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SAN MARINO

Selected Issues and Statistical Appendix

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Approved by European Department

July 12, 2004

Contents Page

I. Financial Sector Developments and Prospects—The Role of Regulation and Supervision...3
A. Introduction and Summary....3
B. Recent Developments and Characteristics....5
C. The Evolving Regulatory and Supervisory Environment....14
D. Concluding Remarks....20

Text Box
1. Offshore Financial Centers and OFC-Like Jurisdictions....4
2. Central Bank of San Marino (CBSM): Functions and Responsibilities....15
3. Luxembourg's Financial Sector....19

Figures
1. Bank Profitability, 1998–2003....6
2. Bank Deposits and Managed/Administered Funds, 1998–2003....7
3. Bank Efficiency, 1998–2003....8
4. Capital Ratios and Non-Performing Loans, 1998–2003....9
5. Banking Sector Indicators, 1998–2003....11
6. Ratio of Loans to Total Assets, 1998–2003....12

Tables
1. International Financial Centers: Financial Sector Characteristics....13
2. International Financial Centers: Regulation and Supervision....18

References....21

II. Budgetary Performance Revisited 22
A. Why Should We Care About Accounting Frameworks? 22
B. Reconciling Stocks and Flows on an Accrual Basis 24
C. Measuring Fiscal Policy Performances 27
D. Beyond the Central Administration 33
E. Conclusions 38

Tables
1. Statement of Central Administration Operations, 1992–2004................................27
2. Alternative Definitions of Fiscal Balance, 1992–2004..31
3. Balance Sheet, 1992–2004...32
4. Net Asset Float, 1992–2004...33

References..39

Statistical Appendix Tables
1. National Accounts, 1992–2002..40
2. National Accounts, 1992–2002..41
3. National Income in Current and Constant Prices, 1997–2002................................42
4. Labor Market Developments, 1992–2003 43
5. Total Employment, 1992–2003..44
6. Central Administration Operations, Accrual Basis, 1992–2004.............................45
7. Public Debt, 1992–2003...46
8. Pension System, 1992–2003 47
9. Interest Rates, 1996–2003..48
10. Monetary Authorities, 1996–2004 49
11. Monetary Survey, 1996–2004...50
12. International Reserve-Like Assets, 1996–2004 51

I. Financial Sector Developments and Prospects—The Role of Regulation and Supervision[1]

A. Introduction and Summary

1. **The paper reviews recent developments in the financial sector of San Marino and provides an update of financial sector regulation and supervision, offering some recommendations on steps to upgrade the regulatory and supervisory framework.** After an overview of recent changes in the banking and nonbanking sectors, the paper examines the issues arising from the recent merger of the Istituto di Credito Sammarinese (ICS) and the Office of Bank Supervision (OBS) to form the Central Bank of San Marino (CBSM). The paper also presents the case for the progressive enhancement of the regulatory and supervisory framework to maintain a sound financial sector, and discusses how the sector's development could benefit from best practices in other international financial centers.

2. **The financial sector of San Marino engages in a broader set of activities than that of its neighboring Italian regions, offering offshore financial services (Box 1).** However, it is not as well developed as other small international financial centers (e.g., the Cayman Islands, Liechtenstein, and Luxembourg). While Sammarinese financial institutions accept foreign deposits and managed funds to a much larger extent that comparators in neighboring regions, there are no mutual funds or international bonds issued under San Marino law unlike the common practice in several international financial centers.[2] The measured strategy undertaken for financial sector development in San Marino, reflecting the view that a small economy must primarily avoid mistakes and the risk of reputational losses, has created a successful financial sector with a reputation for stability. However, increased international competition, tax amnesties in Italy, prospective changes in savings taxation, and the growth in the number of bank and nonbank financial intermediaries have eroded profits in recent years.

3. **There is considerable room to increase the flexibility and innovation needed to remain internationally competitive, while maintaining the strengths and soundness of the financial system.** To create conditions for further development–attracting substantial funds and reaching a size typical of a full-fledged financial center—the Sammarinese financial sector needs to widen the range of services offered, sustain its efficiency, modernize its financial legislation, and maintain a supervisory and regulatory environment that ensures the soundness of the system without imposing an overwhelming burden. Enhancing the regulatory and legislative framework of the financial sector will allow Sammarinese financial institutions to successfully offer additional financial products and

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[1] Prepared by George Anayiotos.

[2] For a detailed description of the structure of the Sammarinese financial sector see Krueger (2001).

Box 1. Offshore Financial Centers and OFC-Like Jurisdictions

Financial sector indicators place San Marino in the category of countries and jurisdictions that are well established as offshore financial centers (OFCs), or OFC-like jurisdictions. However, San Marino has not been included in any of the official OFC lists of countries, territories, and jurisdictions, ranging from the 14 OFCs listed in the joint BIS-IMF-OECD-World Bank statistics on external debt, to the 69 OFCs listed in Errico and Musalem (1999). Neither it has been included in the 19 OFCs constituting the Offshore Group of Banking Supervisors, the list of 20 OFCs using the BIS statistical definition (see below), or the 42 OFCs considered by the Financial Stability Forum's Working Group on Offshore Financial Centers.[1/]

At its broadest, an OFC can be defined as any financial center where offshore activity takes place. A more practical definition of an OFC is a center where the bulk of financial sector activity on both sides of the balance sheet is offshore. That is, the counterparties of the majority of financial institutions' liabilities and assets belong to nonresidents, where the transactions are initiated elsewhere, and where the majority of the institutions involved are controlled by nonresidents. Thus, OFCs are usually referred to as the following:

- jurisdictions with large numbers of financial institutions engaged primarily in business with nonresidents;
- financial systems with external assets and liabilities out of proportion to domestic financial intermediation designed to finance domestic economies; and
- more popularly, centers that provide some or all of the following services: low or zero taxation, moderate or light financial regulation, and banking secrecy and anonymity.

However, the distinction is by no means clear-cut. In addition to banking activities, other services provided by offshore centers include fund management, insurance, trust business, tax planning, and International Business Center (IBC) activity. Also, in the statistical definition of an OFC used by the BIS,[2] an OFC is defined as a jurisdiction in which banks' external liabilities and/or international securities issues are close to or more than 50 percent of GDP and in absolute terms more than $1 billion. With $6.6 billion nonresidents' funds in 2003, San Marino meets the BIS OFC definition.

1/ See IMF (2000b).

2/ Used to compile a list of OFCs for which statistics are available (drawing from the BIS international locational banking statistics and the BIS database on international debt securities), and to classify OFCs in presentations and analysis of the BIS banking statistics. See IMF (2002a).

services and extend their activities outside the country. The introduction of a new banking law and legislation on insurance, mutual and pension funds, and other financial sector products and activities, as well as tax-related legislative initiatives and international agreements for the treatment of financial services, are also necessary to develop the sector. Following the recent Parliamentary approval of new anti-money laundering and counter-financing of terrorism (AML/CFT) provisions bringing San Marino further into line with international standards, and the complete adoption of the 1988 Capital Accord of the Basel Committee on Banking Supervision (Basel I), the supervisory authorities need to prepare for this broader range of services and products that Sammarinese financial institutions will have to offer to support their expansion and to minimize the negative impact of the higher withholding taxes on interest income entailed by a recent agreement with the EU.

4. **The paper is structured as follows:** Section II presents recent developments and characteristics of the financial sector, portraying a sector that has experienced a decline in profitability, while maintaining efficiency, high capitalization, and a low ratio of nonperforming loans. Section III reviews the evolving regulatory and supervisory environment, describing recent key changes, such as setting up a central bank, and suggests measures to nurture the Sammarinese financial sector into a full-fledged financial center. Section IV offers concluding remarks.

B. Recent Developments and Characteristics

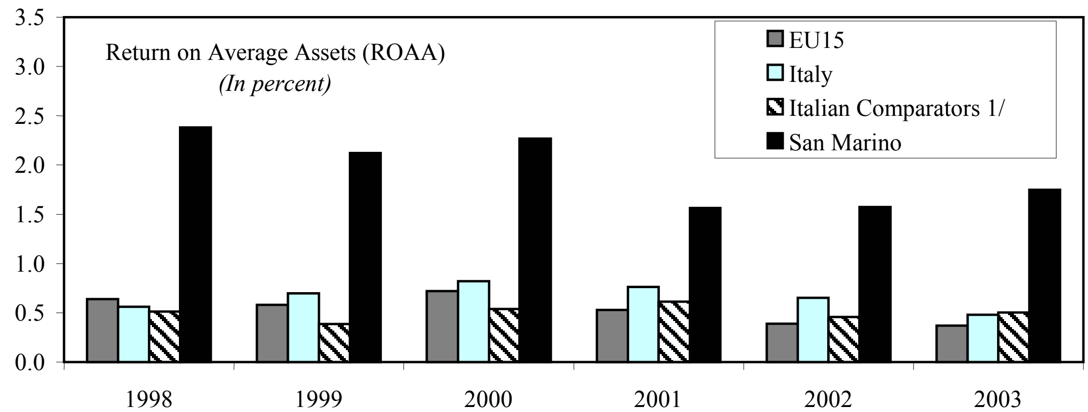
5. **Between 1997–2000 and 2001–03, average financial sector profits fell by about one-third in real terms.** Bank profitability suffered a setback because of increased competition from new entrants and a tax amnesty in Italy (Figure 1).[3] In contrast to the declining number of banks in the euro zone and Italy, the number of banks operating in San Marino more than doubled between 2000 and 2003 (from 4 to 10) and a large number of nonbank financial institutions started operations, intensifying competitive pressures. In addition, a tax amnesty in Italy (*scudo fiscale*)[4] led to an appreciable repatriation of funds deposited in San Marino, including both deposits and funds under management (Figure 2). As Italian investors repatriated funds, income from commissions and fees dropped. Sammarinese banks remain, however, more efficient (with low cost income ratios and high value added per employee) and better capitalized than their comparators, and with fewer nonperforming loans (Figures 3–4).

[3] Comparisons in figures may not be fully accurate, as data for some comparators are from Bankscope and may not be complete for some countries and years.

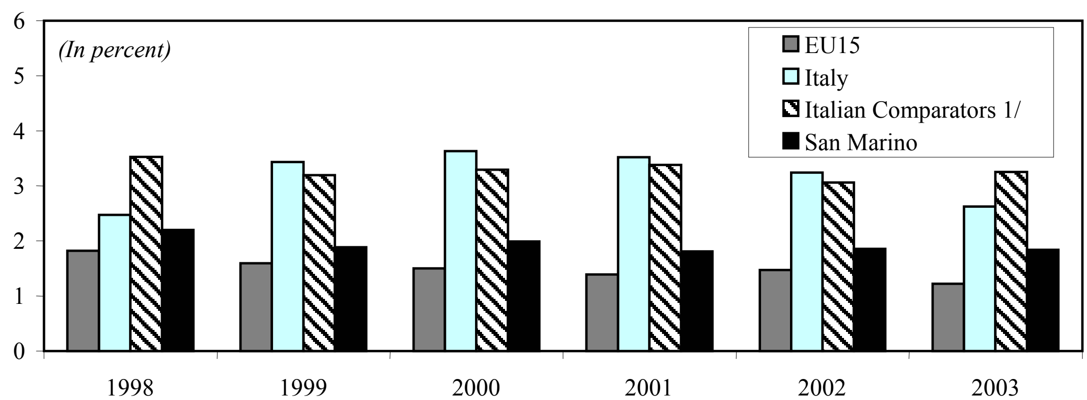
[4] The *scudo fiscale* consisted of a 2002–2003 tax amnesty on undeclared capital held abroad that resulted in an outflow to Italy of about €760 million (11 percent of 2001 nonresidents' funds).

Figure 1. San Marino: Bank Profitability, 1998-2003

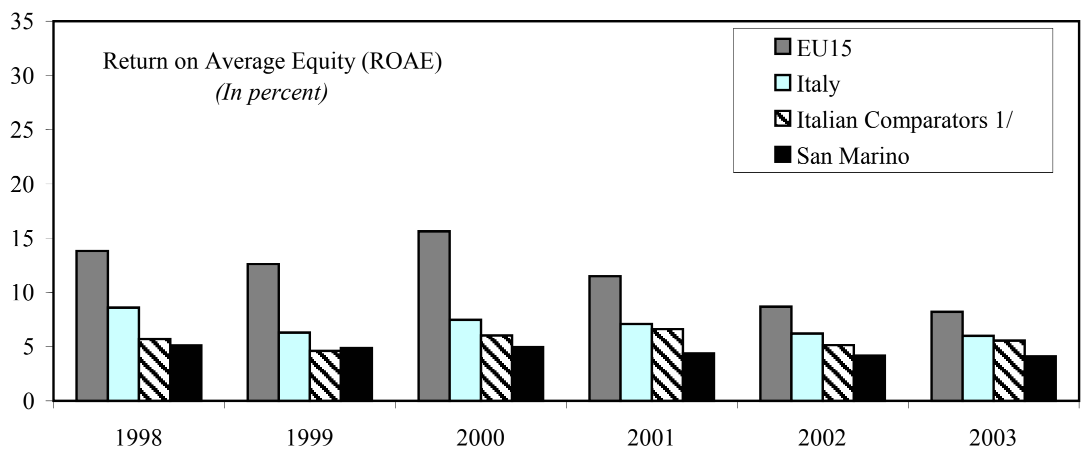
Profitability declined markedly after 2000...



...although the net interest margin remained healthy...

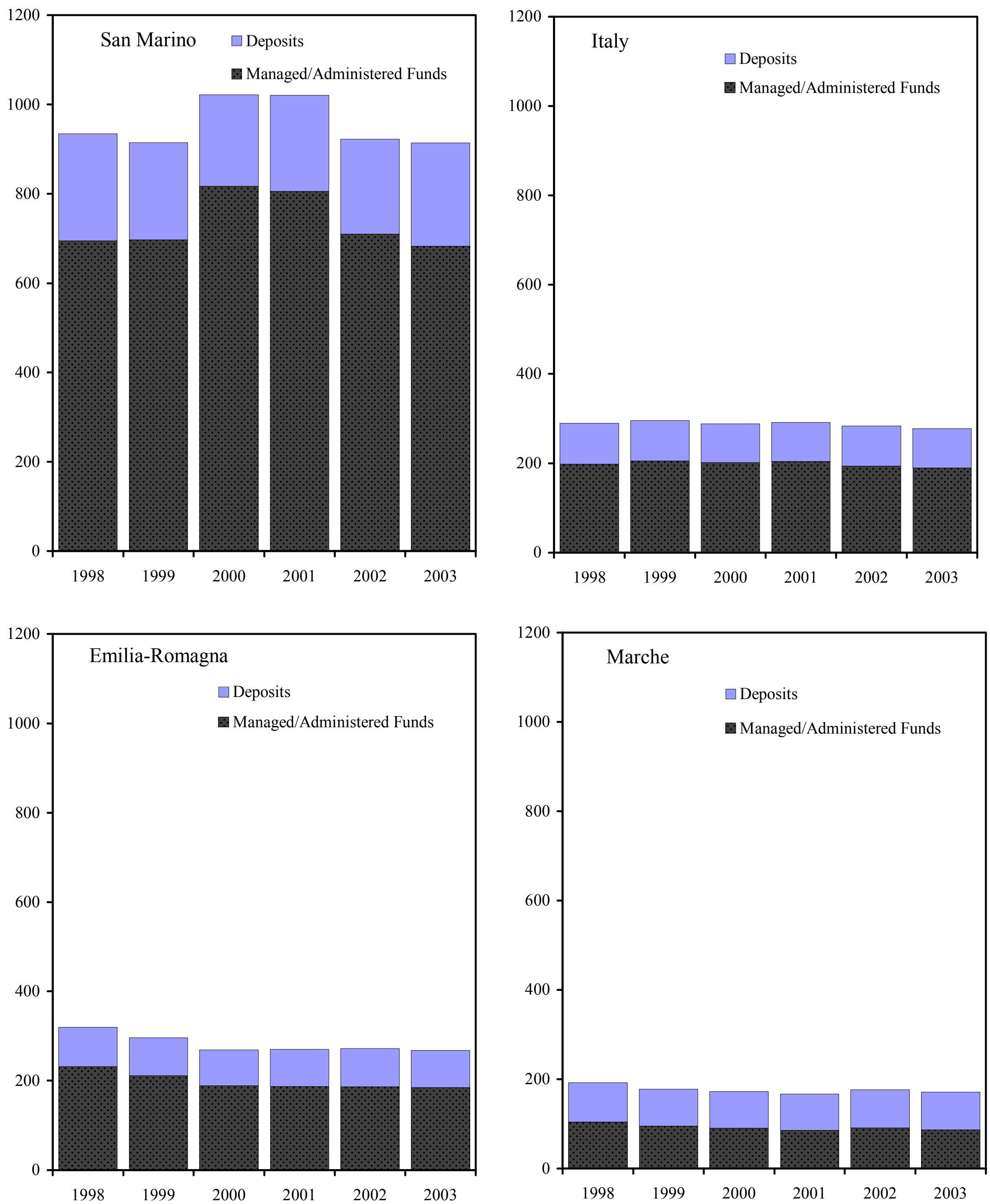


...while the ROAE remained low because of high capitalization relative to comparators.



