

REPUBLIC OF CROATIA

CROATIAN COMPETITION AGENCY

ANNUAL REPORT

on the work of the CCA concerning state aid

and

Report on State Aid for 2004

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I. REPORT ON THE WORK OF THE CROATIAN COMPETITION AGENCY CONCERNING STATE AID IN 2004

Foreword

Free competition is a constitutional category, ensuring all undertakings equal legal position in the market and at the same time representing the basis for the economic establishment of the Republic of Croatia. The constitution provides for the framework of the economic development directed towards optimal allocation of resources in the market which is based on effectiveness, quality and innovation. Monitoring of state aid plays a special role in competition policy, and it is particularly aimed at minimizing the state interventions relating to allocation of resources in the free market and its influence on the economic flow. It is apparent that state aid often enables economically ineffective undertakings to carry on with their business operations, even if they would not be able to do so under the regular market conditions. It does not only place the economically effective undertakings at a competitive disadvantage, but it also compromises the fulfilment of the international commitments undertaken by the Republic of Croatia within the meaning of the Stabilization and Association Agreement (SAA). The SAA stipulates that any state aid which distorts or threatens to distort competition by favouring certain undertakings or certain products shall be incompatible with the proper functioning of the Agreement, in so far as they may affect trade between the Community and Croatia. In other words, any aid which is granted by the state must be brought into compliance with the Croatian state aid rules and the relevant EC acquis. According to the interpretation of the European Commission (EC), any practices contravening the listed obligations may lead to the postponement of the opening of the negotiations between Croatia and the European Union (EU) relating to the chapter covering competition and state aid. In order to avoid any such situation, it is necessary to finalize the process of approximation of Croatian legislation relating to state aid with the relevant EC acquis, but also continuously work on law enforcement and application of the existing rules which have already been adjusted.

The effective implementation of the priority commitment laid down in the Stabilization and Association Agreement relating to the approximation of aid schemes established before the State Aid Act entered into force in early April 2003 with the EC acquis, started with the Alignment Programme of the Existing State Aid Schemes to the Criteria Stipulated in Article 70 paragraph (2) of the Stabilisation and Association Agreement between the Republic of Croatia and the European Communities and their Member States, which was compiled by the Croatian Competition Agency (CCA) and subsequently adopted by the Government of the Republic of Croatia in July 2004. The Programme in question stipulates the sponsors, procedures and deadlines for approximation of the existing aid schemes and at the same time constitutes the methodological basis for the fulfilment of this demanding task, which is not only of a formal legal nature, but in particular cases also goes deep into the roots of traditional financing models reserved for particular sectors and as such requires equivalent adjustments in the business management on the basis known in the EU. As an example, the necessary reforms are to be carried out especially within the shipbuilding sector which has traditionally been an important export oriented segment of the Croatian economy and as such has had a tremendous multiple influence thereon. Consequently, the adoption of a national rescue and restructuring program for the Croatian shipbuilding

is of prior importance. The program is to provide for viable strategies for further development of the national shipbuilding and concrete measures for its recovery.

In a similar way, the Croatian iron industry, despite the difficulties it encounters, must adjust to the operation and financing standards as it has been defined by the provisions of the State Aid Act and the relevant EU legislation. The SAA regulates that it is the obligation of Croatia to initiate the necessary restructuring and adjustment programs relating to its steel industry with the view to achieving sustainability of the sector in question under the normal market conditions. Therefore, it is vital to draft the National restructuring program concerned as soon as possible. This method of solving the difficulties in the steel and shipbuilding sector would, next to the comprehensive business plans ensuring viable operations under market conditions, work towards two goals: recovery and raising competitiveness of the industry in question, and secondly, creating the necessary prerequisites for the faster and successful negotiations with the EU.

The area of fiscal rules concerning the incentives to undertakings also requires bringing into compliance with the principles and criteria set forth by the EC acquis. It was already stated in the European Commission Opinion (avis) and on the occasion of a numerous official meetings of the Croatian and the EU representatives that the area of fiscal aid needs to be given a timely and special attention. Consequently, the priority in this area during 2005 is going to be the harmonization of the Profit Tax Act, which incorporates the amended provisions of the previous laws regulating fiscal incentives, with the relevant EC acquis.

The adoption of the State Aid Act, Regulation on State Aid and other legislation establishing the state aid system in Croatia, represent the first step in the fulfilment of the commitments undertaken by the SSA, whereas the second, even more important step is to act in accordance with the above mentioned regulations. In order to make the implementation of the State Aid Act easier, the CCA compiled the Adjustment Programme of the Croatian State Aid System to the EU State Aid System, which was also adopted by the Croatian Government in July 2004. The Programme substantially points out the necessity of permanent harmonization of the Croatian state aid rules with the EC acquis, but also the principle obligations of the CCA and public administration authorities, local and regional self – government units and other competent legal persons regarding the implementation of the state aid system in Croatia. The main concern thereof is pointed out to be a transparent state aid inventory as a basic feature of the EU state aid system and the timely notification of aid proposals relating to both aid schemes and individual aid. It is namely the notification of new aid proposals or modifications of the existing state aid by the aid provider which is the crucial point in the procedure that enables the authorisation, monitoring the implementation and reporting on state aid to function in practice and in compliance with the State Aid Act and the commitments undertaken under the SAA. The notification of the aid measures concerned is as a rule followed by the submission of all necessary data to the CCA, which are then processed and the cases solved within the set time limits.

In 2004 the problems of non-notification and subsequent (ex post) notification relating to both aid schemes and individual aid still existed. The reason for this is in the first place the lack of knowledge about the state aid system on the part of the aid providers and the employees working on these particular jobs, much less, we hope, due to the deliberate misapplication of the state aid law.

In early May 2004 the Act on the Amendments to the State Aid Act entered into force and it mainly contained some technical adjustments and modifications of the State Aid Act. It is expected that during 2005 the existing State Aid Act will be amended as to particular substantive and procedural provisions, in accordance with the comments given by the EC and the experience gained in the former period of its implementation. Apart from the sponsor – the Ministry of Finance, and other authorities participating in the drafting of the amendments, the CCA also contributed by its experience and the relevant initiatives aimed at the promotion of the Act in question.

In December 2004 the Competition Council adopted the Ordinance on the form and content of the notification and the method of data collection and keeping the state aid register. The Ordinance stipulates the rules with respect to data collection on aid schemes and individual aid as well as the method for data collection necessary for the drafting of the annual report on the work of the CCA concerning state aid for the previous year and the annual report on state aid. The constituent part of the Ordinance is also the standard state aid notification form which was compiled in compliance with the relevant EC standards, laying down the necessary data and justifications needed for the assessment of the aid proposals and enabling a classification method for the purpose of keeping the state aid register.

During 2004 one of the activities of the Competition Agency was also aimed at informing aid providers and aid beneficiaries about state aid rules as well as promoting the implementation of the obligations laid down by the State Aid Act, which still represents a novelty in the work, and collection and allocation of financial resources, among all parties involved. Apart from the seminars and workshops which were organized by the CCA and supported by the experts within the CARDS programme and aimed at professional training of both the employees of the CCA and other public administration officials, the international conference was held in Zagreb in October 2004 under the title *The EU Competition Policy and Consequences for Croatia*. The conference proved important for competition advocacy and the establishment of competition culture with respect to both anti-trust and state aid in Croatia.

Unlike the first State Aid Annual Report for 2003, this second Annual Report on State Aid covers the entire previous year and as such enables the adequate parallel insight into the statistical data on the aid amounts classified in accordance with the prescribed method for keeping the state aid register for the period of 2002 – 2003. Although the enforcement of the state aid system in Croatia is in a rather early phase, it is evident that the total amounts of state aid classified by categories show positive trends. In other words, in comparison with 2003 there is an obviously higher percentage of state aid with horizontal objectives than the sectoral ones. Nevertheless, it must be taken into account that the majority of data from this Report is still based on the data which were collected on the basis of the data stemming from the execution of the state budget and the data collected by the CCA in its regular aid authorization procedure. On the account of that, the CCA will be able, as the need arises, to include the necessary corrections of the data relating to the previous years, in the case they are subsequently collected and consolidated, in its next report, within the meaning of the similar practice in the EU.

The implementation of the state aid system in the sense of the provisions under the Stabilization and Association Agreement, which are incorporated in the State Aid Act and other relevant regulations, requires a stronger professional commitment on the side

of aid providers, relating to economic and social viability when financing particular projects, whereas from aid beneficiaries it entails demonstrated business plans which take into account real market conditions in each particular case. This is closely connected with the presidency conclusions of the European Council in Lisbon 2000 and later European Councils on the need of "*less but better*" state aid expenditure. This means aid essential for ensuring well-defined economic projects contributing to employment, aimed at undertakings which base their success in the market on the knowledge-based economy, sustainable growth and economic effectiveness, which all together lead to raising competitiveness at home and abroad and contribute to greater economic and social prosperity, at the same time respecting the competition rules.

The negotiations of the former candidate countries prove that state aid as a part of competition has been one of the rather difficult chapters regarding the obligations which must be fulfilled according to the Stabilization and Association Agreement. It is therefore necessary to ensure that the CCA, as a competent authority relating to authorisation, monitoring and recovery of state aid, obtains enough administrative capacities and other resources indispensable for the implementation of the jobs which have been entrusted to it and other participants in this process. On the account of the fact that this is one of the most demanding and complex tasks in the process of the transition of the Croatian economy towards free market economy, and on its way to the EU, it is here essential to emphasise the importance of timely implementation of the commitments undertaken under the SAA, because the legal certainty of the previously made investments once the membership in the EU will have been realized may depend on them. Thus, the best way to approach the common market is a well-timed adjustment of the undertakings and the state to the operating conditions, business and financing terms which already exist in the EU.

