The Economic Crisis and the Politics of the Republic of San Marino

A Comparative Case Study

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Abstract:

Like other European microstates, the economy of the Republic of San Marino has flourished in recent decades due to the development of an extensive banking industry. However, after the terrorist attacks of 9/11 and the subsequent international combat against fiscal evasion and money laundering practices, San Marino's banking system has come under severe criticism, and its economy now has to be entirely restructured. A remarkably severe political crisis in the microstate's relationships with Italy has broken out, of which the end is not yet in sight. Consequently, the financial and economic crisis of 2008 has a double impact on the smallest republic of Europe, and the country's politicians are now debating the option of future EU-membership. San Marino's double economic crisis has led to increasing dissatisfaction with existing political practices such as clientelism and patronage, of which the negative consequences are now more clearly felt. Due to its small scale, Sammarinese politics has always been a question of personality and interpersonal relationships instead of ideology, which creates a political environment that is clearly different from larger European democracies. In the current research paper, the political and economic consequences of San Marino's double crisis are outlined and discussed from a comparative perspective, as comparisons will be drawn with three other European microstates as well.

1. Introduction[1]

Located in the heart of Europe, the four minuscule yet independent nations of Andorra, Liechtenstein, Monaco, and San Marino have so far consistently declined the option of EU-membership.[2] The economic advantages that result from their diminutive size have allowed these microstates to reach levels of wealth that surpass those of their larger neighbors, which means that EU-accession would render these countries net-contributors (Dósza 2008: 102). Furthermore, EU-membership would require these microstates to conform to the Union's entire *acquis communautaire*, as a consequence of which their highly profitable financial industries would have to be restructured if not abolished. Whereas the four microstates have all established customs unions with the EU, and Monaco and San Marino have also ratified monetary agreements regarding the use of the euro, full EU-membership has always been deemed undesirable (cf. Eccardt 2005: 51). From an EU-perspective membership of these countries would not be very attractive either, as it is unclear how these microstates could be accommodated within a union consisting of much larger states (Archer and Nugent 2002: 1-2). At present the EU does have a number of relatively small member states, among which Luxembourg, Cyprus, and Malta (and in the near future possibly Iceland), but the smallest of

[1] The information on the basis of which this paper is written has been assembled during field research in San Marino in November 2010. As part of the research, Sammarinese politicians, journalists, business leaders, and other public officials were interviewed. In addition, some archival research and an analysis of secondary literature were carried out. Information about the other microstates largely originates from secondary literature.
[2] Vatican City is occasionally listed in this group of states as well, but due to the fact that it has no real domestic population, is not a UN-member state, and is politically really distinct from the other four microstates, it is not discussed in the present paper.

these (Malta) still has a population size that is approximately two-and-a-half times as large as that of the four microstates *combined*.[3]

Contemporarily, all four European microstates have economies that are primarily based on tourism and finances. Low business and income taxes[4], slack fiscal laws and regulations, and strict privacy rules have made these four countries well-known offshore financial centers or 'tax havens', both for residents (who often are so-called 'tax refugees' from other European countries) and for individuals and businesses abroad. Largely due to their highly profitable financial industries, the four European microstates have become much wealthier than their larger neighbors, with GDP per capita-levels that are well above the Western European average (Armstrong and Read 1995; Dósza 2008: 95).[5] As will be discussed in the current paper however, two momentous events at the dawn of the new millennium – the terrorist attacks of September 11th, 2001 and the financial and economic crisis of 2008 – turn out to have tremendous consequences for the political and economic organization of the European microstates (cf. Hampton and Christensen 2002: 1658). Not only did many microstates across the globe suddenly appear on 'black lists' of international organizations such as the OECD and the IMF, but the 2008 financial crisis also led to a significant decline in tourism to these states, which in most cases is their primary source of income.[6]

In the current paper, the political and economic implications of the 'double crisis' of 2001 and 2008 will be analyzed for the European microstate of San Marino. Although the present analysis will hence chiefly focus on the consequences of these two crises for only one microstate, comparisons with the other three European microstates will be drawn as well. The paper will commence with an overview of San Marino's political history and contemporary political and economic institutions, followed by a discussion of some of the country's remarkable political practices. Subsequently, the consequences of the two crises for Sammarinese politics and economics will be discussed, which will be contrasted with circumstances and developments in the three other microstates. To conclude, an analysis of

[3] Whereas Malta has about 410.000 inhabitants, Andorra has a population size of approximately 85.000 people, and San Marino, Monaco, and Liechtenstein all have around 30.000 people living within their borders (*CIA World Factbook* 2011).

