LE GOUVERNEMENT
DU GRAND-DUCHÉ DE LUXEMBOURG
Ministère des Finances

11TH UPDATE OF THE LUXEMBOURG STABILITY AND GROWTH PROGRAMME FOR THE PERIOD 2009-2014

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CONTENTS

I. GENERAL GUIDELINES AND OBJECTIVES OF THE FISCAL POLICY

The present update of the stability programme has been prepared for the period 2009-2014 and thus covers the entire Government term resulting from the parliamentary elections of 7 June 2009.

The programme presents in the annexed tables the development of public finances in the case of “unchanged policies” baseline scenario. It thus describes the development of public finances (towards a substantial deterioration) on the assumption that the Government will not take any discretionary measures during the period 2011-2014 to consolidate the situation of the public finances.

However, it is not the Government’s intention to allow public finances to take such a track.

Indeed, the Government aims at re-establishing a balanced budget at the level of general government in 2014 at the latest. In order to achieve this goal, the Government will start as soon as possible a dialogue with social partners in order to find a consensus on consolidation measures to be taken. This method should contribute to a successful implementation of the strategy of consolidation of public finances and thus create the conditions to ensure the prosperity of the country in the years to come.

For the period 2008-2010, the Government implemented a counter-cyclical fiscal policy in order to preserve the stability of the financial system and to limit the negative effects of the recession on economic activity and employment.

The Government took its actions within the framework of the European Economic Recovery Plan (EERP) with a view to stimulating the demand for consumption and investment, strengthening consumer confidence, and attenuating the human cost of the economic slowdown and its impact on vulnerable people.

For this purpose, the Government adopted a set of measures that focused on six axes. First of all, it took measures to maintain household purchasing power. To support business activity, it maintained a high level of public investment and it took a series of tax and other measures. In the same way, it intensified efforts to create an administrative environment favourable to economic activity, primarily by means of reducing administrative burdens. As regards employment, the Government decided on accompanying measures for the effects of the crisis. Finally, in accordance with the objectives of the EERP, the Government also wanted to prepare for the post-crisis period with this set of measures.

In September and October 2008, the Government also took coordinated action with the Belgian, French and Dutch governments in order to give systemic support to two financial institutions and thus to ensure the stabilisation of the banking system as well as the protection of savers' deposits. The fast and effective intervention by the authorities made it possible to restore market confidence and limit the effects of contagion to the real economy.

These firm policy actions towards economic activity, employment, purchasing power and the stabilisation of the banking system have affected public finances by increasing budget deficits in 2009 and 2010 and public debt.

The medium-term budgetary strategy follows the Ecofin guidelines and those of the European Council of the 10th and 11th December 2009, namely that all policies in support of the economy will be maintained until economic recovery is fully assured. At the same time, a credible exit strategy from the recovery policies will be developed and budgetary consolidation will have to start in 2011 at the latest. Finally the budgetary strategy envisages an annual consolidation effort of at least 0.5% of GDP in structural terms and will be combined with structural reforms with a view to enhancing the long-term sustainability of public finances.

In addition, the Government declaration of 29 July 2009 lays down the multi-annual guidelines for fiscal policy. Thus, the Government is committed to keeping public finances healthy with, in the long term, both a net budgetary surplus and a low level of public debt. At the same time, it will continue to follow a careful fiscal policy in line with the objectives defined by the Stability and Growth Pact. Finally it will take the necessary measures to ensure the sustainability of public finances in particular by aiming at a sustainable reduction of the trend of growth in public expenditure. More precisely, future growth in Government expenditure must not exceed medium-term economic growth.

With regard to the concrete implementation of these guidelines, the Government has established a certain number of principles concerning public expenditure. It thus wishes to maintain a high level of public investment while it seeks to contain public expenditure related to social transfers by the introduction of more social selectivity; in the same way, it will re-examine the policy of subsidies and social allowance payments in the light of their purpose, their tax and social impacts; the Government also wants to control the growth of its operating expenditure while ensuring the quality of public services and it is committed to taking no measures that have a significant impact on the growth of public expenditure as long as the crisis continues to have a negative impact on tax revenues.

With respect to tax policy and public revenue, the Government has established guidelines as regards personal and business taxation. Thus for personal taxation, it will avoid increasing or reducing personal taxation during the crisis, or proceeding to a correction for inflation of personal taxation during the first half of the new legislative period. The Government will then adapt personal taxation according to the economic and financial situation of the country. As regards business taxation, the Government will pay particular attention to maintaining a competitive tax environment for businesses.

A certain number of circumstances make it all the more necessary for Luxembourg to take up the challenge of budgetary consolidation. Indeed, in the long run, robust and sustainable public finances play a major role in the competitiveness of an ultra-open small-scale economy such as Luxembourg which is characterized in particular by a ratio of exports to GDP mounting to approximately 180%. As regards financial activities, the current crisis will thus have major ramifications for the financial sector on a worldwide scale as well as at the national level. It must be noted that financial activities account for 32% of the added value, 22% of employment and 31% of tax revenues in Luxembourg. Moreover, fiscal policy is confronted with a situation of high volatility in public revenues due to a high degree of openness as well as to the specialised structure of the economy, whereas simultaneously, the structure and the level of public expenditure are relatively rigid in the short and medium term.

Besides the volatility of revenues, it must be noted that a change in potential growth represents a major downside risk. Indeed, the crisis will certainly have a negative impact on potential growth. Before the crisis, potential growth was around 4 to 4.5% of GDP. However, after the crisis, potential growth will decrease and be around 2.5 to 3% of GDP, which will consequently have an effect on the development of public revenues.

The budgetary consolidation proves all the more necessary as the long-term sustainability of public finances is not assured. Indeed, the impact of demographic ageing on public finances will be considerable in the scenario with unchanged policies: in the medium and long term, public expenditure related to ageing will increase by more than 10% of GDP, which is one of the largest growth rates in the European Union.

Finally, the increase in public debt and the related burden will considerably reduce budgetary leeway. Thus, affected by a possible tripling of public debt over the period 2007-2014, the interest to be paid on public debt could mount to € 500 million in 2014, approximately 1% of GDP, against 0.3% currently.

This 11th update of the stability programme describes a Luxembourg economy which will see a change in its economic growth during these years characterised by a reduction of potential growth, a reduction in employment growth and a stabilisation of the unemployment rate at a higher level. Fiscal policy will have to take these changes into account.

II. ECONOMIC SITUATION AND MACROECONOMIC FORECASTS

II.1. The economic situation in 2009

After zero growth (0%) in 2008, GDP decreased by 3.9% in 2009.

This decrease is the consequence of a simultaneous fall in all of the demand components, except public expenditure.

The substitution of private demand by public expenditure through an increase in current expenditure as well as public investment of general government thus avoided an even sharper fall in economic growth.

As far as the various components of domestic demand are concerned, one notes that household consumption drops by -0.7% due in particular to the effect of a deterioration of the situation in the labour market; private investment drops by -11%; exports of goods and services drop by -7.9%; whereas current expenditure by general government increases by 3.4% and public investment by 10%.

The rate of inflation experienced a major deceleration and reached 0.4% (NICP) in 2009.

This evolution is due to an important underlying effect related to a drop in oil prices and to general economic conditions, namely the economic recession.

This context has also implied a fall in the underlying inflation (which excludes petroleum products and other prices determined on the international markets). Indeed, it fell from 2.4% during the first quarter of 2009 to 1.8% at the end of 2009 (2.1% on average in 2009), in particular thanks to a stagnation of food prices.

Despite this drop in the actual inflation rate, prospects for inflation are orientated towards an increase: the positive underlying effect related to the drop in oil prices in 2008 finished at the end of 2009 and the global economic recovery in 2010 leads to a rise of the price of certain raw materials, in particular oil.

Finally, it should be noted that since the end of 2008, Luxembourg recorded a favourable inflation gap (a lower rate of inflation) compared to the eurozone and to its principal trading partners, its neighbouring countries. However, this trend was reversed in mid-2009. In the medium-term, this inverted trend is likely to have negative consequences in terms of price competitiveness for Luxembourg.

At the beginning of the crisis, the labour market resisted well to the economic downturn: in 2008 domestic employment increased by 4.7% and the unemployment rate was at 4.8%.

