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Andorra: Income and Its Drivers in a Long-Term Perspective

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SIP/2025/053

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Andorra: Income and Its Drivers in a Long-Term Perspective
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April 2025

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SELECTED ISSUES PAPERS

Andorra: Income and Its Drivers in a Long-Term Perspective

Principality of Andorra

Prepared by Mariarosaria Comunale[1]

[1] We acknowledge the help from the EUR Regional Economic Outlook team and Claire Li for their inputs based on the October 2024 Regional Economic Outlook for Europe. We thank Helge Berger, Aidyn Bibolov, and Jean-Jacques Hallaert (all EUR) for comments and suggestions, and Thomas Gade, Fuad Hasanov, and Alex Pitt (Malta team), Ezequiel Cabezon (Republic of San Marino team), Salvatore Dell'Erba (Switzerland team) and Valentina Semenova (Cyprus team) for the discussions.

ANDORRA: INCOME AND ITS DRIVERS IN A LONG-TERM PERSPECTIVE [1]

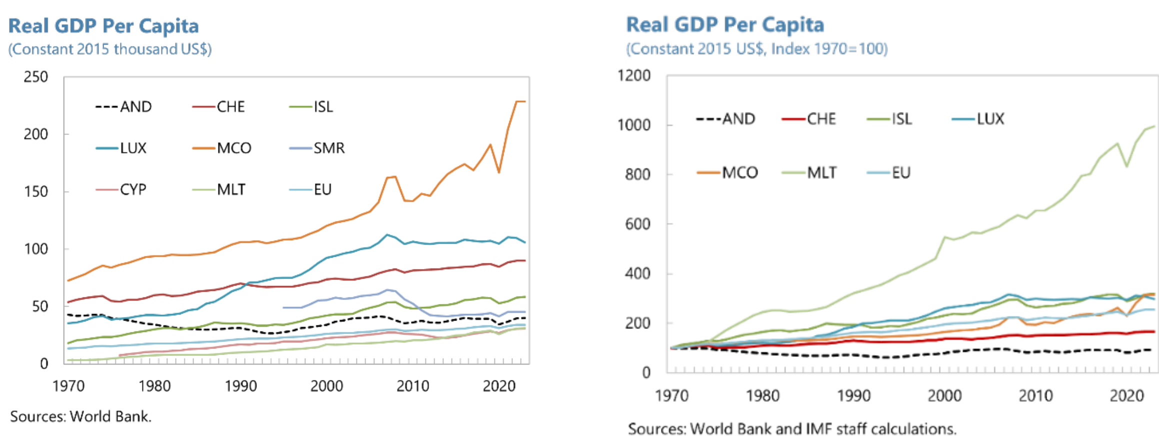
Income in Andorra has stagnated in the last 50 years. Starting from a very high level compared to peers, it has not grown as fast, as investment and productivity have lagged behind. In this study, we analyze the dynamics of income growth in Andorra from 1970 to today, comparing it to peer countries in Europe. We look at how peer countries successfully improved their income over time. Our findings suggest that investments in higher value-added sectors would be needed to keep the Andorran growth at potential and creating the right environment is key.

A. Income in Andorra has Stagnated in the Last 50 years

1. **Andorra's income has stagnated since the 1970s.** The country's income was one of the highest in Europe, but the current level remains slightly below the one 50 years ago. The ability of the country to absorb a large population increase over time while keeping high income levels is notable. However, looking at peers, this performance is an outlier.

2. **Andorra is the only country among European comparators to have experienced a decline in GDP per capita in the last 50 years.** We look at comparators with similar size and development. These are Malta and Cyprus, as they are also small countries relying on tourism; Switzerland, Luxembourg, and Iceland, countries with comparable income levels, as are Monaco and Liechtenstein, microstates with similar characteristics to Andorra, as well as San Marino.

