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July 5, 1994

To: Members of the Executive Board  
From: The Acting Secretary  
Subject: San Marino - Background Developments

This paper provides background information to the staff report on the 1994 Article IV consultation discussions with San Marino, which was circulated as SM/94/144 on June 8, 1994.

Mr. Lane (ext. 37668) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

SAN MARINO

Background Developments

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Approved by the European I Department

June 30, 1994

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San Marino: Basic Data

Total area (sq. Km):	61.2
Population (December 1993):	24,335
GDP per capita (current US\$, 1992):	25,851
Life expectancy (1987):	76 (male) 82 (female)
Infant mortality (1989/1993 average):	9.7 per thousand

	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
<u>(Changes in percent except as otherwise indicated)</u>					
Domestic economy					
Real domestic demand (contribution to GDP growth)	2.2	6.1	6.7	7.5	...
Real foreign balance (contribution to GDP growth)	-0.5	--	0.4	2.2	...
Real GDP	1.7	6.2	7.2	9.6	2.4 <u>1/</u>
Unemployment rate (end of year)	5.1	5.4	4.1	4.1	4.9
Annual average inflation rate	6.3	6.4	6.3	5.1	5.5
External accounts					
Trade balance (in millions of US\$)	-10.3	-12.3	-10.5	0.9	...
Exports (in percent of GDP)	209.6	205.6	217.2	221.1	...
Imports (in percent of GDP)	276.3	265.8	270.5	251.3	...
Number of tourists (in millions)	2.8	2.9	3.1	3.2	3.1
Lira US\$ exchange rate	1,372.1	1,198.1	1,240.6	1,232.4	1,573.7
Nominal effective exchange rate index <u>2/</u>	98.5	100.6	98.9	95.7	79.7
Fiscal variables					
Central government revenue <u>3/</u> <u>4/</u>	37.9	35.6	45.2	47.9	47.0 <u>5/</u>
Central government expenditure <u>3/</u> <u>4/</u>	34.4	36.6	43.0	43.0	46.3 <u>5/</u>
Central government balance <u>3/</u>	3.6	-1.1	2.3	4.9	0.7 <u>5/</u>
Interest rates					
Loans <u>6/</u>	15.0	14.5	15.2	17.9	14.0
Repurchase agreements <u>6/</u>	...	...	...	13.0	8.0
Time deposits <u>6/</u>	8.0	8.0	7.6	10.0	6.5
Italy 3-month interbank rate	...	13.7	12.9	13.9	8.6
Banking system assets and liabilities					
Net foreign assets <u>1/</u>	...	26.9	24.5	46.2	27.2
Domestic credit to nongovernment <u>1/</u>	...	33.5	12.3	35.8	6.8
Domestic deposits <u>1/</u>	...	24.6	24.6	32.1	21.7
Total liabilities	...	31.1	27.9	46.7	22.1

1/ Staff estimate.

2/ Italy's NEER, 1985=100.

3/ In percent of GDP.

4/ Excludes payroll contributions to the Social Security Institute.

5/ Staff estimates based on official projections.

6/ End of period, average.



## I. Introduction

Economic developments in San Marino have been shaped by its unique situation as a tiny enclave in north-central Italy. Given a common currency and the absence of trade barriers, San Marino has participated fully in the vigorous economic growth of neighboring regions of Italy. In addition, through small differences in its tax and regulatory structures from those in Italy, it has developed disproportionately large financial and commercial sectors, catering respectively to nonresident depositors and shoppers. The inflation rate has recently been declining along with rates in Italy.

San Marino appears to have come through the recent European recession virtually unscathed, with little adverse effect on employment. Like surrounding areas of Italy, San Marino benefitted from the depreciation of the lira after September 1992. Unemployment was also attenuated due to the greater flexibility of a manufacturing sector consisting mainly of very small firms. Moreover, the government introduced activist measures to support employment.

San Marino ran substantial fiscal surpluses for most of the past ten years, as rapidly growing revenues more than kept pace with rising expenditures. As a result, the state accumulated substantial assets. The fiscal position recently weakened, with a decline in the surplus. Large increases in public sector payroll in 1992 and 1993 were a key structural factor underlying this decline. An important aspect of San Marino's public finances is the social security system, for which the Institute for Social Security (ISS) has responsibility; this includes health care, pensions, unemployment compensation, and various welfare programs.

Monetary developments are closely linked to those in Italy, resulting in a gradual decline in interest rates from late 1992 through early 1994. There was a rapid expansion of bank assets and liabilities, in which the dominant element was clearly the inflow of nonresident deposits associated with uncertainties about the Italian political and fiscal situation. The exchange and financial accord with Italy, signed in 1991 is now, after considerable delay, on the way to being implemented.

San Marino experienced rapid expansion of both imports and exports in recent years. The customs accord with the European Union (EU), concluded in 1991 and now in the process of implementation, may bring important changes in San Marino's trade relations.

The rest of this paper reviews in more detail the underlying developments in the Sammarinese economy. Chapter II discusses developments in the real sector. Chapter III assesses fiscal developments. Chapter IV reviews monetary developments. Chapter V summarizes developments in the external sector. Appendix I describes state aid to Sammarinese industry. Appendix II characterizes the social security system, and the finances of the ISS. Appendix III presents the main features of San Marino's exchange and trade systems.

## II. The Real Sector

### 1. Aggregate demand, supply and prices

In San Marino, the real economy has grown rapidly over the past several years. Real GDP growth, estimated on the basis of preliminary national accounts, has been constantly accelerating since 1989, reaching 9.6 percent in 1992 (Chart 1 and Tables 1 and 2). Both domestic demand and net export contributions to GDP growth progressively increased from 1989 to 1992, although domestic demand was the senior partner (Chart 2). Rapid growth of exports was mainly offset by rapid growth of imports. The main contribution to domestic demand growth apparently came from investment in 1992 and from inventories in 1990 and 1991. Investment showed wide fluctuations apparently unrelated to the economic cycle, reflecting the small size of the country as well as measurement problems. 1/ Private consumption growth, however, was negative in real terms throughout the period and public consumption growth has been subdued.

There is little indication that San Marino has experienced the recession affecting other European countries including Italy. Employment, both of residents and a broader measure including nonresident workers (*frontalieri*), continued to grow, although at a reduced pace with respect to previous years (Chart 3 and Table 3). The recent performance of the Sammarinese economy differed across sectors; some industries were hit by the recession, while others continued to grow rapidly. In the textile sector, sales fell by 21.1 percent between 1991 and 1993. The tourist industry also experienced difficulties as it faced a 4.3 percent reduction in the number of tourists between 1992 and 1993. At the same time, the ceramics and tiles industry took advantage of the lira depreciation to expand production, mainly for export. The banking system benefitted from large inflows of Italian deposits, resulting from uncertainties about taxation and the political situation in Italy. 2/

The structure of the Sammarinese economy helped cushion employment from the effects of the recession. The small size of firms in the industrial sector (8.4 workers per firm on average) and the large number of family run businesses in the commercial sector (with 2 workers per firm on average) made the economy more adaptable to cyclical fluctuations. In the past few years, the average size of firms in the industrial sector continued to decrease, but employment increased because many new firms were created (3,296 in 1993 compared with 2,755 in 1989). State intervention, including preferential credit, tax exemptions and public employment, also appears to have played a significant role in softening the impact of the recession on the Sammarinese economy. 3/

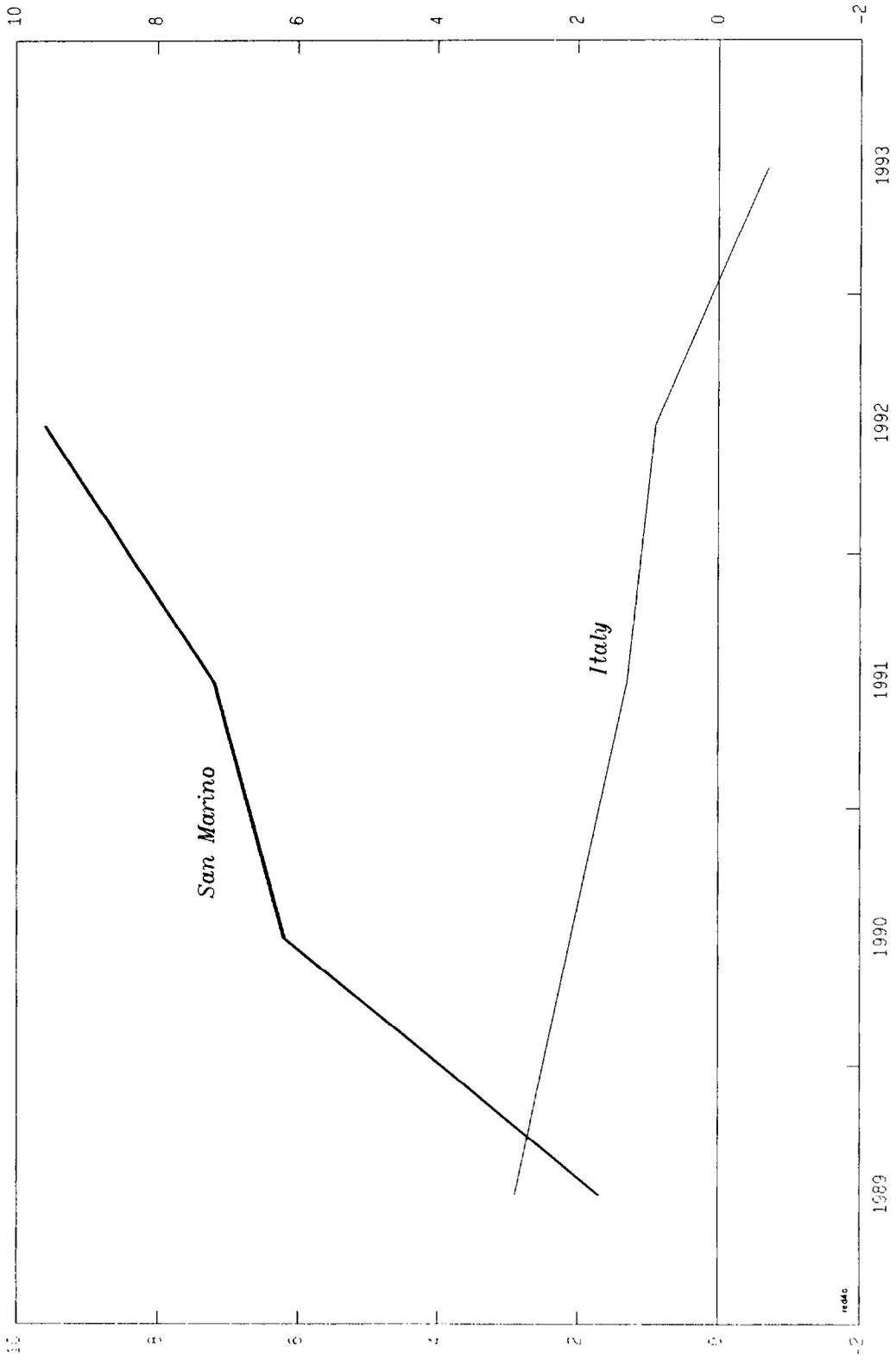
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1/ In particular, investment is treated as a residual in the national accounts.

2/ See Chapter IV.

3/ The forms of state aid in San Marino are described in Appendix I.

CHART 1  
SAN MARINO  
Real GDP Growth  
(In percent)

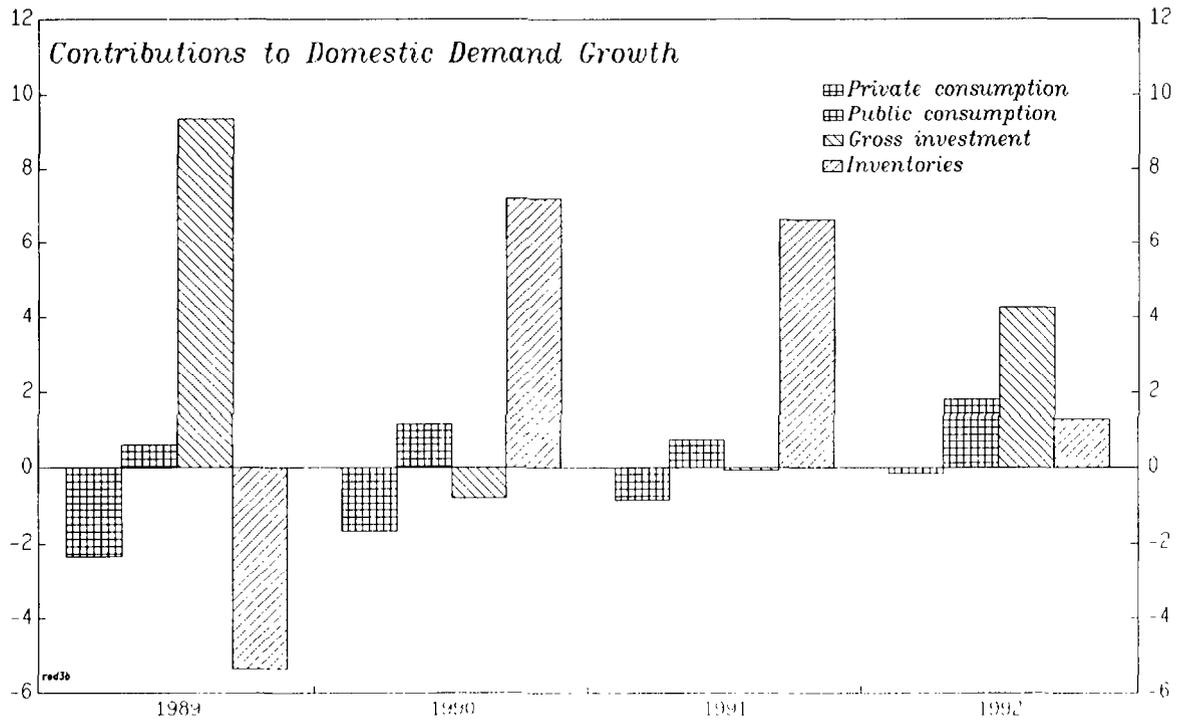
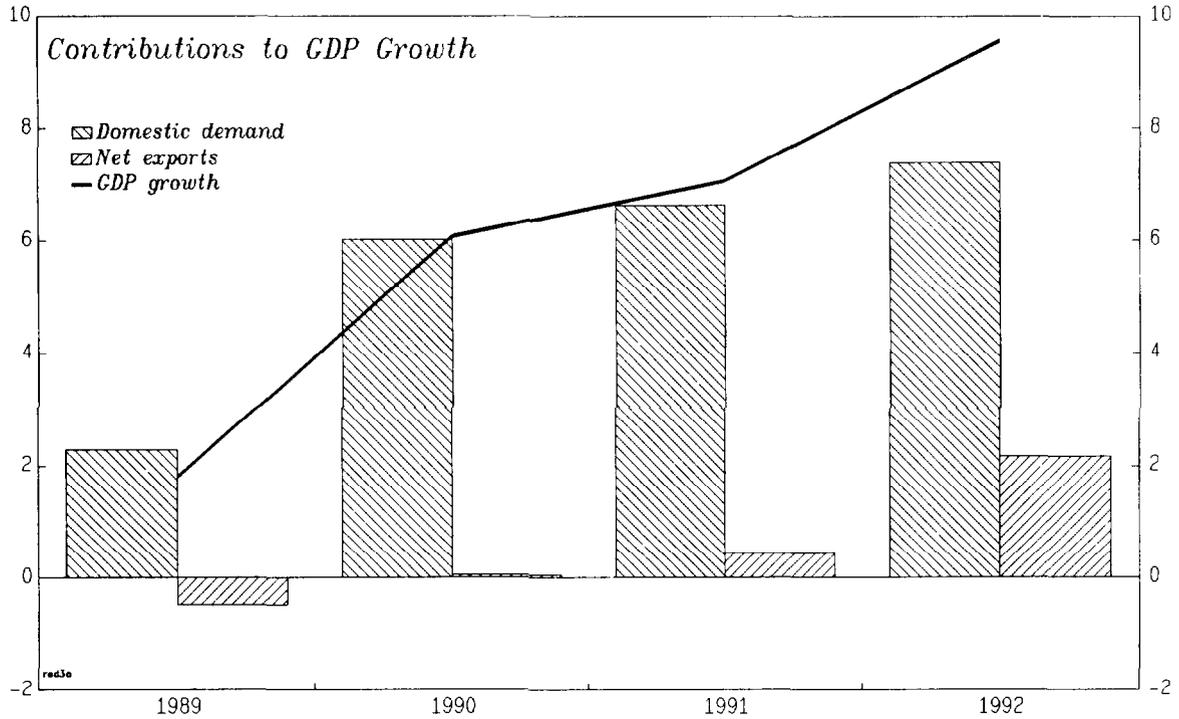


Sources: Data received from the Sammarinese authorities; and staff estimates.



