INTERNATIONAL MONETARY FUND

Liechtenstein: The Fiscal Sector Framework

Rodgers Chawani and Tara Iyer

SIP/2025/045

IMF Selected Issues Papers are prepared by IMF staff as background documentation for periodic consultations with member countries. It is based on the information available at the time it was completed on March 5, 2025. This paper is also published separately as IMF Country Report No 25/77.

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Liechtenstein: The Fiscal Sector Framework
Prepared by Rodgers Chawani and Tara Iyer

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ABSTRACT: This paper analyzes Liechtenstein's fiscal framework, highlighting its successful consolidation following the global financial crisis. The study examines the budget balance rule that anchors fiscal policy, benchmarking key fiscal indicators against European peers. Findings reveal Liechtenstein effectively implemented frontloaded fiscal consolidation through revenue and expenditure measures, improving the fiscal balance by 4.1 percent of GDP during 2014-18. Despite maintaining low tax rates, Liechtenstein operates with a lean government structure, evidenced by low public employment levels and wage bills. The analysis concludes that increased capital investment could boost productivity, which has stagnated over the past two decades despite being higher than Switzerland's.

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SELECTED ISSUES PAPERS

Liechtenstein: The Fiscal Sector Framework

Liechtenstein

Prepared by Rodgers Chawani and Tara Iyer[1]

[1] “The author(s) would like to thank Mark Horton and Kazuko Shirono (all IMF EUR) for their helpful comments and suggestions.”

INTERNATIONAL MONETARY FUND

PRINCIPALITY OF LIECHTENSTEIN

SELECTED ISSUES

March 5, 2025

Approved By

Prepared By Rodgers Chawani and Tara Iyer (all EUR)[1]

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LIECHTENSTEIN: THE FISCAL SECTOR FRAMEWORK[1]

The paper provides an in-depth analysis of Liechtenstein's fiscal sector, highlighting successful consolidation following the global financial crisis and a fiscal framework anchored by a budget balance rule. Liechtenstein maintains a lean government and a strong fiscal position notwithstanding low corporate and personal income tax rates. Additionally, the paper emphasizes the potential benefits of capital investments in enhancing productivity.

A. Introduction: Post GFC Consolidation

1. Liechtenstein effectively pursued fiscal consolidation following the global financial crisis (GFC). Weak fiscal conditions primarily prompted fiscal consolidation. Real GDP growth averaged 4 percent during 2003-07 but experienced a decline by 12 percent in 2009 in the aftermath of the GFC and international pressure to adhere to the OECD standards on tax information exchange. Consolidation emerged as a policy priority primarily due to deteriorating public finance conditions. The multi-year rolling budget forecast for 2010–14 projected a cumulative deficit 14.4 percent of 2010 GDP, potentially straining state fiscal reserves. The tax reforms prompted structural reforms in the financial sector's regulatory framework.

2. The pace of consolidation was sizeable and frontloaded. The fiscal balance improved by 4.1 percent of GDP during 2014–18. The significant and quick consolidation reflected sustainability concerns and the desire to signal a credible reform commitment. Consolidation was based on revenue and expenditure measures. Expenditure savings comprised current expenses, state pension and health contributions, aid, and subventions to municipalities. The state's contribution towards pensions was reduced and decoupled from current expenditure and civil service recruitment slowed. Revenue measures focused on broadening the tax base targeting income and wealth taxes, and rationalization of administrative fees.

3. Against the backdrop of this successful and enduring consolidation, this paper benchmarks Liechtenstein's fiscal sector against peers, while analyzing factors that have contributed to outcomes. It starts with a discussion of the fiscal framework, benchmarks key fiscal aggregates, and concludes with a review of emerging spending pressures for the conduct of fiscal policy going forward.

B. The Fiscal Framework

4. The quality of fiscal institutions is key to the success of consolidation. Countries with stronger institutions deliver stronger fiscal adjustments and are better positioned to respond to external shocks (IMF 2014; Balasundharam et al. 2023). A strong track record of fiscal management also improves the likelihood of successful consolidation (Alesina, Favero, and Giavazzi 2015). The

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implication is that fiscal consolidation should be underpinned by a credible medium-term fiscal framework, supported by strong institutions for sound policy design and robust implementation (IMF 2022). Well-functioning institutions can promote credibility and sustainability, enhance transparency and controls, and help assess risks.

