coc_amended_en.pdf))

## **5. ANNEX**

### **Mandatory variables not included in the Draft Budgetary Plan**

The following mandatory data were not explicitly provided:

- Table 1c. Labour market developments: 2019 levels of unemployment rates
- Table 1d. Net lending/borrowing vis-a-vis the rest of the world.

Not included mandatory variables do not impede the Commission's ability to assess the Draft Budgetary Plan based on the plan's assumptions.