Sources: Department Supervision of the Central Bank of San Marino; and Bankscope.
1/ Banca delle Marche, Cassa di Risparmio di Rimini, Cassa di Risparmio di Cesena, Cassa di Risparmio di Ravenna and Banca Popolare dell'Adriatico.

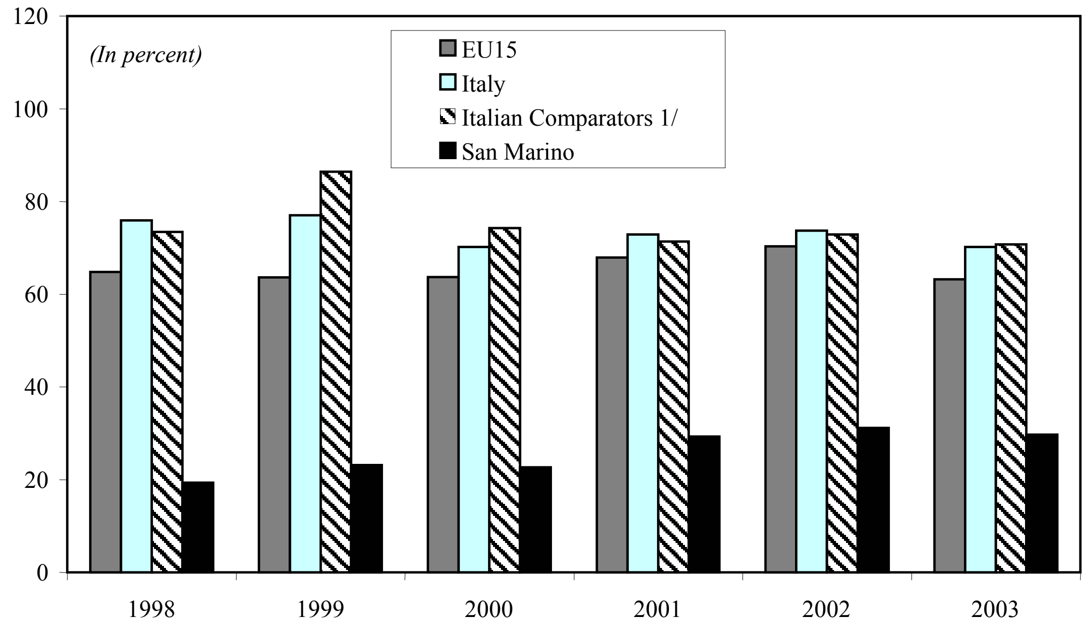
Figure 2. San Marino: Bank Deposits and Managed/Administered Funds, 1998-2003
(In percent of GDP)



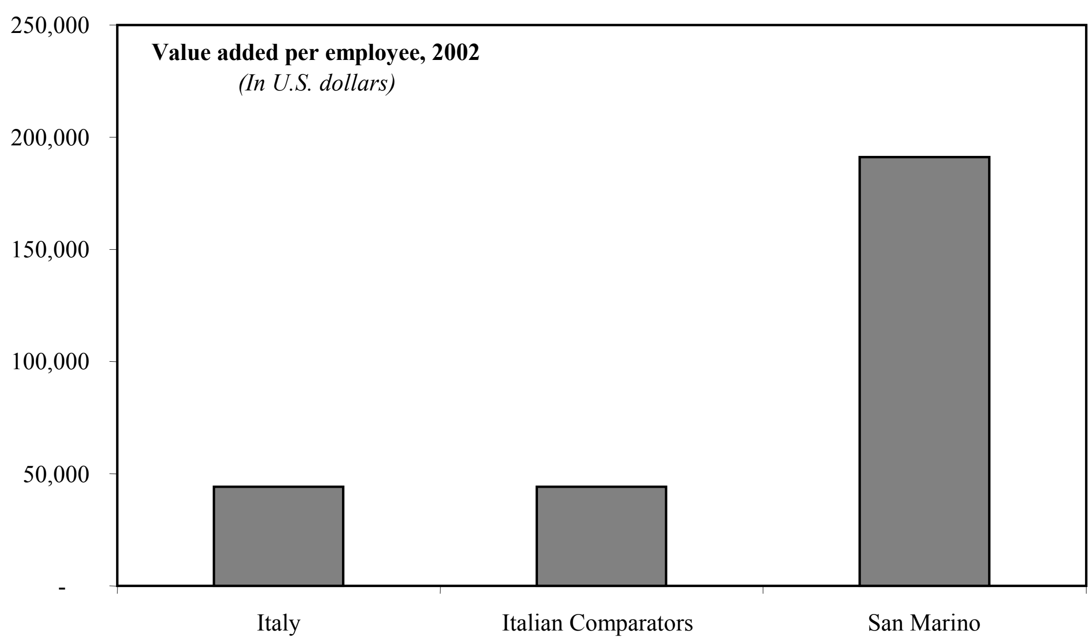
Sources: Bank of Italy; and Central Bank of San Marino, *Financial Statements 2003*.

Figure 3. San Marino: Bank Efficiency, 1998-2003

Cost income ratios are lower in San Marino ...



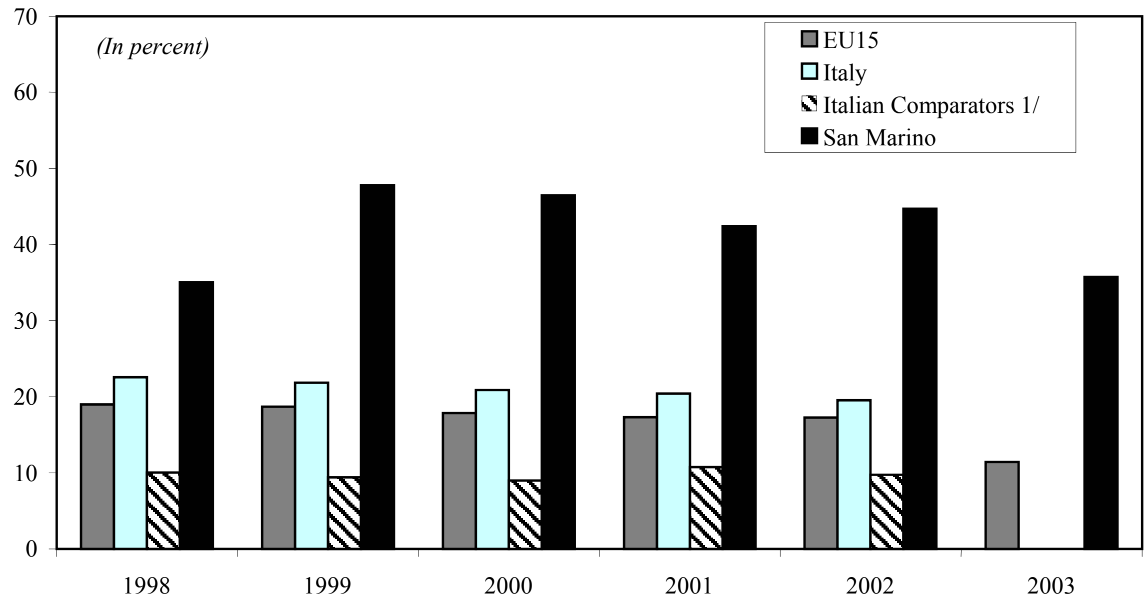
... and value added is higher than in Italian banks.



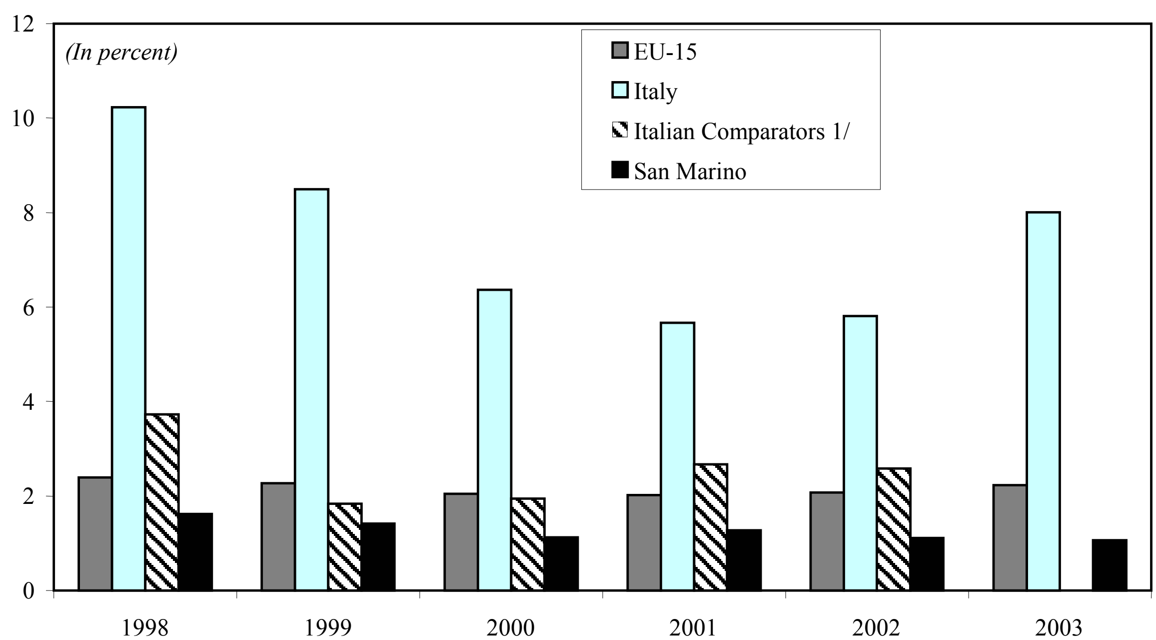
Sources: Department Supervision of the Central Bank of San Marino; and Bankscope.
1/ Banca delle Marche, Cassa di Risparmio di Rimini, Cassa di Risparmio di Cesena, Cassa di Risparmio di Ravenna and Banca Popolare dell'Adriatico.

Figure 4. San Marino: Capital Ratios and Non-Performing Loans, 1998-2003

Banks remain well capitalized with Tier 1 capital ratios well above Italian comparators.



Nonperforming loans are well below Italian comparators and EU averages.



Sources: Department Supervision of the Central Bank of San Marino; and Bankscope.
1/ Banca delle Marche, Cassa di Risparmio di Rimini, Cassa di Risparmio di Cesena, Cassa di Risparmio di Ravenna and Banca Popolare dell'Adriatico.

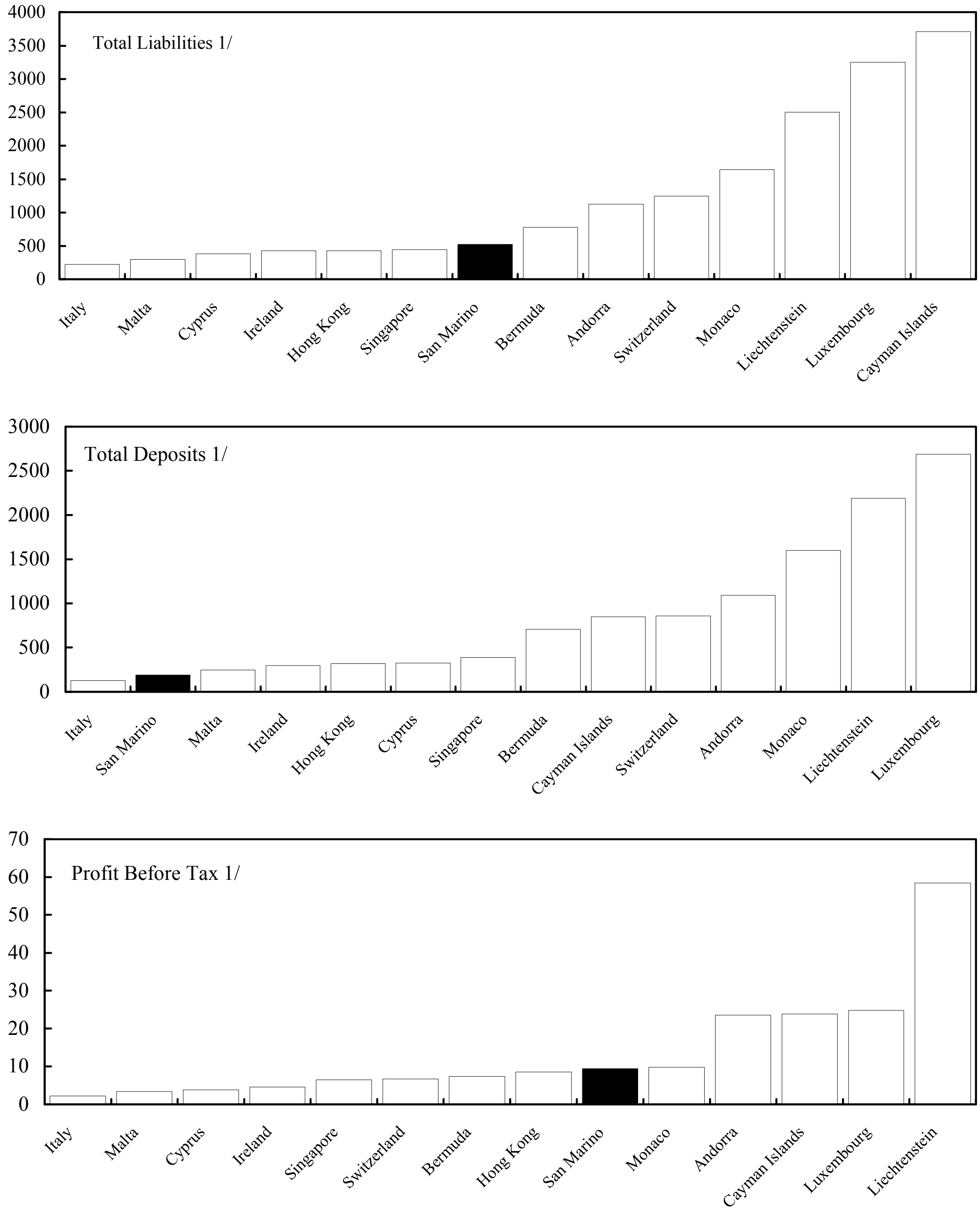
6. **San Marino has developed a financial sector that is not only much larger than any of those in the small cities of the surrounding Italian regions but even compares favorably in size to financial sectors in other countries, both small and large.** Mainly because of tax advantages and efficiency of services, San Marino's financial sector engages in a broader set of activities than financial institutions in neighboring Italian regions. Deposits and managed funds in Sammarinese banks are about ten times GDP, against a ratio of two-three times GDP in Italy and neighboring regions (Figure 2). While the Sammarinese financial system is large by international standards, it does not reach the size of other small centers as a percent of GDP (e.g., Luxembourg, Andorra, Monaco, Liechtenstein, and the Cayman Islands), faring better in terms of total liabilities and profits than deposits (Figure 5).