5. Liechtenstein's fiscal framework is centered on a budget balance rule (BBR). BBRs may target the overall balance, the structural or cyclically adjusted balance, or the balance over the cycle as an anchor for fiscal policy (IMF 2009). In Liechtenstein, the BBR targets balancing income and expenses in the income statement of the central government over the medium term (Art. 2). The income statement comprises the results of business activities, financial, and extraordinary results—revenues minus expenses. A key component is net results from assets under external management—interest and dividend income and capital gains *less* asset management costs. Dividends derive from companies like the Landesbank, Post AG, and Telecom. Extraordinary results refer to occasional and unusual expenses or income of more than CHF10 million.

6. Liechtenstein aims to achieve a balanced nominal budget in practice. Accordingly, the rule offers clear guidance for communication to parliament and the public. However, it does not systematically use macroeconomic assumptions for revenues or expenses, nor does it consider shocks. The rule is embedded in statutory norms, aiming at discipline and sustainability. The Financial Budget Act (FHG) 2010 envisages a multi-annual framework covering four years, updated annually. Since the rule is enshrined in higher-level legislation, it is difficult to reverse and largely insulated from changes in government conferring stability.

7. Coverage is limited to the central government. Municipalities and social security funds operate autonomously. The rule has escape clauses that provide some flexibility in dealing with rare events, including one-off future-oriented projects. If key financial parameters cannot be met and the additional expenditure or shortfall in revenue is not one-off, the FHG obliges the government to draw up proposals for measures to meet the key financial parameters within six months of the financial plan being discussed in parliament. The measures are presented back to parliament which decides whether they are necessary and instruct the government accordingly.

C. Budget Rule Principles

8. The budget rule is anchored on five principles. The first three parameters must be met on average over the financing plan; the last two must be met at the end of the financial plan period.

- *At least a balanced annual income statement*. This has contributed to budget surpluses and accumulation of sizeable fiscal buffers. Strict adherence to the rule could limit flexibility to respond to shocks given the need to be aligned irrespective of the economic cycle. The focus on *net operating balance* or change in net worth excludes net capital investments.

- *The absolute growth of expenditure must not exceed the growth of income*. Strict adherence to this parameter could affect the response to shocks.

- *The ratio between self-financing funds and net investments should be at least 90 percent,* instilling discipline that public investments should primarily be funded through internal resources rather than borrowing. The benchmark has contributed to the current virtually zero debt level. However, it may limit investment in infrastructure or other long-term projects. During a downturn, self-financing may become challenging, leading to underinvestment when it may be needed. Focusing on self-financing may involve high opportunity costs for fiscal buffers. This notwithstanding the Financial Budget Act provides for exceptions for forward-looking and important investments from compliance with the budget rule.

- *The ratio between financial assets and external funds should be at least 420 percent,* providing buffers against market stress, reducing vulnerability to sudden funding disruptions, and signaling enhanced creditworthiness. However, may incentivize a higher-than-norm asset accumulation and involve a higher opportunity cost of maintaining high liquid assets.

- *The ratio between financial assets and operating expenses should be between one and three times,* prioritizing fiscal buffers to cover operational costs and *de facto* being considered as a target for the size of the financial assets. This may risk holding excessive assets with lower overall returns. There is need for analyses of the adequacy of the precautionary balances.

Table 1. Liechtenstein: Central Government Budget Balance Rule

	FP 2020-23	FP 2021-24	FP 2022-25	FP 2023-26	FP 2024-27	FP 2025-28
Annual Result > 0	Met	Met	Met	Met	Met	Met
Absolute growth in income > Absolute growth in Expenses	Not Met	Not Met	Met	Not Met	Not Met	Not Met
Self-financing ratio >=90 percent	Met	Met	Met	Met	Met	Met
Financing ratio >=420	Met	Met	Met	Met	Met	Met
Financial assets to operating expenses = 1-3 times	Met	Met	Met	Met	Met	Met

FP stands for financing plan for the four year period.
Met refers to authorities' assessment and implies in line with benchmark at the end of the four year period
Not Met implies not in line with benchmark at the end of the four year period.

Source: Liechtenstein Authorities

9. Outcomes have been in line with the budget rule except for Benchmark 2. This benchmark has not been met based on the multi-year financing plans. The escape clause has helped to facilitate performance as applying the netting of one-off expenses or income eventually leads to realignment with the rule. There may be scope to review the benchmark given the potential to restrict or delay spending in the context of rising pressures and the track record of frequent breaches.