It is well known that there is a certain time delay before labour markets react to cyclical developments. Thus, the effect of the downturn of the economic situation on the labour market only materialized after 2008 with a domestic employment increase of only 1.2% and an unemployment rate increase to 6% in 2009.

With regard to the various sectors, one can note that the slowdown in employment concerns all sectors, except the non-market services (general government, education, health, social actions).

In particular, it should be noted that the drop was relatively contained in the financial sector while in industry employment fell by about -1.9%, in particular temporary work in industry decreased by 50%. The massive use of part-time work schemes made it possible to avoid additional job losses, primarily in the industry sector.

II.2. Macroeconomic forecasts: international environment

In accordance with the forecast made in autumn 2009 by the European Commission, the stability programme is based on the assumption that economic growth of the eurozone will reach 0.9% in 2010 and 1.7% in 2011.

In order to reflect the impact of the economic crisis on growth potential of the eurozone, it is supposed that the growth rate of the eurozone of 1.7% will be maintained during the period 2012-2014, whereas potential growth rate before the crisis was 2.1%.

The stability programme is based on the assumption of a normalisation of the situation on the international financial markets.

The change in oil prices and the euro exchange rate are prone to a high degree of uncertainty. For the purpose of the stability programme, the price of oil is fixed at USD 76.6 and the rate of exchange at EURO 1 = USD 1.49 during the period 2010-2014 (technical assumptions).

The short-term interest rates will gradually increase during the period 2010-2014 to reach 4.6% in 2014; the long-term interest rates will also increase gradually (from 4% in 2010 to 5.7% in 2013-2014).

II.3. Medium-term macroeconomic forecasts, 2010-2014

The Luxembourg economy came out of recession in the third quarter of 2009. The extent of the recovery (+4.4% compared to the previous quarter) as well as the improvement of the international economic context imply a forecast growth of +2.5% in 2010.

Over the period 2011-2014, the stability programme assumes a normalisation of the economic situation. During this period, economic growth will fluctuate around 3% annually, which corresponds to the new level of potential growth. Consequently, it should be noted that economic growth in 2010-2014 will be well below the average economic growth during the period 1990-2009 (+4.2%).

Inflation will remain moderate throughout the projection period. In 2010, the rate of inflation (NICP) will reach 1.6%. The average inflation during the projection period will be 1.7% and it is only from 2013 that inflation will again exceed the value of 2% which is considered by the ECB as the objective of price stability and which Luxembourg had systematically exceeded during the years before the crisis.

Inflation is moderated by a series of factors: the output gap remains negative until 2013. In addition, the unemployment rate is high and continues to increase until 2012, which will amongst other things have a moderating effect on domestic production costs, in particular wages. Thus production costs will undoubtedly see a change below their historical average, which however does not necessarily make it possible to conclude that cost-competitiveness of the economy of Luxembourg will improve, insofar as the later also depends on the trends in domestic production costs and wages in the majority of its trading partners. Finally, it should be noted that the stability programme is based on the technical assumption of an unchanged oil price during the period 2010-2014 (USD 76.6).

The delayed impact of cyclical conditions on the labour market implies that in 2010, domestic employment will decrease by about 0.5%. In parallel, the unemployment rate increases to 6% in 2009 and to 6.9% in 2010.

In the medium-term, growth of employment will become positive again from 2011 (+1%) and reach 1.6% during the period 2012-2014, under the effect of the progressive improvement of general economic conditions. It should be noted that these growth rates will definitely be lower than the average observed during the period 1990-2009 (+3.4% per annum).

Unemployment will continue to increase until 2012. It will be 7.3% in 2012, whereas the unemployment rate “in the broad sense” (active labour market policies) will be even higher (approximately 9%). Unemployment will be gradually reabsorbed from 2013, but the unemployment rate of 6.5% in 2014 will definitely be higher than the historical average of the period 1990-2009, which is 3.3%.

III. BUDGETARY SITUATION AND PUBLIC DEBT

III.1. General guidelines for fiscal policy

In the short term, taking into account the fragility of the economic recovery in 2010, the counter-cyclical fiscal policy started in 2008-2009 will be maintained during 2010.

The budgetary stimulus lies within the scope of the EERP decided by the European Council of December 2008. This plan was built on three principal pillars, namely the support of demand in accordance with the principles “timely, temporary, targeted”; the increase in public expenditure, accompanied by reductions in the tax burden on households and the support for households and business weakened by the crisis; and an increased effort to implement structural reforms within the context of the Lisbon Strategy in order to prepare for the period after the crisis.

Then, in accordance with the conclusions of the Ecofin Council and the European Council of December 2009, the budgetary consolidation will have to start in 2011 at the latest. It will have to be articulated around an ambitious and credible programme for consolidating public finances.

This is why, given the commitments at the European level, the aim of the budgetary consolidation programme is reflected by the Government’s determination to reach a balanced budgetary position for general government in 2014.

In order to ensure the credibility of such a budgetary consolidation programme and thus to promote the conditions for its successful implementation, the Government wants first of all to reach a social consensus on this objective and on the related measures and instruments to be implemented.

In addition, the sustainability of the budgetary consolidation programme implies that the budget consolidation is accompanied by structural measures aimed at reinforcing growth potential of the economy of Luxembourg and that it respects the principles of solidarity as well as of intra- and inter-generational equality.

Consequently, budgetary consolidation measures will first be on the agenda of consultations and negotiations between the Government and social partners within the framework of the tripartite coordinating committee. These talks will start timely during the first semester of 2010 in order to allow for the hereby taken decisions to be integrated in the budgetary procedure for the year 2011, making it thus possible to implement the adjustment programme from the fiscal year 2011 onwards.

With regard to the present update of the stability programme, this implies that the programme is limited to presenting the adjustment path aimed at achieving the goal of a stable budgetary balance in 2014. Thus, the Government is politically committed to achieving this goal but the measures and instruments to be implemented to reach it are not specified in this stability programme in order not to anticipate the result of the discussions with social partners and Parliament.

III.2. Medium-term fiscal objective

In accordance with the conclusions of the European Council of March 2005, the budgetary medium-term target of a Member State is determined so as to take into account budgetary and economic position and development of the Member State as well as its budgetary risks in terms of long term sustainability of public finances, notably with regard to the foreseeable demographic changes.

The medium-term objectives– in adjusted terms taking into account the economic cycle and without all specific and temporary measures – evolve between -1% of GDP for countries with a low public debt level and high growth potential and a balanced budget or one with a surplus for countries with a high level of public debt and reduced growth potential.

On this basis, Luxembourg has set itself a medium-term budgetary objective of -0.8% of GDP in 2005.

However, the conclusions of the European Council of March 2005 also specify that the implicit liabilities (related to the increasing expenditure due to demographic ageing of the population) must be taken into account as soon as adequate criteria and methods are established for this purpose and approved by the Council.

These criteria and methods were approved by the Ecofin Council in July 2009.

With unchanged policies, public expenditure related to demographic ageing will increase considerably from 2020 onwards and the implicit liabilities of Luxembourg are thus substantially higher than the "explicit" liabilities expressed by gross public debt.

Consequently, the inclusion of these implicit liabilities in the determination of the medium-term objective implies a revision of the objective itself.

The economic rationality underlying the reinforcement of the budgetary objective in the medium term is founded on the pre-financing of the implicit liabilities.

Thus, in the case of Luxembourg, a medium term budgetary objective of +0.5% of GDP in structural terms with the ensuing budget surpluses should allow providing financially for the coverage of the additional public expenditure caused by demographic ageing from here to the 2040 horizon.

Consequently, the Government sets the new budgetary objective in the medium term at 0.5% of GDP in structural terms, i.e. cyclically adjusted and after deduction of specific and temporary measures.

III.3. The budgetary situation in 2008 and 2009

On 1 October 2009, Luxembourg notified to the European Commission a government budgetary surplus of 2.5% of GDP for 2008 and a foreseeable budget deficit of 2.2% of GDP for 2009.

However, according to first estimates on the basis of latest available budgetary data at 31 December 2009, it turns out that the budget deficit in 2009 will be lower than expected and is now estimated at - 1.1% of GDP.

Thus, the economic crisis implied a deterioration of the general government budget balance of 3.6% of GDP or € 1,366 million, changing from a surplus of 2.5% in 2008 to a deficit of -1.1% in 2009.