Figure 1. Real GDP Per Capita: Comparison With Peers



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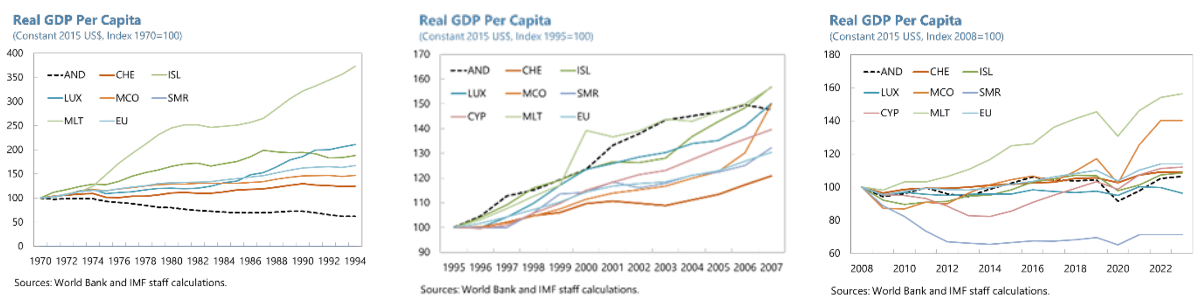
- **The contrast is particularly marked with Malta and Cyprus**, which, starting from a lower base, grew the most. Malta's income was multiplied by 9 and Cyprus' by 3 since the 1970s, thanks to economic diversification, marked productivity gains, and a combination of reforms pre-EU accession and use of EU funding. These countries are now approaching the EU27 average income, completing their catching up, while Andorra has remained only slightly above this level in the recent years (see Appendix).

- **However, countries starting with high income levels also saw significant increases in their GDP per capita**. During the last 50 years, income in Monaco and Luxembourg doubled, while in Switzerland it increased by 70 percent.

Figure 2. Real GDP Per Capita Growth Over Time



3. **In the last 50 years, growth in Andorra barely matched population growth, resulting in a stagnating GDP per capita.** Investment and productivity lagged behind during that period. While cross-border workers, which contributed to the growth experienced in countries like Switzerland, Luxembourg, Liechtenstein, Monaco, and San Marino,[2] may explain in part to their better income performance, other countries (notably island States like Iceland, Cyprus and Malta) also experienced substantial income growth with limited cross-border workers like in Andorra.[3]

4. **This trend was reversed between the mid-1990s and the great financial crisis (GFC), with higher investment and productivity.** The Andorran economy experienced structural changes towards banking and financial services and expanded winter tourism. After the GFC, growth components were more volatile, while the economy adjusted to a real estate market crisis and a retrenchment of financial services as the international financial landscape became unfavorable to Andorran banks. The economy concentrated on sectors with lower value-added, and investment was more limited.

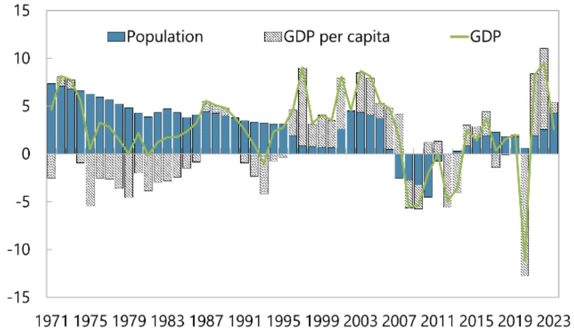
[2] The number of cross-border commuters has increased over time, for instance in Liechtenstein, where 57 percent of employment is now covered by cross-border commuters from 25 percent in the 1980s. For more details on Liechtenstein: Principality of Liechtenstein: Staff Concluding Statement for the 2025 Article IV Mission

[3] For Andorra, the number of cross-border commuters is of approximately 2,000 units (3.5 percent of the population). This small number is due to its geography and infrastructure barriers with neighboring regions.

