

## Liechtenstein and the European Union: A Micro-Switzerland?

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### Abstract

Located in the heart of Europe, isolated in the middle of the mountains, Liechtenstein, one of the richest countries in the world, is gradually trying to find a place in the European Union. Between historical diplomatic heritage and global financial economy, relations between Liechtenstein and the European Union are very much influenced. Often considered a "micro" Swiss in terms of its European policy, the interest of research is to discern the complexities of the European integration of this country and the differences between Switzerland and Liechtenstein from an economic, political and European integration point of view. By analysing the historical and modern relations of Liechtenstein within Europe, as well as between Switzerland and Liechtenstein, and with the European Union, with the help of economic and legal tools, this article aims to the factors that have influenced and still influence Liechtenstein on its European integration, as well as the factors that distinguish Switzerland from Liechtenstein. The results show that Liechtenstein is more advanced in terms of European integration than Switzerland and that Liechtenstein has gradually emancipated itself from Switzerland's political "guardianship".

**Keywords:** Liechtenstein; Switzerland; European integration; Micro-state; European Union; European economic area; European free trade association; Diplomacy; Politics; Economics; European studies; International relations

### Introduction

The Principality of Liechtenstein, a sovereign state since the 19th century, is located in the Eastern Alps between Switzerland and Austria.

The relations of this country with its close and distant neighbours have always been marked by the Liechtenstein dynasty, still today in the power of this constitutional monarchy. History, as well as socio-economic contexts, has shaped this state which knows a prosperous economic period since the second half of the twentieth century.

Just as the study of Liechtenstein's sovereignty showed with the soft power projection of a very small state, the principality focuses its foreign policy on soft power in order to make its interests and objectives prevail in terms of international relations [1]. From this study on Liechtenstein's international relations with other states, it appears that the principality, stripped of all military power, managed to influence other states through more informal instruments related to diplomacy, culture and the economy, which has been confirmed since the beginning of the 21st century.

There is, however, a gap in state of the art research on Liechtenstein's European integration. Thus, this article aims to analyse the stages of Liechtenstein's European integration through the appreciation of its history as well as its particularism, in order to determine if one can analyse the relations of Liechtenstein with the European Union of the same way that it is possible to analyse Switzerland's relations with the European Union.

The purpose of this article is, on the one hand, to analyse relations between the Principality of Liechtenstein and the European Union based on economic and political issues, and, on the other hand, to

show the links and existing similarities with Switzerland on the treatment and management of these international issues.

All these questions seem more than interesting to understand, given the current challenges facing this small country in Europe, as well as the current and future situation that can be envisaged.

### Liechtenstein's Place in Europe: A Soft "Integration"

In order to understand the place of the Principality of Liechtenstein in Europe and the relation of this country with the European Union, it is important to understand its diplomatic and historical relations in Europe. This rather focused, but nevertheless comprehensive, analysis of the history of relations in which this country was involved in the heart of Europe reveals the current issues regarding the "integration" of this country in the European Union, as well as that its weight in the political and economic relations of the region [2].

It is also important to define what European integration is, based on existing definitions. The most common definition of European integration includes the fact, for a state, of transferring its national sovereignty to a supranational authority, including other member states or collaborators of this supranational authority, namely the European Union since the Treaty of Lisbon [3]. This definition is broad enough to allow for multiple degrees of integration, and does not explicitly mean that a state transfers all of its sovereignty to supranational authority. In addition, the definition does not include an obligation to belong to the supranational authority, and thus allows for the consideration of relations between the state and the authority, including negotiations and agreements, not profiling integration into the supranational authority, but integration into a space or community by sharing common values and measures.

### Liechtenstein's historical relations

Created in the early 18th century, Liechtenstein is directly attached to the Liechtenstein dynasty who took possession of these lands on the

Rhine and no special interest. This taking possession allowed the family to be directly vassals of the Holy Roman Empire and thus to sit on the Council of Princes.

The destiny of this small country suddenly changed when in 1806 the Holy Roman Empire was dissolved, and the Confederation of the Rhine was created allowing Liechtenstein to escape the disappearance and at the same time to become a sovereign state. The state was subsequently completely independent in 1815 within the German Confederation [4].