This deterioration is primarily due to the increase in public expenditure.

Indeed, the ratio between public revenues and GDP increased from 40.2% in 2008 to 41.6% in 2009, i.e. an increase of 1.4%. However, at the same time the ratio between public expenditure and GDP increased from 37.7% in 2008 to 42.6% in 2009, i.e. an increase of 4.9%.

A priori, this increase in the ratio of public revenues to GDP is contra-intuitive in times of economic crisis. This development can however be explained by the temporal delay which exists between the business cycle and its impact on specific categories of public revenues.

As mentioned earlier, the labour market reacts with a certain delay to the business cycle. This implies that there is also a delay between the cycle of economic activity and duties levied on household incomes, which are primarily made up of income tax and social security contributions.

In addition, as regards business income tax, taxes paid in 2009 are also based on results of the four to five years preceding 2009. Given the fact that this period includes years characterised by a high profits of companies, in particular those of the finance sector, this effect contributed to stabilising revenues in spite of the economic downturn in 2009.

Consequently, the ratio between direct taxes and GDP increased from 13.4% in 2008 to 13.9% in 2009 and the ratio between social security contributions and GDP increased from 10.9% in 2008 to 12.2% in 2009.

The increase in the ratio between public expenditure and GDP of 4.9% between 2008 and 2009 is mainly due to the increase in the ratio between social transfers and GDP which goes up from 17.9% in 2008 to 20.7% in 2009, an increase of 2.8%. This development is largely explained by the consequences of automatic stabilisers, tacking into account in particular the raise in public expenditure related to unemployment and short-time working.

In addition, current expenditure including wages in the public sector increased from 10.4% of GDP in 2008 to 11.6% of GDP in 2009, i.e. an increase of 1.2% of GDP, of which 0.8% is linked to wages in the public sector.

Finally, the increase in the interest burden from 0.3% of GDP in 2008 to 0.6% of GDP in 2009 is the consequence of the increase in public debt.

As a conclusion, the improvement of the budgetary balance of 2009 compared to the data reported on 1 October 2009 is primarily explained by a better performance than expected in certain categories of revenue. It is advisable nevertheless to note that, in spite of a better performance than envisaged in certain categories of revenue, the change in the total general government revenue was negative in 2009. Indeed, the level of the central government revenue decreased by 1% compared to the previous fiscal year, i.e. a reduction of € 137 million.

III.4. The budget for 2010

On 29 September 2009, the Government presented the draft budget for 2010 to Parliament.

The stability programme foresees a budget deficit of 3.9% of GDP for the financial year 2010 at the level of general government, which represents a deterioration of the general government budgetary balance of 2.8% of GDP in comparison to 2009.

This public deficit is lower than announced at the presentation of the draft budget for 2010 (- 4.4% of GDP). This correction is mainly due to an underlying base effect related to the revision of the public deficit in 2009, such as an improvement of revenues from certain taxes in the light of the derived revenue on 31 December 2009.

The increase in the public deficit from 1.1% of GDP in 2009 to 3.9% of GDP in 2010 can be explained on the one hand by a drop in the ratio between public revenues in terms of GDP of 2% (from 41.6% in 2009 to 39.6% in 2010) and on the other hand by an increase in the ratio between public expenditure and GDP of 0.9% (from 42.6% in 2009 to 43.5% in 2010).

The reduction in the ratio between public revenues and GDP reflects in particular the temporal delay between the business cycle and its impact on public revenues. In 2009, this shift had a stabilising effect on the general government budgetary balance. However, in the absence of a strong recovery of the economy, this stabilising effect gradually weakens and the delay between the business cycle and public revenues has a negative impact on the net budgetary position. Thus, the ratio between direct taxes and GDP decreases from 13.9% in 2009 to 12.5% in 2010 while the ratio between social security contributions and GDP changes from 12.2% in 2009 to 12% in 2010.

The increase in the ratio of public expenditure to GDP from 42.5% in 2009 to 43.7% in 2010 is primarily due to an increase in current expenditure including wages in the public sector (+0.5%) and public capital expenditure (+0.4%).

The budget for 2010 remains an anti-crisis budget and reflects the will of the Government to implement a counter-cyclical fiscal policy.

It is thus characterised by a change in public expenditure (+6.1% in nominal terms), including the maintenance of a high level of public investment, whose growth rate will be above growth of nominal GDP (2.5%).

The priorities defined by the Government as regards public expenditure for the 2010 budget are largely in line with the objectives laid down within the context of the implementation of the Lisbon Strategy:

- Financing of the structural reform of elementary schools, whose budgetary impact for 2010 is estimated at € 120 million or 0.3% of GDP;
- The promotion of public transport by an increase in financial resources of € 60 million;
- As regards family and social policy, measures are taken in support of purchasing power of households and in order to make family life more compatible with professional life by developing care facilities for children. The increase in allocated funds amounts to more than € 100 million;
- To support social cohesion, the cost-of-living allowance for low income households, the guaranteed minimum income and the income for disabled persons are supported by an additional funding of € 25 million;
- The budget allocation for combating climate change goes up from € 55 million in 2008 to € 125 million in 2010 in order to allow the government to carry out part of its environmental objectives laid down in the Kyoto Protocol Agreement;
- The budget allocation for Official Development Aid is set at 1% of GNI, i.e. some € 300 million;
- Public investment is accelerated with a view to the modernisation of public infrastructures. The level will increase from 2.5% of GDP in 2009 to 3.1% of GDP

in 2010 with a growth of 24% in level. This increase occurs in particular in the sectors of hospital infrastructures (+ € 67 million); support to public research is to raise by 17.6% to reach a level of 0.6% of GDP in 2010 after 0.5% in 2009;

– Government support to middle class within the context of the revision of the general framework of assistance to the middle class.

III.5. The budgetary situation of general government in 2011-2014 in a scenario based on "unchanged policies"

In the scenario characterised by "unchanged policies", public finances go through a major and structural deterioration. Thus general government budgetary balance remains negative throughout the whole 2011-2014 period and is to be above 3% of GDP permitted by the Stability and Growth Pact.

Table I: General government – scenario with unchanged policies

	2009	2010	2011	2012	2013	2014
Deficit in € millions	-401	-1 539	-2 051	-1 993	-1 946	-1 477
Deficit in % of GDP	-1.1	-3.9	-5.0	-4.6	-4.3	-3.1
Debt in € millions	5 615.8	7 166	9 871	12 622	15 342	17 735
Debt in % of GDP	14.9	18.3	23.9	29.3	34.1	37.4
Gross debt change in € millions	303.6	1 550	2 704	2 752	2 719	2 393

Indeed, under the delayed negative effects of the economic downturn, the budget deficit worsens until 2011, where it reaches -5% of GDP. Later, the deficit is to diminish gradually under the effect of the resumption of economic growth and reaches -3.1% of GDP in 2014.

This permanent deterioration is due to the fact that the level of public expenditure structurally exceeds that of public revenues. Indeed, over the period 2011-2014, the ratio of public expenditure to GDP rises on average above 43% of GDP, whereas the ratio of public revenues to GDP amounts on average only to 38.8% of GDP.

More particularly, as regards public expenditure, the scenario with "unchanged policies" is based on the following main assumptions over the period 2010-2014:

– After a rise of 24% in 2010, the annual growth rate of public investment is set at 6% over the whole period from 2011 onwards;
– Intermediate consumption, which corresponds to the current expenditure of general government, is set to grow annually by 4% over the whole period. This growth rate will be less than its historical average of 6.3%.

The combination of the various assumptions implies an annual growth in the average general government expenditure of 4.3%.

Public revenues are supposed to improve by 2011 after a fall of 1% in 2010. In 2011, a slight growth of 1.9% is anticipated under the impulse of the delay between the business cycle and specific categories of taxes. Between 2012 and 2014, public revenues increase annually by 5%.

Taking into account these developments, the ratio of public expenditure to GDP starts to decrease, changing from 43.6% in 2010 to 42.7% in 2014, and the ratio of public revenues to GDP increases from 38.1% in 2011, the lowest level, to 39.5% of GDP in 2014. However this does not allow the deficit to be absorbed which still remains very high in 2014 in comparison to its historical level. The permanent character of such a structural deficit is especially caused by the fact that the economy will grow more slowly after the crisis than before the crisis. Thus, even a growth rate close to potential growth of 3% will hardly make it possible to solve the problem of the structural deficit. The structural budget deficit thus is the result of a level of public revenue which is lower due to more moderate economic growth rates and of an unsustainable level as well as growth rate of public expenditure.