7. **Until recently, San Marino lacked the diversity of financial institutions and financial services available to customers in other international financial centers (Table 1).** Until 2000, there were only four banks in San Marino and a limited number of nonbank financial institutions, which together offered a limited number of financial products to customers.[5] With regard to offshore activities, San Marino relies mostly on Italian deposits, while other international financial centers tend to have more diversified sources of funding. Domestic insurance companies and mutual funds are not licensed to operate in San Marino, while bank and nonbank financial institutions in other well-established financial centers offer a wide variety of financial services, including insurance, mutual funds, and private banking services. Loans of Sammarinese banks to productive sectors of the economy remain modest and well below levels in other financial centers (Figure 6), because banks invest a large part of their customers' on-balance-sheet funds in low-yielding/low-risk interbank placements and government securities. This explains the Sammarinese banks' high solvency and liquidity ratios.

8. **Since 2000, the number of financial institutions in San Marino and the range of financial services offered has increased.** The number of banks has risen to 10, with two more about to open (all Sammarinese banks, with two owned by Italian banks). About 40 nonbank financial institutions offer customers a variety of financial products and services. These mainly include fund management and private banking services, but also a diverse range of real estate-related financial products. Sammarinese financial institutions, including asset management subsidiaries of some banks, are developing expertise in personal/private banking and focusing more on asset management. These products are being developed as alternatives to bank deposits in response to the customer demand arising in the low-interest environment. For banks with asset management subsidiaries, off-balance-sheet investment products are tilting the ratio of on-/off-balance sheet financial services in favor of asset

[5] Nonfinancial institutions, included real estate leasing companies financing construction, a firm specializing in providing personal and consumer credit to employees of larger firms against future wages, and a number of firms acting as asset managers or as fiduciary agents for control of companies inside and outside San Marino.

Figure 5. San Marino: Banking Sector Indicators, 1998-2002
(5-year average, in percent of GDP)

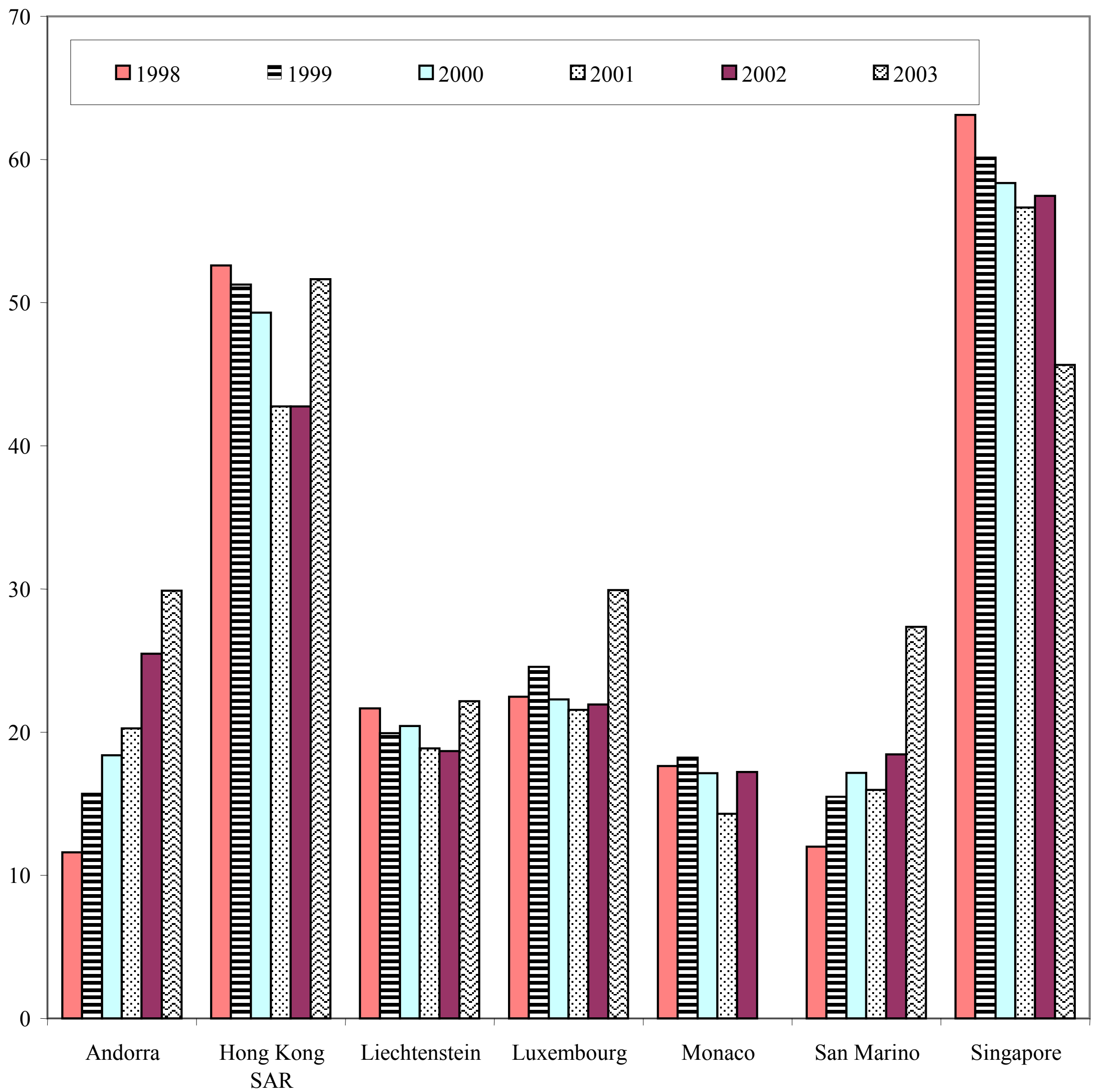


Sources: Bankscope; *World Economic Outlook;* United Nations; and Fund staff estimates.

1/ To ensure comparability, data for San Marino are also from Bankscope and differ from those in Figure 2. Specifically, total liabilities and deposits do not include managed/administered funds, although related commissions and fees contribute to profits.

Figure 6. San Marino: Ratio of Loans to Total Assets, 1998-2003

(in percent)



Source: Bankscope and Fund staff estimates.
1/ Preliminary data for 2003.

Table 1. San Marino: International Financial Centers: Financial Sector Characteristics

	Type of Services	Insurance Activities	Mutual Funds	International Bond Issuance	Banking Secrecy	Currency used	Size of Financial Sector
Aruba	Banking Mortgage Fund Management	Yes	No	No	Very limited financial disclosure Numbered accounts not permitted	Aruban Florin	Banks (2001): 10 Credit Unions (2001): 2 Finance Companies (2001): 1 Offshore Legal Entities (2001): 5,000
Andorra	Banking Fund Management Wealth Management	Yes	No	No	Yes	Euro	Banks (2001): 8 Small number of Fund Management firms and Wealth Management Companies
British Virgin Islands	Banking International Business Companies (IBC) providing trust and company services	Yes	Yes	No	Insurance Law provides confidentiality	US$	Banks (2002): 11 Insurance Companies (2002): 30 Mutual Funds (2002): 2,606; Mutual Fund Administrators (2002): 490 IBC (2002): 350,000
Hong Kong SAR	Banking Securities Business (Brokerage) Fund Management Money Brokerage Hedge Funds Mortgage Intermediation	Yes	Yes	Yes	Moderate	HK$	Deposit taking institutions (2001): 229 Insurance (2001): Small number Brokers (2001): 490 Fund Management Companies (2001): 172 Money Brokers (2001): Small number HK Mortgage Corporation
Cyprus	Banking Fund Management International Business Services Trusts	Yes	No	No	Yes for Offshore Banking Units	Cyprus Pound	Banks (2000): 12 domestic, 31 offshore banking units Cooperative Credit Societies (2000): 360 Insurance Companies (2000): 52 domestic, 28 foreign International Business Companies (2000): 47,465
Liechtenstein	Banking Trust Other fiduciary services Investment management Insurance	Yes	Yes	Yes	Yes	Euro	Banks (2002HI): 17 Investment Funds (2002HI): 81 Insurance (2002HI): 12 Trustees (2002HI): 355
Luxembourg	Banking Administrative and Marketing Services Managed Funds	Yes	Yes	Yes	Yes	Euro	Banks (2001): 189 Insurance (2001):357 Investment Funds (2001): 1,908 Other Financial Sector Professionals (2001): 145
Malta	Banking Offshore nominee services	Yes	No	No	No	Malta Liri	Banks (2002): 14 Insurance Companies (2002): 21 Offshore Nominee Companies (2002): 300; to be elliminated by Sept.2004
Monaco	Banking Asset Management Portfolio Management	Yes	Yes	Yes	Yes	Euro	Credit Institutions (2001): 51 Portfolio Mngnt Co. (2001): 24 Investment Funds (2001): 60 Insurance (2001): 49 Company and Trust Service Providers (2001): 40
Republic of Palau	Banking	No	No	No	Yes	US$	Banks (2001): 13 Nonbank Financial Institutions (2001): 11 (3 not in operation) Credit Unions (2001): a number of small ones
San Marino	Banking Fund Management Fiduciary Services	No	No	No	Yes	Euro	Banks (2003): 10 Nonbank Financial Institutions (2003): about 40
Singapore	Trade Financing Loan Syndication Foreign Exchange Trading Derivative Products Securities Trading and Underwriting Fund Management	Yes	Yes	Yes	Moderate; Numbered accounts allowed	Singapore Dollar	Banks (Sept.2003): 166 Finance Companies (Sept.2003): 4 Insurance Companies (Sept.2003): 140 Insurance Brokers (Sept.2003): 59 Holders of Capital Market Services (CMS) licences (Sept.2003): 166 Holders of Financial Advisers' licences (Sept.2003): 48

Source: IMF FSAP, FSSA, and OFC Module II reports.

management and private banking activities, resulting in a decline in net interest revenue in favor of commission income.

C. The Evolving Regulatory and Supervisory Environment

Ongoing Initiatives

9. **Financial sector regulation and supervision are growing hand in hand with the increasing size and diversity of the financial sector.** In March 2003, San Marino adopted Basel I and has since issued the regulations implementing the related capital adequacy requirements.[6] A new banking law and a law that will introduce mutual funds registered in San Marino are under preparation, and the unification of existing financial sector legislation is also being considered.

10. **A Central Bank law is expected to be approved soon forming a full-fledged CBSM in accordance with the June 2003 law on the functional merger of the ICS and the OBS (Box 2).** The nascent CBSM is envisaged to undertake substantially more important activities than the ICS and the OBS, thereby straining its resources.[7] With the growing number of financial institutions, the supervision department is expected to double its staff—from 8 in mid-2003 to 16 at end-2004—to better carry out its functions. At end-June 2004, there were already 13 supervisory staff. Even with a larger staff, the CBSM's capacity to carry out some of the functions specified in the merger law remains questionable. The CBSM cannot be expected to act as lender of last resort because of its inability to issue currency and the small size of its balance sheet in relation to bank deposits. Furthermore, the issuance of public debt may expose the CBSM's resources to risk.[8]

11. **The new Central Bank law provides an opportunity to lay the cornerstone of a solid legislative framework for financial sector regulation and supervision.** The Central Bank law should grant adequate supervisory and regulatory powers to the CBSM and—in line with international best practices—establish a governance structure that ensures its

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[6] The regulations on market risk and derivatives remain to be issued.

[7] For details on the origins and subsequent operations of ICS see Krueger (2001).

[8] In accordance with a 2004 budget provision, an initiative is under way to place an international bond of up to €120 million (about 10 percent of GDP) with up to a ten-year maturity. It remains to be decided whether this bond will be issued directly by the government, by the CBSM on the government's behalf, or directly by the CBSM. This latter possibility should be avoided as it exposes the CBSM's resources to risk and was, in fact, ruled out in a recent deliberation of the CBSM's Board.

Box 2. Central Bank of San Marino (CBSM): Functions and Responsibilities

Steps have been taken to create the CBSM by merging the former San Marino Credit Institute (ICS) with the Office of Banking Supervision (OBS). The process is guided by the June 2003 law establishing the CBSM and guiding the functional merger between the two institutions. A full-fledged Central Bank law detailing CBSM operations has to be submitted to Parliament by September 2004, and—as previously the ICS—the CBSM is expected to advise the government on financial matters. As provided by the merger law, the current Board of the CBSM will be replaced by the *organo collegiale,* composed of at least three members, preferably with experience in finance and banking, elected by Parliament. To address the conflict of interest arising from the fact that commercial banks held a share of the ICS's—and now CBSM's—capital, the September 2004 law is expected to stipulate that the banks will be deprived of the associated voting rights and have no representatives at the CBSM's Board. To safeguard its own stability, the CBSM is required under the merger law to adopt internal audit structures and principles set forth by the laws and regulations in force.

Further to the ICS's main activity (custody and management of government and public enterprise deposits, reinvesting them along with its own substantial capital), and the regulatory and supervisory role of the OBS, CBSM functions specified in the June 2003 merger law include (i) control and supervision of banking, financial, and credit activities carried out by licensed intermediaries, and savings protection and control over financial services and instruments; (ii) operation and supervision of the clearing service and payment system;[1/] (iii) collection and compilation of monetary, credit, and currency statistics; (iv) lender of last resort (LOLR) operations; (v) management and administration, with possible delegation, of deposit guarantee systems; (vi) direct issue of securities; (vii) management (with possible delegation) of treasury and tax collection services on behalf of the government and public enterprises; and (viii) state debt management, identification of financing needs, and issuance of public debt on behalf of the state, subject to an authorizing law.

In overseeing the functional merger of the ICS and OBS and the adoption of central bank legislation, the authorities need to avoid mismanagement of the change process, which could otherwise adversely affect regulatory and supervisory practices. Instead of running the risk of reducing regulatory and supervisory capacity, the focus should be on delivering enhanced oversight and economies of scale. Implementing the merger and drafting and adopting Central Bank legislation requires careful deliberation related to prerequisites for *(i) effective supervision* (e.g., setting out as a statute clear supervisory objectives and adequate political and budgetary independence; having access to sufficient human resources with a high degree of accountability; and adopting a comprehensive regulatory framework with an appropriate range and use of enforcement powers); *(ii) efficient regulatory framework* (e.g., achieving significant economies of scale, avoiding duplication of functions and resources; and responding quickly to financial innovations); (iii) *increasing regulatory capacity* (e.g., through the formation of a unified agency that will not result in a critical loss of key staff); (iv) *avoiding political pressures* (e.g., by not undermining the budgetary or financial independence of the new CBSM or in some other way causing it to be weaker than the ICS and the OBS it replaces); and *(v) reducing the likelihood of unpredictable or undesirable outcomes* (for example through political influence).[2/]

1/ CBSM, along with five authorized banks, directly maintains foreign accounts and executes foreign transactions (including those on behalf of other Sammarinese banks) without using Italian correspondent banks.

2/ For detailed arguments for and against a unified financial regulatory agency within the structure of a central bank, as well as on how to manage the integration process, see Abrams and Taylor (2000).

operational independence from the government and the banking sector.[9] It should also provide for a stable source of financing and clear lines of accountability to Parliament. The government should take this opportunity to accord the right to grant and revoke licenses for financial institutions to the supervisory authority, which is a matter of course in several other countries.[10]

Further Steps

12. **With a growing financial sector, there is a need for measures to safeguard the soundness of regulation and supervision.** The aim should be to maintain efficiency and minimize the burden on financial institutions. It also is necessary to supplement current supervisory practices with more formal procedures. While off-site inspections and frequent exchanges of information and advice have established a climate of mutual trust between the supervisory authority and financial institutions and contribute to the appeal of San Marino as a financial center, its is necessary to supplement these practices with more frequent on-site inspections. While the recent sharp increase in the number of bank and nonbank financial institutions has enhanced the number and quality of services offered, it has made it more difficult for the supervisors to rely exclusively on continuous personal contacts and data reporting.

13. **To preserve the financial system's reputation for soundness and integrity, San Marino needs to base its regulation and supervision on internationally accepted standards.** To be effective and efficient, the regulatory and supervisory regime in a small state such as San Marino has to be flexible, adaptive, and responsive to the particular circumstances and attributes of the country, while keeping in line with international standards.[11] Financial regulation needs to focus on increased transparency and consider explicitly different types of risks faced by individual financial institutions and by the financial system as a whole. The type and number of the new regulatory standards dealing with these issues need to be carefully selected and designed to ensure that they are in line with international norms. To guarantee their relevance and effectiveness, they have to be clearly important and applicable to the Sammarinese financial system. In developing and applying banking and other financial supervision, San Marino should adhere strictly to international best practices (including on AML/CFT) with a high degree of compliance with the Basel Core Principles (BCP) for effective banking supervision, as well as other standards (i.e. for

[9] The law completing the ICS and OBS merger will stipulate that commercial banks holding shares of the CBSM's capital will not have voting rights on the CBSM's Board (see Box 2).