Nevertheless, it must finally be pointed out that although the commitments undertaken by Croatia under the SAA or on its way towards the membership of the EU, relating to harmonization of the Croatian state aid system and granting procedure, either on the national or local level, are of paramount importance, the establishment of the transparent state aid system which sets clear rules and criteria regarding authorisation and granting of state aid is invaluable for the creation of business conditions in Croatia, which will ensure all undertakings equal opportunities for success, whereas the ineffective and non-competitive ones will not be able to survive at the expense of the successful ones, in other words Croatian tax payers.

Olgica Spevec

President of the Competition Council

1. Introduction

The Croatian Competition Agency (CCA) compiled the Annual Report on the work of the CCA concerning State Aid and Annual Report on State Aid for 2004, within the meaning of Article 19 of the State Aid Act (hereinafter: the Act)¹. The Annual Report was drafted in accordance with the method stipulated for such reports by the European Commission (EC).

The first Annual Report on the work of the CCA concerning state aid and Annual Report on state Aid for 2003 was submitted to the Croatian Parliament in 2004. It was adopted by the Parliament in its 7th session held on 2 July 2004.

The area of state aid in Croatia has been regulated by the State Aid Act which was adopted by the Croatian Parliament on 13 March 2003. The Act entered into force on 2 April 2003 and it was subsequently amended later in 2004.

In its session of 24 July 2003 the Government of the Republic of Croatia adopted the Regulation on state aid (Official Gazette, No 121/03; hereinafter: the Regulation) as a secondary legislation implementing the State Aid Act, which entered into force on 6 August 2003.

The Act and the Regulation established the state aid system² in Croatia, which conforms with the commitments undertaken under the provisions of Article 70 of the Stabilization and Association Agreement between the Republic of Croatia and the European Communities and their Member States³ (SAA). Namely, by signing the SAA the Republic of Croatia undertook the commitment regarding the harmonization of the regulations in the area of state aid with the provisions of Article 87 of the Treaty establishing the European Community⁴.

In addition, Article 70 paragraph (4) of the SAA stipulates that Croatia shall establish an operationally independent authority which is entrusted with the powers necessary for the full application of the SAA in the part relating to state aid issues. The authority in question shall have, *inter alia*, the powers to authorise state aid schemes and individual aid as well as the powers to order the recovery of state aid that has been unlawfully granted.

Within the meaning of the above mentioned, Article 5 of the Act stipulates that the Competition Agency shall authorise and monitor the implementation of state aid schemes and individual aid and order the recovery of aid schemes and individual aid that has been granted or used contrary to the law.

¹ Official Gazette, No 47/03 and 60/04.

² The area of state aid which is a part of competition in wider terms, involves all forms of state interventions in the market to the advantage of particular undertakings (public procurement rules, rules granting special or exclusive rights and state aid rules). Competition in narrower terms (anti-trust) has been regulated by the Competition Act (Official Gazette, No 122/03).

³ Official Gazette – International treaties, No 14/01.

⁴ Title VI – Common rules on competition, taxation and approximation of laws; Section 2 – Aids granted by states; Articles 87, 88 and 89 of the Treaty of Amsterdam as a consolidated version of the Treaty and a primary source of the EU law which serves as a basis for state aid secondary legislation.

2. Definition of state aid

In the sense of the Stabilization and Association Agreement, in the part concerning state aid, the Republic of Croatia undertook two equally important commitments: the first, by which it is prohibited to grant any state aid which distorts or threatens to distort competition by favouring certain undertakings or certain products, in so far they may affect trade between the Community and Croatia, and the second, by which an operationally independent authority shall be established which is entrusted with the powers necessary for the implementation of the state aid system.

Taking into account the undertaken commitment to harmonize the Croatian legislation with the EC acquis⁵, it was also necessary to adopt the State Aid Act and consequently the Regulation on state aid, with the view to incorporating the EC acquis relating to state aid into the Croatian legislation.

In compliance with the EC acquis and the above mentioned Croatian legislation, state aid shall be considered any measure:

- which involves a transfer of state resources, irrespective of the fact whether the resources come from the state budget, the budget of regional or local authorities, public banks or private or public companies, which directly or indirectly manage state resources;
- which constitute an economic advantage that the product, undertaking, sector or region would not have received in the normal course of business;
- which is selective and thus affect the balance between aid recipients and their competitors. Selectivity is what differentiates state aid from so-called "general measures" which apply to all undertakings in all economic sectors without exception;
- which has a potential effect on competition and trade between Member States, in other words between Croatia and the Community. Within the meaning of the EC acquis and particularly the practice of the European Court of Justice, it is sufficient if it can be shown that the aid beneficiary is involved in an economic activity and that he operates in a market in which there is trade between Member States.

State aid can take many forms: state guarantees, soft loans, grants, debt write-offs, capital injections etc. Examples of economic advantage are buys/rents of publicly owned land at less than the market price, sales of land or shares of a company to the state at higher than market price, privileged access to infrastructure without paying a fee etc.

As a rule, measures which are not considered state aid are as follows:

- general economic policy measures, ensuring equal position of all sectors, regions and undertakings (e.g. profit tax reduction relating to all undertakings in Croatia);
- support for households (social support);
- investments in infrastructure (in principle);
- EU funds (e.g. CARDS programme)

⁵ Pursuant to Article 69 of the SAA Croatia undertook the obligation of approximation of its existing laws to that of the Community. The approximation starts on the date of signing of the Agreement and at an early stage it focuses on fundamental elements of the internal market acquis as well as on other trade-related areas.

2.1. Exemptions from the ban on state aid

The EC state aid rules, as well as the corresponding Croatian legislation, regulate that small amounts of aid (*de minimis* aid) do not have a potential effect on competition and trade between Member States, and between Croatia and EU. Such aid is granted within the Community in the amount of not exceeding 100,000 EUR over any period of three years, whereas the amount granted in Croatia is 750,000 HRK, and as such is excepted from the application of the state aid rules and may be granted in all sectors with the exception of aid to promote exports, steel production and transport sector.

State aid is prohibited and this general prohibition of state aid derives from the fact that the uncontrolled advantage given to particular undertakings or sectors would jeopardize the functioning of the common market, diminish economic prosperity and have negative impact on the effectiveness of the economy, foremost on the most effective undertakings, and taking account of the economic power of the most developed Member States, which justifies their higher share in granting aid, substantially influence the balanced and sustainable economic growth and development of the Community and jeopardise competition between undertakings on the market.

Uncontrolled granting of state aid serves the ineffective undertakings and enables them to survive on the market on the expense of the effective ones, postpones structural reforms, negatively affects productivity and competitiveness of the national economy as a whole, but also the individual undertakings.

As there is always an exemption to the rule, the state aid rules also contain a number of exemptions from the general ban, and their common objective is to correct market failures, in other words to enable state interventions where it is necessary to promote economic activities by investments into a balanced regional development, research and development, environmental protection, education and training, SMEs, etc.

Thus, the most relevant exemption clauses are as follows:

- aid to promote the economic development of areas where standard of living is abnormally low or where there is serious underemployment (regional aid),
- aid to facilitate the development of certain economic activities or certain economic areas, where such aid does not adversely affect trading conditions contrary to the common interest.

For better understanding of the above mentioned, the conditions which must be satisfied when state aid is awarded within the meaning of the Regulation on state aid (Official Gazette, No 121/03) and the relevant EC regulations* are outlined in the following tables.

* Article 87 of the Treaty is a primary source of the EC law relating to state aid, secondary legislation covers a number of regulations, communications, notices, frameworks and guidelines by which the state aid system is permanently modified.

The relevant EC acquis relating to state aid is available on the CCA web site: www.crocompet.hr .

Regional aid		
Objectives and scope	Level of aid	Increase in aid level
<i>Initial tangible and intangible investments; Investments in job creation, employment created must be maintained in the region during a minimum period of five years after the investment's completion.</i>	- 20% to 50% of eligible expenditures*; - up to 40% of eligible expenditures in the regions whose GDP per capita is greater than 60% of the Community; - beneficiary's contribution must be at least 25% and must not contain any aid.	- 10% to 15% of eligible expenditures for SMEs, not applicable to transport firms.
<i>Operating aid: -aid must contribute to regional development and may not be intended to promote exports.</i>	<i>-must be proportional to the handicaps it seeks to alleviate, limited in time and progressively reduced.</i>	-

*Pursuant to Article 2 of the Regulation on state aid (Official Gazette, No 121/3) "eligible expenditures means expenditures for which state aid may be granted."

In accordance with the above mentioned, particular rules regulate particular categories of aid which are aimed at tackling problems which may arise in any industry and region. These are so called horizontal rules applicable to:

- aid for small and medium-sized enterprises;
- aid for research and development;
- aid for rescue and restructuring of firms in difficulty;
- aid to employment;
- education and training aid.

