Political situation

Following the 2013 elections [1], the Grand Duchy of Luxembourg is being ruled by a coalition government [2] of three political parties [3]: Democrat (Demokratësch Partei [4], with Prime Minister Xavier Bettel), Socialist (LSAP [5]), and Green (déi gréng [5]).

An important feature of the Luxembourgish political system is its commitment to social dialogue [6]. The role of social partners is enshrined in legislation. What is sometimes called the 'Luxembourg model' is a search for ongoing and institutionalised consensus by means of a Tripartite: a trilateral discussion board with representatives of government, employers and syndicates who agree on important economic and social issues.

Policy dialogue is made easier by the small size of the country and its resulting close proximity between policymakers and leaders of labour and management. This three-way negotiation system stimulates political change and economic diversification in Luxembourg. It thus contributes to the economic and social stability of the country.

Currently, four institutions ensure an ongoing social dialogue:

1. The Economic Committee [7] (Comité de conjoncture) analyses the economic situation and the evolution of conjuncture. It issues monthly reports to the Government Council, advising on measures to prevent layoffs due to circumstantial factors.
2. The Economic and Social Council [8] (Conseil économique et social), placed under the authority of the Prime Minister and financed by the budget of the Ministry of State, is an advisory body which studies economic, social and financial issues and advises the government on the matter. Established in 1966 [9], it is made up of representatives of various sectors, employers and employees, and various experts, with, as defined in the law of 10 March 2014 [10], different ministries and stakeholders ensuring fairness and social inclusion.
3. Sectoral tripartites, shaped on the model of the Steel tripartite Conference (founded in the context of the steel crisis of the 1970s), bring together representatives of business, unions and government on an institutionalized and ongoing dialogue platform.
4. The tripartite Coordination Committee (Comité de coordination tripartite) issues advice notes and recommendations prior to the implementation of actions deemed necessary to tackle unemployment.
Economic situation

Historical background of economic development

Prior to the 19th century, Luxembourg economy was mainly based on agriculture, with an industrial activity strongly rooted in the rural community.

According to economist Gérard Trausch (2012, *Les mutations économiques et sociales de la société luxembourgeoise depuis la révolution française* [11], p.179 and, by the same author, 2009, *La société luxembourgeoise depuis le milieu du 19e siècle dans une perspective économique et sociale* [12]), the development of industry in Luxembourg has evolved in three phases:

1- The pre-industrial period

Luxembourg's political independence in 1839 fostered the development of industry: as a matter of fact, tax revenue (an average of 1.8 million guilders per year) could now be invested in the country itself. On the other hand, the country's membership of the German Zollverein (tariff union) – from 1842 to 1918 - allowed access to an important market.

In the first half of the 19th century, industrial activity [13] in Luxembourg focused on the production of textiles, gloves, pottery, paper, and brewery and tobacco products. The discovery, around 1842, of iron ore in the south of the country started the development of the steel industry, which evolved from 1876 to become the most important industrial sector.

The advent of railways in 1859 made it possible to replace charcoal by coke, thus significantly increasing the productivity of cast iron. Furthermore, rail transport boosted exports not only of ironworks, but also of other industries established in Luxembourg.

2- The industrial era

From 1876 on, technological innovations in steel manufacture enabled the large-scale production of steel. With increasing demand, cast iron and steel were exported, first within the Zollverein, later to partners worldwide after the First World War.

In the 20th century, and particularly from the 1950s, steel industry grew significantly, reaching a peak production in 1974 with over 6 million tons.

On the other hand, Luxembourg’s economy became more diversified during the second half of the 20th century. Increasingly complex businesses emerged, such as major US firms like Goodyear (tire production), DuPont (polyester) or Monsanto (nylon yarn). Concurrently with this diversification, the financial sector developed.

From a societal perspective, it is noteworthy that workers’ mutual aid associations appeared from the middle of the 19th century, the first dating back to 1849. In these mutual aid societies grouped according to occupations, workers and craftsmen contributed to a common fund designed to provide support in case of illness or death. In 1891, legislation recognised the role of mutual aid associations. In 1901, a first law on social insurance was voted in Parliament, making sickness and accident insurance compulsory. Ten years later, in 1911, the law also instituted a compulsory pension insurance scheme. Luxembourg thus progressively implemented a robust social protection system.

Concerning trade unionism, the start of a labour movement was initially held back by the heterogeneity of the workforce in the steel industry, largely made up of immigrants. It was only
towards 1916-1920, when living conditions sharply deteriorated, that the first structured union associations appeared. On 10 February 1958, Luxembourg ratified the [Convention 98 of the International Labour Organization on the Right to Organise and Collective Bargaining](https://www.ilo.org) [14].

### 3- Deindustrialisation, expansion of the tertiary sector and globalisation

From the end of the 1960s, Luxembourg was severely affected by the steel crisis related to worldwide overproduction. The cutback of production was abrupt: the utilisation rates of crude steel producing installations fell from 96 % in 1974 to 55 % in 1982.

Nevertheless, the Grand Duchy managed to overcome the crisis with financial support from public authorities and by establishing a Tripartite Coordination Committee in 1977. The tripartite sectoral Steel Conference managed to avoid mass unemployment by a number of measures, like investment aids, financial restructuring, social support, etc. Deindustrialisation in Luxembourg didn't mean the total disappearance of industry: in fact, it only 'normalised' an over-speeding industry.