CHART 2  
SAN MARINO

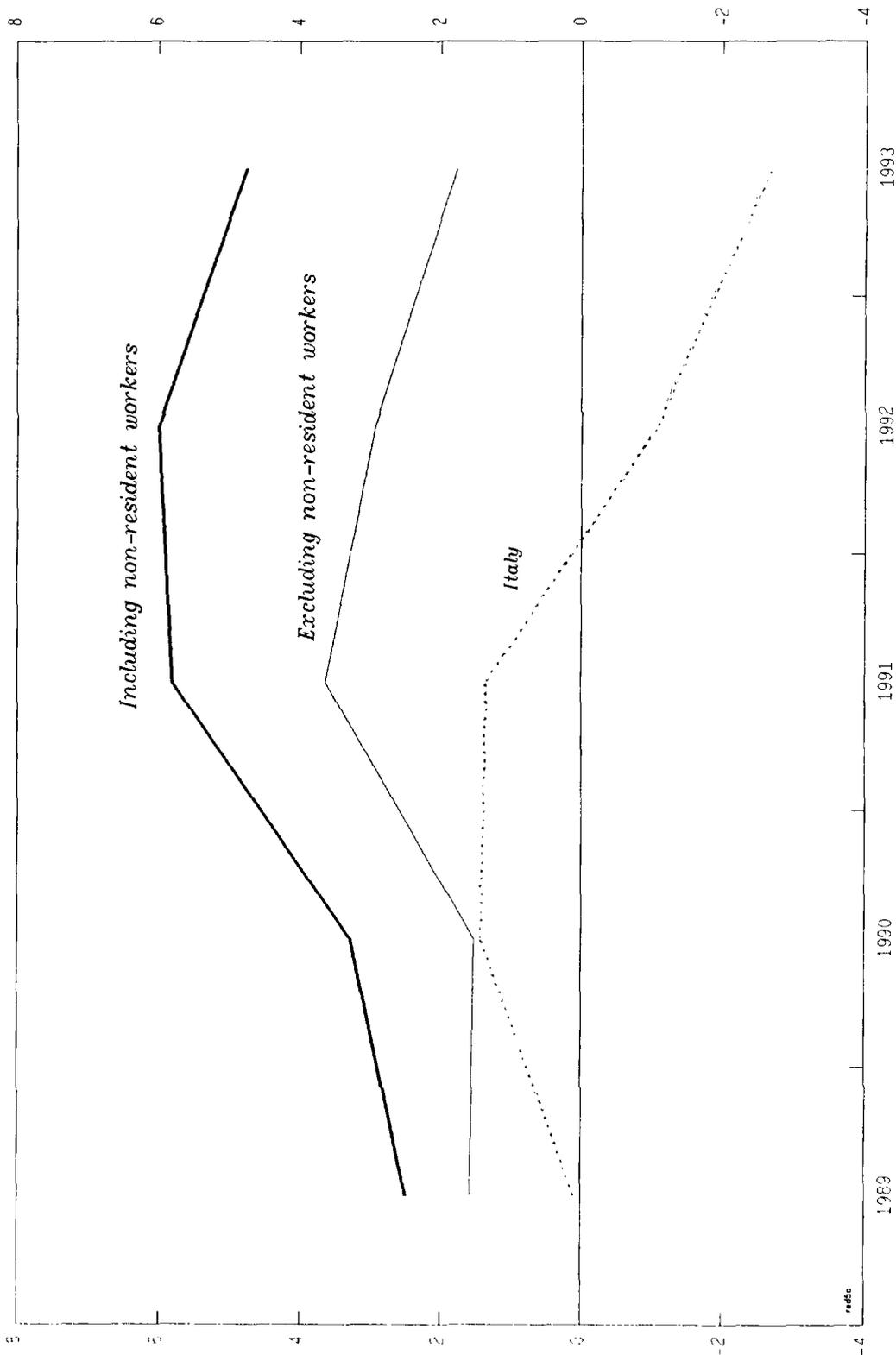
Contributions to GDP and Domestic Demand Growth



Sources: Data received from the Sammarinese authorities; and staff estimates.



CHART 3  
SAN MARINO  
Employment Growth  
(In percent)



Sources: Data received from the Sarmarinense authorities; and Italian authorities.



## 2. Wages and prices

Wages in San Marino are determined by collective bargaining in each sector. Contracts provide for full wage indexation to the Italian consumer price index (CPI), as well as some real wage increase. Contractual and average wages have risen substantially in recent years (Table 4). Wages are currently higher in San Marino than in Italy for comparable categories of workers, but total hourly labor cost has hitherto been lower in San Marino than in Italy, thanks to lower social security contributions (22.9 compared with 45.8 percent of total salary). However, wage increases have eroded the gap, especially since the abolition of automatic wage indexation in Italy in July 1992. No data are available for labor productivity and therefore there is no measure of unit labor cost.

Inflation developments in San Marino are closely linked with those in Italy (Chart 4). It is also difficult to distinguish between them statistically. The CPI for San Marino is calculated using weights based on 1985 consumption surveys for Italy. Differences between the Italian and the Sammarinese CPI largely reflect the fact that until January 1994, San Marino still used the 1985 weights, whereas in Italy the weights were revised twice in the mean time. Differences between the two CPIs are believed only to a limited extent to reflect differences in prices of particular commodities and, given that the weights used in San Marino's CPI are Italian, they also do not reflect the local consumption structure.

In San Marino, prices charged by hotels and restaurants are set by the Committee for Prices on the basis of a proposal made by hotel and restaurant owners. <sup>1/</sup> This system of price control is intended to avoid abuses, and is analogous to arrangements in the neighboring region of *Emilia-Romagna*. An agreement between Italy and San Marino requires that gasoline and tobacco be sold in San Marino at the same prices as in Italy.

## 3. Labor market developments

Total employment excluding nonresident workers (*frontalieri*) has increased by 2 percent a year on average since 1989; the aggregate including *frontalieri* has increased by almost twice as much, 3.9 percent a year (Charts 3 and 5, and Table 3). The number of *frontalieri* reached almost 2,300, some 15 percent of the labor force, at the end of 1993. These are mainly Italians, living in neighboring regions, but there are also some migrant workers from Eastern European countries. The manufacturing, construction and hotel industries employ most *frontalieri*; as a result, this component of employment reaches a peak during the tourist season. The large inflow of nonresident workers is due to tight conditions in the Sammarinese labor market, and to the mismatch between demand and supply for specific

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<sup>1/</sup> The Committee for Prices consists of the Minister of Commerce and representatives of "economic categories" (Manufacturing, Commerce, Tourism, Handicrafts, Self-Employed, and Agriculture) and the trade unions.

skill categories. In particular, few Sammarinese are available for low skill jobs; the unemployed often prefer to wait for a position in the public sector, which offers relatively high salaries, job security, and shorter working hours. There are also some jobs requiring highly specialized skills that must be filled from outside San Marino.

The unemployment rate increased to 4.9 percent at the end of 1993 from 4.1 percent a year earlier (Chart 5), but it remained noticeably below that in Italy (11.3 percent) and in the neighboring region of *Emilia-Romagna* (7.4 percent). <sup>1/</sup>

There have also been important changes in the sectoral distribution of employment (Chart 6 and Table 5). In 1993, 33.2 percent of Sammarinese were employed in the manufacturing sector, down from 39.5 percent in 1980. The second largest sector of employment was the public sector, whose weight in total employment remained stable at around 25 percent. The share of services increased rapidly over the period, from 6.4 to 13.4 percent. The commercial sector's share also had an upward trend, from 14.1 to 17.5 percent. The construction sector declined somewhat as a share of total employment (although expanding in absolute terms). The agricultural sector, once an important part of the economy, shrank further, to account for only 2.1 percent of total employment; its importance is now mostly limited to environmental protection.

San Marino provides income support to workers who are laid off or put onto reduced hours; these programs are similar to those in Italy. Dependent workers who are temporarily laid off or put on reduced hours are entitled to the assistance from the *Cassa Integrazione Guadagni*. Temporarily laid-off self-employed workers can obtain the *Indennità di Disoccupazione*. Workers who are laid off permanently receive the *Indennità Economica Speciale*. In addition, workers who cannot find a job in the private sector and who are certified unemployable due to physical handicap or social maladjustment have the right to be employed by the public administration under the terms of the Full Employment Law; such workers are employed in special units for public works projects.

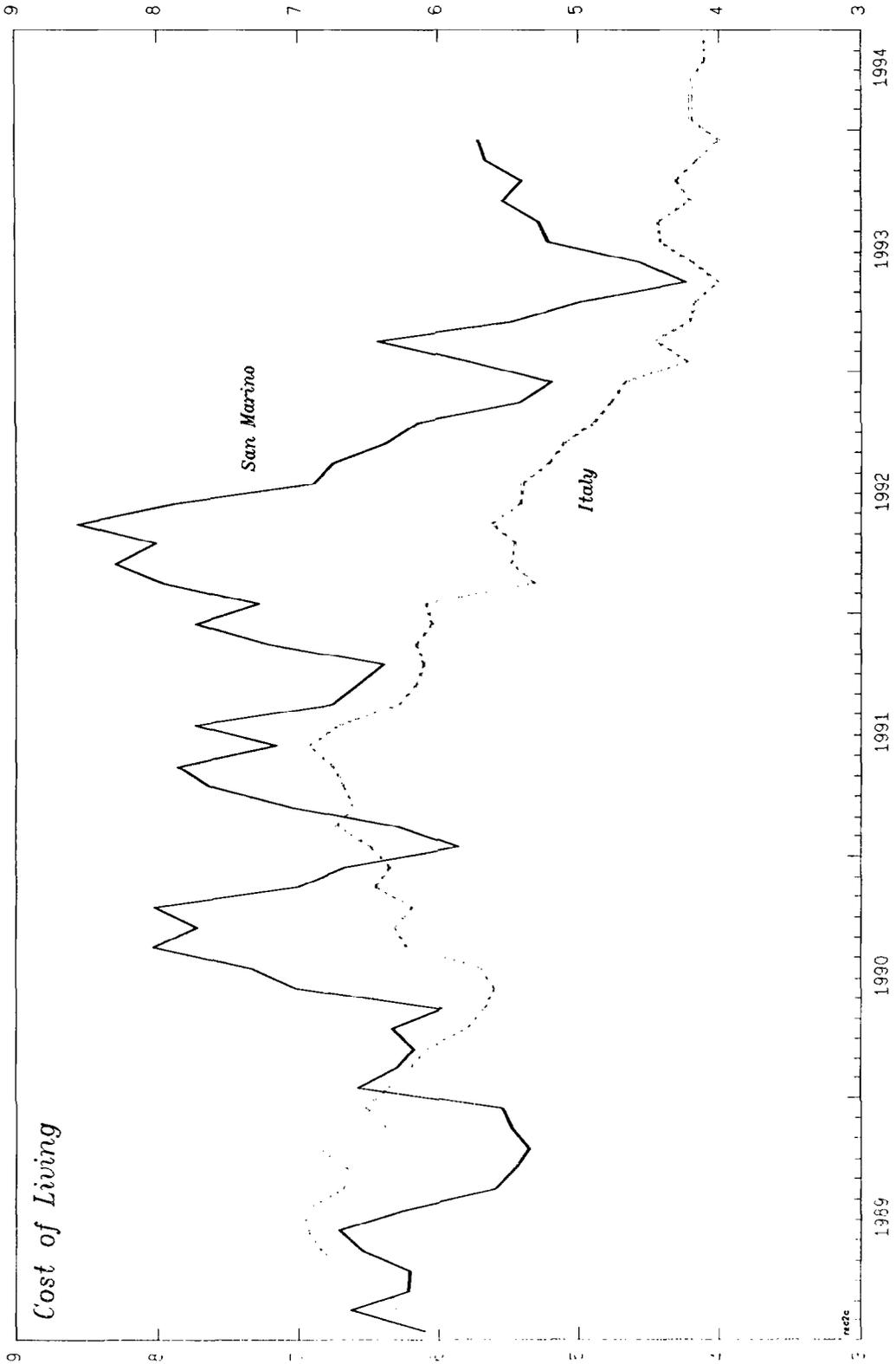
### III. Fiscal Developments

The state has an important presence in San Marino. The general government, comprising the central administration and the social security institute, is estimated to spend about 48 percent of GDP, while the overall

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<sup>1/</sup> The definition of unemployed in San Marino, as in Italy, excludes workers receiving wage supplementation subsidies, discussed in Appendix II, but the latter did not increase in recent years.

CHART 4  
SAN MARINO  
Italian and Sammarinese Consumer Price Indices  
(Year-on-year change)

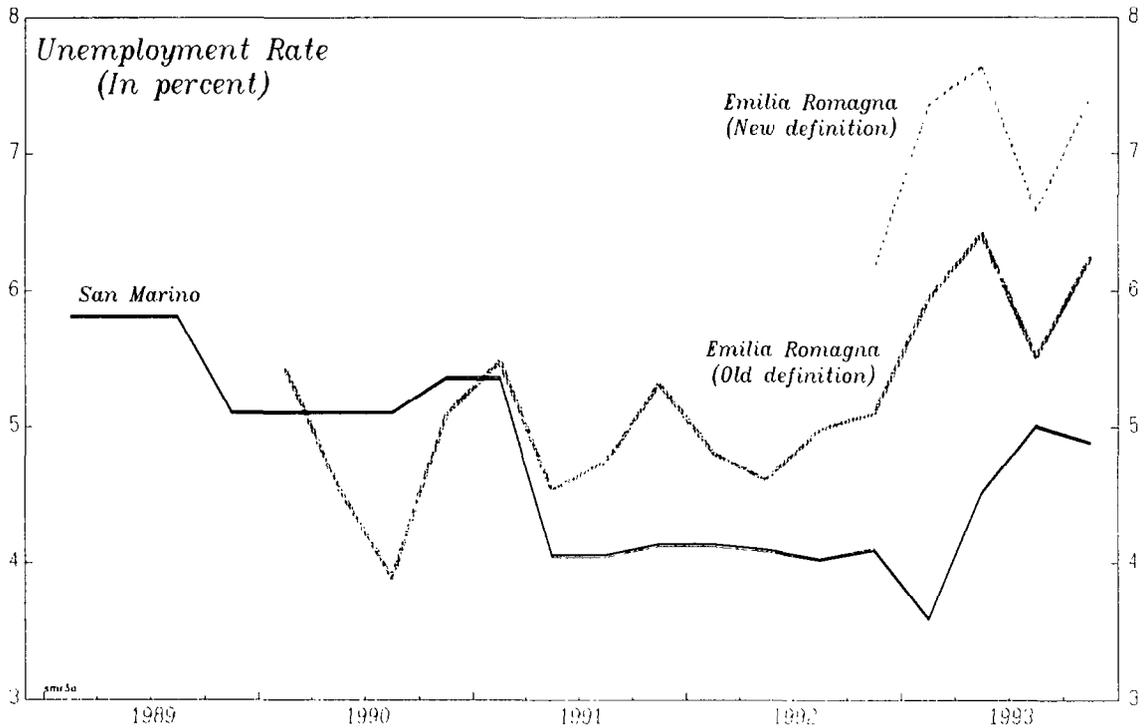
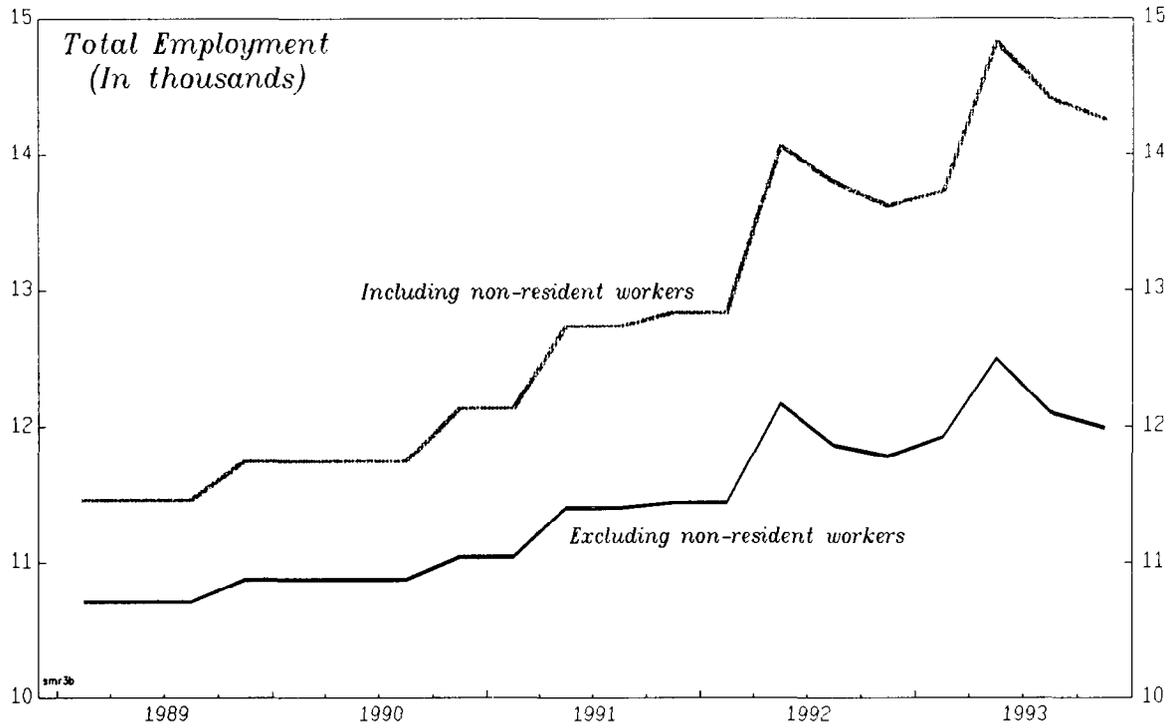


Sources: Bank of Italy; and Sammarinese authorities.