In parallel, taking into account the major financing needs of general government during these years, the public finance situation continues to deteriorate with the very fast increase in public debt and its related interest rate costs.

Indeed, in the case of the scenario with ”unchanged policies”, the major recurring budget deficits entail that public debt increases from a level of 18.3% of GDP in 2010 to 37.4% of GDP in 2014. Such a change would represent an increase of more than 500% in the level of public debt compared to the level before the crisis, namely 6.6% in 2007. The servicing of public debt would follow this same path of dynamic by increasing from a cost of 0.3% of GDP in 2007 to 1% in 2014, thus limiting even more the leeway in the fiscal policy.

Consequently, such an increase in public debt will also have a negative impact on the long-term quality and sustainability of public finances, insofar as the public finance situation thus deteriorates considerably well before the beginning, in 2020-2025, of the period when costs related to ageing will start growing steadily. Public finances will henceforth be in a much more unfavourable starting situation in view of facing the upcoming challenges related to the costs of demographic trends.

III.6. Exit strategy for the budget deficit

The Government’s budgetary objective is a balanced budget of general public government in 2014 at the latest.

The successful implementation of this target implies a budgetary effort of about € 300-500 million per year during the period 2011-2014 to arrive at a total annual effort in 2014 close to € 1,600 million.

The budgetary consolidation will start in 2011 and correction measures to the deficit will consequently be taken for the first year of budgetary consolidation in 2011. It should be noted that among the measures and reforms adopted within the context of the public finance consolidation programme, some will produce their positive effects on the budget consolidation process only gradually. In addition, the negative impact on public revenues resulting from the delay between the business cycle and public revenues will continue to produce negative effects during 2011 and even 2012.

This implies that even if structural adjustment measures are taken at the beginning of the consolidation period, the budgetary adjustment will become effective only after a while insofar as the effects of budgetary consolidation measures intensify progressively. This also implies that these structural measures will have to be taken at the beginning of the consolidation period so that aim of a balanced budget in 2014 can be achieved.

Table II: General government – adjustment path

	2009	2010	2011	2012	2013	2014
Deficit in € millions	-401	-1 539	-1 239	-905	-495	0
Deficit in % of GDP	-1.1	-3.9	-3.0	-2.1	-1.1	0.0
Deficit reduction in € millions	...	...	300	334	410	495
Deficit reduction in % of GDP	...	...	0.9	0.9	1.0	1.1
Cumulative deficit reduction in € millions	...	...	300	634	1 044	1 539
Cumulative deficit reduction in % of GDP	...	...	0.9	1.8	2.8	3.9
Debt in € millions	...	...	9 071	10 722	11 992	12 885
Debt in % of GDP	...	...	22.0	24.9	26.7	27.2
Change in gross debt in € millions			1 904	1 652	1 269	893

It should be stressed that the re-establishment of the general government budgetary balance will require consolidation measures on the level of its three sub-sectors, namely central government, local government and social security. After these efforts on the level of these three components of general government, central government, on which a major part of the budgetary consolidation effort will concentrate, will continue to experience a budget deficit of about € 1,200 million in 2014. This deficit at the level of central government will then imply a need for gross financing at the level of general government of the same order of magnitude, i.e. the public debt will continue to increase beyond 2014 even if the budgetary balance is restored in 2014 at the level of the general government.

It should be noted that the return to the nominal balance in the budget in 2014 implies a structural deficit of 0.5% of GDP. The medium-term objective is thus not achieved and budgetary consolidation measures of about 1% of the GDP in structural terms will have to be implemented from 2015 in order to converge quickly towards the medium-term objective.

III.7. The public debt

Luxembourg general government debt continues to be well below the reference value of 60% of GDP foreseen in article 126 of the Treaty on the Functioning of the European Union.

Indeed, in 2009 the general government debt amounted to € 5,616 million or 14.9% of GDP.

On 31 December 2009, the central government had reserves at its own disposal (resources available in special funds, budgetary reserves and financial fixed assets) of about € 3,655 million or 9.7% of GDP. These reserves were accumulated in particular during the last decade, during which the central government budgetary situation generally yielded surpluses.

Furthermore, the social security sector regularly generated surpluses and these surpluses were put in reserve to pay for future social transfers. In 2010, the compensation funds in reserve will reach approximately 28% of GDP, i.e. € 10.8 million.

The central government debt, in addition to the "conventional" public debt also includes the debt of public institutions.

Furthermore, the Government has granted financial guarantees to property developers in view of the construction of public infrastructure *(Loi de Garantie*). In accordance with the decision of Eurostat on the statistical processing of partnerships between the private and public sectors (Press release of 11 February 2004), these transactions are recorded as loans charged in the accounts of the general government. During the period 2008-2011, the impact of this decision on the ratio between the gross public debt and GDP varies between 1.5%-1.8% per year.

The Treasury bills issued by the Government are not actually reimbursable funds collected by the Government. They document multi-annual contributions with respect to international financial institutions (EBRD, AsFD, IFAD, GEF, IDA, MIGA). These bills do not earn interest and they are paid if and when they become due. On 31 December 2009, outstanding bills totalled € 80.2 million. The payment of the Treasury bills is done via the public debt fund. According to currently known deadlines, the reimbursements of Treasury bills will be € 15.3 million in 2010, € 14.6 million in 2011, € 11.8 million in 2012 and € 8.9 million in 2013.

The Government did not issue new loans during the fiscal years 1998 to 2005. On the contrary, it has in the meantime repaid the entire existing debt going back to before 1998.

For each year 2005-2009, the Government was authorised to issue one or more loans for financing investments in infrastructure projects by the means of the railway fund and the road construction fund, amounting to € 100 million per fund, i.e. a total of € 1,000 million over the whole period. The authorisations of 2005 to 2008 were used each time by the taking up of bank loans contracted for ten years to a total amount of € 800 million. In 2007 a further bank loan of € 132 million over twenty years was added, for the purposes of the government acquisition of the railway infrastructure owned by Arcelor S.A., which was the subject of a specific law. It should be noted that the authorisation of a loan for 2009 had not yet been used at the end of December 2009.

The budgetary law for 2006 had also authorised the Government to borrow an amount of € 300 million to cover the budget deficit. This authorisation was not used until October 2008 within the context of stabilisation measures for the financial sector in the context of the financial crisis. This € 300 million were financed by a bank loan.

In the context of the financial crisis, in December 2008 the Government also carried out the floatation of a general public bond of € 2 billion.

With an “unchanged policies” scenario, gross public debt amounts to € 17,735 million or 37.4% of GDP in 2014 and the interest paid to the servicing of public debt amounts to € 488 million, 1% of GDP.

The implementation of a budgetary consolidation strategy from 2011 and the re-establishment of the nominal balance in the budget at the level of general government in 2014 will imply a downwards correction of the need for cumulated financing. Thus, the public debt amounts to € 12,885 million or 27.2% of GDP in 2014 and the related servicing of the debt to approximately € 350 million (0.7% of GDP).

It should be noted that in spite of the re-establishment of nominal balance at the level of general government in 2014, the central government budgetary balance will remain negative in 2014 and beyond, implying the existence of a need for gross financing and thus the increase in the general government debt in 2014 and beyond.

III.8 Sensitivity analysis

The sensitivity analysis is based on the simulation of a negative external shock of -0.5% on the level of the growth rate in the eurozone from 2011 and a weaker growth of the relevant markets for Luxembourg (-1.4% from 2011 compared to the central scenario).

This shock has a significant negative impact on the growth rate during the projection period. Whereas in the central scenario economic growth is close to an annual 3% from 2011, the alternative scenario implies an annual growth rate of about 2% during the period 2011-2014.

This decrease in economic growth is primarily due to a reduction of the positive contribution of foreign trade to general growth and to a stronger fall in the level of private investment due to less favourable prospects for growth and profits for companies.

In this alternative scenario, the inflation path is hardly affected until 2012, but beyond 2013 the inflation rate increases again by just below 2% per annum.