D. Expenditures

10. Liechtenstein maintains a small government footprint. During the fiscal consolidation, spending declined by 5 percentage points and was significantly lower compared to the Euro area average and Switzerland during 2011–22. Current spending accounted for the bulk of the spending adjustment. The wage bill is among the lowest in Europe at 5.2 percent of GDP. General government employment levels are relatively low at 7.7 percent of the workforce compared to the EU median of about 16–17 percent. Capital spending was below 2 percent of GDP compared to 3½ percent on average for the EU (2011–22).

11. Social protection spending and public investment are low compared to peers. Social protection is about 36 percent of total government outlays or 8.1 percent of GDP, well below the Euro area average of 16 percent of GDP in 2022. Low social spending is primarily driven by relatively low pension spending following the pension reform of 2013 and reduced state contributions. Public investment is also low and averaged 1.5 percent of GDP during 2013–2022.

12. Liechtenstein spending envelope is stable but experienced unique trends over the last decade (see functional breakdown in Figure). There was the upscaling of public expenditures in the period following the GFC and subsequent structural changes in the regulatory framework for the financial sector. Without policy measures the central government was projected to accumulate a deficit of 13½ percent of GDP by the end of 2014. This led to restructuring of the budget by reducing current expenses and state contributions to the pensions. More recently, the pandemic and energy prices crisis induced another spike in public spending reverting to 31.3 percent of GDP in 2020, reflecting largely discretionary relief measures and augmentation of the Pillar 1 pension.

13. A functional breakdown of expenditures shows social protection and education as the main drivers of public outlays.[2] Spending on social protection was 8 percent of GDP in 2022, significantly lower than Euro area (16 percent) while education expenditure reached 4 percent of GDP in 2022, comparable to that of the Euro area. Reflecting the lean civil service public services outlay were only 4.3 percent of GDP in 2022.

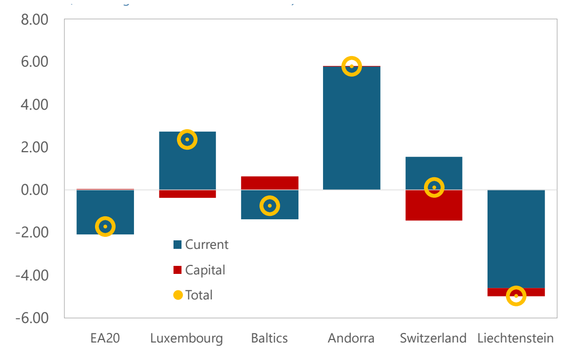
- *Social protection.* Primarily based on a three-pillar system, including old-age and survivors' insurance, disability insurance, family allowances, unemployment insurance, and mandatory health insurance for all residents. The maximum old age pension is CHF 2,450 (paid 13 times a year), and the minimum is CHF 1,225. Old age and survivors' insurance covers old age pensions, widows, and widowers' pensions amounting to 80 percent of the maximum old age pension. . A family compensation fund pays one-time childbirth, monthly children, and single parents' allowances.

- *Education.* Public education expenditure reached 4 percent of GDP in 2022 of which government contributed 78 percent while the municipalities funded 22 percent. The state operates own public schools and further provides scholarships and interest-free loans to support education. Education is free and compulsory for children ages 6–15. After compulsory schooling, several paths open relating to general or vocational education and training based on teachers and parents' evaluation. With the excellent vocational training opportunities available, Liechtenstein has a low youth unemployment rate.

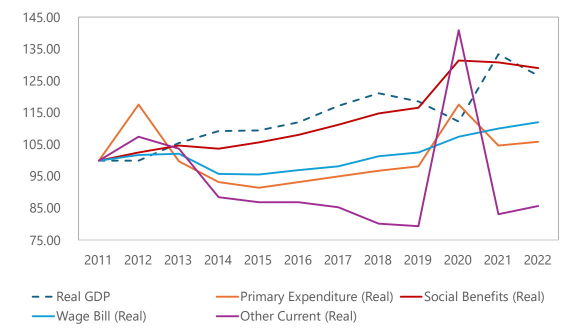
[2] A functional breakdown of spending keeps the analysis tractable makes it easier to incorporate estimates of future spending needs already in the literature.