[10] At present, the government grants and revokes bank licenses, with the CBSM providing only a nonbinding opinion.

[11] For issues concerning trends in regulation and supervision with particular reference to small OFCs, see Mistry (2004).

insurance, in line with the International Association of Insurance Supervisors (IAIS) standards, and for securities markets, in line with the International Organization of Securities Commissions (IOSCO) standards), as appropriate.

14. **San Marino also needs to revamp its financial sector regulation and supervision framework to cover insurance, mutual funds, and other financial sector activities.** These activities provide an additional source of growth and are important parts of financial sector business in other well-established international financial centers (Table 1). For example, in Luxembourg (Box 3) investment funds and insurance services form the bulk of the financial sector's activities.[12] Throughout the introduction and development of the financial sector, Luxembourg's public policy has ensured a stable and sound regulatory and supervision environment and intensified AML/CFT efforts. In 1999, legislative frameworks were introduced for mortgage banking, international pension funds, and supplementary pension schemes, and a law on internet banking and e-commerce was passed. As Luxembourg's financial sector is dominated by international banking, extensive regulatory and supervisory legislation relevant to foreign banks is in place.

15. **In developing further its supervision and regulation framework, San Marino could, depending on the key characteristics of its evolving financial sector, adopt features from other countries' regulatory and oversight models.** For example, if the number of foreign financial institutions were to grow large, San Marino could benefit from adopting a model similar to Luxembourg's. Because of the large number of foreign intermediaries, Luxembourg's model is based on a combination of direct inspection of bank accounts and exchange of information, relying crucially on bilateral arrangements for supervision of cross-border banking groups.[13] Alternative arrangements could range from following the EU Directives on regulation and supervision with harmonized and mutually recognized rules and regulations, to the shift toward market-based supervision ("New Zealand approach"), where the emphasis is put on transparency and enhanced disclosure of public information rather than on-site inspections and exchanges of confidential information. Some of the advantages of the EU Directives-based model include consolidated supervision (especially beneficial for small countries that lack resources), elimination of the need for ad hoc arrangements, and reduced risk of regulatory capture and supervisory forbearance that may delay decisive regulatory action.[14] The main advantage of the market-based supervision model is that it may avoid the need to rely on ad hoc bilateral or multilateral arrangements.[15]

[12] See IMF (2004).

[13] See IMF (2000a).

[14] See Annex I in IMF (1999).

[15] One feature of the "New Zealand approach" system is that is supported by home country (i.e. Australia) supervision of the major banks.

Table 2. San Marino: International Financial Centers: Regulation and Supervision

	Regulatory Bodies	Supervisory Authorities	Delegation of Reg&Sup Responsibilities	Staffing number of employees	Licencing of Financial Institutions
Aruba	Central Bank of Aruba (CBA)	CBA Reporting Center for Unusual Transactions (RCUT)	No Foreign banks supervised by their home countries on a consolidated basis	...	CBA
Andorra	Superior Commission of Finances (CSF) (Highest body; reports to the Ministry of Finance); Andorra's National Institute of Finances (INAF) (Technical executive body with own legal personality)	CSF INAF Ministry of Finance oversees the insurance sector Unit for Prevention of Money Laundering	No	...	Ministry of Finance
British Virgin Islands	Financial Services Commission (FSC)	FSC	No	75	FSC: Licencing and Supervisory Committee
Cyprus	Central Bank of Cyprus (CBC) Commission for Cooperatives (CC) Insurance Companies Control Service (ICCS) at the Ministry of Finance Securities and Exchange Commission (SEC)	CBC CC ICCS SEC Unit for Combating Money Laundering Offences	No Offshore Banks supervised by CBC Offshore Insurance Companies supervised by ICCS Exchange of information with foreign supervisors	CBC has 30 supervisors	CBC
Hong Kong SAR	Banks: Hong Kong Monetary Authority (HKMA) Insurance: Office of the Commissioner for Insurance (OCI) Securities markets: Securities and Futures Commission (SFC) Pension system: Mandatory Provident Fund Schemes Authority (MPFA) Joint Financial Inteligence Unit (JFIU)	HKMA OCI SFC	No	...	HKMA
Liechtenstein	Financial Services Authority (FSA) Insurance Supervisory Authority (ISA)	FSA ISA Due Dilligence Unit (DDU) for AML/CFT	FSA relies on external auditors for on-site supervision of banking and securities activities. Insurance supervision directly by ISA.	FSA: 11	Government is licencing all banking, investment, and insurance activities
Malta	Malta Financial Services Authority (MFSA) Financial Intelligence Analysis Unit (FIAU)	MFSA	No For foreign insurers MFSA relies largely on supervision by home supervisor	112	MFSA
Luxembourg	Financial Sector Surveillance Commission (CSSF) Insurance Commission (CAA)	CSSF CAA	Use of external auditors for verification of regulatory reporting and compliance with prudential supervision requirements. Reliance on supervisory authorities of foreign countries to assess the quality of the activities of foreign intermediaries.	...	Ministry of Treasury and Budget
Monaco	French Banking Regulation Committee (CRBF)	Credit Institutions: French Banking Commission (FCB) Insurance: Min.of Fin.and Econ.,Division of Economic Expansion (DEE) Portfolio Mngnt Banks: Supervisory Commission for Portfolio Mngnt (CCGP); FCB; Department of Finance and Economy Mutual Funds: Supervisory Commission of Mutual Funds Company and Trust Service Providers: DEE AML/CFT: Service for the Information and Supervision of Financial Circuits (SICCFIN)	French authorities, with the exception of AML/CFT	57	French Committee of Credit Establishments and Investment Enterprises (CECEI)
Republic of Palau	Financial Institutions Commission (FIC)	FIC	No Three branches of U.S.-based banks follow U.S. prudential regulations	...	FIC
San Marino	Central Bank of Marino (CBSM)	CBSM	No	13	Ministry of Finance
Singapore	Monetary Authority of Singapore (MAS)	MAS serves both as central bank and as a unified supervisory and regulatory authority for all banks and nonbank financial institutions.	No MAS maintains various information sharing arrangements with host and home country supervisors	...	MAS

Source: IMF FSAP, FSSA, and OFC Module II reports.

Box 3. Luxembourg's Financial Sector

The financial sector is clearly the engine of growth of Luxembourg's economy, accounting for about one fifth of GDP in 2003. During the 1990s, the sector's real value added expanded at an average rate of 9 percent a year, with several linkages between financial and other service activities, including accounting, legal, and computer services. The sector's main activities are (i) international banking, with more than 180 mostly foreign-owned banks; (ii) an investment fund center that manages more than US$700 billion in assets; and (iii) a growing insurance industry that focuses on life- and reinsurance activities. The Luxembourg financial sector's pursuit of low-risk activities is reflected in the available financial vulnerability indicators. [1/]

Throughout the development of the financial sector, Luxemburg's public policy has ensured a stable and sound regulatory and supervisory environment. Important changes in the regulatory environment were enacted, especially in 1999. Legislative frameworks were introduced for mortgage banking, international pension funds, and supplementary pension schemes, and a law on Internet banking and e-commerce was passed. All these provided Luxembourg's financial sector a flexible legal basis to develop new market niches in an increasingly competitive financial market environment.

Supervision and regulation of the financial sector are now based on the EU's Second Banking Directive. The Directive establishes the principles of mutual recognition of authorization and prudential supervision systems and home country control. It also incorporates the Basel Committee's Minimum Standards for supervision of international banking groups and cross-border activities. These principles and standards are applied to Luxembourg as follows:

- Any bank registered in Luxembourg must have a transparent shareholding structure and clearly indicate who is the bank's ultimate supervisory authority. In addition, licensing will be granted only to banks whose home supervisory authority complies with Basel Core Principles.

- Oversight of subsidiaries of foreign banks is carried out by the Luxembourg authorities through on- and off-site inspections. Prudential rules must be observed on both a consolidated and sub consolidated basis. At the EU level, bilateral memoranda of understanding have been signed with other supervisors. Moreover, exchanges of information take place at frequent bilateral meetings and at the Group de Contact. Foreign supervisors are granted partial access to information from on-site inspections. As regards non-EU counterparts, memoranda of understanding (e.g., with Switzerland and the United States) or exchanges of letters (e.g., with some emerging market economies, including Korea, Turkey, and Russia) define the responsibilities of supervisors.

- Oversight of branches of foreign banks is the responsibility of their home supervisor. Nonbank holding companies are supervised only if they own a bank in Luxembourg.

Throughout the development of its financial sector, Luxembourg has intensified AML and CFT efforts**.** In particular, legislation was passed to incorporate the Financial Action Task Force (FATF) recommendations, and the judicial procedure for mutual international assistance was enhanced. In addition, in order to avoid abuse of Luxembourg's bank secrecy laws, legislation was passed that strengthened international cooperation in tax fraud cases. Authorities have hired more supervision staff, conducted more on-site inspections, and adopted an internal Code of Conduct for bank supervisory staff regarding the trading and holding of securities.

1/ See IMF (2002b).

16. **In designing the specific characteristics of the regulatory and supervisory framework, the authorities could also benefit from best practices prevailing in other international financial centers (Table 2).** Similarities and differences between the Sammarinese financial sector and those of other countries justify to a certain degree arrangements similar to, or different from, those in these countries. Economies of scale in supervision and regulation, as well as difficulties in building expertise in such small states, may justify different approaches.[16] The special feature of San Marino as an "embedded" state within a large EU economy justifies taking into consideration (i) regulatory and supervisory arrangements in similar "embedded" states, such as Andorra, Monaco, and Lichtenstein; and (ii) EU-related "standards," in connection with supervision and regulation considerations of EU members (e.g., Austria, Belgium, and Luxembourg) with similar financial sector features (e.g., bank secrecy).

D. Concluding Remarks

17. **San Marino has identified and initiated policy initiatives required to make the transition to a full-fledged financial center.** These include establishing the CBSM and augmenting its regulatory and supervisory capabilities. The small size of San Marino should allow the authorities to design an efficient supervisory and regulatory framework conducive to the growth of its financial sector. However, extra effort and caution are needed in following steps taken by other financial centers, because circumstances have changed. There is now greater international scrutiny of financial centers, including the elimination of tax advantages (especially in Europe), and heightened AML/CFT-related concerns increasing the costs and risks to international financial centers. The initiatives taken to successfully establish financial centers in the past need to be complemented with extra safeguards and vigilance. Oversights and delayed action by the regulatory and supervisory authorities may have serious consequences. To safeguard against vulnerabilities from cross-border financial activities—in accordance with FATF recommendations—it is important that "know-your-customer" measures are implemented with particular attention and vigor, supplementing the reliance on customer identification carried out by regulated institutions abroad. Coupled with some favorable international developments, a sound regulatory and supervisory framework would allow San Marino to develop a financial sector on a scale similar to those in other small financial centers.

[16] For example, some small financial centers have outsourced part of their supervisory responsibilities (e.g., Luxembourg and Monaco), or adopted neighboring countries' financial sector laws.

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II. BUDGETARY PERFORMANCE REVISITED [17, 18]

1. **The primary purpose of this chapter is to provide a more comprehensive conceptual and accounting framework to monitor and evaluate San Marino's fiscal policy stance.** The chapter is organized as follows: Section A provides theoretical arguments for improving reliability and transparency in fiscal reporting. Section B illustrates how to reclassify San Marino's finance statistics on an accrual basis, while using cash and balance sheet information to obtain a consistent treatment of economic and financing transactions. Section C assesses the country's budgetary performance and vulnerabilities by means of such an integrated accounting system of stocks and flows. Section D broadens the coverage of the analysis by focusing on social security and public corporations, while emphasizing unresolved issues. Section E concludes.

A. Why Should We Care About Accounting Frameworks?

2. **To assess the impact of government policies and activities on the economy, as well as their sustainability, it is necessary to evaluate government behavior in the context of its intertemporal budget constraint.** In this perspective, fiscal data should be designed to facilitate macroeconomic analysis. Accordingly, government finance statistics should (i) enable us to assess the financial soundness of the general government sector through an integrated accounting system including an income statement, a cash-flow statement, and a balance sheet; (ii) be closely linked to other macroeconomic statistical systems (national accounts, balance of payments, and monetary and financial statistics); and (iii) adequately capture the impact of fiscal actions on the economy and the timing of their effects. These wide-ranging objectives clearly call for a fiscal accounting framework conceived from an accrual perspective.

3. **However, for billing or control purposes, governments have traditionally organized their transactions on a cash basis, so as to focus their attention on pressing financing needs.** To reconcile this occasionally conflicting set of goals, the revised *Government Finance Statistics (GFS) Manual* has introduced a new reporting methodology that uses accrual data to record government resource flows and aggregates cash data to measure financial liquidity.[19] In addition, by breaking down assets and liabilities into their constituents and establishing their changes from one period to another in terms of

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[17] Prepared by Silvia Sgherri.

[18] The content of this chapter has been discussed with officials at the Ministry of Finance and representatives of the Office of Economic Planning and Centre for Data and Statistical Analysis in the course of the IMF mission to San Marino for the 2004 Article IV consultation.

[19] International Monetary Fund (2001).

transactions and other economic flows, the new accounting framework provides statistical explanation of the factors causing variations in government's net worth.

4. **The adoption of an accrual-based compilation approach has the additional virtue of enhancing budgetary transparency and the effectiveness of external fiscal rules (such as deficit-GDP or debt-GDP ratios), as advocated by the recent literature on fiscal consolidation.**[20] Accrual fiscal accounting can improve public expenditure management by making it more difficult to use budgetary gimmicks aimed at bypassing fiscal constraints. For instance, cash accounting allows governments to maneuver the size of unpaid orders (payment arrears) and unspent commitments (expenditure carryovers) that do not have to be financed in the same fiscal year, in which they produce effects. In contrast, the switch from cash- to accrual-based fiscal accounts requires that unpaid orders be recorded as expenditure as soon as the economic value is created, transformed, transferred, or extinguished, regardless of the timing of their financing. As a consequence, under accrual accounting, building up arrears does not help to reduce budget deficits, whereas it swells outstanding liabilities.

5. **More subtly, adherence to an accounting framework that appropriately distinguishes between government resource flows and net acquisitions of financial and nonfinancial assets prevents changes in net worth from corrupting the operating balance.** Distinctive examples of accounting practices in explicit contrast to this principle are the following: the inclusion, as accrued revenue, of the proceeds from new borrowing operations (e.g., the issue of new bonds through the securitization of unpaid social security contributions); the recording of holding gains/losses (owing to changes either in asset prices or in the volume of the assets) above the line; and the covering of operating losses of public enterprises via government-financed increases in their capital stock. In the first two instances, fiscal statistics should signal the rise/decline in net assets and have no effect on the fiscal balance, as these operations represent changes in the net worth unrelated to operating transactions. In the last case, losses of public enterprises should be transparently covered by public transfers recorded among expenditures, since there is no actual upsurge in government's net worth.

6. **Given that the official presentation of San Marino's fiscal accounts violates several of the above principles, the next section demonstrates how the central administration finance statistics can be reclassified to bring them in line with best practices.** The twofold objective of this reclassification is to reflect appropriately the accrual basis of accounting and to reconcile government resource flows with changes in stocks during each accounting period between 1992 and 2003. To this end, the use of cash and balance sheet data on financing transactions was essential.

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[20] See, among others, Perotti, Alesina, and Maré (1998); Premchand (1995); Potter and Diamond (1999); and Reviglio (2001).