[4] Andorra and Monaco have no income tax at all, and taxation levels in Liechtenstein and San Marino are much lower than in neighboring countries.

[5] According to World Bank-statistics from 2008, with GDP-per capita figures of $201.164 and $138.354 respectively, Monaco and Liechtenstein have the highest GDP-scores in the world. San Marino ($61.223, 9th in the world) and Andorra ($44.291, 24th) have somewhat lower rankings, but are clearly above the levels of Italy ($38.385) and Spain ($35.000) (*World Bank* 2008).

[6] Only for Liechtenstein, banking and finance is a more significant source of income than tourism.

the opportunities for San Marino (and the other microstates) to emerge out of the crisis will be presented, after which some final conclusions will be drawn.

2. Political History and Contemporary Political and Economic Institutions of San Marino

Supposedly founded in 301 BC, the Most Serene Republic of San Marino is often assumed to be the most ancient republic in the world. According to the legend about its origins, the country was created by the stonecutter Marinus the Dalmatian, who was chased for his Christian beliefs under the infamous Diocletianic Persecutions (Duursma 1996: 216; Sundhaussen 2003: 274; Eccardt 2005: 278-279). On the slopes of Mount Titano, Marinus and a small group of his followers found refuge and established a small commune that was based on the freedom to profess religion, which remained the cornerstone of Sammarinese identity in the ages that followed. Whether this legend is accurate or not, historians and archaeologists have found evidence of the existence of an independent society on San Marino's current location going back to at least the 9th century (Miller 1901: 635; Bacciocchi 1999: 27).

Writings from the early Middle Ages substantiate the existence of the *Arengo* (or *Arringo*), a legislative council composed of all the Sammarinese heads of families, which constituted the most important institution of the polity (Miller 1901: 635; Sundhaussen 2003: 217). The *Arengo* was an association in which all important political issues in the Republic were discussed and decided upon, and attendance at *Arengo*-meetings used to be compulsory. For most of the Middle Ages, San Marino therefore had a system of direct and participatory democracy, even though only a selective group of (male) citizens could participate in decision-making. Due to the growth of the population and the ensuing logistical problems of organizing *Arengo*-meetings, the largest part of the council's powers were gradually transferred to a representative body, the Council of Sixty[7] (Giannini 1899: 31; Bacciocchi 1999: 28-29; Casali and Crescentini 2003: 57-58). It is also clear that already in the 13th century, the duumvirate of the Captains Regent (*Capitani Reggenti*) formed the political leadership of the Sammarinese polity (Sundhaussen 2003: 217; Casali and Crescentini 2003: 61). In the year 1600, the first Statutes of San Marino were established and written down, thus forming one of the most ancient written constitutions in the world (Catudal 1975: 194; Bacciocchi 1999: 28). In these Statutes, the legislative and constitutional competences of the

[7] *Consiglio dei Sessanta* in Italian, and nowadays known as the *Consiglio Grande e Generale*, the Great and General Council.

Council of Sixty have been formulated, as well as its task to nominate and appoint people to the main political positions of the polity.

From the 15th century onwards, the democratic traditions of the Republic have declined significantly, as the *Arengo* was no longer convoked and the Council of Sixty (which at times existed of far less than sixty members) had become an oligarchic assembly of which the members were selected by cooptation from within the Council itself (Bacciocchi 1999: 31-32). As a consequence, the political power of the Republic was in the hands of the few powerful families that controlled the Council of Sixty, and who became the aristocracy of San Marino. This situation remained until 1906, when under pressure from the first democratic and socialist movements the *Arengo* was convoked for the first time in 400 years, and universal male suffrage was introduced. The first Sammarinese democracy was short-lived however, as fascists took over the country in 1926, following similar developments in Italy. For San Marino, the fascist era marked a return to the pre-1906 *Oligarchia*, in the sense that the fascist rulers of San Marino by and large came from the same families that controlled the Council of Sixty before 1906 (de Visser 1941: 49-51; Pelliconi 1995: 86).

After the end of the Second World War democracy returned to San Marino, and a coalition government composed of communists (PCS) and socialists (PSS) ruled the country from 1945 until 1957.[8] In circumstances resembling a *coup d'état*[9], this government came to an end, female suffrage was introduced, and since 1957 the Christian-democrats (PDCS) have been in office with varying coalition partners (Duursma 1996: 227; Bacciocchi 1999: 123-124). After the end of the Cold War and the collapse of communism, the hitherto stable party system of San Marino disintegrated, to the point where at present not less than twelve political

[8] As such, San Marino was the only country in the western world with a democratically elected government in which communists were represented, and unlike the Italian socialist party, the Sammarinese socialists chose to align themselves with the communist party instead of the Christian-democratic party (PDCS), which has since the end of the war always been the largest party in San Marino (Bacciocchi 1999: 104).