Small and medium-sized enterprises		
Objectives of aid	Level of aid	Aid level in the regions eligible for regional aid
<i>Aid for investment</i>	- up to 15% of eligible costs in the case of small enterprises; - up to 7,5% of eligible costs in the case of medium-sized enterprises; - eligible costs for investment and for job creation may be cumulated.	<i>Aid intensity shall not exceed the regional aid ceilings, if the aid is granted under the condition that the investment is maintained in the recipient region for at least five years and that the beneficiary's contribution to its financing is at least 25%, which must not contain any aid.</i>
<i>Aid for consultancy services</i>	<i>- up to 50% of eligible costs of outside consultants' services. The services concerned shall not be a continuous or periodic activity nor relate to the enterprise's operating expenditure.</i>	
<i>Aid for participation in fairs and exhibitions</i>	<i>- up to 50% of the eligible costs - additional costs incurred for renting, setting up and running the stand, and only on the first participation of an enterprise in a particular fair or exhibition.</i>	
<i>Aid to SMEs may not be granted to enterprises for the activity of shipbuilding and maritime transport.</i>		

Rescue and restructuring		
Objectives of aid	Level of aid	Conditions for the authorisation of aid
<i>Rescue aid to make it possible to keep a company in difficulty afloat for the time needed to work out a restructuring plan</i>	<i>Not exceeding 75,000,000 HRK, including other aids from the state aid schemes, whereas this level may be exceeded only on the basis of a restructuring plan and the approval under Article 13 of the Act.</i>	<ul style="list-style-type: none"> - must consist of liquidity support in the form of loan guarantees or loans bearing normal commercial interest rates, and must be reimbursed over a period of not more than twelve months after disbursement of the last instalment to the firm; - must be warranted on the grounds of serious social difficulties; - must be restricted to the amount needed to keep the firm in business for the period needed to devise the restructuring plan (max. 6 months); - should be a one-off operation.
<i>Restructuring</i>	<i>Not exceeding 75,000,000 HRK, including other aids from the state aid schemes, whereas this level may be exceeded only on the basis of a restructuring plan and the approval under Article 13 of the Act.</i>	<ul style="list-style-type: none"> - a restructuring programme must be submitted by the firm; - aid must be limited to the minimum needed to enable restructuring measures to be undertaken in the light of the existing financial resources of the company; - aid beneficiaries are expected to make a significant contribution to the restructuring plan; - may be granted where less than 10 years have elapsed since the last restructuring aid has been granted only in exceptional and unforeseeable circumstances.
<i>Aid provider shall once a year submit to the CCA the report on the implementation of the restructuring plan.</i>		

Training aid		
Objectives of aid	Level of aid	Increase in aid level
<i>General training</i>	<i>-up to 50% of eligible expenditures.</i>	<ul style="list-style-type: none"> - up to 20% of eligible expenditures for SMEs; - 5% to 10% of eligible expenses;
<i>Specific training</i>	<i>-up to 25% of eligible expenditures.</i>	<ul style="list-style-type: none"> - up to 10% of eligible expenditures for disadvantaged workers; - up to 100% for maritime transport for on-board training carried out on board ships registered in Croatia, the trainee may not be an active member of the crew.

Furthermore, industry-specific or so called "sectoral" rules have also been adopted, defining state aid in particular industries which encounter serious problems beyond their control, and which arise as the consequence of their inability to find prompt and adequate solutions to competitive pressures from other countries and regions. The sectors concerned are the iron and steel industry and shipbuilding.

Steel industry		
Application of rules	<i>Production of steel products under Protocol 2 of the SAA</i>	
Objectives of aid	Level of aid	Specific conditions
<i>Research and development</i>	<i>Application of the rules laid down under the Regulation on horizontal state aid.</i>	
<i>Environmental protection</i>		
<i>Employment</i>		
<i>Training</i>		
<i>SMEs</i>	<i>Application of the rules laid down under the Regulation on horizontal state aid.</i>	<i>Consultancy services and participation in fairs and exhibitions.</i>
<i>Payments to workers made redundant or retired before legal retirement age</i>	<i>- up to 50% of the incurred costs.</i>	<i>- the payments arise from the partial or total closure of steel plants which have not already been taken into account for approval of aid.</i>
<i>Aid to steel firms which permanently cease production of steel products, which are directly or indirectly controlled by, or which themselves directly or indirectly control a firm that is itself a steel firm.</i>	<i>- proved that the amount of the aid does not exceed the residual book value of the plants to be closed.</i>	<ul style="list-style-type: none"> <i>- the firms became legal entities before 1 January 2002 and they have not reorganised their production or plant structure since 1 January 2002;</i> <i>- cessation of production within six months from the payment of aid;</i> <i>- one time, last time principle;</i> <i>- the firm has been effectively and legally separated from the corporate structure for at least six months before payment of the aid;</i> <i>- accounts of the firm have been independently certified;</i> <i>- there is a genuine and verifiable reduction in production capacity such as to yield an appreciable benefit for the industry as a whole in terms of a reduction in the production capacity for steel products over a period of five years following the date of the closure/payment of aid.</i>

Shipbuilding		
Scope of the application of the rules laid down under the Regulation	Aid granted for shipbuilding, ship repair and ship conversion to undertakings engaged in such activities but also to related entities. Vessels shall mean vessels of not less than 100 gt used for the transportation of passengers and goods, vessels of not less than 100 gt for the performance of a specialised service , tugs of not less than 365 kW, fishing vessels of not less than 100 gt, and unfinished shells of the above-mentioned vessels that are afloat and mobile.	
Objectives of aid	Specific conditions	
Environmental protection	Application of the rules laid down under the Regulation	
Research and development		
Rescue and restructuring aid	Application of the rules laid down under the Regulation	<ul style="list-style-type: none"> - the aid beneficiary uses the aid for the first time; - aid can be granted once only("one time, last time principle"); - there is a irreversible reduction in the capacity; - the closed capacity must have been regularly used for shipbuilding; - the closed capacity must remain closed for not less than 10 years.
Regional aid	<p>Application of the rules laid down by the Regulation concerning the regional aid.</p> <p>The intensity of aid:</p> <ul style="list-style-type: none"> - from 12,5% to 22,5% of eligible expenditure. 	<ul style="list-style-type: none"> - aid granted only for investment in upgrading and/or modernising existing yards, with the objective of improving the productivity of existing installations; - aid for job creation linked to investment and operating aid under Title III of the Regulation may not be granted.
Closure aid provided that the resulting capacity reduction is of genuine and irreversible nature;	- aid in the amount of the residual book value of the installations, or the discounted value of the contribution to fixed costs obtainable from the installations over a three-year period, provided that the capacity remains closed for not less than 10 years.	<p>The costs eligible for the aid are:</p> <ul style="list-style-type: none"> - payments to workers made redundant or retired before legal retirement age; - the costs of counselling services to workers made redundant or retired before legal retirement age; - payments to workers for vocational retraining; - expenditure incurred for the redevelopment of the yards.
Investment aid for innovation	Up to 10% of eligible costs*;	Provided that it relates to the industrial application of innovative products and processes.

**Eligible costs means expenditure on investments and engineering activities related to innovation.*

Although general state aid rules apply in the transport sector, particularly in the road transport sector, special rules which are laid down in the separate Commission notices and guidelines, in Croatia it is the Regulation on state aid, apply in the other transport sectors, such as rail, inland waterways and maritime transport.

In the case of aid for investments in infrastructure, as already mentioned above, such aid usually does not constitute state aid. Nevertheless, if such measures benefit certain undertakings, the provisions contained in the state aid legislation shall apply. The existing Commission rules and the relevant case law indicate that here we deal with a complex issue which can be assessed using a case by case method. There are also no explicit definitions of infrastructure, business activity or of general economic interest services. Even though the traditional definition of infrastructure implies rail financing as well as investments in sea and air ports, the recent definition also covers investments in telecommunications infrastructure, construction of sports stadiums and congress centres and the development of public and private partnerships.

In order to avoid the application of the state aid rules to investments in infrastructure, it is necessary that three conditions are cumulatively met: there is no market based interest or motivation for such investments, the aid does not constitute an economic advantage for a particular undertaking or undertakings, and there is a general interest for investments in a particular infrastructure project. The practice of the European Commission so far shows that the above mentioned conditions are applied, whereas their further application should increase legal certainty and enable interventions, where necessary, as well as ensure new investments in infrastructure projects, which is especially important in a country such as Croatia.

2.2. Procedural provisions relating to approval and monitoring of state aid

The ministries and other public administration authorities are obliged to submit to the Competition Agency (hereinafter: the Agency) for preliminary examination any aid scheme proposals, prior to the submission of the proposals (acts and other proposals) containing aid measures to the Government of the Republic of Croatia (hereinafter: the Government). Only after it has been given the opinion of the Agency, the aid scheme proposal may be submitted to the Government. The aid proposals which have been transmitted to the Government without the positive opinion of the Agency should be sent back to the sponsor for revision.

Accordingly, the Agency gives opinion on aid proposals establishing aid schemes, whereas it issues decisions relating to proposed approval and granting of individual aid, whereby the proposal containing individual aid may be approved, rejected or dismissed.

Against the decision of the Agency no appeal is allowed, but the injured party may file an administrative dispute before the Administrative Court of the Republic of Croatia. The decisions of the Agency giving approval (positive decisions) or rejecting approval (negative decision), or revoking approval for a proposal containing individual aid and ordering the recovery of the aid used on the basis of the approved or awarded individual aid (revocation of a decision), as well as the rulings of the Administrative Court of the Republic of Croatia passed on the basis of these administrative acts shall be published in the *Official Gazette*.