B. Reconciling Stocks and Flows on an Accrual Basis

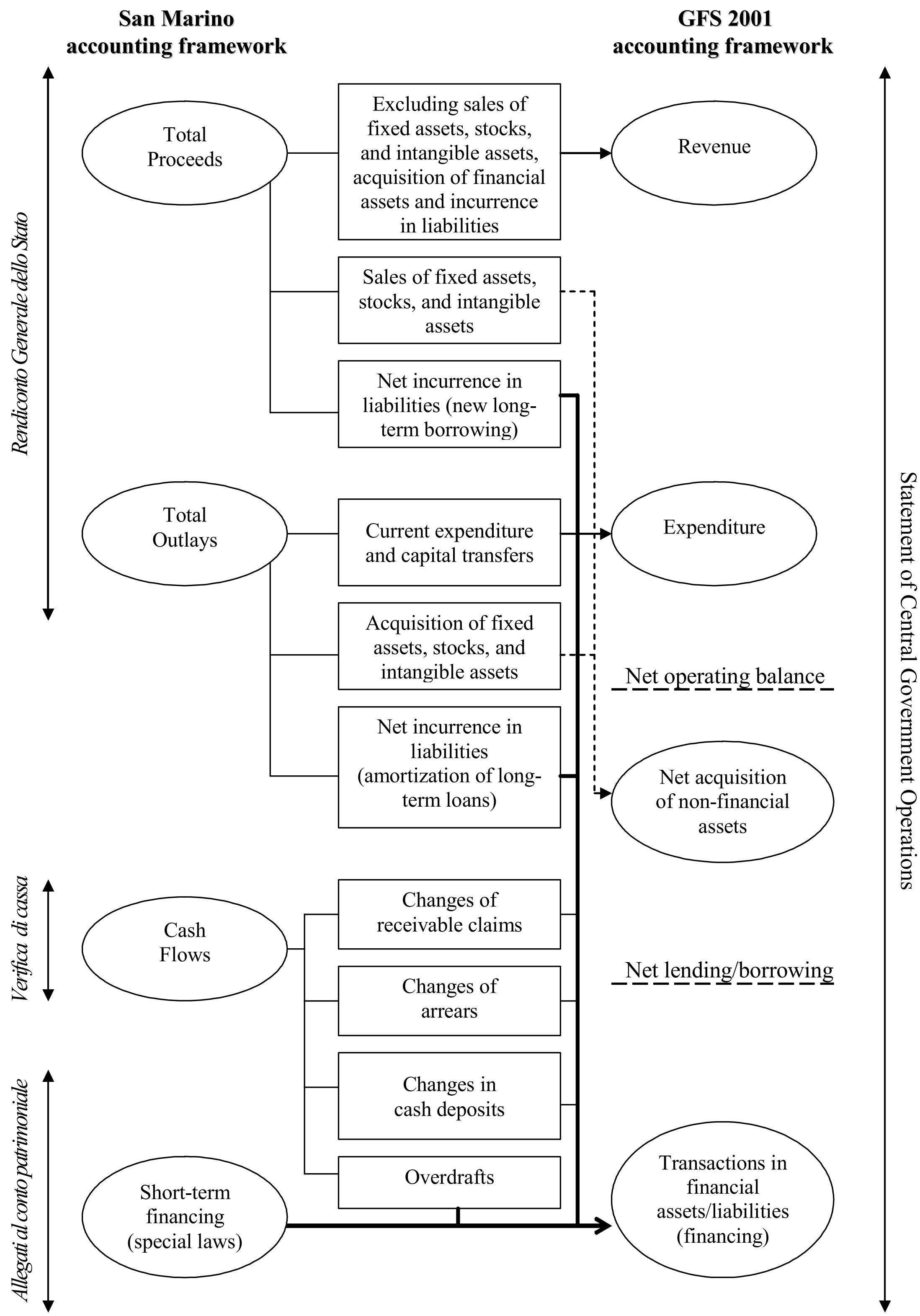
7. **The Sammarinese authorities compile central administration finance statistics on both a cash and an accrual basis.** Specifically, for each transaction recorded in the budget, they readily provide the following pieces of information:

- outstanding claims at the beginning of each fiscal year considered;
- amount of outstanding claims cashed during that year;
- outstanding claims at the end of that fiscal year;
- budget estimate on an accrual basis;
- budget outturn on an accrual basis;
- budget overrun;
- payments/receipts due; and
- accrued but unpaid claims.

Prima facie, San Marino's fiscal statistics adequately separate the timing of fiscal actions on the economy from their effects on the central administration's cash position.

8. **However, a more thorough analysis of Sammarinese budgetary data reveals important inconsistencies between the accounting of economic transaction flows and the reporting of net acquisitions of assets and liabilities.** These discrepancies have the potential to distort fiscal sustainability analysis because they misrepresent the impact of fiscal operations on the central administration's net worth.

9. **The figure below depicts the essential steps taken—and the sources of information used—to reconcile economic and financial flows with variations in net worth, in compliance with the general accounting criteria outlined in the previous section.** Essentially, four types of corrections have been made to the authorities' compilation methodology. They include (i) the reclassification of transactions affecting the nonfinancial government's net worth, namely, acquisition, disposal, and consumption of fixed capital; (ii) the accounting of new borrowing and principal repayment transactions regarding long-term loans; (iii) the reporting of short-term bank financing of capital expenditure borne by public enterprises; and (iv) the treatment of changes in the stock of net government arrears, mainly stemming from unsettled tax reimbursements.


San Marino
accounting framework
GFS 2001
accounting framework
Rendiconto Generale dello Stato
Verifica di cassa
Allegati al conto patrimoniale
Statement of Central Government Operations
Total
Proceeds
Excluding sales of fixed assets, stocks, and intangible assets, acquisition of financial assets and incurrence in liabilities
Revenue
Sales of fixed assets, stocks, and intangible assets
Net incurrence in liabilities (new long-term borrowing)
Total
Outlays
Current expenditure and capital transfers
Expenditure
Acquisition of fixed assets, stocks, and intangible assets
Net operating balance
Net incurrence in liabilities (amortization of long-term loans)
Net acquisition of non-financial assets
Cash
Flows
Changes of receivable claims
Net lending/borrowing
Changes of arrears
Changes in cash deposits
Overdrafts
Short-term financing (special laws)
Transactions in financial assets/liabilities (financing)

10. **The first correction has been made to ensure that the net result of transactions changing the value and the volume of nonfinancial government's holdings have been excluded from the computation of the net operating balance.** This has amounted to excluding acquisition and consumption of fixed capital (i.e., the portion of physical amortization accrued during the year) from expenditures and disposal of fixed capital (i.e., assets sales) from revenues. The resulting net operating balance provides a "cleaner" measure of the ongoing sustainability of normal fiscal operations over which the government has direct control. The net acquisition of nonfinancial assets contributes, instead, to determine net lending/borrowing, which can be seen as an indicator of the financial impact of government activity on the rest of the economy.[21]

11. **Second, standard financing items have appropriately been moved "below the line."** San Marino's official central administration budget is written so as to close at par, which implies that loans-related principal repayment transactions are treated as capital expenditures while corresponding "borrowing requirements" are included among the revenues.

12. **Third, short-term bank financing of capital expenditure borne by public enterprises has been included in the central administration's budget as a financing item, since it explicitly represents a domestic liability incurred by the central administration.** The amount of capital expenditure being financed has been correspondingly added to central administration capital transfers. This correction has been essential to reconcile changes in the stock of public debt from one period to the next with the net result of economic transactions, as measured by the net lending/borrowing indicator.

13. **Finally, occasional reassessments of the stock of net government arrears—mainly stemming from unsettled reimbursements of import tax (*monofase*) proceeds—have been recorded below the line as holding gains/losses, as they change the central administration's net worth.[22]** This was the case, just to mention the most recent one, with the exceptional reassessment of the stock of tax credits in 2001—due to adoption of new criteria for assessing the risk of insolvency of taxpayers with overdue taxes—that lowered the central administration's net asset position by over 8 percent of GDP. It is clear that such

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[21] When nonfinancial assets are acquired under financial lease, the leased assets legally remain the property of the lessor, so that no actual transaction takes place. For this reason, no correction to the authorities' budgetary accounts has been made in this regard. However, it can be argued that the lease originates a de facto change in ownership, which is financed by the implicit creation of a loan.

[22] The *monofase* is a single-stage indirect tax levied on goods and services intended for domestic consumption and reimbursed each time imported goods are subsequently reexported. Delays in settling corresponding tax credits, hence, give rise to recurring and substantial variations in the central administration's net asset position.

changes in net worth are not the results of government transactions and ought not to be treated as public spending.

C. Measuring Fiscal Policy Performances

14. As a result of the reclassification exercise described in the previous section, this section discusses San Marino's budgetary performance, as summarized in the statement of central administration operations and related balance sheet.

Statement of Central Administration Operations

15. **Over the past decade, San Marino has run persistent budget deficits that have markedly weakened its fiscal position (Table 1). A glaring budget weakness is the poor revenue performance.** Total revenues net of reimbursements and asset sales fell by about 7 percent of GDP from 1992 to 2003, reflecting collapsing nontax revenues, a large contraction of import taxes—which account for over 90 percent of indirect taxes—and lower direct taxes.

Table 1. San Marino: Statement of Central Administration Operations, 1992-2004

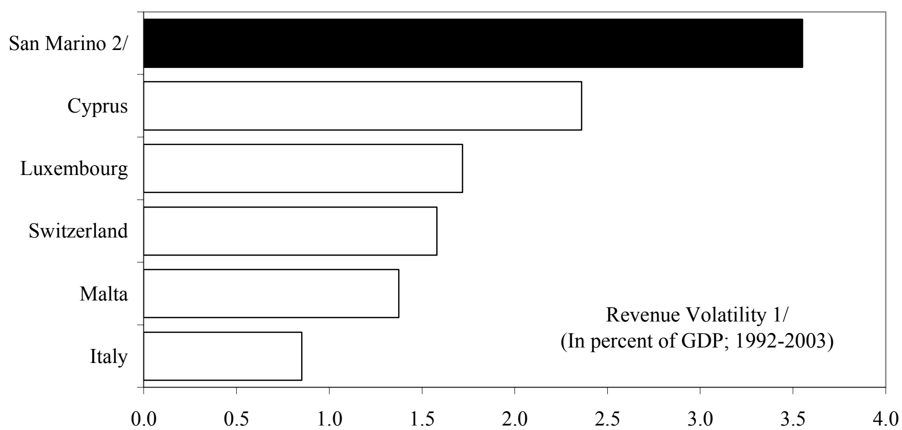
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 Prel.	2004 Budget
	(Million of euros)												
Revenues 1/	141.6	156.0	170.4	173.6	184.9	204.1	223.2	215.5	229.1	249.9	254.7	285.4	268.4
Expenditure 2/	145.8	164.3	193.3	200.2	207.4	219.6	235.5	248.7	265.7	285.3	276.8	272.4	277.6
Net Operating Balance	-4.3	-8.4	-22.9	-26.6	-22.5	-15.5	-12.3	-33.2	-36.6	-35.4	-22.2	13.0	-9.1
Asset Sales	2.3	1.2	2.0	1.2	6.3	2.3	24.5	9.3	7.5	2.7	1.7	2.6	3.5
Net Lending/Borrowing	-2.0	-7.2	-20.8	-25.4	-16.2	-13.2	12.2	-23.9	-29.0	-32.7	-20.4	15.7	-5.6
Net Incurrence of liabilities	-20.7	-10.6	-19.1	-43.5	3.3	-2.8	38.4	-50.1	39.4	-14.8	-68.5	4.3	-5.6
Net acquisition of financial assets	18.7	3.5	-1.7	18.1	-19.5	-10.5	-26.2	26.1	-68.5	-17.9	48.1	11.4	0.0
	(Percent of GDP)												
Revenues 1/	36.9	35.9	35.3	31.2	30.5	30.9	30.9	26.9	27.3	27.4	27.2	29.8	26.9
Expenditure 2/	38.0	37.8	40.0	36.0	34.2	33.2	32.6	31.0	31.6	31.3	29.6	28.4	27.8
Net Operating Balance	-1.1	-1.9	-4.7	-4.8	-3.7	-2.3	-1.7	-4.1	-4.4	-3.9	-2.4	1.4	-0.9
Asset Sales	0.6	0.3	0.4	0.2	1.0	0.3	3.4	1.2	0.9	0.3	0.2	0.3	0.4
Net Lending/Borrowing	-0.5	-1.7	-4.3	-4.6	-2.7	-2.0	1.7	-3.0	-3.5	-3.6	-2.2	1.6	-0.6
Net incurrence of liabilities	-5.4	-2.4	-4.0	-7.8	0.5	-0.4	5.3	-6.2	4.7	-1.6	-7.3	0.4	-0.6
Net acquisition of financial assets	4.9	0.8	-0.4	3.3	-3.2	-1.6	-3.6	3.3	-8.2	-2.0	5.1	1.2	0.0

Sources: Department of Budget and Planning, '*Rendiconto Generale dello Stato*', '*Verifica di Cassa*', and '*Allegati al Conto del Patrimonio*'; and Fund staff calculations.

1/ Net of tax reimbursements and asset sales.
2/ Net of tax reimbursements.

16. **Revenues from *monofase* have withered by about 3 percent of GDP since 1992.** The *monofase* has been a constant source of revenue volatility and of shocks to the net financial position of the central administration (see figure below). Imported goods generate tax credits for the government that are then in large part offset by tax reimbursements for reexported goods. Net taxes are settled only with long delays, and there can be large revisions of tax credits and liabilities. In 2001, for example, revisions of both direct and indirect tax credits increased the net liability float by 8 percent of GDP, accounting for almost the entire deterioration in the net financial position of the government in that year. Despite recent improvements in indirect tax administration, the uncertainty, length, and lack of transparency characterizing the existing reimbursement mechanism remain significant sources of revenue and financial volatility.

Fiscal vulnerability mainly stems from highly volatile net revenues



Source: Department of Budget and Planning, '*Rendiconto Generale dello Stato*', '*Verifica di Cassa*', and '*Allegati al Conto del Patrimonio*'; and Fund staff calculations.
1/ Average standard deviation of central government net revenues in percent of GDP.
2/ Excludes Social Security

17. **Between 1992 and 2003, the reduced profitability of the banking sector and the decline in interest rates curtailed revenues from taxes on the financial sector—including profit taxes from financial institutions and withholding taxes on interest —by more than 4 percent of GDP.** Since 2001, the introduction of tax amnesties in Italy (*scudi fiscali*)—which has slowed nonresidents' deposit growth and reduced nonresidents' assets under management in San Marino—has further depressed the tax base.

