

Opinion of the Chamber of Commerce on the Government draft budget

Uncertainties, deficits, resilience, recovery

On 14 October, the Government presented its 2021 draft budget, accompanied by a multi-year draft budget, in a peculiar environment, to say the least, with expenditures exploding as a result of aid measures and sharply declining revenues. Central government spending in 2020 is set to exceed the amounts budgeted last year by EUR 2 billion, while public revenue is meant to fall by some EUR 2.5 billion in 2020, compared to the amounts in the 2020 draft budget, against the backdrop of a 6% decline in real GDP in 2020. The result is a central government deficit that could exceed EUR 5 billion in 2020. Even with a mechanical economic rebound in 2021, this deficit is expected to remain high, at EUR 2.5 billion in 2021. The public debt, for its part, would be 27.4% of the GDP in 2020 and could reach 29.4% of the GDP the following year. This would surpass what is considered the 'government norm' of 30% as early as 2022.

Nevertheless, in an unprecedented socio-economic crisis generated by the pandemic, we applaud the fact that Luxembourg's public finances are fundamentally healthier than in other European Union Member States. This relative health makes it possible to implement an anti-cyclical budgetary policy, through an aid programme that is indispensable to save economic substance, to avoid a sharp rise in unemployment, and to maintain investment capacity and the ability of economic actors to contribute to tax and social security revenues. The Chamber of Commerce also welcomes the new support measures presented by the Government on 13 November 2020, which include broadening the scope of aid to sectors whose activity is seriously affected by the crisis, extending part-time work until June 2021 and covering the uncovered costs of companies suffering a loss of at least 40% of their monthly turnover compared to the amount earned in 2019.

This anti-cyclical policy, which can also be seen in the ambitious public investment programme, must also be able to prepare the ground for a rapid and lasting recovery after the health crisis. An effective translation of an anti-cyclical budgetary policy also consists in reducing deficits and indebtedness during periods of more vigorous growth, which will have to be recovered quickly after the crisis, to bring Luxembourg back on the path of sustainable development and focused on its modern and dynamic socio-economic model and very generous social protection model. Likewise, it will be necessary to accumulate financial reserves in a more proactive manner, which will make it possible to better temper the increase in public debt during a next crisis or shock that affects our public finances.

In these circumstances, it is therefore more urgent than ever to implement a strategy for a gradual reduction of deficits and to plan for an organised exit from the economic crisis, which is hitting businesses hard, and SMEs in particular. Last July, the Chamber of Commerce published its ideas for the recovery (see www.cc.lu/en/ideas-for-recovery). The overall plan is based on five complementary pillars necessary for a rapid and sustainable recovery, and the Chamber of Commerce will evaluate the current draft budget through the lens of these pillars, presented here as levers. While the institution welcomes the many recommendations in the draft budget, it nevertheless believes that many aspects would benefit from being more fully completed.

Lever 1 - The structural framework: Solid foundations for a sustainable recovery

Legal, fiscal and political stability are recognised as key elements of Luxembourg's attractiveness by foreign investors, while digitalisation seems to be gaining in importance every day. The idea is to consolidate these advantages in order to pursue economic diversification, without however neglecting support for 'historical' sectors. The structural lever also implies a coherent budgetary framework, which better anchors the investment choices of economic entities.

Digitalisation as a driver of efficiency

In its 2021 draft budget, the Government affirms that it wants to 'proceed with a real digitalisation (and not a simple dematerialisation) of administrative procedures, which will lead to a considerable gain in efficiency and transparency'. The Chamber of Commerce can only welcome this claim, which the various projects of the *Digital Lëtzebuerg* initiative indeed support. The Chamber of Commerce invites the authorities to connect digitalisation with administrative simplification by favouring the principle of 'only once': once information or a document is provided, it must be shared within the various administrations that need it. Digital progress should also be closely monitored. Taking inspiration, for example, from the Observatoire de la qualité des démarches en ligne, the French organisation whose role it is to monitor the quality of online procedures in France, the authorities should set up a real 'barometer' for the digitalisation of public services.

Diversification of the economy as a source of productivity

Various initiatives help to diversify the economy of the Grand Duchy. Most notably these include the so-called third industrial revolution (TIR) strategy, the positioning of Luxembourg as a 'startup nation', the 'Spaceresources.lu' initiative and high productivity activities, for example digitalisation, energy transition and the circular economy. The Chamber of Commerce reiterates its idea of building in Luxembourg a 'health ecosystem', a true *Medical Valley*, as the country has serious assets in this area, such as the HealthTech cluster or the Luxembourg Institute of Health (LIH). At the same time, it is necessary to continue to develop the financial sector as well as the industrial, commercial and services sectors. Priorities within the TIR strategy must also be implemented without further delay. The Chamber of Commerce regrets the removal, without replacement measures, of the amended law on venture capital investment certificates. This law was cumbersome, but a substitution mechanism should have been provided, in order to support innovative businesses.