The nineteenth century represents an important period in the opening of the state on the economy of the region to break the rural isolation in which it sank then. A first custom agreement was signed with Austria in 1852 which enabled Liechtenstein to set up its first industries as well as its first bank. It was at this time also that Liechtenstein was given its first and only railway line, still in service today and which is really only an extension of the Austrian rail network. Today the relations between the two countries are always cordial, and the geographical proximity has allowed them to maintain important links with the signing of several bilateral agreements outside the relations envisaged by the European Economic Area.

Liechtenstein stood out like Switzerland by its apparent neutrality, formalized in 1868 with the dissolution of its army, and the declaration of its permanent neutrality. During the First and Second World Wars, Liechtenstein thus stood apart from the conflicts that swept Europe, notably thanks to its union with Switzerland<sup>1</sup>.

A conflict of interest, however, needs to be clarified and partly explains some of the European complications. In the aftermath of the First World War, the newly formed Czechoslovakia refused to recognize the sovereignty of the Principality of Liechtenstein for ideological reasons against the Liechtenstein dynasty. The Czechoslovak state is thus confiscating several lands belonging to the princely family, through a nationalization of these goods. This conflict between the two countries lasted until the beginning of the twenty-first century, despite the proposals of agreements between the two parties, despite the fact that Czechoslovakia broke up into two. It was finally in 2009 that Liechtenstein and the Czech Republic signed a mutual recognition agreement. In recent years, a special effort has been put in place to strengthen relations between the two states [5].

This diplomatic episode seems interesting from a European point of view. The Czech Republic joined the European Union in 2004 as a member state, but in 1996 it submitted its application. Liechtenstein was the only state in the world not to recognize the Czech Republic when it was created. Subsequently, Liechtenstein set up its diplomatic forces to delay the state's accession to the United Nations [6]. It is more than conceivable that Liechtenstein's position vis-à-vis the European Union and the integration of the Czech Republic has been influenced by this international affair.

### European "integration" of Liechtenstein

As the study on Andorra and the European Union shows, there are several degrees of integration of a state into the European Union. These degrees are four in number [7]:

- Creation or maintenance of a dialogue, accompanied by unilateral measures preceding negotiations with the European Union.
- Negotiations carried out directly between the state and the European Union on specific issues, beyond the measures already taken by the state to integrate a part of European Union law.
- Signing of a multi-sector agreement to integrate a significant part of EU law into the national law of the state.
- Full integration in the form of a candidacy to become a full member of the European Union, preceded by legal alignment with European standards.

Each of these degrees makes it possible to position on a scale states that have their particularities on this question. These degrees are proposed in a growing order of integration ranging from simple dialogue to fictitious integration as a fully member state. This is more of a classification than real steps towards integration, because the goal of the states is not always to move up these steps until the accession to the rank of full-member state of the European Union. In addition, some states have such complex relationships with the European Union that it is not possible to assign them to a specific degree and it is often necessary to consider the relationship as being between two degrees of integration [8].

Liechtenstein develops its first international relations outside of German and Austrian influence from the beginning of the 20th century. One of the first international achievements was economic and today still engages Switzerland and Liechtenstein to collaborate in the same customs territory, through the Swiss Customs Union of March 29, 1923 [9]. Liechtenstein's economic disengagement from Austria following the First World War has an economic and political interest. Before that, Switzerland and Liechtenstein signed a treaty allowing Switzerland to represent Liechtenstein in a diplomatic and consular manner in countries where such bodies were not directly present for the Principality [10].

Meanwhile, Liechtenstein adopts a more democratic constitution on October 5, 1921. The latter provides inter alia that the prince is the representative of the state (Article 8), that the parliament is the only one able to approve the international treaties (Article 67), however, for a law to be valid, it is necessary to have the approval of the prince (Article 9). This constitution, however, has undergone several changes over time, but the fundamentals remain and form the basis of all international relations undertaken by Liechtenstein [11].

Subsequently Liechtenstein's international "career" was marked by its accession to the Council of Europe in 1978 and then to the United Nations in 1990 as a member state. In 1991, the principality became a member of the European Free Trade Association<sup>2</sup>, and the free trade area. On the side of the European Union, Liechtenstein joins the European Economic Area in 1995 at the same time as the World Trade Organization, without, however, leaving the European Free Trade Association [12].