Figure 3. Real GDP Growth Decomposition and Population

Growth in Real GDP and Components

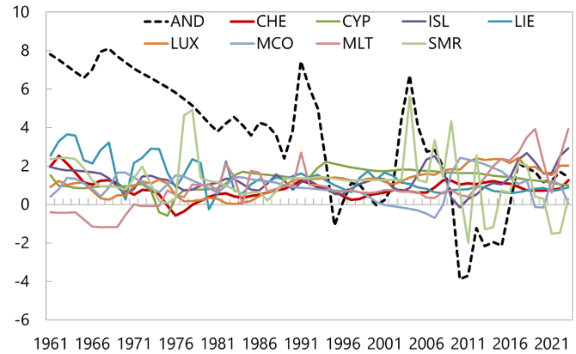
(Percentage change, y/y)



Sources: World Bank and IMF staff calculations.
Note: GDP data is in constant 2015 US$.

Population Growth

(Percentage y/y)



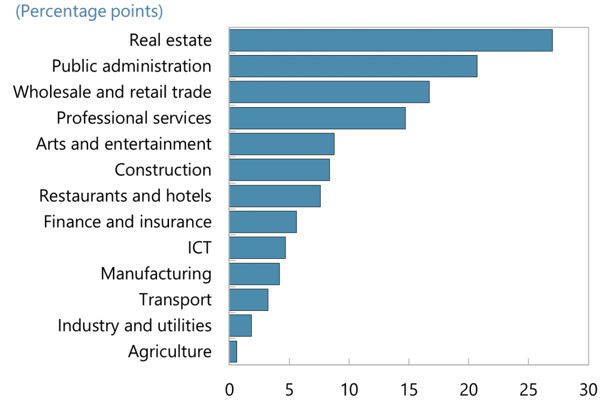
Sources: World Bank.

B. Economic Sectors, Productivity and GDP Per Capita

5. In the last 20 years, growth remained dominated by low value-added sectors in Andorra. Tourism-related sectors remained important while the real estate sector grew substantially. On the other hand, the contribution of the financial and insurance sector halved, following the 2015 banking crisis and structural changes in global banking and financial secrecy. Most of Andorra's GVA growth now comes from real estate, wholesale and trade, and public administration. The contribution of higher value-added sectors, such as Information and Communication Technology (ICT) services remained limited.

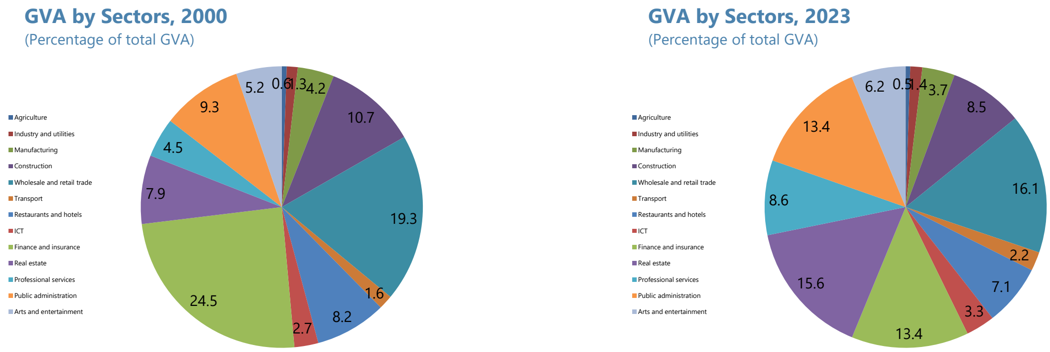
Contribution to GVA Growth, 2000-2023

(Percentage points)