The budgetary framework as a tool for transparency

Although the Chamber of Commerce welcomed the establishment in 2014 of budgetary governance more in line with the European budgetary surveillance framework, it regrets that, despite the importance given to management as an objective even within the 2018 coalition agreement, these points do not appear more in the 2021 draft budget than in previous drafts.

When the health crisis is over, it will be important to initiate a deficit exit strategy that will incorporate a standard framework of current expenditures that will favour sustainable growth compatible with social cohesion.

All in all, the current crisis should be overcome by taking it as an opportunity to overhaul the budgetary framework through a real 'general review of public finances'. The budget could then become a tool for prioritising public choices, as part of the new recovery strategy, green, digital and inclusive, focused on resilience.

Lever 2 - Public investments: Preparing for the future and mitigating the drop in private demand

In the current economic environment, public investments are of crucial importance. Correctly selected, they can even mitigate the probable drop in private investment expenditures and significantly enhance the potential for economic growth in the medium term. The Chamber of Commerce notes with satisfaction that

public investments have been identified by the Government as an essential lever for recovery. They would fluctuate around 5% of the GDP during the period 2021-2024, with increased expenditure to supply the rail fund and the road fund, support electromobility, renewable energies or economic activity zones. Such an effort is by no means a luxury given Luxembourg's delays in terms of housing or transport, in a dynamic demographic context.

The Chamber of Commerce recognises that the investment priorities of the draft budget are linked to sustainability and resilience, but nevertheless regrets that the TIR strategy is not more at the heart of the Grand Duchy's public investment policy. The Chamber of Commerce would also like to highlight the importance of greater involvement from local authorities which, as a reminder, represent nearly 40% of total public investment. The Chamber of Commerce is still surprised that new technologies, such as hydrogen, 'will be analysed in the years to come', when it is crucial to take an interest now, in order to have the most effective environmental transition in the long term, with a view to diversifying the technologies to be tested and implemented and developing Luxembourg as a 'technological and innovation laboratory in the heart of Europe'.

Finally, the Chamber of Commerce hopes that in the future, the investments of public administrations will be broken down according to their economic nature and the public activity concerned to ensure better monitoring over time.

Lever 3 - Research, development and innovation: At the heart of digital, environmental and energy transitions

Innovation is a decisive lever for job creation, strengthening the competitiveness of businesses or even the transition to sustainable growth. It must target the challenges and opportunities of tomorrow, such as digitalisation, mobility, energy, health and even finance. The 2021 draft budget proposes to adapt the legal framework in order to encourage innovation in the field of new technologies. Several provisions, such as a reduction in the subscription tax for investment funds financing sustainable economic activities, an increase in contributions allocated to the University, the Luxembourg National Research Fund (FNR) and public research centers, or the increase expected by 2024 of expenditures from the innovation fund are also proposed. Support for companies carrying out research projects aimed at transforming or modernising production processes is also planned.

Nevertheless, the Chamber of Commerce regrets that the introduction of the carbon tax, as provided for by the Integrated National Energy and Climate Plan (NECP), is carried out without any development of tax exemptions or deductions for companies who invest in efficient decarbonisation technologies. It also notes the absence of tax incentives aimed at promoting RDI in general, whether in the form of tax credits, rate cuts or other mechanisms.

Lever 4 - Jobs and talent: A skilled workforce to meet the challenges of tomorrow

It is imperative that Luxembourg have a highly qualified workforce in order to face the many challenges that are already materialising or will materialise in the short and medium term. Companies are already facing serious recruitment problems in this sense. Attracting talent on Luxembourg soil, maintaining the jobs already present in the Grand Duchy, while training them on an ongoing basis, therefore constitutes a lever for recovery that should be prioritised as a matter of urgency.

Attract foreign talent

The 2021 draft budget contains welcome innovations, such as the new impatriation plan including the elimination of the discriminatory criterion requiring companies to have 20 or more employees to benefit from it or the extension of its duration from 5 to 8 years. Details on tax residencies are also welcomed.

However, other aspects of the budget proposal are much less adequate. Raising the threshold for the required minimum annual remuneration from EUR 50,000 to EUR 100,000 in order to benefit from the

impatriation regime will restrict the scope of the new framework and exclude certain SMEs. The Chamber of Commerce insists on the need to revise this threshold and recommends not to go beyond an income threshold based on the European Blue Card, that is at most EUR 78,000 (and EUR 62,000 for professions in shortage). In addition, this bonus will be capped at 30% of the employee's salary and will be exempt from tax up to 50%.