The impact on the unemployment rate is relatively limited, but the growth of domestic employment is weaker (+/- 1% during the period 2011-2014).

Table III: General government – alternative scenario (negative shock of growth)

	2010	2011	2012	2013	2014
Economic growth	2.5	2.4	1.7	1.8	2.0
Private consumption deflator	1.6	1.7	1.8	1.9	2.0
Change in domestic employment	-0.5	0.9	1.2	1.1	1.0
Unemployment rate	6.9	7.3	7.5	7.2	6.7
Deficit in € millions	-1 539	-1 309	-1 035	-715	-300
Deficit in % of GDP	-3.9	-3.2	-2.4	-1.6	-0.6
Debt in € millions	7 166.3	9 151	10 872	12 245	13 230
Debt in % of GDP	18.3	22.2	25.2	27.2	27.9

For public finances, the implication of this negative shock on the level of the growth of the eurozone is that the objective of a balanced net budgetary position of the general government in 2014 will not be achieved. In fact, in 2014 the general government expresses a financing requirement of 0.6% of GDP and the total effect of the shock of growth on the public finances results in an increase in the public debt of 0.7% of GDP, i.e. a level of debt of 27.9% of GDP in the alternative scenario against a public debt of 27.2% of GDP in the central scenario (the scenario compatible with the re-establishment of the budgetary balance in 2014).

III.9 Comparison with earlier stability programmes

The development of the economic situation has been much more unfavourable compared to the forecast of the 10th update of the stability programme. In fact, 2009 was characterised by a global economic recession, following the financial crisis started in 2008, of a magnitude without precedent since 1945 and which could not be reasonably anticipated in October 2008, during the development of the 10th update of the stability programme, or even in January 2009 during the development of its addendum. In concrete terms, while the GDP of the EU was supposed to grow by 1.2% in 2009, the economic growth was negative, reaching -4% of GDP in 2009.

Consequently, the growth rate of Luxembourg was caught in the wake of the economic recession: instead of a forecast growth rate of 3% of GDP for 2009, in line with the downwards trend estimated for the whole EU for 2009, the economy actually went through major contraction of its level of production with a drop of -3.9% of GDP in 2009.

In the same way, this shock of the economic situation had a negative effect on prices: whereas the ECB had still counted on an inflation rate of 2.3-2.9% in 2009 taking into account the existence of inflationary pressures at the end of 2008, inflation finally rose by a very low level of 0.9% in the eurozone. With the double effect of cheaper oil prices and an increased rate of exchange for the euro against the dollar, the inflation rate (NICP) was lower than envisaged in Luxembourg at 0.4% instead of 3.7%.

The development in the labour market followed the same path of deterioration compared to the forecasts made in the 10th update: unemployment accounted for 6% instead of 4.5% at the end of 2009 and the growth of domestic employment was slower than forecast at 1.2% instead of 2.7%.

The deviation of the macroeconomic aggregates with respect to their anticipated path obviously did not remain without consequences on the level of public finances. Thus, the financing needs expressed by the general government in 2009 and 2010 are considered higher than in the addendum to the 10th update of the stability programme. The deviation was relatively low in 2009 (unanticipated deterioration of the net budgetary position of 0.5% of GDP) and definitely larger in 2010 (2.4% of GDP), also implying a revision in the rise in public debt in 2010 (+1.3% compared to the addendum of the 10th update of the stability programme).

IV. QUALITY OF PUBLIC FINANCES

The national plan for innovation and full employment sent to the European Commission in autumn 2009 completely matches the strategy for the medium-term return to structural balance of public finances.

During the period 2005-2008, the general government budgetary balance had surpluses. Following the economic downturn in 2008-2009 and the implementation of exceptional measures aimed at supporting economic activity and employment, the budgetary situation of the general government became overdrawn in 2009 (-1.1% of GDP). It will remain overdrawn in 2010 (-3.9% of GDP). The Government took advantage of the period of favourable economic growth in 2005-2007 to consolidate public finances and to transfer to the reserves the budget surpluses of 2005-2008. The existence of these reserves created leeway which made it possible for Luxembourg to face the budgetary consequences of the downturn of the economic situation without excessively increasing the burden of public debt.

Indeed, the total situation of the Luxembourg public finances could not be appreciated correctly by only reading the net budgetary position or the public debt without taking into account the existence of reserves at the central government level (and of the social security). These reserves were built up during the period of rapid economic growth that yielded a string of large budget surpluses, which in turn were not re-injected into the budgetary circuit and therefore not used for the financing of current expenditures.

The general account of the Government provides the essential data on the financial resources of the Government. The general ledger of the Government establishes the relation between these resources and employment, thus making it possible to establish a patrimonial situation of the Government in the form of a balance sheet.

On 31 December 2009, the structure of this assessment shows the following situation:

Resources (liabilities)	
Funds owned by the Government (special funds and budgetary reserves)	€ 1,298 million
Funds owned by the Government corresponding to financial fixed assets acquired by budgetary expenditure	€ 2,357 million
Third party funds lodged with the Government	€ 602 million
Third party funds borrowed by the Government (gross public debt)	€ 3,513 million
Uses (assets)	
Bank financial assets	€ 2,102 million
Non-bank financial assets	€ 4,657 million
Balance (net public debt)	€ 1,011 million

These reserves are essentially transferred to the different special government investment funds and are used to achieve the specific objectives for which each special fund was set up via a special law. Over the course of the fiscal year, the resources available in the special funds increase due to the inflow of Government budgetary endowments and decrease when expenditure is paid using the funds. At the end of December 2009, the assets of the special funds were about € 2,655 million.

However, the economic crisis reduced the budgetary leeway and exhausted the budgetary reserves of the Government. In parallel, Luxembourg is confronted with challenges of a structural nature, such as the loss of potential growth resulting from this economic crisis and demographic ageing.

The Government's crisis exit strategy will make it possible to preserve healthy public finances and thus ensure growth and prosperity in the medium and long term.

For this purpose, the 2009-2014 governmental programme puts emphasis on certain policies based on public expenditure, while insisting on the importance of preserving the social justice. In addition, the Government is committed to following a prudent tax policy aimed at maintaining a tax framework that is favourable to employment and household purchasing power.

As regards the long-term sustainability of public finances, the governmental programme announces the implementation of a reform of the pension system aimed at simultaneously ensuring financial sustainability, social sustainability, political sustainability and the legitimacy of the pension system. The proposals by the Government will be inspired in particular by work of the group of experts set up following the discussions within the tripartite Coordinating committee in April 2006 which reported its conclusions in December 2008.

In addition, the national plan for innovation and full employment puts forward the reforms implemented to strengthen growth potential of the economy. The governmental initiatives more particularly aim to stimulate the labour market, improve the tax and legislative environment of business and to maintain a high quality of the social security system.

V. LONG-TERM SUSTAINABILITY OF PUBLIC FINANCES

The financial sustainability of the pension system is guaranteed in the medium-term because of a relatively young population of people of working-age and a robust growth in domestic employment, namely an annual growth of 3% on average during the last 10 years.

However, in the long run, there is a real challenge to ensure the sustainability of public finances because of the economic cost and budgetary growth related to the ageing of the population.

In fact, public expenditure related to demographic ageing is projected to increase, with unchanged policies, from 19.9% of GDP in 2010 to 38% of GDP in 2060 (according to the long-term projections developed by the *Inspection générale de la sécurité sociale*).

80% of this increase will be primarily due to an increase in pension expenditure (all sectors combined), which increases from 8.6% of GDP in 2010 to 23.9% of GDP in 2060.

Admittedly, the starting position of Luxembourg to face this challenge is relatively favourable (which could nevertheless change quickly in the case of a scenario with "unchanged policies").

Thus Luxembourg can prevail upon a budgetary position that did not worsen too much (in international comparison) following the economic crisis. In the same way, the medium-term budgetary objective of a structural surplus accounts for 0.5% of GDP per year. The existence of a *Fonds de compensation* reserve that increases from 28% of GDP in 2010 to more than 40% in 2020 will make it possible to partially face the financing challenges. Finally, the country still benefits from a relatively low level of public debt.

However, irrespective to the underlying macroeconomic assumptions, all long-term projections confirm the assumption that by 2050 or 2060, the sustainability of the public finances is not assured.