Unlike a number of states that left the European Free Trade Association<sup>3</sup>, Liechtenstein, despite its entry into the European Economic Area, has not left EFTA, like Switzerland. The coexistence of these two organizations for Liechtenstein is not a problem and even if the customs union accompanying the European Economic Area seems more advantageous for Liechtenstein, the alliance of these two

<sup>1</sup> A more precise description of the historical relations between Switzerland and Liechtenstein is to be made in the second stage of the study.

<sup>2</sup> Despite the fact that Liechtenstein has been indirectly a member of EFTA since 1960, from the Swiss Customs Union.

organizations can only be beneficial for the economy of the country. What lies behind the fact that Liechtenstein has remained a member of EFTA despite its accession to the EEA is that membership of EFTA must necessarily be a member of the EU or EFTA. Membership in the EEA is therefore two pillars and this is also why EFTA members joining the EU have left EFTA.

Membership of the European Free Trade Association only binds the country economically. It is an intergovernmental organization that is only focused on free trade, without any transfer of jurisdiction, each state preserving its sovereignty. In addition, tariffs are not standardized because they are not a customs union and therefore may differ from country to country.

Membership in the EEA engages states more deeply than EFTA does. Thus the agreement provides for the guarantee of the four freedoms, namely the free movement of goods, services, capital and persons. While preserving economic exclusion, EFTA states that have joined the EEA may retain their distance from the political procedures implied by the Maastricht Treaty [13].

It should be noted that, just like Switzerland, Liechtenstein joined the Schengen area on 19 December 2011, in the continuity of its integration into the common market by the EEA, and always with a certain economic perspective [14]. There are also bilateral agreements between Liechtenstein and the European Union on taxation and fiscal transparency of the country [15].

The integration of Liechtenstein into the European Union is therefore in a much more advanced path that pushes us to gradually place this state in the third degree of our scale of European integration. Much more than a simple bilateral agreement, relations between Liechtenstein and the European Union are far more advanced than other states that have adopted the European currency such as Andorra or Monaco.

Its status as a member of the European Economic Area not only gives it full access to the European Common Market, but also political power within the European Union without being a full member.

However, this integration poses the problem of accession to the status of Member State which is not necessarily the objective of all the states involved on the scale of European integration. Liechtenstein in its historical objectives of political neutrality and its various particularities has no other than economic interests to maintain with the European Union. A perspective of full integration of Liechtenstein into the European Union therefore seems to be compromised by the interests of Liechtenstein, which is pleased with its current position. However, Liechtenstein's foreign policy in the last ten years tends to show the exact opposite and pushes the scale of European integration towards a certain realization. A passage from Step 3 to Step 4 thus seems to be possible for Liechtenstein. One of the main causes of this positioning is for full integration into the European Union and a future candidature is in addition to increasing the political involvement of the state in European affairs, the possible disappearance of the European Economic Area with the admission procedures of Norway and Iceland which would leave Liechtenstein the sole beneficiary of this Association Agreement. The integration of degree 4 represents a possible solution for the future of relations between the Principality and the European Union. However, there is one last option which

would make it possible to maintain the current state of affairs and which would consist of enlarging the European Economic Area to other micro-states such as Andorra, Monaco or San Marino, but it does not seem that this solution is the one that prevails in the international perspectives of Liechtenstein [5].

## Switzerland and Liechtenstein

The relations between the Swiss Confederation and Liechtenstein have always been very extensive and their links very tight. From the customs union whose formation, we have discussed and which is still in force today to the sharing of their common border, Switzerland and Liechtenstein have become real political and economic partners. All this raises questions about these relationships, as well as their contemporary and future limits.

### Liechtenstein, "little brother" of Switzerland

Switzerland and Liechtenstein have had special relations since the beginning of the 20th century, particularly in the political and financial fields, bringing historically closer ties between the two entities.

Although already mentioned, Liechtenstein shares a customs union with Switzerland, as well as a common currency, the Swiss franc. The economy of Liechtenstein is influenced by Switzerland in a geographical way, despite the fact that the only railway line of the country is with its other neighbour, Austria. Beyond the geographical proximity, it is the same Germanic language, called Alemannic, that the neighbouring Swiss cantons share. The culture of the Principality can also be similar to that of certain regions of Switzerland [1].

