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July 31, 1996

To: Members of the Executive Board

From: The Secretary

Subject: San Marino - Recent Economic Developments

Attached for the information of the Executive Directors is a paper on recent economic developments in San Marino, which has been revised to take into account information received from the Sammarinese authorities following the Board discussion of the 1996 Article IV consultation with San Marino on July 24, 1996. The revisions do not affect the substance of the documentation provided to the Board.

As set forth in EBD/94/95 (6/7/94), with the approval of the Sammarinese authorities, this document will be released for publication.

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INTERNATIONAL MONETARY FUND

# SAN MARINO

## Recent Economic Developments

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and Pierre Gschwindt de Gyor (STA)

Approved by the European I Department

July 26, 1996

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Table 1. San Marino: Basic Data

| | |
|---|---|
| Total area (sq. Km): | 61.2 |
| Population (December 1995): | 24,974 |
| GDP per capita (current US$, 1994): | 24,620 |
| Life expectancy (1987): | 76 (male) |
| | 82 (female) |
| Infant mortality (1989/1993 average): | 9.7 per thousand |

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|
| | (Changes in percent except as otherwise indicated) | | | | | |
| Output and prices | | | | | | |
| Real GDP 1/ | 5.9 | 5.7 | 13.5 | 7.4 | 5.3 | 5.0 |
| Employment | 3.3 | 5.8 | 6.0 | 4.8 | 4.8 | 5.3 |
| Unemployment rate (end of year) | 5.4 | 4.1 | 4.1 | 4.9 | 4.5 | 3.8 |
| Annual average inflation rate | 6.4 | 6.3 | 5.1 | 5.5 | 4.0 | 5.0 |
| Wage growth | 7.4 | 8.8 | 7.4 | 6.2 | 5.1 | ... |
| External accounts | | | | | | |
| Trade balance (in millions of US$) | -286.4 | -279.0 | -250.1 | -240.6 | -235.9 | ... |
| Exports 2/ | 193.9 | 201.5 | 244.7 | 226.8 | 233.4 | ... |
| Imports 2/ | -250.7 | -251.0 | -292.0 | -269.8 | -272.2 | ... |
| Current account balance (in millions of US$) | 48.6 | 53.6 | 97.3 | 74.6 | 53.0 | ... |
| Number of tourists (in millions) | 2.9 | 3.1 | 3.2 | 3.1 | 3.1 | 3.4 |
| Lira US$ exchange rate | 1,130 | 1,151 | 1,471 | 1,704 | 1,630 | 1,585 |
| Nominal effective exchange rate index (Italy) | 110.0 | 98.6 | 95.5 | 80.4 | 76.9 | 69.3 |
| Real effective exchange rate index (Italy) | 100.0 | 100.8 | 97.9 | 83.2 | 78.2 | 71.7 |
| Fiscal variables 2/ 3/ | | | | | | |
| Central government revenue 4/ | 36.1 | 40.5 | 41.7 | 35.3 | 33.9 | 34.8 5/ |
| Central government expenditure 4/ | 37.2 | 38.2 | 36.9 | 35.0 | 34.2 | 35.1 5/ |
| Central government balance | -1.1 | 2.3 | 4.7 | 0.2 | -0.4 | -0.2 5/ |
| Central government deposits 6/ | 24.1 | 23.3 | 24.2 | 22.1 | 19.5 | 17.7 |
| Interest rates | | | | | | |
| Loans 7/ | 14.5 | 15.2 | 17.9 | 14.0 | 15.0 | 15.5 |
| Repurchase agreements 7/ | ... | ... | 13.0 | 8.0 | 9.5 | 8.7 |
| Time deposits 7/ | 8.0 | 7.6 | 10.0 | 6.5 | 7.5 | 7.2 |
| Italy 3-month Treasury bill rate | 12.3 | 12.7 | 14.5 | 10.5 | 8.8 | 10.7 |
| Banking system liabilities | 31.1 | 27.9 | 46.7 | 22.1 | 4.5 | 24.7 |
| (in percent of GDP) | 495.6 | 556.4 | 682.1 | 734.9 | 691.4 | 783.2 |

1/ Staff estimates.
2/ In percent of GDP.
3/ On a cash basis.
4/ Includes payroll contributions to the Social Security Institute.
5/ Staff estimate.
6/ Excluding pension fund reserves.
7/ End of period.

## I. Introduction

Economic developments in San Marino have been shaped by its unique situation as an 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 large financial and commercial sectors. The inflation rate has hovered around 5 percent along with rates in Italy.

Despite its small size, San Marino has a remarkably well diversified economic structure. As a result, the country came through the 1992-93 European recession virtually unscathed and took full advantage of the following recovery. Like surrounding areas of Italy, Sammarinese manufacturing and tourism sectors benefitted from the depreciation of the lira after September 1992. In addition, the financial sector boomed as political turmoil in Italy caused large capital inflows. In this environment, the unemployment rate--already well below the European average --dropped to 3.8 percent in December 1995.

Despite some weakening in recent years, the public finances of San Marino remain in an enviable condition. Substantial fiscal surpluses for most of the past ten years allowed the state to accumulate net financial assets. However, during the period 1993-95, surpluses disappeared as the fall in the revenue-to-GDP ratio (largely due to tax administration problems) was not compensated by a similar decline in expenditures. Central government expenditures were boosted by large increases in the public payroll and in net transfers to the pension institute, which were needed to finance the rising costs of health care and the maturing pension system. To counterbalance these trends, the authorities acted promptly by introducing a hiring freeze in the public sector, taking some measures to reduce health care costs, and presenting a draft pension reform law.

The currency union with Italy implies that monetary and interest rate developments are closely linked to those in Italy. During the 1990s, there was a rapid expansion of bank activity, in which the dominant element was the inflow of nonresident deposits associated with uncertainties about the Italian political and fiscal situation. At the time of the mission, the implementation of the latest Exchange and Financial Agreement with Italy, signed in 1991, was considered imminent. This agreement would allow domestic banks to deal directly in foreign exchange.

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 scheduled to come fully into force in 1996, is expected to eliminate some competitive disadvantages that Sammarinese firms faced with respect to firms located in EU countries.

The rest of this document reviews in more detail the underlying developments of the Sammarinese economy. Chapter II discusses the real sector; Chapter III assesses the public finances; Chapter IV reviews financial sector activities; and Chapter V summarizes developments in the external sector. In addition, Appendix I focuses on the labor market and the role of cross-border workers, and Appendix II studies the pension system and alternative reform proposals. Appendix III describes San Marino's exchange and trade system.

## II. The Real Sector

For a country of small dimensions, San Marino has a highly diversified economic base, with manufacturing, tourism, other services, and the public sector employing similar shares of the labor force (Chart 1). This has not always been the case. The Sammarinese economy was predominantly agricultural until expanding tourism in nearby Italian seaside resorts in the 1960s induced a boom in day-visitors. Today, three million tourists visit San Marino annually. In the 1970s, improvements to transport infrastructure in Northern and Central Italy linked San Marino to the rest of Italy and to wider European markets, significantly spurring manufacturing. This was in turn followed, in the mid-1980s, by strong growth in the financial sector. Improvements in telecommunications, favorable withholding tax differentials, and political uncertainty in Italy ignited the financial sector boom.

Currently, the manufacturing sector accounts for the largest share of employment, about a third of the total. It is vertically integrated with firms in Italy and, therefore, it is mainly export-oriented. Manufacturing firms also tend to be small with around 10 workers per firm, making them highly flexible when confronting new business opportunities.

It is estimated that, in terms of employment, tourism constitutes the second most important economic sector. 1/ In 1995, San Marino had 3.4 million visitors. Visitors often take advantage of indirect tax differentials with Italy. Thus, the retailing industry is heavily dependent upon tourism receipts. Given the number of visitors the hotel sector is comparatively underdeveloped, with a total capacity of around 1000 beds.

The financial sector has become the most dynamic sector of the economy, benefitting enormously from large inflows of nonresident deposits. In response to a series of financial agreements with Italy restricting the activities of Sammarinese commercial banks, the Sammarinese financial sector specialized in providing lira denominated financial instruments to Italians who wish to hold such deposits outside Italy.

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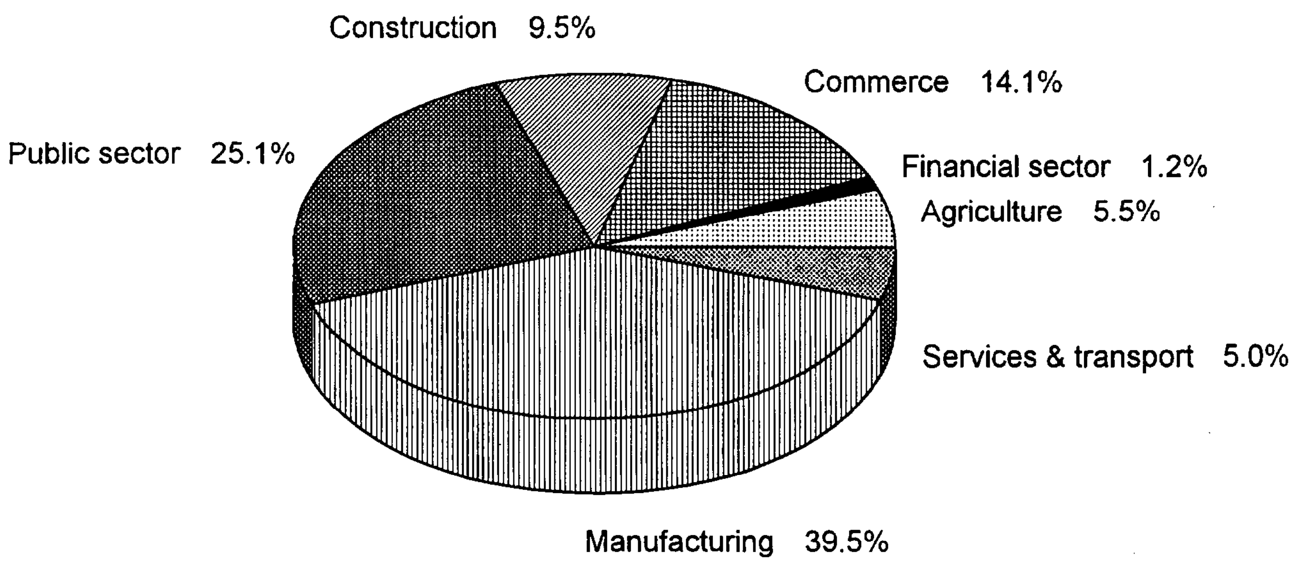
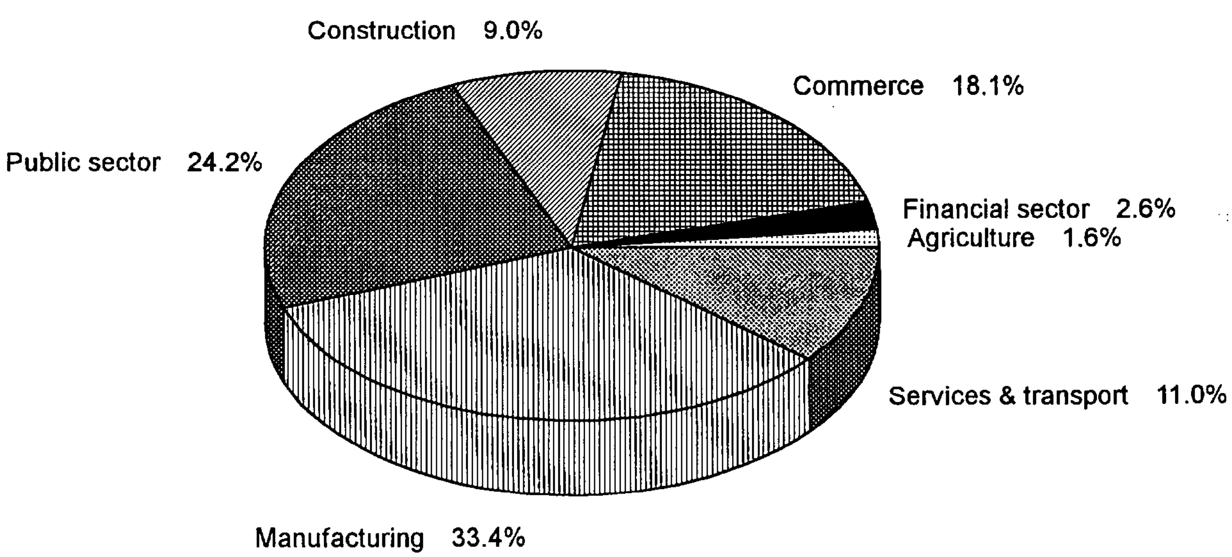
1/ Sammarinese employment data does not have a separate category for tourism. Workers directly involved in the tourism industry would be counted in either the commerce or service sectors.

Chart 1
San Marino
Employment by Sector
(In percent of total employment)

1980




1995




Source: Bolletino di Statistica

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1. <u>Aggregate supply and demand</u>

San Marino has enjoyed five years of very rapid economic growth with the real economy increasing by an average of 7.6 percent per year between 1990 and 1994 (Tables 1-3 and Chart 2). While growth slowed slightly during 1993-94 relative to the extraordinary peak year of 1992, it remained high relative to the surrounding regions of north-central Italy and the rest of Europe. In 1993, San Marino's growth was propelled by the financial sector inflows, which counteracted the fall in demand in the manufacturing and tourism sectors. In 1994, when financial flows stagnated, the depreciation of the lira and the economic recovery in Italy encouraged the expansion of manufacturing and tourism.

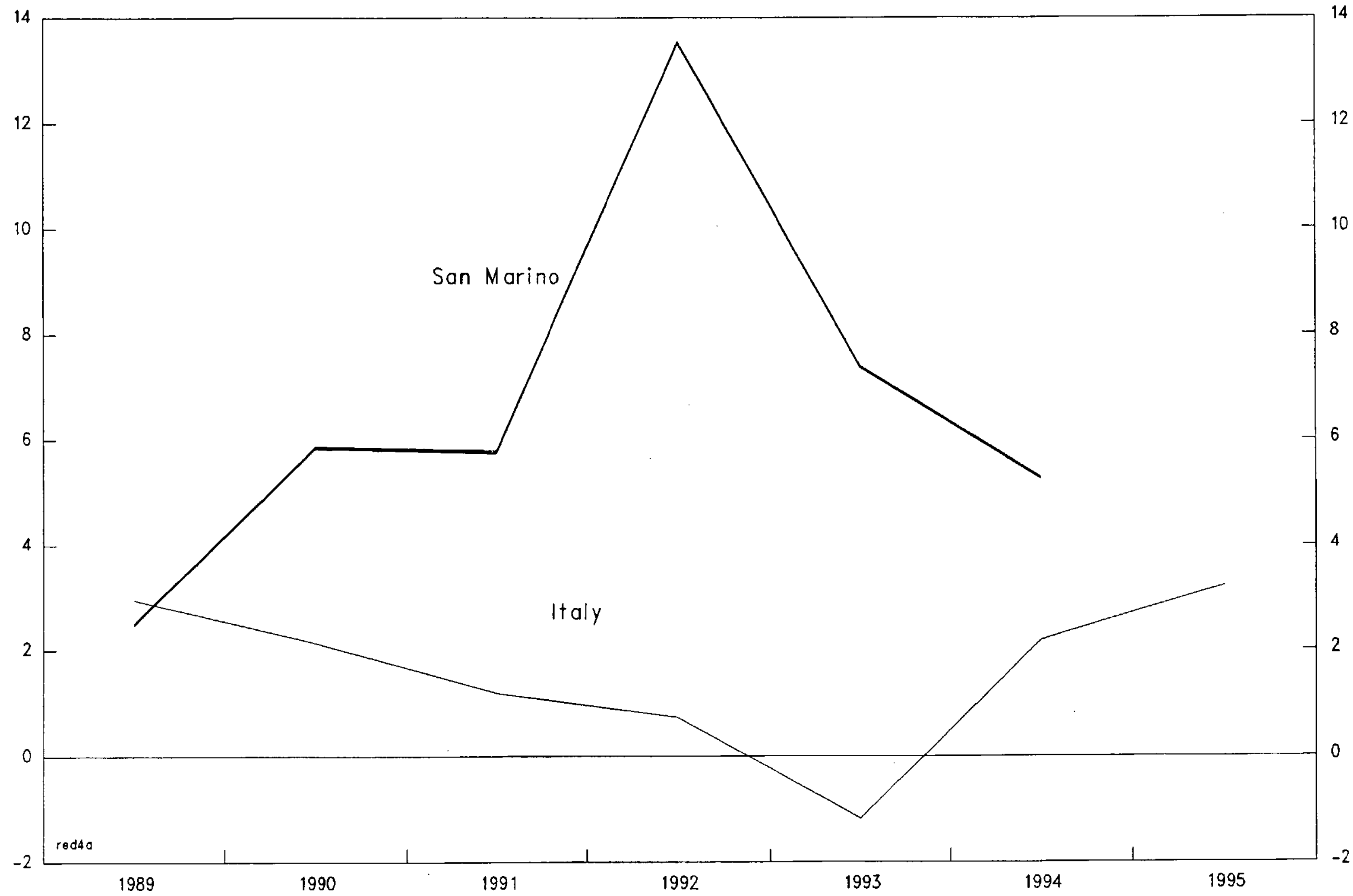
The year 1992 marks the high point of recent Sammarinese economic development with real GDP growing at a remarkable 13.5 percent. This growth was in large part due to the massive increase in capital flows into the financial sector. Political uncertainty in Italy prompted a large increase of nonresident deposits into the Republic. During that year gross assets of the banking sector grew by 45 percent. Tourism also had a good year, with over 3.2 million tourists visiting the Republic.

In 1993 the adverse consequences of the recession which afflicted much of the rest of Europe was largely absorbed by a further expansion of the financial sector. However, the growth rate of capital inflows declined slightly relative to the previous year, with gross banking assets rising by 22 percent. The recession in Italy and the rest of Europe had a significant impact upon other sectors of the economy. The number of tourists visiting San Marino fell by 4.3 percent. Parts of the manufacturing sector were also affected by the slowdown, most notably textiles, which suffered a 21 percent fall in sales between 1991 and 1993.

Following the 1994 general election, political uncertainty in Italy temporarily subsided and the growth of financial flows into San Marino slowed. Gross banking assets increased by only 4.5 percent, a rate considerably below that enjoyed in previous years. However, other sectors--most notably manufacturing--benefitted from the real depreciation of the lira and the subsequent economic recovery in north-Italy. Furthermore, the tourism industry started to regain the visitors it had lost during the recession of 1993. The overall effect of these sectoral developments was positive, with the real economy expanding by 5.3 percent.

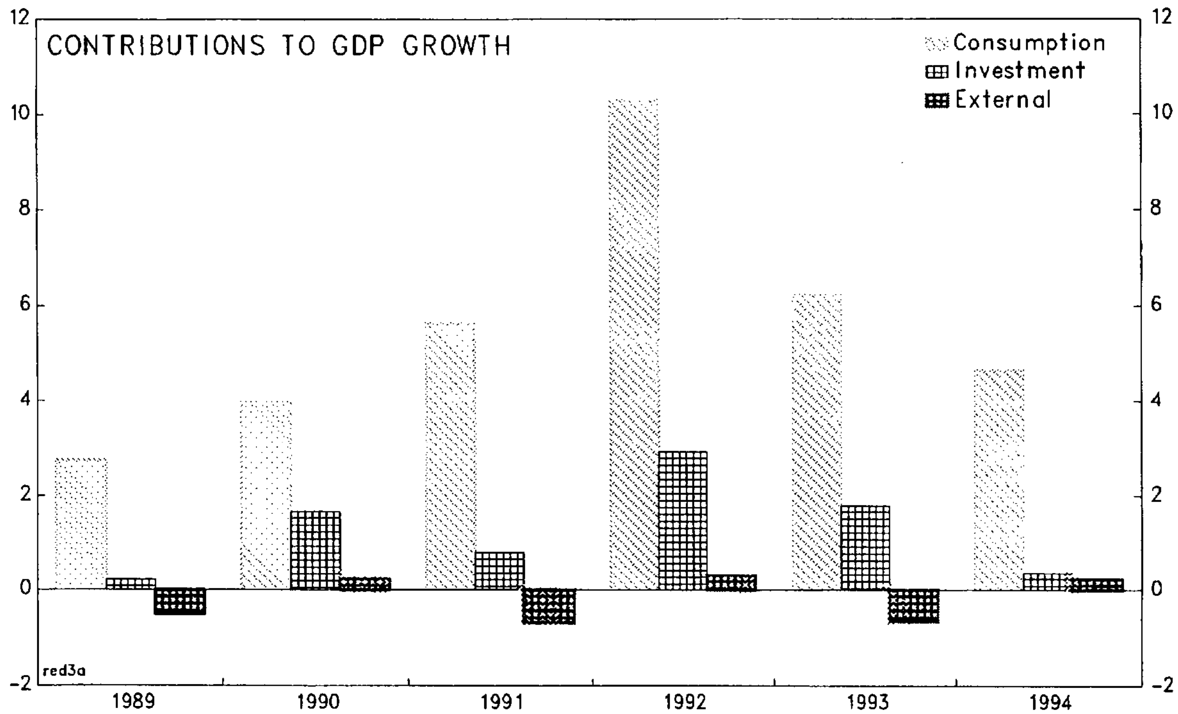
In recent years, domestic components of aggregate demand have tended to follow the pattern of GDP growth. However, the aggregate figures for investment and consumption tend to hide compositional changes between the public and private sectors (Tables 4 and 5 and Chart 3). The public sector aggregates--both consumption and investment--grew strongly in 1993 and helped sustain economic growth during the recession, but their growth tailed off in 1994. In contrast, private sector growth was more subdued in 1993 due to the recessionary impulse from the rest of Europe, but it recovered in 1994 together with the Italian economy.

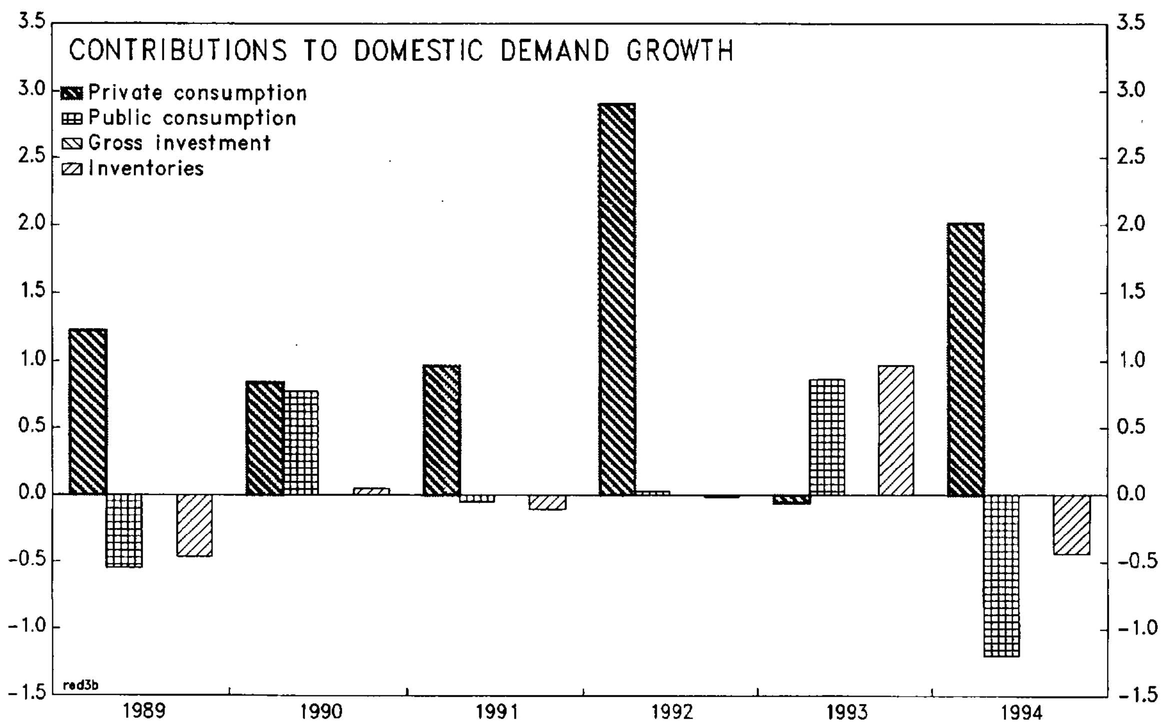
CHART 2
SAN MARINO
**Real GDP Growth**
**(In percent)**




Sources: Data received from the Sammarinese authorities; staff estimates, and IMF, World Economic Outlook.