Thus, the social security budget balance will become negative from 2025 onwards, which will consequently reduce the reserves until their exhaustion around 2035. From this moment of the exhaustion of the compensation reserves onwards, the social security deficit will have to be covered by the issuing of public debt, implying that the ratio between public debt will exceed the reference value of 60% of GDP around 2040 (and will then continue to increase).

Beyond the basically unsustainable nature of this scenario, it should be noted in addition that it is based on assumptions which must still materialise in the future (with the risk of an additional deterioration of the figures), namely: a level of potential growth of 4% until 2015 which will then drop to 3%; a structural budget surplus until 2011; a constant unemployment rate of 4.2%; an increase in the level of participation in general and in particular that of older workers from 32% to 42% in 2040-2050.

In addition, the governmental programme of 2009 declares the following on this matter:

– That “on the level of social transfers, the medium-term objective will be to slow down the growth of the expenditure by introducing more social selectivity”;
– That “it is imperative to address the long-term sustainability of our social security systems vis-à-vis the foreseeable demographic ageing, which will generate an increase in the costs for health care, the assumption of responsibility for long-term care and, especially, pensions” and
– That “the current good health of the financial basis of the scheme should allow a discussion in all serenity concerning the choice of the adjustments to be made”.

The governmental statement made by the Prime Minister in July 2009 reaffirms the ideas in this order that:

“The government wants to deal with these problems now. The problems, risks and uncertainties linked to the future of our old-age insurance systems. This is why the Minister for Social Security, in collaboration with the Minister for Finance, will deal with the problems relating to the long term. They will do it in collaboration with social partners, while using the work done during the cycle of tripartite meetings that the Minister for Social Security had convened during the last legislature to discuss these problems. This work must be finished during the first half of this term.”

In view of the reform of the pension system, the guiding principles followed by the Government are inter-generational equality, the appropriateness of resources and expenditure, the fair redistribution of income and the principle of financing the pension system by distribution with the building-up of a compensation reserve.

These guiding principles result, among other things, in the following objectives:

- To link the duration of active life to longevity;
- To ensure equity between the available income of workers and pensioners;
- To guarantee an adequate level of pension;
- To avoid poverty among pension recipients;
- To provide a suitable and strong governance.

VI. INSTITUTIONAL ASPECTS OF PUBLIC FINANCES

The legal framework of the institutional features of public finances is laid down by the Law of 8 June 1999 on the State Budget, Accounts and Treasury.

The law of 8 June 1999 involved an overhaul of the central government budgetary and accounting system by foreseeing in particular the improvement of the regulations for budgetary accounting, the possibility of granting certain public services greater financial autonomy and the creation of the *Direction du contrôle financier* (DCF).

The creation of the *Direction du contrôle financier* reinforced the coordination and the monitoring of the public expenditure control mission. Financial controllers are placed throughout different ministerial departments where they perform their control missions. These they carry out with a certain degree of independence, to the extent that they do not receive exact instructions regarding specific files. The control mission of the financial controllers is an *ex ante* mission: meaning that the compliance of the expenditure with its applicable resolutions and regulations is verified prior to the commitment of said expenditure.

Nevertheless, the surveillance mission of the *Direction du contrôle financier* does not cover aspects relating to the appropriateness and effectiveness of public expenditure. This mission is entrusted to the *Inspection générale des Finances* which is also responsible for drawing up the preliminary draft bill regarding the State revenue and expenditure budget.

Within the context of the multi-annual guidelines for the fiscal policy expressed in the governmental declaration of July 2009 to Parliament, the Government began “to examine the means to improve the procedure for the preparation, implementation and evaluation of the budget with a twofold objective: i) the modernisation of the State and ii) the effectiveness of public expenditure”. This objective is part of the government’s general budgetary strategy “to reduce sustainably the trend of growth of public expenditure in order to avoid the resurgence of a structural deficit in public finances”.

In the past, the governmental programme of August 2004 envisaged additional adaptations to the budgetary procedure: “Given that the annual procedure for preparing the State budget constitutes an essential factor in the control of public finances, the Government shall, from the 2005 fiscal year onwards, proceed with an overhaul of the current budgetary procedure, which will translate in particular into the adjournment of the approval of the draft budget at governmental level from the month of August to the month of October. By thus bringing the adoption of the draft budget closer to the year that it relates to, the quality of budgetary forecasts will be able to be further improved as a result of being able to take into account the economic forecasts of the international and national statistics bodies of the second semester in the budgetary work context. Suppressing the budgetary amendment procedure will furthermore allow a greater concentration of available resources on the exhaustive analysis of budget provision requests and on the multi-annual planning of State investments”.

The new budgetary procedure applies from the development of the draft budget for 2005, in accordance with the principles stated in the governmental programme of August 2004.

In addition, the governmental declaration of August 2004 provided that: “All the projects of direct and indirect investments by the Government will be subject to a more detailed analysis and procedure whose objective is to reduce the cost of public investments. More particular attention will also be paid, from the planning phase onwards, to an assessment of the running and operating costs of the new infrastructures in a bid to control the balanced budgetary position of State operating expenditure”.

In April 2006, a new procedure involving the preparation and presentation of large-scale infrastructure projects was implemented. It foresees in particular that any significant change in programme arising after the vote of an authorisation law must be subjected to a new assessment by the Parliament and that any exceeding of the authorised budget for implementation will necessarily result in the presentation of a new government bill in the event that said budget overrun is greater than 5%.

As regards the budgetary procedure in itself, it starts each year with the Minister having the budget in his portfolio forwarding the budgetary circular to all the government departments. The budgetary circular includes guidelines of a political nature (e.g. budgetary strategy and objectives) and of a technical nature (e.g. macroeconomic assumptions, growth rate ceilings according to category of public expenditure) to be observed by the ministerial departments when drawing up their budgetary proposals.

In May, the broad guidelines of the governmental policy are presented to the Chamber of Deputies by the Prime Minister in the context of the declaration by the Government on the country's economic, social and financial situation.

Following the presentation of the political priorities of the governmental action and the framing of the budgetary priorities of the government departments in line with these main trends, in August the Minister with the budget in his portfolio starts the bilateral discussions with the other members of the Government and the draft budget is finalized by the Council of State towards the end of September.

In addition, the Minister of Finance informs the Council of State of the “horizontal” and “specific” guidelines formulated by the Eurogroup in the context of the mid-term review of the budgetary policies.

At the beginning of October, the draft budget is presented to the Parliament. The presentation of the draft budget for 2010 took place on 29 September 2009.

The draft budget consists of three volumes. In addition to the actual budget law (volume I), volume II outlines the multi-annual capital spending programme. For the draft budget 2010, the multi-annual programme covers the period 2009-2013. In addition, since 2007 the draft budget is accompanied by a volume III which presents in a detailed way the shift from the “working balances” various sub-sectors of the general government to the balance of financing of the under-sectors established in accordance with the rules and concepts of the stability programme.

The presentation of volume III of the draft budget enables the transparency of public finances to be increased while also incorporating the national fiscal policy in the wider context of the multilateral monitoring of fiscal policies in the European Union and of the Stability and Growth Pact.

In addition to the improved integration of the national fiscal policy with European monitoring processes, the concurrent edition of the draft budget and the stability programme also allows the Parliament to include the assessment of the draft budget for the fiscal year ahead within the broader context of the medium-term and long-term budgetary planning.