18. **Taxes on nonfinancial corporate profits have performed poorly because of generous tax exemptions.** Although nonfinancial corporations have a larger net income than financial institutions, profit taxes on the former are only about half of those on the latter. In 2002, 7 percent of manufacturing firms were exempt from taxation, with an estimated

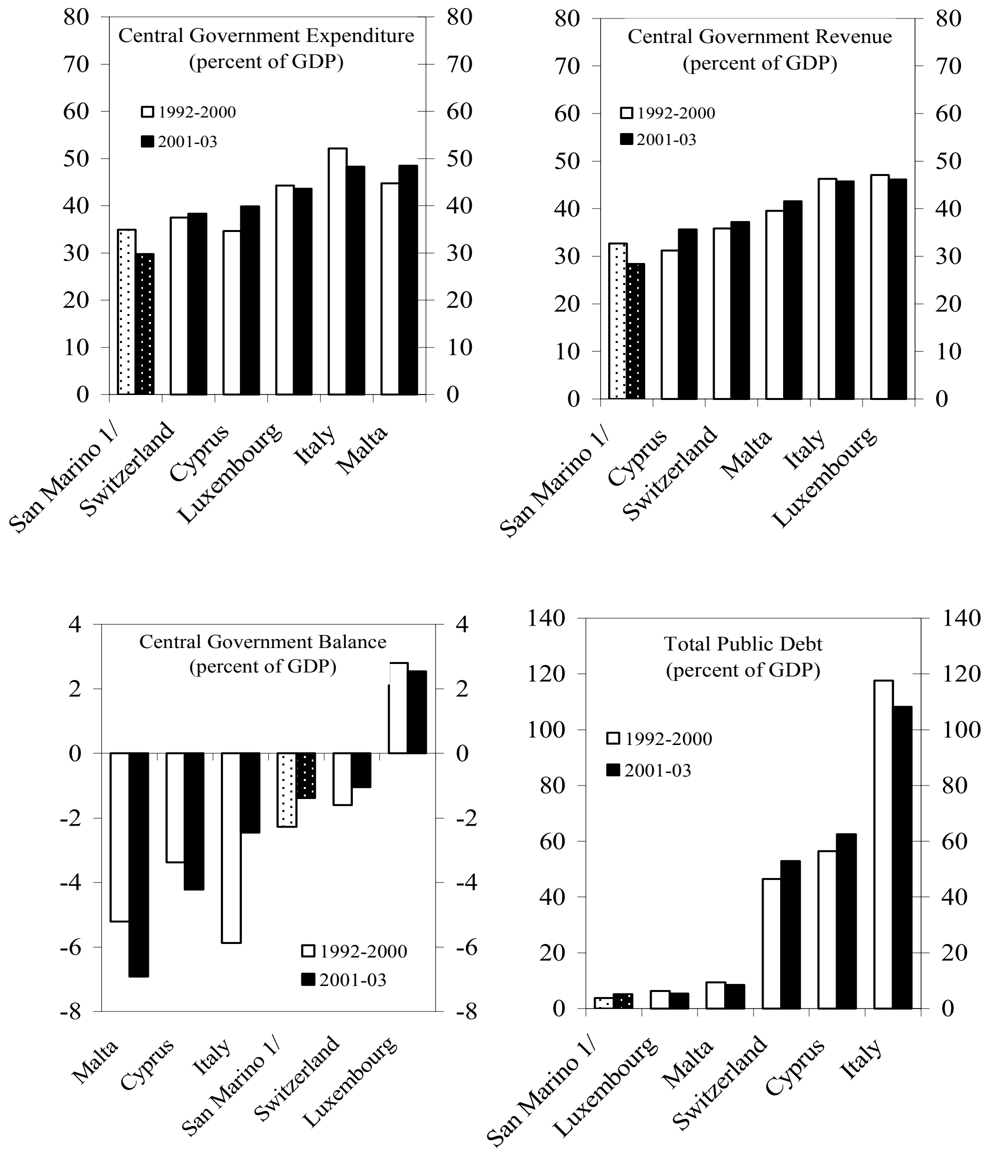
revenue loss of about 3 percent of GDP. The government suspended the application of the law granting exemptions in 2002 and the percentage of exempt firms has subsequently steadily declined.

19. **Between 1992 and 2003, the authorities reduced expenditures by more than 9½ percent of GDP to counterbalance the loss of revenue.** Both current and capital expenditures were curtailed. A tight hiring freeze and the limited growth in real public sector wages in recent years trimmed the wage bill by almost 1½ percent of GDP. Current transfers to the public sector—mostly transfers to the Social Security Institute (SSI), which is responsible for health and pension expenditure—fell by a similar amount. Capital expenditures contracted by almost 5 percent of GDP.

20. **Fiscal adjustment is under way—with a better-than-targeted 2003 outcome (the original target was a deficit of 1.6 percent of GDP), a budget close to balance for 2004, and balanced-budget targets for 2005–06.** Although the measures that underpinned the 2003 adjustment (such as reductions in the public sector wage bill) are likely to have permanent effects and could lead to a better-than-targeted 2004 outcome, shortcomings in tax collection and administration may erode both the country's competitive tax advantages and weaken its financial position (see figure below).

21. **Table 2 reconciles different definitions of the fiscal balance.** The cash balance can be derived from the accrual balance by subtracting the net asset float accrued, but not cashed, in the relevant fiscal year, and by adding the part of the asset float outstanding at the beginning of the fiscal year that was cashed during that year. The table also reconciles the accrual order balance with the deficit/surplus concept monitored by the authorities (the *avanzo/disavanzo d'esercizio*). This measure is different from a standard central government balance on an accrual basis, as it includes both reassessments of the outstanding net float and net debt financing above the line, as discussed above. Since the adjustments mainly consist of downward revisions of the liability float made by the tax office after processing reimbursement applications presented by the exporters, the *avanzo di esercizio* typically registered a stronger fiscal position than the accrual balance (with the notable exceptions of fiscal years 2001 and 2003).

Overall fiscal performances have been relatively satisfactory by international standards



Sources: Department of Budget and Planning, 'Rendiconto Generale dello Stato' and 'Allegati al Conto del Patrimonio'; IMF, *World Economic Outlook*; and Fund staff calculations.
1/ Excludes Social Security.

22. To square the circle, we now turn to the analysis of the central administration's net asset position. As noted initially, the revised accounting framework, which breaks down assets and liabilities into their constituents and establishes their changes from one period to another in term of transactions and other economic flows, enables us to track explicitly variations in government's net worth.

Table 2. San Marino: Alternative Definitions of Fiscal Balance, 1992-2004

		1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 Prel.	2004 Budget
		(Million of euros)												
1.	Accrual Balance	-2.0	-7.2	-20.8	-25.4	-16.2	-13.2	12.2	-23.9	-26.5	-32.7	-20.4	15.7	-5.6
	Percent of GDP	-0.5	-1.7	-4.3	-4.6	-2.7	-2.0	1.7	-3.0	-3.2	-3.6	-2.2	1.6	-0.6
(-)	New Net Asset Float	-14.6	-14.0	-26.2	-27.9	-13.4	-18.0	24.6	-41.4	15.9	19.3	-22.0	-2.6	0.0
	Percent of GDP	-3.8	-3.2	-5.4	-5.0	-2.2	-2.7	3.4	-5.2	1.9	2.1	-2.3	-0.3	0.0
(+)	Old Net Asset Float Cashed	6.3	-5.7	-7.2	13.8	-21.6	-19.2	-17.2	7.0	-28.4	20.3	47.6	-4.7	0.0
	Percent of GDP	1.6	-1.3	-1.5	2.5	-3.6	-2.9	-2.4	0.9	-3.4	2.2	5.1	-0.5	0.0
(=)	Cash Balance	18.9	1.1	-1.8	16.3	-24.3	-14.4	-29.6	24.5	-73.3	-31.7	49.1	13.6	-5.6
	Percent of GDP	4.9	0.3	-0.4	2.9	-4.0	-2.2	-4.1	3.1	-8.7	-3.5	5.3	1.4	-0.6
2.	Accrual Balance	-2.0	-7.2	-20.8	-25.4	-16.2	-13.2	12.2	-23.9	-26.5	-32.7	-20.4	15.7	-5.6
	Percent of GDP	-0.5	-1.7	-4.3	-4.6	-2.7	-2.0	1.7	-3.0	-3.2	-3.6	-2.2	1.6	-0.6
(+)	Reassessment of Old Asset Float	1.2	3.4	3.4	44.7	12.1	27.0	-14.9	13.6	3.7	-80.1	15.9	1.5	0.0
	Percent of GDP	0.3	0.8	0.7	8.0	2.0	4.1	-2.1	1.7	0.4	-8.8	1.7	0.2	0.0
(+)	Net Debt Financing	-0.2	2.3	0.1	1.8	4.8	4.0	3.4	1.6	4.9	13.8	-1.0	-2.2	5.6
	Percent of GDP	-0.1	0.5	0.0	0.3	0.8	0.6	0.5	0.2	0.6	1.5	-0.1	-0.2	0.6
(=)	*Avanzo d'Esercizio*	-1.0	-1.4	-17.4	21.1	0.8	17.8	0.7	-8.7	-20.5	-99.0	-5.6	14.9	0.0
	Percent of GDP	-0.3	-0.3	-3.6	3.8	0.1	2.7	0.1	-1.1	-2.4	-10.9	-0.6	1.6	0.0

Sources: Department of Budget and Planning, '*Rendiconto Generale dello Stato*', '*Verifica di Cassa*', and '*Allegati al Conto del Patrimonio*'; and Fund staff calculations.

The Balance Sheet

23. **The persistent budget deficits of the last decade have shifted the net financial position of the central government from a net asset position of 6 percent of GDP in 1992 to a net liability position of more than 11 percent of GDP in 2003 (Table 3).** To finance the deficit, the government reduced its deposits with the banking system and, since the mid-1990s, has borrowed short term (see also Table 7 in the Statistical Appendix).

Table 3. San Marino: Balance Sheet, 1992-2004

	1992	1993	1994	1995	1997	1998	1999	2000	2001	2002	2003 Prel.	2004 Budget
	(Million of euros)											
Assets	279.6	330.6	412.1	494.1	716.7	808.0	177.1	200.3	228.3	277.2	338.5	338.5
Percent of GDP	72.9	76.1	85.4	88.8	108.4	111.7	22.1	23.9	25.1	29.6	35.3	33.9
Bank Deposits	97.0	100.4	98.7	116.8	86.8	60.6	86.7	18.2	0.3	48.4	59.8	59.8
Percent of GDP	25.3	23.1	20.4	21.0	13.1	8.4	10.8	2.2	0.0	5.2	6.2	6.0
Asset Float	182.6	230.2	313.4	377.3	629.9	747.4	90.4	182.1	228.0	228.8	278.7	278.7
Percent of GDP	47.6	53.0	64.9	67.8	95.3	103.3	11.3	21.7	25.0	24.5	29.1	27.9
Liabilities	256.7	311.4	410.4	473.1	686.0	780.0	159.5	208.0	348.8	402.2	446.4	452.0
Percent of GDP	66.9	71.7	85.0	85.1	103.8	107.8	19.9	24.8	38.3	43.0	46.6	45.3
Public Debt	13.5	15.9	15.9	17.7	26.5	29.9	31.5	36.4	50.2	49.1	46.9	52.6
Percent of GDP	3.5	3.6	3.3	3.2	4.0	4.1	3.9	4.3	5.5	5.3	4.9	5.3
Liability Float	243.2	295.6	394.5	455.4	659.5	750.1	128.0	171.6	298.6	353.1	399.4	399.4
Percent of GDP	63.4	68.0	81.7	81.9	99.8	103.7	16.0	20.4	32.8	37.8	41.7	40.0
Net Assets (= Assets - Liabilities)	22.9	19.2	1.7	20.9	30.7	28.0	17.6	-7.7	-120.5	-125.0	-107.9	-113.5
Percent of GDP	6.0	4.4	0.3	3.8	4.6	3.9	2.2	-0.9	-13.2	-13.4	-11.3	-11.4
Avanzo d'Esercizio - Net Debt Financing 1/	-0.8	-3.7	-17.5	19.2	13.8	-2.7	-10.3	-25.3	-112.8	-4.6	17.2	-5.6
Percent of GDP	-0.2	-0.9	-3.6	3.5	2.1	-0.4	-1.3	-3.0	-12.4	-0.5	1.8	-0.6

Sources: Department of Budget and Planning, '*Rendiconto Generale dello Stato*', '*Verifica di Cassa*', and '*Allegati al Conto del Patrimonio*'; and Fund staff calculations.

1/ The *Avanzo d'Esercizio* excluding Net Debt Financing coincides with the change in the net asset position (see also table 2).

24. **Periods of exceptionally high growth and prudent fiscal policies generated fiscal surpluses for a number of years during the 1980s, thereby helping to accumulate government deposits equivalent to over 25 percent of GDP in 1992. By 2001, central administration's bank deposits had been steadily drawn down to zero.** Moreover, since 1994, specific investment projects carried out by public corporations have been financed through domestic bank overdrafts, thereby boosting the weight of short-term indebtedness.

25. **In order to emphasize the main sources of vulnerability of San Marino's budgetary stance, and in compliance with the general accounting principles outlined in Section B, the staff has broken down period-by-period variations in the net assets float by (i) new accrued but unpaid claims; (ii) outstanding claims cashed during the year; and (iii) a reassessment of the stock of outstanding claims.** Results are summarized in Table 4. Strikingly, during most years, the order of magnitude of these swings has been twice as large as the stock of outstanding public debt.

Table 4. San Marino: Net Asset Float, 1992-2004

		1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 Prel.	2004 Budget
		(Million of euros)												
	Old Stock of Net Asset Float	-40.9	-60.5	-65.4	-81.1	-78.1	-57.8	-29.6	-2.7	-37.5	10.5	-70.6	-124.3	-120.7
	Percent of GDP	-10.7	-13.9	-13.5	-14.6	-12.9	-8.8	-4.1	-0.3	-4.5	1.2	-7.6	-13.0	-12.1
(+)	New Net Asset Float	-14.6	-14.0	-26.2	-27.9	-13.4	-18.0	24.6	-41.4	15.9	19.3	-22.0	-2.6	0.0
	Percent of GDP	-3.8	-3.2	-5.4	-5.0	-2.2	-2.7	3.4	-5.2	1.9	2.1	-2.3	-0.3	0.0
(-)	Old Net Asset Float Cashed	6.3	-5.7	-7.2	13.8	-21.6	-19.2	-17.2	7.0	-28.4	20.3	47.6	-4.7	0.0
	Percent of GDP	1.6	-1.3	-1.5	2.5	-3.6	-2.9	-2.4	0.9	-3.4	2.2	5.1	-0.5	0.0
(+)	Reassessment of Old Asset Float	1.2	3.4	3.4	44.7	12.1	27.0	-14.9	13.6	3.7	-80.1	15.9	1.5	0.0
	Percent of GDP	0.3	0.8	0.7	8.0	2.0	4.1	-2.1	1.7	0.4	-8.8	1.7	0.2	0.0
(=)	New Stock of Net Asset Float	-60.5	-65.4	-81.1	-78.1	-57.8	-29.6	-2.7	-37.5	10.5	-70.6	-124.3	-120.7	-120.7
	Percent of GDP	-15.8	-15.0	-16.8	-14.0	-9.5	-4.5	-0.4	-4.7	1.2	-7.8	-13.3	-12.6	-12.1

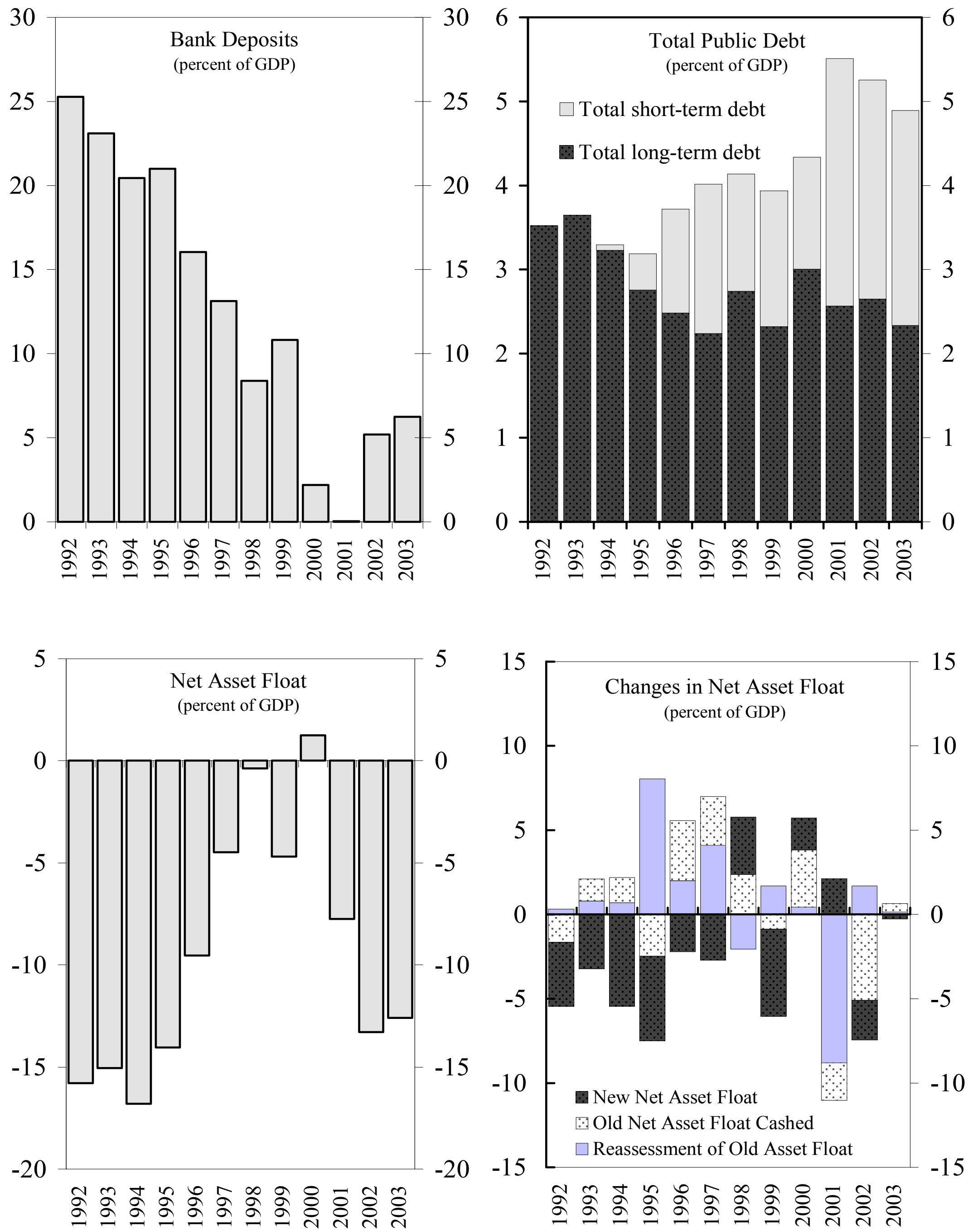
Sources: Department of Budget and Planning, '*Rendiconto Generale dello Stato*', '*Verifica di Cassa*', and '*Allegati al Conto del Patrimonio*'; and Fund staff calculations.