Sources: Andorran authorities and IMF staff calculations

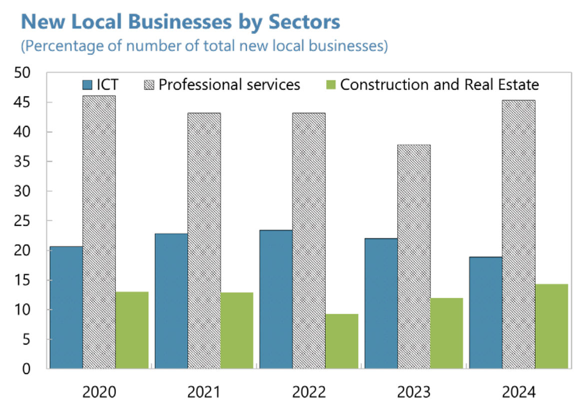
Figure 4. Gross Value-Added Decomposition



Sources: Andorran authorities and IMF staff calculations.

Sources: Andorran authorities and IMF staff calculations.

6. **The expansion of new businesses remains limited and constrained by structural bottlenecks.** New ICT businesses in particular account for only 20 percent of new firms in Andorra and firms working in higher value-added segments are mostly smaller firms and especially clustered in programming and technical assistance. Some success stories illustrate the potential for new investment, for example in the MedTech sector. However, a number of bottlenecks have been identified as constraints to private sector development and to attracting FDIs in Andorra. These include a limited domestic market, administrative rigidities, housing affordability issues, and difficulties to attract talent. A recent survey shows that firms have difficulties hiring specialists, resulting in a decline in overall ICT personnel since 2020,[4] while expenditure in ICT by firms grew by 13 percent between 2018 and 2022.



Sources: Andorran authorities and IMF staff calculations.

7. **This contrasts with countries that experienced fast growth in GDP per capita over the same period.** The examples of Malta and Cyprus are particularly striking, with a greater focus on high value-added sectors, including ICT. Other examples include Switzerland and Liechtenstein, which has developed a highly specialized manufacturing sector.[5] Among EU countries, Malta leads in

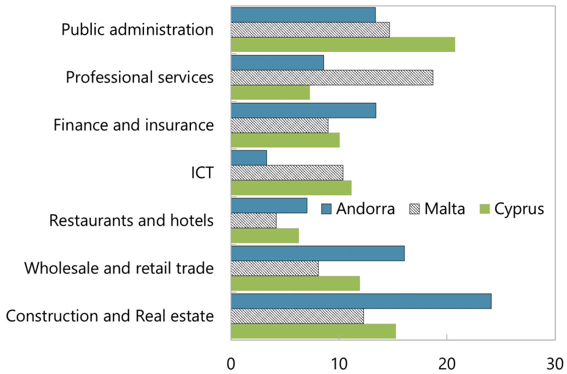
[4] This is based on the ICT enterprise survey and the survey on the use of technologies in companies for 2022.

[5] For Liechtenstein, manufacturing contributes about 37 percent of GVA, hence it is a country with a different economic structure than Andorra. Compared with other small sovereigns with large financial centers, Liechtenstein's specialized and export-oriented manufacturing sector stands out for contributing materially to GVA. The second largest industry is the private banking and wealth management oriented financial services sector which represents 11 percent of GVA (S&P Global Ratings, Liechtenstein Report, 2023).

terms of contribution of ICT to GVA, while among all the peers Switzerland leads in professional services.[6]

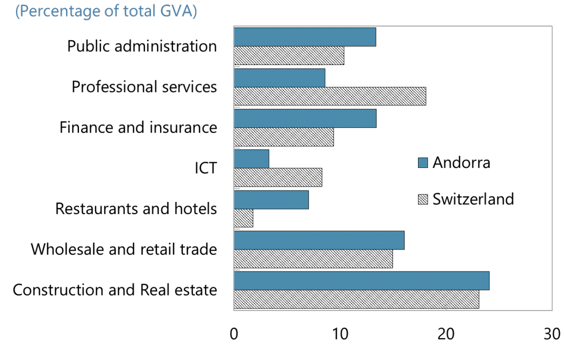
Figure 5. Contribution to Real GVA: Comparison With Peers

Contribution of Selected Sectors to Real GVA, 2023
(Percentage of total GVA)



Sources: Andorran authorities, OECD, CYSTAT, and IMF staff calculations.