Table 1A. Macroeconomic forecast

	ESA code	2008	2008	2009	2010	2011	2012	2013	2014
		€ billion	%	%	%	%	%	%	%
1. Real GDP	B1 * G	29.5	0.0	-3.9	2.5	3.0	2.7	2.9	3.1
2. Nominal GDP	B1 * G	39.3	5.0	-4.2	3.9	5.4	4.3	4.4	5.4
		Growth sources: constant price variation							
3. Private consumption expenditure	P.3	10.7	3.9	-0.7	0.2	0.4	0.2	1.0	2.4
4. Government consumption expenditure	P.3	4.5	3.0	3.4	2.1	1.5	1.8	2.1	2.0
5. Gross fixed capital formation	P.51	6.9	-0.1	-11.0	6.9	8.8	-3.6	-4.5	-3.0
6. Changes in inventories (in % of GDP)	P.52 + P.53	-	0.7	0.4	0.2	0.1	0.0	0.0	0.0
7. Exports of goods and services	P.6	54.6	1.5	-7.9	5.2	4.8	5.3	5.8	6.2
8. Imports of goods and services	P.7	47.7	3.3	-9.0	5.5	5.2	4.1	4.8	5.7
		Contribution to GDP growth							
9. Total final domestic demand		-	1.8	-2.3	1.9	2.4	-0.5	-0.3	0.5
10. Changes in inventories	P.52 + P.53	-	0.6	-1.4	-0.2	-0.1	0.0	0.0	0.0
11. External balance of goods and services	B.11	-	-2.3	-0.2	0.8	0.7	3.3	3.2	2.6

Table 1B. Price developments

	ESA code	2008	2009	2010	2011	2012	2013	2014
		%	%	%	%	%	%	%
1. GDP deflator		5.0	-0.3	1.4	2.4	1.6	1.5	2.2
2. Private consumption deflator		3.7	0.2	1.6	1.7	1.9	2.2	2.5
3. Rate of inflation (HICP)		4.1	4.1	0.0	2.1	1.8	…	…
4. Public consumption deflator		3.8	3.8	2.2	1.7	1.4	1.8	2.3
5. Investment deflator		2.0	1.1	1.8	1.2	2.0	2.3	2.5
6. Export price deflator (goods and services)		0.9	-4.7	2.0	2.6	1.4	0.9	1.7
7. Import price deflator (goods and services)		-0.8	-4.4	2.8	2.2	1.7	1.2	1.8

Table 1C. Labour market developments

	ESA code	2008	2008	2009	2010	2011	2012	2013	2014
		Level	%	%	%	%	%	%	%
1. Domestic employment, people (in thousands)		348.8	4.7	1.2	-0.5	1.0	1.6	1.6	1.6
2. Employment, hours worked		…	4.3	-1.4	-1.5	0.8	1.3	1.4	1.3
3. ILO unemployment rate (%)		…	4.8	6.0	6.9	7.2	7.3	7.0	6.5
4. Labour productivity (real GDP per person employed)		…	-4.5	-4.8	3.1	2.0	1.2	1.3	1.5
5. Labour productivity (real GDP per hour worked)		…	-4.2	-2.4	4.0	2.3	1.4	1.5	1.7
6. Compensation of employees (€ billion)	D.1	17.4	7.0	0.7	0.8	3.5	3.6	4.5	4.9
7. Compensation per employee (€ 1000 / year)		52.9	2.1	-0.3	1.6	2.7	2.0	2.7	3.1

Table 2A. General government budgetary situation (in % of GDP)

in % of the GDP	ESA code	2008	2008	2009	2010	2011	2012	2013	2014
		€ millions	%	%	%	%	%	%	%
			Net lending of sub-sectors						
1. General government	S.13	965	2.5	-1.1	-3.9	- 5.0	- 4.6	- 4.3	- 3.1
2. Central government	S.1311	-90	-0.2	-2.9	-5.5	-6.6	-6.3	-5.9	-4.8
3. […]	S.1312	…	…	…	…	…	…	…	…
4. Local government	S.1313	-5	0.0	-0.1	-0.2	-0.2	-0.1	0.1	0.3
5. Social security	S.1314	1 060	2.7	2.0	1.8	1.8	1.8	1.5	1.4
			General government (S. 13)						
6. Total revenue	TR	15 808	40.2	41.6	39.6	38.3	38.5	39.0	39.5
7. Total expenditure	TE	14 843	37.7	42.6	43.5	43.2	43.2	43.3	42.6
8. Budget balance	EDP B.9	965	2.5	-1.1	-3.9	- 5.0	- 4.6	- 4.3	- 3.1
9. Interest burden	EDP D.41	116	0.3	0.6	0.6	0.7	0.9	1.0	1.0
10. Primary balance		1 081	2.8	-0.5	-3.3	-4.3	-3.7	-3.3	-2.1
11. One-off and temporary measures		0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
			Main components of revenue						
12. Taxes (12=12a+12b+12c)		9 924	25.2	25.7	23.9	22.5	22.9	23.4	24.1
12a. Taxes on production and imports	D.2	4 655	11.8	11.8	11.4	10.8	10.9	10.9	10.9
12b.+12c. Current taxes on income and wealth and taxes on capital	D.5+D.91	5 269	13.4	13.9	12.5	11.7	12.0	12.5	13.2
13. Social contributions	D.61	4 298	10.9	12.2	12.0	11.8	11.7	11.6	11.5
14. Property income	D.4	740	1.9	1.4	1.4	1.7	1.7	1.7	1.7
15. Other revenue		845	2.1	2.3	2.2	2.1	2.2	2.2	2.2
16.=6. Total revenue	TR	15 807	40.1	41.6	39.5	38.1	38.5	38.9	39.5
p.m.: Tax burden (D.2+D.5+D.61+D.91 D.995)		…	36.1	37.9	35.9	34.3	34.6	35.0	35.6
			Main components of expenditure						
17. Employee compensation and intermediate consumption		4 114	10.4	11.6	12.0	11.8	11.7	11.7	11.6
17a. Compensation of employees	D.1	2 812	7.1	7.9	8.2	8.1	8.0	8.0	7.9
17b. Intermediate consumption	P.2	1 302	3.3	3.7	3.8	3.7	3.7	3.7	3.7
18. Social transfers (18=18a+18b)		7 108	17.9	20.7	20.7	20.5	20.3	20.3	20.0
18a. Social transfers in kind	D.6311, D.63121, D63131	1 830	4.7	5.2	5.2	5.2	5.2	5.2	5.2
18b. Social transfers in cash	D.62	5 278	13.4	15.5	15.5	15.3	15.1	15.1	14.8
19.=9. Interest expenditure	EDP D.41	116	0.3	0.6	0.6	0.7	0.9	1.0	1.0
20. Subsidies	D.3	584	1.5	1.6	1.7	1.6	1.6	1.6	1.6
21. Gross fixed capital formation	P.51	1 408	3.6	3.5	3.9	3.9	3.9	3.9	3.9
22. Other expenditure		1 627	4.1	4.5	4.7	4.8	4.8	4.7	4.6
23.=7. Total expenditure	TE	14 843	37.8	42.5	43.6	43.3	43.2	43.2	42.7
p.m. Public consumption (in nominal terms)	P.3	5 920	15.0	16.8	17.1	16.8	16.8	16.8	16.7

Table 2B. General government budgetary situation (in million €)

