Caption: In a special edition on Luxembourg published on 4 November 1992, the British daily newspaper Financial Times reports on how the Luxembourg economy is enjoying significant benefits as a result of the policy of diversification — especially towards the banking sector — pursued in recent decades.


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Diversification has helped keep the economy in good shape

Banking takes up steel slack

PARADOXICALLY, the strength of the Luxembourg economy in 1992 is probably best illustrated by the difficulties facing its single biggest employer, the Arbed steel group.

Thanks to a policy of economic diversification pursued since the big steel crisis of the mid-1970s, the economy continues to perform well, in spite of the malaise in steel.

Banking, plastics, rubber and new industries, such as glass production, are clearly helping to compensate for the downturn in the steel market, which is hurting not only Arbed but also steel producers across Europe.

The figures testify to the achievements of diversification. Growth in industrial production held steady at 2 per cent in the 1992 first half, in spite of the slowdown in demand for steel; and overall economic growth for 1992 is forecast to match the 3.7 per cent increase seen in 1991. Growth in 1993 is projected to be only slightly slower at 3.5 per cent.

Inflation, currently around 3 per cent, has been kept in bounds, defying a two-point rise in value-added tax (VAT) to 15 per cent, carried out to bring Luxembourg more into line with its EC partners.

All in all, Luxembourg can boast that it is one of the few signatories to the Maastricht treaty that already fulfils all five criteria for economic and monetary union. As a small, open economy, however, it remains susceptible to weaknesses imported from the outside, particularly from Germany, its biggest trading partner.

Still, the ease with which Luxembourg has managed so far – to ride out the current steel crisis is a far cry from the country's heavy dependence, 20 years ago, on iron and steel which made it acutely vulnerable to the steel business cycle.

"At the peak in 1974, Luxembourg was, in per capita terms, the biggest steel producer the world has ever seen, producing 17 tonnes per head of population per year, against only half a tonne for the US," says Mr. Michel Waringo, a director of Banque Générale de Luxembourg.

Since then, Arbed's size has been severely reduced, and the resulting slack in the economy has been taken up by the banking sector. In nearly 20 years since the steel industry shrank, the number of banks has increased fivefold to 192, giving the tiny Luxembourg capital more banks per square metre than any other city in the world.

The number of people employed by the steel industry has dropped sharply to just 8,000, from 28,000 in 1974, while the arrival of scores of new banks in the 1980s has increased employment in the banking sector to 15,000. Overall, services now generate 65 per cent of GDP, with banking alone accounting for 15 per cent, while traditional industry makes up 25 per cent of GDP – a near-reversal of the old ratios.

"It would be dangerous to go below this 25 per cent level," says Mr Georges Schmit, an industry specialist at the economic affairs ministry. "Luxembourg paid a heavy price in the past for relying on one sector, and policy now is aimed at a balanced, diversified economic structure."
Tripartite approach worked

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Mr Lucien Jung, managing director of Fedil, the Luxembourg industry federation, believes that a target level of 30 to 35 per cent would be healthier for the economy. Individual investments by companies in the banking and financial services tend to be lighter than those in manufacturing industry, making them more transient and less dependable.

"If they (the banks) can earn 10 per cent more in London or Zurich, they leave. But if an industrial company makes an investment of LFr1bn (£20m), it's bound not to leave so quickly," he argues.

The banking community counters this argument by pointing to the recent heavy investment by foreign banks in new, purpose-built premises and their new-found efforts to step up the training of staff.

The ultimately successful move away from an over-reliance on steel was achieved by the use of what has come to be known as the "Luxembourg model". Under this tripartite approach between industry, government and the unions, Arbed promised not to push through forced redundancies, the unions pledged not to strike, and the government agreed to help promote industrial restructuring.

Another part of the model, still at the country's disposal, is the use of "short-time" working schedules to bridge the peaks and troughs in demand at otherwise healthy companies. The latest company to introduce short-time is Villeroy & Boch, the German-based manufacturer of porcelain, tiles and sanitary fittings, which employs 1,400 people at a tableware factory in Luxembourg.

Some 1,300 of these employees were put on short-time schedules when the factory was closed for two weeks in September and October. Similar measures are expected later in November and December, to help the factory weather a drop in demand on recession-plagued foreign markets. Government funds, raised by a "solidarity levy" on taxpayers, ensure that employees receive up to 80 per cent of their normal full-time salary while production is shut down.

Short-time work schedules are one of the reasons why Luxembourg has such a low rate of unemployment. Only 2,800 people, or about 1.7 per cent of the working population, are registered as out of work, putting the country close to achieving the near-impossible feat of full employment.

But Mr Schmit, of the economics ministry, points out that national statistics are perhaps inappropriate for gauging Luxembourg's labour market. Purely national statistics do not include the 44,000 cross-border commuters who stream into the Grand Duchy every working day from Germany, France and Belgium, filling jobs for which there are simply no more Luxembourgers available.

This heavy dependence on non-Luxembourg labour - including foreigners living within Luxembourg and those living just outside - puts the country in a unique position within the Twelve. Forty-five per cent of jobs in Luxembourg are held by non-nationals, mainly immigrants from Italy and Portugal and their children.

For the time being, Luxembourg is finding enough foreign workers to keep its factories and offices running. But in the longer term, its reliance on crucial non-national labour is a worry for corporate recruiters and government policy-makers.