CHART 3
SAN MARINO
Contributions to GDP and Domestic Demand Growth




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

While there are no national accounts estimates for 1995, there are a number of indicators that suggest that the prospects of strong growth remained good. First, as a result of another round of political instability in Italy, San Marino enjoyed large inflows of capital. Second, the tourism sector continued to recover with the number of tourists increasing by 8.3 percent in 1995, exceeding the previous peak year of 1992. Third, the continued recovery in north-central Italy sustained demand for Sammarinese manufactured goods.

### 2. Wage determination

The labor market in San Marino is highly unionized and collective agreements dominate the wage determination process. Historically negotiated contracts provided for full indexation to the consumer price index, plus a productivity-related real wage increase. However, recent reforms of the wage bargaining system in Italy, most notably the elimination of automatic wage indexation, meant that this system would lead to a deterioration in relative wage competitiveness vis-à-vis Italy.

In response to the changes in Italy, private sector contracts are being reformed. The previous system of full backward-looking price indexation is gradually being replaced with a system based upon the future expected inflation rate in Italy, with allowances for real wage adjustments contingent on business performance. The process started with contracts negotiated in the building sector which came into force on January 1, 1995. It is expected that backward-looking price indexation will be removed from all private sector wage contracts by 1997. In contrast, although there is no legal requirement, public sector wage contracts are still based upon full indexation.

Real consumption wages tend to be higher in San Marino than in Italy for comparable workers. However, hourly labor costs in San Marino tend to be lower than in Italy. This is almost entirely due to the lower social security contributions in San Marino, which are one third of those in Italy. This competitive advantage explains why San Marino remains an attractive location for manufacturing industries. 1/

### 3. Prices and inflation

Due to the currency union with Italy inflation developments in San Marino are effectively coupled with those of Italy. Any differences between the Italian and Sammarinese CPI simply reflect either the different consumption baskets used in each country or changes in indirect tax rates. During the period 1992-94 inflation in San Marino remained around 5½ percent (Table 6 and Chart 4).

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1/ Since no data is available for labor productivity, there is no measure of unit labor costs.

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


Source: Bank of Italy.

In San Marino a limited number of prices are determined administratively. These controls are largely due to attempts to ensure product quality in the tourism sector or to custom arrangements with Italy. Prices charged by hotels and restaurants are set by the Committee for Prices on the basis of the proposal made by hotel and restaurant owners. 1/ These arrangements are similar to those found in the neighboring regions of Italy. Similarly, an agreement between Italy and San Marino requires that gasoline and tobacco sold in San Marino have the same price as in Italy.

4. Employment and unemployment

Total employment has continued to grow strongly over the period 1993-95, with an annual average growth rate of 4.6 percent. Cross-border workers (*frontalieri*) comprise an increasing proportion of the Sammarinese labor force. These workers are mainly Italians living in the surrounding regions. By 1995 the proportion of cross-border workers had reached 27 percent of private sector employment and 19 percent of total employment (Tables 6-9 and Charts 5-6).

There is a distinct trend toward segmentation in the Sammarinese labor market. Sammarinese workers are largely found in the public sector, finance, or in entrepreneurial activities. Cross-border workers are heavily concentrated in the manufacturing, construction, transportation, and hotel and catering industries. Within these industries cross-border workers tend to be found in unskilled and semi-skilled occupations. In 1995, 11 percent of all cross-border workers were summer seasonal workers.

Traditionally self employment was an important category of total employment, primarily because of the large number of small retailing, handicrafts and light manufacturing firms in the Republic. In 1990, 21 percent of the labor force was self-employed. However, this share fell to 17 percent in 1995, mostly due to the strong growth of dependent employment.

Unemployment in San Marino is low by European standards. During the period 1990-94 the unemployment rate in San Marino hovered around the 4-5 percent range. However, the rate fell to 3.8 percent in December 1995. Interestingly, unemployment has been remarkably unresponsive to the rapid growth in labor demand. This issue is discussed in Appendix I where it is argued that this is consistent with the view that San Marino suffers from a problem of voluntary "wait" unemployment. Sammarinese workers forego the possibility of a job in the "secondary" sector in order to wait for a desirable job in the "primary" sector. The composition of the unemployed pool confirms this view where two types of workers dominate the unemployment register: middle aged women seeking part time public sector employment, and highly qualified young workers seeking full time employment in the public sector.

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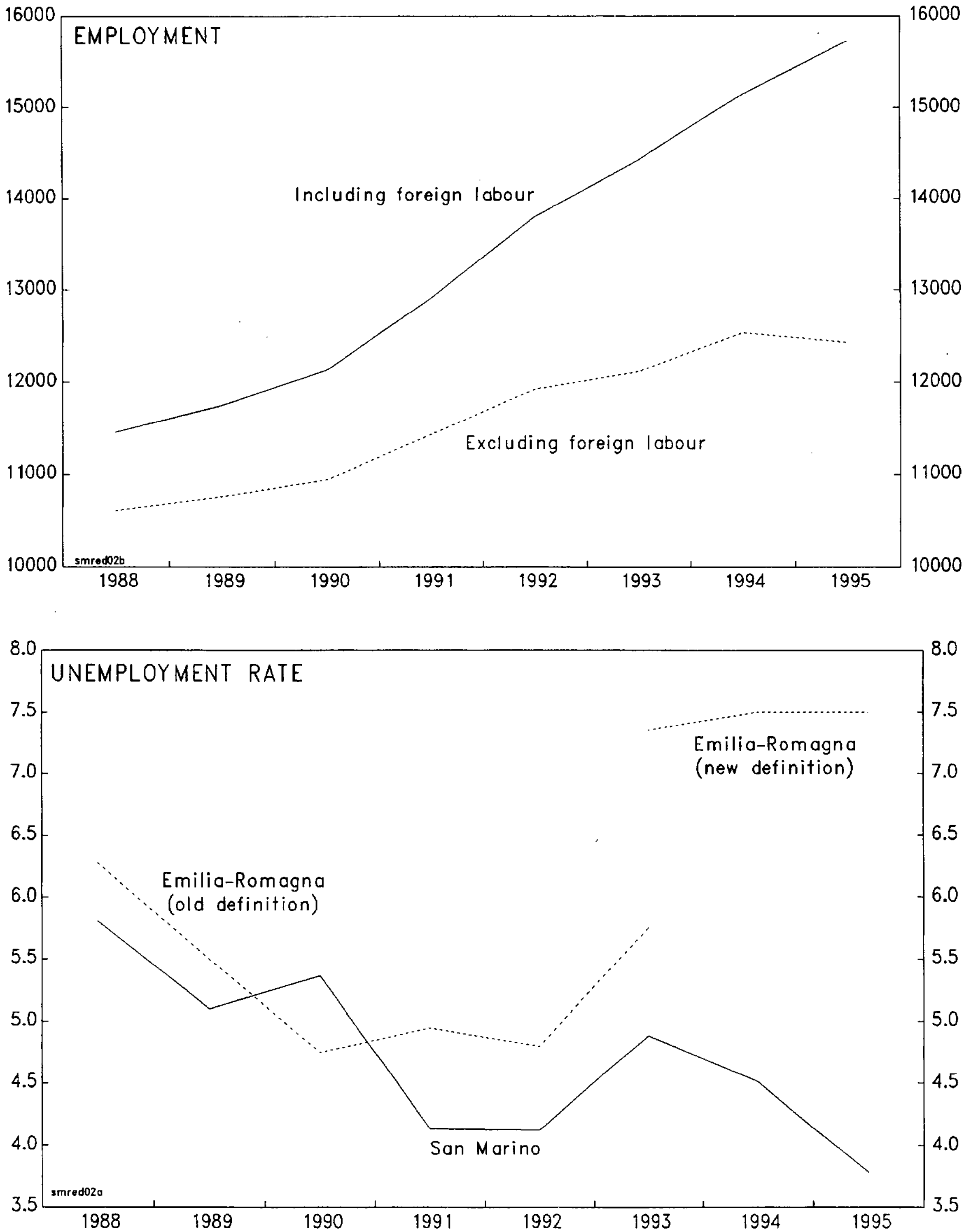
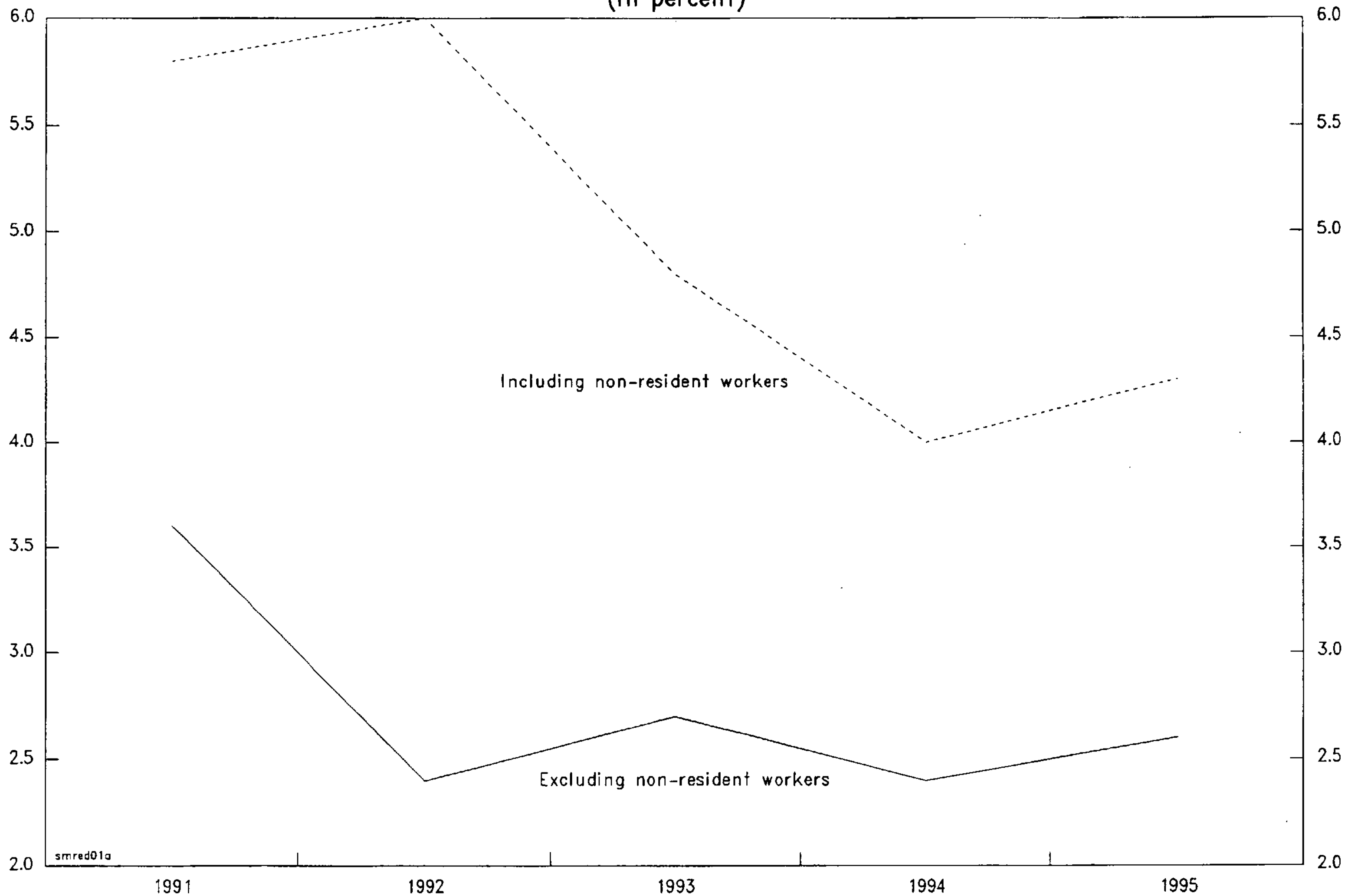
1/ The Committee for Prices consists of the Minister of Commerce and representatives of "economic categories" (manufacturing, commerce, tourism, handicrafts, self-employed, and agriculture) and the trade unions.

CHART 5
SAN MARINO
# Total Employment and Unemployment Rate




Sources: Bullettino di Statistica, 1990 - 1995, and staff estimates.

CHART 6
SAN MARINO
## Employment Growth
(In percent)




Source: Bolletino di Statistica.

Sammarinese employment law encourages a degree of "waiting". In order to obtain a job, a worker must first register as unemployed. When vacancies become available firms must search in the unemployment list to find a suitable candidate. Should no such candidate be available, the firm can then search amongst employed Sammarinese residents and abroad. In practice, full employment in the private sector ensures that few private firms are constrained by these regulations. Thus, firms resort to filling their vacancies with cross-border workers. 1/

In San Marino, the costs of this "wait" unemployment has been contained by the limited provisions of the unemployment benefits system. Two types of income support are available to workers who become unemployed: ordinary unemployment benefit and unemployment benefit for redundant workers (*Indennitá Economiche Speciale*). 2/ Most workers waiting for a public sector job can only claim ordinary unemployment benefit, and the actual benefit level is extremely low. The maximum benefit that can be received is Lit 4,000 ($2.60) per day. The minimum level of benefit is set at Lit 600 ($0.38) per day with a maximum duration of benefits of 100 days. Only 10 percent of eligible workers find it worthwhile to claim this benefit.

The *Indennitá Economiche Speciale* is the unemployment benefit paid to redundant workers. Its provisions are much more generous than ordinary unemployment benefit. Eligible workers receive 70 percent of their previous salary for the first six months of unemployment, followed by 65 percent for the second six months. Workers claiming this benefit are given priority on the unemployment list. The vast majority of these workers are looking for employment in the private sector. The recent strong growth in private sector labor demand has facilitated finding jobs for previously redundant workers. On average this benefit is granted for three months. The majority of workers find employment between one and eight months after losing their previous job.

## 5. Industrial policy

In order to promote economic development the government has offered three types of assistance to the industrial sector: corporate tax exemptions, subsidized credit, and social security exemptions. However the government is considering number of proposals which will extend the assistance it gives to firms. The most notable proposal is a plan to introduce a marketing board to promote Sammarinese goods abroad.

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1/ Private sector firms incur in significant hiring costs with cross-border workers because they must prove that an unemployed Sammarinese worker cannot be found. Thus, vacancies can remain unfilled for considerable periods of time.

2/ San Marino provides a third income support fund. Firms who lay off workers temporarily are entitled to claim from the wage supplementation fund (*Cassa Integrazione Guadagni*) in order to continue wage payments.

As a result of a 1991 law, corporate tax exemptions have grown very rapidly in recent years reaching 2.1 percent of GDP in 1994. The exemption from the corporate income tax is conditional on profits being re-invested and needs to be approved by a commission.

Subsidized credit is available to several sectors of the economy. The budget determines the total amount of available funds, while the government specifies the precise allocation to each sector. Firms apply to the *Comitato per il Credito Agevolato* which comprises of government representatives, trade unions, banks, and industrialists. After a subsidy has been approved, then a commercial bank examines the loan application and decides whether to finance the project. However, the government does not guarantee the loan which eliminates the issue of moral hazard. The commercial bank has a strong incentive to ensure the viability of each project. Three maturities of loans are available, three, five, and ten years, depending on the type of investment. The subsidized credit takes the form of a subsidy on the loan's interest payments. The extent of the subsidy depends upon a number of factors such as the number of new jobs created, but typically the subsidy falls within 3 to 5 percent. Total expenditure on subsidized credit in 1995 was 1.2 percent of GDP. Chart 7 shows the evolution of the outstanding amount of preferential credit.

Firms may also be exempted from social security contributions *(fiscalizzazione degli oneri sociali)* in order to provide subsidies for on-the-job training and for employment of certain types of workers such as handicapped workers. In 1995 these subsidies amounted to 0.1 percent of GDP.

## 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 35 percent of GDP, while the overall 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 and social security contributions; and promotion of the formation of business groups in order to take over and recapitalize firms in financial disarray.

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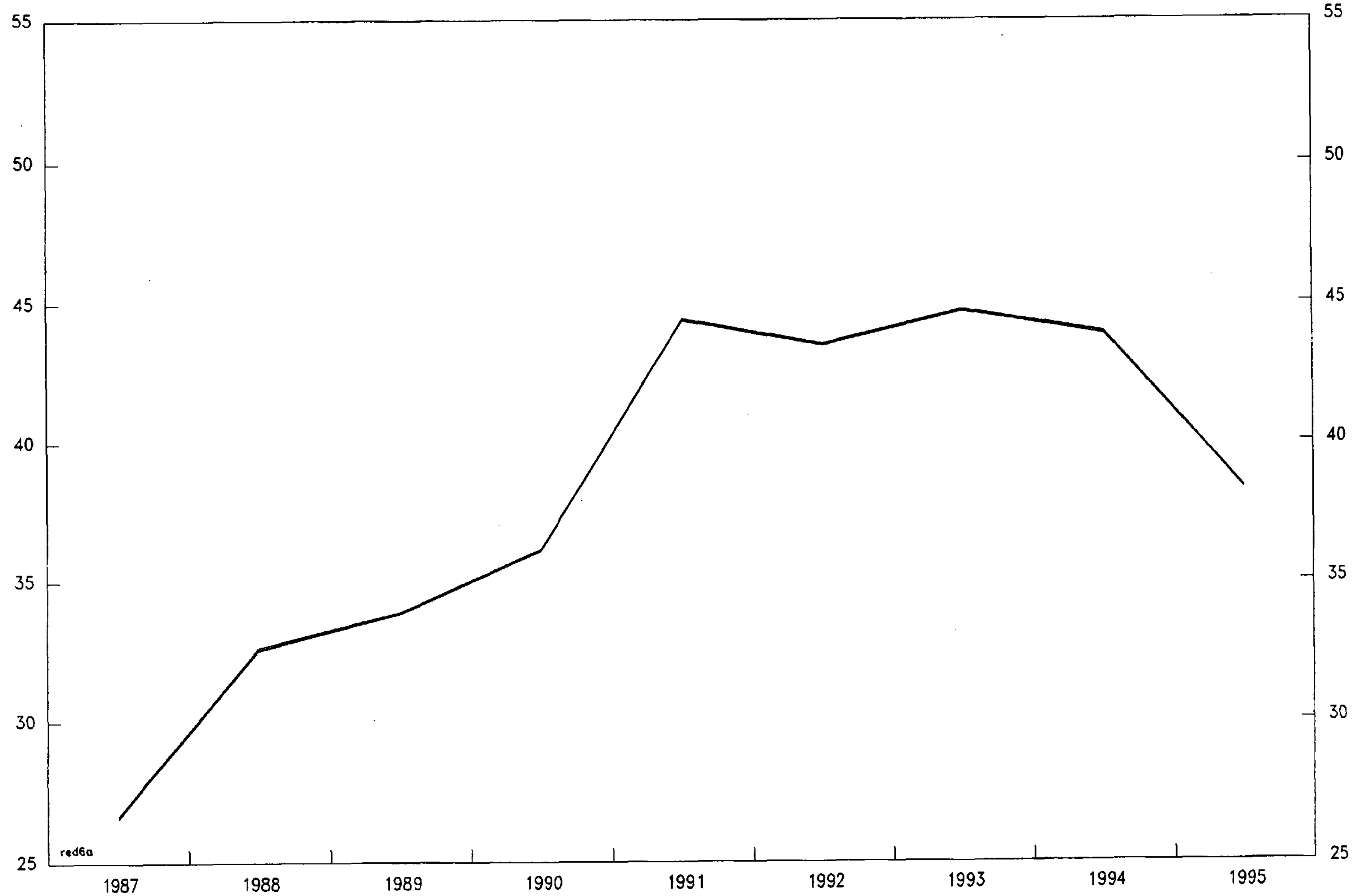
1/ The overall public sector includes the general government and the public enterprises.

CHART 7
SAN MARINO
Subsidized Loans
(In billion lire) 1/




Source: Data received from Sammarinese authorities.

1/ Outstanding amount on June 30 for 1987-91 and 95. Outstanding amount on December 31 fcr 1992-94.

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, the one-stage import tax has a rate that is 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. 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

San Marino does not produce consolidated general government accounts. Accounts and budgets are prepared separately for the central administration, the social security institute, and each public enterprise. The staff estimated general government accounts by adding social security contributions paid by the private sector to central government revenues and expenditures.

The authorities prepare and monitor all accounts only on an accrual basis. Upon request by the staff, the authorities provided revenues and expenditures on a cash basis for 1988-94 and partial estimates for 1995. The 1996 budget is available only on an accrual basis.

### a. Estimated cash accounts of the general government 1989-95

Tables 10 and 11 present the general government accounts on a cash basis (see also the top panel of Chart 8). 1/ The evolution of public finances in the 1990s is difficult to assess because fiscal years for *monofase* revenues had varying length. Instead of end-February (the usual date), central administration accounts were closed at end-April in 1991 and at end-March in 1992. These delays produced a 14-month fiscal year in 1991

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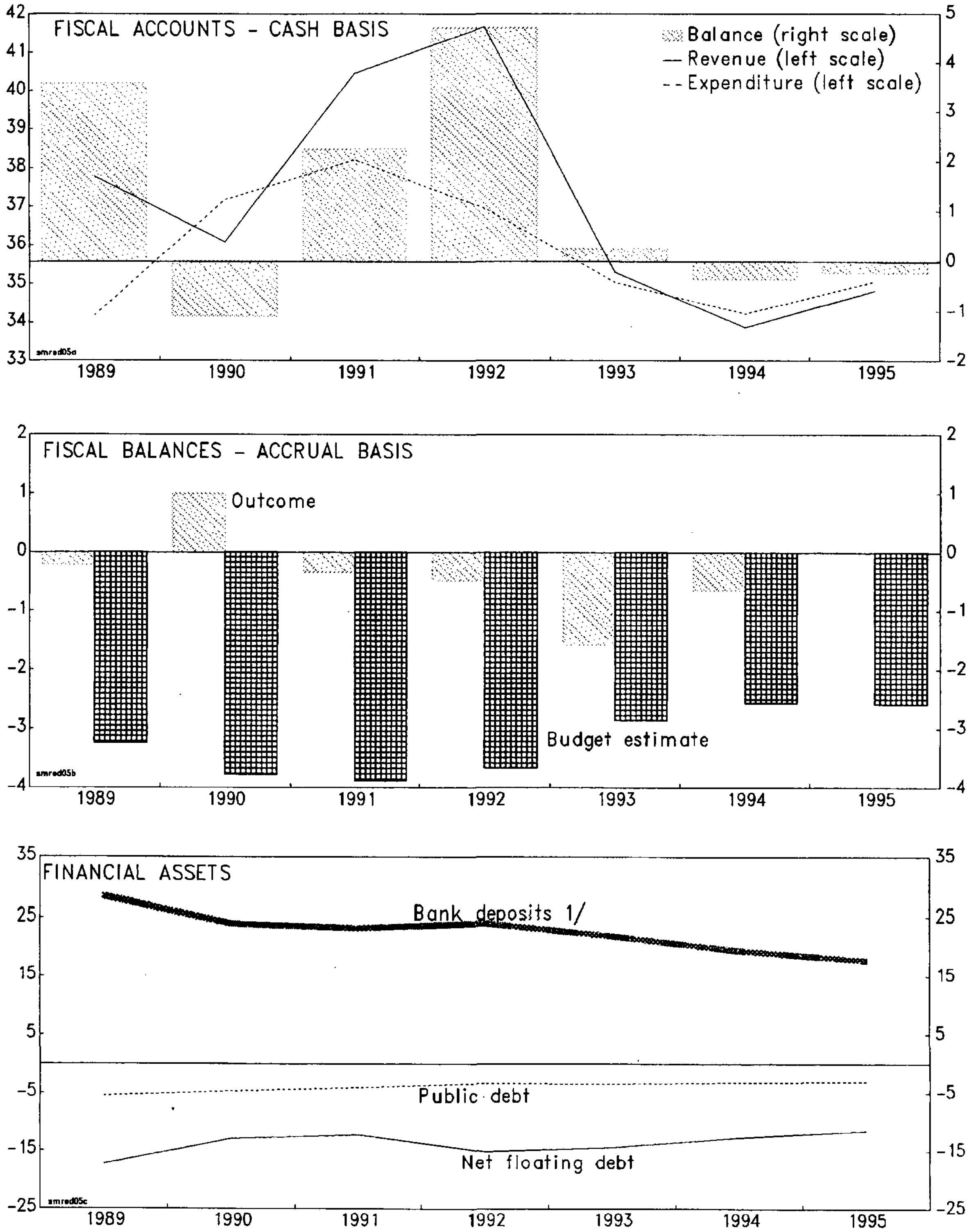
1/ The cash accounts of the central administration provided by the authorities were reclassified and corrected to allow for contributions paid by the private sector to the social security institute and for the 50 percent of direct taxes that until 1990 was earmarked to the social security institute.