Figure 1. Evolution of Spending

Change in Total Spending
(Percentage points of GDP, 2021–2022)



Real Primary Expenditure Growth
(In index, 2011=100)



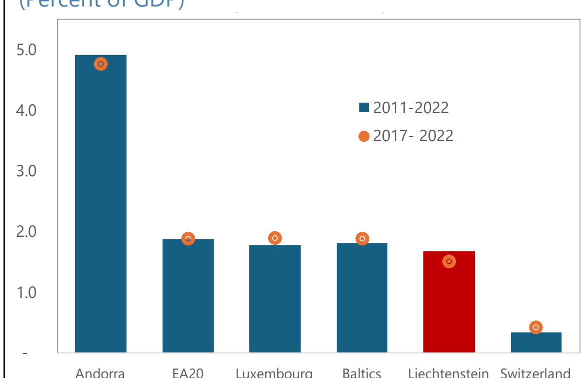
Compensation of Employees
(Percent of GDP)

Sources: Government Finance Statistics, IMF, and IMF Staff Calculations

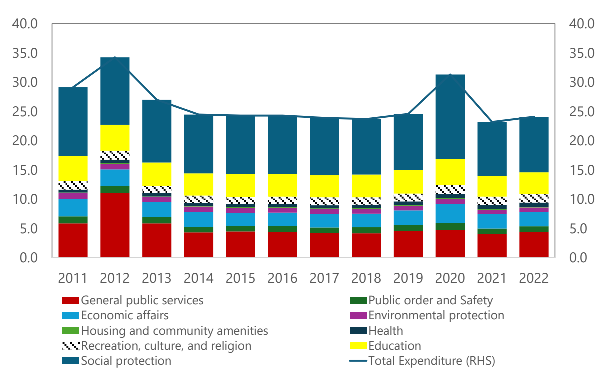
Social Security Benefits
(Percent of GDP)

Sources: Government Finance Statistics, IMF, and IMF Staff Calculations

General Government Capital Spending
(Percent of GDP)



Government Expenditure by Function
(In percent of GDP)



- *Health* – The quality of life is high—life expectancy is 84.3 years (EU 80.6), with women expected to live 2.3 years longer. Liechtenstein has a universal healthcare system that includes public and private healthcare options. Health insurance is mandatory financed by employer and employee based on per capita premium. Government however subsidizes low-income individuals, children, and young adults but only account for 40 percent of health care insurance.

E. Revenue

14. Liechtenstein maintains a low tax regime. The tax-to-GDP ratio has generally been low compared to peers, averaging 14¾ percent of GDP in the last two decades, significantly lower than that of the Austria, Euro area, and Switzerland and at a similar level as Andorra for the past decade. While VAT, customs, heavy goods vehicle tax, CO_2 tax, and stamp duties are levied in line with Swiss regime, the rest of the taxes are determined domestically.

15. Taxation relies on direct taxes. PIT and CIT contribute about 60 percent of the tax revenue. CIT revenue was, on average, higher at 4.5 percent of GDP during 2000-22 for Liechtenstein compared to the Austria (2.4 percent), the Euro area (2.9 percent), and Switzerland (2.7 percent). PIT revenue was lower on average at 3.7 percent of GDP during 2000-22 compared to Austria (9.8 percent) and Switzerland (8.3 percent).

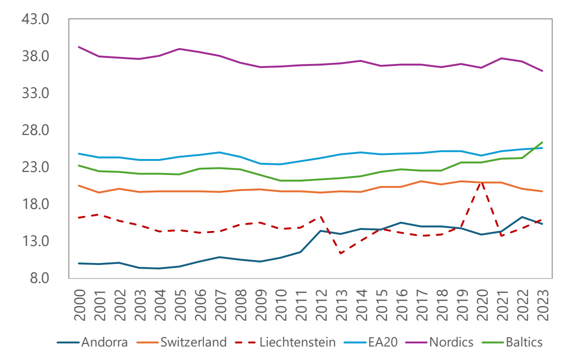
- *PIT.* Residents pay unlimited worldwide income taxes. Individual income taxes cover employment, self-employment, agriculture, forestry, pensions, and other income. A wealth tax is determined by applying a standard return of 4 percent to the net worth of notional income. Non-residents are subject to taxation on income sourced from Liechtenstein, which includes earnings from employment and pensions. This taxation is however limited due to double tax agreements. Progressive PIT rates vary from 2.5 to 24 percent.