[9] In 1957, the withdrawal of support of five socialist MPs who did not wish to support the government any longer led to a perfect split in parliament (30 government MPs versus 30 opposition MPs). When one of the communist MPs decided to withdraw his support as well, the government, now having a minority of seats in the Council, closed parliament and called for new elections. The opposition did not accept this decision and instead formed a provisionary government in the industrial town of Rovereta, in the north of San Marino. This government was immediately recognized as legitimate by Italy, France, and the United States, and the Italian government decided to send 150 militaries to the Republic. Under this pressure, the left-wing government resigned, and Christian-democrats together with the new social-democratic party that was established by the dissenting socialist and communist MPs formed a new government, without organizing new elections (Catudal 1975: 194; Duursma 1996: 220-221; Bacciocchi 1999: 114-117; Sundhaussen 2003: 218). The events of 1957 are currently known as the "*fatti di Rovereta*", and Sammarinese people have since then been divided on the issue, with both sides accusing the other one of committing a *coup d'état*. Several decades later, documents from U.S. archives demonstrated that the CIA and the American government had close links with the Sammarinese Christian-democratic opposition, and actively endeavored to destabilize the left-wing government (Bacciocchi 1999: 117-118).

parties are represented in the Council of Sixty. Due to a new electoral law that was introduced in 2006 and that aimed at countering further fragmentation of San Marino's party system, parties now have to form pre-electoral alliances (just like in Italy). At present, San Marino is ruled by the right-wing *Patto per San Marino*, which consists of Christian-democrats, liberals, and nationalists, whereas the opposing *Riforme e Libertà*-coalition is composed of social-democrats, socialists, and progressive Christian-democrats.

2.1. Contemporary Political and Economic Institutions of San Marino

The Sammarinese political system is structured along the lines of a parliamentary democracy, with a government (the *Congresso di Stato*) that is presided over by two Captains Regent (*Capitani Reggenti*), and that is politically accountable to a legislature (the *Consiglio Grande e Generale*, or Council of Sixty). The Captains Regent have a term in office of only half a year (which is the shortest of any head of state in the world) and are elected by and from among the members of the Council of Sixty. After having served as Captain Regent for half a year, it is by law forbidden to be elected to this position again for at least three years (Duursma 1996: 220; Eccardt 2005: 287-288).[10] San Marino's legislative power is vested in the Council of Sixty, which is elected every four years on the basis of proportional representation by party lists. The Council has the competence to appoint people to the other important organs of the state, such as the government ministers, the Captains Regent, the Council of Twelve, and the judiciary (Duursma 1996: 219-221). The Council of Twelve (*Consiglio dei Dodici*) is a remarkable historic institution that used to have a number of significant judicial competences (as it was for example the administrative judge in third instance), but with the recent separation of powers has lost much of its duties, and is now primarily an administrative organ. However, the Council of Twelve does continue to decide in matters that involve the acquisition and possession of territory, which is an important matter in a country with an area of only 61 square kilometers (Duursma 1996: 225-226). Whereas the relationship between the executive, legislative, and judicial powers in the Sammarinese system always used to be somewhat unclear, in recent years more strict separations between these powers have been established (Pelliconi 1995: 67).

In addition to the upper layer of national government, San Marino is subdivided in nine communes (*Castelli*), which each have their own local administration (the *Giunte di*

[10] Together with their extreme short period in office and the fact that there are two heads of state instead of one, the impossibility of reelection of the Captains Regent is said to be devised in order to prevent for the concentration of power in the hands of one person, which is evidently a risk in a small state with only a few people that are willing and able to assume political positions.

Castello). Each *Giunta* has its own assembly, which is directly elected by the inhabitants of the commune, and is headed by a *Capitano di Castello* (Duursma 1996: 221-222). It should further be noted that San Marino employs a number of instruments of direct democracy, among which the referendum and the popular initiative. The most remarkable manifestation of direct democracy in the country is however the biannual *Istanze d'Arengo*, during which citizens have the right to present requests of public interest to the newly elected Captains Regent (Bacciocchi 1999: 32).