CHART 8

SAN MARINO

# Fiscal Policy Indicators

(In percent of GDP)




Sources: Ministry of Finance, and staff estimates.

1/ This excludes pension fund reserves.

and two 11-month fiscal years in 1992 and 1993. As a result, in 1991, revenues were artificially higher. In 1992, revenues were also higher than usual as the lagged effects of the longer fiscal year in 1991 more than compensated the fall in accruing revenues caused by the shorter fiscal year in 1992. 1/ In contrast, in 1993, with two 11-month fiscal years in a row, revenues collected were very low. Finally, in 1994, revenues probably continued to be biased downwards by the lagged effect of the previous 11-month fiscal years.

These peculiarities make a precise assessment of fiscal developments difficult. While San Marino had run an average surplus of 2½ percent of GDP in 1989-92, surpluses disappeared thereafter and small deficits emerged in 1994 and 1995. The varying length of fiscal years could explain the deterioration in 1993, and possibly in 1994, but it seems unlikely that it could account also for the 1995 outcome. Thus, it is possible that there has been some weakening in tax administration, with tax collections being overwhelmed by the 50 percent increase in trade volumes in 1990-94. The tax administration office reviews all tax and refund claims instead of a sample as is done in other countries. In addition, on the expenditure side, there seems to be a slowly rising trend in the wage bill 2/ and in the net transfers to social security, especially for the increasing health care costs.

In 1995, total revenues were estimated close to 35 percent of GDP, down 1.3 percent of GDP from 1990, the last comparable year. Direct taxes accounted for 30 percent of all revenues (10 percent of GDP) with a large contribution from the corporate income tax. 3/ 4/ Indirect taxes

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1/ Almost 50 percent of the main single source of revenue (the *monofase* tax on imports) is collected the year after it accrues.

2/ This trend might change in the future as the recently implemented hiring freeze starts to be effective. Sharp wage increases were negotiated for 1992 and 1993 having 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. Wage increases also affect retirement benefits since these are linked to an average of an individual's income over his last five years worked.

3/ In turn, more than half of the yield of the corporate income tax was from banks.

represented 45 percent of revenues (15.6 percent of GDP) with the import tax reaching almost 10 percent of GDP. 1/ As the Agreement on Cooperation and Customs Union requires, in January 1996, the government imposed a variable rate complementary tax on domestic products intended for home consumption. San Marino also received an annual transfer from the Italian Government (*Canone Doganale*), 2/ and one from the EU as reimbursement of tariffs levied on non-EU products imported in San Marino. Finally, social security contributions paid by the private sector stood at 6.2 percent of GDP.

In 1995, total expenditures amounted to 35 percent of GDP, almost 1 percent of GDP more than in 1994 but some 2 percent of GDP less than in 1990. Most expenditures were either current or net transfers (33 percent of GDP) while capital transfers were small (2.3 percent of GDP).

Current expenditures have usually remained substantially below revenues, allowing the government to generate current account savings which averaged 3.9 percent of GDP over the period 1989-95. Current expenditures consist mainly of wages and salaries (10.8 percent of GDP in 1995) and purchases of goods and services (4.2 percent of GDP in 1995). Debt service is small since government debt is virtually nonexistent. Other current expenditures (1.1 percent of GDP in 1995) are mainly interest subsidies.

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4/ (...continued)

4/ The income tax (*Imposta Generale sul Reddito*) is levied on several categories of income stipulated by law, net of allowable deductions. 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. 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 24 percent. In addition, other forms of income, such as capital gains and retirement pensions, are taxed at a different rate.

1/ The import tax 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 specific 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 oil price at the same level as that prevailing in Italy. All imports by entities of the public sector are exempt from both taxes. The rest of indirect taxes are revenues generated by the state monopoly of tobacco products and proceeds from licenses and fees. 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.

2/ This transfer, last negotiated in 1984, represents partial compensation for San Marino's giving up certain revenue sources and for the use of the Italian lira as the domestic currency.

Net transfer payments represent a substantial expenditure item directed primarily to the social security institute (14 percent of GDP in 1995) while net transfers to public enterprises being small and declining (1.6 percent of GDP in 1995). Almost half of the transfers to social security correspond to contributions collected by the government on behalf of the social security institute. 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. Net transfers to public enterprises are mainly directed to the Public Works Corporation (AASP), and to a smaller extent to the Olympic Committee (CONS), and the University of San Marino; instead, the Numismatic and Philatelic Agency (AASFN) and the Public Utilities Company (AASS) have been net contributors to the budget. 1/

Capital transfers remained below their historical average in 1995, although they were larger than in 1994. The three-year investment program recently initiated by the government most likely will increase this expenditure item in future years.

### b. Central government accounts on an accrual basis

Tables 12 and 13 show the central government accounts on an accrual basis. On this basis tax collection lags do not affect the fiscal balance. Thus, the drop of the revenue-to-GDP ratio in 1993 is smaller than in the cash accounts and there are some indications of a rebound in 1994.

Tables 12 and 13 also report initial budget estimates. The Sammarinese authorities systematically overestimated deficits with higher-than-expected revenues more than compensating for expenditure overruns (see also the intermediate panel of Chart 8). 2/ This bias extends to the accrual balance for 1995--based on mid-year official estimates--and to the 1996 budget. If the biases are similar to those of previous years, then the final fiscal outcome should be close to balance in both, 1995 and 1996. 3/

The 1996 budget seeks to maintain the stance of fiscal policy. It includes no major changes in taxation and some redistribution within expenditures. Wages and salaries are projected to fall by some ½ percent of GDP due to a hiring freeze implemented in September 1995, and other current expenditures, including transfers, are projected to increase correspondingly. As in 1995, the 1996 budget forecasts a deficit of

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1/ The central government finances most of the public enterprises' investment projects. This, combined with inter-enterprise transfers makes it difficult to ascertain exactly which public enterprises are net contributors to the budget.

2/ Expenditure overruns were concentrated in current expenditures, especially wages and transfers to the social security institute.

3/ Tables 12 and 13 present two accrual balances: the first excludes net debt financing, which is classified below the line; the second includes net debt financing above the line as in the authorities' presentation.

2½ percent of GDP. However, the Sammarinese authorities have a tradition of underestimating revenues with projected budget deficits of 2-3 percent of GDP. The authorities and staff agreed that in the current environment of still relatively strong growth there were no reasons to believe that the 1996 fiscal outcome would deviate appreciably from the balanced budgets of the last three years.

Table 14 reconciles the different definitions of fiscal balance used by the authorities and the staff. The cash balance can be derived from the accrual balance (excluding net debt financing) by subtracting the new net asset float accrued in the fiscal year but not cashed, and by adding the part of the outstanding asset float (at the beginning of the fiscal year) that was cashed. Since the latter tends to exceed the former, the cash balance is usually better than the accrual balance. 1/ The table also reconciles the accrual balance with the deficit measure tracked by the Sammarinese authorities, called *Avanzo d'esercizio*. This corresponds to the accrual balance adjusted for the annual reassessment of the net float outstanding and including net debt financing above the line. Since the adjustments are usually favorable to the fiscal balance, 2/ the *Avanzo d'esercizio* has been typically better than the balance on an accrual basis.

c. Net government's asset position

The net asset position tracked by the government is the *Avanzo d'amministrazione*, which corresponds to the sum of bank deposits and net asset float (Tables 15 and 16). 3/ San Marino's prudent fiscal policies that generated fiscal surpluses for a number of years allowed accumulating government deposits of around 20 percent of GDP in 1994. In the four years to 1994, however, the *Avanzo d'amministrazione* fell by 4 percent of GDP to 7 percent, as the steady decline in the ratio of bank deposits to GDP that occurred during the 1990s was not fully compensated by the increase in the net asset float.

The staff calculated an alternative net asset position which takes into account also the stock of public debt. In this definition, the decline of net assets until 1994 is smaller (from 7.1 percent of GDP in 1991 to 3.8 percent of GDP in 1994) because the public debt-to-GDP ratio also falls (Chart 8, bottom panel). The annual change in this net asset position corresponds to the *Avanzo d'esercizio* in the definition excluding net debt financing.

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1/ Reconciling cash and accrual balances for 1995 and 1996 is not possible since there is no information on the evolution of the float.

2/ Mainly, it consists of downward revisions of the liability float made by the tax office after processing the requests of reimbursement of the *monofase* tax presented by importers.

3/ Its annual change is the *Avanzo d'esercizio* (in the definition including net debt financing above the line).

The implications of using the staff's net asset position rather than the authorities' is evident in 1995 and 1996. If 1995 and 1996 fiscal accounts closed with the implausible deficits projected by the authorities and the latter were financed by increasing the public debt (as indicated in the budget), then the net asset position calculated by the staff would turn negative in 1996, while the *Avanzo d'amministrazione* would remain unchanged.

## 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, and 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 social security reform 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. The pension system has accumulated assets of some 6 percent of GDP. Appendix II provides a fuller description of the social security system in San Marino and of a draft pension reform law recently presented by the government.

## 3. The public enterprises

There are four nonfinancial public enterprises and a few other nonfinancial public entities in San Marino (Tables 17 and 18). 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 1994, the largest three public enterprises combined had spending of more than 10 percent of GDP, while the rest together spent less than 1½ percent of GDP. The payroll of the all of these entities represented about one quarter of the total public sector payroll, or about 3¼ 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, and transportation. 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 3½ percent of GDP.

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 (CONS) is in charge of the organization of sports activities in San Marino; its expenses consist mainly of salaries and spending on infrastructure (of the order of Lit 6 billion) is financed entirely from the state budget.

The government has 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.

## IV. Money and Finance

San Marino's financial sector is very large in proportion to its economy. Total assets in the banking system were eight times GDP in 1995. There are four commercial banks that attract most of their business from

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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 circulated by San Marino. These coins are guaranteed by the Ministry of Finance and by Italy.

Italy and, in turn, invest most of their assets in Italian banks and government bonds (Chart 9).

The activities of the Sammarinese financial system are determined by a series of financial economic, monetary, and exchange agreements concluded with Italy. The most important of these agreements is the currency union with Italy whereby San Marino uses the lira as legal tender. Thus, the Sammarinese authorities have no influence over either domestic credit or the money supply, with local monetary conditions effectively determined by policy decisions taken by the Bank of Italy. 1/ As a consequence, interest rates in the Republic move in line with those in Italy (Table 19). Through their subsidized credit facility authorities have some limited ability to influence interest rates paid on loans taken by certain industrial enterprises by reducing the effective interest rate paid by these enterprises. However the overall impact of this facility on the level of interest rates in the San Marino is negligible.

An agreement signed with Italy in 1939 forbids Sammarinese banks from transferring funds outside Italy unless transfers are made through an Italian correspondent bank. This restriction is due to be eliminated under a new Financial and Exchange Agreement signed in 1991. Under this agreement Sammarinese credit institutions would be permitted to engage in exchange transactions subject to the authorization of the Sammarinese central bank.

The financial sector has focused upon a limited set of financial transactions--primarily repurchase agreements--to maximize the competitive advantage of Sammarinese banks vis-à-vis their Italian counterparts. Externally, Italian tax law treats Sammarinese banks as "individuals" so that they have to pay a withholding tax on interest earned in Italy, putting them at a disadvantage with domestic Italian banks. (Withholding taxes on repurchase agreements are lower than on deposits.) This disadvantage is compounded by the lack of a convention between Italy and San Marino on double taxation of corporate profits. Domestically, repurchase agreements are off-balance sheet items, and are not subject to the liquidity requirements that affect deposits. For these reasons, repurchase agreements take up about one half of total banks' assets.

Due to the specialized nature of the services offered to nonresident depositors, capital flows into San Marino are highly sensitive to political developments in Italy. The early 1990s saw very large capital inflows, particularly in 1992 when both the stock of foreign assets and quantity of repos doubled in just one year. After the 1994 elections in Italy, there was a severe slowdown of inflows, and the number of repurchase agreements fell in absolute terms. In 1995, capital inflows resumed together with political instability in Italy (Table 20).

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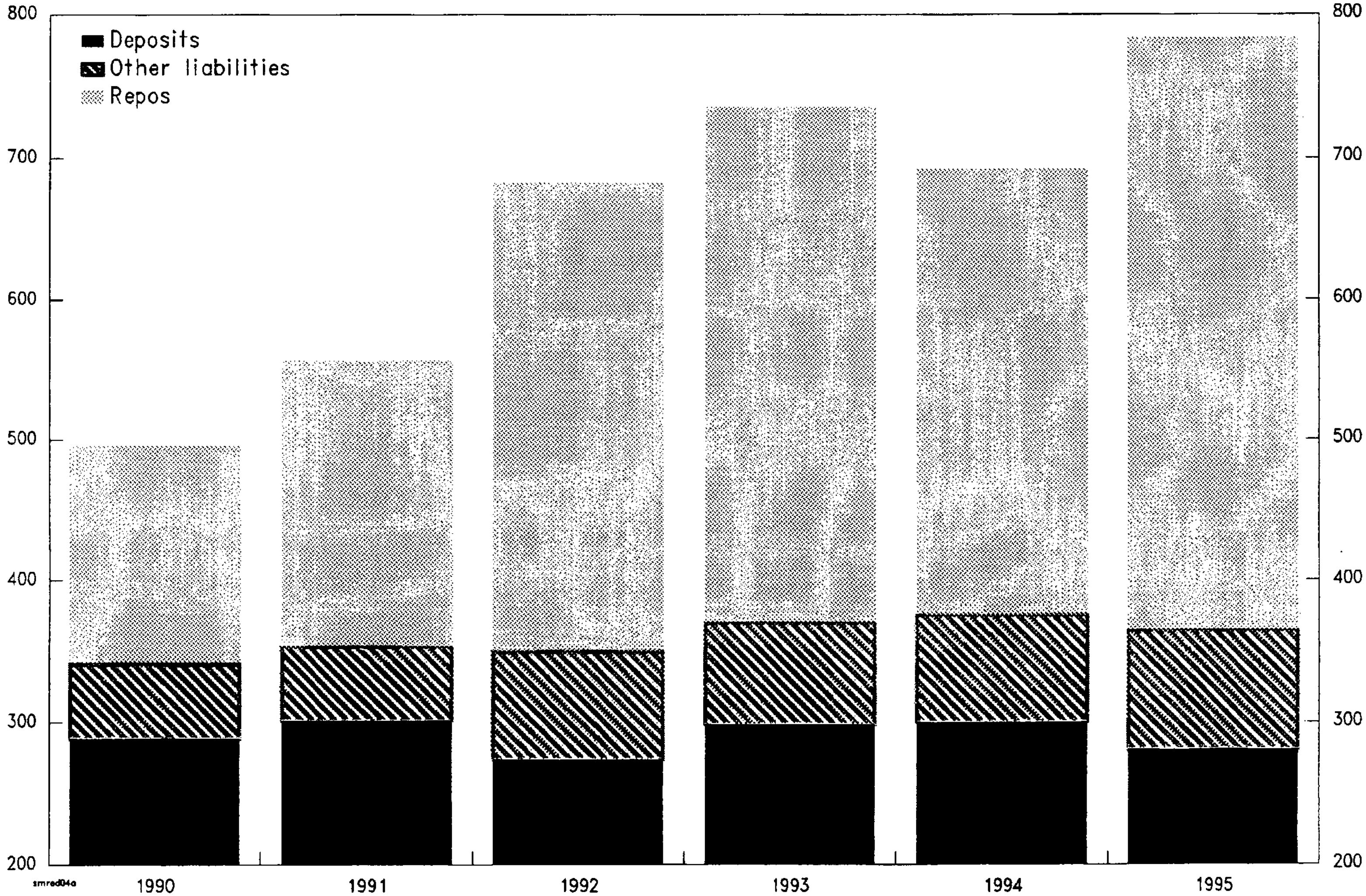
1/ The authorities can issue non-gold coins, but the amount is limited by an agreement signed with Italy in 1991 to the Lit 2.7 billion a year. The Sammarinese authorities can issue gold coins without limit.

CHART 9

SAN MARINO

## Gross Liabilities of the Banking System

(In percent of GDP)




Source: Office of Banking Supervision.

At the end of 1995, gross foreign assets of the banking sector are estimated to have represented more than 80 percent of the total assets of the banking system (Tables 21 and 22). 1/ The entire financial system (the ICS plus the four major commercial banks) had a comfortable net foreign asset position of Lit 2,238 billion, reflecting a history of government financial surpluses and excesses of domestic savings over investment. In turn, foreign liabilities were estimated to be Lit 4,677 billion in 1995, or 55 percent of total liabilities (Tables 23 and 24).

The authorities have taken steps to prevent the Sammarinese financial system from being used for money laundering operations. San Marino has recently signed the Council of Europe's Convention on Money laundering and the government is in the process of drawing up legislation to comply with its provisions. Current banking regulations require new customers to provide identification before accounts are opened. Banks must also identify customers that make transactions over Lit 20 million. Further, recent legislation forbids the use of cash for transactions above Lit 80 million.

1. Development of the central bank

The Sammarinese central bank--the *Istituto di Credito Sammarinese* (ICS) began operations in 1992. ICS has five main functions. First, it acts as a state treasury to manage both state and public sector deposits. Should the government at some point in the future decide to fund its fiscal deficits by bond issues, the ICS will be responsible for issuing and managing this debt. Second, it promotes the expansion and development of the financial sector. Third, it regulates banking sector activities in financial markets. Fourth, it collects and disseminates financial data. Fifth, it is in charge of relations with external agencies and international organizations--including the IMF--on monetary issues.

The most important activity of the ICS is the management of public sector deposits. In 1995 the ICS held deposits of Lit 288 billion, of which Lit 217 billion were held on behalf of the central government and Lit 41 billion on behalf of the public utilities (Table 25). Before the creation of ICS these deposits were held in commercial banks. When ICS took over the management of these funds, it deposited them in commercial banks at an interest rate lower than the market rate, thus giving an implicit subsidy to the banks. In the last two years, this interest subsidy has been almost eliminated and ICS has also placed a substantial proportion of state funds in financial institutions in Italy.

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1/ Due to bank secrecy laws, the Sammarinese monetary authorities do not provide any classification of assets and liabilities according to the residency of the holder. Also, there are no data on Sammarinese deposits abroad. The figures presented are staff estimates based upon the available data and numerous assumptions. These estimates are likely to err on the side of understating the size of nonresident deposits.

ICS is currently considering a number of reforms to the Sammarinese financial system. It is proposing to set up a clearing house on behalf of the commercial banks in order to improve domestic banking competitiveness. ICS also considered the introduction of a legal reserve requirement on domestic banks to build a pool of reserves in case of potential banking problems. However, interest in this proposal has recently waned.

ICS has recently played an active role in the creation of a new mutual fund called the *Titano Fund* for Sammarinese investors. ICS recognized the need to develop a regulatory framework for mutual funds and used Luxembourg as its model. ICS organized a partnership between a financial institution in Luxembourg, that provided the technical expertise, and two Sammarinese banks that provided marketing services for the new fund. 1/ The response from domestic investors thus far has been modest. The ICS is currently considering a reduction of brokerage costs to increase the attractiveness of the new instruments. However, it is concerned that such a step might encourage speculative rather than long term investments.

## 2. Commercial banks

San Marino has four major commercial banks. They are the *Credito Industriale Sammarinese* (the Industrial Investment Bank of San Marino), the *Banca Agricola Commerciale* (the Agricultural Commerce Bank), the *Cassa di Risparmio* (the Savings Bank) and the *Cassa Rurale di Faetano* (the Rural Bank of Faetano). Sammarinese banks are not subject to legal reserve requirement. 2/ However, Sammarinese banks are legally required to maintain a liquidity ratio of at least 10 percent of their deposits less 10 times their capital in the form of bonds issued or guaranteed by either the Italian government or international organizations. In practice, the high capitalization of Sammarinese banks and the large multiplying factor (10 times) makes the liquidity requirement negative and, therefore, not binding.

Sammarinese tax law gives strong incentives for Italians to deposit funds in San Marino. Interest income earned on deposits is subject to a lower withholding tax in San Marino than income earned on deposits held in Italian banks (13 percent against 30 percent). When the earnings are repatriated Italian residents are required to pay tax on interest income net of taxes paid in San Marino. However, it is widely believed that much of this income goes unreported to the Italian tax authorities.

Nonresident funds are primarily channeled into repurchase agreements. Typically, Sammarinese commercial banks purchase through Italian intermediaries Euro-lire certificates of deposits with a 3- or 6-month maturity and resell them to their customers as 3-month repurchase

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1/ The two Sammarinese banks involved in the *Titano* Fund are the *Cassa di Risparmio* and the *Cassa Rurale di Faetano*.

2/ In contrast Italian banks are required to maintain 15 percent of their deposits with a maturity of 18 months or less at the central bank at a below market interest rate.

agreements. At the end of 1995, commercial banks held Lit 4,511 billion securities sold under repurchase agreements. 1/ These instruments offer four advantages to domestic banks. First, they improve the competitiveness of Sammarinese banks over their Italian counterparts since they minimize operating costs by focusing domestic bank activity on a small number of basic financial services; in contrast, Italian banks offer a much wider range of services and maintain a far larger network of branches. Second, these transactions are recorded off the balance sheet and so the legal liquidity requirement does not apply. 2/ Third, exposure to interest rate and exchange rate risk is minimized. Fourth, since transactions are completed "offshore" in the Euro-lire market, Sammarinese banks avoid the discriminatory tax regime they would normally face with other financial transactions in Italy. The only cost they face is the commission they pay to their Italian intermediaries.

Domestic credit forms a comparatively small part of banks businesses. In 1995, domestic credit was Lit 1,102 billion representing 13 percent of total bank assets. Sammarinese banks tend to provide short-term rather than long-term credit to the domestic sector. Commercial banks are also responsible for administering subsidized credit to the industrial sector, which takes the form of interest rate subsidies. Sammarinese banks are financially strong. Nonperforming loans and arrears constitute about 3.5 percent of loans, which is much lower than the comparable figure for Italian banks. Also, capital adequacy ratios are twice the Basle norm.

3. Nonbank financial institutions

The nonbank financial sector is currently undergoing a period of rapid growth--five new institutions were approved by the Congress of State in consultation with the Office of Bank Supervision in December 1995. Thus, a total of 17 nonbank financial institutions operate in San Marino. These institutions undertake three types of activities: portfolio management, deposit taking, and leasing activities. Several of these institutions are linked to Sammarinese commercial banks. In 1995 the nonbank financial sector intermediated Lit 1,600 billion. However, this figure is inflated by including the real estate assets of companies primarily concerned with property rental.

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1/ The amounts of securities sold under repurchase agreements appear at the end of each calendar quarter in each bank's accounts. However, these accounts probably do not reflect the average importance of such transactions because the commercial banks reverse many of these repurchase agreements just before the date for which these balance sheets are compiled. This has a "window dressing" effect which gives the impression that a greater proportion of commercial bank funding comes from deposits, which are regarded as more stable than repos.

1/ At end-1996 San Marino will adopt a new accounting system according to EC directives whereby repo operations will be included in banks' balance sheets.

Nonbank financial institutions do not have to comply with the mandatory liquidity requirements of commercial banks. However, a license must be obtained from the Office of Banking Supervision before any institution may operate within San Marino.

An important weakness of the Sammarinese financial system is the lack of any domestic insurance firms. The authorities are attempting to address this deficit by drafting a new law which will provide the legal framework for insurance firms operating in the Republic.

## V. The External Sector

### 1. Balance of payments developments

The Sammarinese economy is highly open and there are free capital movements and extensive movement of labor. The external accounts thus reflect the importance of trade in goods, particularly with Italy, tourism, cross-border workers, and financial sector flows. The authorities do not compile any balance of payments presentation, but a rudimentary presentation can be constructed using available data and some estimates up to 1994 (Table 26).

Merchandise exports and imports both exceed twice GDP during 1990-94 and expanded rapidly in recent years: in 1994, exports rose by some 12 percent in dollar terms while imports rose by 9 percent. There was a substantial deficit on trade in goods during 1990-94 period, but it declined from 57 percent of GDP in 1990 to 39 percent in 1994.