CHART 5  
SAN MARINO

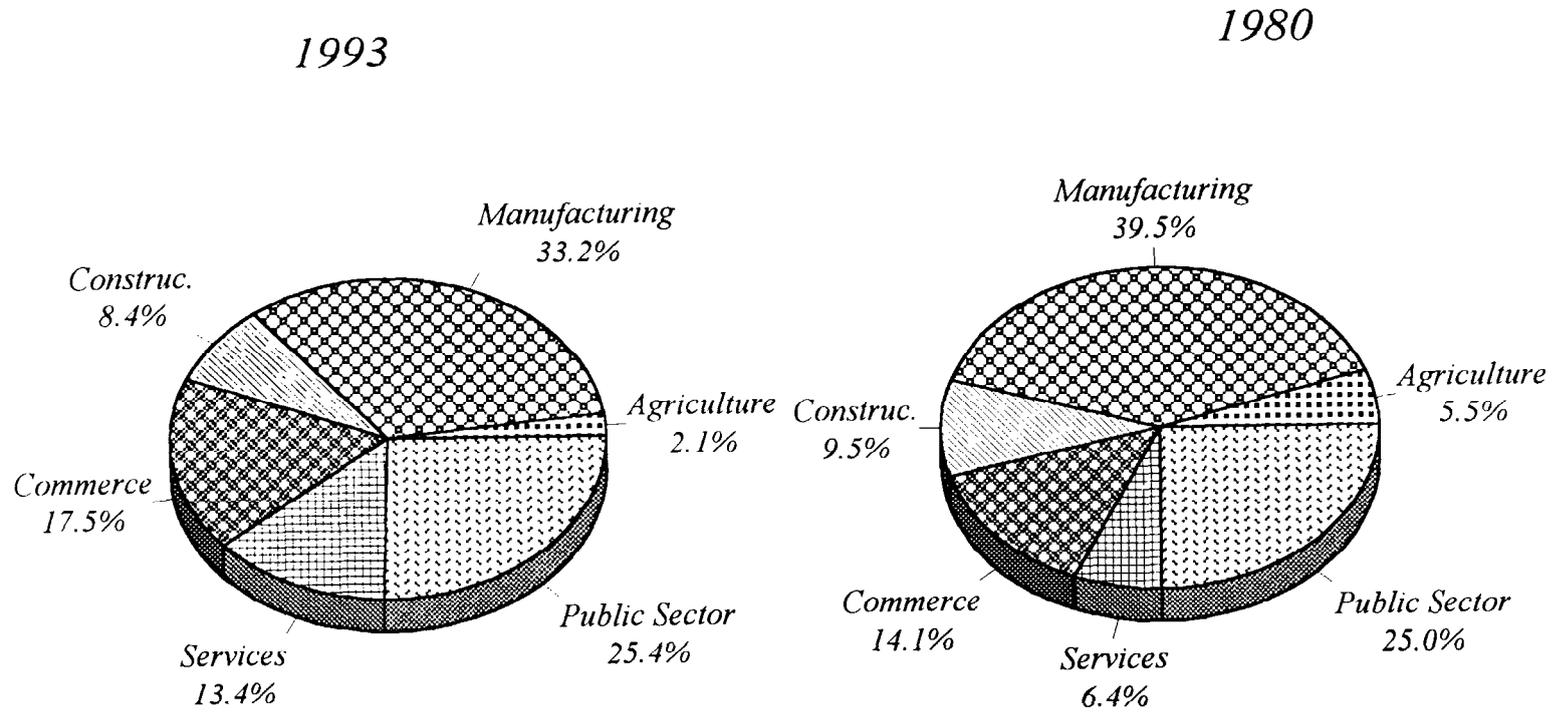
Total Employment and Unemployment Rate



Sources: Sammarinese authorities; and Italian authorities.



# Chart 6 San Marino Employment by Sector (In Percent of Total Employment)



Source: Sammarinese authorities.



public sector employs about one quarter of the labor force. 1/ Moreover, the government operates through several channels in pursuit of its commitment to near full employment. These channels include: interest subsidies to firms in difficulties and to firms engaging in projects shown to offer significant employment opportunities; temporary exemptions from the corporate income tax, the imports tax, and social security contributions; and promotion of the formation of business groups in order to take over and recapitalize firms in financial disarray. 2/

In addition, San Marino uses its tax system to encourage the development of several economic activities by giving Sammarinese firms an edge over those in neighboring Italian regions. For example, there is no general sales tax, but a one-stage import tax with a rate below the Italian VAT rate; public utilities are provided at rates 10 to 20 percent below those in Italy; most forms of personal and corporate income are taxed at rates that are substantially lower than in Italy; and social security contributions are also lower than in Italy.

In general, the public finances have been sound, but the policy framework is rigid, leaving little room for the exercise of fiscal policy within a given fiscal year. In practice, the government has limited control over its overall volume of spending and taxation: key tax and spending decisions by both the central administration and the public enterprises are embodied in legislation and must be accommodated by the administration, including by resource transfers to the social security institute and the public enterprises whenever necessary.

The following sections provide a general description of San Marino's public sector as well as a discussion of the most important recent developments in the public finances.

#### 1. The general government

The finances of the government have been quite solid in San Marino in recent years, with the central administration running an average surplus of an estimated 3 percent of GDP in the period 1989-1992 (Chart 7, and Tables 6 and 7). A substantial weakening occurred in 1993, with the estimated surplus falling to only 0.5 percent of GDP. This deterioration is due in large part to the direct and indirect effects of large wage increases, especially in 1992, as well as increasing costs in the provision of health care.

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1/ The overall public sector includes the general government and the public enterprises. Because of the lack of comprehensive data on the finances of nongovernment public entities it was not possible to compute the accounts of the overall public sector.

2/ Interest subsidies have been of the order of 1 percent of GDP in recent years; the fiscal cost of tax exemptions is estimated at 0.7 percent of GDP in 1993.

Staff estimates for 1993 show that total revenues (excluding social security contributions) represented 47 percent of GDP, of which 44.5 percent consisted of tax revenues and social security contributions (collected on behalf of the social security institute), 1.1 percent represented an annual transfer from the Italian Government (*Canone Doganale*), 1/ and the rest were revenues generated by the state monopoly of tobacco products and proceeds from licenses and fees. 2/

Revenues from the import tax account for about two thirds of all tax revenues, excluding social security contributions (10.5 percent of GDP). This is a one-stage tax (*monofase*) levied on imports from outside Italy, with a basic rate of 15 percent and four special rates of 2, 5, 8 and 9 percent for special categories of goods. In addition to the *monofase*, there is an excise tax levied on imported petroleum products, to fulfill an agreement with Italy to keep the after-tax retail price at the same level as that prevailing in Italy. All imports by entities of the public sector are exempt from both taxes.

The income tax (*Imposta General sul Reddito*) accounts for about one third of all tax revenues excluding social security contributions. This tax is levied on several categories of income stipulated by law, net of allowable deductions. 3/ In addition, other forms of income, such as capital gains and retirement pensions, are taxed at a different rate. Family allowances and social pensions are exempted from the tax. The personal income tax is applied with a progressive rate structure, with marginal tax rates oscillating between 12 and 50 percent across eight income brackets. Profits of corporations are taxed at a proportional rate of 25 percent.

Current government expenditures inclusive of transfers amounted to 46.3 percent of GDP in 1993, consisting mainly of net transfer payments (25.3 percent of GDP), wages and salaries (11.3 percent of GDP), and purchases of goods and services (4.7 percent of GDP). There is little debt service since government debt is virtually nonexistent. Current expenditures have usually remained substantially below revenues, allowing

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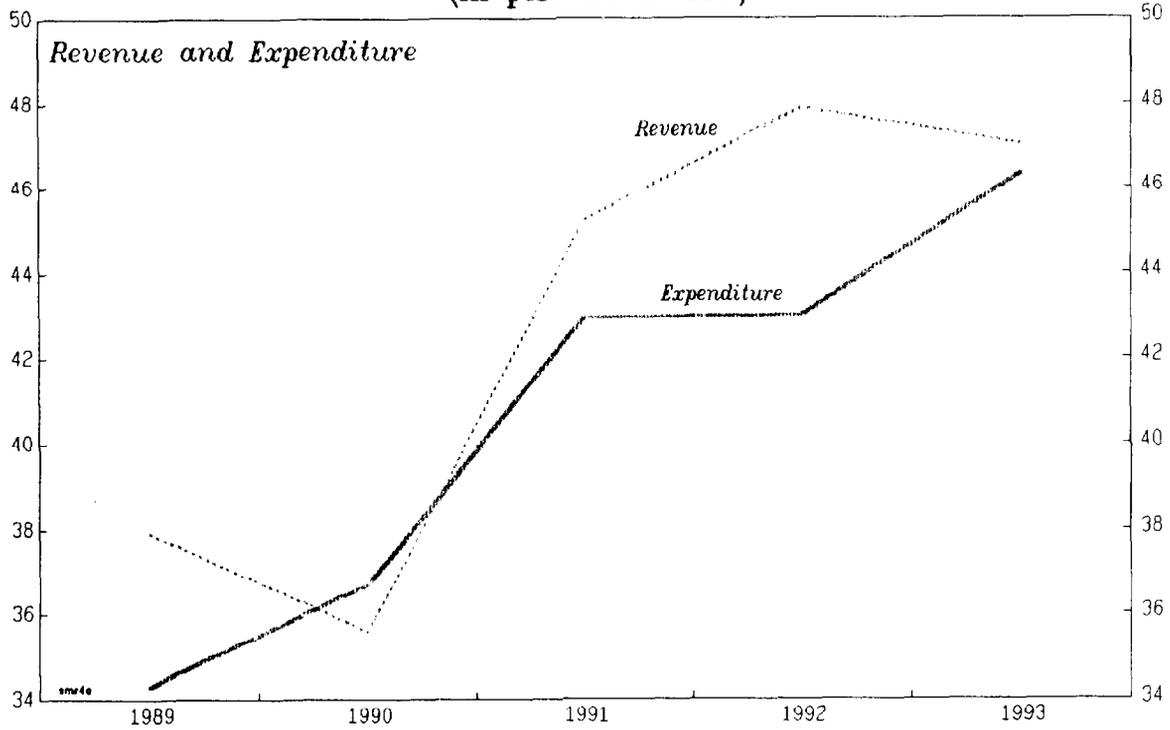
1/ This transfer, last negotiated in 1984, represents partial compensation for San Marino's giving up certain revenue sources such as the collection of tariffs on imports from outside Italy, and for the use of the Italian lira as the domestic currency.

2/ The government has a monopoly over the import and domestic sale of tobacco products, which it purchases from Italian producers at wholesale prices and sales domestically at the after-tax retail price prevailing in Italy.

3/ The categories are: income derived from employment (including self-employment), capital, land, buildings, entrepreneurial income and sundry income. Wages and interests are subject to withholding at the source, as advance payments for the personal income tax. Withholding of tax on interests earned by nonresidents is not reimbursed.

CHART 7  
SAN MARINO

Revenue, Expenditure and Overall Balance  
of Central Administration  
(In percent of GDP)



Sources: Sammarinese authorities; and staff estimates.



the government to generate current account savings which averaged 4.8 percent of GDP over the period 1989-1993.

Net transfer payments represent a substantial expenditure item. In 1993 the social security institute received net transfers from the central administration of Lit 159.3 billion, or about 20 percent of GDP, about half of which represents contributions collected by the government on behalf of the social security institute and the rest includes financing for the national health program, the government's social security contributions as an employer, and its matching contributions to the various pension funds.

Current expenditures have risen very rapidly over the last few years. Nontransfer current expenditures rose by about 50 percent between 1990 and 1993 (about 30 percent in real terms). The public sector payroll increased by 33.6 percent during that period, especially in 1992, reflecting both significant salary increases and higher levels of employment. 1/ Net transfer payments have also grown very rapidly.

Chart 7 depicts the trends of total revenues and expenditures of the central administration for the period 1989-1993. Both revenues and expenditures rose quickly during those years. The rapid growth in expenditures is explained mainly by the evolution of state transfers to other entities of the public sector, especially the social security institute. Revenues more than kept pace with rising expenditures making it possible for the government to generate surpluses every year since 1989 except 1990.

Chart 7 also reveals a weakening of the fiscal situation in 1993, mainly as a result of sharp wage increases negotiated for 1992 and 1993. Large wage increases are likely to have significant delayed budgetary effects because in San Marino several expenditure categories are sensitive to fluctuations in public sector wages with a lag. In particular, increases in public wages have a direct effect on net transfer payments to public enterprises and the social security institute, as their budgets tend to worsen. Wages increases also affect retirement benefits since these are linked to an average of an individual's income over his last five years in the labor force. There is also the possibility of an additional fiscal burden associated with either increased subsidies or foregone revenues if wage increases in the public sector lead to similar increases in the private sector and worsen the financial situation of some already weak firms. 2/

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1/ On a contractual basis, average salaries in the public sector increased by 5.0 percent in 1991 and 14.9 percent in 1992. Public sector employment increased by 4.0 percent in 1991 and 6.5 percent in 1992.

2/ It is estimated that the fiscal cost of tax exemptions doubled in 1993.

Thus, the wage increase of 1992 is likely to have set in motion this set of adverse fiscal developments, which are likely to be felt in the upcoming years.

2. Social security

The social security institute (ISS) offers retirement pensions, health care, several forms of income supplementation, and other services. Until 1990 the ISS's revenues consisted of payroll contributions and an earmarked one-half of the general income tax revenues. In practice, these revenues were insufficient to meet the system's outlays, especially the rapidly rising costs of health care services, so additional transfers from the central administration were needed. Moreover, cross-subsidization was taking place as surpluses of pension funds for some categories of employees were used to cover deficits in other areas. With the 1991 reform of the social security the earmarked income tax revenues were abolished, payroll contributions for particular components of social security were increased, and cross-subsidization from the pension funds was eliminated, although surpluses in other areas such as income supplementation can still be used to cover deficits elsewhere. Appendix II provides a fuller description of the social security system in San Marino.

3. The public enterprises

There are four nonfinancial public enterprises and a few other nonfinancial public entities in San Marino (Tables 8 and 9). The public enterprises, ranked by their volume of spending, are: the Public Utilities Company (AASS), the Public Works Corporation (AASP), the Numismatic and Philatelic Agency (AASFN), and the National Dairy Corporation. There are also two smaller public entities, the Olympic Committee and the University of San Marino. In 1992, the largest three public enterprises combined had spending of about 12 percent of GDP, while the rest together spent less than 2 percent of GDP. The payroll of the all of these entities represented about one quarter of the total public sector payroll, or about 3 1/2 percent of GDP.

All public enterprises are exempt from the import tax, but not from social security contributions. They are also required to transfer their profits to the central administration at the end of the year. In principle, public enterprises are autonomous and their operations are directed by a Board of Directors appointed by the Parliament. In practice, however, there is limited autonomy and the Board of Directors has to seek approval from the central administration for a number of issues such as the determination of tariffs, the execution of investment plans, subcontracting of services, and wage policies.

The AASS is in charge of providing public utilities to San Marino, including water, electricity, gas, garbage collection, transportation, and inspection of health standards. For water, electricity and gas the AASS acts only as a distribution agency for imports from Italy. The AASS

monitors separately the operations of each of these service-providing units. There is cross-subsidization from water, electricity and gas, which are profitable, to the other activities. The AASS has consistently posted operating surpluses, which has allowed it to finance part of its capital expenditures out of its own resources.