When it comes to the international relations of San Marino, the republic's connection with Italy is evidently of paramount importance, and it is no understatement to say that the entire well-being of the country depends on these relations. Whereas San Marino for centuries has maintained a policy of abstinence and isolation from international affairs, after the Second World War this policy has shifted dramatically, and the country now maintains connections with many international actors. In 1988 the Republic became a member of the Council of Europe, in 1992 it entered the United Nations, and it is now a member-state of a multitude of international organizations (Duursma 1996: 232-233). Nevertheless, the republic's dependence on Italy remains critical, and events in the past have demonstrated that a negative attitude of Italy vis-à-vis San Marino can have disastrous consequences.[11]

In terms of economics the Sammarinese system is characterized by a comparatively very large public sector; about one quarter of the Sammarinese workforce is hired by the state, which means that more than four thousand people are working in the bureaucracy.[12] The government of San Marino has an extensive control over the country's private sector, which consists primarily of businesses in the finance and tourism-sectors.[13] Many of San Marino's politicians are concurrently active in the private sector, which means that a fusion of public and private interests can occasionally be witnessed. Of course, this intimacy between San Marino's public and private sectors can be advantageous, since it allows for a better understanding of each others' interests and since economic policies can be implemented more quickly and more efficiently. On the other hand, the independence and autonomy of the microstate's private sector seems to be rather restricted, since the government has the authority and intention to exercise a firm control on Sammarinese businesses. For example,

[11] In the past, Italy has repeatedly demonstrated its ability and determination to influence Sammarinese domestic affairs, as for example during the blockade of the 1950s and during the *fatti di Rovereta* of 1957 (see reference #9).
[12] According to the Sammarinese statistics office (*Ufficio Programmazione Economica – Centro Elaborazione Dati e Statistica, www.upeceds.sm*), in March 2011 4.193 Sammarinese were working in the public sector.
[13] According to the State Secretary for Finances (*Segreteria di Stato per le Finanze*), the tourism and financial sectors accounted for over 50% and 17.6% of San Marino's GDP in 2010 respectively.

the government of San Marino has devised strict laws regarding the hiring of employees in the public sector, as a consequence of which companies are forced to hire Sammarinese nationals instead of less expensive employees from Italy.

2.2. Political Practice of San Marino

San Marino's limited population size obviously has far-reaching consequences for the nature of the country's political system. A natural proximity exists between the country's citizens and politicians, as a consequence of which personal interests and interpersonal relationships regularly enter the political and public domain. Although twelve different political parties are represented in the Council of Sixty, no real ideological differences between them can be discerned, and the parties appear to differ primarily on issues of personality. In the absence of ideological variations, voting behavior of Sammarinese citizens is principally based on traditional links between families and political parties or politicians. Because of the proximity between politicians and citizens, but also because of the fact that politics often directly affects people's lives, it is fair to say that citizens of San Marino display a greater interest in politics than citizens of larger countries, which can be witnessed by higher levels of political awareness, efficacy, and participation.

The government of San Marino plays a supreme role in the public life of the country. Since government is by far the largest employer, many citizens are economically dependent on it. Furthermore, as a consequence of the fact that San Marino's media, judiciary, civic and societal organizations, and private sector are miniature and comparatively not very professional (due to a limited pool of qualified employees), the government is able to dominate these institutions as well. Many of the Secretaries of State (ministers) in the Sammarinese government are powerful individuals who have mostly been in politics for a relatively long time and at various positions. Oftentimes, they also have extensive links with the Sammarinese private sector, and especially with the financial sector. In the absence of significant ideological cleavages, Sammarinese political parties are mostly based on the leverage and reputation of these 'big-man' politicians. As a consequence of the fact that these individuals establish and sustain personal bonds with people from all segments of society, the supremacy of the government is further amplified.

The most remarkable characteristic of the Sammarinese political system is, however, the pervasiveness of patronage and clientelism. Since jobs in the civil service can be distributed by politicians without many restrictions or transparency regulations, the appointment of political supporters, friends, or family members in public functions happens commonly. In addition, especially in advance to elections it is common that politicians use their position to reward supporters or to attract new ones. Because many ministers and parliamentarians are also active in other sectors of society, or because they have extensive (family-) linkages to so many other people, they can offer citizens loans, reparations to their house, a piece of land, and many other benefits and services that can be thought of. It should be emphasized however that the clientelistic nature of Sammarinese politics is not only the result of the politicians' behavior, but is also a consequence of the way in which citizens regard politics; that is, mostly as something that can directly benefit themselves. In such an environment, politicians who do not engage in clientelism and patronage stand no chance in elections, meaning that patron-client relations can by and large be seen as unavoidable. Furthermore, due to the limited pool of political talent, the political professionalism that is required in order to curb clientelism is often not present among the country's politicians. Many politicians also maintain extensive clientelistic links with Sammarinese emigrants, who still have voting rights in national elections. Since approximately one-third of Sammarinese nationals live outside the country (predominantly in France, the US, and Argentina), their potential electoral influence should not be underestimated.