The deficit on trade in goods was more than offset by a surplus on services. Tourist receipts, dominated by purchase of goods by nonresidents, were a large component of the external accounts, with a surplus of 42 percent of GDP in 1994, down from 59 percent in 1990. With regard to factor income, the most important component was interest earned on the assets of Sammarinese banks abroad. This income increased by 52 percent between 1990 and 1994--reaching an estimated 17 percent of GDP--with the rapid expansion of the banking system's as well as a rise in lira interest rates in 1990-93. 1/ There was an expanding net outflow of labor income, associated with the strong growth of employment by cross border workers.

There is a small net inflow of unrequited transfers 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*, and tariffs on imports from non-EU countries collected by the EU on behalf of San Marino.

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1/ It should be kept in mind that this estimate depends on the estimate of net foreign assets, which, as noted in the previous section, is likely to err on the low side.

San Marino's current account surplus stood at 9 percent of GDP in 1994. Current account surpluses are matched by capital outflows associated with increased net foreign assets of commercial banks.

The currency union, and until 1991 the absence of a central bank, made it difficult to define international reserves. The estimates presented in Table 26 take the net foreign assets of the Sammarinese central bank (ICS) as a measure of official reserves for 1991-94. Before ICS began operations, the overall balance is recorded as zero.

## 2. The Financial and Exchange Agreement with Italy

The latest Financial and Exchange Agreement with Italy was signed in 1991 but has still not been implemented. However, at the time of the mission, most pending items had been resolved and implementation was imminent. The agreement continues the monetary union with Italy, making the lira legal tender in San Marino and spelling out the exchange arrangements for its exchange into other currencies. In addition, 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. (Sammarinese banks may not currently maintain correspondent accounts with banks outside Italy.) The agreement would give ICS the status of a fully licensed foreign exchange bank under Italian law; ICS could also, at its discretion, grant some of the associated rights to Sammarinese commercial banks.

The delays in implementation of the agreement were primarily due to Italian concerns that San Marino could become a center for money laundering and tax evasion. Following an exchange of letters, a joint committee was set up in 1994 that determined the conditions under which the agreement will be implemented. The fear of money laundering was allayed by San Marino's signature of the Council of Europe's declaration against money laundering, and its implementation by San Marino's Office of Bank Supervision which issued the necessary regulatory instructions. In cases of suspected tax evasion by Italian citizens, the Sammarinese judicial system will conduct the appropriate enquiries and in collaboration with the Office of Bank Supervision furnish information to the Italian authorities.

Implementation of the agreement will also require the ICS and the commercial banks to make arrangements for performing international transactions competitively and to train personnel in this new field of activities.

## 3. The Agreement on Cooperation and Customs Union with the EU

On December 16, 1991, an Agreement on Cooperation and Customs Union (ACCU) was signed between the European Union, EU, and the Republic of San Marino. The ACCU establishes a customs union between the EU and the Republic of San Marino, and also regulates trade between San Marino and 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. 1/ The Sammarinese single-stage import tax (*monofase*) is the main tax affected; the ACCU does not require San Marino to abolish this tax, but states that, within six months of its entry into force, San Marino must introduce an equivalent value added tax on domestic products intended for home consumption. Although the ACCU has not yet come into force, the authorities introduced a complementary tax to apply to domestic products for home consumption as of January 1, 1996.

The ACCU has been ratified by San Marino and the 12 country members of the EU in 1991. However, it still needs to be ratified by the three countries that joined the EU since the ACCU was signed. An interim agreement was concluded 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.

This agreement is expected to eliminate some competitive disadvantages that Sammarinese firms vis-à-vis firms located in EU countries. First, EU firms importing goods from San Marino were not entitled to pre-financing of VAT. This was a financial cost, as an EU firm importing goods from San Marino had to pay VAT when the goods crossed the border, while for intra-EU trade VAT payments are only settled every 3 to 12 months. Second, when Sammarinese goods were exported to the EU, they incurred the costs of documentation and customs procedures, which the single market had eliminated for intra-EU trade.

San Marino's trade policy will next focus on reducing transportation costs for extra-EU trade. Until recently, one port (Genoa) and one airport (Bologna) were designated as customs places for San Marino's imports and exports of goods entering or leaving the EU. The harbors of Venice and Ancona and the airport of Milan have been added as EU customs places.

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1/ Under an Interim Agreement signed in 1992, trade between San Marino and the EU is exempted from import and export duties.

Table 1. San Marino: National Accounts

(In billions of lire)

| | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|
| Gross domestic product | 570 | 650 | 777 | 881 | 979 |
| Consumption | 447 | 516 | 614 | 689 | 761 |
| Of which: | | | | | |
| Private | 359 | 412 | 499 | 551 | 599 |
| Public | 88 | 104 | 115 | 139 | 162 |
| Gross investment | 137 | 153 | 181 | 216 | 240 |
| Private fixed capital formation | 112 | 127 | 154 | 172 | 209 |
| Public fixed capital formation | 17 | 18 | 20 | 28 | 18 |
| Change in stocks | 7 | 7 | 8 | 16 | 13 |
| Exports of goods and services | 1,443 | 1,642 | 2,298 | 2,400 | 2,691 |
| Imports of goods and services | -1,456 | -1,661 | -2,315 | -2,424 | -2,714 |
| Balance of goods and services | -14 | -19 | -18 | -24 | -23 |

Source: Fund staff estimates.

Table 2. San Marino: National Accounts

(In billions of lire; at 1990 prices)

| | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|
| Gross domestic product | 570.3 | 603.2 | 684.8 | 735.3 | 774.1 |
| Consumption | 446.9 | 479.0 | 541.1 | 575.4 | 602.3 |
| Of which: | | | | | |
| Private | 358.8 | 382.5 | 439.5 | 459.5 | 474.1 |
| Public | 88.1 | 96.6 | 101.7 | 115.9 | 128.2 |
| Gross investment | 137.1 | 141.7 | 159.3 | 179.9 | 190.1 |
| Private fixed capital formation | 112.4 | 117.9 | 135.4 | 143.4 | 165.7 |
| Public fixed capital formation | 17.4 | 17.1 | 17.3 | 23.2 | 14.4 |
| Change in stocks | 7.3 | 6.7 | 6.6 | 13.3 | 10.0 |
| Exports of goods and services | 1,442.7 | 1,524.3 | 2,024.3 | 2,003.3 | 2,128.6 |
| Imports of goods and services | -1,456.4 | -1,541.8 | -2,039.9 | -2,023.3 | -2,146.8 |
| Balance of goods and services | -13.7 | -17.5 | -15.6 | -19.9 | -18.3 |
| Memorandum item: | | | | | |
| Sammarinese CPI | 100.0 | 107.7 | 113.5 | 119.8 | 126.4 |

Source: Fund staff estimates.

Table 3. San Marino: National Accounts

(Changes in real terms over the previous year)

| | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|
| Gross domestic product | 5.9 | 5.8 | 13.5 | 7.4 | 5.3 |
| Consumption | 5.0 | 7.2 | 13.0 | 6.3 | 4.7 |
| Of which: | | | | | |
| Private | 4.9 | 6.6 | 14.9 | 4.6 | 3.2 |
| Public | 5.4 | 9.6 | 5.3 | 14.0 | 10.6 |
| Gross investment | 7.0 | 3.3 | 12.4 | 12.9 | 5.7 |
| Private fixed capital formation | 4.2 | 4.9 | 14.8 | 5.9 | 15.5 |
| Public fixed capital formation | 31.5 | -1.8 | 1.1 | 34.4 | -38.0 |
| Exports of goods and services | -5.4 | 5.7 | 32.8 | -1.0 | 6.3 |
| Imports of goods and services | -5.4 | 5.9 | 32.3 | -0.8 | 6.1 |
| Memorandum item: | | | | | |
| Sammarinese CPI | 6.7 | 7.7 | 5.4 | 5.6 | 5.5 |

Source: Fund staff estimates.

Table 4. San Marino: National Accounts

(Contributions to growth)

| | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|
| Gross domestic product | 5.9 | 5.8 | 13.5 | 7.4 | 5.3 |
| Consumption | 4.0 | 5.6 | 10.3 | 5.0 | 3.7 |
| Of which: | | | | | |
| Private | 3.1 | 4.1 | 9.5 | 2.9 | 2.0 |
| Public | 0.8 | 1.5 | 0.8 | 2.1 | 1.7 |
| Gross investment | 1.7 | 0.8 | 2.9 | 3.0 | 1.4 |
| Private fixed capital formation | 0.8 | 1.0 | 2.9 | 1.2 | 3.0 |
| Public fixed capital formation | 0.8 | -0.1 | -- | 0.9 | -1.2 |
| Change in stocks | -- | -0.1 | -- | 1.0 | -0.4 |
| External sector | 0.2 | -0.7 | 0.3 | -0.6 | 0.2 |

Source: Fund staff estimates.

Table 5. San Marino: National Accounts

(As a proportion of GDP)

| | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|
| Gross domestic product | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Consumption | 78.4 | 79.4 | 79.0 | 78.2 | 77.8 |
| Of which: | | | | | |
| Private | 62.9 | 63.4 | 64.2 | 62.5 | 61.2 |
| Public | 15.4 | 16.0 | 14.8 | 15.8 | 16.6 |
| Gross investment | 24.0 | 23.5 | 23.3 | 24.5 | 24.6 |
| Private fixed capital formation | 19.7 | 19.5 | 19.8 | 19.5 | 21.4 |
| Public fixed capital formation | 3.1 | 2.8 | 2.5 | 3.2 | 1.9 |
| Change in stocks | 1.3 | 1.1 | 1.0 | 1.8 | 1.3 |
| Exports of goods and services | 253.0 | 252.7 | 295.6 | 272.4 | 275.0 |
| Imports of goods and services | -255.4 | -255.6 | -297.9 | -275.2 | -277.3 |
| Balance of goods and services | -2.4 | -2.9 | -2.3 | -2.7 | -2.4 |

Source: Fund staff estimates.

Table 6. San Marino: Labor Market 1/

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Unemployment | 493 | 503 | 616 | 580 | 495 |
| Labor force | 13,332 | 14,113 | 14,874 | 15,519 | 16,073 |
| Cross border workers | 1,434 | 1,931 | 2,268 | 2,665 | 2,986 |
| Resident labor force | 11,898 | 12,182 | 12,606 | 12,854 | 13,087 |
| Unemployment rate | 4.14 | 4.13 | 4.89 | 4.51 | 3.78 |
| Total employment | 12,839 | 13,610 | 14,258 | 14,939 | 15,578 |
| Percentage growth | 5.8 | 6.0 | 4.8 | 4.8 | 4.3 |
| Total resident employment | 11,405 | 11,679 | 11,990 | 12,274 | 12,592 |
| Percentage growth | 3.6 | 2.4 | 2.7 | 2.4 | 2.6 |
| Contractual wage (percent change) | 8.8 | 7.3 | 6.2 | 5.0 | ... |
| CPI (Italy) | 6.4 | 5.4 | 4.4 | 3.9 | 5.4 |
| CPI (San Marino) | 7.7 | 5.4 | 5.6 | 5.5 | 5.3 |

Source: Data provided by the Sammarinese authorities.

1/ Date refers to December 31 of each year.

Table 7. San Marino: Change in Employment by Sector 1/

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Employment by sector | | | | | |
| Agriculture | -2.3 | 0.1 | -0.7 | -12.9 | -2.7 |
| Manufacturing | 3.4 | 2.1 | 3.2 | 7.2 | 3.5 |
| Construction | 9.4 | 4.5 | 8.0 | 8.0 | 11.5 |
| Commerce | 7.2 | 7.6 | 4.0 | 1.3 | 4.3 |
| Transportation | 23.5 | 23.4 | -2.5 | 1.4 | 10.3 |
| Banking and insurance | 6.9 | 15.3 | 15.0 | 2.6 | 4.3 |
| Services | 16.2 | 15.1 | 11.0 | 6.7 | 8.3 |
| Government | 5.1 | 7.4 | 16.1 | 5.7 | 2.5 |
| Public corporations | 1.6 | 4.7 | -20.6 | 0.1 | -2.0 |
| Total employment | | | | | |
| Private sector | 6.5 | 5.8 | 4.9 | 4.9 | 5.3 |
| Public sector | 4.0 | 6.5 | 4.3 | 4.3 | 1.4 |
| Total | 5.8 | 6.0 | 4.8 | 4.8 | 4.3 |

Source: Centro Elaborzione Dati e Statistica, *Bolletino di statistica*.

1/ Date refers to December 31 of each year.

Table 8. San Marino: Total Employment 1/

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Employment by sector | | | | | |
| Agriculture | 296 | 296 | 294 | 256 | 249 |
| Manufacturing | 4,495 | 4,591 | 4,739 | 5,078 | 5,256 |
| Construction | 1,058 | 1,106 | 1,195 | 1,291 | 1,440 |
| Commerce | 2,232 | 2,402 | 2,499 | 2,531 | 2,641 |
| Transportation | 231 | 285 | 278 | 282 | 311 |
| Banking and insurance | 294 | 339 | 390 | 400 | 417 |
| Services | 970 | 1,116 | 1,239 | 1,322 | 1,432 |
| Government | 2,196 | 2,358 | 2,737 | 2,892 | 2,963 |
| Public corporations | 1,067 | 1,117 | 887 | 887 | 869 |
| Total employment | | | | | |
| Private sector | 9,576 | 10,135 | 10,634 | 11,160 | 11,746 |
| Public sector | 3,263 | 3,475 | 3,624 | 3,779 | 3,832 |
| Total | 12,839 | 13,610 | 14,258 | 14,939 | 15,578 |

Source: Centro Elaborzione Dati e Statistica, *Bolletino di statistica.*

1/ Date refers to December 31 of each year.

Table 9. San Marino: Employment by Sector as a Proportion of Total Employment

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Employment by sector | | | | | |
| Agriculture | 2.3 | 2.2 | 2.1 | 1.7 | 1.6 |
| Manufacturing | 35.0 | 33.7 | 33.2 | 34.0 | 33.7 |
| Construction | 8.2 | 8.1 | 8.4 | 8.6 | 9.2 |
| Commerce | 17.4 | 17.6 | 17.5 | 16.9 | 17.0 |
| Transportation | 1.8 | 2.1 | 1.9 | 1.9 | 2.0 |
| Banking and insurance | 2.3 | 2.5 | 2.7 | 2.7 | 2.7 |
| Services | 7.6 | 8.2 | 8.7 | 8.8 | 9.2 |
| Government | 17.1 | 17.3 | 19.2 | 19.4 | 19.0 |
| Public corporations | 8.3 | 8.2 | 6.2 | 5.9 | 5.6 |
| Total employment | | | | | |
| Private sector | 74.6 | 74.5 | 74.6 | 74.7 | 75.4 |
| Public sector | 25.4 | 25.5 | 25.4 | 25.3 | 24.6 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Source: Centro Elaborzione Dati e Statistica, *Bolletino di statistica*.

Table 10. San Marino: Cash Balance of the Central Administration
Adjusted for Contributions Collected on Behalf of Social Security Institute

(In billions of lire)

| | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 est. |
|---|---|---|---|---|---|---|---|---|
| Total revenue | 206.7 | 190.7 | 205.7 | 262.8 | 323.8 | 310.8 | 331.5 | 374.9 |
| Direct taxes 1/ | 52.3 | 42.6 | 54.3 | 65.9 | 79.5 | 92.2 | 111.0 | 108.4 |
| Of which: Without tax on interest | 10.8 | 11.3 | 12.4 | 13.6 | 15.1 | 16.0 | 14.5 | 15.0 |
| Tax dependent income | 9.3 | 11.5 | 13.8 | 15.9 | 20.0 | 7.9 | 10.7 | 14.5 |
| Tax nondependent income | 4.2 | 4.3 | 5.7 | 6.8 | 13.0 | 15.9 | 11.1 | 15.9 |
| Tax on corporate income | 14.2 | 19.5 | 26.8 | 30.2 | 36.9 | 53.1 | 71.0 | 57.1 |
| Of which: banks | ... | ... | ... | 15.4 | 26.7 | 40.4 | 33.6 | ... |
| Indirect taxes | 104.5 | 92.1 | 90.4 | 126.6 | 177.7 | 125.9 | 135.2 | 168.4 |
| Monofase | 87.6 | 74.5 | 72.1 | 81.9 | 121.7 | 69.8 | 74.1 | 99.6 |
| Special gas tax | ... | ... | ... | 21.7 | 22.8 | 23.8 | 25.5 | 26.9 |
| State monopolies | 7.8 | 8.1 | 8.0 | 9.6 | 14.2 | 13.4 | 12.8 | 19.5 |
| Other indirect taxes | 9.1 | 9.5 | 10.3 | 13.5 | 19.0 | 18.8 | 22.8 | 22.4 |
| Canone Doganale and tariffs | 9.0 | 9.0 | 9.0 | 9.0 | 9.0 | 9.0 | 18.1 | 15.0 |
| Other | 12.7 | 16.5 | 17.4 | 24.1 | 13.7 | 33.6 | 10.5 | 16.2 |
| Social security contributions collected on behalf of I.S.S. | 28.2 | 30.5 | 34.5 | 37.3 | 43.9 | 50.1 | 56.8 | 66.8 |
| Current expenditure | 78.8 | 87.2 | 100.1 | 115.5 | 131.4 | 149.8 | 161.9 | 176.7 |
| Wages and salaries | 48.8 | 54.1 | 63.6 | 72.2 | 83.2 | 93.7 | 108.6 | 116.3 |
| Interest payments | 3.0 | 2.3 | 2.3 | 2.3 | 2.3 | 2.5 | 2.8 | 2.8 |
| Goods and services | 21.6 | 24.2 | 24.4 | 31.8 | 32.2 | 45.1 | 38.6 | 45.7 |
| Other 2/ | 5.4 | 6.7 | 9.7 | 9.2 | 13.6 | 8.5 | 12.0 | 12.0 |
| Net transfers | -66.6 | -72.9 | -94.5 | -114.3 | -136.1 | -134.0 | -154.9 | -175.4 |
| Social security 1/ | -61.9 | -55.9 | -101.5 | -82.9 | -101.1 | -114.6 | -136.8 | -150.7 |
| Including benefits financed with contributions transferred to I.S.S. | -28.2 | -30.5 | -34.5 | -37.3 | -43.9 | -50.1 | -56.8 | -66.8 |
| Rest of nonfinancial public sector | -0.9 | -11.3 | -13.0 | -8.0 | -20.5 | -12.6 | -10.1 | -16.7 |
| AASFN | 12.5 | 7.7 | 3.9 | 8.5 | 4.2 | 5.7 | 8.3 | 6.3 |
| AASS | 7.7 | 3.0 | 9.0 | 7.4 | 7.5 | 12.2 | 12.4 | 9.4 |
| AASP | -18.3 | -18.9 | -19.8 | -17.5 | -26.5 | -22.0 | -22.1 | -23.1 |
| CONS | -2.7 | -3.0 | -3.2 | -3.6 | -4.3 | -5.8 | -5.8 | -6.3 |
| University | -- | -- | -2.6 | -3.0 | -1.5 | -3.0 | -3.0 | -3.2 |
| National Dairy Corporation | -0.1 | -0.1 | -0.2 | 0.1 | 0.1 | 0.3 | 0.1 | 0.1 |
| Other | -3.9 | -5.6 | 20.0 | -23.4 | -14.5 | -6.9 | -8.0 | -8.0 |
| Current account balance | 61.3 | 30.6 | 11.1 | 33.0 | 56.3 | 27.0 | 14.7 | 22.7 |
| Capital account transfers | 14.3 | 12.4 | 17.4 | 18.4 | 19.6 | 24.8 | 18.2 | 25.2 |
| Overall balance | 47.0 | 18.2 | -6.3 | 14.6 | 36.6 | 2.2 | -3.5 | -2.5 |
| Financing | -47.0 | -18.2 | 6.3 | -14.6 | -36.6 | -2.2 | 3.5 | 2.5 |
| Reduction in bank deposits | -46.7 | -17.8 | 6.6 | -14.2 | -36.2 | -6.7 | 3.4 | -- |
| Net debt financing | -0.3 | -0.3 | -0.4 | -0.4 | -0.4 | 4.5 | 0.1 | 2.5 |
| Memorandum item: | | | | | | | | |
| Total expenditures | 159.7 | 172.5 | 211.9 | 248.2 | 287.1 | 308.6 | 335.0 | 377.3 |

Sources: Data provided by the Sammarinese authorities; and Fund staff estimates.

1/ Years 1988, 1989, and 1990 corrected for 50 percent of direct tax revenues earmarked for social security.
2/ Includes interest subsidies to private enterprises.

Table 11. San Marino: Cash Balance of the Central Administration
Adjusted for Contributions Collected on Behalf of Social Security Institute

(In percent of GDP)

| | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 est. |
|---|---|---|---|---|---|---|---|---|
| Total revenue | 44.3 | 37.8 | 36.1 | 40.5 | 41.7 | 35.3 | 33.9 | 34.8 |
| Direct taxes 1/ | 11.2 | 8.4 | 9.5 | 10.1 | 10.2 | 10.5 | 11.3 | 10.1 |
| Of which: | | | | | | | | |
| With. tax on interest | 2.3 | 2.2 | 2.2 | 2.1 | 1.9 | 1.8 | 1.5 | 1.4 |
| Tax dependent income | 2.0 | 2.3 | 2.4 | 2.4 | 2.6 | 0.9 | 1.1 | 1.3 |
| Tax nondependent income | 0.9 | 0.9 | 1.0 | 1.1 | 1.7 | 1.8 | 1.1 | 1.5 |
| Tax on corporate income | 3.1 | 3.9 | 4.7 | 4.6 | 4.8 | 6.0 | 7.3 | 5.3 |
| Of which: banks | ... | ... | ... | 2.4 | 3.4 | 4.6 | 3.4 | ... |
| Indirect taxes | 22.4 | 18.2 | 15.9 | 19.5 | 22.9 | 14.3 | 13.8 | 15.6 |
| Monofase | 18.8 | 14.8 | 12.6 | 12.6 | 15.7 | 7.9 | 7.6 | 9.3 |
| Special gas tax | ... | ... | ... | 3.3 | 2.9 | 2.7 | 2.6 | 2.5 |
| State monopolies | 1.7 | 1.6 | 1.4 | 1.5 | 1.8 | 1.5 | 1.3 | 1.8 |
| Other indirect taxes | 1.9 | 1.9 | 1.8 | 2.1 | 2.4 | 2.1 | 2.3 | 2.1 |
| Canone Doganale and tariffs | 1.9 | 1.8 | 1.6 | 1.4 | 1.2 | 1.0 | 1.8 | 1.4 |
| Other | 2.7 | 3.3 | 3.1 | 3.7 | 1.8 | 3.8 | 1.1 | 1.5 |
| Social security contributions collected on behalf of I.S.S. | 6.0 | 6.0 | 6.0 | 5.7 | 5.7 | 5.7 | 5.8 | 6.2 |
| Current expenditure | 16.9 | 17.3 | 17.5 | 17.8 | 16.9 | 17.0 | 16.5 | 16.4 |
| Wages and salaries | 10.4 | 10.7 | 11.1 | 11.1 | 10.7 | 10.6 | 11.1 | 10.8 |
| Interest payments | 0.6 | 0.5 | 0.4 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 |
| Goods and services | 4.6 | 4.8 | 4.3 | 4.9 | 4.1 | 5.1 | 3.9 | 4.2 |
| Other 2/ | 1.1 | 1.3 | 1.7 | 1.4 | 1.8 | 1.0 | 1.2 | 1.1 |
| Net transfers | -14.3 | -14.4 | -16.6 | -17.6 | -17.5 | -15.2 | -15.8 | -16.3 |
| Social security 1/ | -13.2 | -11.1 | -17.8 | -12.8 | -13.0 | -13.0 | -14.0 | -14.0 |
| Including benefits financed with contributions transferred to I.S.S. | -6.0 | -6.0 | -6.0 | -5.7 | -5.7 | -5.7 | -5.8 | -6.2 |
| Rest of nonfinancial public sector | -0.2 | -2.2 | -2.3 | -1.2 | -2.6 | -1.4 | -1.0 | -1.6 |
| AASFN | 2.7 | 1.5 | 0.7 | 1.3 | 0.5 | 0.6 | 0.9 | 0.6 |
| AASS | 1.6 | 0.6 | 1.6 | 1.1 | 1.0 | 1.4 | 1.3 | 0.9 |
| AASP | -3.9 | -3.8 | -3.5 | -2.7 | -3.4 | -2.5 | -2.3 | -2.1 |
| CONS | -0.6 | -0.6 | -0.6 | -0.6 | -0.6 | -0.7 | -0.6 | -0.6 |
| University | -- | -- | -0.5 | -0.5 | -0.2 | -0.3 | -0.3 | -0.3 |
| National Dairy Corporation | -- | -- | -- | -- | -- | -- | -- | -- |
| Other | -0.8 | -1.1 | 3.5 | -3.6 | -1.9 | -0.8 | -0.8 | -0.7 |
| Current account balance | 13.1 | 6.1 | 1.9 | 5.1 | 7.2 | 3.1 | 1.5 | 2.1 |
| Capital account transfers | 3.1 | 2.5 | 3.0 | 2.8 | 2.5 | 2.8 | 1.9 | 2.3 |
| Overall balance | 10.1 | 3.6 | -1.1 | 2.3 | 4.7 | 0.2 | -0.4 | -0.2 |
| Financing | -10.1 | -3.6 | 1.1 | -2.3 | -4.7 | -0.2 | 0.4 | 0.2 |
| Reduction in bank deposits | -10.0 | -3.5 | 1.2 | -2.2 | -4.7 | -0.8 | 0.3 | -- |
| Net debt financing | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | 0.5 | -- | 0.2 |
| Memorandum item: | | | | | | | | |
| Total expenditures | 34.2 | 34.2 | 37.2 | 38.2 | 36.9 | 35.0 | 34.2 | 35.1 |

Sources: Data provided by the Sammarinese authorities; and Fund staff estimates.