In parallel to these developments in the steel industry, Luxembourg continued to develop its tertiary sector: business services, computer services, transport, communication, and in particular the financial sector. The expansion of the latter was not originally motivated by a deliberate policy on the part of the Grand Duchy, but it was largely favoured by new and more restrictive regulations introduced in other countries.

Today, banking and financial services have taken over as driving forces of the national economy. The Luxembourg financial centre has a number of assets: its geographical location and the small size of the country, a favourable economic environment and responsiveness to changes in the international regulatory and legislative context, a flexible but effective supervision structure of the financial sector, etc.

The expansion of the service sector in Luxembourg's economy has had a spillover effect on other sectors, in particular service providers and other enterprises, notably in the trade sector and in the catering and hotel industry.

With increasing economic internationalisation Luxembourg has experienced an unprecedented development. Between 1980 and 2000, the growth of GDP per capita was more important than in most other countries. The expanding labour market of the country has attracted a significant number of immigrants and cross-border workers.

From 2000 on, economic growth has slowed down, though the overall economic situation remains relatively positive. Still, the 2008 crisis has led to a rapid and significant deterioration in the labour market, with increased unemployment and a downward revision of public finances.

### Distinctive economic characteristics of present-day Luxembourg

- **A small but open economy:** From the beginning of its political independence, Luxembourg is part of larger markets or economic unions (Zollverein, UEBL, ECSC, EEC - see article 1.1 [Historical Development](https://www) [15])
- **A highly specialised and flexible economy:** The small size of the territory has allowed Luxembourg to adapt laws and institutions such as to foster economic development with a high degree of specialisation. The main areas of specialisation have been steel production in the past and currently are financial services
- **Exposure to external developments:** Due to the important role of foreign investment and
external demand for products and services, the country is exposed to alterations in European and international environments, such as general economic conditions or financial or legislative provisions in other countries.

- **A transnational labour market:** Luxembourg’s labour market is composed of Luxembourg nationals, foreign residents and cross-border workers (see article 1.3 Population[16]). Owing to the expansion of financial and IT services, foreign employees are strongly represented at both ends of the qualification spectrum: they mostly either do unqualified work or hold highly qualified positions. Luxembourg nationals are predominant in public administration and services.

- **Labour market regulation and social security:** In the course of the 20th century, Luxembourg has established a strong system of social security and labour market regulation (i.e. minimum wages, automatic wage indexation).

## Current situation and outlook

Today financial services (banking, financial auxiliaries) represent the most important sector in Luxembourg economy. Industry has gradually lost influence over the years, whereas the tertiary sector has developed: at first business services, then the financial sector, and in recent years the sectors of transport and communications with dynamic growth and a high potential for development.

The presence of other sectors has remained relatively stable. As for agriculture, its importance has been progressively decreasing.

The deterioration of the international economic environment has led to a remarkable slowdown of Luxembourg’s economy from 2008 on. GDP growth even became momentarily negative (in 2012), and unemployment rate has reached unprecedented levels in Luxembourg, though in the subsequent years a relative recovery has begun.

In international comparison, Luxembourg economy is performing rather well. **Per capita GDP**[17] remains at a high level with EUR 87 600 per inhabitant in 2014. This figure should however be put
into perspective, given the importance of cross-border workers who by definition are not included as residents in the statistics.

To ensure more sustainable national competitiveness while meeting regulatory provisions agreed at international level, Luxembourg has recently initiated a number of legislative and regulatory measures.

The 2015 State budget and the paquet d’avenir [package for the future] policy announce fiscal and structural changes aimed at modernising public structures in the medium and long term, such as to reduce public debt and place public finances on a sustainable path. Its 250 reform measures involve taxation, social benefits, housing, employment, family, education, health and retirement.

The chart below shows the numerical target of this policy on the balance of Central administration.

**Prospects**

The perspective as described in the January 2016 Flash conjoncture [18] publication presents a more positive outlook than the November 2015 Note de conjoncture [19]:

- Growth acquisition for 2015 at the end of the 3rd quarter could be revised upwards, with 4.8 % instead of STATEC’s November forecast (3.2 %). The sectors that most contributed to growth were the financial sector, transport services, business services and the construction sector.
- Non-financial services, representing around 60 % of total value-added value maintain their dynamic, though depending on the sector. Positive evolutions are noted in business services (legal, accounting and management services), whereas the trade sector and the hotels and restaurants sector suffered from the VAT increase from the beginning of the year.
- Unemployment rate is in decrease compared to last year (6.7 % in December 2015), confirming the improvement of economic activity.
- The progression of wages stays very moderate.

- With falling oil prices, particularly after the definitive lifting of sanctions against Iran, salary indexation has been postponed once again, until the 2nd semester 2016. Still, the core inflation [20] rate continues to rise with 0.9 % over one year.

- Tax receipts are up 3.8 %. This progression is lower than the average annual growth of 6.2 % over the 5 past years. The slower progression of tax receipts is due to the reduction of VAT income from e-commerce and to the 11.7 % decrease of revenue from excise duty.

**Effects on the development of the education system**

While the government focuses on avoiding an increase in public expenditure as a whole, the budget for education has been slightly raised in the past few years. Moreover, reforms are being implemented in the field of education, as well as measures for young job seekers. The level of State co-funding of in-company continuous vocational training has also been redefined, and expenses on study grants and loans have been restructured.
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