From an economic point of view, the two states had to move towards a tax economy in order to break their relative geographic isolation. Switzerland and Liechtenstein were included in the list of tax havens compiled in 1994 by Hines and Rice [16]. However, this ranking has changed considerably since, notably following the G20 of 2009, when the resolution was taken to include the fight against tax havens on the agenda. This resulted in the signing of transparency agreements and promises in terms of fiscal policy. These transparency agreements were signed by Switzerland and Liechtenstein at different times. Despite this, the two states remain the best off-shore places in Europe and their economic model is relatively similar, on a much different scale, however, and with some limitations [17].

Liechtenstein has also long been considered in a practical way and by many financial sector professionals as the 27th Swiss canton, in which investments were more of a national than international standard. Indeed, before Liechtenstein became a member of the European Economic Area, Switzerland was responsible for representing Liechtenstein's interests in this organization, and so it was Switzerland that oversaw the whole of the external economic policy of Liechtenstein. With the customs union, Liechtenstein was simply an extension of Switzerland with its own local jurisdiction [18].

Politically, Switzerland and Liechtenstein have often shared the same destiny internationally. Indeed, the two states have since the nineteenth century this desire for neutrality on the international scene, suggesting that this is what drove the two countries to stay behind the European construction [19].

<sup>3</sup> The European Free Trade Association was originally created to bring together states not wishing to join the European Economic Community. A number of states have left this organization after joining the European Economic Community, such as the United Kingdom, Denmark, Portugal, Austria, Sweden and Finland (Rao, 2011).

Thus the rapprochement between Switzerland and Liechtenstein at the beginning of the twentieth century leaves important traces today in the functioning of the country and in its future objectives. However, the two countries hold a different place in international relations and everyone knows how to pull out of the game in order to represent their interests and stand out.

### A principality that emancipates and stands out

The accession to membership of the European Economic Area by Liechtenstein in 1995 allowed the state to gradually break away from the Swiss tutelage that really prevented it from conducting its own international policy on the European level.

	Liechtenstein	Canton of St. Gallen	Canton of Graubünden
Gross domestic product per capita <sup>1</sup> in USD <sup>2</sup> .	179,479	75,549	73,826
Unemployment rate <sup>3</sup> (in %).	1,9	2,52	1,71
Share of tertiary employment <sup>4</sup> (in %).	59,9	65,4	73,5

**Table 1:** Comparison of Canton of St. Gallen and Graubünden with Liechtenstein.

The geographical dimensions of the Swiss cantons with respect to Liechtenstein seem at first to be excessive, and yet it is interesting to compare these two frontier cantons in order to give an account of the idea that draws Liechtenstein as a Swiss extension in the form of a canton.

Firstly, GDP per capita gives us a global indication, indicative of true economic independence on the part of Liechtenstein, which has diversified its economy in order to create a substantial wealth, a financial majority [20]. Liechtenstein thus has one of the highest per capita GDP in the world, with a fairly homogeneous society that still has a high standard of living, even above that of Switzerland.

The share of unemployment in the population gives us a more general point of view and highlights the economic wealth and cultural dynamics that surround the region as a whole. This indication allows us to visualize the geographical area as dynamic and economically attractive.

Finally, the share of tertiary employment in the labour force gives us information about the society described. It should be noted that the frontier cantons have an important or even massive part of tertiary work, which gives us information on the importance of a region oriented towards a certain type of professionalization and a certain place occupied within the geographical distribution of work on Swiss territory. On the contrary, the share of tertiary employment in the labour force in Liechtenstein is very much lower and although it represents a significant share, going beyond half of the population, these are other indications delivered. We can thus appreciate the peculiarities of a society as a whole, which has a heterogeneous population in terms of jobs and social classes. This aspect is not found

Before going any further, an economic approach seems more than interesting in order to show the particularities that at first glance differentiate Liechtenstein economically and then politically from Switzerland. For that, it seems relevant to compare not directly Switzerland and Liechtenstein which have territorial dimensions, demographics and economic models far too distant, but rather the border cantons of Liechtenstein.

The Canton of St. Gallen and Graubünden are the two Swiss cantons bordering Liechtenstein, respectively to the east and south of Liechtenstein. Nevertheless, the first is 12 times larger than Liechtenstein, and 13 times more populated, while the second is 44 times larger and 5 times more populated (Table 1).

in the border cantons which are nationally distributed, assigning them a large share of tertiary jobs.