1/ Years 1988, 1989, and 1990 corrected for 50 percent of direct tax revenues earmarked for social security.
2/ Includes interest subsidies to private enterprises.

Table 12. San Marino: Accrual Balance of the Central Administration

(In billions of lire)

| | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 Official mid-year estimate | 1996 budget |
|---|---|---|---|---|---|---|---|---|---|
| Revenues | 253.8 | 266.9 | 312.1 | 347.0 | 389.2 | 430.1 | 489.7 | 547.2 | 600.3 |
| (budget estimate) | ... | ... | 263.7 | 276.1 | 348.9 | 394.3 | 425.5 | 492.5 | 600.3 |
| Tax | 196.4 | 206.8 | 245.5 | 273.1 | 306.2 | 348.6 | 407.3 | 457.6 | 510.0 |
| (budget estimate) | ... | ... | 197.9 | 208.4 | 278.3 | 316.3 | 349.7 | 410.1 | 510.0 |
| Direct 1/ | 38.7 | 46.6 | 58.7 | 67.5 | 84.8 | 91.7 | 115.5 | 113.6 | 122.8 |
| (budget estimate) | ... | ... | 22.5 | 26.5 | 70.0 | 80.0 | 91.4 | 105.5 | 122.8 |
| Indirect | 9.0 | 9.5 | 10.4 | 13.5 | 19.0 | 18.8 | 22.8 | 22.4 | 23.0 |
| (budget estimate) | ... | ... | 10.5 | 10.3 | 11.8 | 15.8 | 19.1 | 22.6 | 23.0 |
| Import tax | 148.7 | 150.7 | 176.4 | 192.2 | 202.3 | 238.1 | 269.0 | 321.5 | 364.2 |
| (budget estimate) | ... | ... | 164.9 | 171.6 | 196.5 | 220.5 | 239.2 | 282.0 | 364.2 |
| Nontax | 56.3 | 59.2 | 65.7 | 69.1 | 78.5 | 79.1 | 78.5 | 86.8 | 88.2 |
| (budget estimate) | ... | ... | 63.7 | 65.6 | 68.7 | 74.5 | 73.0 | 79.6 | 88.2 |
| Sale of assets | 1.2 | 0.9 | 1.0 | 4.8 | 4.5 | 2.3 | 3.9 | 2.8 | 2.1 |
| (budget estimate) | ... | ... | 2.1 | 2.1 | 1.8 | 3.5 | 2.8 | 2.8 | 2.1 |
| Expenditures | 249.6 | 268.0 | 306.4 | 349.2 | 393.0 | 444.0 | 496.1 | 575.2 | 628.2 |
| (budget estimate) | ... | ... | 285.3 | 301.3 | 377.4 | 419.5 | 450.6 | 520.4 | 628.2 |
| Current | 235.3 | 233.8 | 270.0 | 304.6 | 344.6 | 402.1 | 456.6 | 531.7 | 580.3 |
| (budget estimate) | ... | ... | 248.2 | 258.7 | 332.6 | 377.9 | 411.7 | 478.1 | 580.3 |
| Of which: wages and salaries | 40.6 | 54.6 | 66.1 | 72.5 | 84.6 | 97.8 | 109.2 | 118.0 | 125.6 |
| (budget estimate) | ... | ... | 49.4 | 71.9 | 80.6 | 94.3 | 110.5 | 114.5 | 125.6 |
| transfers to I.S.S. 1/ | 19.3 | 31.5 | 37.0 | 54.4 | 69.7 | 85.9 | 92.9 | 95.9 | 96.0 |
| (budget estimate) | ... | ... | ... | ... | 58.9 | 72.2 | 84.5 | 94.0 | 96.0 |
| transfers to A.A.S.P. | ... | 18.1 | 18.8 | 20.1 | 23.2 | 22.4 | 21.4 | 22.7 | 22.9 |
| (budget estimate) | ... | ... | ... | ... | 21.9 | 23.5 | 19.4 | 22.0 | 22.9 |
| transfers to A.A.S.F.N. | ... | 2.7 | 5.3 | 4.5 | 5.8 | 7.4 | 11.0 | 15.1 | 15.7 |
| (budget estimate) | ... | ... | ... | ... | 15.5 | 14.4 | 14.1 | 15.0 | 15.7 |
| transfers to A.A.S.S. | ... | 3.5 | 3.7 | 3.6 | 0.8 | 3.6 | 2.6 | 4.0 | 4.0 |
| (budget estimate) | ... | ... | ... | ... | 3.9 | 3.6 | 3.6 | 4.0 | 4.0 |
| Capital | 14.3 | 34.1 | 36.4 | 44.6 | 48.4 | 41.9 | 39.5 | 43.4 | 47.9 |
| (budget estimate) | ... | ... | 37.2 | 42.7 | 44.8 | 41.6 | 39.0 | 42.3 | 47.9 |
| Of which: | | | | | | | | | |
| transfers to A.A.S.P. | ... | 10.8 | 12.4 | 13.6 | 13.8 | 14.4 | 14.5 | 14.0 | 15.5 |
| (budget estimate) | ... | ... | ... | 11.5 | 14.0 | 13.5 | 15.3 | 13.0 | 15.5 |
| transfers to A.A.S.S. | ... | 5.9 | 7.9 | 9.7 | 9.7 | 5.5 | 5.4 | 7.2 | 4.0 |
| (budget estimate) | ... | ... | ... | 9.5 | 9.7 | 4.7 | 5.2 | 7.2 | 4.0 |
| Accrual balance excluding net debt financing | 4.3 | -1.1 | 5.7 | -2.2 | -3.8 | -13.9 | -6.3 | -27.9 | -27.9 |
| (budget estimate) | -14.2 | -16.4 | -21.6 | -25.2 | -28.5 | -25.2 | -25.2 | -27.9 | -27.9 |
| Net debt financing | -0.3 | -0.3 | -0.4 | -0.4 | -0.4 | 4.5 | 0.1 | 27.9 | 27.9 |
| Accrual balance including net debt financing | 4.0 | -1.4 | 5.3 | -2.6 | -4.2 | -9.4 | -6.2 | -- | -- |
| (budget estimate) | -14.5 | -16.8 | -21.9 | -25.6 | -28.9 | -20.7 | -25.0 | -- | -- |

Source: Department of Budget and Programming, Relazione Previsionale e Programmatica; and Fund staff estimates.

1/ Years 1988, 1989, and 1990 corrected for 50 percent of direct tax revenues earmarked for social security.

Table 13. San Marino: Accrual Balance of the Central Administration

(In percent of GDP)

| | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 Official mid-year estimate | 1996 budget |
|---|---|---|---|---|---|---|---|---|---|
| Revenues | 54.4 | 52.9 | 54.7 | 53.4 | 50.1 | 48.8 | 50.0 | 50.8 | 50.7 |
| (budget estimate) | ... | ... | 46.2 | 42.5 | 44.9 | 44.8 | 43.5 | 45.8 | 50.7 |
| Tax | 42.1 | 41.0 | 43.0 | 42.0 | 39.4 | 39.6 | 41.6 | 42.5 | 43.1 |
| (budget estimate) | ... | ... | 34.7 | 32.1 | 35.8 | 35.9 | 35.7 | 38.1 | 43.1 |
| Direct 1/ | 8.3 | 9.2 | 10.3 | 10.4 | 10.9 | 10.4 | 11.8 | 10.6 | 10.4 |
| (budget estimate) | ... | ... | 3.9 | 4.1 | 9.0 | 9.1 | 9.3 | 9.8 | 10.4 |
| Indirect | 1.9 | 1.9 | 1.8 | 2.1 | 2.4 | 2.1 | 2.3 | 2.1 | 1.9 |
| (budget estimate) | ... | ... | 1.8 | 1.6 | 1.5 | 1.8 | 1.9 | 2.1 | 1.9 |
| Import tax | 31.9 | 29.8 | 30.9 | 29.6 | 26.0 | 27.0 | 27.5 | 29.9 | 30.8 |
| (budget estimate) | ... | ... | 28.9 | 26.4 | 25.3 | 25.0 | 24.4 | 26.2 | 30.8 |
| Nontax | 12.1 | 11.7 | 11.5 | 10.6 | 10.1 | 9.0 | 8.0 | 8.1 | 7.5 |
| (budget estimate) | ... | ... | 11.2 | 10.1 | 8.8 | 8.5 | 7.5 | 7.4 | 7.5 |
| Sale of assets | 0.3 | 0.2 | 0.2 | 0.7 | 0.6 | 0.3 | 0.4 | 0.3 | 0.2 |
| (budget estimate) | ... | ... | 0.4 | 0.3 | 0.2 | 0.4 | 0.3 | 0.3 | 0.2 |
| Expenditures | 53.5 | 53.1 | 53.7 | 53.7 | 50.6 | 50.4 | 50.7 | 53.4 | 53.1 |
| (budget estimate) | ... | ... | 50.0 | 46.4 | 48.5 | 47.6 | 46.1 | 48.3 | 53.1 |
| Current | 50.4 | 46.3 | 47.3 | 46.9 | 44.3 | 45.6 | 46.7 | 49.4 | 49.0 |
| (budget estimate) | ... | ... | 43.5 | 39.8 | 42.8 | 42.9 | 42.1 | 44.4 | 49.0 |
| Of which: wages and salaries | 8.7 | 10.8 | 11.6 | 11.2 | 10.9 | 11.1 | 11.2 | 11.0 | 10.6 |
| (budget estimate) | ... | ... | 8.7 | 11.1 | 10.4 | 10.7 | 11.3 | 10.6 | 10.6 |
| transfers to I.S.S. 1/ | 4.1 | 6.2 | 6.5 | 8.4 | 9.0 | 9.8 | 9.5 | 8.9 | 8.1 |
| (budget estimate) | ... | ... | -- | -- | 7.6 | 8.2 | 8.6 | 8.7 | 8.1 |
| transfers to A.A.S.P. | -- | 3.6 | 3.3 | 3.1 | 3.0 | 2.5 | 2.2 | 2.1 | 1.9 |
| (budget estimate) | ... | ... | -- | -- | 2.8 | 2.7 | 2.0 | 2.0 | 1.9 |
| transfers to A.A.S.F.N | -- | 0.5 | 0.9 | 0.7 | 0.7 | 0.8 | 1.1 | 1.4 | 1.3 |
| (budget estimate) | ... | ... | -- | -- | 2.0 | 1.6 | 1.4 | 1.4 | 1.3 |
| transfers to A.A.S.S. | -- | 0.7 | 0.6 | 0.6 | 0.1 | 0.4 | 0.3 | 0.4 | 0.3 |
| (budget estimate) | ... | ... | -- | -- | 0.5 | 0.4 | 0.4 | 0.4 | 0.3 |
| Capital | 3.1 | 6.8 | 6.4 | 6.9 | 6.2 | 4.8 | 4.0 | 4.0 | 4.0 |
| (budget estimate) | ... | ... | 6.5 | 6.6 | 5.8 | 4.7 | 4.0 | 3.9 | 4.0 |
| Of which: | | | | | | | | | |
| transfers to A.A.S.P. | ... | 2.1 | 2.2 | 2.1 | 1.8 | 1.6 | 1.5 | 1.3 | 1.3 |
| (budget estimate) | ... | ... | -- | 1.8 | 1.8 | 1.5 | 1.6 | 1.2 | 1.3 |
| transfers to A.A.S.S. | -- | 1.2 | 1.4 | 1.5 | 1.2 | 0.6 | 0.5 | 0.7 | 0.3 |
| (budget estimate) | ... | ... | -- | 1.5 | 1.2 | 0.5 | 0.5 | 0.7 | 0.3 |
| Accrual balance excluding net debt financing | 0.9 | -0.2 | 1.0 | -0.3 | -0.5 | -1.6 | -0.6 | -2.6 | -2.4 |
| (budget estimate) | ... | ... | -3.8 | -3.9 | -3.7 | -2.9 | -2.6 | -2.6 | -2.4 |
| Net debt financing | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | 0.5 | -- | 2.6 | 2.4 |
| Accrual balance including net debt financing | 0.8 | -0.3 | 0.9 | -0.4 | -0.5 | -1.1 | -0.6 | -- | -- |
| (budget estimate) | -3.1 | -3.3 | -3.8 | -3.9 | -3.7 | -2.3 | -2.6 | -- | -- |

Sources: Department of Budget and Programming, Relazione Previsionale e Programmatica; and Fund staff estimates.

1/ Years 1988, 1989, and 1990 corrected for 50 percent of direct tax revenues earmarked for social security.

Table 14. San Marino: Definitions of Fiscal Balance of the Central Administration

(In billions of lire)

| | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 Official mid-year | 1996 budget |
|---|---|---|---|---|---|---|---|---|---|
| Avanzo d'esercizio Including net debt financing | 21.0 | 6.2 | 7.3 | 8.7 | -1.9 | -2.7 | 0.3 | -- | -- |
| (Percent of GDP) | 4.5 | 1.2 | 1.3 | 1.3 | -0.2 | -0.3 | -- | -- | -- |
| (-) Net debt financing 1/ | -0.3 | -0.3 | -0.4 | -0.4 | -0.4 | 4.5 | 0.1 | 27.9 | 27.9 |
| (Percent of GDP) | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | 0.5 | -- | 2.6 | 2.4 |
| (=) Avanzo d'esercizio Excluding net debt financing | 21.3 | 6.5 | 7.7 | 9.1 | -1.5 | -7.3 | 0.2 | -27.9 | -27.9 |
| (Percent of GDP) | 4.6 | 1.3 | 1.3 | 1.4 | -0.2 | -0.8 | -- | -2.6 | -2.4 |
| (-) Reass. old asset float | 17.0 | 7.6 | 2.0 | 11.3 | 2.3 | 6.7 | 6.5 | ... | ... |
| (Percent of GDP) | 3.6 | 1.5 | 0.3 | 1.7 | 0.3 | 0.8 | 0.7 | ... | ... |
| (=) Accrual balance excluding net debt financing | 4.3 | -1.1 | 5.7 | -2.2 | -3.8 | -13.9 | -6.3 | -27.9 | -27.9 |
| (Percent of GDP) | 0.9 | -0.2 | 1.0 | -0.3 | -0.5 | -1.6 | -0.6 | -2.6 | -2.4 |
| (-) New net asset float | -27.5 | -24.0 | 3.4 | -9.9 | -28.2 | -27.1 | -16.8 | ... | ... |
| (Percent of GDP) | -5.9 | -4.8 | 0.6 | -1.5 | -3.6 | -3.1 | -1.7 | ... | ... |
| (+) Old net asset float cashed | 15.3 | -4.7 | -8.6 | 6.9 | 12.2 | -11.0 | -13.9 | ... | ... |
| (Percent of GDP) | 3.3 | -0.9 | -1.5 | 1.1 | 1.6 | -1.3 | -1.4 | ... | ... |
| (=) Cash balance 2/ | 47.0 | 18.2 | -6.3 | 14.6 | 36.6 | 2.2 | -3.5 | -27.9 | -27.9 |
| (Percent of GDP) | 10.1 | 3.6 | -1.1 | 2.3 | 4.7 | 0.2 | -0.4 | -2.6 | -2.4 |

Sources: Department of Budget and Programming, Relazione Previsionale e Programmatica; data provided by the Sammarinese authorities; and Fund staff estimates.

1/ A negative sign indicates net amortization.
2/ Cash balance in 1995 is different from the one in Tables 10 and 11 since this table is based on official projections. Although no official estimates of the cash balance are available for 1995 and 1996, official publications show that projected deficits on an accrual basis will be financed with debt financing, implicitly assuming a cash deficit equal to the accrual one.

Table 15. San Marino: Net Asset Position of the Central Administration

(In billions of lire)

| | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 Official mid-year estimate | 1996 budget |
|---|---|---|---|---|---|---|---|---|---|
| Assets | | | | | | | | | |
| Bank deposits | 126.1 | 143.9 | 137.3 | 151.5 | 187.7 | 194.5 | 191.1 | 191.1 | 191.1 |
| (Percent of GDP) | 27.0 | 28.5 | 24.1 | 23.3 | 24.2 | 22.1 | 19.5 | 17.8 | 16.1 |
| Asset float | 113.7 | 148.4 | 241.0 | 296.5 | 353.6 | 445.7 | 606.9 | 606.9 | 606.9 |
| (Percent of GDP) | 24.4 | 29.4 | 42.3 | 45.6 | 45.5 | 50.6 | 62.0 | 56.4 | 51.3 |
| Liabilities | | | | | | | | | |
| Public debt | 27.6 | 27.3 | 26.9 | 26.6 | 26.2 | 30.7 | 30.8 | 58.7 | 86.6 |
| (Percent of GDP) | 5.9 | 5.4 | 4.7 | 4.1 | 3.4 | 3.5 | 3.1 | 5.5 | 7.3 |
| Liability float | 189.6 | 236.0 | 314.6 | 375.6 | 470.9 | 572.3 | 729.9 | 729.9 | 729.9 |
| (Percent of GDP) | 40.6 | 46.8 | 55.2 | 57.8 | 60.6 | 65.0 | 74.6 | 67.8 | 61.6 |
| Net assets (=1+2-3-4) | 22.5 | 29.0 | 36.7 | 45.8 | 44.3 | 37.1 | 37.3 | 9.3 | -18.5 |
| (Percent of GDP) | 4.8 | 5.8 | 6.4 | 7.1 | 5.7 | 4.2 | 3.8 | 0.9 | -1.6 |
| Avanzo d'amministrazione (=1+2-4) | 50.1 | 56.3 | 63.7 | 72.4 | 70.5 | 67.8 | 68.1 | 68.1 | 68.1 |
| (Percent of GDP) | 10.7 | 11.2 | 11.2 | 11.1 | 9.1 | 7.7 | 7.0 | 6.3 | 5.7 |
| Memorandum items: | | | | | | | | | |
| Avanzo d'esercizio Excluding net debt financing 1/ | 21.3 | 6.5 | 7.7 | 9.1 | -1.5 | -7.2 | 0.2 | -27.9 | -27.9 |
| (Percent of GDP) | 4.6 | 1.3 | 1.3 | 1.4 | -0.2 | -0.8 | -- | -2.6 | -2.4 |
| Avanzo d'esercizio Including net debt financing 2/ | 21.0 | 6.2 | 7.3 | 8.7 | -1.9 | -2.7 | 0.3 | -- | -- |
| (Percent of GDP) | 4.5 | 1.2 | 1.3 | 1.3 | -0.2 | -0.3 | -- | -- | -- |

Sources: Department of Budget and Programming, Relazione Previsionale e Programmatica; and Fund staff estimates.

1/ The "Avanzo d'esercizio" excluding net debt financing coincides with the change in the net asset position.
2/ The "Avanzo d'esercizio" including net debt financing coincides with the change in the "Avanzo d'Amministrazione."

Table 16. San Marino: Net Asset Float

(In billions of lire)

| | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 Official mid-year estimate | 1996 budget |
|---|---|---|---|---|---|---|---|---|---|
| Old stock of net asset float | -50.2 | -75.9 | -87.6 | -73.6 | -79.1 | -117.2 | -126.7 | -123.0 | -123.0 |
| (Percent of GDP) | -10.8 | -15.0 | -15.4 | -11.3 | -10.2 | -13.3 | -12.9 | -11.4 | -10.4 |
| (+) New net asset float | -27.5 | -24.0 | 3.4 | -9.9 | -28.2 | -27.1 | -16.8 | ... | ... |
| (Percent of GDP) | -5.9 | -4.8 | 0.6 | -1.5 | -3.6 | -3.1 | -1.7 | ... | ... |
| (-) Old net asset float cashed | 15.3 | -4.7 | -8.6 | 6.9 | 12.2 | -11.0 | -13.9 | ... | ... |
| (Percent of GDP) | 3.3 | -0.9 | -1.5 | 1.1 | 1.6 | -1.3 | -1.4 | ... | ... |
| (+) Old net asset float revision | 17.0 | 7.6 | 2.0 | 11.3 | 2.3 | 6.7 | 6.5 | ... | ... |
| (Percent of GDP) | 3.6 | 1.5 | 0.3 | 1.7 | 0.3 | 0.8 | 0.7 | | |
| New stock of net asset float | -75.9 | -87.6 | -73.6 | -79.1 | -117.2 | -126.7 | -123.0 | -123.0 | -123.0 |
| (Percent of GDP) | -16.3 | -17.3 | -12.9 | -12.2 | -15.1 | -14.4 | -12.6 | -11.4 | -10.4 |

Sources: Department of Budget and Programming, Relazione Previsionale e Programmatica; data provided by the Sammarinese authorities; and Fund staff estimates.

Table 17. San Marino: Operations of the Public Enterprises 1/

(In millions of lire)

| | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|---|
| Public Utilities Corporation (AASS) | | | | | | |
| Operating revenue | 24,717 | 28,848 | 36,924 | 41,648 | 44,785 | 51,116 |
| Operating expenditure | 17,510 | 15,958 | 35,213 | 36,294 | 40,707 | 43,569 |
| Operational balance | 7,208 | 12,890 | 1,711 | 5,354 | 4,079 | 7,547 |
| Net transfers | 5,409 | -3,797 | 8,459 | 4,743 | 8,000 | 3,793 |
| Current account balance | 12,617 | 9,093 | 10,170 | 10,097 | 12,079 | 11,339 |
| Capital expenditures | 10,432 | 9,507 | 9,846 | 9,736 | 6,839 | 14,148 |
| Overall balance | 2,185 | -414 | 324 | 361 | 5,240 | -2,809 |
| Public Works Corporation (AASP) | | | | | | |
| Operating revenue | 592 | 628 | 1,199 | 747 | 909 | 1,467 |
| Operating expenditure | 13,256 | 13,947 | 15,100 | 16,364 | 17,699 | 19,010 |
| Operational balance | -12,664 | -13,319 | -13,901 | -15,617 | -16,790 | -17,543 |
| Net transfers | 22,998 | 24,389 | 25,975 | 28,538 | 29,966 | 32,866 |
| Current account balance | 10,334 | 11,070 | 12,074 | 12,921 | 13,176 | 15,323 |
| Capital expenditures | 14,114 | 14,850 | 15,955 | 17,109 | 17,171 | 19,096 |
| Overall balance | -3,780 | -3,780 | -3,881 | -4,188 | -3,995 | -3,773 |
| Coins and Stamps Corporation (AASFN) | | | | | | |
| Operating revenue | 897 | 797 | 1,113 | 942 | 796 | 624 |
| Operating expenditure | 3,548 | 3,896 | 4,116 | 4,128 | 4,484 | 4,554 |
| Operational balance | -2,651 | -3,099 | -3,003 | -3,186 | -3,688 | -3,931 |
| Net transfers | 2,540 | 2,675 | 2,797 | 2,915 | 3,533 | 4,672 |
| Current account balance | -111 | -424 | -205 | -271 | -155 | 741 |
| Capital expenditures | 68 | 75 | 82 | 289 | 109 | 20 |
| Overall balance | -179 | -499 | -288 | -560 | -264 | 722 |
| Consolidated accounts of the largest three public enterprises | | | | | | |
| Operating revenue | 26,207 | 30,273 | 39,236 | 43,337 | 46,490 | 53,207 |
| Operating expenditure | 34,314 | 33,801 | 54,429 | 56,786 | 62,889 | 67,134 |
| Operational balance | -8,107 | -3,528 | -15,193 | -13,449 | -16,399 | -13,927 |
| Net transfers | 30,947 | 23,267 | 37,231 | 36,197 | 41,499 | 41,331 |
| Current account balance | 22,840 | 19,739 | 22,039 | 22,748 | 25,100 | 27,404 |
| Capital expenditures | 24,614 | 24,432 | 25,884 | 27,134 | 24,119 | 33,263 |
| Overall balance | -1,774 | -4,693 | -3,845 | -4,386 | 981 | -5,860 |

Source: Relazione Previsionale e Programmatica, various issues.