D. Beyond the Central Administration

26. **Reconciling the inconsistencies between changes in the central administration's net worth and transaction flows is undoubtedly an important step in the right direction.** However, a comprehensive evaluation of San Marino's budgetary soundness is still beyond reach, given the lack of an accounting system covering the central government and—more broadly—the public sector.[23] Sammarinese authorities started compiling consolidated statistics in 1999, on the basis of separate financial statements and balance sheet information for the Social Security Institute (SSI) and other public corporations. The usefulness of these data remains, however, limited because of long delays in their release and, more critically, their origin from a disjointed—and possibly mutually incompatible—set of accounts. Based on the fragmented information available, this section attempts to portray recent developments in the SSI and other public corporations.

[23] The lack of comparability of net cash inflows over time—owing to the varying length of the fiscal year over time—and the long and variable lags in the settlement of several transactions—mainly regarding collection and reimbursement of the *monofase*— have also been cited as important weaknesses of government finance statistics. Although it is true that, for these reasons, the cash-basis fiscal balance tends to vary widely from year to year and is therefore uninformative, an accrual-based accounting system is unaffected by these problems.

During the past decade, the central administration's net asset position has markedly deteriorated



Source: Department of Budget and Planning, '*Rendiconto Generale dello Stato*', '*Verifica di Cassa*', and '*Allegati al Conto del Patrimonio*'; and Fund staff calculations.

Social Security Institute

27. **The SSI offers retirement pensions, health care, and several forms of income supplementation.**[24] Historically, it accounts for most of the budget transfers within the public sector.

28. **In 1991, a major reform of the social security system increased payroll contributions for particular components of social security, abolished cross subsidization among various pension funds (also known as solidarity contributions), and introduced explicit financing of health care services via current transfers from the central administration.** Post reform, the overall cash inflow of pension funds turned substantially positive. In 1996, the authorities also decided to transfer part of the surplus of the family allowance fund (Cassa Assegni Familiari)—which is financed by employer contributions in the case of dependent employees and by the central administration in the case of artisans—to the pension fund for employees. Given that family allowances have remained unchanged in nominal terms since 1994, while the total wage bill has increased, the family allowance fund has run increasing surpluses over time. As a result of these intrafund transfers, pension system reserves rose steadily over the second half of the 1990s (see Table 8 in the Statistical Appendix).[25]

29. **While reserves remain substantial, generous pension benefits and population aging are projected to endanger the long-term solvency of the system.** Even under past favorable employment trends, increasing transfers to the SSI over time would be required to prevent debt dynamics from deteriorating markedly (see staff report). At present, transfers from the government and other SSI funds are needed to finance pension expenditure of over 6 percent of GDP and continue accumulating reserves, even though a healthy worker-to-retiree ratio of 4:1 is boosting contributions.

30. **Total health care expenditure accounted for another 6 percent of GDP in 2002.** Since 2003, the budget has provided a fixed allocation to the SSI for health expenditure, after years in which it was almost fully financed with ex post budget transfers. The government has recently limited the range of pharmaceutical products offered free of charge, whereas savings on the wage bill of the SSI have stabilized health expenditure in percent of GDP.

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[24] See Prati, McHugh, and Gschwindt de Gyor (1996) for a study of the current pension system and Zanforlin (2001) for a sustainability analysis of the planned pension reform.

[25] Pension system assets are mainly deposited with commercial banks and invested in short-term repurchase operations.

Public Corporations

31. **The three main nonfinancial public corporations in San Marino are the Public Utility Company (AASS, Azienda Autonoma Servizi Statali), the Public Works Company (Azienda Autonoma Servizi Pubblici), and the Coin and Stamp Agency (AASFN, Azienda Autonoma Servizi Filatelico-Numismatici).** Three other minor enterprises (the National Dairy Corporation, the University, and the Olympic Committee) complete the list.

32. **In 2002, the combined expenditure of all public enterprises was about 8.5 percent of GDP, with the three largest enterprises accounting for almost 90 percent of the total.** In this respect, there has been a steady decline since 1992, when their expenditure amounted to 11 percent of GDP. Likewise, the tight hiring freeze reduced employment in public enterprises below 3.5 percent of total employment in 2002, helping bring public sector employment in line with that of other small European economies (see figure below).

33. **Since 1981, the AASS has been in charge of providing public utilities in 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 has consistently posted operating surpluses (with a record of about €9 million in 2002, nearly 1 percent of GDP) that are fully transferred to the central administration's budget. The AASS's gross fixed investment has been financed with the contribution of central administration capital transfers up to 2001. Currently, capital expenditure is fully funded by internal reserves built up using past surpluses. The government is seriously committed to transforming the AASS into a publicly owned stock company within the next two years, after which it will be run on the basis of standard business criteria. To this end, the Parliament has nominated a committee of three experts to appraise the AASS's net worth.

34. **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 provision of special services (such as cleaning and security) to the central administration.** In 2002, over 97 percent of the AASP's current proceeds derived from the central administration's current transfers (about 2 percent of GDP), whereas the financing of capital expenditure (less than ½ percent of GDP) was split evenly between central administration capital transfers and short-term domestic borrowing.[26] Containing wage costs and rationalizing the use of resources remain critical steps to increase efficiency in AASP expenditure management. Under the terms of the Full Employment Law (Law

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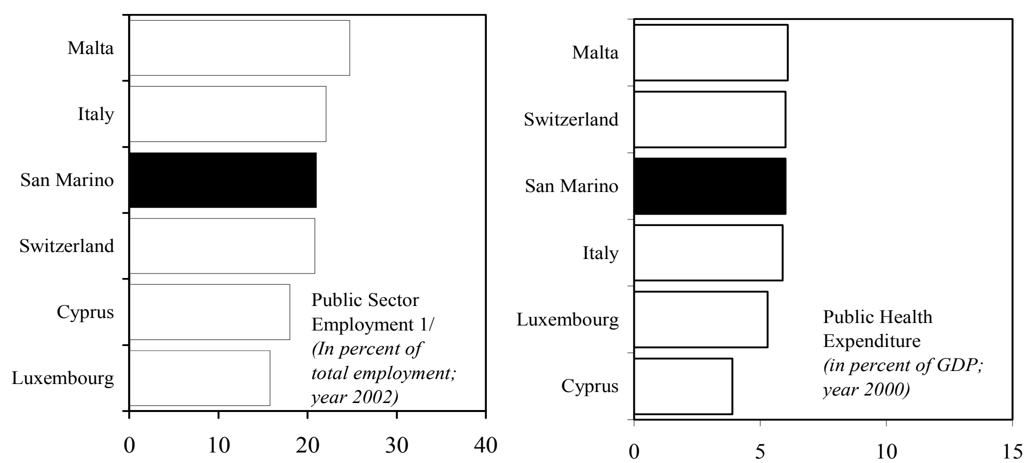
[26] Accounting issues related to the financing of specific investment projects carried out by the AASP have been discussed in Section B. A special law (Law 129/1993) defines terms and conditions under which a bank account overdraft is allowed.

151/1985), the AASP is indeed presumed to act as employer of last resort and forced to hire all those Sammarinese workers who are certified to be unemployable in the private sector owing to physical or mental disabilities. Such a presumption should be removed through the planned reform of the public administration, giving managers autonomy in hiring decisions. At the same time, an appropriately designed welfare program should address the needs of those disabled who are unable to obtain employment. In addition, new procedures on public procurement are expected to enhance the transparency of a significant fraction of AASP operations, given that large construction projects are usually undertaken by private subcontractors.

The presence of the public sector in San Marino is not larger than in other small European economies



Sources: San Marino's Ufficio Programmazione Economica e Centro Elaborazione Dati e Statistica; United Nations, Statistical Bulletin; Human Development Indicators 2003; and Fund staff calculations.
1/ Public Administration and Defence; Compulsory Social Security; Education; Health and Social Work.

35. **The AASFN is in charge of managing the production and distribution of stamps and coins, both for use as legal tender and for collectors.**[27] While in the past coins and stamps each accounted for about half of AASFN proceeds, the introduction of the euro has boosted the potential market for San Marino euro coins. As a consequence, the profits generated in 2002 by coin-related transactions almost doubled with respect to the previous year, raising the AASFN total operating surplus to about 1 percent of GDP.

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[27] An agreement with Italy sets the maximum amount of coins to be circulated in San Marino and foresees an annual fixed payment of €4.6 million as compensation to San Marino for not issuing banknotes.

E. Conclusions

36. **The use of an integrated accounting system of stocks and flows, able to distinguish appropriately between net acquisitions of financial and nonfinancial assets and government resource flows, is a *sine qua non* for an adequate evaluation of San Marino's budgetary performance and vulnerabilities.** As a consequence, it is necessary to improve the reliability and transparency of the Sammarinese fiscal accounting by reconciling the inconsistencies between changes in the central administration's net worth and transaction flows. The ongoing compilation of a set of experimental consolidated accounts for the 2002 public sector based on GFS methodology is an essential endeavor, and one which the staff is strongly encouraging.

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Table 1. San Marino: National Accounts, 1992-2002
(In billions of lire)

	1992	1993	1994	1997	1998	1999	2000	2001	2002
Gross domestic product	777	881	979	1280	1401	1551	1626	1763	1812
Consumption	614	689	761	806	829	863	901	920	929
Gross fixed investment	181	216	240	532	518	642	697	919	1090
Change in stocks	8	16	13	41	69	83	121	44	-22
Exports of goods and services	2,298	2,400	2,691	2,992	2840	3066	3150	3258	3215
Imports of goods and services	-2,315	-2,424	-2,714	-3,050	-2855	-3102	-3243	-3377	-3401
Balance of goods and services	-17	-24	-23	-58	-15	-36	-93	-119	-186

Source: Statistics office, *Conti Economici Nationali 1998-2002* .

Table 2. San Marino: National Accounts, 1992-2002
(In billions of lire; at 1995 prices)

	1992	1993	1994	1997	1998	1999	2000	2001	2002
Gross domestic product	685	735	774	946	1302	1419	1450	1531	1535
Consumption	541	575	602	596	771	789	804	799	788
Gross investment	159	180	190	393	481	587	621	798	924
Change in stocks	7	13	10	30	64	76	108	38	-19
Exports of goods and services	2024	2003	2129	2212	2639	2805	2810	2828	2727
Imports of goods and services	-2040	-2023	-2147	-2254	-2653	-2838	-2893	-2932	-2885
Balance of goods and services	-16	-20	-18	-42	-14	-33	-83	-103	-158
Memorandum item:									
Sammarinese CPI	87	91	95	107	109	111	113	115	117

Source: Statistics office, *Conti Economici Nationali 1998-2002* .

Table 3. San Marino: National Income in Current and Constant Prices, 1997-2002
(In billions of lire)

	1997	1998	1999	2000	2001	2002
			In current prices			
Gross national income	1179	1261	1372	1424	1529	1604
Current taxes on income and wealth	144	164	167	162	188	194
Social contributions and benefits	20	22	21	21	20	13
Other current transfers	38	49	53	53	62	47
Disposable national income	977	1027	1131	1187	1258	1351
			In constant (1995) prices			
Gross national income	1116	1172	1256	1270	1328	1361
Current taxes on income and wealth	136	152	153	145	163	165
Social contributions and benefits	19	20	19	19	18	11
Other current transfers	36	45	49	47	54	40
Disposable national income	925	954	1035	1059	1092	1146

Source: Statistics office, *Conti Economici Nationali 1998-2002* .

Table 4. San Marino: Labor Market Developments, 1992-2003 1/

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Unemployment	503	616	580	495	653	568	553	454	428	422	583	619
Labor force	14,113	14,874	15,519	16,073	16,638	17,078	17,781	18,464	19,072	19,594	20,205	20,236
Cross border workers	1,931	2,268	2,640	2,986	3,182	3,428	3,828	4,244	4,273	4,615	4,104	4,405
Resident labor force	12,182	12,606	12,879	13,087	13,456	13,650	13,953	14,220	14,799	14,979	16,101	15,831
Unemployment rate	4.1	4.9	4.5	3.8	4.9	4.2	4.0	3.2	2.9	2.8	3.6	3.9
Total employment	13,610	14,258	14,939	15,578	15,985	16,510	17,228	18,010	18,644	19,172	19,622	19,617
Percent change 3/	6.0	4.8	4.8	4.3	2.6	3.3	4.3	4.5	3.5	2.8	2.3	0.0
Total resident employment	11,679	11,990	12,299	12,592	12,803	13,082	13,400	13,766	14,371	14,557	15,518	15,212
Percent change 3/	2.4	2.7	2.6	2.4	1.7	2.2	2.4	2.7	4.4	1.3	6.6	-2.0
Contractual wage (percent change)	7.3	6.2	5.0	6.4	5.0	4.0	5.1	5.1	5.0	...	...	...
CPI (Italy) (percent change)	5.1	4.5	4.0	5.2	4.0	2.0	2.0	1.7	2.5	2.8	2.5	2.7
CPI (San Marino) (percent change)	5.4	4.7	5.0	5.0	4.9	2.0	1.8	1.6	2.6	2.8	2.3	2.5

Source: Data provided by the Sammarinese authorities.

1/ Unless otherwise noted, date refers to December 31 of each year.

Table 5. San Marino: Total Employment, 1992-2003 1/

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Agriculture	296	294	256	249	247	250	245	249	244	35	35	31
Manufacturing	4,591	4,739	5,078	5,256	5,339	5,515	5774	5934	6132	5946	6022	6070
Construction	1,106	1,195	1,291	1,440	1,479	1,451	1510	1569	1603	1342	1351	1363
Commerce	2,402	2,499	2,531	2,641	2,736	2,710	2804	3059	3278	2584	2701	2650
Transportation	285	278	282	311	337	353	362	394	435	362	371	380
Finance	339	390	400	417	433	471	511	541	574	586	636	660
Services	1,116	1,239	1,322	1,432	1,511	1,684	1802	2018	2223	1666	1950	2059
Government	2,358	2,737	2,892	2,963	3,029	3,148	3236	3279	3228	3559	3475	3358
Public corporations	1,117	887	887	869	874	928	984	967	927	851	828	778
Total employment												
Private sector	10,135	10,634	11,160	11,746	12,082	12,434	13,008	13,764	14,489	12,521	13,066	13,213
Public sector	3,475	3,624	3,779	3,832	3,903	4,076	4,220	4,246	4,155	4,410	4,303	4,136
Total	13,610	14,258	14,939	15,578	15,985	16,510	17,228	18,010	18,644	16,931	17,369	17,349

Source: Data provided by the Sammarinese authorities.

1/ Data refer to December 31 of each year.

