EUROPEAN COMMISSION

Brussels, 7.6.2011
SEC(2011) 811 final

Recommendation for a

COUNCIL RECOMMENDATION

on the National Reform Programme 2011 of Luxembourg

and delivering a Council opinion

on the updated Stability Programme of Luxembourg, 2011-2014

{SEC(2011) 724 final}

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Recommendation for a

COUNCIL RECOMMENDATION

on the National Reform Programme 2011 of Luxembourg

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on the updated Stability Programme of Luxembourg, 2011-2014

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 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(3) thereof,

Having regard to the recommendation of the European Commission[2],

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

After consulting the Economic and Financial Committee,

Whereas:

(1) On 26 March 2010, the European Council agreed to the European Commission's proposal to launch a new strategy for jobs and growth, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe’s potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States,[3] which together form the “Integrated guidelines”. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

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1 OJ L 209, 2.8.1997, p. 1.
2 OJ C , p. .
3 Maintained for 2011 by Council Decision 2011/308/EU of 19 May 2011.

(3) On 12 January 2011, the Commission adopted the first Annual Growth Survey, marking the start of a new cycle of economic governance in the EU and the first European semester of ex-ante and integrated policy coordination, which is anchored in the Europe 2020 strategy.

(4) On 25 March 2011, the European Council endorsed the priorities for fiscal consolidation and structural reform (in line with the Council's conclusions of 15 February and 7 March 2011 and further to the Commission's Annual Growth Survey). It underscored the need to give priority to restoring sound budgets and fiscal sustainability, reducing unemployment through labour market reforms and making new efforts to enhance growth. It requested Member States to translate these priorities into concrete measures to be included in their Stability or Convergence Programmes and National Reform Programmes.

(5) On 25 March 2011, the European Council also invited the Member States participating in the Euro Plus Pact to present their commitments in time to be included in their Stability or Convergence Programmes and their National Reform Programmes.

(6) On 29 April 2011, Luxembourg submitted its update 2011 Stability Programmecovering the period 2011-2014 and its 2011 National Reform Programme. In order to take account of the interlinkages, the two programmes have been assessed at the same time.

(7) Considering the exceptional weight of the financial sector in the economy, Luxembourg has withstood the financial and economic crisis relatively well. After real GDP fell by 3.6% in 2009 the economy recovered quickly in 2010. GDP expanded by about 3.5%, boosted by an increase in public spending decided by the Government as part of the European Economic Recovery Programme, and by a strong increase in net exports. Employment remained resilient, partly due to a sizable recourse to short-time working arrangements, encouraged by the authorities. Unemployment began to rise from the beginning of 2008 on and broadly stabilised at about 6%, a level which is historically high in Luxembourg. Despite the recession, public finances in Luxembourg are relatively sound (a deficit of 1.7% and gross debt of 18.4% in 2010), thanks to a very favourable starting position.

(8) Based on the assessment of the updated Stability Programme pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections is slightly cautious when compared with the Commission services 2011 Spring forecast. According to the programme, the target for 2011 is a deficit of 1.0%, which is in line with the Commission services' spring forecast. The programme, under an unchanged policy scenario, projects a deterioration of the headline deficit in 2012 to 1.5% of GDP before it improves gradually again to 0.8% of GDP by 2014. The Commission services' forecast is slightly more optimistic projecting a deficit of 1.1% of GDP in 2012, based on a more favourable macro-economic scenario and a slower increase in expenditure. The programme does not foresee the achievement of the Medium Term Objective (hereinafter MTO), which is defined as a structural surplus of 0.5% of GDP, within the 2011-2014 programming period. On the contrary, the structural balance (recalculated by Commission services based on the information in the programme, following the commonly agreed methodology) is expected to deteriorate gradually from a 0.3% surplus in 2011 to a 0.8% deficit in 2014.

(9) With GDP growth projected to remain robust, Luxembourg's public finances could benefit from a further improvement of the structural balance with a view to achieving the MTO already in 2012. This would provide the country a safety margin against a possible future economic downturn and help improve long-term sustainability of public finances. Additionally, in the light of the estimated impact of the implicit liabilities related to population ageing, the country would benefit from having a more ambitious MTO.

(10) The increase in age-related public expenditure in Luxembourg in coming decades is projected to be the strongest in the EU. The short-term financing of the pension system is currently supported by a low old-age dependency ratio and depends in part on the contributions paid by the relatively young population of cross-border workers. In future, both factors will reverse and pension costs are anticipated to increase substantially. Although the government has accumulated sizeable assets and pension reserves are still growing, these will not be sufficient to ensure the sustainability of the system. In addition, the employment rate of older workers (age 55-64) at 38.2% (2009) is one of the lowest in the EU-27 (EU average: 46%). While the statutory retirement age is in principle 65 years, the Luxembourg pension system often allows retiring earlier with virtually no reduction in the pension level, which is, moreover, comparatively high. As a result, the average age of withdrawal from the labour market is 59.4 years, which weighs on the costs of the pension system. The government's plans for a pension reform foresee a new model aimed at keeping jobholders in work longer on a voluntary basis. This would improve the dependency ratio of the pension system. However, this mechanism would only concern new pensioners and only apply to the part of the career situated after the entry into force of the reform, so it would only produce its full effect in 40 years.