As this concise discussion of the Sammarinese political and economical system reveals, the smallness of San Marino unquestionably creates a societal environment that is different from larger countries. Due to the microstate's dependence on tourism and banking, fluctuations in the world economy have more far-reaching consequences here than in other places, as will become clear in the following section. In addition to that however, it should be noted that the peculiar nature of the Sammarinese system also brings about a different reaction to economic setbacks than would be expected in larger states. Whereas the government of San Marino clearly is the dominant player in society, and would therefore in theory be able to implement economic reforms rather swiftly, the clientelistic links that exist between citizens and politicians form a significant impediment to such action. In the following paragraph, the impact and consequences of the 9/11 terror attacks and the 2008 financial crisis will be discussed for San Marino, and a comparison with Monaco, Liechtenstein, and Andorra will be drawn.

3. The Impact and the Consequences of the 'Double Crisis' in the Four Microstates

Already in 1998, the Organization for Economic Cooperation and Development (OECD) published a report in which the establishment of an international framework to curb harmful tax practices was announced (OECD 1998; Hishikawa 2002: 393; Hampton and Christensen

2002: 1660). In this report, a distinction was made between so-called 'tax havens' and 'harmful preferential tax regimes'[14], and whereas Monaco, Liechtenstein, and Andorra all fell in the tax haven-category, San Marino has been able to remove itself from this list before it was published and ultimately fell within the second category (Hampton and Christensen 2002: 1660; Maurer 2007: 163). The countries labeled as tax havens were given until 2002 to reform their financial industries, but when this deadline passed, none of the European nations on the list had taken any significant initiatives in the right direction. Only in 2009, Monaco, Liechtenstein and Andorra finally complied with the OECD's demands, and were subsequently removed from the list of uncooperative tax havens (*OECD Centre for Tax Policy and Administration* 2009).

Whereas the OECD and also the International Monetary Fund (IMF, cf. IMF 2000) thus have developed measures to counter offshore finance already before the terrorist attacks of 11 September 2001, these attacks unquestionably initiated a significant increase in the attention for so-called harmful tax practices (Hampton and Christensen 2002: 1662). Following the attacks, the United States' government quickly subsumed the curtailment of offshore finance under the broader 'war against terror', as it was suspected that terrorist organizations had numerous bank accounts in offshore finance centers. Whereas the US thus far had been only moderately involved in the combat against offshore finance (cf. Hishikawa 2002: 412-414), this changed drastically after the 9/11 attacks, and other countries swiftly joined Washington in its renewed emphasis on fighting tax evasion and money laundering. Thus, the pressure on microstates identified as tax havens mounted, and especially for countries that are economically heavily dependent on the US, such as the microstates in the Eastern Caribbean (Vlcek 2007), no alternatives to abolishing offshore finance remained. By contrast, European microstates were for the largest part of the first decade of the new millennium able to withstand these international pressures; at least until the recent economic crisis broke out.

In the midst of the international struggle against offshore financing, the financial and economic crisis of 2008 erupted. Despite the comparative wealth of the European microstates, the vulnerability of their economies and the relative size of their financial sectors meant that the crisis potentially had much graver consequences here than in the rest of Europe. In addition, as an effect of the crisis the larger neighbors of the European microstates

[14] A tax haven was defined by the OECD as a jurisdiction with the ability to finance its public services with no or nominal income taxes, which is being used by nonresidents to escape tax in their country of residence. Harmful preferential tax regimes were defined as jurisdictions that raise significant amounts of revenue through their income tax, but whose tax systems have harmful tax competition features (cf. Hishikawa 2002: 393)

increasingly saw the need for the further restraint of harmful tax practices, and the pressure exercised by these states (among which France, Spain, Germany, and Italy) had much greater results on the fiscal policies of the European microstates than the already existing demands of international organizations and the United States. The economic future of the European microstates now seems to depend principally on their capability to restructure their financial sectors according to modern international standards, and to reform their economies and find alternative sources of income.