1/ Accounts computed on an accrual basis.

Table 18. San Marino: Operations of the Public Enterprises

(In percentage of GDP)

| | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|---|
| Public Utilities Corporation (AASS) | | | | | | |
| Operating revenue | 4.9 | 5.1 | 5.7 | 5.4 | 5.1 | 5.2 |
| Operating expenditure | 3.5 | 2.8 | 5.4 | 4.7 | 4.6 | 4.5 |
| Operational balance | 1.4 | 2.3 | 0.3 | 0.7 | 0.5 | 0.8 |
| Net transfers | 1.1 | -0.7 | 1.3 | 0.6 | 0.9 | 0.4 |
| Current account balance | 2.5 | 1.6 | 1.6 | 1.3 | 1.4 | 1.2 |
| Capital expenditures | 2.1 | 1.7 | 1.5 | 1.3 | 0.8 | 1.4 |
| Overall balance | 0.4 | -0.1 | -- | -- | 0.6 | -0.3 |
| Public Workers Corporation (AASP) | | | | | | |
| Operating revenue | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 | 0.1 |
| Operating expenditure | 2.6 | 2.4 | 2.3 | 2.1 | 2.0 | 1.9 |
| Operational balance | -2.5 | -2.3 | -2.1 | -2.0 | -1.9 | -1.8 |
| Net transfers | 4.6 | 4.3 | 4.0 | 3.7 | 3.4 | 3.4 |
| Current account balance | 2.0 | 1.9 | 1.9 | 1.7 | 1.5 | 1.6 |
| Capital expenditures | 2.8 | 2.6 | 2.5 | 2.2 | 1.9 | 2.0 |
| Overall balance | -0.7 | -0.7 | -0.6 | -0.5 | -0.5 | -0.4 |
| Coins and Stamps Corporation (AASFN) | | | | | | |
| Operating revenue | 0.2 | 0.1 | 0.2 | 0.1 | 0.1 | 0.1 |
| Operating expenditure | 0.7 | 0.7 | 0.6 | 0.5 | 0.5 | 0.5 |
| Operational balance | -0.5 | -0.5 | -0.5 | -0.4 | -0.4 | -0.4 |
| Net transfers | 0.5 | 0.5 | 0.4 | 0.4 | 0.4 | 0.5 |
| Current account balance | -- | -0.1 | -- | -- | -- | 0.1 |
| Capital expenditures | -- | -- | -- | -- | -- | -- |
| Overall balance | -- | -0.1 | -- | -0.1 | -- | 0.1 |
| Consolidated accounts of the largest three public enterprises | | | | | | |
| Operating revenue | 5.2 | 5.3 | 6.0 | 5.6 | 5.3 | 5.4 |
| Operating expenditure | 6.8 | 5.9 | 8.4 | 7.3 | 7.1 | 6.9 |
| Operational balance | -1.6 | -0.6 | -2.3 | -1.7 | -1.9 | -1.4 |
| Net transfers | 6.1 | 4.1 | 5.7 | 4.7 | 4.7 | 4.2 |
| Current account balance | 4.5 | 3.5 | 3.4 | 2.9 | 2.8 | 2.8 |
| Capital expenditures | 4.9 | 4.3 | 4.0 | 3.5 | 2.7 | 3.4 |
| Overall balance | -0.4 | -0.8 | -0.6 | -0.6 | 0.1 | -0.6 |

Source: Relazione Previsionale e Programmatica, various issues.

Table 19. San Marino: Interest Rates

(In percent; end of period)

| | Deposit Rates | | Loan Rates | | |
|---|---|---|---|---|---|
| | Sight savings | Time | Prime | Average | Repurchase agreements |
| 1990 | 7.5 | 8.0 | 11.0 | 14.5 | ... |
| 1991 | 7.3 | 7.6 | 10.8 | 15.2 | ... |
| 1992 | 9.0 | 10.0 | 13.3 | 17.9 | 13.0 |
| 1993 | 8.2 | 9.0 | 12.0 | 16.0 | 10.0 |
| 1994 | 7.0 | 7.5 | 11.0 | 15.0 | 9.5 |
| Mar. 1995 | 6.8 | 7.3 | 11.0 | 14.9 | 9.0 |
| Jun. 1995 | 6.9 | 7.5 | 11.8 | 15.2 | 9.2 |
| Sep. 1995 | 6.8 | 7.4 | 12.0 | 15.3 | 9.1 |
| Dec. 1995 | 6.5 | 7.2 | 12.5 | 15.5 | 8.7 |
| Mar. 1996 | 6.5 | 7.0 | 12.5 | 15.1 | 8.5 |

Source: Data provided by the Sammarinese authorities.

Table 20. San Marino: Preliminary Monetary Survey
Summary Table Including Correction for Repos 1/

(In billions of lire)

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Net foreign assets | 975 | 1,425 | 1,798 | 1,754 | 2,238 |
| Net claim on the central government (Budget + ISS) | -179 | -218 | -245 | -239 | -252 |
| Domestic credits (to other nonbank domestic sectors, gross) | 586 | 796 | 850 | 989 | 1,102 |
| Deposit money | 1,090 | 1,440 | 1,776 | 1,844 | 2,297 |
| Other items net | 292 | 563 | 627 | 661 | 791 |

Source: Data provided by the Sammarinese authorities.

1/ Italian lira banknotes in circulation outside the banking sector in San Marino are not estimated here. In addition, Sammarinese hold deposits in Italian banks that are not covered by this monetary survey.

Table 21. San Marino: Monetary Accounts--Assets

(In billions of lire)

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|
| Total foreign assets | 2,201 | 2,809 | 4,222 | 5,315 | 5,418 | 6,915 |
| Of which: | | | | | | |
| Foreign assets held as deposits | 1,319 | 1,487 | 1,638 | 2,100 | 2,324 | 2,404 |
| Securities sold under repos | 882 | 1,322 | 2,584 | 3,215 | 3,094 | 4,511 |
| Claims on the central government (budget + ISS) | -- | -- | -- | 5 | -5 | -- |
| Claims on other nonbank domestic sector | 522 | 586 | 796 | 850 | 989 | 1,102 |
| Other assets | 102 | 219 | 285 | 313 | 358 | 423 |
| Total gross assets | 2,826 | 3,615 | 5,302 | 6,474 | 6,766 | 8,435 |

Source: Data provided by the Sammarinese authorities.

Table 22. San Marino: Monetary Accounts--Assets

(In percent of GDP)

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|
| Total foreign assets | 386.0 | 432.4 | 543.1 | 603.3 | 553.7 | 642.4 |
| Of which: | | | | | | |
| Foreign assets held as deposits | 231.4 | 228.9 | 210.7 | 238.4 | 237.5 | 223.3 |
| Securities sold under repos | 154.7 | 203.5 | 332.4 | 365.0 | 316.2 | 419.1 |
| Claims on the central government (budget + ISS) | -- | -- | -- | -0.5 | -0.5 | -0.5 |
| Claims on other nonbank domestic sector | 91.5 | 90.3 | 102.4 | 96.5 | 101.1 | 102.4 |
| Other assets | 18.0 | 33.7 | 36.6 | 35.6 | 36.6 | 39.3 |
| Total gross assets | 495.6 | 556.4 | 682.1 | 734.9 | 691.4 | 783.6 |

Source: Data provided by the Sammarinese authorities.

Table 23. San Marino: Monetary Accounts--Liabilities

(In billions of lire)

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|
| Foreign liabilities | 1,418 | 1,834 | 2,797 | 3,517 | 3,664 | 4,677 |
| Of which: | | | | | | |
| Foreign liabilities as deposits | 757 | 843 | 859 | 1,106 | 1,344 | 1,294 |
| Liabilities as repos | 662 | 992 | 1,938 | 2,411 | 2,321 | 3,383 |
| Liabilities to the central government (budget + ISS) | 172 | 180 | 219 | 240 | 239 | 247 |
| Liabilities of other nonbank domestic sector | 875 | 1,090 | 1,440 | 1,776 | 1,844 | 2,297 |
| Of which: | | | | | | |
| Domestic liabilities as deposits | 655 | 760 | 794 | 972 | 1,070 | 1,169 |
| Liabilities as repos | 221 | 331 | 646 | 804 | 774 | 1,128 |
| Other liabilities | 361 | 511 | 847 | 940 | 1,019 | 1,214 |
| Total gross liabilities | 2,826 | 3,615 | 5,302 | 6,474 | 6,766 | 8,435 |

Source: Data provided by the Sammarinese authorities.

Table 24. San Marino: Monetary Accounts--Liabilities

(In percent of GDP)

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|
| Foreign liabilities | 248.7 | 282.3 | 359.8 | 399.3 | 374.5 | 434.5 |
| Of which: | | | | | | |
| Foreign liabilities as deposits | 132.7 | 129.7 | 110.5 | 125.6 | 137.3 | 120.2 |
| Liabilities as repos | 116.0 | 152.6 | 249.3 | 273.7 | 237.1 | 314.3 |
| Liabilities to the central government (budget + ISS) | 30.1 | 27.7 | 28.1 | 27.3 | 24.4 | 22.9 |
| Liabilities of other nonbank domestic sector | 153.5 | 167.8 | 185.2 | 201.6 | 188.4 | 213.4 |
| Of which: | | | | | | |
| Domestic liabilities as deposits | 114.8 | 116.9 | 102.1 | 110.4 | 109.4 | 108.6 |
| Liabilities as repos | 38.7 | 50.9 | 83.1 | 91.2 | 79.0 | 104.8 |
| Other liabilities | 63.3 | 78.7 | 109.0 | 106.8 | 104.1 | 112.8 |
| Total gross liabilities | 495.6 | 556.4 | 682.1 | 734.9 | 691.4 | 783.6 |
| Memorandum item: | | | | | | |
| GDP | 570.0 | 650.0 | 777.0 | 881.0 | 979.0 | 1,076.0 1/ |

Source: Data provided by the Sammarinese authorities.

1/ Estimated based on an assumption of 10 percent nominal growth rate in 1995.

Table 25. San Marino: Public Sector Deposits

(In billions of lire)

| | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|---|
| Central Government | 134 | 172 | 180 | 220 | 240 | 239 | 247 |
| State budget | 129 | 163 | 169 | 203 | 168 | 216 | 217 |
| at ICS | -- | -- | -- | 61 | 168 | 216 | 217 |
| at commercial banks | 129 | 163 | 169 | 142 | -- | -- | -- |
| Other liabilities of ICS to state budget | -- | -- | -- | -- | 38 | -- | -- |
| Social Security Institute | 5 | 9 | 11 | 17 | 34 | 23 | 30 |
| at ICS | -- | -- | -- | 12 | 34 | 23 | 30 |
| at commercial banks | 5 | 9 | 11 | 5 | -- | -- | -- |
| Public enterprises | 22 | 30 | 27 | 39 | 16 | 37 | 41 |
| at ICS | -- | -- | -- | 5 | 16 | 37 | 41 |
| at commercial banks | 22 | 30 | 27 | 34 | -- | -- | -- |
| Public sector | 156 | 202 | 207 | 259 | 256 | 276 | 288 |

Source: Data provided by the Sammarinese authorities.

Table 26. San Marino: Balance of Payments

| | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|
| | | | (In millions of U.S. dollars) | | |
| Trade balance | -286.4 | -279.0 | -250.1 | -240.6 | -235.9 |
| Exports, f.o.b. | 978.5 | 1,137.4 | 1,293.3 | 1,269.6 | 1,416.3 |
| Imports, c.i.f. | -1,264.9 | -1,416.4 | -1,543.4 | -510.1 | -1,652.2 |
| Nonfactor services (net) | 274.2 | 262.6 | 238.0 | 225.4 | 221.6 |
| Tourist receipts | 298.0 | 288.8 | 268.7 | 255.5 | 252.5 |
| Other services | -23.8 | -26.2 | -30.7 | -30.1 | -30.9 |
| Factor income (net) | 51.2 | 60.7 | 99.7 | 82.2 | 60.2 |
| Interest payments | 69.1 | 87.1 | 130.0 | 117.8 | 105.0 |
| Labor income (net) | -17.9 | -26.4 | -30.3 | -35.6 | -44.8 |
| Transfers (net) | 9.5 | 9.3 | 9.6 | 7.7 | 7.1 |
| Current account balance | 48.6 | 53.6 | 97.3 | 74.6 | 53.0 |
| Capital account (net) | -48.6 | -53.6 | -97.3 | -74.6 | -53.0 |
| Official | -3.6 | -2.8 | -2.9 | -2.7 | -2.7 |
| Private | -45.0 | -49.1 | -51.8 | -29.9 | 30.7 |
| Change in reserves | -- | -1.7 | -42.6 | -42.0 | -81.0 |
| | | | (In percent of GDP) | | |
| Exports | 193.9 | 201.5 | 244.7 | 226.8 | 233.4 |
| Imports | -250.7 | -251.0 | -292.0 | -269.8 | -272.2 |
| Balance of goods and nonfactor services | -2.4 | -2.9 | 2.3 | -2.7 | -2.4 |
| Current account balance | 9.6 | 9.5 | 18.4 | 13.3 | 8.7 |
| Memorandum item: | | | | | |
| GDP (in millions of U.S. dollars) | 504.6 | 564.4 | 528.5 | 559.8 | 606.9 |

Source: Staff estimates.

## Cross Border Workers 1/

### 1. Introduction

Over the last ten years San Marino has enjoyed an unprecedented period of job creation with total employment increasing by almost 50 percent (Tables 1 and 2). Increased financial flows, extensive tax incentives, subsidized credit for the private sector, and more recently the depreciation of the lira have resulted in growth averaging around 5 percent a year. Only part of this large increase in labor demand has been met by increased labor supply by Sammarinese workers. Cross-border workers--almost all from Italy 2/--have taken an increasingly significant proportion of the new jobs created by the Sammarinese economy. In 1986 the total number of cross-border workers working in San Marino stood at 638. This number represented about 12 percent of private sector employment and 8 percent of total employment. By 1995 that number had grown to 2,972--an increase of 359 percent. Cross-border workers now account for 27 percent of private sector employment and 20 percent of total employment (Table 3).

Two of the most important issues raised by these flows of cross-border workers are examined in this appendix. The first concerns the impact of cross-border employment upon the Sammarinese labor market. Specifically, the appendix examines the effect of cross-border workers on wages, employment, and output. The second issue concerns the social security system. The question examined is whether the social security system has incurred liabilities to cross-border workers through its unemployment benefits and pension provisions which will cause fiscal difficulties in the future.

This appendix will argue that the large increase in cross-border employment has had two important consequences for the labor market. First, and most importantly, at a time when the economy is enjoying healthy demand for its goods and services, cross-border workers reduce the supply constraint that would otherwise choke off output growth. Second, cross-border employment is a manifestation of an increasing trend toward labor market segmentation in San Marino, which in turn encourages "wait" unemployment. However, the Sammarinese benefits system minimizes the adverse consequences of this increase in voluntary unemployment by restricting the generosity, coverage and duration of benefits. Thus, the fiscal implications of higher voluntary unemployment are minimized.

Segmentation exacerbates unemployment in San Marino because in encourages "job queuing." Sammarinese workers wait on the unemployment register until a suitable high paying job in the public or finance sector

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1/ Prepared by James McHugh.

2/ Almost 95 percent of cross border workers in San Marino come from Italy, of which a quarter come from the nearby town of Rimini. A further 3.7 percent originate from Eastern Europe and Russia. Only a tiny minority of cross border workers come from other EU countries (Chart 1).

becomes available, rather than find a job immediately in the less attractive but growing sectors of tourism, manufacturing, and transportation. As a result, jobs in the latter sectors have been increasingly filled by cross-border workers.

Segmentation plus increased cross-border employment can explain the surprising unresponsiveness of unemployment with respect to increases in employment. During the recession of the early 1980s the unemployment rate reached over 7 percent. By 1985--when cross-border employment started to rise rapidly--the unemployment rate had fallen to around 5 percent. After 1985 it hovered within the 4-5 percent range until December 1995, when unemployment broke through the 4 percent barrier and reached 3.7 percent. This fall in unemployment coincides with an announcement that there will be a future hiring freeze in the public sector. Section III explains how such an announcement can reduce unemployment without any actual change in employment in the public sector.

2. Cross-border workers--institutional issues

Recent labor market data strongly suggests that the Sammarinese labor market has become increasingly segmented. Sammarinese workers are predominantly employed in the highly paid jobs in the financial and public sectors or involved in entrepreneurial activities. In 1995 these categories accounted for 44 percent of total employment (Tables 1, 2, 5 and 6). Cross-border workers are predominantly employed in unskilled, semi skilled and manual employment in the hotel and catering, construction, manufacturing and transportation sectors (Tables 3 and 7).

Sammarinese employment law contains severe hiring restrictions which treats cross-border workers very differently from Sammarinese workers. If a firm wishes to hire a worker, it must first consider those workers who have registered as unemployed at the employment office. Each worker on the list is prioritized according to both the length of unemployment and social need. 1/ This system gives preferential treatment to unemployed applicants and, therefore it gives an incentive for people seeking a job in a relatively scarce occupation to wait on the unemployment list rather than find work in another less popular sector. A worker that was initially registered as unemployed and who then found work would lose his/her position in the list, putting him/her at a disadvantage when a suitable vacancy arises in the future. Furthermore, cross-border workers cannot register as unemployed and are, therefore, excluded from many high-paying occupations.

In practice, many private sector firms--especially those firms operating in retailing, manufacturing, and tourism that require unskilled or semi skilled labor--find it very difficult to find unemployed Sammarinese

1/ For example, a married man with dependent children is considered to have a greater social need than a single man without children and so the married man would be placed higher on the unemployment list than the single man.

workers prepared to work in these sectors. Therefore, these vacancies are increasingly filled by cross-border workers. In order to legally 1/ hire a cross-border worker the firm must go through the formality of looking at the unemployment list. Once the firm has satisfied the employment office that there are no available unemployed Sammarinese workers, the firm can try to hire either an employed Sammarinese worker or a cross-border worker. When a cross-border worker is found the firm must apply for a work permit, which is usually granted within a few weeks. Permits are renewed automatically each year. Thus, for many private sector firms these hiring restrictions simply translate into delays in hiring a cross-border worker (Table 4).

Hiring restrictions are important in the public and financial sectors. There are two groups of unemployed Sammarinese workers who are attracted to these sectors by high pay, good conditions and job security. The first group consists of educated young workers seeking their first job. Typically, these workers have completed high school education and often have gone on to university (Table 7). For these workers a full time position in the public or finance sectors is very attractive. The second group consists of women with dependent children seeking employment with flexible hours 2/ (Table 8). Since there is ample evidence of alternative employment available to these groups, there is strong reason to believe that these workers may be voluntarily unemployed.

## 3. The impact of cross-border workers upon the labor market

The impact of cross-border workers upon the Sammarinese labor market is examined with the help of a simple dual labor market model illustrated in Chart 1. 3/ The model assumes that the labor market is made up of two sectors; a primary sector which is assumed to consist of well paid jobs, such as in the public and finance sector sectors, and a secondary sector which consists of unskilled, low paid jobs, such sector as the manufacturing and hotel and catering sectors. The total Sammarinese labor force is represented by the horizontal axis. Real wages in the primary sector are given by the left hand side vertical axis. Similarly the right hand side vertical axis represents the real wage in the secondary sector.

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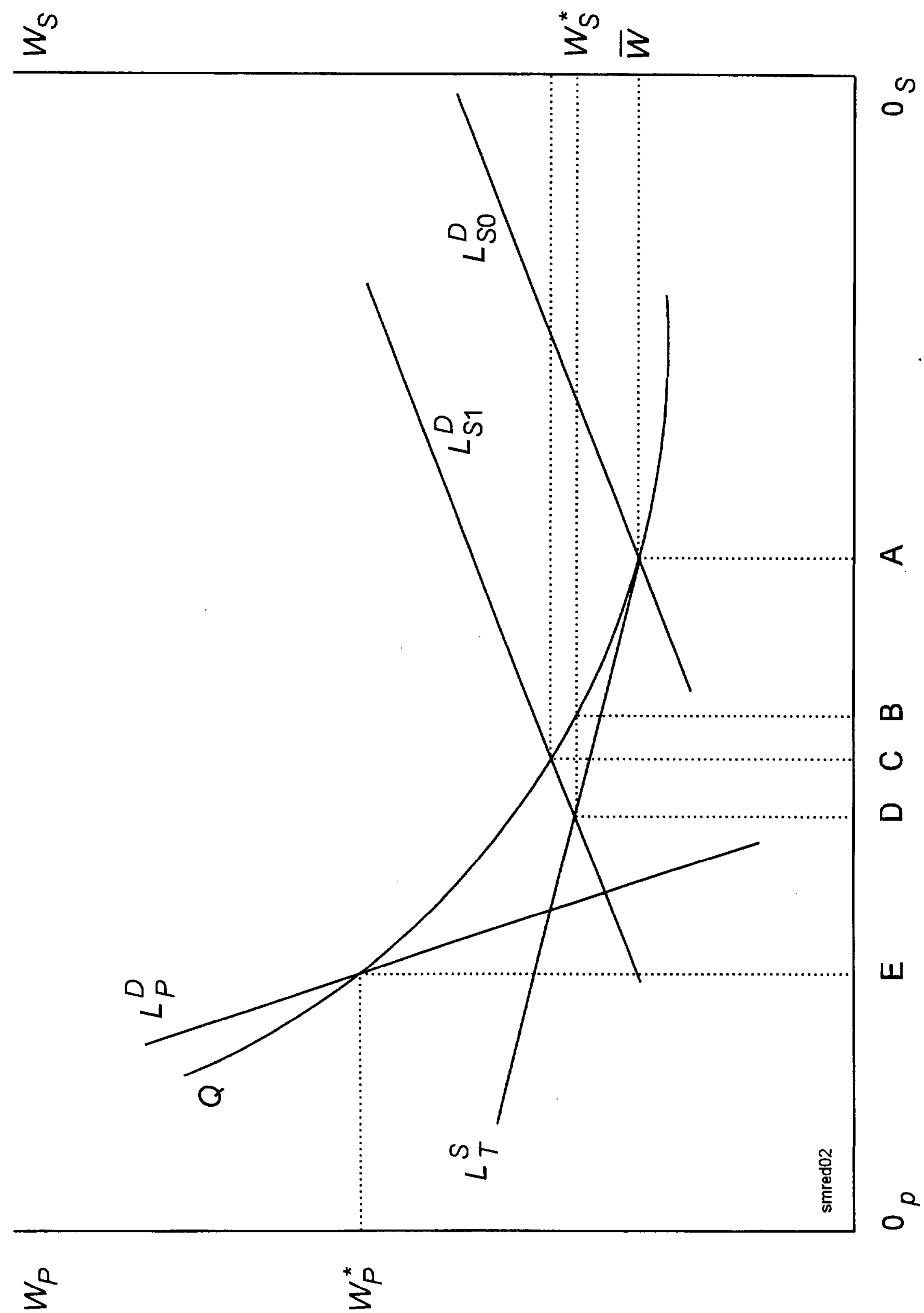
1/ These regulations are strictly enforced with regular inspections of firms by the Ministry of Labor. Extremely large fines are imposed upon firms who illegally employ cross border workers.

2/ The public sector is particularly attractive for such workers because it offers part time jobs and tends to have more flexible working hours of than private sector firms.

3/ See Harris and Todaro (1970), Corden and Findlay (1975) and Mincer (1976).

Chart 1

The Impact of Cross Border Workers on the Sammarinese Labour Market



The demand for primary sector jobs is given by $L_P^D$. All Sammarinese workers would like to work in the primary sector but wages are determined by some form of "insider-outsider" 1/ or "efficiency wage" 2/ arrangement and so real wages are determined above the market clearing level. The nonmarket clearing wage determination process in the primary sector is explained by legal restrictions which prevent cross-border workers from entering this sector and bidding the real wage down. The employment level in primary sector is given by $O_pE$ with workers receiving a real wage of $W_P^*$.