The Croatian membership in the EU will pass the powers relating to authorization of state aid in the Republic of Croatia from the CCA as a national authority to the European Commission. Therefore, it is necessary to prepare the aid providers and aid beneficiaries for the rules applicable in the EU, with the eventual objective of minimizing the state aid and bringing the existing state aid rules into compliance with the relevant EU regulations. The undertakings are to be prepared for competition in which the interventions of the state are only of a temporary nature, exceptional and justifiable from the point of view of the effect they produce on other market competitors.

Namely, the European Commission monitors the approved state aid in the EU, based particularly on the ways in which the approved total amounts of aid are spent and according to the types of aid which have been granted by a particular Member State. The survey shows that there is a gradual decrease in the total amount of state aid granted by the Member States within the past years and that the majority of aid has been aimed at the promotion of common interest for the EU. This trend in the Member States contributes to raising competitiveness of the EU as a whole and also within its single Member States.

3. The work of the Croatian Competition Agency in 2004

Following the adoption of the State Aid Act the first year of its application was marked by the activities related to further harmonization and adoption of the regulations pursuant to the state aid provisions and commitments undertaken under the Stabilization and Association Agreement, giving opinions on the aid proposals or approval of aid, work on competition advocacy as regards state aid, internal organization of the Agency, institutional capacity building with the view to timely performance of the jobs entrusted to the Agency in compliance with the law. Nevertheless, given that state aid represents a relatively new legal matter in the Croatian legislation and since the new state aid system requires a new approach in the state aid procedures on the part of the aid providers and the general public as well as raising transparency within the procedures for granting aid and particular knowledge of the EC acquis in this area, the majority of the activities of the Agency in the years of 2004 and 2005 has been directed to the establishment of a direct communication with the ministries and public administration authorities – aid providers, their training and awareness raising in respond to the challenges imposed to them by the State Aid Act.

3.1. Harmonization of the state aid system

Pursuant to the obligations stipulated within the National Programme for the Integration of the Republic of Croatia into the EU 2004 and the Implementation Plan for the SAA concluded between the Republic of Croatia and the European Communities and their Member States, the Competition Council has adopted two programmes determining the activities and dynamics of the harmonization process relating to the programmes that were in force before the conclusion of the Stabilization and Association Agreement, as follows:

- a) the Alignment Programme of the Existing State Aid to the Criteria Stipulated in Art 70 (2) of the SAA (hereinafter: the Alignment Programme), and
- b) the Adjustment Programme of the Croatian State Aid System to the EU State Aid System (hereinafter: the Adjustment Programme).

Both programmes were approved by the Government of the Republic of Croatia and thus became binding for all aid providers.

The **Alignment Programme** defines responsible authorities, the alignment procedure, and the terms of alignment. Authorities responsible for aligning the aid schemes to the state aid regulations are the Competition Agency and the state aid providers, i.e. central public administration authorities, local and regional self-government units, authorised legal persons and other legal persons. The alignment procedure involves three phases: the first phase covers the establishment of the state aid register and authorization of the aligned existing schemes and other legal acts on the basis of which aid schemes had been authorised or granted. In the second phase the aid providers align the aid schemes and other legal acts by virtue of which state aid had been authorised or granted before the entry into force of the State Aid Act. Finally, the third phase refers to the submittal of the aligned aid scheme proposals or other legal acts containing aid scheme proposals, supported by the positive opinion of the Agency, to the responsible authority for adoption. Pursuant to Article 20 of the State Aid Act the whole procedure is scheduled for completion by 1 January 2006, whereas in compliance with the commitments undertaken by the SAA by 1 March 2006.

Within the meaning of the above Programme after the Agency requested the aid providers to submit the aid schemes, it established a list of existing aid schemes based on the received data, but also on the grounds of the information on aid schemes that came to its knowledge which have not been submitted by aid providers. The list comprises the existing aid schemes which were valid on 2 April 2003, i.e. the date when the State Aid Act entered into force. The completed list has been sent to competent ministries and other public administration authorities – aid providers to give a statement thereon and shall be accordingly revised and checked.

The above mentioned list of aid schemes is very important given that within the meaning of the EC state aid rules all aid schemes that are not on the established list shall be considered new aid. The difference between existing aid and new aid is essential on the account of the fact that new aid must be brought into compliance with the state aid rules and must be assessed accordingly. In the case of the aid granted contrary to the state aid rules, it is considered unlawful aid which must be recovered.

The **Adjustment Programme** seeks to assess the level of legal harmonisation of the state aid system in the Republic of Croatia with that in the European Union and defines the principal tasks of the Competition Agency, central public administration authorities, local and regional self-government units, and legal persons authorised to implement the state aid system in the Republic of Croatia pursuant to the State Aid Act.

Furthermore, the Agency issued opinions on several acts and other legal documents containing aid schemes, which was followed by the procedure of their alignment with the state aid regulations within the competent ministries.

3.2. Other activities of the Agency relating to the harmonization of the state aid system

Pursuant to Article 16 of the State Aid Act, and Article 38 of the Regulation on state aid, the Competition Council adopted the Ordinance on the form and content of the notification and the method of data collection and keeping the State Aid register which lays down the form and content of the notification and the method of data collection and keeping the register involving aid schemes and individual aid, which must be transmitted to the Competition Agency by the aid providers and the method used for data collection in compiling the annual report on the work of the CCA in the previous year relating to state aid and the annual report on state aid.

Given that one of the tasks of the CCA is also to give legal opinions on new draft laws or amendments to the existing laws and other implementing rules, with the view to full harmonization of the national legislation with the EC acquis, upon the request or initiative of the competent ministries in the report period the CCA also issued numerous expert opinions on act proposals and other legal documents directly or indirectly relating to state aid. Here are especially to be mentioned the Draft Act on Investment Promotion, Draft Regulation on antidumping and compensation duties and Ordinance on the criteria and procedure for a public operator to become eligible for covering the costs from the state budget etc.

At the same time, the state aid providers request that the representatives of the Agency take part in the activities in the process of re-defining the state aid policy within particular sectors and working groups revising particular legal acts and state aid schemes. Thus, in

2004 the representatives of the Agency participated on a permanent or temporary basis in the work of the working groups for drafting the National Restructuring Program in the Croatian Steel Sector, Act on Public Transport relating to the Regular and Seasonal Coastal Maritime Navigation and the working group on developing a regional strategy and capacity building.

Worth mentioning is also the establishment and maintenance of the web site of the Agency in both Croatian and English, containing all relevant legal acts from the state aid legal framework, decisions of the Competition Council and translations of the EC acquis in the area of state aid which makes this relatively new legal matter accessible to all interested parties – public administration, undertakings and general public.

4. Application of the State Aid Act

Pursuant to the provisions of the State Aid Act in the case of individual state aid (aid to specified beneficiaries) the Competition Agency issues decisions on the compatibility of aid with the State Aid Act (approval or positive decision, rejection or negative decision), or dismisses the aid provider's proposal where it is established that the aid in question does not constitute state aid within the meaning of the State Aid Act (e.g. aid for population policies and programmes, general economic policy measures etc.) In the case of state aid schemes, that is programmes and legal acts issued by the public administration authorities granting funds or incentives for particular programmes for ex ante unspecified beneficiaries from the state budget or the budget of local and regional self-government units, the Agency gives opinions assessing the compatibility of the schemes in question with the provisions of the State Aid Act and the EC acquis.

In 2004, there were 41 (forty one) individual state aid cases registered by the Agency and 50 (fifty) requests relating to proposals containing aid schemes. Nevertheless, the majority thereof were actually proposals concerning applications for granting certain types of state aid sent to the Ministry of finance of the Government of the Republic of Croatia which were communicated to the Agency in the form of "a notice" and lacking the necessary data and documentation which would enable the Agency to take a decision on compatibility or incompatibility of the aid in question. During 2004 there were 26 (twenty six) resolved cases or just above 30% of the registered total. Taking into account that the major part of the requests transmitted by the aid providers was received in the second part of the report year when a part of training programme relating to this matter had been finalized and the above mentioned Alignment and Adjustment Programmes had been adopted, the majority was resolved in 2005, whereas a part thereof is still pending owing to the lack of complete documentation. (The list of the cases registered in 2004 has already been sent to the European Commission.)

The above said indicates that the state aid monitoring system in 2004 was not functioning as intended. A certain step forward can be observed, but we must be aware of the fact that the whole process requires some time of getting under way, first of all here are meant the activities with regard to education and training aimed at aid providers, with the objective to make the notification procedure a common practice. On one hand, relating to aid providers, the employees working on the jobs connected with proposing and granting state aid must be specialized in this field, on the other hand, the employees of the Agency must be also continuously trained and specialized in specific sectors (shipbuilding, transport, horizontal aid) as well as permanently observe the changes of the state aid rules and the adoption thereof within the Community. Namely, the state aid rules are a part of competition rules which are constantly updated and subject to modifications and changes, whereas the judgements of the European Court of Justice, which constitute a part of the EC acquis, are also binding for Croatia, often offer new solutions to the problems which the Agency also encounters in taking its decisions and making assessments relating to state aid proposals.

The state aid requests registered in 2004 mainly referred to road infrastructure, utilities infrastructure, and tourism, incentive programmes for SMEs, shipbuilding and transport sector.