The activities of the AASP can be divided into four categories: construction of buildings, maintenance and construction of roads, administration of parks and landscaping, and the provision of special services (such as cleaning and security) to the public administration. The AASP undertakes some construction itself, but subcontracts the larger projects. 1/ The AASP hires most of the handicapped or other workers who are given employment under the terms of the Full Employment Law. The AASP is largely financed by transfers from the central administration, which are of the order of 3 1/2 percent of GDP. In 1993, some 300 workers (about a percent of public sector employment) who had been performing cleaning, security, and other services for the government under the AASP, were transferred to the central administration, where they are employed under a special contract (*contratto privatistico*) that gives the government greater flexibility in reallocating these workers among different activities where they are needed.

The AASFN is in charge of managing the production and distribution of stamps and coins both for use as legal tender and for collector markets. 2/ The *Centrale del Latte* (CL) is a state monopoly in the processing and distribution of dairy products, created in the early 1970s; it is now something of an anachronism, given the tiny size of the domestic dairy farming sector that it was originally intended to serve. The Olympic Committee (OC) is in charge of the organization of sports activities in San Marino; its expenses, consisting mainly of salaries and spending on infrastructure (of the order of Lit 4 billion) are financed entirely from the state budget.

The government has recently begun to consider the possibility of privatizing some public enterprises' activities. Some likely candidates would include the public utilities provided by the AASS, and the productive services provided by the AASP.

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1/ There is no general procedure of public bidding for awarding projects to the participating contractors. The board of Directors of the AASP has a list of possible contractors and makes an preliminary selection, which has to be approved by the central administration. Only occasionally are some projects open to public bidding.

2/ An agreement with Italy sets maximum of coins to be issued by San Marino. These coins are put in circulation and are guaranteed by the Ministry of Finance.

#### IV. Money and Finance

##### 1. General features of the Sammarinese financial sector

San Marino's financial sector is large in relation to the size of the country. In 1992, the total assets of the banking system were some 700 percent of GDP. The four commercial banks depend on nonresidents for a large proportion of their funds, in the form of deposits and repurchase agreements. 1/ The currency union with Italy, together with bank secrecy, has made San Marino an attractive repository for Italian savings, particularly with the uncertainties of Italy's political and tax situation since 1992. The Sammarinese banks, in turn, invest most of the funds at their disposal in liabilities of Italian banks and Government. San Marino's role as an "offshore" financial center has hitherto been limited by a 1939 agreement with Italy that stipulates that Sammarinese banks may only transfer funds abroad through Italian correspondents. This restriction is due to be eliminated under the 1991 Financial and Exchange Agreement with Italy, which has not yet been implemented due to Italian concerns with regard to fiscal monitoring and safeguards against money laundering.

Given the use of the Italian lira as the domestic currency, San Marino until recently had no central bank. 2/ The *Istituto di Credito Sammarinese* (ICS), an embryonic central bank, was established in 1991 and began operating in 1992, with the mandate to promote the development of the economy; to oversee the smooth functioning of the banking and financial system; to encourage growth of trade; and to promote the balanced expansion of the banking and financial system. However, the ICS has no instruments with which to influence domestic money, credit, and interest rates, and also no influence over domestic inflation. At present, its main role is as state treasury agent. The ICS shares responsibility for the financial system with the Office for Banking Supervision (*Ispettorato*), founded in 1984, which supervises, regulates, and gathers data on banks and other financial institutions.

Recent trends in interest rates, which are closely linked with those in Italy, are discussed in Section 2. Development in money and credit, and the banking sector, including government deposits, are described in Section 3. Section 4 is related to nonbank financial institutions, while Section 5 contains information on the Financial and Exchange Agreement with Italy.

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1/ The banks are *Credito Industriale Sammarinese* (the Industrial Investment Bank), the *Banca Agricola Commerciale* (the Bank of Commercial Agriculture), the *Cassa di Risparmio* (the Savings Bank), and the *Cassa Rurale di Faetano* (the Rural Bank of Faetano).

2/ Sammarinese non-gold coins are issued within limitations that are set in the Sammarinese-Italian monetary agreement (Lit 2.7 billion a year in the 1991 agreement). Sammarinese gold coins can be issued without legal limitations. There are no estimates of currency in circulation in San Marino.

## 2. Interest rates

Sammarinese interest rates rose sharply in 1992 with the September ERM crisis and continuing financial difficulties in Italy. Then, they followed a downward course along with Italian rates during 1993 and early 1994 (Table 10 and Chart 8). Average rates on repurchase agreements offered by Sammarinese banks reached 13 percent in 1992, and then declined to 7.3 percent in the first quarter of 1994. Similarly, average Sammarinese savings deposit rates rose to 10.0 in 1992 and then declined to 6.0, demand deposits from 9.0 to 5.0, and loans from 17.9 to 13.5 percent. This decline in nominal interest rates clearly represents a decrease in real interest rates, given that inflation (by either Italian or Sammarinese measures) decelerated by approximately 0.8 percentage points from 1992 through early 1994.

## 3. Money and credit

The Sammarinese banking system has grown rapidly in recent years, associated mainly with a rising volume of nonresident funds. The authorities do not provide any classification of bank assets and liabilities on the basis of residency, on the grounds of bank secrecy. This complicates the tasks of compiling monetary data in line with international standards and of interpreting movements in the data. Accordingly, the figures reported in this section are staff estimates based on available data, using numerous assumptions which were discussed with the authorities. These estimates are more likely to err on the side of under-representing the increasing relative importance of nonresident deposits, and therefore of exaggerating the levels and growth rates of domestic money and credit.

There are several reasons that San Marino has attracted nonresident banking business. Sammarinese banks are not subject to a legal reserve requirement, in contrast to the 15 percent requirement in Italy. There is, however, a legal liquidity requirement: banks must hold at least 10 percent of their deposits less 10 times their capital in the form of bonds issued or guaranteed by the Italian Government or international organizations. 1/ In addition, Sammarinese banks concentrate on a limited number of basic operations and have lower operating costs than many Italian banks, which offer a wider range of services and maintain extensive branch networks. As a result, interest rates on deposits and repos are generally slightly higher in San Marino than in Italy (Table 10). Moreover, interest on deposits is subject to a 13 percent withholding tax in San Marino, less than the corresponding withholding tax on deposits in Italy. 2/ Nonetheless,

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1/ This legal requirement does not apply to repurchase agreements, which are recorded off balance sheet by the banks.

2/ In principle, Italian residents are subject to income tax on interest on Sammarinese bank deposits net of Sammarinese withholding tax, but it is widely believed that given bank secrecy in San Marino, most of this income goes unreported.

differentials on interest rates cannot alone explain the attractiveness of San Marino for Italian savers. Political uncertainties and fears of extraordinary taxation in Italy were likely responsible for large inflows of Italian savings into the Sammarinese banking system in 1992 and 1993.

The past few years have witnessed rapid growth in domestic deposit money, which expanded by an estimated 32 percent in 1992 and 23 percent in 1993. The gross liabilities of the banking system to the domestic nongovernment sectors, comprising domestic deposits and repurchase contracts with residents, was estimated at Lit 1,753 billion, more than twice GDP (Table 11). Foreign liabilities, mainly nonresident deposits and repurchase agreements, expanded even more rapidly, by 53 percent in 1992 and 29 percent in 1993, reaching more than 50 percent of the banking system's total liabilities.

Repurchase agreements now account for a large share of the Sammarinese banks' business. Typically, banks buy Euro-certificates of deposits denominated in Italian lira with a 3- or 6-month maturity and resell them through 3-month repurchase contracts, which does not expose them to much interest-rate risk. Securities sold under repurchase agreements grew very rapidly in the past few years to reach roughly half of the total assets of the banking system at the end of 1993. <sup>1/</sup>

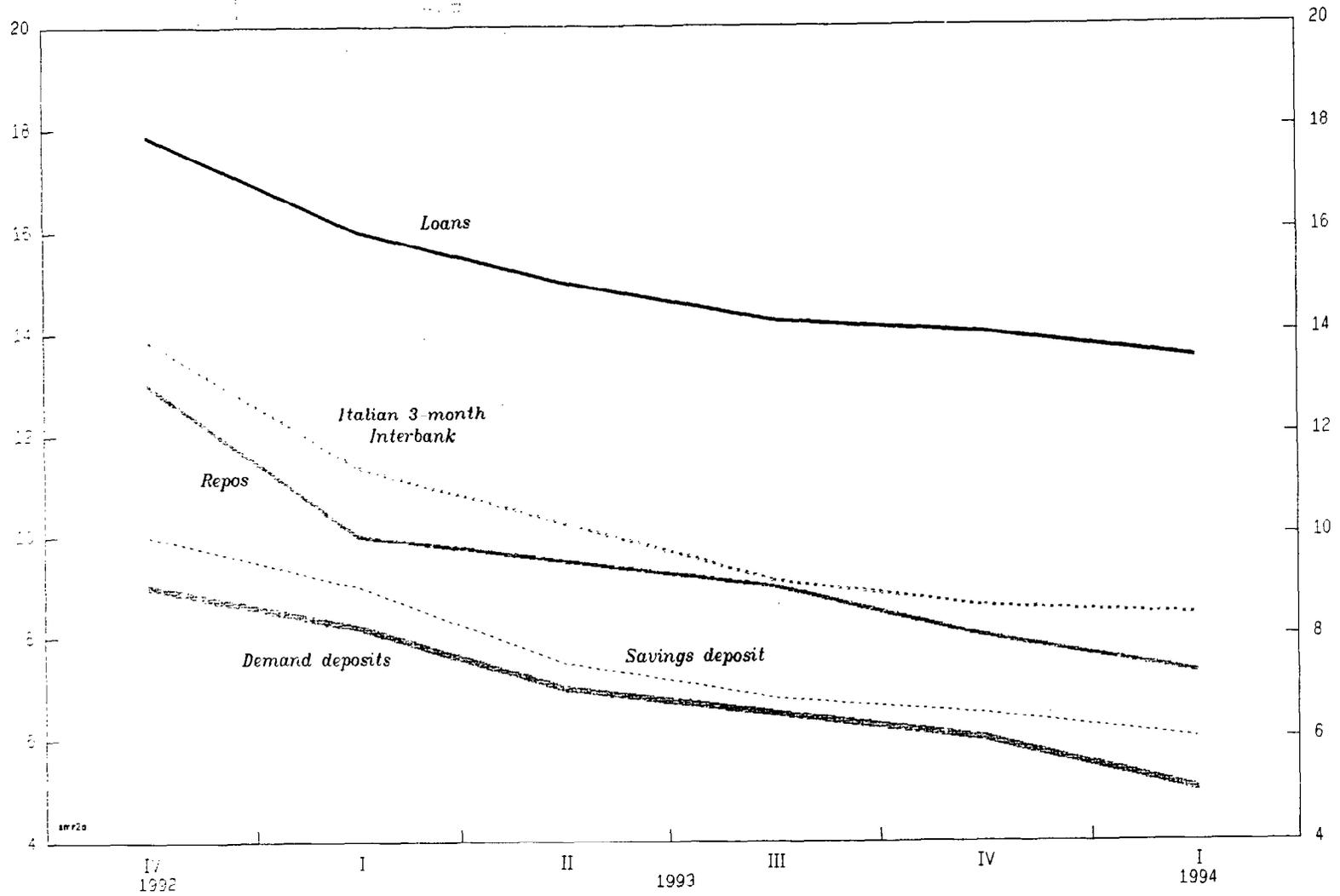
The Sammarinese banks invested most of the funds they collected back in Italy. At the end of 1993, gross foreign assets of banks are estimated to have represented more than 80 percent of the total assets of the banking system (Table 11). The entire banking system (ICS plus the four commercial banks) had a comfortable net foreign asset position of Lit 1,813 billion at the end of 1993, reflecting a history of government financial surpluses and excesses of domestic savings over investment.

Gross domestic bank credit (Lit 850 billion in 1993) was very small in relation to either deposits or net foreign assets, some 13 percent of total bank assets. The credit structure of the Sammarinese banking system is weighted heavily toward short-term lending. At the end of 1993, half of credits to domestic sectors were short-term credits and the rest mainly medium-term. However, the weight of medium- and long-term credits has increased over the past two years: the outstanding amount of medium-term

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<sup>1/</sup> Securities sold under repurchase agreements are recorded off balance sheet by the Sammarinese banks. The corresponding amounts have been re-integrated in the banks accounts for obtaining a presentation in accordance with international standards, as shown in Table 11. The amounts of securities sold under repurchase agreements that appear in the banks' accounts, which are compiled at the end of each calendar quarter, likely do not correctly reflect the average importance of such transactions because banks reverse much of these repurchase agreements just before the date for which the balance sheets are compiled. This window-dressing is designed to create the impression that a greater proportion of banks' funding comes from deposits, which are regarded as more stable than repos.

CHART 8  
 SAN MARINO  
 Selected Interest Rates



Sources: Sammarinese authorities; and Bank of Italy.



loans to the private sector grew by 31 percent in 1992 and 62 percent in 1993. Preferential credit also played an increasing role, with the outstanding amount rising by 15 percent in 1992 and 26 percent in 1993 (Chart 9). 1/

Nonperforming loans and arrears on interest increased by 88 percent in 1992 and 41 percent in 1993, to reach around 4 percent of total loans. This was a rapid rate of increase, but the incidence remained lower than in Italy, reflecting the lesser severity of the recession in San Marino. The increase in nonperforming loans does not seem to constitute a serious problem for the Sammarinese banks, which are well capitalized. On average, banks' capital (net of provisions) is 15 to 20 percent of their loans, compared with the Basle Standard of 8 percent adopted in the EU. 2/

The government of San Marino accumulated large financial assets as a result of a series of fiscal surpluses over recent years. The deposits of the central administration, including the state budget and the Social Security Institute (ISS) reached Lit 240 billion at the end of 1993, some 30 percentage points of GDP (Table 12). These deposits were transferred to the ICS from the Sammarinese commercial banks during 1992 and 1993 and the ICS now has exclusive responsibility for managing them. 3/ In addition, a large share of the deposits of public enterprises, which are also legally permitted to hold deposits at commercial banks, has been transferred to the ICS (Lit 16 billion at the end of 1993). 4/ The ICS in turn deposited in the commercial banks over one-third of funds it received in government deposits. The banks remunerated these deposits at 2 percentage points below the Italian 3-month's interbank rate.

#### 4. Nonbank financial institutions

Eleven nonbank financial institutions are registered in San Marino, of which nine had started to operate by the end of 1993. Those that were in

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1/ Preferential credit arrangements are discussed in Appendix I.

2/ Moreover, according to the *Ispettorato*, virtually all of Sammarinese banks' capital is Tier 1 capital, and does not include items such as subordinated debt.

3/ One third of the central administration deposits had been transferred to the ICS at the end of 1992 and the remainder by the end of 1993.

4/ Neither the government nor the public enterprises have engaged in repurchase agreements, so all their holdings are in the form of regular deposits. However, starting in 1993, a new accounting procedure for tax payments has been implemented at the ICS and the government deposit accounts are not immediately credited from taxes received, which are recorded for a limited period of time on a separate account pending acknowledgement of receipt by the government. As a result, the ICS balance sheets show a nondeposit liability of the ICS to the government for the corresponding amounts of taxes: Lit 38 billion at the end of 1993, which is included in the Lit 240 billion mentioned above.

operation were involved in portfolio management, managing a total of Lit 1,418 billion--equivalent to an estimated 170 percent of domestic credit. Three of these firms were also engaged in leasing operations, with assets valued at Lit 84 billion. There are no insurance companies.

The comparatively large volume of funds managed in San Marino may to a considerable extent reflect nonresident activities attracted by the tax advantages of San Marino. The opportunities may expand further with the implementation of the exchange and financial agreement with Italy; the *Ispettorato*, which has to give its approval to the creation of any new nonbank financial institution, has received many new applications in recent months.