The announced abolition of the circular relating to stock options without distinguishing between the warrants system and that of stock options is just as regrettable, as similar devices are present in many European jurisdictions. Luxembourg, where the financial industry remains a flagship, cannot find itself without such a system, which could certainly be reviewed in order to ensure a more direct link between the underlying performance and the performance of the business. Finally, a repeal cannot in any event lead to any legal uncertainty.

Train and retain Luxembourg talent

The Chamber of Commerce welcomes the strong increase planned in the allocation to the Employment Fund intended in particular to finance aid for hiring the unemployed elderly, apprenticeships, professional internships and training courses, and contracts for reinsertion into the job market. It also welcomes the strengthening of the employment development agency, ADEM, aimed at improving the coherence between the needs of businesses and job seekers. Various digital skills initiatives, such as the Digital Skills Bridge, have also been budgeted.

The 2021 draft budget also provides for the introduction of a participatory bonus. However, this plan is fairly limited in scope, as it cannot exceed 5% of the company's income and 25% of the gross annual remuneration of the employee who benefits from it. In addition, only 50% of the premium is exempt from tax and companies that do not, or do not yet, make a profit, will not be able to benefit from it.

The Chamber of Commerce further notes that the draft budget provides for 1,000 contracts - without further details - in the public service in 2021, while the private sector is facing serious difficulties in recruiting qualified staff. The latter is facing a real drain of employees leaving for the public sector, for which it has nevertheless provided and financed the training.

Finally, the Chamber of Commerce regrets that harmonising the social security plan for the self-employed with that of salaried employees does not seem to be on the agenda and invites the authorities to reconsider this issue.

Lever 5 - Taxation: Essential in a very competitive international environment

The 2021 draft budget contains several developments in tax matters, which the Chamber of Commerce welcomes. The project foresees the introduction of ecological criteria for capital expenditures within the framework of the energetic renovation of buildings, for example. It also introduces an allowance for rental reductions granted until 31 December 2020 on the basis of a commercial lease contract and due to the COVID-19 crisis. The Chamber of Commerce supports this measure, which is likely to mitigate the negative effects of the crisis, even if the planned allowance seems too limited.

It also welcomes the tax exemption for allowances granted to support micro-businesses in the context of the health crisis, the VAT plan for small businesses (an increase in the threshold for the exemption), or the recovery of taxes.

Finally, if the Chamber of Commerce approves the exclusive allocation of the proceeds of the carbon tax to financing and supporting the ecological transition, it questions the provisional amounts given in the 2021 draft budget, namely only 40.5% (that is, EUR 64.6 million) of the CO2 tax contribution will be allocated to the climate and energy fund.

In conclusion, with the exception of the participative bonus - which is basically a variant of the profit-sharing plan proposed by the Chamber of Commerce - and certain specific positive points, no other proposal from the Chamber of Commerce in terms of the recovery has been taken into account, whether in terms of

transversal measures (reduction in the corporate income tax, Luxembourg's 'IRC', rate that should be announced now as part of an ambitious roadmap to bring this rate back, for example as of 2022 onwards, to the European median level, loss carryover for the past, introduction of a reserve that is immune and exempt, even partially, from wealth tax) or measures in favour of entrepreneurship, particularly at the initial stage of development. The repeal of the law on venture capital investment certificates, without providing an alternative, also sends a rather negative message to the sector.

Finally, while one-off measures have been observed in terms of digital transformation, energy and R&D, a real tax incentive (tax credit or tax deduction) is missing for the investments made.

It goes without saying that the draft budget contains potentially damaging provisions, such as the 20% levy on gross rental income from real estate located in Luxembourg and to which specialised investment funds will be subject (no distinction is made regarding the activities or objectives of the funds concerned); the increase from 1.1% to 3.4% of duties in the event of the contribution of buildings to a company, while these rights limit the movement of goods; or the abolition of the allowance for sustainable mobility in favour of natural persons. The Chamber of Commerce also regrets a modification of the tax consolidation plan that is too limited in time and in its scope.

Beyond the lack of ambition of the tax measures and given the current crisis, the tax part of the 2021 draft budget is characterised by the wholesale abolition of certain advantages without discernment between objectively different situations. There is also great legal uncertainty due to the lack of precision of several provisions, and the failure to anticipate the consequences of switching from one plan to another, without a transitional period.

With a view to economic recovery, Luxembourg should present a roadmap to eliminate these weaknesses as quickly as possible and to mitigate, if not eliminate, certain anomalies, such as the wealth tax and the subscription tax. A coordinated strategy for the development of R&D (with SMEs in particular) and for new entrepreneurs, who are key players for qualitative growth, must also be defined and implemented. It is essential to attract highly qualified professionals to Luxembourg.

The Chamber of Commerce insists on the need to move forward simultaneously on these five levers, which are entirely complementary and therefore create a complete plan for a dynamic and lasting recovery.

The full text of the Chamber of Commerce draft budget opinion is available in French [here](#).