In 2004 the Agency issued no decision on incompatibility of any aid proposal authorizing or granting individual aid, although a number of received requests and notices thereof

involved some elements of unlawful aid. Namely, the Agency drew the attention of the aid providers in all such cases to illegal elements contained in the aid in question, provided the explanation thereof and left enough time for the incomplete notification to be supplemented by all additional information or for the adjustment or modifications thereof (which also complies with the EC practice). Given that the new state aid system only started to apply, the objective of the Agency is not to take hasty negative decisions rejecting approval to state aid proposals and thereby causing market failures, bankruptcy or insolvency of particular aid beneficiaries without prior notice and time necessary for adjustment. Pursuant to the State Aid Act, the consequence of a negative decision (denial of approval) of the Agency relating to state aid which has already been granted is the recovery order for unlawfully granted state aid increased by the amount of legal interest.

4.1. State aid system at the local level

As already stated in the introduction, the state aid monitoring system which is defined under the State Aid Act also applies to local and regional self-government units.

Consequently, in November 2004 the Agency asked the aid providers on the local level (20 counties, the City of Zagreb, 123 other towns and 426 municipalities) to provide the aid schemes falling under their competence as well as the data on the aid granted in the period from 2002 – 2004. The inquiries were supplemented by summarized relevant provisions of the State Aid Act and Regulation on state aid and a detailed explanation of the definition of state aid, assessment criteria thereof etc.

Despite the reminders which were subsequently sent, 12 (twelve) counties, the City of Zagreb, 52 (fifty two) other towns and 151 (one hundred and fifty one) municipalities responded to the above mentioned writing, which amounts to 60% of the counties, 42% of the cities and 35% of the municipalities. What causes a special concern is the fact that precisely the cities and municipalities which are according to knowledge of the Agency significantly involved in investments into economic projects, in spite of numerous reminders sent, failed to submit the necessary information, aid schemes, programmes or complete data relating to such aid programmes. At the same time, in 2004 the Agency received no request from the local and regional self-government units concerning the approval or prior opinion of the Agency, which is pursuant to the State Aid Act obligatory prior to granting individual aid or adoption of an aid scheme in favour of a particular sector or undertaking.

Taking everything said into account, in other words the apparent non-application of the State Aid Act on the part of the aid providers on the local level, one of the most important activities of the Agency in the forthcoming period will be the establishment of a direct cooperation with the local authorities, with the objective of transferring the knowledge relating to this subject, commitments undertaken by the Republic of Croatia under the SAA and obligations which are to be entered into by the Croatian membership in the EU in the field of state aid, and what is of the uttermost importance, the binding provisions of the State Aid Act and the Regulation on state aid to the aid providers on the local level. The education and training of the employees within the local authorities will also be focused on the possible negative consequences of granting unlawful aid contrary to the provisions defined under the State Aid Act.

4.2. Selected state aid cases

I Case

Request for approval of the proposed Decision on initiation of the proceedings relating to the financial guarantee contract between the Republic of Croatia and European Bank for Reconstruction and Development concerning the Port of Dubrovnik Infrastructure Modernization Project

The Agency registered the case relating to the Port of Dubrovnik Infrastructure Modernization Project which would have been partly financed by the loan taken from the European Bank for Reconstruction and Development amounting to 26.5 million Euro accompanied by a state guarantee.

It was established by the Agency that the state guarantee in this particular case does not constitute state aid within the meaning of Article 3 paragraph (1) of the State Aid Act, given that it does not distort or threaten to distort competition and does not favour any port user, but provides benefit to all port users. The state guarantee as an instrument of state aid is a potential state expenditure, but in the case in question the beneficiary of the loan accompanied by the state guarantee is the Port Authority Dubrovnik, an institution – legal person established by the Republic of Croatia which is considered a port of special economic interest for Croatia.

The construction of the port infrastructure is necessary for the Port Authority Dubrovnik enabling it to perform its business activities within the meaning of Article 50 of the Act on Maritime Assets and Sea Ports and accordingly does not distort competition. Pursuant to the provisions of the Act in question, the founder of a port authority – the Republic of Croatia is obliged to finance the construction and maintenance of the port infrastructure and therewith enable the operational activities of the port authority.

Consequently, in the assessment of the Competition Council it was established that the modernization and construction of the berth area of the Port of Dubrovnik constitutes investment in infrastructure as the first step in creating additional capacities for increased number of larger sizes of cruise vessels which also moored in this port before, but at certain risks and under safety standards that were lower than those provided in other Mediterranean ports.

Taking into account that all ships on their cruising trips will be given access under the same conditions, the aid in question is not in favour of an undertaking or undertakings (in this case port users) and does not have an effect on competition and trade within the Republic of Croatia and the Republic of Croatia and other Mediterranean ports of the Member States. Therefore, in the opinion of the Competition Council the state guarantee in question does not constitute state aid within the meaning of the State Aid Act.

II Case

Request for subsequent approval for the Decision on granting state guarantee associated with a loan taken by Hrvatske autoceste d.o.o. with Privredna banka Zagreb, d.d.

The Agency received a request for subsequent approval for the proposed Decision on granting state guarantee associated with a loan taken by Hrvatske autoceste d.o.o. with Privredna banka Zagreb, d.d. The financial resources under the loan contract for which state guarantee is to be given are aimed at construction and maintenance of public roads.

The Agency established that the Decision on granting state guarantee for the loan taken by Hrvatske autoceste d.o.o. with Privredna banka Zagreb, d.d. was adopted by the Government of the Republic of Croatia on 17 September 2004 without the approval of the Agency, and accordingly it initiated the proceedings for subsequent approval of the state aid in question.

In the assessment of the Agency the relevant documentation proved that the given state guarantee does not constitute state aid within the meaning of Article 3 paragraph (1) of the State Aid Act, given that it does not distort or threaten to distort competition, on the account of the fact that the financial resources covered by the loan will be used exclusively for investment into construction and maintenance of public roads (excluding the motorways).

Namely, a particular measure concerning the financing of infrastructure may be considered state aid only if it cumulatively satisfies the following basic criteria:

- it must involve a transfer of state resources,
- it should constitute an economic advantage that the undertaking would not have received in the normal course of business,
- it must be selective (selectivity is what differentiates state aid from so called "general measures"), and
- it must have a potential effect on competition (possible distortion).

If one of the stated criteria is not satisfied, a measure cannot be considered state aid. Since the undertaking Hrvatske ceste d.o.o. manages public roads which are considered public good in common use in Croatia, in this particular case there is no effect on competition.

Taking the above said into account, the Agency issued a decision on dismissal of the request for subsequent approval in question (no-aid decision).

III Case

Request for opinion on compliance of the proposed programmes of the Croatian Agency for Small Entrepreneurship (HAMAG) with the provisions of the State Aid Act and Regulation on state aid

The Agency received the request to issue its opinion on the compliance of the programmes (aid schemes) *New Undertaking, Working Capital, Growth and Development, Areas of Special State Concern* and *Agriculture* with the provisions of the State Aid Act and Regulation on state aid.

After the inquiry into the programmes it was established that they contain state aid to small and medium-sized enterprises (SMEs) covering the initial investment costs as well as regional state aid. The instrument of aid is guarantee given by HAMAG for the loans given by the banks and other legal persons (creditors) to the undertakings involved.

Pursuant to Article 22 paragraph (5) of the Regulation on state aid the eligible costs for which state aid may be granted to SMEs are initial investment costs, such as investment in tangible assets (land, buildings and plant) and investment in intangible assets (acquisition of patent rights, licences, know-how or unpatented technical knowledge).

Consequently, the Agency issued opinions relating to the programmes *New Undertaking, Working Capital, Growth and Development* and *Areas of Special State Concern* on the compliance thereof with the provisions of the State Aid Act and Regulation on state aid and asked HAMAG to submit the relevant aid levels.

As regards the programme *Agriculture* pursuant to Article 1 paragraph (2) of the State Aid Act the Agency informed HAMAG the State Aid Act does not apply to state aid to agriculture and fisheries and therefore is not authorized to issue opinions thereon.

IV Case

Request for opinion on the proposed subsidies for organized foreign tourist traffic in 2005

The Agency received the request for opinion on the proposed Programme for Subsidizing Organized Foreign Tourist Traffic in 2005.

After the inquiry into the submitted documentation the Agency established that aid in question constitutes state aid and it communicated to the aid provider in writing that the proposed Programme in question must be revised and brought into compliance with the State Aid Act and Regulation on state aid.

The final text of the Programme proposes subsidies as a measure of economic policy with the objective to increase foreign tourist traffic in early season and after season and therewith contribute to the overall activities of the tourist sector.

Aid beneficiaries within the Programme for Subsidizing Organized Foreign Tourist Traffic are all foreign legal persons (tour operators, travel and tourist agencies) meeting the requirements prescribed by the Programme in question, which bring foreign tourists to Croatia by using organised means of transportation such as specially chartered planes, buses, trains and/or ships. The proposed gross amount of aid in the form of subsidies for organised tourist traffic in 2005 is 55 million Kuna.

In its opinion the Competition Council stated that the proposed subsidies may constitute incompatible aid within the meaning of Article 4 paragraph (1) of the State Aid Act which stipulates that state aid in any form whatsoever which distorts or threatens to distort competition by providing benefit in the market to the beneficiary of aid, and in particular insofar as it may affect the international obligations undertaken by the Republic of Croatia, shall be considered incompatible with the State Aid Act. Given that the sector of tourism is opened to international competition, the proposed subsidies may distort competition and have effect on international trade.