- *CIT.* Levied on a company's profit, allowing for tax-related adjustments, including a 4 percent notional interest. Dividend income and capital gains from the sale of participations are generally exempt from taxation if the anti-abuse provision does not apply. Income on assets under the management of investment funds is not taxed at the level of the investment fund company. The CIT rate has remained at 12.5 percent. The Principality has signed numerous double tax agreements with countries worldwide.

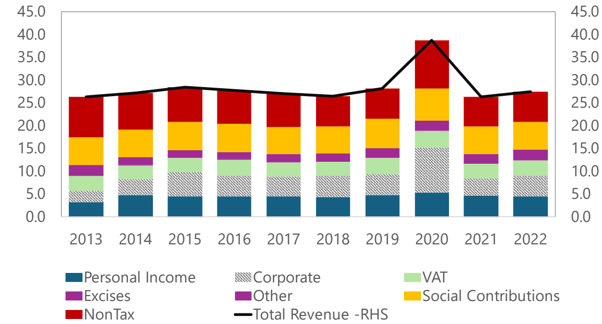
16. Indirect taxes comprise VAT; excise taxes have remained very low. The VAT rate recently increased from 7.7 to 8.1 percent in line with Switzerland, still much lower compared to EU peers. A reduced VAT rate of 2.6 percent applies for some goods and services, including water and cultural services, and to certain sectors, notably agriculture. The hotel and lodging industry is subject to a reduced VAT rate of 3.8 percent. Medical treatment and real estate are exempted.

Figure 2. Evolution of Revenue and Taxes

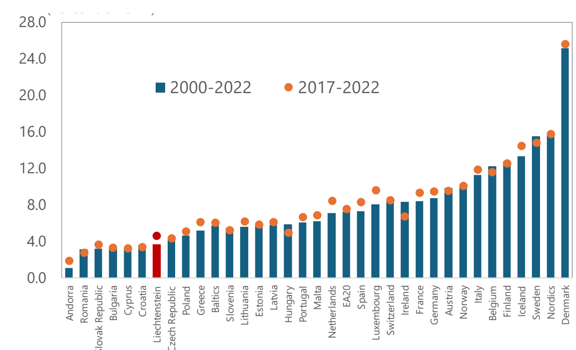
General Government Taxes
(Percent of GDP)



General Government Revenue by Type
(In percent)

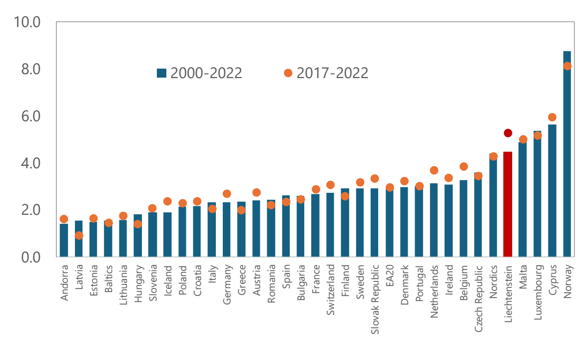


Personal Income Tax
(Percent of GDP)



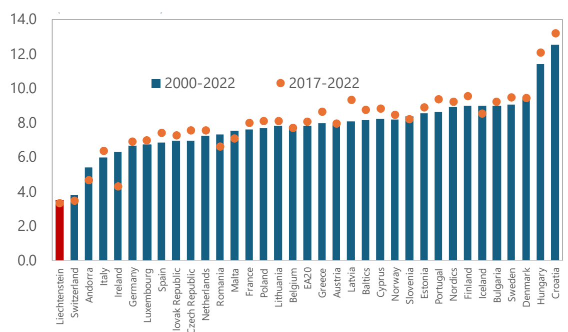
Sources: Government Finance Statistics, IMF, and IMF Staff Calculations

Corporate Income Tax
(Percent of GDP)



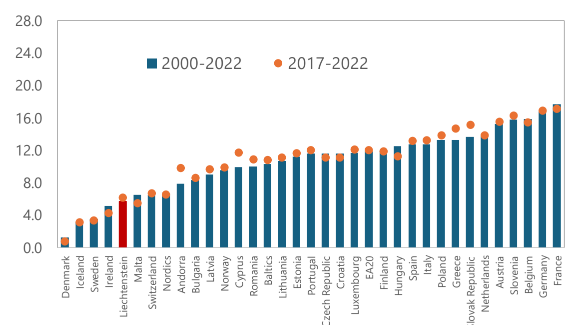
Sources: Government Finance Statistics, IMF, and IMF Staff Calculations