Contribution of Selected Sectors to Real GVA, 2023
(Percentage of total GVA)



Sources: Andorran authorities, Switzerland Federal Statistical Office, IMF staff calculations. Note: For Switzerland, Professional services includes Real Estate, and ICT includes Transportation.

8. Comprehensive economic agendas drove income performance in peer countries. This was driven by policy credibility and an enabling business environment, that allowed for the development of specialized high value-added sectors with large contributions to economic growth, supported by investment and productivity gains. In the case of Malta, the top performer in our sample in terms of income growth, the economy pivoted towards a high-quality services-driven economy, while tourism-related sectors, still important, decreased their economic contribution (see Appendix). The large inflow of foreign workers has been also directed to support IT-based services and not limited to tourism. With limited room for manufacturing, specialization was key, with the fast expansion of the online gaming industry. Comprehensive structural reforms, e.g., Malta's Smart Specialization Strategy for the period 2021-2027, thrived with the active involvement of the private sector, on carefully selected priority areas including digital economy and climate change.[7] The Digital Decade Strategic Roadmap 2023 – 2030, the "Malta Vision 2050, and the Malta Tourism Strategy 2021– 2030 illustrate the prioritization of policies towards a productivity-driven growth strategy that focuses on digital innovation, infrastructure, education, healthcare, sustainability, and quality job creation.[8]

[6] See for ICT: ICT sector - value added, employment and R&D - Statistics Explained and for professional services: Businesses in the professional, scientific and technical activities sector - Statistics Explained

[7] Smart specialization is a key principle underpinning the European Commission Cohesion Policy for the period 2021-2027 in the Research, Technology, Development and Innovation (RTDI) priority. This approach brings together different actors to identify a country's national competitive strengths and research and innovation potential. See Policy & Strategy – Xjenza Malta

[8] See for instance: Malta Vision 2050 for a summary.

C. Conclusions: Diversification, Productivity and GDP Per Capita in Andorra Going Forward

9. Income in Andorra has stagnated in the last 50 years, with an economy dominated with lower value-added sectors. The construction and tourism sectors have brought a significant contribution to growth in Andorra and the financial sector remains important. The experience of peers, which experienced much higher GDP per capita growth, illustrates the importance of a comprehensive strategy to enable the development of higher value-added sectors, with often a high degree of specialization, in line with the country's size. Andorra has important advantages that can support income over the medium term, including large excess savings. As highlighted in the staff report, the policy framework lends credibility to the business environment. In addition, large savings, reflected in the very high current account surplus, can be unlocked to support growth going forward, reversing the limited contribution of investment to growth today.[9] Removing existing bottlenecks is paramount going forward. The experiences of peer countries show the importance of developing a comprehensive approach to diversification while favoring specialization. Furthermore, the examples of Malta and Cyprus illustrate the role that timely (in their case pre-EU accession) reforms can play in supporting growth going forward.

10. A range of actions could be instrumental in supporting GDP per capita going forward. First, removing bottlenecks would require multiple measures, from easing the business environment (incl. use of common digital platforms), addressing housing availability issues, upskilling the labor force and actions aimed at attracting talents especially in sectors such as ICT. Second, expanding opportunities through diversification and full access to the single market, that could be unlocked with the EU Association Agreement, if adopted, as a potential trigger for reforms, FDI inflows, and closer cross-country collaborations on research and innovation via EU programs. Not only innovative sectors but also traditional sectors can benefit from these reforms and expand towards a more high-end market (e.g., tourism) and specialize in new areas more organically (e.g., from health tourism to medical products), leveraging the advantages associated with being a microstate.[10] Andorra can also benefit of its consensus-driven, collegial decision-making practice when shaping strategies, involving different stakeholders. The "innovation area" is a welcomed plan on this regard connecting possible new innovative firms with the education system and public investments, albeit this project is still very much at an initial stage.[11]

[9] Total investments are estimated to be of around 8 percent of GDP, with private investments counting for 3 percent of GDP.