The subsidies within the Programme concerned are to cover the operating costs and normal operating risks of any tour operators or agencies, which they incur in their normal course of business. In that sense the proposed subsidies constitute operating aid to cover current expenses which may be granted within the meaning of Article 49 of the Regulation on state aid only if it contributes to regional development, if its level is proportional to the handicaps it seeks to alleviate, if it is limited in time and progressively reduced and if it is not intended to promote exports.

Given the fact that the proposed subsidies have been granted continuously since 1994, and taking into account that they have been progressively reduced, the Council established that the subsidies in question were initially awarded throughout the year, but later on they were reduced to the period of early season and after season and limited to air charter programmes.

Consequently, taking into account great war damages for material and immaterial losses within the sector of tourism in the territory of the Republic of Croatia, but also outside its territory, the Council concluded that in this particular case the proposed Programme for Subsidizing Organized Foreign Tourist Traffic in 2005 may constitute state aid within the meaning of Article 4 paragraph (2) of the State Aid Act, the more so since the Programme in question puts an end to such subsidizing models.

Nevertheless, under regular circumstances such aid in the form of subsidies is regarded incompatible, given that it is meant to cover operating costs of foreign tour operators, whereas it does not benefit foreign tourists as direct beneficiaries and is intended to promote exports. On the account of that the Council held the opinion that the aid provider in question should in future include in its proposed measures the types of aid compatible with the State Aid Act and Regulation on state aid. The Council also pointed out that the European Commission, which is the competent authority for authorisation, monitoring and recovery of state aid within the EU Member States, has also taken negative decisions relating to similar aid schemes on the basis of which particular Member States intended to give incentives to foreign tour operators, whereas it assessed as compatible certain aid earmarked for the promotion of tourism in particular Italian regions (Sicily) under regional aid schemes and the direct beneficiaries of which were proved to be tourists and not undertakings – domestic and foreign tour operators.

5. Activities relating to the CARDS Programme 2002

The implementation of the project *State Aid in Croatia, Support to the Croatian Competition Agency* started in March 2004 and was successfully completed in November of the same year. The objectives of the project, such as drafting of the amendments to the State Aid Act and Regulation on state aid and guidelines for application of state aid rules concerning particular categories of state aid, organisation of subject oriented seminars and workshops for aid providers and the employees of the Agency, have been successfully accomplished⁶.

The activities within the project concerned have been used as a basis for the preparation of the *twinning* project which is to be carried out in the cooperation with the German and Slovenian partners during 2005 and 2006. The *twinning* project will include the enforcement of the legislative framework in the area of state aid and the establishment of a comprehensive state aid inventory. For the purposes mentioned above, and in the cooperation with the domestic and foreign experts, in 2004 the Agency carried out the analyses of the needs and of the structure of the future data base for which the IT equipment and program support will also be provided under the CARDS Programme.

Project budget is 1.200,000 (one million two hundred) Euro, of which is 400,000 (four hundred thousand) Euro earmarked for the data system and 800,000 (eight hundred thousand) Euro for technical support.

The Agency also established a fruitful cooperation with the representatives of the European Commission DG Competition, in the form of technical consultations and less formal meetings, as well as through written notices and opinions on certain issues which the Agency encounters in its every day work. Moreover, the Agency was requested to inform the EC on a regular basis and in the form of statistical reviews on the number of registered notifications, resolved cases and issued opinions (enforcement record).

The representatives of the CCA also visited the Ministry of Finance of the Republic of Slovenia, the State Aid Department, and used this opportunity to share experience relating to the collection of data and alignment procedure concerning the existing aid in the Republic of Slovenia.

⁶ There were eight seminars and workshops, five of them were held on the premises of the CCA and three on other locations.

6. Administrative capacity and capacity building of the Agency and aid providers

Pursuant to the Statute of the CCA, the activities relating to the application of the State Aid Act have been entrusted to the State Aid Division which consists of the Assessment of State Aid and State Aid System departments.

In the beginning of 2004 the work on the implementation of the State Aid Act was performed by four (4) employees. Later on, in July, the CCA employed two more experts (one lawyer and an economist), thus the total of the employees as of 31 December 2004 engaged in the division concerned was six (6), two graduated lawyers who passed their bar exam and four graduate economists, one of which is a certified auditor.

Further strengthening of the administrative capacity of the State Aid Division and the CCA as a whole is one of the requirements of the European Commission which was particularly emphasised in the EC Opinion on the application of Croatia for membership of the European Union (avis) in April 2004: *"Concerning administrative capacity, in addition to the competence for anti-trust, the Competition Agency has also been made responsible for the implementation of the State Aid Act and for the drafting of the necessary by-laws. It will need the necessary additional administrative resources to this effect."* Moreover, the responsibilities involving control and monitoring of the state aid system on the national and local level entail additional capacities and new employees. Nevertheless, it directly depends on financial resources which the Agency is allocated from the state budget.

In the report period the CCA was particularly engaged in state aid advocacy and raising awareness in the area concerned, providing relevant training for its own employees and participating in seminars and workshops organized within the support from the Programme CARDS and aimed at aid providers (a total of 8 seminars).

According to the recent volume of work, but also in participation of the future activities once when the state aid notification system becomes fully incorporated, the CCA will need financial resources for taking at least fifteen (15) employees in charge of state aid jobs. As an example, before becoming the EU Member States the Republic of Slovenia employed eleven (11) and Rumania thirty five (35) people on the jobs relating to authorisation and monitoring of state aid.

Other than the employment of the new staff, its permanent training and professional development, the experience in the implementation of the State Aid Act and Stabilization and Association Agreement has shown that it is absolutely necessary also to increase the number of employees or at least to specialize the existing employees within public administration authorities for the jobs connected with aid proposals, in other words requests which they receive from aid beneficiaries, and to provide for their additional training and professional development.

II REPORT ON STATE AID FOR 2004

Introduction

This second Annual Report on State Aid in the Republic of Croatia since the entry into force of the State Aid Act (Official Gazette No 47/03, 60/04) covers the data for 2004 but also the revised data for 2002 and 2003 which enables the comparison of aid awards granted as well as their trend. The Report consists of four parts. The first part provides for the overview of the total state aid granted within the above mentioned three-year period, categories and instruments of aid. The second part refers to aid to agriculture and fisheries, the third part deals with state aid for manufacturing and services, involving horizontal and sectoral aid. The fourth part provides for the data on regional aid.

The classification of state aid by categories and instruments has been carried out in accordance with the Ordinance on the form and content of the notification and the method of data collection and keeping the state aid register (Official Gazette No 11/05).

The state aid survey presented in this Report has been carried out taking into account the method used by the European Commission (EC) in drafting reports on state aid (state aid scoreboards).

In the course of 2004 the Croatian Competition Agency (hereinafter: the Agency) adopted a part of the programmes (aid schemes) and set the criteria for adoption of general and individual aid in cooperation with the competent ministries – aid providers and started with the authorisation of state aid in compliance with the State Aid Act. However, the Agency is still establishing its own data base on state aid which will ensure a reliable and credible record of the state aid granted. Here the Agency does not depend solely on its administrative and financial resources but also on the timely notification of aid, which aid providers are to submit to the Agency, the local and regional self-government units included, prior to its award on any level. Given that in 2004 the state aid notification system and the authorisation of aid were not yet fully incorporated, the data used in this Report were provided by the Ministry of Finance in its Report on Execution of the State Budget for the period of the last three years, but also by the aid providers which submitted the necessary documentation to the Agency.

In comparison to the last-year report the data for 2002 and 2002 have been revised and updated by the data that were not available or not collected at the time of drafting of the last year's report. The most important changes refer to the following:

- the incentives relating to infrastructure investments, which as a rule do not constitute state aid, have been excluded;
- the transfer of the financial resources from the state budget to the local and regional self-government units, which also do not constitute state aid, have not been taken into account;
- the calculation of the aid intensity on the basis of a guarantee differs from the one used in the last year's report. The aid intensity of a guarantee which is considered state aid, and which does not involve the risk factor, i.e. the market price for the guarantee is not paid, shall be calculated as a difference between the market price and the price paid for the granted guarantee;

- only the data covering the amounts of aid which were actually submitted by the local and regional self-government units have been taken into account in this Report;
- pursuant to the Profit Tax Act only the amounts of aid contained in tax concessions have been included.

State aid to agriculture and fisheries is regulated by separate laws and regulations and the provisions of the State Aid Act and Regulation on state aid are not applicable thereon. The amounts of state aid in question are a constituent part of this Report in accordance with the available data which have been collected within the cooperation of the Agency with the competent ministry within the meaning of Article 19 of the State Aid Act.

This Report may be considered a step forward on the way to establishing a transparent state aid system in the Republic of Croatia. A complete report which would contain a comprehensive state aid survey will be possible once the state aid granting system becomes fully incorporated, the Agency establishes its own state aid register and all aid providers in Croatia, on both the national and local level, align the state aid granting system with the state aid rules and obligations stemming from the State Aid Act and once the Agency on the basis of so collected state aid data establishes its own comprehensive state aid inventory. In practice it means a notification procedure which implies prior assessment of aid on the part of the Agency, which is still not the case. The experience of other transitional countries which are today the EU Member States shows that the process in question takes certain time and effort relating to the adjustment to the new state aid system, in the first place through education, training and state aid advocacy.