3.1. The Impact of the Crisis in San Marino

Even though the Republic of San Marino had skillfully managed to avoid being named on the 'black list' of the OECD, after 2008 the Italian government significantly increased its pressure on the microstate (IMF 2011: 11). Whereas the Sammarinese financial sector continued to grow strongly for the main part of the 1990s and 2000s, in 2009 the Italian government announced a tax amnesty for Italians who repatriated their offshore assets, while concurrently announcing further legal action against those who maintained their bank accounts in San Marino. In addition, the government in Rome discouraged Italian companies to do business with the republic, and when a money-laundering scandal in San Marino's largest bank (the *Cassa di Risparmio della Repubblica di San Marino*) became public and the executives of the bank were arrested, San Marino's image as a malevolent fiscal paradise was complete (IMF 2011: 14). The Italian minister for economy and finance, Giulio Tremonti, has made the combat against *evasione fiscale* one of his political priorities, and has taken firm action against the Sammarinese government since 2008. Many Sammarinese officials assert that Tremonti has a personal grievance against the tiny republic, and is actively attempting to challenge San Marino's 1700-year old sovereignty.

Since 2008 therefore, the republic has finally (and severely) been confronted with the negative effects of its banking system. Since it took such a long time for the microstate's politicians to arrive at this realization however, the process of reform is likely to be more painful and complicated than in other offshore finance centers. In the Sammarinese media and public life in general, a broad discussion about the need for reform has started, and although most citizens feel that the harsh actions of the Italian government are unjustified, the morality of the country's politicians and political system is fiercely criticized. Whereas clientelism and patronage could freely develop over the course of the last decades, these practices are now strongly denounced, and newspapers are filled with stories about corruption, cronyism, and even links between the government and the Calabrian mafia group *'Ndrangheta*. An oftenheard complaint is that whereas San Marino used to be a country of high morals and a safe-haven for the oppressed and persecuted, now it has become a corrupted safe-haven for shady people with too much money.

Whereas the Sammarinese economy had been growing with over four percent annually during the 1990s and the beginning of the 2000s, in 2008 this declined to two percent, and for 2009 a shrink of over twelve percent was noted.[15] Whereas the economic decline was partially caused by general factors such as decreasing exports and decreased activity in the industrial sector, the severity of the Sammarinese economic downturn is primarily an effect of the country's dependence on tourism and finances; two sectors that were hit exceptionally hard by the crisis. The strained relation with Italy and the actions taken by the Italian government have inflicted further damage on the Sammarinese economy, resulting in the dramatic economic situation of today. Whereas the OECD-initiatives against harmful tax practices thus initially could not persuade the Sammarinese government to modify or reform its economy, the current crisis and the ensuing problems with Italy do provide a sufficient motivation (or need) for reorganization.

The political and economic dynamics of the Sammarinese system (as described in the preceding paragraph) however clearly form the biggest obstacle to economic reform. Firstly, the country's peculiar institutional structure appears to obstruct any potential plans for change. With Captains Regent that fulfill a strictly ceremonial function and a highly fragmented parliament, the incentive for change can only come from the ministers that already for decades control Sammarinese politics. The personal involvement of many of these high-ranking Sammarinese politicians in the country's financial institutions impedes on their political determination to modify the system. Since not only their personal wealth but also the political survival of these politicians is linked to revenues from the financial sector, such transformations are likely to have negative electoral consequences. The money that is made in the financial sector has regularly been used to develop or sustain clientelistic networks, and if politicians in this sense lose their ability to 'deliver', voters are likely to support other candidates. Hence, Sammarinese politicians will only change the financial industries of their country if their really is no alternative, and this now finally seems to be the case.

In addition to a reorganization or restriction of San Marino's banking system, Sammarinese officials recognize that the oversized public sector of the country will have to be reformed as well. Moreover, contemporary laws that force Sammarinese businesses to hire

[15] Statistics derived from the Sammarinese Chamber of Commerce (*Camera di Commercio*) website (www.cc.sm).

(more expensive) Sammarinese employees instead of Italians will need to be abolished in order to make the country's private sector more profitable and competing. However, in this light the same problems can be identified; since jobs in the public and private sector have traditionally been distributed to political supporters with the aim to establish patron-client networks, cutbacks in the number of available jobs will undoubtedly and immediately have dramatic electoral consequences, and any attempt to do so is broadly considered to be political suicide. Whereas thus not only the consequences of the economic crisis are more dramatic in San Marino than elsewhere, the international vulnerability and the dynamics of domestic Sammarinese politics have the effect of further aggravating and complicating the situation.