These particularities are characteristic of a complete society centred on a national identity. Added to the important cultural factor that has developed in recent years, Liechtenstein is characterized by progressive detachment, economic, cultural and political. Liechtenstein is thus defined as a country with its own economic and cultural complexities that strongly detaches Switzerland from an economic and international point of view. These two variables are known to play an important role in the internal policies of countries, and we thus see better the international positions of Liechtenstein on European integration. We find ourselves facing a country with a large number of wealth and whose integration into the European Union is a secondary objective and in which the country will want to draw the most advantageous parties.

In terms of international politics, the Liechtenstein detachment of "protective" Switzerland has been particularly visible in recent years. In addition to Liechtenstein's detachment from Switzerland's "tutelage" in the European Free Trade Association in 1991, accession to the European Economic Area membership in 1995 marked a certain break with Switzerland, which is not a member of the EEA, is only connected to Europe by bilateral agreements. This reluctance in Switzerland compared to the emancipation of Liechtenstein is indicative of a certain break in the international policies of the two states. On the world stage, Liechtenstein also marks a break when the country signs the GATT agreements in 1994, whereas Switzerland signed them in 1966. The same goes for Liechtenstein's accession to the World Trade Organization in 1995<sup>8</sup>

<sup>1</sup> FSO Switzerland, 2014 for the Swiss cantons and World Bank, 2014 for Liechtenstein.

<sup>2</sup> Calculated using an average exchange rate for the year 2015 with 1 CHF=1.040285 USD.

<sup>3</sup> SECO Switzerland, 2016 for the Swiss cantons and ILOSTAT, 2016 for Liechtenstein.

<sup>4</sup> FSOs Switzerland, 2013 for the Swiss cantons and Office of Statistics of the Principality of Liechtenstein, 2013 for Liechtenstein.

<sup>8</sup> Despite the fact that the Customs Union between the two countries is still relevant and that many economists consider the two countries in one in this economic union (Horn, Mavroidis, Sapir, 2010).

All of these factors give Liechtenstein considerable room for manoeuvre in the future as regards its international political decisions at European level. Despite the fact that the EEA agreement does not cover the customs union, the common agricultural or fisheries policies, the economic and monetary union or the tax system, it is not impossible that Liechtenstein will reach phase 4 of the European integration scale. Liechtenstein's legal alignment in recent years has tended to show European harmonization of its jurisdiction, in favour of increased international and economic openness. Today Liechtenstein's European integration is seen as a necessity both economically and politically and the detachment with Switzerland seems progressive and non-brutal, allowing the two states to maintain excellent relations. One of the most important issues is the benefits and costs of European participation for Liechtenstein, which largely hinders the country's political ambitions as one of the richest in proportion to its population [5].

Switzerland and Liechtenstein are not yet ready to join the European Union in the years to come. However, Liechtenstein differs from Switzerland in its peculiarities and its recent international commitments, making this small country of the Alps one of the most advanced micro-states in terms of European integration with San Marino [21-23].

## Conclusion

Analysing the history and particularity of Liechtenstein's international relations as well as the prospects for development makes it possible to have a global vision of this small state and the geopolitical complexities that surround it. In considering both economic and political aspects, this research links Liechtenstein's objectives in terms of European integration with the opportunities available to it. Comparing this microstate with neighbouring Switzerland, while observing the historical, economic and political links, allows this study to highlight reconciliations and differentiation that shed light on a more European point of view.

Overall, it is clear that Liechtenstein is a state that was relatively excluded from the construction of Europe by its historical characteristics and its traditional international values, common with Switzerland. However, we also observe that the common agreements and policies between the two countries have influenced the destiny of Liechtenstein on European integration and that Switzerland as Liechtenstein's representative on the international scene has made extensive decisions on its behalf and in agreement with its national policy. However, the end of the twentieth century was marked by emancipation on the international level of Liechtenstein, and a relative independence on the European level. Today, Liechtenstein sees several scenarios available to it, and almost all tend towards further European integration.

Future scientific research in this field should tend to take into account all these particularities in order to consider the state of

Liechtenstein with all of its peculiarities. Taking historical, but also cultural and linguistic, relations into account, especially with the new European programs in which Liechtenstein participates, and analysing the place of this micro-state within these would make it possible to highlight more clearly the results proposed in this article.

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