The labor supply decision for those workers not working in the primary sector must equalize the expected benefit of "waiting" on the unemployment list until a job in the primary sector becomes available with the cost of foregone income from working in the secondary sector. Clearly the net benefits of waiting are reduced (i) the higher the real wage in the secondary sector; (ii) the lower the probability of getting a job in the primary sector in the future; (iii) the lower the real wage in the primary sector, and (iv) the lower the level of benefits relative to secondary sector wages. The locus of points where the representative Sammarinese worker is indifferent between the primary and secondary sectors is given by $Q$. This function can be considered as the Sammarinese labor supply function for secondary sector jobs.

If cross-border workers are allowed to compete for jobs in the secondary sector, their reservation wage--given by $\bar{W}$ --would be the real wage abroad plus commuting costs, and costs due to lower job security. 3/ At this wage a cross-border worker will be indifferent between working in San Marino or abroad. Since Sammarinese workers do not incur commuting costs and have greater job security there will be a proportion of Sammarinese workers willing to work in the secondary sector for $\bar{W}$.

The joint labor supply of both cross-border and Sammarinese workers is an increasing function of the real wage, represented by $L_T^S$. Since the pool of cross-border workers is very large relative to the size of the

1/ See Lindbeck and Snower (1987).
2/ See Akerlof (1984), Shapiro and Stiglitz (1984).
3/ Sammarinese citizens have greater job security than cross border workers because the latter must have a work permit which has to be renewed annually.

Sammarinese labor markets relatively small changes in real wages will produce large labor supply responses from cross-border workers above their reservation wage. Thus, the presence of cross-border workers makes the overall labor supply more elastic with respect to the secondary sector real wage.

To examine the implications of introducing cross-border workers, the initial labor demand in the secondary sector--given by $L_{S0}^{D}$ --is "normalized" so produce a real wage equal to the reservation wage. This gives an initial market clearing real wage of $\overline{W}$ with employment level--comprising of just Sammarinese workers--given by $O_SA$.

Unemployment is given by *EA*. There is "quasi involuntary" unemployment amongst the Sammarinese labor force in the sense that there are workers prepared to work in the primary sector at the existing wage but can not find employment. However, these workers are voluntarily unemployed because there are jobs available in the secondary sector, but they are not prepared to work at the secondary sector wage. All unemployment is due to "waiting" or "job queuing" for future primary sector jobs.

Suppose that labor demand in the secondary sector increases to $L_{S1}^{D}$.

If cross-border workers are forbidden to work in San Marino real wages in the secondary sector increases, employment rises to $O_SC$ and unemployment in San Marino falls to *EC*. If cross-border workers are permitted to work, the more elastic labor supply gives an employment level in the secondary sector of $O_SD$. Cross-border workers take *DB* jobs while Sammarinese employment in the secondary sector increases by *BA*. Total employment is $O_pE + 0_sD$ but unemployment in San Marino is now *EB* which is greater than *EC*.

This diagram illustrates a number of interesting points about how cross-border employment affects the Sammarinese labor market. First, the supply constraint is reduced. Total employment and output are clearly higher when cross-border workers are allowed to compete for jobs in the secondary sector. Second, given an increase in labor demand in the secondary sector, unemployment amongst Sammarinese workers is higher when cross-border workers are allowed than when they are not allowed. Cross-border workers limit the growth of real wages following an increase in labor demand, reducing the labor supply response of Sammarinese workers. Third, the responsiveness of unemployment to changes labor demand in the secondary sector is reduced when cross-border workers are allowed to work in San Marino. Unemployment fell by *CA* when cross-border workers were forbidden to the work in San Marino, but only fell by *BA* when permission was granted.

The effect of an announcement of a future hiring freeze in the public sector is illustrated in Chart 2. Since both the stock of jobs and wages in the primary sector are unchanged in the current period the line giving the locus of points where the workers are indifferent between the primary and secondary sector (given by $Q'$) must go through point Z. However, the

likelihood of obtaining a job in the primary sector has been reduced, and so the function pivots leftwards around *Z*. This is because the expected benefit of waiting for a primary sector job is reduced and secondary sector jobs become more attractive. The effect on employment is to increase Sammarinese employment at the expense of cross-border employment whilst leaving the real wage unchanged. Sammarinese employment increases by *FB* and unemployment becomes *EF*. This diagram emphasizes the point that expectations about demand conditions in the primary sector can have an important impact upon labor supply decisions in the secondary sector.

A further question analyzed is what will be the impact of a cut in employment in the public sector. The cut will shift the $L_P^D$ function to

the left taking the indifference curve *Q* with it. Employment in the secondary sector will increase because the probability of obtaining a primary sector job is reduced. The overall effect on unemployment will be ambiguous depending upon whether the loss in primary sector employment is compensated by increasing secondary sector employment.

4. Fiscal implications of cross-border workers

A potential danger raised by the increased flow of cross-border workers could be that the State is incurring unsustainable unemployment benefit and pension liabilities. A closer examination of the Sammarinese social security provisions suggest that cross-border workers create only minor problems for the unemployment benefit system. However, the pension liabilities accrued to cross-border workers are a much more significant issue. Since the current pension system is "pay-as-you-go" the demographic profile of cross-border workers emphasizes the point that the system could have serious funding difficulties in the early part of the next century.

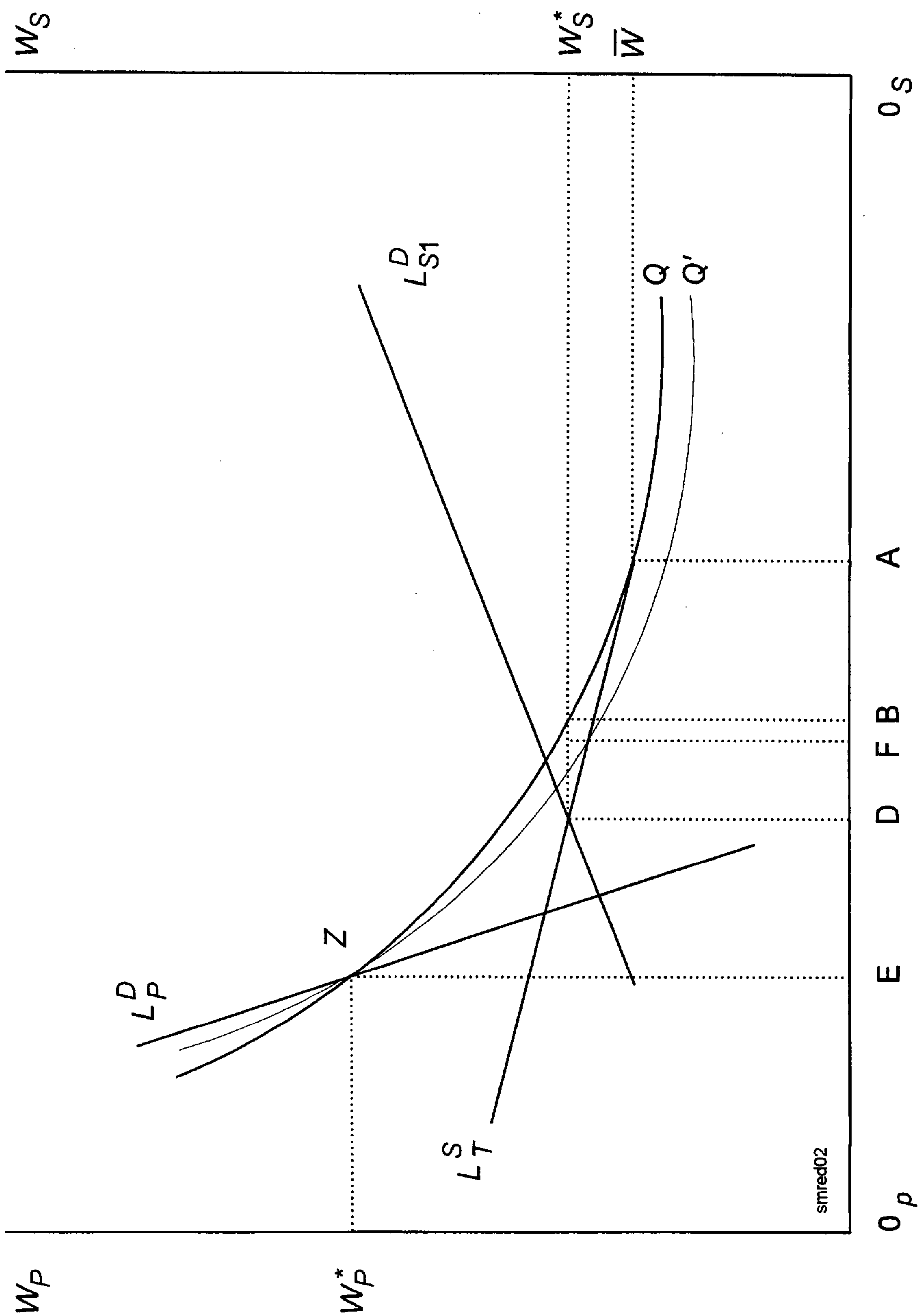
a. Unemployment benefits

In principle unemployment benefit could cause serious fiscal difficulties in the case of an economic downturn. In such a case, rising unemployment benefit claims coupled with a declining tax base could cause serious fiscal difficulties. In practice, however, eligibility for unemployment benefits is limited to workers made redundant or temporarily laid off. Moreover, benefit duration is limited to a maximum of one year.

Three types of income support for unemployed workers are offered in San Marino. The first is ordinary unemployment benefit. In principle all unemployed Sammarinese workers are entitled to this benefit if they have contributed to social security in the previous three years. Cross-border

Chart 2

An Announcement of a Future Hiring Freeze in the Public Sector



workers are not entitled to claim this benefit. In reality only 10 percent of eligible workers claim this benefit because the benefit level is extremely low. It ranges from Lit 600 ($0.38) per day to Lit 4000 ($2.60) per day, depending upon the circumstances of the applicant. Benefit duration is restricted for 100 days, after which the unemployed worker must wait a year before making a new claim. Refusal to accept an offer of employment will result in the suspension of benefit entitlement. Total expenditure on this benefit in 1995 was Lit 25 million ($16,000), accounting for 0.001 percent of total government expenditure.

Cross-border workers are entitled to the second type of unemployment benefit--*Indennitá Integrazione Speciale*. This benefit applies to unemployed dependent workers who are made redundant due to company closure. Each eligible worker is entitled to receive 70 percent of his/her previous salary for the first six months of unemployment, falling to 65 percent for the second six months of unemployment. These workers are given priority on the unemployment list and great effort is made on the part of the employment office to find them suitable alternative employment. Unemployment duration for workers claiming this type of benefit is comparatively low. The average period of unemployment is three months, with the majority of workers finding employment between one and eight months of losing their job. Only 1 percent of eligible workers remain unemployed for the entire period of benefit eligibility, which is one year. The low duration observed in this unemployment benefit is partly the fact that it is only received by workers who are displaced from the private sector and typically these workers wish to continue employment in that sector. Since labor demand has grown strongly in the private sector, displaced workers usually have little difficulty in finding new employment.

The third form of unemployment assistance is the *Cassa Integrazione Guadagni (C.I.G.)*. The fund caters to temporarily laid-off dependent workers. Cross-border workers are eligible and are treated in an identical manner to Sammarinese workers. The *C.I.G.* covers layoffs due to bad weather, temporary falls in demand, and industrial restructuring. Benefits are paid directly to the firm, who then uses the benefit to supplement wages. Therefore, all eligible workers remain "employed" by the firm, despite being laid off. Firms can claim the benefit for an initial period of six months, after which the benefit can be extended with the authorization of the Ministry of Labor. A further extension can only be granted if the firm is undergoing a restructuring process which involves a training component for its workers.

In summary, cross-border workers present few potential problems for the Sammarinese unemployment benefits system. While these workers are entitled to certain benefits--which do seem to be rather generous in terms of replacement ratios--eligibility is restricted. Furthermore, duration is typically limited to one year, which places an effective cap on total expenditures. A downturn in economic activity could potentially cause short term difficulties for the social security system but this would be self correcting as benefit eligibility expires.

b. Pensions

The Sammarinese social security system provides retirement benefits to all cross-border workers who have reached the age of 60, have worked at least 15 years in San Marino, and have made the necessary contributions. Disability pensions and survival pensions are also provided to cross-border workers. 1/ Workers who have worked for less than 15 years but who have made social security contributions--receive a pro rata pension. This pension is often supplemented with entitlements accumulated in Italy.

The extent to which the Sammarinese social security system will incur large future liabilities to cross-border workers depends in part upon the employment duration of these workers. Table 9 suggests that only a minority of these workers remains employed for longer than five years. For example only one-half of all cross-border workers employed in 1995 have worked in San Marino for five years or longer. If one considers employment of 10 or more years, one finds that only 19 percent of cross-border workers employed in 1995 were hired in or before 1986. Therefore, the number of cross-border workers currently eligible for pensions is small.

Although duration data suggests the future pension problem may not be as severe as first thought, there are factors which would lead to a less optimistic scenario. First, the current demographic profile of cross-border workers shows a bulge in the 30-39 age group. Over 70 percent of the cross-border workers are within the 25-49 age group with 32 percent in the 30-39 age group (Table 10). Under the current pension provisions these workers will start to retire in large numbers after 2015. Second, the duration data does not distinguish cross-border workers by age. Since younger workers tend to leave jobs more frequently than older workers, employment duration in the 30-39 is likely to be higher than that suggested by Table 10.

Therefore, San Marino is likely to be incurring significant pension liabilities to cross-border workers. Furthermore these liabilities will peak in the early part of the next century, at a time when the ratio of workers to retirees is projected to be lower. Therefore, current levels of pension provision may be difficult to meet in the future.

5. Conclusions

The existence of a large pool of available cross-border workers greatly enhances the degree of labor market flexibility. This is vital for San Marino, since it has no alternative policy instruments to counter the adverse consequences of real and nominal shocks. Its currency union with Italy prohibits the use of exchange rate adjustments to restore international competitiveness. Interest rate policy is determined by monetary conditions in Italy. The high levels of import penetration means that any attempt to use fiscal policy will be quickly dissipated in higher

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1/ Eligibility for these benefits require the worker to make contributions for at least seven years.

imports. In recent years the rising numbers of cross-border workers has greatly reduced supply constraints, limiting the growth of real product wages and encouraging greater output growth.

Cross-border employment coupled with labor market segmentation has encouraged a minority of workers seeking employment in the public and financial sector to remain unemployed rather than find alternative employment in other less attractive sectors. This has led to high and sustained levels of unemployment, given the massive increase in employment. More recently, unemployment has started to fall probably because an announced hiring freeze in the public sector has reduced the likelihood that workers in the secondary sector will obtain public sector employment in the future. However, it is probably the case that low levels of benefit payments and restricted eligibility has limited the problem of "wait" unemployment.

Cross-border workers present few long term problems to the current unemployment benefits system. Benefits are well targeted and have limited duration. An economic downturn that increases unemployment and reduces the tax base would only cause temporary fiscal problems. Pensions are provided to cross-border workers on the same basis as Sammarinese workers. However, high levels of labor turnover mean that fewer liabilities are being accumulated to these workers than would at first appear. The demographic trends amongst these workers, however, do point to potential funding problems in the early part of the next century.

Table 1. San Marino: Total Employment

| | 1991 | 1992 | 1993 | 1994 | 1995 | 1986-95 | 1991-95 |
|---|---|---|---|---|---|---|---|
| Employment (Sammarinese and cross border) | | | | | | | |
| All workers | 12,908 | 13,792 | 14,409 | 15,144 | 15,578 | 5,046 | 2,670 |
| Dependent employment | 10,259 | 11,133 | 11,740 | 12,531 | 12,941 | 4,865 | 2,752 |
| Self-employment | 2,649 | 2,659 | 2,669 | 2,613 | 2,637 | 181 | -82 |
| Sammarinese employment | | | | | | | |
| All workers | 11,441 | 11,922 | 12,117 | 12,531 | 12,606 | 2,392 | 835 |
| Dependent employment | 8,802 | 9,277 | 9,461 | 9,932 | 9,982 | 2,221 | 920 |
| Self-employment | 2,639 | 2,645 | 2,656 | 2,599 | 2,624 | 171 | -85 |
| Cross border workers | | | | | | | |
| All workers | 1,467 | 1,870 | 2,292 | 2,613 | 2,972 | 2,324 | 1,505 |
| Dependent employment | 1,457 | 1,856 | 2,279 | 2,599 | 3,289 | 2,314 | 1,502 |
| Self-employment | 10 | 14 | 13 | 14 | 13 | 10 | 3 |

Source: Centro Elaborzione Dati e Statistica, Bolletino di statistica.

Table 2. San Marino: Percentage Change in Total Employment

| | 1991 | 1992 | 1993 | 1994 | 1995 | 1986-95 | 1991-95 |
|---|---|---|---|---|---|---|---|
| Employment (Sammarinese and cross border) | | | | | | | |
| All workers | 7.7 | 8.5 | 5.5 | 6.7 | 4.8 | 47.9 | 20.8 |
| Dependent employment | 5.5 | 5.4 | 2.0 | 5.0 | 2.4 | 60.2 | 27.0 |
| Self-employment | 1.6 | 0.2 | 0.4 | -5.7 | 1.1 | 7.4 | -3.0 |
| Sammarinese employment | | | | | | | |
| All workers | 4.6 | 4.2 | 1.6 | 3.4 | 0.6 | 27.5 | 10.2 |
| Dependent employment | 5.5 | 5.4 | 2.0 | 5.0 | 2.4 | 34.3 | 14.3 |
| Self-employment | 1.6 | 0.2 | 0.4 | -5.7 | 1.1 | 7.0 | -3.1 |
| Cross border workers | | | | | | | |
| All workers | 22.9 | 27.5 | 22.6 | 14.0 | 13.7 | 358.6 | 102.6 |
| Dependent employment | 23.0 | 27.4 | 22.8 | 14.0 | 13.9 | 358.8 | 103.6 |
| Self-employment | 11.1 | 40.0 | -7.1 | 7.7 | -7.1 | 333.3 | 30.0 |

Source: Centro Elaborzione Dati e Statistica, Bolletino di statistica.

Table 3. San Marino: Foreign Workers as a Proportion of Total Employment in Each Sector

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Employment by sector | | | | | |
| Agriculture | 2.0 | 2.0 | 2.1 | 2.7 | 3.5 |
| Manufacturing | 16.2 | 19.4 | 23.1 | 24.8 | 27.6 |
| Construction | 22.5 | 28.5 | 33.4 | 35.6 | 39.2 |
| Commerce | 15.5 | 16.2 | 18.5 | 20.3 | 25.2 |
| Transport | 24.0 | 32.8 | 34.3 | 39.1 | 42.7 |
| Credit and insurance | 1.7 | 2.3 | 2.8 | 4.4 | 4.6 |
| Services | 7.7 | 12.3 | 15.7 | 16.9 | 21.2 |
| Total employment | | | | | |
| Private sector | 15.2 | 18.1 | 21.3 | 23.1 | 26.7 |
| Total | 11.4 | 13.6 | 15.9 | 17.3 | 20.4 |

Source: Centro Elaborzione Dati e Statistica, *Bolletino di statistica*.

Table 4. San Marino: Foreign Workers by Nationality 1/

| | Total | Percent of total |
|---|---|---|
| Italy | 3,117 | 94.4 |
| Eastern Europe and Russia | 122 | 3.7 |
| EU excluding Italy | 11 | 0.3 |
| Rest of the World | 52 | 1.6 |
| Total | 3,302 | 100.0 |

Source: *Indagine suo Lavoratori Frontalieri Nella Republica Di San Marino, C.D.L.S.*

1/ July 31, 1995.

Table 5. San Marino: Total Employment

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Employment by sector | | | | | |
| Agriculture | 296 | 296 | 294 | 256 | 249 |
| Manufacturing | 4,495 | 4,591 | 4,739 | 5,078 | 5,256 |
| Construction | 1,058 | 1,106 | 1,195 | 1,291 | 1,440 |
| Commerce | 2,232 | 2,402 | 2,499 | 2,531 | 2,641 |
| Transport | 231 | 285 | 278 | 282 | 311 |
| Banking and insurance | 294 | 339 | 390 | 400 | 417 |
| Services | 970 | 1,116 | 1,239 | 1,322 | 1,432 |
| Government | 2,196 | 2,358 | 2,737 | 2,892 | 2,963 |
| Public corporations | 1,067 | 1,117 | 887 | 887 | 869 |
| Total employment | | | | | |
| Private sector | 9,576 | 10,135 | 10,634 | 11,160 | 11,746 |
| Public sector | 3,263 | 3,475 | 3,624 | 3,779 | 3,832 |
| Total | 12,839 | 13,610 | 14,258 | 14,939 | 15,578 |

Source: Centro Elaborzione Dati e Statistica, *Bolletino di statistica.*

Table 6. San Marino: Employment by Sector as a Proportion of Total Employment

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Employment by sector | | | | | |
| Agriculture | 2.3 | 2.2 | 2.1 | 1.7 | 1.6 |
| Manufacturing | 35.0 | 33.7 | 33.2 | 34.0 | 33.7 |
| Construction | 8.2 | 8.1 | 8.4 | 8.6 | 9.2 |
| Commerce | 17.4 | 17.6 | 17.5 | 16.9 | 17.0 |
| Transport | 1.8 | 2.1 | 1.9 | 1.9 | 2.0 |
| Banking and insurance | 2.3 | 2.5 | 2.7 | 2.7 | 2.7 |
| Services | 7.6 | 8.2 | 8.7 | 8.8 | 9.2 |
| Government | 17.1 | 17.3 | 19.2 | 19.4 | 19.0 |
| Public corporations | 8.3 | 8.2 | 6.2 | 5.9 | 5.6 |
| Total employment | | | | | |
| Private sector | 74.6 | 74.5 | 74.6 | 74.7 | 75.4 |
| Public sector | 25.4 | 25.5 | 25.4 | 25.3 | 24.6 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Source: Centro Elaborzione Dati e Statistica, *Bolletino di statistica.*

Table 7. San Marino: Foreign Workers by Sector and Type of Employment 1/

| | Agriculture | Manufacturing | Construction | Commerce | Transport | Banking and Insurance | Services | Total |
|---|---|---|---|---|---|---|---|---|
| Managerial | -- | 64 | 8 | 11 | 3 | 7 | 13 | 106 |
| White collar | 1 | 347 | 21 | 94 | 19 | 4 | 80 | 566 |
| Secretarial | -- | 47 | 2 | 18 | 5 | 9 | 27 | 108 |
| Intermediate | -- | 92 | 3 | 20 | 74 | -- | 14 | 203 |
| Skilled workers | 4 | 471 | 306 | 116 | 18 | -- | 29 | 944 |
| Semi-skilled | 2 | 303 | 153 | 181 | 12 | -- | 18 | 669 |
| Unskilled | 2 | 138 | 74 | 362 | -- | -- | 139 | 706 |
| Total | 9 | 1,462 | 567 | 802 | 131 | 20 | 311 | 3,302 |

Source: *Indagine sui Lavoratori Frontalieri Nella Repubblica Di San Marino, C.D.L.S.*

1/ Data refers to July 1995. The total number of cross border employment is greater in the summer due to seasonal employment.

Table 8. San Marino: Unemployment

| | Male | Female | Total |
|---|---|---|---|
| Unemployment by age | | | |
| 16-18 | 3 | 12 | 15 |
| 19-24 | 39 | 117 | 156 |
| 24-35 | 44 | 171 | 215 |
| 36+ | 17 | 92 | 109 |
| Total | 103 | 392 | 495 |
| Unemployment by age as a proportion of total | | | |
| 16-18 | 0.6 | 2.4 | 3.0 |
| 19-24 | 7.9 | 23.6 | 31.5 |
| 24-35 | 8.9 | 34.5 | 43.4 |
| 36+ | 3.4 | 18.6 | 22.0 |
| Total | 20.8 | 79.2 | 100.0 |
| Unemployed by previous occupation | | | |
| Manufacturing | | | 11 |
| Commerce | | | 3 |
| Services | | | 2 |
| No previous employment | | | 479 |
| Total | | | 495 |
| Type of employment sought | | | |
| Full time | | | 267 |
| Part time | | | 48 |
| Temporary | | | 179 |
| Special | | | 1 |
| Total | | | 495 |
| Education and unemployment | | | |
| Basic literacy | -- | 6 | 6 |
| Elementary school (6-11 years) | 5 | 41 | 46 |
| Middle school (11-14 years) | 14 | 72 | 86 |
| Technical school (14-18 years) | 9 | 56 | 65 |
| High school (14-18) | 57 | 162 | 219 |
| University diploma | 3 | 14 | 17 |
| University degree | 15 | 41 | 56 |
| Total | 103 | 392 | 495 |

Source: Centro Elaborzione Dati e Statistica, *Bolletino di Statistica*.