In the context of the severe crisis that is now plaguing the republic, for the first time in history Sammarinese politicians are now seriously debating the option of European Union-membership. Since the country's financial system will have to be reformed anyway, the main obstacle to EU-membership now has to be realized irrespective of whether San Marino becomes an EU-member or not. Therefore, according to progressive politicians the benefits of membership now outweigh the downsides, and the procedures that will eventually lead to membership have to be set in motion. A referendum on the issue was scheduled to be held on March 27th 2011, but several days in advance the government blocked the referendum on the grounds that it will set in motion the accession procedures itself. As a consequence, the process towards EU-membership has been stalled for now, but the public discussion continues.

3.2. The Other Microstates: Monaco, Liechtenstein, and Andorra

In contrast to San Marino, the three other West-European microstates were named on the OECD blacklist under the category "tax havens", and were only removed from this list in 2009. Just like San Marino, the other microstates have over the last decades of the 20th century developed extensive and highly profitable banking industries, under roughly similar conditions of low taxation, strict privacy laws, and flexible fiscal laws. Also analogous to San Marino, the political elites of Monaco, Liechtenstein, and Andorra are significantly embroiled in their countries' financial institutions, and in the principalities of Monaco and Liechtenstein the royal families are also involved (Donaghy 2002: 282; Beattie 2004: 295). This hampers attempts at reforming or restricting the financial sectors of these countries, and the same problems that exist in San Marino can therefore be observed in the other three microstates as well.

Just like in San Marino, politics in the other European microstates largely revolves around a number of key individuals, instead of ideologies or policy goals. In all four countries, government has a supreme political position in society, and these microstates' legislatures are comparatively weak. Also, political power is exercised by a small political elite that has the network and the resources to control and dominate politics, and that maintains links with every part of society, including the private sector. In Monaco and Liechtenstein, the royal families are obviously the main players within the political elite, and both the Monegasque and Liechtensteiner royal families have noteworthy connections with the economic and financial institutions of those countries. Due to this fusion between public and private interests, attempts at reforming the financial and economic organization of these three microstates are just as problematical as in San Marino, and in that sense the four countries thus face similar complications.

There are also some differences between the four countries, however. Whereas San Marino's economy is tightly connected to that of its Italian neighbor, for the Monegasque economy a comparable situation exists with France (Donaghy and Clarke 2003: 7; Grinda 2007: 116-117). Economically therefore, these two countries are strictly connected and dependent on one larger power, which is testified by the number of extensive and far-reaching Italo-Sammarinese and Franco-Monegasque economic and financial treaties. In terms of the economic crisis and the limitation of harmful tax practices therefore, for San Marino and Monaco the relationship with Italy and France is of crucial significance, as these countries have the power to make or break these microstates' economies. As we have seen in the preceding section, for San Marino the most essential problem today is its strained relationship with the Italian government, which is the main factor in explaining San Marino's widespread economic and political troubles. Recently, Monaco has found itself in a similar kind of clash with France, as the government in Paris substantially increased its pressure on the Monegasque authorities after the financial and economic crisis broke out in 2008. One year later, Monaco succumbed to this pressure and decided to fully comply with the OECD-standards. In contrast to San Marino therefore, Monaco's relations with its larger neighbor have now soothed considerably. In general, the Monegasque economy was relatively untouched by the economic crisis; although a land reclamation plan was postponed the economy so far has continued to grow, albeit at a slower rate than before (Monaco Government Website 2011).

In contrast to Monaco and San Marino, the other two European microstates share borders with more than just one larger country. Liechtenstein has the comparative advantage of neighboring two countries which have also been under attack for their tax regulations: Switzerland and Austria. For this Alpine microstate therefore, the greatest pressure to restructure its financial system did not come from its direct neighbors, but from Germany, with which the microstate entered what its authorities call a "tax war". Liechtenstein initially strongly denounced the OECD's initiative to curtail harmful tax policies, and Prince Hans-Adam accused the organization of aiming at a "world-wide tax cartel" (Beattie 2004: 331).[16] Similar to the other microstates in the region however, the financial and economic crisis of 2008 strongly amplified the determination of EU-member states to eradicate fiscal evasion and tax havens, and together with Monaco and Andorra in 2009 Liechtenstein finally conformed to the OECD's demands. Whereas Liechtenstein's economy entered a sharp recession towards the end of 2008, the economy of the microstate stabilized rapidly again, and the country thus has not suffered from the effects of the crisis to the same extent as San Marino. The main explanation for this difference can be found in the fact that Liechtenstein's economy is tightly connected to the Swiss economy, which suffered less from the crisis than surrounding countries (OECD 2011). In contrast to San Marino, Liechtenstein's relations with its direct neighbors remained tranquil after the outbreak of the crisis.