Value Added Tax
(Percent of GDP)



Sources: Government Finance Statistics, IMF, and IMF Staff Calculations

Social Contributions
(Percent of GDP)



Sources: Government Finance Statistics, IMF, and IMF Staff Calculations

17. Despite the existing preferential treatments, collection of VAT is broader compared to peers. In terms of performance, the OECD VAT revenue ratio (VRR) provides a measure of the extent to which a VAT regime collects on the natural base of the tax i.e., final consumption expenditure. To achieve this, the VRR estimates the difference, if any, between the VAT revenue collected under a country's VAT regime and what would theoretically be raised if VAT was uniformly applied at the standard rate to the entire potential tax base. The formula is:

$$VRR = \; VR/(\beta \; X \; r)$$

Where: VR = actual VAT revenues; β = potential tax base and r = standard VAT rate (default VAT rate applicable to the tax base). The significant data limitations notwithstanding, the OECD unweighted VRR for Liechtenstein and Switzerland is about 0.7 on average which suggests that, on average, an estimated 30 percent of theoretical potential VAT revenue is not collected, lower compared to the OECD average of 42 percent. This implies VAT compliance is high.

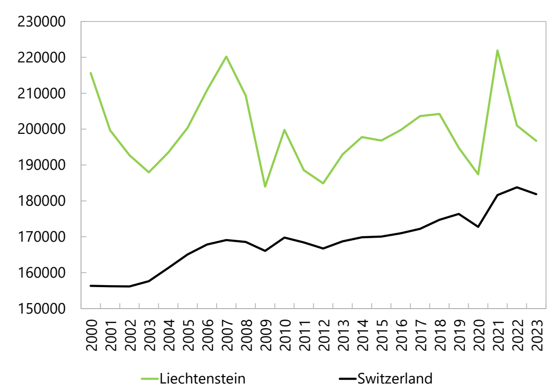
18. Aligning with international tax standards remains a policy priority. Liechtenstein joined the inclusive framework on Base Erosion and Profit Shifting (BEPS) in 2016, complies with all international standards on exchange of tax information, elimination of harmful tax practices, and artificial tax structures. Liechtenstein is implementing the OECD Pillar II tax reforms although the impact has not been quantified. Liechtenstein introduced an income inclusion rule (IIR) and a qualified domestic top-up tax (QDMTT) effective January 2024. This measure ensures that all domestic group companies are subject to the effective taxation of 15 percent. The undertaxed payment rule (UTPR) is not effective yet. The impact on tax revenue has not been quantified; if foreign jurisdictions in which multinational corporate groups operate already ensure sufficient taxation, then IIR does not lead to any additional income.

F. Impact of Infrastructure Investment on Productivity

19. Productivity in Liechtenstein has been flat over the past two decades. Productivity, measured as real GDP per full-time equivalent (FTE), has been volatile but not grown over time. Productivity is higher than in Switzerland, but the gap has narrowed. Based on other estimated measures (e.g., productivity measured through hours worked), productivity has been declining in Liechtenstein while it has increased in Switzerland. Liechtenstein is exposed to some structural and cyclical factors that have led to a stagnation in productivity in Europe. One contributor is an aging workforce, which reduces labor

Figure 3. Productivity in Liechtenstein and Switzerland

(Real GDP per FTE, CHF)



Source: Liechtenstein Authority.

supply and can lower overall productivity. In recent years, geopolitical uncertainties have affected business confidence and investment.

20. Additional public investment spending may boost productivity and potential growth.[3] For example, investment in infrastructure might support increased productivity by stimulating additional private investment and reducing congestion and travel times (see the Labor Market SIP).

[3] A tractable empirical model estimated on Liechtenstein data with variables including public investment, productivity, and GDP growth also indicates that there is a positive impact on productivity of increased public capital spending. If capital spending/GDP were to increase by 1pp, the model predicts that there would be a temporary boost to productivity growth by around 3 percent. There is some uncertainty on these effects given data limitations, and it would be useful to extend the analysis to include more variables as macroeconomic statistics are extended.

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