[10] See How small states can benefit from innovation | United Nations Development Programme. .[10] For instance, the success of Singapore and other "smart cities" have been built on a business-friendly and agile regulatory environment and strong investments in infrastructure, education, healthcare, and public services. See Singapore Overview: Development news, research, data | World Bank.

[11] For now, only limited resources have been directed from the 2025 budget to new grants for business in innovation and R&D (they count for approximately 0.5 million EUR).

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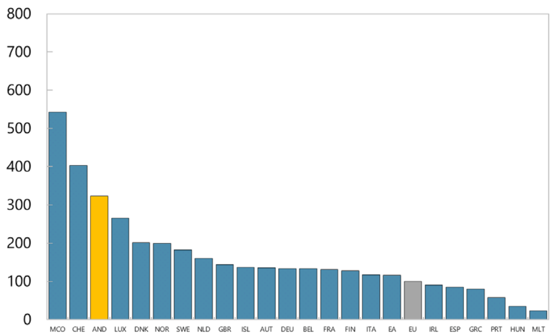
Appendix I. Comparison With Peers

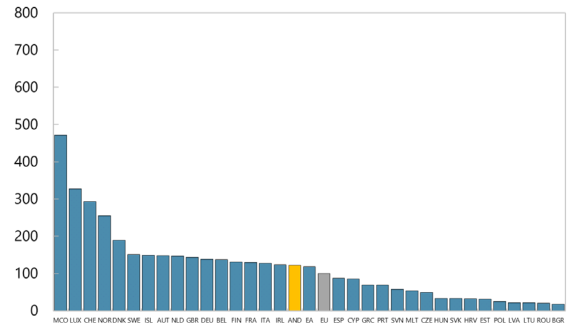
Figure A.I.1. Real GDP Per Capita Ranking Over Time

Real GDP Per Capita,1970
(Index EU = 100)



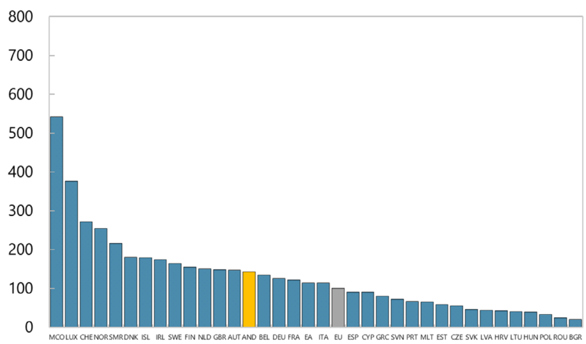
Sources: World Bank and IMF staff calculations.

Real GDP Per Capita,1995
(Index EU = 100)



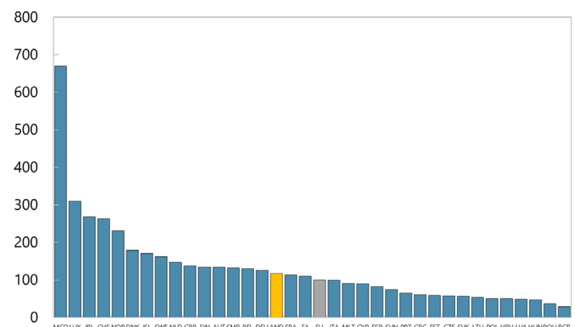
Sources: World Bank and IMF staff calculations.

Real GDP Per Capita, 2007
(Index EU = 100)



Sources: World Bank and IMF staff calculations.

Real GDP Per Capita, 2023
(Index EU = 100)



Sources: World Bank and IMF staff calculations.

Figure A.I.2 The Evolution of the GVA in Andorra Compared to EU Peers