Table 6. San Marino: Central Administration Operations, Accrual Basis, 1992-2004

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 Preliminary	2004 Budget
	(Million of euros)												
Revenues 1/	143.9	157.2	172.4	174.8	191.2	206.4	247.7	224.7	236.6	252.6	256.4	288.0	271.9
Tax	101.5	116.5	129.2	128.3	139.5	157.1	177.8	170.9	182.5	196.7	198.2	219.7	208.8
Direct 1/	42.4	45.9	56.0	53.2	58.6	70.0	80.2	81.3	79.2	96.7	104.1	100.0	101.1
Import Tax 1/	49.3	61.0	61.4	62.8	68.9	74.4	84.9	74.5	87.3	82.3	71.8	94.9	86.3
Other indirect taxes	9.8	9.7	11.8	12.2	12.0	12.7	12.7	15.2	15.9	17.7	22.3	24.9	21.4
Non-Tax 1/ 2/	40.0	39.4	41.2	45.3	45.4	47.0	45.4	44.5	46.6	53.2	56.5	65.7	59.7
Asset Sales	2.3	1.2	2.0	1.2	6.3	2.3	24.5	9.3	7.5	2.7	1.7	2.6	3.5
Expenditure 1/	145.8	164.3	193.3	200.2	207.4	219.6	235.5	248.7	265.7	285.3	276.8	272.4	277.6
Current expenditure	118.5	141.5	153.3	159.6	171.6	186.3	198.8	221.9	235.6	240.2	251.9	250.6	254.2
Wages & Salaries	41.6	48.7	56.3	60.4	64.9	71.4	79.0	84.4	91.6	91.9	90.5	91.2	91.7
Transfers to Public Sector	54.7	53.3	57.9	72.2	75.0	61.3	81.8	98.1	99.4	109.9	123.0	123.7	115.7
o/w ISS	36.4	43.4	47.6	47.0	49.3	52.5	51.0	68.2	70.4	76.6	92.0	84.3	77.0
Transfers to Private Sector	...	...	...	6.7	6.8	7.9	8.8	8.4	8.9	6.3	9.7	8.0	7.6
Interest Payments	...	...	...	1.5	1.9	2.6	3.4	2.8	2.5	2.4	2.4	2.2	2.9
Others 3/	22.2	39.5	39.2	18.8	23.0	43.2	25.8	28.3	33.2	29.8	26.4	25.5	36.4
Capital expenditure	27.3	22.8	40.0	40.7	35.8	33.3	36.8	26.7	30.1	45.1	24.9	21.8	23.3
Transfers to Public Sector	12.1	10.3	10.3	10.4	13.7	14.8	12.7	11.2	15.0	12.7	3.1	7.9	6.1
Others	15.2	12.6	29.7	30.3	22.1	18.5	24.0	15.5	15.0	32.4	21.8	13.9	17.2
Balance	-2.0	-7.2	-20.8	-25.4	-16.2	-13.2	12.2	-23.9	-29.0	-32.7	-20.4	15.7	-5.6
Financing	2.0	7.2	20.8	25.4	16.2	13.2	-12.2	23.9	29.0	32.7	20.4	-15.7	5.6
Net Debt Financing	-0.2	2.3	0.1	1.8	4.8	4.0	3.4	1.6	4.9	13.8	-1.0	-2.2	5.6
Change in Deposits	-18.7	-3.5	1.7	-18.1	19.5	10.5	26.2	-26.1	68.5	17.9	-48.1	-11.4	0.0
Change in Net Government Arrears	20.9	8.3	19.0	41.7	-8.2	-1.2	-41.8	48.4	-44.3	1.0	69.6	-2.1	0.0
Memorandum Items:													
Tax reimbursements	59.4	66.2	82.5	108.4	158.4	188.4	183.9	236.3	180.6	224.4	216.4	226.5	251.1
Reassessment of old arrears	1.2	3.4	3.4	44.7	12.1	27.0	-14.9	13.6	3.7	-80.1	15.9	1.5	0.0
	(Percent of GDP)												
Revenues 1/	37.5	36.2	35.7	31.4	31.5	31.2	34.2	28.1	28.2	27.7	27.4	30.1	27.3
Tax	26.5	26.8	26.8	23.1	23.0	23.8	24.6	21.3	21.7	21.6	21.2	22.9	20.9
Direct 1/	11.1	10.6	11.6	9.6	9.7	10.6	11.1	10.2	9.4	10.6	11.1	10.4	10.1
Import Tax 1/	12.9	14.0	12.7	11.3	11.4	11.3	11.7	9.3	10.4	9.0	7.7	9.9	8.6
Other indirect taxes	2.6	2.2	2.4	2.2	2.0	1.9	1.8	1.9	1.9	1.9	2.4	2.6	2.1
Non-Tax 1/ 2/	10.4	9.1	8.5	8.1	7.5	7.1	6.3	5.6	5.6	5.8	6.0	6.9	6.0
Asset Sales	0.6	0.3	0.4	0.2	1.0	0.3	3.4	1.2	0.9	0.3	0.2	0.3	0.4
Expenditure 1/	38.0	37.8	40.0	36.0	34.2	33.2	32.6	31.0	31.6	31.3	29.6	28.4	27.8
Current expenditure	30.9	32.6	31.8	28.7	28.3	28.2	27.5	27.7	28.1	26.4	26.9	26.1	25.5
Wages & Salaries	10.9	11.2	11.7	10.9	10.7	10.8	10.9	10.5	10.9	10.1	9.7	9.5	9.2
Transfers to Public Sector	14.3	12.3	12.0	13.0	12.4	9.3	11.3	12.3	11.8	12.1	13.2	12.9	11.6
o/w ISS	9.5	10.0	9.8	8.5	8.1	7.9	7.1	8.5	8.4	8.4	9.8	8.8	7.7
Transfers to Private Sector	...	...	...	1.2	1.1	1.2	1.2	1.0	1.1	0.7	1.0	0.8	0.8
Interest Payments	...	...	...	0.3	0.3	0.4	0.5	0.3	0.3	0.3	0.3	0.2	0.3
Others 3/	5.8	9.1	8.1	3.4	3.8	6.5	3.6	3.5	4.0	3.3	2.8	2.7	3.7
Capital expenditure	7.1	5.3	8.3	7.3	5.9	5.0	5.1	3.3	3.6	4.9	2.7	2.3	2.3
Transfers to Public Sector	3.2	2.4	2.1	1.9	2.3	2.2	1.8	1.4	1.8	1.4	0.3	0.8	0.6
Others	4.0	2.9	6.1	5.4	3.6	2.8	3.3	1.9	1.8	3.6	2.3	1.5	1.7
Balance	-0.5	-1.7	-4.3	-4.6	-2.7	-2.0	1.7	-3.0	-3.5	-3.6	-2.2	1.6	-0.6
Financing	0.5	1.7	4.3	4.6	2.7	2.0	-1.7	3.0	3.5	3.6	2.2	-1.6	0.6
Net Debt Financing	-0.1	0.5	0.0	0.3	0.8	0.6	0.5	0.2	0.6	1.5	-0.1	-0.2	0.6
Change in Deposits	-4.9	-0.8	0.4	-3.3	3.2	1.6	3.6	-3.3	8.2	2.0	-5.1	-1.2	0.0
Change in Net Government Arrears	5.4	1.9	3.9	7.5	-1.3	-0.2	-5.8	6.0	-5.3	0.1	7.4	-0.2	0.0
Memorandum Items:													
Tax reimbursements	15.5	15.2	17.1	19.5	26.1	28.5	25.4	29.5	21.5	24.6	23.1	23.6	25.2
Reassessment of old arrears	0.3	0.8	0.7	8.0	2.0	4.1	-2.1	1.7	0.4	-8.8	1.7	0.2	0.0

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

1/ Net of tax reimbursements.

2/ Includes custom duties, state monopolies, other special revenues, revenues from financial assets, interests on credits and deposits.

3/ Includes purchases of goods and services, remunerations for consultancies, contribution to interest payments on publicly subsidized loans, and transport costs.

Table 7. San Marino: Public Debt, 1992-2003 1/

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
					(Million of euros)							
Total long-term debt	13.5	15.9	15.6	15.3	15.0	14.8	19.8	18.6	25.2	23.4	24.8	22.4
(in percent of GDP)	3.5	3.6	3.2	2.8	2.5	2.2	2.7	2.3	3.0	2.6	2.6	2.3
Total short-term debt			0.3	2.4	7.5	11.7	10.1	13.0	11.2	26.8	24.4	24.5
(in percent of GDP)			0.1	0.4	1.2	1.8	1.4	1.6	1.3	2.9	2.6	2.6
Total public debt	13.5	15.9	15.9	17.7	22.5	26.5	29.9	31.5	36.4	50.2	49.1	46.9
(in percent of GDP)	3.5	3.6	3.3	3.2	3.7	4.0	4.1	3.9	4.3	5.5	5.3	4.9

Sources: Department of Budget and Planning, *Relazione Previsionale e Programmatica* ; and Fund staff estimates.
1/ End of period data.

Table 8. San Marino: Pension System, 1992-2003
(In percent of GDP)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Social security (SS) contributions 1/	3.0	3.1	3.5	3.6	4.0	4.2	4.5	4.6	4.9	5.2	5.4	5.6
o/w SS contributions of dependent employees	2.5	2.6	3.0	3.0	3.4	3.6	3.9	4.0	4.3	4.6	4.7	4.8
Government transfers	0.6	0.6	0.7	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.9	0.9
Imputed contribution 5/	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Intra-fund transfers 4/	0.0	0.0	0.0	0.0	0.4	0.5	0.5	0.5	0.5	0.6	0.6	0.7
Yield	0.0	0.1	0.1	0.2	0.3	0.2	0.2	0.3	0.3	0.4	0.3	0.3
Pension expenditure	3.2	3.4	3.8	3.7	4.1	4.3	4.8	4.9	5.4	5.8	6.4	6.9
o/w Pension expenditure on dependent employees	2.3	2.5	2.7	2.7	3.1	3.2	3.6	3.7	4.1	4.4	4.9	5.3
General expenditure 2/	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Intra-fund outlays 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserves	0.3	1.0	1.8	2.7	4.2	5.7	7.2	8.3	9.9	11.5	13.0	13.8

Source: Ufficio Programmazione Economica e Centro Elaborazione Dati e Statistica.
1/ Net of reimbursements.
2/ Portion of administrative expenditures borne by SSI.
3/ Amount of resources used to cover the deficit of voluntary pension funds.
4/ Surplus of the funds for family allowances and social service activities.
5/ SS contributions computed on the yearly allowances paid to dependent workers (i.e., sick leave, unemployment benefits, etc.).

Table 9. San Marino: Interest Rates, 1996-2003

(In percent; end-of-period)

	Deposit Rates		Loan Rates			
	Sight savings	Time	Prime	Average	Repurchase agreements	Italian deposit rate 1/
1996	5.5	6.2	11.5	14.5	7.6	6.5
1997	3.5	4.7	9.0	11.4	5.9	4.8
1998	2.9	3.7	7.8	9.5	4.3	3.2
1999	1.2	2.5	5.2	7.9	2.6	1.6
2000	1.2	2.6	6.1	9.2	3.9	1.8
2001	1.4	2.9	6.0	8.8	4.0	2.0
2002	1.4	2.7	5.2	8.0	3.1	1.4
2003	1.0	1.6	4.4	7.5	2.2	0.9

Sources: Data provided by the Sammerinese authorities; IMF, *International Financial Statistics* .

1/ Italian deposit data are annual averages.

Table 10. San Marino: Monetary Authorities, 1996-2004 1/
(in billions of lire)

	1996	1997	1998	1999	2000	2001	2002	2003				2004
								March	June	Sept.	Dec.	March
Foreign assets	329	322	282	278	281	293	339	372	361	417	387	412
Claims on general government	2	17	29	28	29	28	30	30	30	29	30	29
Claims on deposit money banks	41	19	2	1	8	19	6	1	0	2	14	0
Claims on nonbank financial insitutions	172	189	236	255	320	387	633	641	668	684	737	824
Reserve money	48	38	43	43	57	77	81	92	102	109	108	104
Deposit money banks' deposits	0	0	3	1	4	25	4	18	11	21	13	16
Other demand deposits	21	21	23	23	52	52	42	39	48	39	38	39
Time, savings and foreign currency deposits	27	17	16	19	1	0	35	35	43	49	57	49
Bonds	257	255	181	104	117	114	134	153	140	151	167	176
Foreign liabilities	0	0	0	0	0	25	29	18	25	11	2	10
Central government deposits	270	267	216	209	195	172	193	217	185	245	238	247
Central Administration	224	208	178	173	162	138	158	159	159	207	188	213
Social Security	31	41	23	12	10	14	16	35	7	9	26	9
Other	14	18	15	24	23	19	19	23	19	29	24	26
Capital accounts	54	63	67	71	75	79	80	81	86	87	91	86
Other items (net)	0	-11	-13	-13	-8	-12	-6	-5	-5	-4	-6	-4
Memorandum items:												
Foreign assets (share of GDP)	0.27	0.25	0.20	0.18	0.17	0.16	0.19	...	...	...	...	...
Foreign liabilities (share of GDP)	0.00	0.00	0.00	0.00	0.00	0.01	0.02	...	...	...	...	...

Source: End-of-period data provided by the Sammarinese authorities; IMF, *International Financial Statistics.*
1/ San Marino has adopted the euro at a rate of 1936.27 Italian lire per 1 euro.

Table 11. San Marino: Monetary Survey, 1996-2004 1/
(in billions of lire)

	1996	1997	1998	1999	2000	2001	2002	2003				2004
								March	June	Sept.	Dec.	March
Foreign assets (net)	1332	1404	1217	1424	1218	1333	2829	2871	2645	2580	2335	2090
Domestic credit	1208	1533	1914	2086	2652	3053	3650	3654	3946	3932	4327	4704
Claims on general government (net)	-268	-250	-187	-181	-166	-144	-163	-187	-155	-216	-208	-218
Claims on private sector (deposit money banks)	1304	1594	1865	2013	2498	2810	3180	3200	3432	3464	3798	4097
Claims on nonbank financial insitutions	172	189	236	255	320	387	633	641	668	684	737	824
Other items, net (including capital accounts)	-812	-939	-1141	-1224	-1384	-1353	-1631	-1687	-1730	-1646	-1677	-1765
Broad Money	1728	1997	1990	2286	2486	3033	4849	4838	4860	4865	4984	5029
Money	437	442	487	554	579	666	1240	1316	1309	1301	1266	1182
Quasi-money	1291	1555	1502	1732	1907	2367	3608	3522	3551	3564	3718	3847
Memorandum items:												
Foreign assets, net (share of GDP)	1.08	1.10	0.87	0.92	0.75	0.74	1.56	...	...	...	...	...
Domestic credit (share of GDP)	0.98	1.20	1.37	1.35	1.63	1.70	2.02	...	...	...	...	...
Broad money (share of GDP)	1.41	1.56	1.42	1.47	1.53	1.69	2.68	...	...	...	...	...

Sources: End-of-period data provided by the Sammarinese authorities; IMF, *International Financial Statistics* .
1/ San Marino has adopted the euro at a rate of 1936.27 Italian lire per 1 euro.

Table 12. San Marino: International Reserve-Like Assets, 1996-2004 1/
(in billions of lire)

	1996	1997	1998	1999	2000	2001	2002	2003				2004
								March	June	Sept.	Dec.	March
Central Bank												
Foreign assets of the Central Bank	329	322	282	278	281	293	339	372	361	417	387	412
Foreign liabilities of the Central Bank	0	0	0	0	0	25	29	18	25	11	2	10
Banking Institutions												
Foreign assets of banking institutions	7200	7755	7245	8607	8926	9783	8850	8947	8817	8530	8479	8317
Foreign liabilities of banking institutions	6197	6673	6311	7461	7989	8719	6330	6428	6508	6356	6530	6629
Net foreign assets of banking institutions	1003	1082	935	1146	937	1065	2519	2518	2308	2174	1949	1688
Memorandum items: As share of GDP												
Foreign assets	5.84	6.06	5.17	5.55	5.49	5.44	4.89	...	...	...	...	...
Foreign liabilities	5.02	5.21	4.50	4.81	4.91	4.85	3.50	...	...	...	...	...
Net Foreign assets	0.81	0.85	0.67	0.74	0.58	0.59	1.39	...	...	...	...	...

Source: End-of-period data provided by the Sammarinese authorities; IMF, *International Financial Statistics* .

1/ San Marino has adopted the euro at a rate of 1936.27 Italian lire per 1 euro.