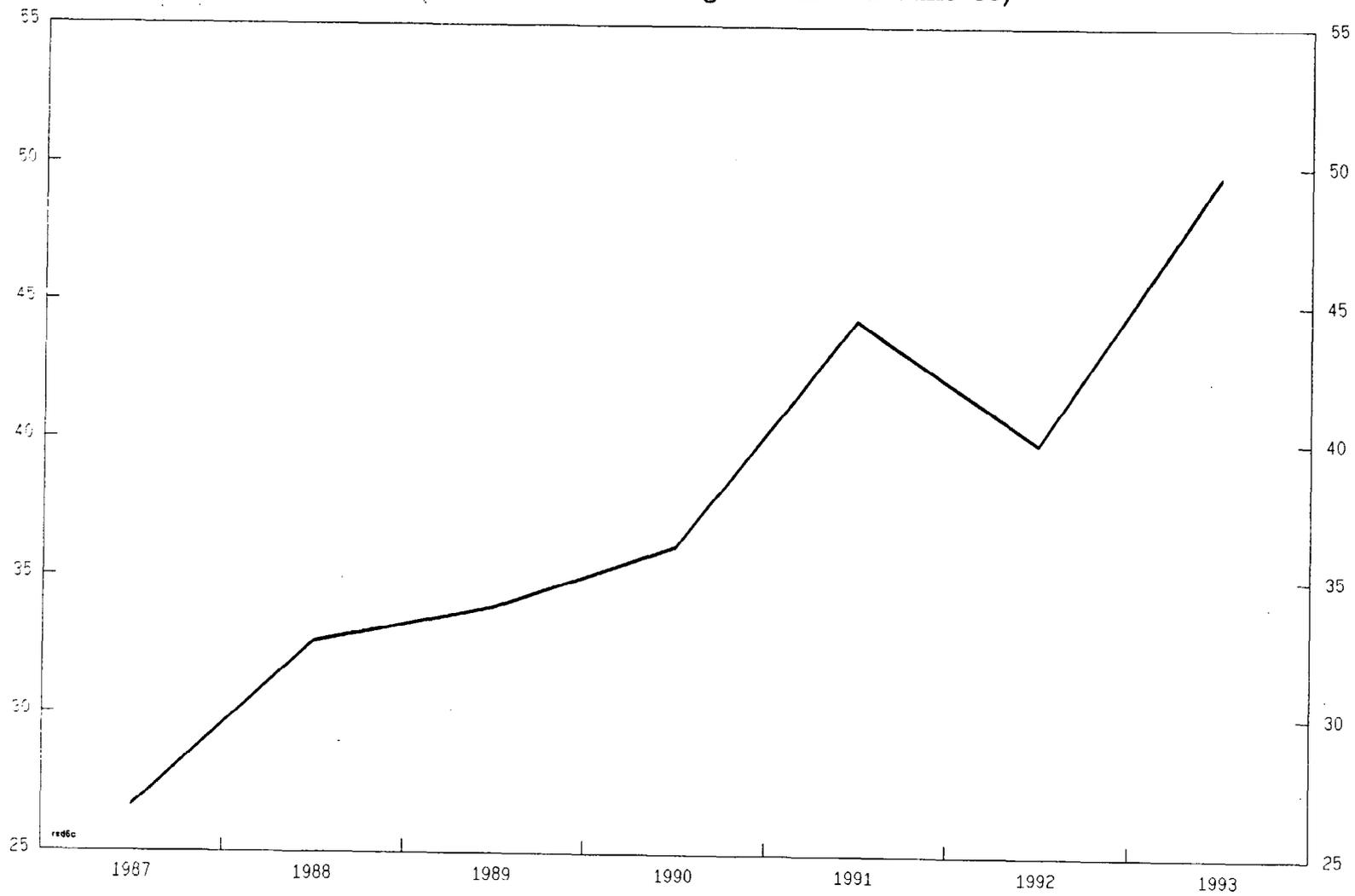
The government has also recently become involved in encouraging such nonbank financial activity. It is intended that, in the near future, an institution would be established to manage a mutual fund; the managing institution's capital would be held by the ICS, the Sammarinese commercial banks, and an important Italian bank. This institution would initially be created in Luxembourg, but registration would be transferred to San Marino as soon as enabling laws have been passed. The role of the Sammarinese commercial banks in the management of this mutual fund would become progressively larger. The assets held by the mutual fund would be non-Sammarinese but the stated intention is that shares in the funds would be held mainly by Sammarinese residents. The holding of shares of this mutual fund would likely be accorded preferential tax treatment.

##### 5. The financial and exchange agreement with Italy

The new Financial and Exchange Agreement with Italy was signed in 1991 but has still not been implemented. When implemented, the agreement would give the Sammarinese banking system direct access to foreign and international markets, whereas at present all transactions are required to go through Italian correspondents. The agreement would give the ICS the status of a foreign exchange bank under Italian law; the ICS could also, at its discretion, transfer some of the associated rights to Sammarinese commercial banks, as might be considered desirable in order to avoid unnecessary steps and resulting delays in the corresponding procedures.

The delay in implementation of the agreement was primarily due to Italian concerns that San Marino could become a more important center for money laundering and tax evasion. The fear of money laundering was dramatized by the alleged use of Sammarinese banks for transfers of illicit funds by members of Italy's security service, exposed in connection with the recent bribery scandals in Italy. The use of Sammarinese banks for tax evasion is a longer standing issue, which has been highlighted by the recent surge of nonresident funds into Sammarinese banks, as well as by Italy's ongoing fiscal difficulties.

CHART 9  
SAN MARINO  
Subsidized Loans  
(In billion lire; outstanding amount on June 30)



Source: Data received from Sammarinese authorities.



A ministerial exchange of letters set in motion a procedure for implementing the Exchange and Financial Agreement, effective April 1, 1994. According to this procedure, a joint committee will be set up to determine the conditions under which the agreement will be implemented. A key issue for this committee to resolve is fiscal monitoring. At this time, it is not clear whether arrangements would entail first- or second-degree monitoring, distinguished on the basis of whether the Sammarinese authorities would have to report to the Italian tax authorities with regard to money deposited by Italian residents in San Marino or whether this information would be provided only if deposits were subsequently transferred to a third country.

## V. The External Sector

### 1. Balance of payments developments

International trade and capital flows are highly important to the Sammarinese economy. The Sammarinese authorities do not compile any balance-of-payments accounts, but a rudimentary set of accounts can be constructed using available data and some estimates (Table 13). Merchandise exports and imports both exceeded twice GDP throughout the 1988-1992 period. Both expanded rapidly in recent years: in 1992, exports rose by some 19 percent in dollar terms while imports rose by 9 percent. There was a substantial deficit on merchandise trade throughout the 1988-1992 period, which declined sharply in the early 1990s, from 60 percent of GDP in 1990 to 30 percent in 1992.

The deficit on merchandise trade was more than covered by a surplus on services. Tourist receipts, dominated by purchases of goods by nonresidents, were a large component of the external accounts, with an overall surplus of 35 percent of GDP in 1992. With regard to factor income, the most important component was interest earned on the assets of Sammarinese banks' net foreign assets. This income increased by an estimated 68 percent in dollar terms in 1992, reaching an estimated 17 percent of GDP, with the rapid expansion of the banking system's net foreign assets as well as a rise in lira interest rates. <sup>1/</sup> There was an expanding net outflow of labor income, associated with the extensive use of nonresident labor in San Marino.

Unrequited transfers have resulted in a small net inflow to San Marino. Private transfers consist mainly of foreign pension income received by Sammarinese who have returned home to retire. Official transfers consist of the fixed payment from Italy of Lit 9 billion under the *Canone Doganale*, in

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<sup>1/</sup> It should be cautioned that this depends on the estimate of net foreign assets, which in turn depends on the estimate of nonresident deposits; the latter estimate, based on discussions with the authorities, is likely to err on the low side.

consideration of customs duties collected by the Italian Government as well as seignorage received by Italy under the currency union.

Overall, the current account showed a rising surplus over the past four years, which reached nearly 20 percent of GDP in 1992. This corresponded to a capital outflow, as banks increased their net foreign assets. These estimates also imply that Sammarinese nonbank residents shifted funds into San Marino, particularly in 1992--in tandem with nonresidents, who shifted funds into Sammarinese banks due to political and fiscal uncertainties in Italy.

The currency union, and until 1991 the absence of a central bank, have made the definition of international reserves and the overall balance problematic. In the balance of payments table, the net foreign assets of the Sammarinese Credit Institute (ICS) are taken as a measure of official reserves; the overall balance is the change in these reserves. Prior to 1991, when the ICS began operations, the overall balance is recorded as zero. Some alternative measures of international reserves are also possible (Table 14). One is the government's deposits in the Sammarinese banking system, used as a measure of international reserves at the time San Marino's quota in the Fund was calculated, as it represents the resources immediately at the disposal of the authorities. In a balance of payments context, though, this measure has the conceptual drawback that it is a claim of the domestic government on domestic banks, and is not directly related to international transactions. An alternative measure of net international reserves would, in principle, be the NFA of the banking system since it is through variations in this NFA that other current and capital transactions are financed. However, this can only be estimated with a considerable margin of error, because of the lack of data on the large volume of nonresident deposits which are a short-term foreign liability of the banking system.

## 2. The cooperation agreement with the EU

An important set of developments affecting international trade concern San Marino's relations with the EU. On December 16, 1991, an Agreement on Cooperation and Customs Union (ACCU) was signed in Brussels between the EU and the Republic of San Marino. The ACCU establishes a customs union between the European Union (EU) and the Republic of San Marino, and also regulates trade between San Marino and the non-EU countries. It states that the trade between the EU and San Marino shall be exempt from all import and export duties and charges having equivalent effect starting January 1, 1996. The Sammarinese single-stage import tax (*monofase*) is the main tax affected; the ACCU does not require San Marino to abolish this tax, but does state that, within six months of its entry into force, San Marino must introduce an equivalent value added tax for domestic products intended for home consumption. Since the ACCU has not yet come into force, no domestic VAT has yet been introduced, and none is likely to be considered until 1996.

Through this agreement, San Marino hopes to eliminate some competitive disadvantages that Sammarinese firms now face compared with firms located in EU countries. First, EU firms importing goods from San Marino are not entitled to pre-financing of VAT. This is a financial cost, as an EU firm importing goods from San Marino has to pay VAT when the goods cross the border, while for intra-EU trade VAT payments are only settled every 3 to 12 months. Second, when Sammarinese goods are exported to the EU, they incur the costs of documentation and customs procedures, which the Single Market has eliminated for intra-EU trade.

Pending the implementation of the ACCU, which has been delayed due to the time required for ratification by national parliaments, an Interim Agreement was conducted in late 1992 establishing the main commercial and customs provisions of the ACCU. A bilateral Cooperation Committee was established at the administrative level to oversee its implementation.

Table 1. San Marino: National Accounts

(In billions of Italian lire)

	1988	1989	1990	1991	1992
Gross domestic product	467	505	570	650	748
Imports	1,335	1,443	1,569	1,818	1,949
Total resources	1,802	1,948	2,140	2,467	2,697
Exports	1,324	1,429	1,555	1,805	1,950
Variation of stocks	17	-9	30	73	86
Final consumption	438	456	483	513	551
Of which: Private	332	341	353	371	389
Public	106	116	130	143	163
Gross investment	23	71	72	76	110
Total uses	1,802	1,948	2,140	2,467	2,697

Source: Data received from the authorities and Fund staff estimates.

Table 2. San Marino: National Accounts

(Changes in real terms over the previous year, in percent)

	1989	1990	1991	1992
Gross domestic product	1.7	6.2	7.2	9.6
Imports	1.7	2.2	8.9	2.0
Total resources	1.7	3.2	8.5	4.0
Exports	1.5	2.2	9.2	2.8
Final consumption	-2.0	-0.5	-0.0	2.2
Of which: Private	-3.4	-2.5	-1.3	-0.2
Public	2.5	5.3	3.5	8.5
Gross investment	196.4	-5.7	-0.5	37.5
Total uses	1.7	3.2	8.5	4.0
Memorandum item:				
Italian CPI inflation	6.3	6.4	6.3	5.1

Source: Data received from the authorities and Fund staff estimates.

Table 3. San Marino: Employment, Unemployment, and Labor Force

	1988	1989	1990	1991	1992	1993
Unemployment	661	585	625	493	503	616
Labor force	12,123	12,333	12,759	13,332	14,113	14,874
Frontalieri	755	872	1,092	1,395	1,829	2,268
Resident labor force	11,368	11,461	11,667	11,937	12,284	12,606
Unemployment rate	5.81	5.10	5.36	4.13	4.09	4.89
Total employment	11,462	11,748	12,134	12,839	13,610	14,258
(Percentage growth)	2.6	2.5	3.3	5.8	6.0	4.8
Total resident employment	10,707	10,876	11,042	11,444	11,781	11,990
(Percentage growth)	1.9	1.6	1.5	3.6	2.9	1.8

Source: Sammarinese authorities.

Table 4. San Marino: Wages and Prices  
(Changes in percent)

	1988	1989	1990	1991	1992	1993
Average contractual wage	5.9	7.1	7.4	8.8	7.3	...
Average per capita wage	5.6	6.7	9.9	10.3	5.7	...
Consumer price index	4.7	6.0	6.9	7.0	7.0	5.4
Memorandum items:						
Italy minimum contractual wage	7.2	6.8	7.7	9.0	4.6	2.8
Italy consumer price index	5.0	6.6	6.1	6.5	5.3	4.2

Source: Data received from the Sammarinese authorities and Bank of Italy.

Table 5. San Marino: Employment by Sector

	1988	1989	1990	1991	1992	1993
Agriculture	335	314	303	296	296	294
Manufacturing	4,257	4,315	4,346	4,495	4,591	4,739
Construction	891	921	967	1,058	1,106	1,195
Commerce	1,823	1,966	2,082	2,232	2,402	2,499
Transport	165	187	187	231	285	278
Finance	239	251	275	294	339	390
Services	741	762	835	970	1,116	1,239
Government	3,011	3,032	3,139	3,263	3,475	3,624
Unemployment	661	585	625	493	503	616
Total	12,123	12,333	12,759	13,332	14,113	14,874
<u>(As a percentage of the labor force)</u>						
Agriculture	2.8	2.5	2.4	2.2	2.1	2.0
Manufacturing	35.1	35.0	34.1	33.7	32.5	31.9
Construction	7.3	7.5	7.6	7.9	7.8	8.0
Commerce	15.0	15.9	16.3	16.7	17.0	16.8
Transport	1.4	1.5	1.5	1.7	2.0	1.9
Finance	2.0	2.0	2.2	2.2	2.4	2.6
Services	6.1	6.2	6.5	7.3	7.9	8.3
Government	24.8	24.6	24.6	24.5	24.6	24.4
Unemployment	5.5	4.7	4.9	3.7	3.6	4.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Sammarinese authorities.

Table 6. San Marino: Operations of the Central Administration

(In billions of Italian lire)

	1989	1990	1991	1992	1993 Prelim.
Total revenue	191.4	202.9	293.8	358.4	380.1
Direct taxes	73.8	86.1	134.1	158.1	170.9
Indirect taxes	92.1	90.4	126.6	177.7	189.3
Canone Doganale	9.0	9.0	9.0	9.0	9.0
Other	16.5	17.4	24.1	13.7	11.0
Current expenditure	87.2	100.1	115.5	131.4	149.7
Wages and salaries	54.1	63.6	72.2	83.2	91.4
Interest payments	2.3	2.3	2.3	2.3	2.3
Goods and services	24.2	24.4	31.8	32.2	38.0
Other <u>1/</u>	6.7	9.7	9.2	13.6	18.0
Net transfers	-73.6	-91.8	-145.2	-170.8	-204.7
Social security	-56.6	-98.8	-113.8	-135.8	-159.3
Rest of nonfinancial public sector	-11.3	-13.0	-8.0	-20.5	-26.6
Other	-5.6	20.0	-23.4	-14.5	-18.8
Current account balance	30.6	11.1	33.0	56.3	25.7
Capital account transfers	12.4	17.4	18.4	19.6	20.0
Overall balance	18.2	-6.3	14.6	36.6	5.7
Financing	-18.2	6.3	-14.6	-36.6	-5.7
Net change in cash balance	-17.8	6.6	-14.2	-36.2	-5.2
Amortization	-0.3	-0.4	-0.4	-0.4	-0.5

<sup>a</sup> Source: Sammarinese authorities and Fund staff estimates.

<sup>1/</sup> Includes interest subsidies to private enterprises.

Table 7. San Marino: Operations of the Central Administration

(In percent of GDP)

	1989	1990	1991	1992	<u>1993</u> Prelim.
Total revenue	37.9	35.6	45.2	47.9	47.0
Direct taxes	14.6	15.1	20.6	21.1	21.1
Indirect taxes	18.2	15.9	19.5	23.7	23.4
Canone Doganale	1.8	1.6	1.4	1.2	1.1
Other	3.3	3.1	3.7	1.8	1.4
Current expenditure	17.3	17.5	17.8	17.6	18.5
Wages and salaries	10.7	11.1	11.1	11.1	11.3
Interest payments	0.5	0.4	0.4	0.3	0.3
Goods and services	4.8	4.3	4.9	4.3	4.7
Other <u>1/</u>	1.3	1.7	1.4	1.8	2.2
Net transfers	-14.6	-16.1	-22.4	-22.8	-25.3
Social security	-11.2	-17.3	-17.5	-18.1	-19.7
Rest of nonfinancial public sector	-2.2	-2.3	-1.2	-2.7	-3.3
Other	-1.1	3.5	-3.6	-1.9	-2.3
Current account balance	6.1	1.9	5.1	7.5	3.2
Capital account transfers	2.5	3.0	2.8	2.6	2.5
Overall balance	3.6	-1.1	2.3	4.9	0.7
Financing	-3.6	1.1	-2.3	-4.9	-0.7
Net change in cash balance	-3.5	1.2	-2.2	-4.8	-0.6
Amortization	-0.1	-0.1	-0.1	-0.1	-0.1
Memorandum items:					
Total expenditures	34.3	36.7	43.0	43.0	46.3

Source: Sammarinese authorities and Fund staff estimates.

