



# **Budgeting in Luxembourg**

## **Analysis and Recommendations**

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# Context of the budget review

- Request of the Ministry of Finance;
- Specific guidelines set by the Ministry;
- Integrated in the preparation process of the reform initiative;
- Feedback ensuring policy relevance.

# Focus of the review

- Description of budget institutions and fiscal policy in Luxembourg;
- Fiscal planning (baseline estimates, medium term expenditure framework, fiscal rules, spending review, budgetary discipline, budget classification, budget documentation, special funds);
- Financial reporting, audit and evaluation;
- Consistency with EU requirements;
- Steering of agencies.

# Medium Term Expenditure Framework

- Luxembourg has no medium term framework (MTEF);
- Recommendation: introduce MTEF;
- Choices to be made:
  - Fixed or flexible framework;
  - If fixed: rolling or periodic;
  - Sub-ceilings for sectors or ministries;
  - Coverage: entitlement spending, interest;
  - Can the ceiling(s) in out-years be filled with new spending starting in future years ?

# EU Requirements on Budgetary Framework

- Aim: allow the assessment of compliance with the thresholds of the Stability and Growth Pact as amended in the « six-pack » (2010);
- Applies to general government (not only central government);
- Applies to expenditures, revenues and balance;
- Planning horizon of at least three years (upcoming budget year and two out-years);
- Base line estimates of major expenditure and revenue items;
- No requirements on any of the choices, mentioned in the previous slide.

# Fiscal rules

- A Medium Term Expenditure Framework (MTEF) must be anchored in a fiscal rule;
- Recommendation: introduce trend based balance rule;
- GDP trend estimation is a difficult technical problem, not only of countries using a fixed MTEF, but also for countries who use a flexible MTEF (or no MTEF);
- Current global financial crisis makes the problem even larger;
- A fixed MTEF requires a threshold for GDP trend deviation, that triggers revision.

# EU requirements on fiscal rules

- Headline deficit lower than 3 percent of GDP.
- Medium Term Objective (MTO): structural deficit lower than 1 percent of GDP for Eurozone countries. Structural deficit should be brought down with 0.5 percent annually if the MTO is not reached (2005 revision of the Stability and Growth Pact).
- Six-pack: “principle of prudent fiscal policy making”: general government expenditure growth should not exceed a prudent medium-term rate of potential GDP growth, unless the excess is compensated by measures on the revenue side; if the MTO is not yet achieved expenditure growth should not exceed a rate below the reference medium-term rate of potential GDP growth.
- Fiscal compact: structural budget balance to be anchored in national legislation.

# Trend based balance rule and EU requirements

- If Luxembourg would adopt a trend based balance rule (zero structural deficit) with a threshold for MTEF revision of 3 percent, it would comply with:
  - the 3 percent headline deficit limit;
  - the principle of prudent fiscal policy making for central government (assuming an output elasticity of the tax yield  $\geq 1$ );
  - The Fiscal Compact.
- If Luxembourg would adopt in addition pay-as-you-go rule at the tax side, it would increasingly remain below the limits of the SGP and the Fiscal Compact.

# Spending review

- The report recommends the introduction of a spending review procedure in Luxembourg;
- In contrast to programme evaluation, spending review is a part of the budget process; it is conducted under supervision of the Minister of Finance; it looks not only backward but also forward, and develops options for savings (not only efficiency savings but also options for lower service levels).
- Experience in UK and the Netherlands suggests that spending review is most effective if it is linked to the periodical revision of the MTEF.