(11) The price and cost competitiveness of Luxembourg has deteriorated substantially since the beginning of the last decade. This is due to developments both in wages and productivity. Over the period 2000-2010, unit labour costs rose about one and a half times faster in Luxembourg than on average in the EU-15, and more than five times faster than in Germany. Given the agreement between the government and the trade unions to postpone, from Spring to October 2011, the application of the automatic wage indexation mechanism, there will be a substantial moderation of real wage growth in 2011. A decision has yet to be taken concerning the subsequent threshold. Given the current inflation outlook the next automatic indexation could fall already in spring 2012, thus wiping out the earlier gains in cost competitiveness.

(12) Despite historically strong employment growth, the employment rate of the resident population is lower than the EU average, especially at both ends of the age spectrum. Job creation in recent years has mainly benefitted non-residents. Even though the rise in unemployment since 2008 is related to the recession, it has an increasingly structural character, illustrated by the fact that during the growth years prior to the crisis, employment needed to grow at around 4% a year in order to produce a marginal decline in unemployment. Youth unemployment is relatively high at 16.1% in 2010 compared to 6% of total active population. The unemployment rate depends heavily on the educational level. Young residents face an acute competition for available jobs from non-residents, who are often as much or even more skilled.

(13) The Luxembourg government outlined a series of commitments in the context of the Euro Plus Pact.[4] These commitments refer to the four areas of the Pact. On the fiscal side, the government approved the features of a pension reform and commits itself to finalising the reform by the end of 2011. To reinforce financial stability, measures focus on boosting the resistance of the financial sector through regulation and supervision at the European and international level and pursuing the efforts to diversify the structure of the Luxembourg economy. Employment measures focus on increasing the efficiency of active employment policies (reform of the "Administration de l'Emploi") and encouraging life long learning in the private sector by a higher co-financing rate by the state. The competitiveness measures include a postponement of the indexation of wages from spring 2011 (implied by the automatic indexation system) to October 2011, and a commitment to negotiate with social partners a similar postponement for 2012. Moreover, the government committed to improve the business environment through administrative simplification and better infrastructure. They are in line with the broader reform agenda outlined in the Stability and National Reform Programmes and address challenges in the areas of pensions, competitiveness, employment (particularly of young and older workers) and the financial sector. However, some of the proposed reforms lack detail. The Euro Plus Pact commitments have been assessed and taken into account in the recommendations.

(14) The Commission has assessed the Stability Programme and National Reform Programme including the Euro Plus Pact commitments for Luxembourg[5]. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Luxembourg but also their conformity with EU rules and guidance, given the need to reinforce the overall economic governance of the European Union by providing EU level input into future national decisions. In this light, the Commission considers that a more ambitious reduction of the deficit in 2011 should be possible in view of the favourable macro-economic outlook, and that a stronger fiscal effort would allow to reach the MTO in 2012. Further steps should also be taken to reform the pension system and promote active ageing, to strengthen competitiveness, and to help young people into jobs.

(15) In light of this assessment, the Council has examined the 2011 update of the Stability Programme of Luxembourg and its opinion[6] is reflected in particular in its recommendation under (1) and (2) below. Taking into account the European Council conclusions of 25 March 2011, the Council has examined the National Reform Programme of Luxembourg,

HEREBY RECOMMENDS that Luxembourg should take action within the period 2011-2012 to:

(1) Take advantage of the improving cyclical conditions to strengthen the fiscal effort in order to further reduce the headline deficit and reach the medium-term objective in 2012.

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[4] More details on the commitments made under the Euro Plus Pact can be found SEC(2011) 724.

[5] SEC(2011) 724.

[6] Foreseen in Article 5(3) of Council Regulation (EC) No 1466/97.

(2) Propose and implement a broad pension reform to ensure the long-term sustainability of the pension system, starting with measures that will increase the participation rate of older workers, in particular by discouraging early retirement and including measures that link the statutory retirement age to life expectancy.

(3) Reform, in consultation with social partners and in accordance with national practices, the system of wage setting to ensure that wage growth better reflects developments in labour productivity and competitiveness.

(4) Take steps to reduce youth unemployment by reinforcing training and education measures aimed at better matching young people's skills to labour demand.

Done at Brussels,

For the Council
The President