The last European microstate to be discussed here, Andorra, has been confronted with two neighbors who were resolutely striving to restrict its preferential tax regime; France and Spain. The toughest action was taken by the French president (and co-Prince of Andorra) Nicolas Sarkozy, who even threatened to abandon his function as one of the two heads of state of the Pyrenean principality. The Spanish government also increased the political pressure on the Andorran government after the 2008 financial crisis, and only very recently (in February 2011) removed Andorra from its own list of tax havens. In contrast to the other microstates however, Andorra's economy was already in dire straits before the outbreak of the crisis, as tourist inflows had decreased significantly since 2006.[17] In addition, because Andorra's economy is significantly linked to the Spanish economy, which was badly hit by the crisis, Andorra was also plagued by spillover effects from one of its neighbors. Thus, for Andorra the 2008 crisis had the effect of aggravating an economy that was already in decline, and the prospects for this microstate now definitely look more cumbersome than for the others.

[16] Furthermore, in reaction to mounting criticism from Germany, the Prince complained that whereas Liechtenstein managed to remain independent in the Second World War, the Germans would now finally come to rule the Principality.
[17] Tourism accounts for over 80% of Andorra's national income, which means that decreasing inflows of tourists have dramatic consequences.

Due to the fact that the economies of the European microstates are primarily built on tourism and the banking and finance sector, the financial and economic crisis can be supposed to have hit these countries harder than their larger neighbors. Whereas international action against harmful tax practices already commenced in the 1990s, the terrorist attacks of 2001 and the 2008 financial crisis have eventually forced all microstates to restructure their financial institutions. In all of the four cases, pressure from larger neighboring states constituted the principal incentive for change, and not the demands and policies of international organizations like the OECD and the IMF. Strikingly however, although the financial industries of the microstates generally had similar characteristics, the contemporary crisis has more serious consequences for San Marino and Andorra than for Monaco and Liechtenstein. Swift action taken by the Monegasque and Liechtensteiner authorities has enabled these countries to avoid sharp economic decline, whereas San Marino continues to be plagued by its antagonistic relations with Italy. The Andorran case is deviant in the sense that its economy already experienced problems in advance to the 2008 crisis, which subsequently further aggravated the situation.

4. Conclusion: How to Emerge out of the Crisis?

Although European microstates have generally witnessed higher rates of economic growth than their larger neighbors in the postwar period, that pattern now seems to have come to an end. By taking full advantage of European integration without having to carry the burdens of EU-membership themselves, the financial industries of San Marino, Liechtenstein, Andorra, and Monaco could develop and flourish. Having acquired the status of fiscal paradises and tax havens over the course of the second half of the 20th century, in the 1990s international organizations finally launched a program to counter the tax systems of these countries. This process was accelerated by the terrorist attacks on the World Trade Center, but for the European microstates the real problems only started after the outbreak of the financial and economic crisis in 2008. Strong pressures from the larger states to which the economies of these microstates are tied have now instigated processes of reform in all four microstates.

For the case of San Marino, which was the main country under scrutiny in this paper, the economic crisis turns out to have disastrous consequences. Having been a poor and underdeveloped country far into the 20th century, its economy boomed in the 1960s and 1970s due to the expansion of the tourist and finance industries. It is yet unclear how the contemporary quarrel with the Italian government will unfold, but in any case San Marino will have to implement significant reforms. What is more significant and problematic than these reforms however, is that a change will also have to be pursued in the mentality of the country's politicians and citizens. Practices such as clientelism and patronage, which have plagued the country for decades, are now broadly condemned, and the actions and behavior of individual politicians are more strongly criticized. Since the survival of politicians (and citizens) largely depends on these practices however, it will take a lot of courage and professionalism to alter this mentality and abolish these practices. One strategy that may be pursued in order to do so is to seek EU-membership, and a broad debate about this option has now started.

For all four European microstates, some of the major problems are the prevalence of personalistic politics, the omnipresence and omnipotence of government in society, and the absence of a strict separation between the public and private sector. Since powerful individuals have been able to wield excessive power and influence in their micro-communities by combining public and private functions, the distinction between public and private interests is occasionally blurred, which obviously hampers efforts to reform the system. Furthermore, due to the relative weakness or incapacity of other societal actors, the success of reforms is largely dependent on the same individuals who will be most strongly disadvantaged by such reforms. In such an environment, accession to a supranational organization that would be able to bypass these elites might not be a bad idea after all.

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