1/ Includes interest subsidies to private enterprises.

Table 8. San Marino: Operations of the Public Enterprises 1/

(In millions of Italian lire)

	1989	1990	1991	1992	1993 Prelim.
I. AASS <u>2/</u>					
Operating revenue	24,717	28,848	36,924	41,648	43,752
Operating expenditure	17,510	15,958	35,213	36,294	38,710
Operational balance	7,208	12,890	1,711	5,354	5,043
Net transfers	6,718	-2,488	9,888	6,297	6,100
Current account balance	13,926	10,402	11,599	11,651	11,143
Capital expenditures	10,432	9,507	9,846	9,736	7,611
Overall balance	3,494	895	1,752	1,915	3,532
II. AASP <u>3/</u>					
Operating revenue	592	628	1,199	747	850
Operating expenditure	13,256	13,947	15,100	16,364	17,865
Operational balance	-12,664	-13,319	-13,901	-15,617	-17,015
Net transfers	26,778	28,169	29,856	32,726	34,415
Current account balance	14,114	14,850	15,955	17,109	17,400
Capital expenditures	14,114	14,850	15,955	17,109	17,400
Overall balance	--	--	--	--	--
III. AASFN <u>4/</u>					
Operating revenue	897	797	1,113	942	1,300
Operating expenditure	3,548	3,896	4,116	4,128	5,091
Operational balance	-2,651	-3,099	-3,003	-3,186	-3,791
Net transfers	2,865	3,000	3,133	3,274	3,941
Current account balance	214	-99	131	88	150
Capital expenditures	68	75	82	289	150
Overall balance	146	-174	49	-201	--
IV. Consolidated accounts of the largest three public enterprises					
Operating revenue	26,207	30,273	39,236	43,337	45,902
Operating expenditure	34,314	33,801	54,429	56,786	61,666
Operational balance	-8,107	-3,528	-15,193	-13,449	-15,764
Net transfers	36,361	28,681	42,878	42,297	44,456
Current account balance	28,254	25,153	27,685	28,848	28,693
Capital expenditures	24,614	24,432	25,884	27,134	25,161
Overall balance	3,640	721	1,801	1,714	3,532

Source: Department of Budget and Programming, Relazione Previsionale e Programmatica, various issues.

1/ Accounts computed on an accrual basis.

2/ Public Utilities Corporation.

3/ Public Works Corporation

4/ Coins and Stamps Corporation.

Table 9. San Marino: Operations of the Public Enterprises

(In percent of GDP)

	1989	1990	1991	1992	<u>1993</u> Prelim.
I. AASS <u>1/</u>					
Operating revenue	4.9	5.1	5.7	5.6	5.4
Operating expenditure	3.5	2.8	5.4	4.8	4.8
Operational balance	1.4	2.3	0.3	0.7	0.6
Net transfers from the CA	1.3	-0.4	1.5	0.8	0.8
Current account balance	2.8	1.8	1.8	1.6	1.4
Capital expenditures	2.1	1.7	1.5	1.3	0.9
Overall balance	0.7	0.2	0.3	0.3	0.4
II. AASP <u>2/</u>					
Operating revenue	0.1	0.1	0.2	0.1	0.1
Operating expenditure	2.6	2.4	2.3	2.2	2.2
Operational balance	-2.5	-2.3	-2.1	-2.1	-2.1
Net transfers from the CA	5.3	4.9	4.6	4.4	4.3
Current account balance	2.8	2.6	2.5	2.3	2.2
Capital expenditures	2.8	2.6	2.5	2.3	2.2
Overall balance	--	--	--	--	--
III. AASFN <u>3/</u>					
Operating revenue	0.2	0.1	0.2	0.1	0.2
Operating expenditure	0.7	0.7	0.6	0.6	0.6
Operational balance	-0.5	-0.5	-0.5	-0.4	-0.5
Net transfers from the CA	0.6	0.5	0.5	0.4	0.5
Current account balance	--	--	--	--	--
Capital expenditures	--	--	--	--	--
Overall balance	--	--	--	--	--
IV. Consolidated accounts of the largest three public enterprises					
Operating revenue	5.2	5.3	6.0	5.8	5.7
Operating expenditure	6.8	5.9	8.4	7.6	7.6
Operational balance	-1.6	-0.6	-2.3	-1.8	-2.0
Net transfers from the CA	7.2	5.0	6.6	5.7	5.5
Current account balance	5.6	4.4	4.3	3.9	3.5
Capital expenditures	4.9	4.3	4.0	3.6	3.1
Overall balance	0.7	0.1	0.3	0.2	0.4

Source: Department of Budget and Programming, Relazione Previsionale e Programmatica, various issues.

1/ Public Utilities Corporation.

2/ Public Works Corporation

3/ Coins and Stamps Corporation.

Table 10. San Marino: Interest rates

(In percent; end of period)

	<u>Deposit Rates</u>		<u>Loan Rates</u>		Repurchase Agreements	<u>Italian Rates</u> <sup>1/</sup>	
	Sight Savings	Time	Prime	Average		3-month T-bill	Average deposit
1988	7.2	7.5	11.0	14.0	...	11.2	6.9
1989	7.7	8.0	12.0	15.0	...	12.7	6.9
1990	7.5	8.0	11.0	14.5	...	12.3	7.4
1991	7.3	7.6	10.8	15.2	...	12.7	7.4
1992	9.0	10.0	13.3	17.9	13.0	14.5	7.9
March 1993	8.2	9.0	12.0	16.0	10.0	12.5	8.1
June 1993	7.0	7.5	11.0	15.0	9.5	10.6	7.6
Sept. 1993	6.5	6.8	10.0	14.3	9.0	8.9	6.8
Dec. 1993	6.0	6.5	9.5	14.0	8.0	8.2	6.5
Feb. 1994	5.0	6.0	9.0	13.5	7.3	8.7	6.3

Source: Data received from Sammarinese and Italian authorities.

<sup>1/</sup> Period averages.

Table 11. San Marino: Monetary Survey

(In billions of Italian lire)

	1989	1990	1991	1992	1993
Net foreign assets	617	783	975	1,425	1,813
Foreign assets	1,669	2,201	2,809	4,222	5,409
Of which					
repurchase agreements	480	882	1,322	2,584	3,215
Foreign liabilities	1,052	1,418	1,834	2,797	3,596
Of which					
repurchase agreements	360	662	992	1,938	2,411
Domestic credit	257	351	407	578	605
to central government	-134	-171	-179	-218	-245
to nongovernment	391	522	586	796	850
Other items net	-173	-258	-292	-563	-627
Deposit money <u>1/</u>	702	875	1,090	1,440	1,753
Deposits	582	655	760	794	972
Repurchase agreements	120	221	331	646	804
Memorandum item:					
Total assets -					
total liabilities	2,155	2,826	3,615	5,302	6,474

Source: Data received from the Sammarinese authorities and Fund staff estimates.

1/ Does not include Italian lira banknotes in circulation outside the banking sector in San Marino, or Sammarinese-held deposits in Italian banks.

Table 12. San Marino: Public Sector Deposits

(In billions of Italian lire)

	1989	1990	1991	1992	1993
Central Government	134	172	180	220	240
State budget	129	163	169	203	168
at ICS	--	--	--	61	168
at commercial banks	129	163	169	142	--
Other liabilities of ICS to state budget	--	--	--	--	38
Social Security Institute	5	9	11	17	34
at ICS	--	--	--	12	34
at commercial banks	5	9	11	5	--
Public enterprises	22	30	27	39	16
at ICS	--	--	--	5	16
at commercial banks	22	30	27	34	...
Public sector	156	202	207	259	256

Source: Data received from the Sammarinese authorities.

Table 13. San Marino: Balance of Payments, 1988-92

	1988	1989	1990	1991	1992
<u>(In millions of U.S. dollars)</u>					
Trade balance	-237.2	-245.4	-286.3	-279.0	-185.4
Exports, f.o.b.	754.1	771.1	978.5	1137.4	1358.0
Imports, c.i.f.	991.3	1016.4	1264.9	1416.4	1543.4
Services (net)	253.7	272.1	325.3	332.2	293.3
Tourist receipts	246.6	253.4	297.8	294.7	217.0
Other services	-17.9	-18.4	-23.8	-26.2	-30.7
Factor income (net)	25.0	37.0	51.3	63.8	107.0
Interest payments	34.8	48.5	69.1	87.5	140.7
Official	-2.5	-2.3	-2.6	-2.2	-1.9
Private	37.3	50.9	71.7	89.7	142.6
Labor income (net)	-9.7	-11.5	-17.8	-23.7	-33.8
Transfers (net)	8.5	8.2	9.5	9.3	9.5
Official	6.9	6.6	7.5	7.3	7.4
Private	1.6	1.6	2.0	2.0	2.2
Current account balance	25.0	34.9	48.5	62.5	117.4
Capital inflow (net)	-25.0	-34.9	-48.5	-60.9	-74.0
Official	-1.0	-2.2	-3.6	-2.8	-2.9
Private	-24.0	-32.7	-44.8	-58.1	-71.2
Overall balance	--	--	--	1.6	43.4
<u>(In percent of GDP)</u>					
Exports	210.3	209.6	205.6	217.2	221.1
Imports	276.4	276.3	265.8	270.5	251.3
Trade balance	-66.1	-66.7	-60.2	-53.3	-30.2
Balance of goods and nonfactor services	-2.4	-2.8	-2.6	-2.0	0.1
Current account balance	7.0	9.5	10.2	11.9	19.1
Memorandum:					
GDP in millions of U.S. dollars	358.7	367.9	475.9	523.6	614.2

Source: Data received from the authorities and Fund staff estimates.

Table 14. San Marino: International Reserves - Alternative Measures

(In millions of U.S. dollars; end of period)

	1988	1989	1990	1991	1992
Net foreign assets of ICS	--	--	--	1.7	44.3
Deposits of state budget	...	...	144.2	146.8	163.8
Net foreign assets of banking system	372.3	485.6	692.8	845.3	1105.9
Memorandum: Merchandise imports	991.3	1016.4	1264.9	1416.4	1543.4

Source: Data received from the authorities and Fund staff estimates.

State Aid to Sammarinese Industry

1. Subsidized credit

Sammarinese firms have had access to preferential credit since 1983; the law governing such credit was revised in January 1993. 1/ The current procedure for obtaining a subsidized loan is the following: first, an enterprise applies for a subsidized loan to the Committee for Subsidized Credit "*Comitato per il Credito Agevolato*", formed by the economic Ministers and representatives of banks, trade unions and "economic categories" (i.e., manufacturing, commerce, tourism, handicrafts, agriculture, and self-employed). After the subsidy has been granted by the Committee, a bank examines the loan application and decide whether to finance the project.

The conditions under which subsidized loans are granted are specified in a convention between the government and the banks at the beginning of each year. The convention sets a reference interest rate to be charged on all loans, which has been very similar to (on average 1 percent less than) the rate charged on subsidized credit in Italy. 2/ The convention also specifies how many percentage points of the reference interest rate will be paid by the State; the range goes from 3 to 5 percent, depending on a number of criteria, including the jobs created with the investment. The share of the total cost of an investment that may be financed with subsidized credit varies, reaching 100 percent of the investment cost in the case of investments for "technological upgrading." Three maturities of loans are possible, three, five and ten years, depending on the type of investment; 10-year loans are mainly granted for construction projects.

Subsidized credit is available to several sectors of the economy. The budget law sets the annual allocation for all sectors, while a government decree (*decreto regenziale*) each year specifies the funds available to each sector (industry, commerce, handicraft, hotels, etc.). The allocation is decided by taking into account which sectors the government wants to promote; for example, in 1994, Lit 10 billion were allocated for hotel and business infrastructure. The breakdown is generic for commerce and handicrafts, while there is a detailed breakdown within the manufacturing industry category. In the past, investment in high-tech machinery was a preferential criterion regardless of the sector. Past applications by the same firm are also taken into account. The funds allocated have usually been enough to satisfy the requests for commerce and handicrafts, while they tend to fall short of the requests of industry. In the 11 years of existence of the program, 713 out of 762 requests for subsidized loans were granted.

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1/ This refers to the "*Credito agevolato alle imprese*", n.13, January 28, 1993.

2/ The rate is revised every six months (compared with every two months in Italy) to remove the borrower's incentive to refinance the loan when market interest rates fall. In the future, the reference interest rate may be indexed to the interbank rate.

According to the new law on subsidized credit passed in January 1993, subsidized loans are no longer guaranteed by the State. Even under the previous law, the government never bailed out companies in difficulty; at most it tried to find possible buyers. In the commercial sector, there are no instances of nonperforming loans. In 11 years, only 10 loans out of 713 had problems with the banks and in only three of these cases was State intervention necessary.

One problem of the system is that the government does not keep track of the success rate of the intervention in terms of increased productivity, but only know that the subsidized firms were able to maintain or slightly increase their employment. Two other forms of subsidized credit are available: for development in the historical center, loans of up to Lit 20 million are provided at zero interest; while for upgrading of hotels, subsidized credit is provided at a reduced interest rate.

## 2. Exemptions from social security contributions

Firms may be partially or totally exempted from social security contributions (*fiscalizzazione degli oneri sociali*) under certain conditions, to provide subsidies for on-the-job training and for the employment of particular types of workers. In 1993, these subsidies included: a state contribution of Lit 83.7 million for apprenticeship; Lit 120.9 million for professional formation; Lit 263.2 million for female employment in textile and clothing and part-time employment in manufacturing and handicraft industries; Lit 128.6 million for summer employment; and Lit 18.1 million for the employment of handicapped workers.

The Social Security System

1. Introduction

The social security system provides three types of services to all eligible residents: pensions, health care, and income supplementation. The first two are available to all residents as well as to Sammarinese nationals living abroad, provided that they meet certain criteria (explained below). Income supplementation includes a number of different schemes of assistance to specific sectors of the population deemed in need of support. The finances of each of these subsystems are managed independently, although there is some degree of cross-subsidization.

The operations of the social security system are overseen by the Social Security Institute (ISS) which, in turn, is supervised by the Ministry of Health and Social Security (MHSS). The MHSS is in charge of the design of health policy, investment programs, and other areas related to social security. Based on a proposal by the ISS, the MHSS prepares the annual budget for the ISS, which has to be approved by the Parliament, and is executed by the ISS. In practice, the ISS has had limited control over its own budget which reflects in part salary levels negotiated between the government and the unions, and changes in the coverage of health services, which are determined by law. 1/

A law on social security was introduced in 1991 which changed the way in which the ISS is financed, as will be explained below.

2. Pensions

The pension system provides retirement benefits to local residents and cross-border workers who have worked at least 15 years in San Marino and made the contributions required by law. The pension system also provides disability pensions, survival benefits, and a minimum retirement payment to all residents ages 60 and older who can prove that they have no other sources of income. Eligibility for survival and disability benefits requires at least seven years of regular contributions made by the affected worker. To be eligible for the minimum pension an individual must have lived in San Marino for at least five years. 2/

The minimum retirement age is 60, except for farmers and employers, for whom it is 65. The retirement benefits are calculated on the basis of the number of years of contributions to the ISS, and the retiree's income over the last five years. If an individual retires the year he becomes eligible,

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1/ The salaries of all medical and administrative personnel working for the ISS are determined by law.

2/ There are no private pension funds; however, in some instances private employers provide additional retirement benefits to their workers without requiring explicit contributions.

his retirement pension is determined as a fraction of the simple average of the individual's income over the last five years, with a coefficient computed by adding 3 percentage points for each of the first 15 years in the labor force and 2 percentage points for each additional year. The resulting annual pension is subject to a ceiling equal to either: (i) 100 percent of the last year's income; or (ii) Lit 53 million, whichever is less. The pension system also contemplates a system of incentives for delaying retirement: in case of late retirement, the worker gets not only the additional 2 percentage points for each extra year in the labor force, but also an additional 3 percentage points of the resulting pension for each year of delayed retirement.