Table 9. San Marino: Employment Duration of Foreign Workers

| | Duration (1) | Cumulative Total (2) | Cumulative Percentage (3) | Foreign Workers (4) | Duration/Total No. of Foreign Workers (2)/(4) |
|---|---|---|---|---|---|
| Year entering employment | | | | | |
| Before 1980 | 71 | 71 | 2.2 | ... | ... |
| 1981-85 | 51 | 122 | 3.7 | 648 | 18.8 |
| 1986 | 52 | 174 | 5.3 | 768 | 22.7 |
| 1987 | 33 | 207 | 6.3 | 787 | 26.3 |
| 1988 | 72 | 279 | 8.4 | 849 | 32.9 |
| 1989 | 73 | 352 | 10.7 | 984 | 35.8 |
| 1990 | 156 | 508 | 15.4 | 1,194 | 42.5 |
| 1991 | 223 | 731 | 22.1 | 1,467 | 49.8 |
| 1992 | 364 | 1,095 | 33.2 | 1,870 | 58.6 |
| 1993 | 478 | 1,573 | 47.6 | 2,292 | 68.6 |
| 1994 | 702 | 2,275 | 68.9 | 2,613 | 87.1 |
| 1995 | 1,027 | 3,302 | 100.0 | 3,302 | 100.0 |

Source: *Indagine suo Lavoratori Frontalieri Nella Republica Di San Marino, C.D.L.S.*

Table 10. San Marino: Age Distribution of Cross Border Workers 1/

| | Total | Percentage |
|---|---|---|
| Age | | |
| 14-19 | 59 | 1.8 |
| 20-24 | 460 | 13.9 |
| 25-29 | 824 | 25.0 |
| 30-39 | 1.059 | 32.1 |
| 40-49 | 597 | 18.1 |
| 50-59 | 267 | 8.1 |
| 60-64 | 35 | 1.1 |
| 65+ | 1 | -- |
| Total | 3.302 | 100.0 |

Source: *Indagine suo Lavoratori Frontalieri Nella Republica Di San Marino, C.D.L.S.*

1/ July 1995.

## The Pension System 1/

This appendix describes the existing pension system in San Marino, illustrates the main points of a draft reform recently proposed by the government, assesses its implications and discusses possible alternative reform options, namely a fully-funded system. The appendix also estimates the transition costs of switching from a pay-as-you-go to a fully-funded pension system.

### 1. The current pension system

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 age 65 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/ 3/

The minimum retirement age for old-age pensions is 60, except for farmers and employers, who may only retire at 65. Public employees are entitled also to seniority pensions provided they have contributed for at least 35 years and have reached 56 years of age. If an individual retires the year he becomes eligible, the pension is determined as a fraction of the simple average (corrected for inflation) of the individual's income over the last five years for dependent workers (ten years for self-employed), 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 55 million (in 1995), whichever is less. The monthly pension is also subject to a minimum in 1995 equal to Lit 1,081,810 for farmers and Lit 1,102,475 for all other categories. 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 additional year in the labor

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1/ Prepared by Alessandro Prati.

2/ These pensions, called *pensioni sociali*, amounted to Lit 560,000 per month in 1995 paid for 13 months a year. This amount is indexed to the average wage. To obtain a *pensione sociale*, a person must have an income smaller or equal to the current legal amount of the *pensione sociale*. If the income is smaller but greater than zero, the *pensione sociale* is reduced correspondingly.

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

force, but also an additional 3 percentage points of the resulting pension for each year of delayed retirement. All pensions are fully indexed to past inflation.

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 (ten for self-employed), 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 pensions of cross-border workers are regulated by a convention with Italy. If cross-border workers pay contributions for at least 20 years to either Italy or San Marino, then they will receive from San Marino a fraction--proportional to the number of years worked in San Marino--of the pension to which they would be entitled on the basis of Sammarinese laws; the reference income will be the average income earned in San Marino adjusted for inflation. If cross-border workers pay contributions for less than 20 years to either Italy or San Marino, then they will receive from San Marino only a rent (*rendita*) based on the capitalized contributions paid to San Marino. This payment is usually far less generous than the regular pension.

The pension system is financed by a combination of payroll taxes and 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 surpass 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. 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

| | Worker | Employer | State |
|---|---|---|---|
| All dependent workers | 1.6 | 10.3 | 1/10 x (1.6+10.3) = 1.19 |
| Artisans, handicraft | 16.2 | ... | 1/4 x (14.0) = 3.5 |
| Agricultural workers | 10.0 of minimum income | ... | 80 percent of the deficit |
| Shopkeepers | 17.5 | ... | 1/4 x (17.5) = 4.375 |
| Professionals and entrepreneurs | 10.0 | ... | 1/10 x (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 1). 1/ At the end of 1995, although the 1995 surplus had not yet been included, reserve funds of the pension system had reached 62 billion lire (5.8 percent of GDP). 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 2). The pension fund for employees is running substantial surpluses while funds of the self-employed workers are in deficit. Since significant demographic differences across workers in different sectors are unlikely, and self-employed pay higher contribution rates and retire later, this result reflects mainly greater evasion of contributions by self-employed workers.

2. The reform proposal of the government

The government has recently prepared a draft pension reform to be discussed with trade unions and industrialists. The main points of the draft law are:

- a gradual increase of the minimum retirement age for seniority pensions of public employees from 56 to 60;

- a gradual increase of the minimum retirement age for old-age pensions of (public and private) dependent workers from 60 to 65, allowing for seniority pensions after 60 years of age for all those with at least 35 years of contributions;

- a gradual increase of the minimum number of years of contribution to qualify for a pension from 15 to 20;

- a reduction in the coefficient used to compute pensions from 3 to 2.2 percent per year for the first 15 years of contributions and from 2 to 1.8 percent for each additional year;

- a gradual increase from 5 to 10 years of the period on which the average reference salary is calculated;

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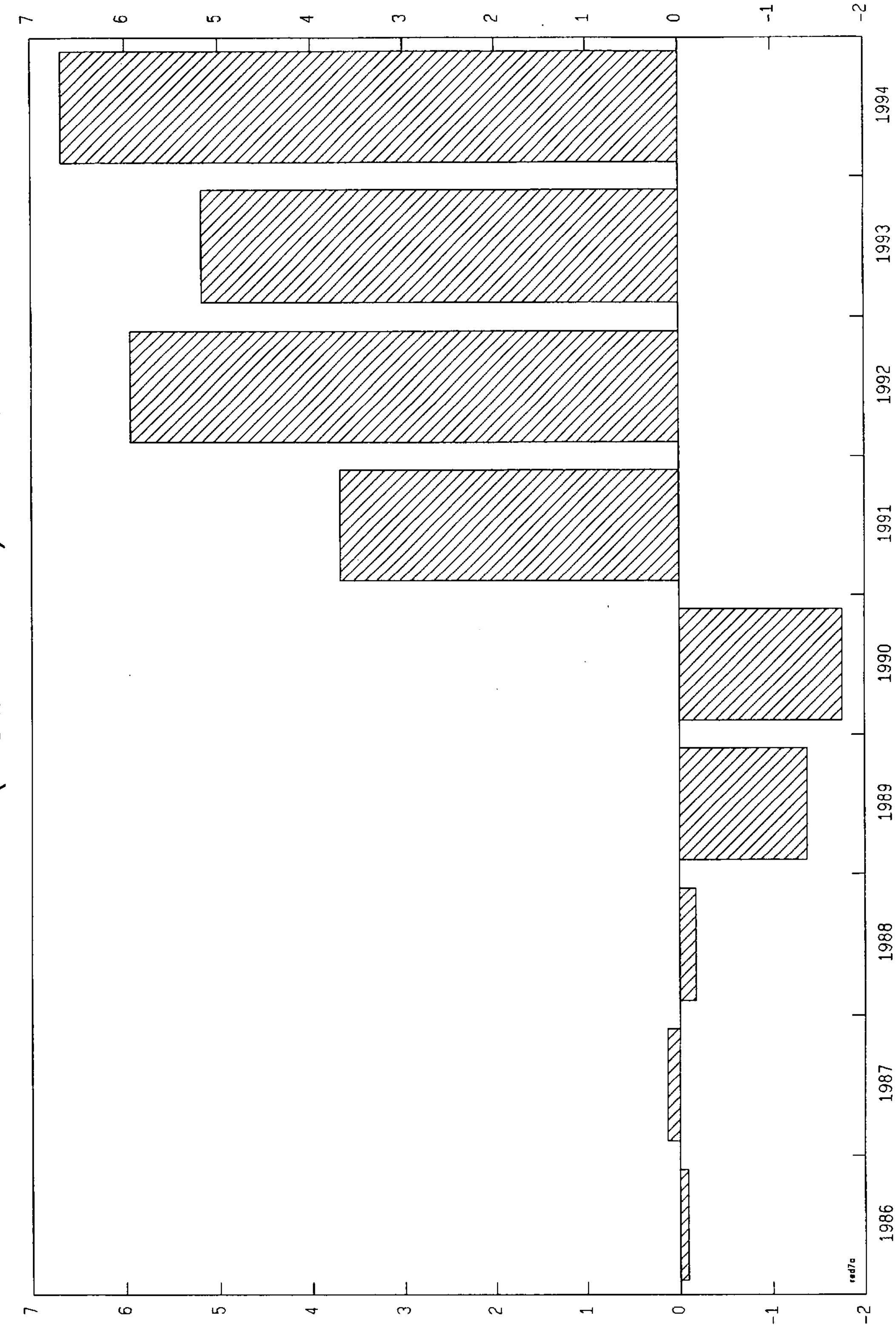
1/ Currently, social security contributions to pension funds are larger than the current outlays in the funds for dependent workers, professionals and entrepreneurs, which together account for about 70 percent of total benefits.

CHART 1
SAN MARINO
Annual Cash Flow of Pension Funds
(In billions of lire)

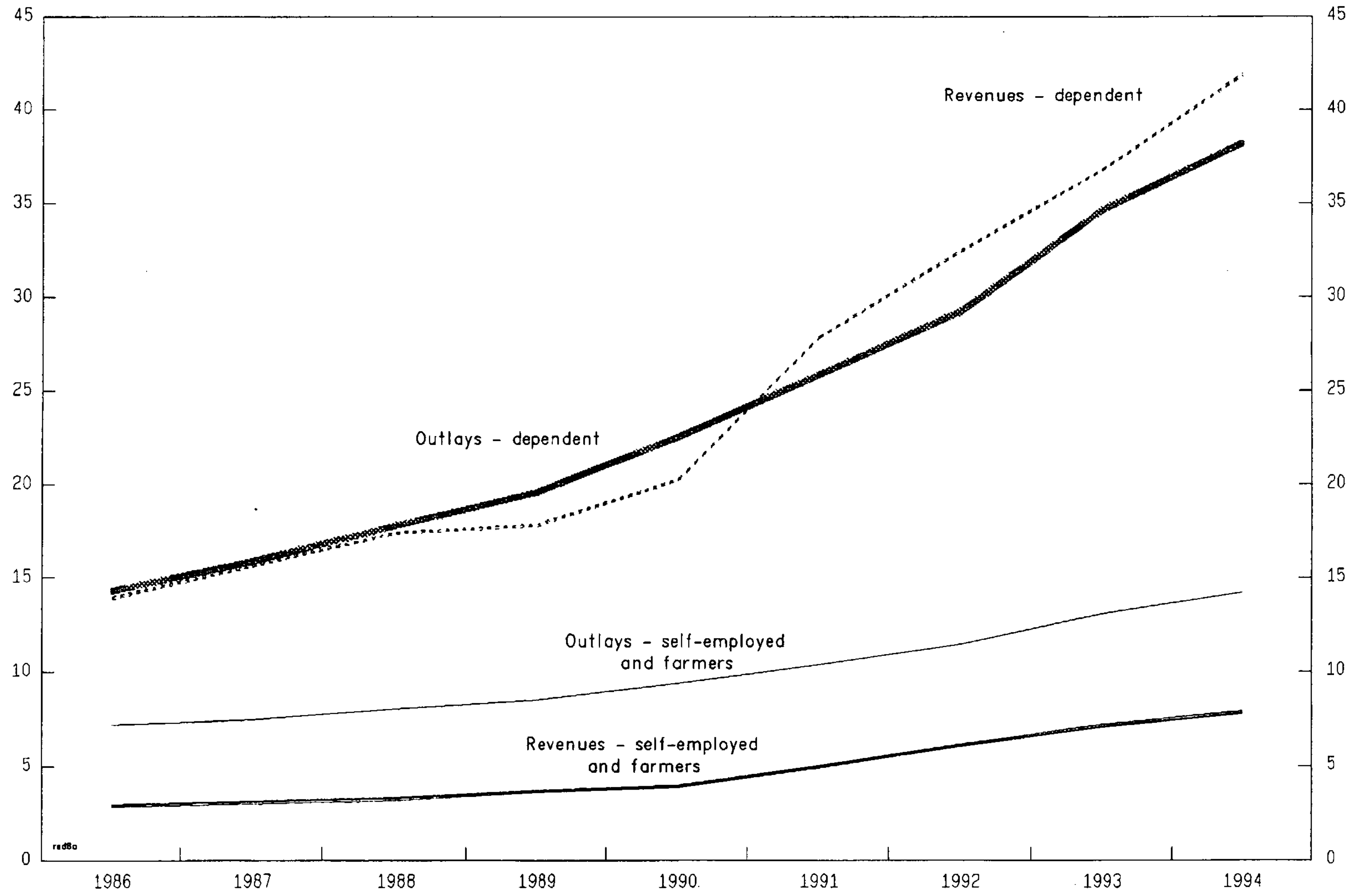



Source: Relazione Previsionale e Programmatica.

CHART 2

SAN MARINO

**Pension Funds: Revenues and Outlays 1/**




Source: Relazione Previsionale e Programmatica.

1/ Revenues include government contributions.

- an increase of the contribution rate of dependent workers from 11.9 to 12.5 percent, of which 2 percent would be paid by the worker and 10.5 percent by the employer;

- an increase in the maximum annual income on which contributions are paid from current Lit 58 million to Lit 58 million plus 60 percent of the additional income until Lit 80 million plus 40 percent of the additional income above Lit 80 million (all brackets indexed to inflation);

- a larger scope for voluntary contributions;

- new norms disciplining optional private pension funds.

3. Outlook and reform options

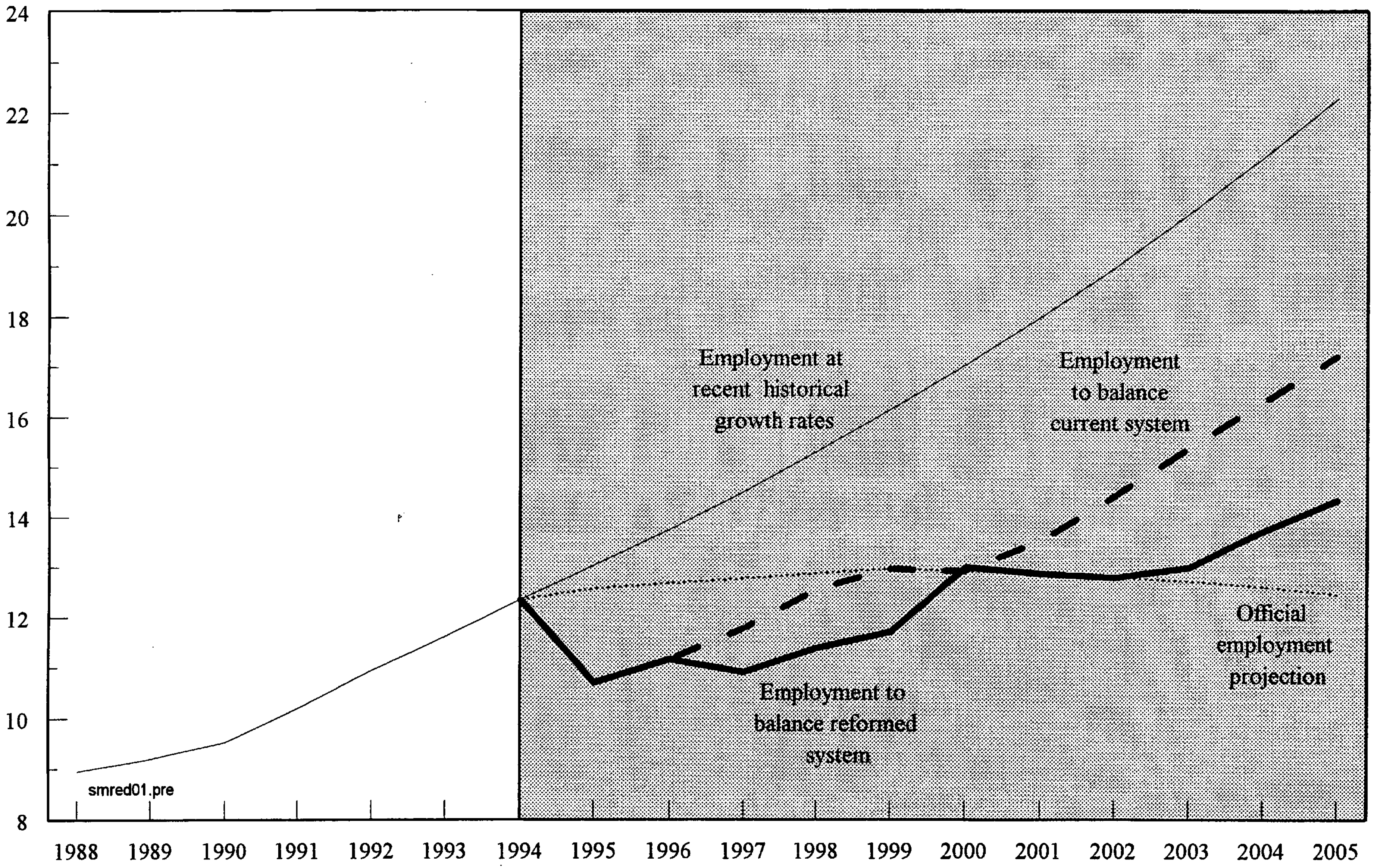
The financial situation of the pension system is currently being helped by a favorable demographic situation. The ratio of number of workers contributing to the ISS to retirees is 4:1, compared to 1:1 in Italy. This favorable ratio is due in great part to the presence of a significant number of cross-border workers (*frontalieri*) and recent re-immigration of relatively young Sammarinese living abroad. Demographic projections show that with no further inflow of cross-border workers the ratio of workers to retirees would deteriorate rapidly to 2:1 in 2005 and to 1½:1 in 2010.

Chart 3 illustrates how the solvency of the dependent workers' pension fund crucially depends on future employment developments. As a benchmark, the chart shows the employment path that would balance the current system, corresponding to an average growth of 3.1 percent per year in the next decade. This is well below the annual average of 5.5 percent experienced in the period 1988-94. If employment continued to grow at similar rates for the next decade, the dependent workers' fund would accumulate further reserves and pension benefits could be maintained. In contrast, if the inflow of cross-border workers stopped and employment grew in line with Sammarinese working age population as in the official projections, reserves of the current system would start decumulating in five years. Finally, the chart shows the employment level that would balance a system reformed along the lines of the recent government proposal. In this case, employment growth should average only 1.4 percent per year to balance the system. If, instead, there was no employment growth and a reformed system, deficits would emerge in seven years time.

Employment growth rates recently experienced by San Marino, as well as those needed to balance the current and reformed system, are extremely high by European standards. 1/ In the medium term, the required employment growth could also be difficult to achieve since the mere physical size of

1/ Employment growth in the European Union averaged an annual 0.2 percent between 1978 and 1995.

Chart 3
Employment Projections
(In thousands of dependent workers)




Sources: Data from the authorities and staff estimates.

San Marino would limit employment. In addition, due to its small size, San Marino is vulnerable to external shocks that could have a negative effect on employment growth in the future. Finally, the high employment growth necessary to balance the system implies that current benefits are extremely generous in relation to contributions and that the current system is not fair across generations because it redistributes a large amount of resources from the working population to retirees. These considerations indicate that the pension system cannot rely on high employment growth to maintain solvency, and that equity can be enhanced by increasing the link between benefits and contributions.

The reform proposed by the government is a commendable effort toward increasing the efficiency and equity of the system, but it has a number of shortcomings. First, the phasing-in of several provisions is too slow: for example, the minimum retirement age for seniority pensions of public employees will need 20 years to increase from 56 to 60. Second, seniority pensions are not penalized with respect to old-age pensions to take into account the fact that seniority pensioners are likely to receive a pension for a longer period than old-age retirees. Third, the increase from 5 to 10 years used to compute the average reference salary is insufficient; average lifetime income would be better since it would eliminate the incentives to under-report incomes, especially among self-employed. Fourth, as long as the link between benefits and contributions remains weak, increasing the scope for voluntary contributions is dangerous since it offers investment returns well in excess of those offered by financial market investments, at a cost to the public finances. Finally, as long as the system remains on a pay-as-you-go basis, cross-subsidization among pension funds should be allowed so that the solvency of the system would not be affected by shocks in the sectoral composition of the labor force; of course, this requires equalizing the rules regulating the pension system of each category of workers.

A more radical reform aimed at replacing the current pay-as-you-go system with a fully-funded system would have many advantages. First, a fully-funded system would not depend on uncertain and continuous flows of cross-border workers to remain solvent. Second, it would not require continuous revision to the system's parameters to maintain solvency. Third, it would introduce greater fairness across generations by eliminating the current redistribution of resources from the working population to retirees. It must be pointed out that pensions for the most needy segments of the population could still be financed out of general government revenues. Fourth, the system would increase labor market efficiency and promote the diversification of assets.

The feasibility of this reform option clearly depends on the resources available to finance the transition from the current pay-as-you-go to a fully-funded system. San Marino is a country particularly well-suited to consider this possibility since the Social Security Institute has accumulated sizeable reserve funds, the central administration has a positive net asset position, and the budget is in balance. For dependent workers--some 80 percent of total employment--the staff estimated that the discounted present value of future pension flows of current retirees would amount to about 15 percent of 1993 GDP 1/ while the pension rights accumulated so far by those still working would total about 100 percent of GDP. 2/ 3/ The sum of these amounts provides an approximation of the transition costs of shifting to a fully-funded system, but it is also a measure of the costs that will have to be incurred under the existing rules of the current pay-as-you-go system simply to pay the pensions matured until 1993. Further work is necessary to refine these estimates.

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1/ This figure is obtained taking into account the 1993 age distribution of retirees, their average pension, an average life expectancy of 77 years and a 3 percent discount rate.

2/ This approximate calculation adds the discounted present value of the pension flows to which each age group would have been entitled in 1993 on the basis of the current rules and the average number of years of contribution. Note that age groups with less than 15 years of contributions were assumed to have right to a pension proportional to the number of years of contribution.

3/ Note that this estimate is very sensitive to the coefficients used for the calculation of pension benefits. Using the coefficient proposed in the draft reform law (2.2 percent for the first 15 years and 1.8 percent thereafter), the estimate of the pension rights so far accumulated by the working population of dependents would fall to about 75 percent of GDP. Alternatively, this figure would be reduced to about 50 percent of GDP with a uniform coefficient of 1.5 percent and to 35 percent of GDP with one of 1 percent.

## Exchange and Trade System
## (Position as of December 31, 1995)

### 1. Exchange arrangement

The currency of San Marino is the Italian lira. 1/ 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 accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund Agreement, on September 23, 1992.

### 2. Administration of control

Under the terms of the Agreement on Financial and Exchange Relations of May 1991, the Istituto di Credito Sammarinese is 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.

### 3. 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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1/ 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).

4. 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.

5. Imports and import payments

Imports from Italy are not subject to restriction, whereas imports from third countries are subject to control under 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.

6. Payments for invisibles

There are no restrictions on payments for invisibles.

7. 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.

8. Proceeds from invisibles

Proceeds from invisibles are not regulated.

9. Capital

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.

10. Gold

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

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Appendix I: State Aid to Sammarinese Industry
Appendix II: The Social Security System