	ESA code	2008	2009	2010	2011	2012	2013	2014
		€ millions	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions
		Net lending of sub-sectors						
1. General government	S.13	965	-401	-1 539	- 2051	- 1993	- 1946	- 1477
2. Central government	S.1311	-90	-1 095	-2 163	-2 707	-2 714	-2 662	-2 290
3. […]	S.1312							
4. Local government	S.1313	-5	-53	-75	-80	-34	29	149
5. Social security	S.1314	1 060	748	698	736	756	687	664
		General government						
6. Total revenue	TR	15 808	15 671	15 512	15 803	16 604	17 536	18 736
7. Total expenditure	TE	14 843	16 072	17 051	17 855	18 597	19 482	20 213
8. Budget balance	EDP B.9	965	-401	-1 539	-2 052	-1 993	-1 946	-1 477
9. Interest burden	EDP D.41	116	229	225	288	368	464	488
10. Primary balance		1 081	-172	-1 314	-1 764	-1 625	-1 482	-989
11. One-off and temporary measures		0	0	0	0	0	0	0
		Main components of revenue						
12. Taxes (12=12a+12b+12c)		9 924	9 678	9 380	9 323	9 864	10 515	11 398
12a. Taxes on production and imports	D.2	4 655	4 444	4 479	4 478	4 678	4 907	5 161
12b.+12c. Current taxes on income and wealth and taxes on capital	D.5+D.91	5 269	5 234	4 901	4 845	5 186	5 608	6 237
13. Social contributions	D.61	4 298	4 598	4 708	4 872	5 042	5 232	5 445
14. Property income	D.4	740	510	556	708	746	785	824
15. Other revenue		845	885	867	900	952	1 003	1 068
Saleable output	P.11	367	424	372	392	420	451	486
Revenue from other non-commercial production	P.131	324	323	348	363	380	400	422
Other current transfers	D.7	61	28	64	49	53	56	60
Transfers of capital to be received	D.9	93	110	83	96	99	96	100
16.=6. Total revenue	TR	15 807	15 671	15 511	15 803	16 604	17 535	18 735
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		14 222	14 276	14 088	14 195	14 906	15 747	16 843
		Princiaples components of the expenditure						
17. Employee compensation	D.1	2 812	2 996	3 208	3 332	3 451	3 585	3 742
18. Intermediate consumption	P.2	1 302	1 404	1 479	1 518	1 588	1 655	1 710
19. Social transfers (19=19a+19b)		7 108	7 815	8 126	8 466	8 755	9 164	9 520
19a. Social transfers in kind	D.6311, D.63121, D63131	1 830	1 964	2 037	2 137	2 244	2 366	2 508
19b. Social transfers in cash	D.62	5 278	5 851	6 089	6 329	6 511	6 798	7 012
20.=9. Interest expenditure	EDP D.41	116	229	225	288	368	464	488
21. Subsidies	D.3	584	616	662	672	687	707	728
22. Gross fixed capital formation	P.51	1 408	1 315	1 523	1 603	1 687	1 775	1 869
23. Other expenditure		1 511	1 696	1 829	1 976	2 062	2 132	2 158
Other taxes on production	D.29	8	7	7	7	7	7	7
Other current transfers	D.7	1 027	1 120	1 199	1 271	1 325	1 368	1 414
Transfers of capital to be paid	D.9	488	586	615	708	712	753	736
Acquisitions less transfers of non-financial non-produced assets	K.2	-12	-17	8	-10	18	4	1
24.=7. Total expenditure	TE	14 841	16 071	17 052	17 855	18 598	19 482	20 215
p.m. Public consumption (in nominal terms)	P.3	5 920	6 326	6 704	6 938	7 239	7 576	7 936

Table 3. General government expenditure according to function

in % of GDP	COFOG code	2008	2010
1. General public services	1	4.0	…
2. Defense	2	0.3	…
3. Public order and safety	3	0.9	…
4. Economic affairs and services	4	4.4	…
5. Environmental protection	5	1.0	…
6. Housing and community amenities	6	0.7	…
7. Health	7	4.5	…
8. Recreation, culture and religion	8	1.8	…
9. Education	9	4.5	…
10. Social protection	10	15.7	…
11. Total expenditure	TE	37.7	43.5

Table 4. Public debt

in % of GDP	ESA code	2008	2009	2010	2011	2012	2013	2014
		%	%	%	%	%	%	%
1. Gross debt		13.5	14.9	18.3	23.9	29.3	34.1	37.4
2. Change in gross debt		0.3	1.4	3.4	5.6	5.4	4.8	3.3
		Elements contributing to gross debt development						
3. Primary balance		2.8	-0.5	-3.3	-4.3	-3.7	-3.3	-2.1
4. Interest expenditure	EDP D.41	0.3	0.6	0.6	0.7	0.9	1.0	1.0
5. Stock-flow adjustment		2.8	0.3	-0.5	0.6	0.8	0.5	0.2
p.m.: implicit interest rate		2.2	4.1	3.1	2.9	2.9	3.0	2.8
		Other relevant variables						
6. Liquid financial assets		…	…	…	…	…	…	…
7. Net debt		…	…	…	…	…	…	…

Table 5. Cyclical developments of public finances

in % of GDP	ESA code	2008	2009	2010	2011	2012	2013	2014
		%	%	%	%	%	%	%
1. Real growth in GDP (%)		0.0	-3.9	2.5	3.0	2.7	2.9	3.1
2. Net lending/borrowing of general government	EDP B.9	2.5	-1.1	-3.9	- 5.0	- 4.6	- 4.3	- 3.1
3. Interest expenditure	EDP D.41	0.3	0.6	0.6	0.7	0.9	1.0	1.0
4. One-off and temporary measures		0.0	0.0	0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		3.0	2.5	2.2	2.1	2.0	1.9	1.8
6. Output gap		3.4	-3.1	-2.9	-2.0	-1.2	-0.2	1.0
7. Cyclical budgetary components		1.7	-1.5	-1.4	-1.0	-0.6	-0.1	0.5
8. Cyclically-adjusted budgetary balance		0.8	0.4	-2.5	-4.0	-4.0	-4.2	-3.6
9. Cyclically-adjusted primary balance		1.1	1.0	-1.9	-3.3	-3.1	-3.2	-2.6
10. Structural balance		0.8	0.4	-2.5	-4.0	-4.0	-4.2	-3.6

Table 6. Divergences from the previous programme update

	ESA code	**2008**	**2009**	**2010**
Growth in GDP (%)				
10th update		1.0	-0.9	1.4
11th update		0.0	-2.9	2.5
Difference		-1.0	-2.0	1.1
Net lending/borrowing of general government (in % of GDP)	EDP B.9			
10th update		2.0	-0.6	-1.5
11th update		2.5	-1.1	-3.9
Difference		0.5	-0.5	-2.4
General government debt (in % of GDP)				
10th update		14.4	14.9	17.0
11th update		13.5	14.9	18.3
Difference		-0.9	0.0	1.3

Table 7. Long-term sustainability of the public finances

in % of GDP	2007	2010	2015	2020	2030	2040	2050	2060
General government expenditure	36.2	43.5	…	…	…	…	…	…
Of which: expenditure related to demographic ageing	*20.1*	*19.9*	*20.0*	*21.1*	*26.1*	*31.3*	*35.8*	*38.0*
Education	8.7	8.6	8.9	9.9	14.2	18.4	22.1	23.9
Care of health	5.8	5.9	6.1	6.2	6.5	6.8	7.0	7.0
Insurance-dependence ("length-term care")	1.4	1.4	1.4	1.5	1.8	2.4	3.0	3.4
Education	3.8	3.6	3.2	3.1	3.2	3.3	3.3	3.3
Other expenditure related to demographic ageing	…	…	…	…	…	…	…	…
Unemployment benefits	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Interest expenditure	0.2	0.6	…	…	…	…	…	…
Total revenue	39.9	39.6	…	…	…	…	…	…
Of which: property income	*1.6*	*1.4*	…	…	…	…	…	…
Of which: social contributions	*10.7*	*12.0*	…	…	…	…	…	…
Reserves of pension funds	21.8	28.0	37.5	46.0	39.3	0.0	0.0	0.0
General government gross debt	6.6	18.3	…	…	…	…	…	…
				Assumptions				
Labour productivity developments	1.7	1.4	1.9	2.0	1.7	1.7	1.7	1.7
Potential economic growth	4.5	5.0	4.0	2.7	2.1	2.2	2.2	2.0
Participation rate (men, 15-64 years)	74.7	74.4	73.6	72.7	71.8	72.5	72.4	72.1
Participation rate (women, 15-64 years)	57.9	59.5	60.5	61.1	61.9	62.0	61.7	61.4
Total participation rate (15-64 years)	66.4	67.0	67.1	66.9	66.9	67.3	67.1	66.8
Unemployment rate	4.2	4.6	4.6	4.6	4.6	4.6	4.6	4.6
Inactive/active ratio (65+ years/15-64 years)	20.7	21.1	22.3	24.2	30.8	36.3	37.8	39.1

Table 8. Macroeconomic scenario – Basic assumptions

	2008	2009	2010	2011	2012	2013	2014
Short-term interest rate in € (annual average)	4.6	1.1	1.0	1.9	3.1	4.6	4.6
Long-term interest rate in € (annual average)	4.3	3.8	4.0	4.6	4.9	5.7	5.7
Exchange rate USD/€ (average annual)	1.47	1.40	1.49	1.49	1.49	1.49	1.49
Nominal effective exchange rate*	-0.9	0.3	-0.5	-0.0	-0.0	-0.0	-0.0
Economic growth eurozone	0.6	-4.0	0.7	1.5	1.7	1.7	1.7
Economic growth of relevant foreign markets	1.4	-8.6	2.2	4.3	4.2	4.2	4.2
World import volume growth (excluding EU)	…	…	…	…			
Price of oil (USD)	98.1	61.7	76.6	76.6	76.6	76.6	76.6