This rule for the computation of retirement benefits creates an incentive to underreport income during all years in the labor force except the last five, and then to overestimate income until retirement. It is widely believed that this practice is widespread in San Marino, particularly among the self-employed.

The pension system is financed by a combination of payroll taxes paid by employers and employees, as well as a supplementary contribution made by the central administration. These resources are credited to separate pension funds for each economic sector. In those cases where current payments suffice to meet current outlays, the difference is put in the respective sectoral pension fund. The deficits of the other pension funds are financed from the surpluses currently being generated by the various income supplementation funds (see below) but, according to the 1991 law on social security no cross-subsidization across pension funds may occur. The contribution rates for each sectoral pension fund are as follows (expressed in percentage points):

Rates of Payroll Contributions

	<u>Worker</u>	<u>Employer</u>	<u>State</u>
All dependent workers	1.6	10.3	$1/10 \times (1.6+10.3) = 1.19$
Artisans, handicraft	14.0	...	$1/4 \times (14.0) = 3.5$
Agricultural workers		...	
Shopkeepers	17.5	...	$1/4 \times (17.5) = 4.375$
Professionals and entrepreneurs	10.0	...	$1/10 \times (10.0) = 1.0$

A look at the evolution of the pension funds over the last five years reveals two main facts. First, there was a sharp break in 1991 as the overall (flow) annual balance of pension funds turned substantially positive after years of being in red (Chart 10). 1/ This is a direct result of the increased rates of contribution stipulated in the 1991 Law.

Second, there is a striking contrast between the financial situation of pension funds for employees, where contributions are withheld at the source, with those of self-employed workers where contributions are based on declarations of personal income (Chart 11). The pension fund for employees is running substantial surpluses while funds of the self-employed workers are in deficit. Since there are unlikely to be significant demographic differences across workers in different sectors, this result reflects mainly greater evasion of contributions by self-employed workers.

The financial situation of the pension system is currently being helped by a favorable demographic situation. Currently, the ratio of number of workers contributing to the ISS to retirees is 4:1, compared to 1:1 in Italy. This favorable ratio is due in great part to the presence of a significant number of cross-border workers (*frontalieri*) and recent re-immigration of relatively young Sammarinese living abroad.

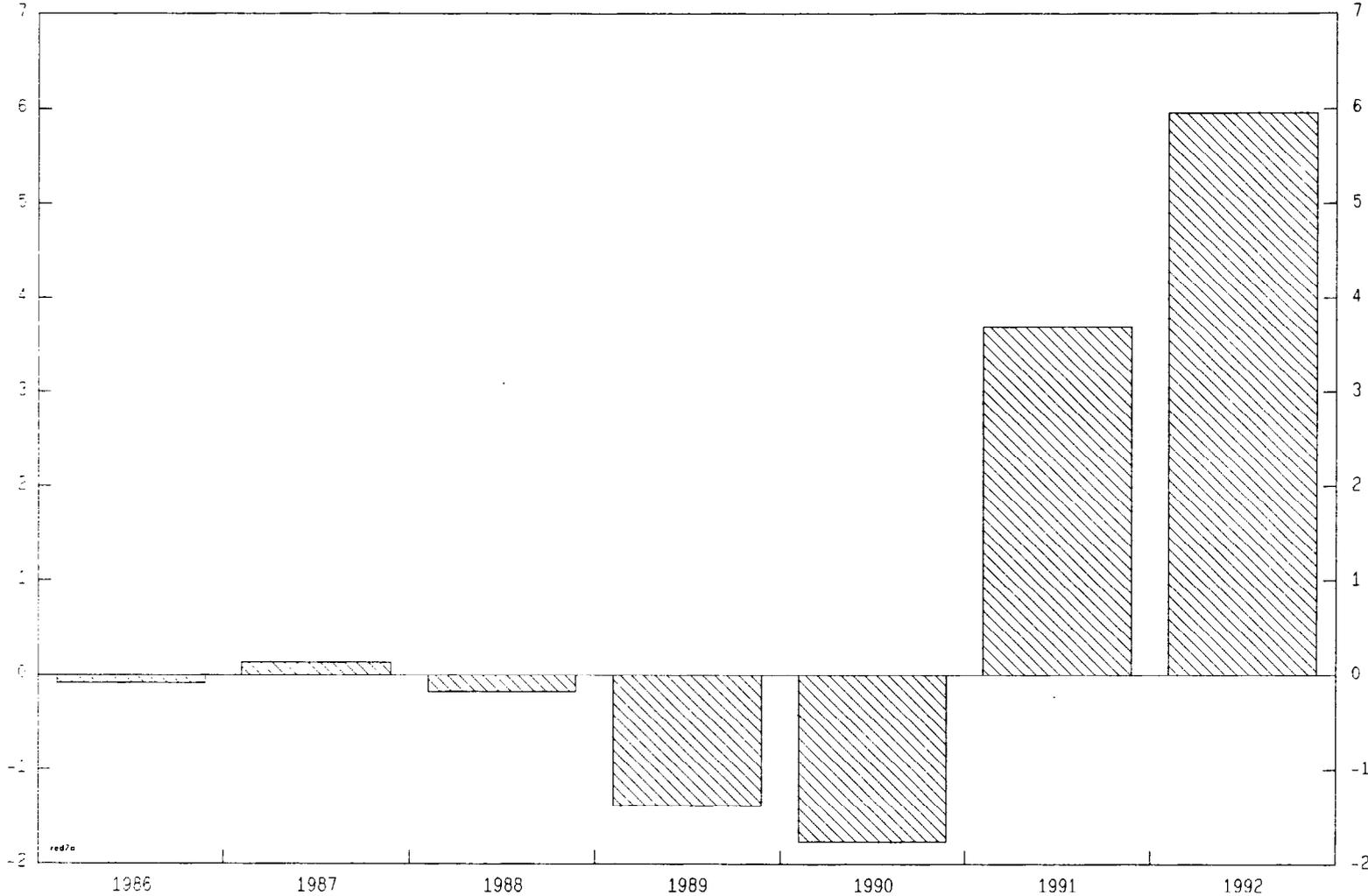
It should be stressed, however, that unlike most countries, in San Marino basic demographic indicators are quite volatile, given the reduced size of its population and the relatively large (and variable) volume of migratory flows and cross-border workers. This volatility enhances the case for building reserves in the pension system because relatively large demographic changes with serious consequences for the finances of the social security system cannot be ruled out. As an illustrative example two demographic ratios are considered: number of individuals aged 20 to 59; per individual older than 59 (RAT1), and number of individuals 20 to 59 per individual younger than 20 or older than 59 (RAT2). These ratios are forecast under two different scenarios: in Scenario 1 about two hundred workers ages 20 to 39 immigrate every year; whereas in Scenario 2 there is no immigration at all. 2/ The relevance of these two scenarios lies in the fact that net migration flows of the order of 200 young people per year over recent years have helped keep San Marino's ratio of workers per retiree at its current level of 4; however, it is difficult to determine whether this trend is sustainable over the medium- or long-run. The ratio RAT1 summarizes the effects of the age structure of the population on retirement pensions, and to the extent that retired individuals demand health care more

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1/ Currently, social security contributions to pension funds are larger than the current outlays in the funds for dependent workers, professionals and entrepreneurs, which together account for about 70 percent of total benefits.

2/ A constant birth rate of 2.4 percent applied over population ages 18-45 was used, which yields a realistic number of births. The exercise was based on San Marino's actual population by age structure in 1993.

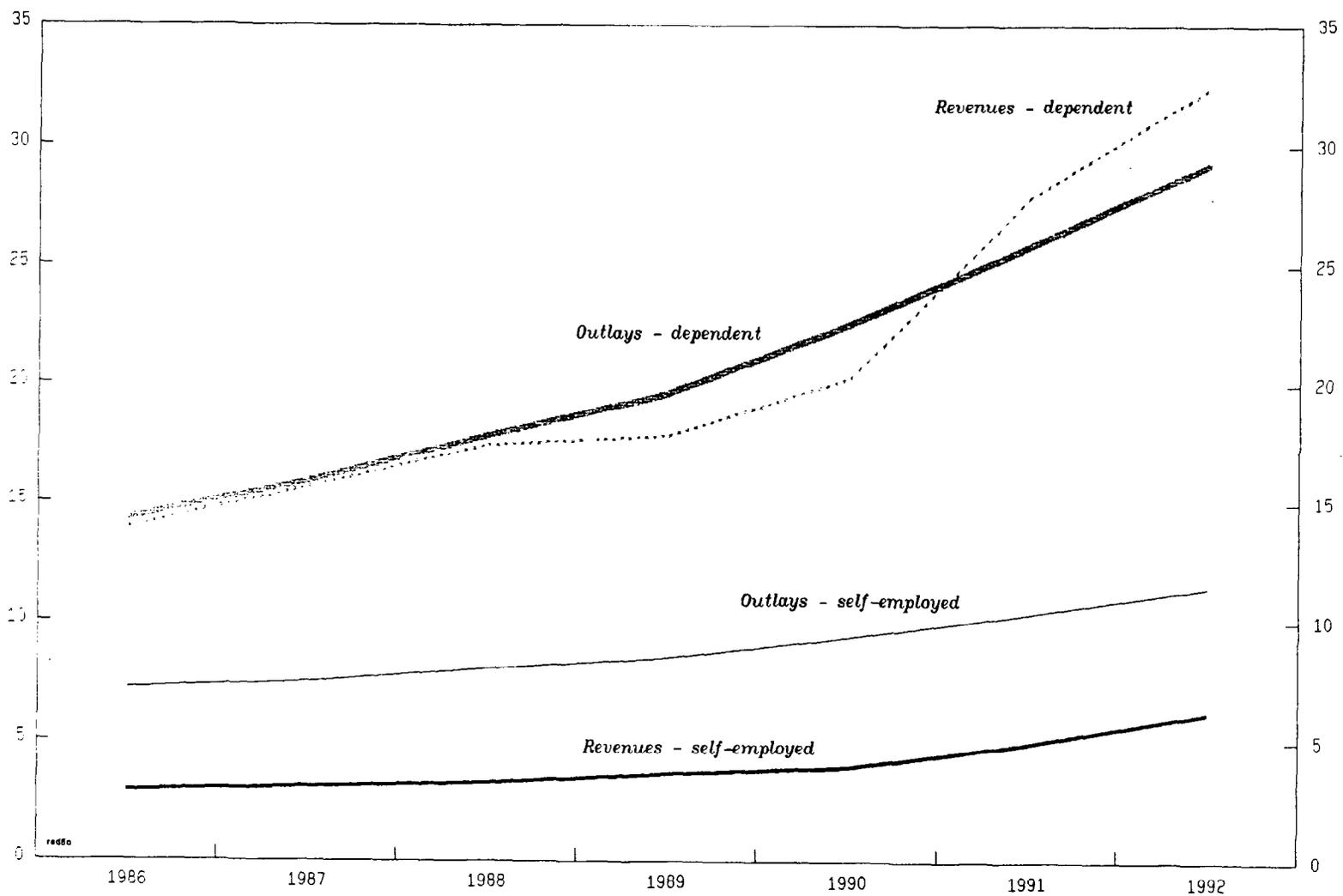
CHART 10  
SAN MARINO  
Annual Cash Flow of Pension Funds  
(In billions of lire)



Source: Relazione Previsionale e Programmatica.



CHART 11  
 SAN MARINO  
 Pension Funds: Revenues and Outlays 1/



Source: Relazione Previsionale e Programmatica.

1/ Revenues exclude government contributions.



often, is also an indicator of the affect of aging or the finances of the health care system. RAT2 summarizes the effects of population aging on family allowances and other dependent-related benefits. In both cases the simulations show that, with the assumed rates of growth and the current age structure, a demographic transition implying a relatively quick ageing of the population is likely to occur over the next few decades (Chart 12). Moreover, in Scenario 1, where the flow of young immigrants is sustained, RAT1 is expected to decrease from its current level of 3.5 to slightly below 3 in year 2000 and to about 2.5 in 2010 (Chart 13). RAT2 remains almost stable in the case of steady migration. In Scenario 2, without migratory flows, RAT1 would be 2.7 in year 2000 and about 2 in 2010; thereafter this ratio continues to deteriorate, albeit at a lower rate.

These results highlight the importance of immigration for the demographic assumptions on which the solvency of the pension funds depends. It is questionable whether present immigration trends are sustainable over the distant future. Moreover, these projections draw attention to the fact that any change in immigration trends could take several years to have its full effect.

The authorities have asserted that they do not expect a serious worsening for at least the next five years, although they do expect a reduction in the position of the pension funds. They have already taken action in anticipation of this development, by allocating 15 percent of the proceeds from all surplus non-pension funds to the different retirement funds. Nevertheless, further work on actuarial calculations over different time horizons and under different demographic scenarios is clearly needed.

### 3. National health insurance

The ISS provides a wide array of medical services to all residents in San Marino, as well as cross-border workers and Sammarinese nationals living abroad. All hospitals and pharmacies are owned and run by the ISS. Likewise, all medical personnel is employed by the ISS, except for a few medical specialists whose services are contracted on a fee-for-service basis. The provision of medical services is made mostly in hospitals and is completely free, as is the provision of medicines. There are no fees or deductibles associated with medical expenses, and nor are there any caps to spending on each individual.

In some cases, mostly emergencies, local residents may choose to have their medical services provided by Italian hospitals and, similarly, Italians can be treated in San Marino. In either case the services are provided free of charge, and reimbursements between the two states takes place in accordance with a bilateral agreement of mutual cooperation in the area of public health.

In practice, the health care operations of the ISS are financed mainly by transfers from the central government. The only nontransfer revenues pertaining to health care are the reimbursements made by the Italian

Government and profits from the sale of nonmedicine items by the pharmacies; these revenues, however, account for only 12 percent of total expenditures.

In recent years the per-capita cost of providing health care has increased significantly (Chart 14). The reasons for this increase include an expansion of coverage and, especially, a significant increase in salaries of employees of the ISS, factors over which the ISS has had little control. In the past the ISS proposed a reduction in the number of services covered by the health insurance plan, and the introduction of user fees, but the government rejected both proposals with the exception of a very small number of services. Health care costs in San Marino are higher than in Italy, due in part to diseconomies of scale associated with the smaller size of the domestic market.

#### 4. Income supplementation

There are several income supplementation schemes, which can be classified as follows:

##### a. Unemployment benefits

In San Marino there are three wage supplementation funds for workers who have been permanently or temporarily laid off:

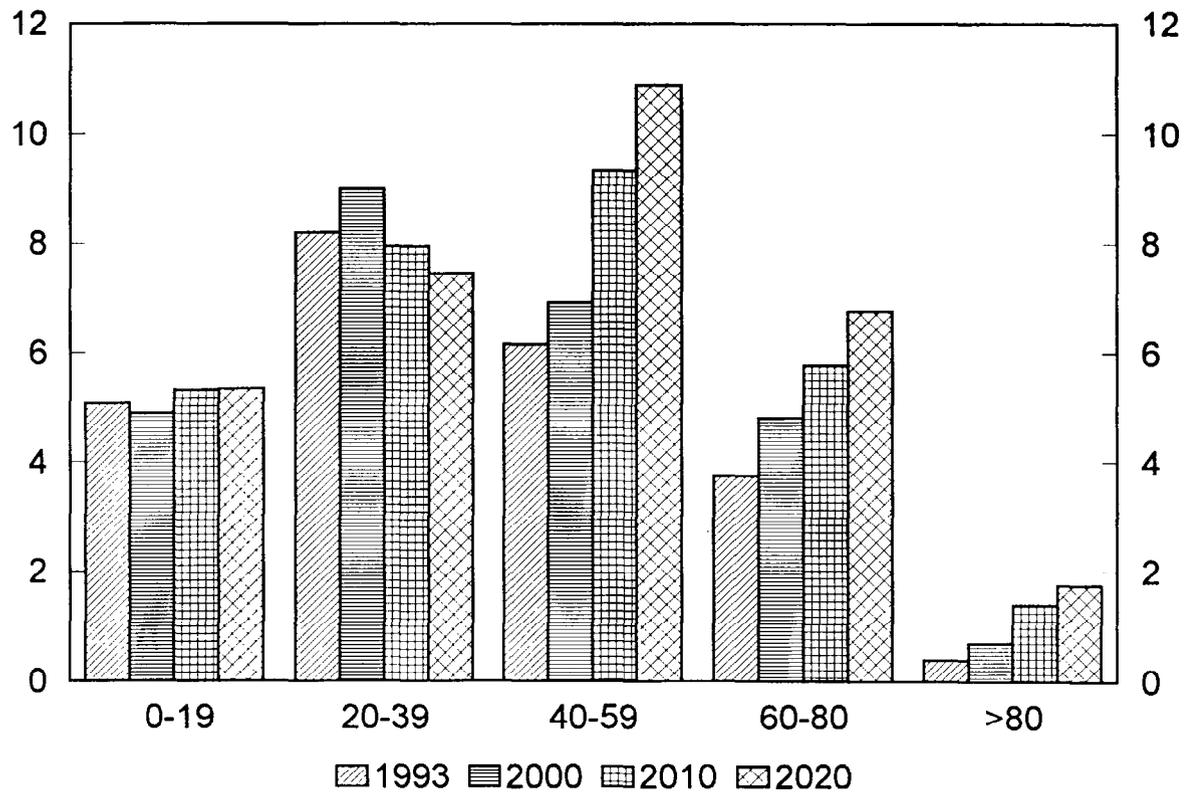
(i) The *Indennità economica speciale* is the wage supplementation program for permanently laid off workers and is analogous to the Italian *Cassa Integrazione Speciale*. Workers in all sectors (dependent and self-employed) are eligible. Assistance is paid directly by the ISS to the worker for periods of one year or less; the worker receives 75 percent of his wage during the first six months and 60 percent in the next six months. There is also a maximum salary on which these percentages apply.