1. Overview of state aid in 2004

The state aid granted in Croatia in 2004 amounted to HRK 6,090.1 million, which is 3,8% less than in the previous year, but by 17.6% more than in 2002. The share of state aid in GDP, amounted to 2.9%, which is 12,2% less than the share realized in 2003 (3,3%). A comparison of the values in € equivalents shows a 2.9% reduction in relation to 2003, and a 16,2% increase in relation to 2002.

The main characteristic of the year 2004 is a decrease of the share of state aid in the state expenditures compared to 2003 and 2002.

Table 1 shows the total amount of state aid granted in Croatia in 2002, 2003 and 2004 compared to basic macroeconomic indicators.

Table 1: State aid in Croatia (including agriculture and fisheries) in 2002, 2003 and 2004

	Measure	2002	2003	2004	Indices		
					03/02	04/02	04/03
State aid	in mil HRK	5.177,2	6.332,2	6.090,1	122,3	117,6	96,2
State aid	mil EUR*	699,0	837,2	812,5	119,8	116,2	97,1
GDP	mil HRK	176.429,0	189.040,0	207.028,0	107,1	117,3	109,5
GDP	mil EUR	23.820,0	24.994,0	27.621,5	104,9	116,0	110,5
Government expenditure	mil HRK	70.397,4	77.075,5	83.145,1	109,5	118,1	107,9
Government expenditure	mil EUR	9.504,5	10.190,6	11.093,2	107,2	116,7	108,9
Employees	number	1.359.015,0	1.392.509,8	1.409.633,8	102,5	103,7	101,2
State aid share in GDP	in %	2,9	3,3	2,9	114,2	100,2	87,8
State aid per employee	in HRK	3.809,5	4.547,3	4.320,4	119,4	113,4	95,0
State aid per employee	in EUR	514,3	601,2	576,4	116,9	112,1	95,9
State aid share in government expenditure	in %	7,4	8,2	7,3	111,7	99,6	89,2
Per capita state aid**	in HRK	1.176,6	1.439,1	1.384,1	122,3	117,6	96,2
Per capita state aid	in EUR	158,9	190,3	184,7	119,8	116,2	97,1

Source: Croatian Bureau of Statistics, Ministry of Finance (statistical survey of budgetary expenditure), and data processed in CCA.

* Croatian National Bank average rate against 1 EUR was in 2002 7.406773 HRK, in 2003 7.563414 HRK and in 2004 7.495169 HRK.

** Population size 4.4 million according to the 2001 census.

Per capita state aid in 2004 amounted to 1,360.7 HRK which is a slight 3,8% reduction in relation to 2003.

Given that according with the method used in the EU state aid to agriculture and fisheries are separately monitored and assessed, as well as state aid to the transport sector, this Report also contains the analyses of state aid in Croatia in the last three years excluding the state aid to agriculture, fisheries and transport sector.

The analysis shows that state aid excluding the above mentioned sectors in 2004 amounted to 2,297.9 million HRK, or 306.6 million EUR, which is a decrease of 25,6% than in 2003. The state aid share in the GDP in 2004 was 1,11%.

The rail sector in the EU has been regulated by a separate legislative framework under the EC Treaty, where state aid issues stand in a direct relation to the process of liberalization of the rail transport services.

Table 2: Total state aid in Croatia (less agriculture, fisheries and transport) in 2002, 2003 and 2004

Measure		2002	2003	2004
Total state aid (less agriculture, fisheries and transport)	mil HRK	2.047,3	3.089,6	2.297,9
Total state aid (less agriculture, fisheries and transport)	mil €	276,4	408,5	306,6
GDP	mil HRK	176.429,0	189.040,0	207.028,0
GDP	mil €	23.820,0	24.994,0	27.621,5
State aid share in GDP (less agriculture, fisheries and transport)	%	1,16	1,63	1,11

Source: Ministry of Finance, other state aid providers, data processed in CCA.

Table 3: Total state aid in Croatia (including agriculture, less rail transport) in 2002, 2003 and 2004

Measure		2002	2003	2004
Total state aid (less rail transport)	mil HRK	4.684,1	5.882,1	5.652,7
Total state aid (less rail transport)	mil €	632,4	777,7	754,2
GDP	mil HRK	176.429,0	189.040,0	207.028,0
GDP	mil €	23.820,0	24.994,0	27.621,5
State aid share in GDP (less rail transport)	%	2,65	3,11	2,73

Source: Ministry of Finance, other state aid providers, data processed in CCA.

The indicated amounts do not cover the precise amount of aid in the form of guarantees given to railways given that the data on all issued guarantees to railway transport were not available to the Agency.

Table 4: State aid in Croatia compared to the EU Member States in 2003

2003	Total aid less railways		Total aid less transport, agriculture and fisheries	
	in million EURO	The share of aid to GDP (%)	in million EURO	% of GDP
Croatia 2003	777	3,11	408	1,63
Croatia 2004	747	2,73	307	1,11
EU-15	52.775	0,57	37.334	0,40
BE	1.075	0,40	655	0,24
DK	1.254	0,67	921	0,49
DE	16.431	0,77	14.398	0,68
EL	615	0,40	333	0,22
ES	4.019	0,54	3.174	0,43
FR	8.827	0,57	4.806	0,31
IE	934	0,69	417	0,31
IT	7.087	0,54	5.689	0,44
LU	71	0,30	36	0,15
NL	1.505	0,33	497	0,11
AT	1.495	0,66	590	0,26
PT	1.616	1,24	1.254	0,96
FI	2.028	1,41	519	0,36
SE	1.609	0,60	1.039	0,39
UK	4.209	0,26	3.006	0,19

Source: DG Competition and Eurostat

As a comparison, the share of aid (less railways) to GDP in the EU in 2003 was 0, 57%. Indicators relating to particular Member States indicate that the lowest share of aid to GDP was in United Kingdom (0, 26%) and the highest in Finland (1, 41%).

The data from the statistical tables relating to absolute amounts of aid granted show that Croatia compared to the EU Member States grants relatively small amounts of aid, especially excluding railways, agriculture and fisheries, whereas a lower amount of aid was granted only in Luxemburg. Nevertheless, in the share of aid to GDP, Croatia must proceed with necessary adjustment as to track the EU average.

1.1. Categories of state aid

Pursuant to the provisions under the Regulation on state aid and EU methodology, there are basically the following categories of aid: horizontal aid, sectoral and regional aid, and state aid to agriculture and fisheries⁷.

Horizontal aid is earmarked for all undertakings and sectors, and as such they distort competition less significantly than sector-specific aid, which are awarded to particular undertaking or undertakings within particular industries or groups of industries.

The objective of regional aid is to promote economic development of certain areas and to facilitate the development of certain economic activities in underdeveloped areas.

Within the meaning of Article 70 paragraph (7) of the Stabilisation and Association Agreement (SAA) the whole territory of the Republic of Croatia shall be deemed one region, in other words an area where the standard of living is abnormally low or where there is serious underemployment.

However, the commitments undertaken under the SAA oblige Croatia within three years from the entry into force of the Agreement in question to submit to the European Commission its GDP per capita figures harmonised at NUTS II level. They should then jointly evaluate the eligibility of the regions of Croatia as well as the maximum aid intensities in relation thereto in order to draw up the regional aid map on the basis of the relevant Community guidelines.

The regional map in question shall determine Areas A and Areas B eligible for regional aid. Until 1 January 2006 the whole territory of the Republic of Croatia, for the purposes of application of the Regulation on state aid, shall be considered Area A.

⁷ Annex, I Categories of State Aid

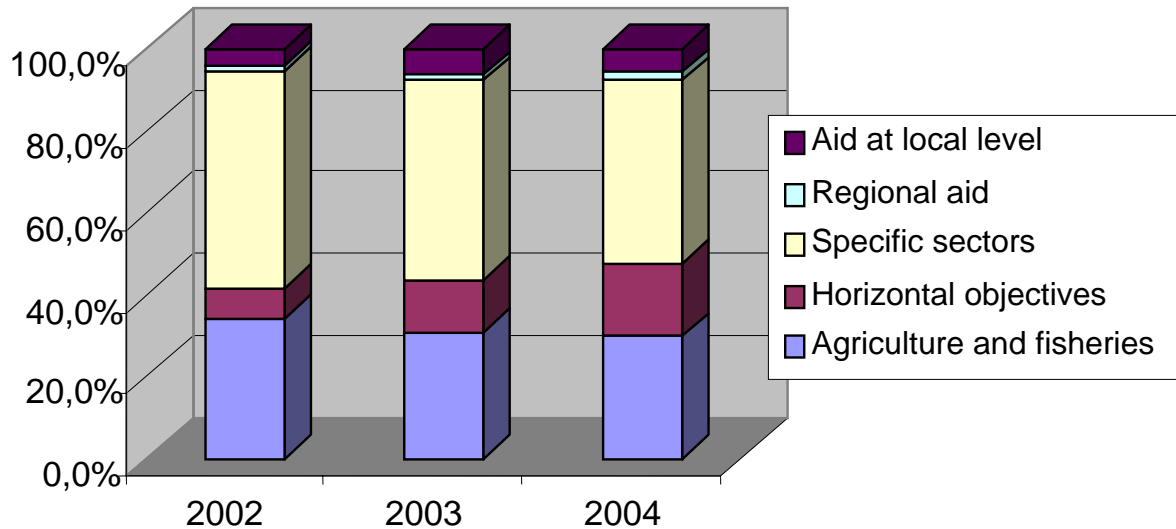
Table 5: Shares of certain categories of aid in 2002, 2003 and 2004