(ii) The *Cassa Integrazione Guadagni* (CIG) is the wage supplementation program for temporarily laid off dependent workers and is similar to the analogous Italian program. Both Sammarinese residents (citizens and noncitizens) and nonresident workers (*frontalieri*) in San Marino are eligible, and they are treated equally. The CIG covers layoffs ranging from a few hours or days to several months in a row. The work reduction must be the result of external causes, including bad weather, industrial restructuring, and temporary falls in demand. <sup>1/</sup> Wage supplementation is paid by the ISS, which receives social contributions earmarked for the CIG. Eligibility for assistance from the CIG requires an agreement between the entrepreneurs, the trade unions, and the Ministry of Labor. There is a CIG Committee formed by the entrepreneurs, the trade unions, the director of the ISS, and the director of the employment office

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<sup>1/</sup> Previously, CIG assistance for restructuring was provided only in the case of economic crisis but in 1986, this was extended to firms that are restructuring in the absence of an immediate crisis.

Chart 12  
**San Marino**  
**Population by Age Structure**  
(In thousands)

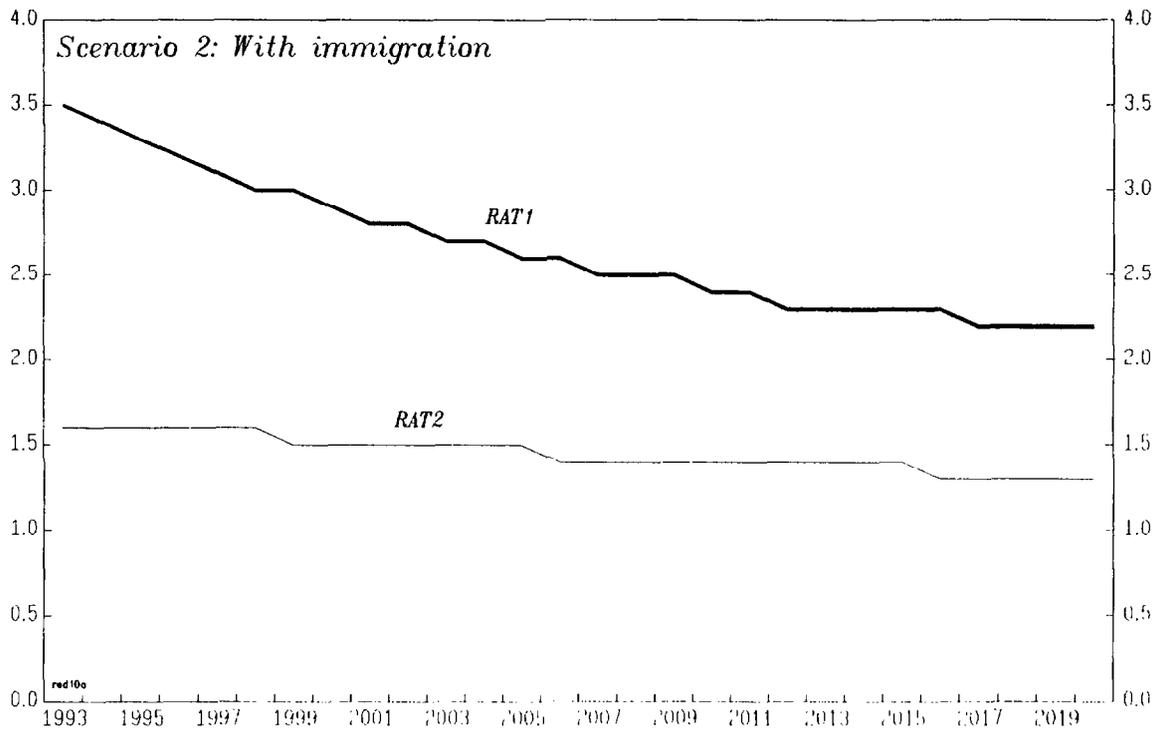
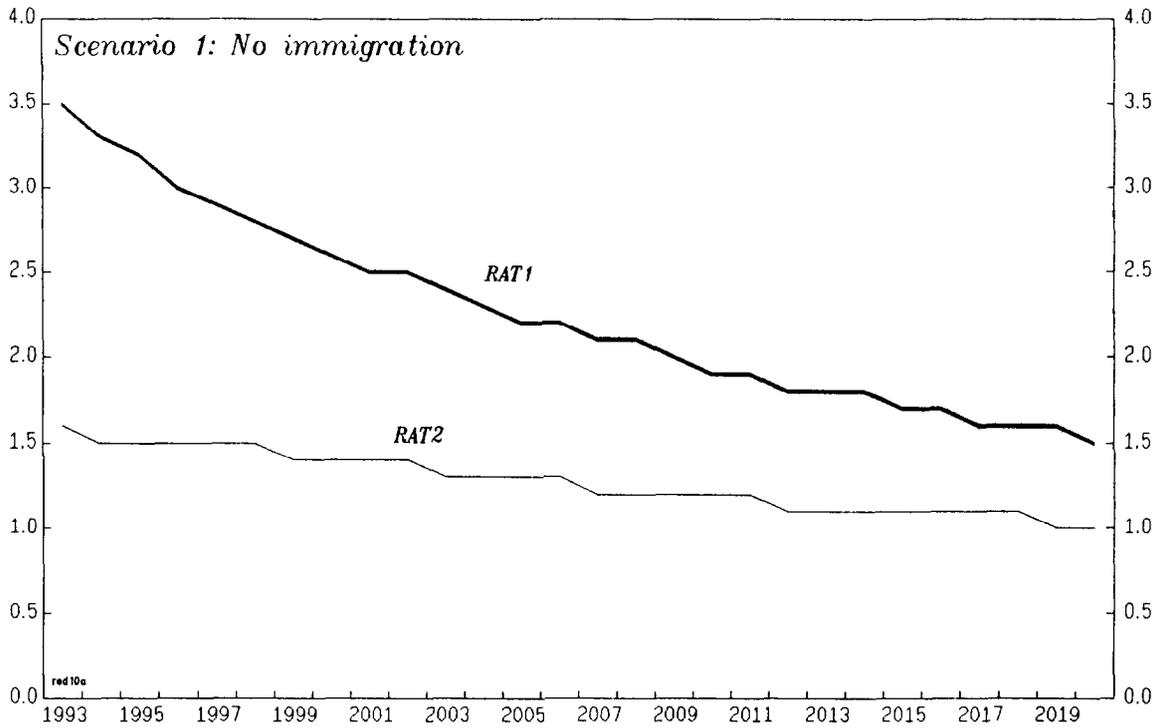


Sources: Bollettino di Statistica; and staff projections based on Scenario 1.



CHART 13  
SAN MARINO

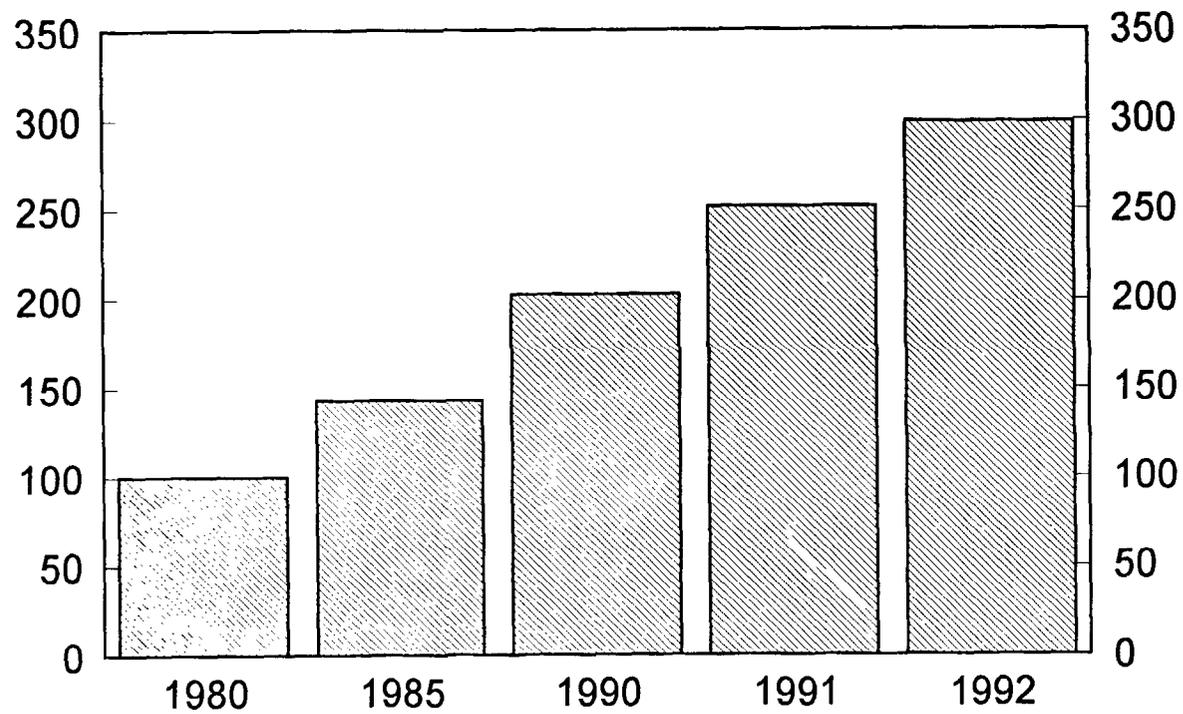
Projection of Retirement (RAT1) and Dependent (RAT2) Ratios



Source: Staff projections.



Chart 14  
San Marino  
Evolution of Health Care Costs Per Capita in Real Terms



Source: Relazione Previsionale e Programmatica



of the Ministry of Labor. The Ministry of Labor, however, has no discretion regarding the grant of CIG, provided that the prerequisites for its concession are satisfied.

(iii) The *Indennità di disoccupazione* is analogous to the *Cassa Integrazione Guadagni*, but is for self-employed workers who are temporarily out of work.

b. Other benefits

These include wage supplementation for reasons of illness, maternity, accidents, etc. The benefits are available to all workers, dependent and independent, and are financed in part by payroll contributions of 5 percent of wages of dependent workers and 2 percent of the income of the self-employed; the remaining expenditures are financed by the central administration.

Another income supplementation scheme is family assistance. This consists in a flat amount that increases with the number of eligible dependents living in a household. Eligible for this benefit are all dependent workers, artisans and pensioners. 1/ These benefits are financed by contributions amounting to 4.61 percent of earnings.

c. Services

The ISS owns and runs several facilities for people with disabilities or in need of care, such as nurseries, retirement houses, etc. These services are provided free of charge.

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1/ Eligible dependents include children up to 16 years if they do not work; up to 20 years if they go to school; and up to 25 years if they go to college. The monthly allowances are currently: Lit 78,000 for the first dependent; Lit 102,000 for the second dependent; Lit 126,000 for the third dependent; and Lit 150,000 for the fourth dependent.

Exchange and Trade System

(Position as of December 31, 1993)

Exchange arrangement

The currency of San Marino is the Italian Lira. <sup>1/</sup> The central monetary institution is the *Istituto di Credito Sammarinese*. There are no taxes or subsidies on purchases or sales of foreign exchange. Forward transactions may be conducted through commercial banks without restriction at rates quoted in Italian markets.

San Marino formally accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund Agreement, as from September 23, 1992.

Administration of control

When the Agreement on Financial and Exchange Relations of May 1991 comes into effect, the Central Bank of San Marino will be a foreign exchange bank with the authority to grant foreign exchange dealer status to Sammarinese financial institutions; currently, Sammarinese banks may maintain accounts only with financial institutions in Italy. As a result, foreign exchange transactions of domestic banks are effectively limited to buying foreign exchange, at rates similar to those quoted in Italy, and to conducting third-country transactions through Italian correspondents.

Residents of San Marino are allowed to conduct foreign exchange transactions freely, with settlement effected through authorized Italian intermediaries (the Bank of Italy, the Italian Foreign Exchange Office, authorized banks, and the Postal Administration). Direct settlements (with residents drawing on their own external accounts) authorized under Italian Exchange Control Regulations in 1990 have not yet been utilized.

Prescription of currency

Settlements with foreign countries are made in convertible currencies or in lire on foreign accounts. San Marino does not maintain any bilateral payments arrangements.

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<sup>1/</sup> The Monetary Agreement between San Marino and Italy, renewed on December 21, 1991, provides for San Marino to issue annually agreed amounts of San Marino lira coins equivalent in form to Italian coinage; these coins will be legal tender in both countries. The San Marino gold scudo is also issued but is legal tender only in San Marino. It is not generally used in transactions because its numismatic value exceeds its defined legal value (Lit 50,000 per 1 scudo).

Resident and nonresident accounts

Residents and nonresidents are free to maintain any type of deposit accounts; in practice, deposit accounts other than in lire are not offered by domestic banks.

Imports and import payments

Imports from Italy are not subject to restriction, whereas imports from third countries are subject to control by the relevant Italian regulations. No license, other than the general business license, is required to engage in trade transactions. Trade is free of regulation except that the importation of electricity, gas, and water is reserved for the public sector. Payments for imports are unrestricted.

Imports into Italy are currently governed by Decree No. 40 of December 22, 1972, as amended.

Customs duties on imports from non-European Union (EU) member countries are collected by the EU customs authorities on behalf of San Marino. A sales tax is levied on all imports at the time of entry. The structure of this tax corresponds closely to the Italian value-added tax, but the average effective rate is about 4 percent lower. Sales tax levied on imports are rebated when the goods are re-exported.

Payments for invisibles

There are no restrictions on payments for invisibles.

Exports and export proceeds

Export proceeds are not subject to surrender requirements. There are no taxes or quantitative restrictions on exports.

Exports to Italy are not regulated, while exports to third countries are governed by relevant Italian regulations. Exports from Italy are currently governed by Decree No. 40 of December 22, 1972 as amended. Exports to any country of products listed in Decree No. 68 require export licenses; other exports do not require authorization.

Proceeds from invisibles

Proceeds from invisibles are not regulated.

Capital

All inward and outward capital transfers, with few exceptions, are not restricted. Foreign direct investments, irrespective of the extent of ownership, require government approval, which is based on conformity with

long-term developmental and environmental policy considerations. The purchase and ownership of real property by nonnationals require approval from the Council of Twelve, and approval is granted on merit and on a case-by-case basis. There are no restrictions on the repatriation of profits or capital. Foreign investors are accorded equal treatment with national firms; that is, investment incentives that are available to domestic investors are equally available to foreign investors.

Gold

International trade in gold is governed by the Italy-San Marino Agreement on Financial and Exchange Relations.

Changes during 1993

No significant changes occurred in the exchange and trade system.

## Bibliography

### Fund sources:

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### Other sources:

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Alberto Chezzi and Marino Albani, Il sistema Bancario e Finanziario Sammarinese (Rimini: Maggioli Editore, 1991).

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The following table shows the results of the regression analysis. The dependent variable is the log of the number of employees. The independent variables are the log of the number of employees in the previous period, the log of the number of employees in the previous period squared, the log of the number of employees in the previous period cubed, the log of the number of employees in the previous period to the fourth power, the log of the number of employees in the previous period to the fifth power, the log of the number of employees in the previous period to the sixth power, the log of the number of employees in the previous period to the seventh power, the log of the number of employees in the previous period to the eighth power, the log of the number of employees in the previous period to the ninth power, and the log of the number of employees in the previous period to the tenth power. The results show that the log of the number of employees in the previous period is a significant predictor of the log of the number of employees in the current period. The coefficient on the log of the number of employees in the previous period is 0.95, which is statistically significant at the 1% level. The other coefficients are not statistically significant.