Category		2002			2003			2004		
		in mil HRK	in mil EUR	Share (%)	in mil HRK	in mil EUR	Share (%)	in mil HRK	in mil EUR	Share (%)
1.	Agriculture and fisheries	1.779,2	240,2	34,4	1.949,4	257,7	30,8	1.819,8	242,8	29,9
2.	Manufacturing and services	3.107,2	419,5	60,0	3.884,9	513,6	61,4	3.789,7	505,6	62,2
	2.1 Horizontal objectives	384,9	52,0	7,4	807,7	106,8	12,8	1.073,3	143,2	17,6
	R&D	0,0	0,0	0,0	27,8	3,7	0,4	111,5	14,9	1,8
	Environmental protection	0,0	0,0	0,0	6,0	0,8	0,1	0,0	0,0	0,0
	Rescue and restructuring	0,0	0,0	0,0	0,0	0,0	0,0	34,6	4,6	0,6
	SMEs	27,2	3,7	0,5	32,8	4,3	0,5	37,5	5,0	0,6
	Training	0,0	0,0	0,0	0,0	0,0	0,0	62,6	8,4	1,0
	Employment	177,6	24,0	3,4	485,0	64,1	7,7	456,8	60,9	7,5
	Culture	0,0	0,0	0,0	16,1	2,1	0,3	40,3	5,4	0,7
	Energy saving	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Other objectives	180,0	24,3	3,5	240,0	31,7	3,8	330,0	44,0	5,4
	2.2 SPECIFIC SECTORS	2.722,4	367,6	52,6	3.077,2	406,9	48,6	2.716,5	362,4	44,6
	Steel manufacturing	2,0	0,3	0,0	4,0	0,5	0,0	0,0	0,0	0,0
	Transport	1.350,7	182,4	26,1	1.293,2	171,0	20,4	1.972,4	263,2	32,4
	Shipbuilding	652,7	88,1	12,6	987,1	130,5	15,6	516,8	69,0	8,5
	Tourism	62,2	8,4	1,2	213,2	28,2	3,4	82,0	10,9	1,3
	Other sectors	382,7	51,6	7,4	449,7	59,5	7,2	145,3	19,4	2,4
	Financial services	272,0	36,7	5,3	130,0	17,2	2,1	0,0	0,0	0,0
3.	Regional aid	72,5	9,8	1,4	89,2	11,8	1,4	137,0	18,3	2,3
4.	Aid on local level*	218,3	29,5	4,2	408,7	54,0	6,5	343,5	45,8	5,6
TOTAL		5.177,2	699,0	100,0	6.332,2	837,1	100,0	6.090,0	812,5	100,0

Source: Ministry of Finance, other state aid providers, data processed in CCA.

* In its statistical review the Agency has only taken into account the amounts of state aid from the local and regional self-government units which actually submitted the relevant data thereto.

Picture 1: Shares of aid by categories in 2002, 2003 and 2004



The overview by categories of aid shows that the major part of state aid in 2002 and 2004 referred to sectoral aid and aid to agriculture and fisheries. The share of regional aid remained almost unchanged during the whole period. In 2004 there was an upward trend in horizontal aid, which in 2002 had a share of 7, 4%, whereas in 2004 this share was increased to 17, 6%. The growth in horizontal aid significantly influenced the fall in sectoral aid from 52, 6% share in 2002 to 44, 6% in 2004.

Given that aid to agriculture and fisheries has been regulated by special laws and as such does not fall under the competence of the Agency and the state aid system to which the provisions of the State Aid Act apply, this Report does not provide for a detailed analysis of aid to agriculture and fisheries, but only for the an analyses relating to state aid in other sectors (manufacturing and services).

Table 6: Shares of certain categories of aid less aid to agriculture and fisheries in 2002, 2003 and 2004

Category	2002			2003			2004		
	in mil HRK	in mil EUR	Share (%)	in mil HRK	in mil EUR	Share (%)	In mil HRK	in mil EUR	Share (%)
2. <i>Manufacturing and services</i>	3.107,2	419,5	91,4	3.884,9	513,6	88,6	3.789,7	505,6	88,7
2.1. Horizontal objectives	384,9	52,0	11,3	807,7	106,8	18,4	1.073,3	143,2	25,1
R&D	0,0	0,0	0,0	27,8	3,7	0,6	111,5	14,9	2,6
Environmental protection	0,0	0,0	0,0	6,0	0,8	0,1	0,0	0,0	0,0
Rescue and restructuring	0,0	0,0	0,0	0,0	0,0	0,0	34,6	4,6	0,8
SMEs	27,2	3,7	0,8	32,8	4,3	0,7	37,5	5,0	0,9
Training	0,0	0,0	0,0	0,0	0,0	0,0	62,6	8,4	1,5
Employment	177,6	24,0	5,2	485,0	64,1	11,1	456,8	60,9	10,7
Culture	0,0	0,0	0,0	16,1	2,1	0,4	40,3	5,4	0,9
Energy saving	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Other objectives	180,0	24,3	5,3	240,0	31,7	5,5	330,0	44,0	7,7
2.2. SPECIFIC SECTORS	2.722,4	367,6	80,1	3.077,2	406,9	70,2	2.716,5	362,4	63,6
Steel manufacturing	2,0	0,3	0,0	4,0	0,5	0,0	0,0	0,0	0,0
Transport	1.350,7	182,4	39,8	1.293,2	171,0	29,5	1.972,4	263,2	46,2
Shipbuilding	652,7	88,1	19,2	987,1	130,5	22,5	516,8	69,0	12,1
Tourism	62,2	8,4	1,8	213,2	28,2	4,9	82,0	10,9	1,9
Other sectors	382,7	51,6	11,3	449,7	59,5	10,4	145,3	19,4	3,4
Financial services	272,0	36,7	8,0	130,0	17,2	3,0	0,0	0,0	0,0
3. <i>Regional aid</i>	72,5	9,8	2,1	89,2	11,8	2,0	137,0	18,3	3,2
4. <i>Aid on local level</i>	218,3	29,5	6,4	408,7	54,0	9,3	343,5	45,8	8,0
TOTAL	3.398,0	458,8	100,0	4.382,8	579,5	100,0	4.270,3	569,7	100,0

Source: Ministry of Finance, other state aid providers, data processed in CCA.

In 2004 the manufacturing and services sector was awarded aid in the amount of about 3.8 billion HRK, or 505.6 million EURO, which is some 2, 5% less than in the year of 2003.

At the same time, aid to manufacturing and services sector amounted to 88, 7% of the total amount of aid awarded, whereas the regional aid amounted to 3, 2% or barely 137 million HRK, the local aid granted by local and regional self-government units 8% or 343.5 million HRK.

The structure of aid granted shows that still aid earmarked for specific sectors prevails (transport, shipbuilding, tourism) which amount to as much as 64% of aid, whereas the share of horizontal aid remained appreciably lower, and amounted to some 25%.

In 2004 the figures show a downward trend for sectoral aid, and an upward trend relating to aid with horizontal objectives.

The indicators provide an indication of the positive trends within the responsible economic policy creators and aid providers which become more aware of the need to shift aid towards horizontal objectives and leave the selective approach in awarding state aid, whereby the state resources are to be redirected towards state aid which is not only in conformity with the EU state aid rules but which also benefit the economy as a whole and in a long run are an essential prerequisite for raising competitiveness of the

Croatian economy (investments in education and training, environmental protection, employment etc) .

1.2. State aid instruments

State aid is awarded from the state budget and takes various forms. They may be direct (increase in state expenditures) and indirect (decrease in state expenditures) and are awarded through the following instruments⁸:

- (A1) – subsidies
- (A2) – tax relief, tax exemption, tax and contributions remission and allowances
- (B) – equity participation
- (C1) – soft loans
- (C2) – other instruments
- (D) – guarantees

Table 7: State aid in Croatia by instruments in 2002

In mil HRK

Category		A1	A2	B	C1	C2	D	TOTAL
1.	<i>Agriculture and fisheries</i>	1.617,0	0,0	0,0	0,0	0,0	162,2	1.779,2
2.	<i>Manufacturing and services</i>	1.604,2	35,9	421,2	180,0	0,0	865,9	3.107,2
2.1.	<i>Horizontal objectives</i>	169,0	35,9	0,0	180,0	0,0	0,0	384,9
	R&D	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Environmental protection	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Rescue and restructuring	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	SMEs	27,2	0,0	0,0	0,0	0,0	0,0	27,2
	Training	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Employment	141,8	35,9	0,0	0,0	0,0	0,0	177,6
	Culture	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Energy saving	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Other objectives	0,0	0,0	0,0	180,0	0,0	0,0	180,0
2.2.	SPECIFIC SECTORS	1.435,2	0,0	421,2	0,0	0,0	865,9	2.722,4
	Steel manufacturing	0,0	0,0	0,0	0,0	0,0	2,0	2,0
	Transport	906,5	0,0	150,0	0,0	0,0	294,3	1.350,7
	Shipbuilding	399,1	0,0	0,0	0,0	0,0	253,6	652,7
	Tourism	101,8	0,0	0,0	0,0	0,0	-39,6	62,2
	Other sectors	27,0	0,0	0,0	0,0	0,0	355,7	382,7
	Financial services	0,8	0,0	271,2	0,0	0,0	0,0	272,0
3.	<i>Regional aid</i>	22,0	50,5	0,0	0,0	0,0	13,2	72,5
4.	<i>Aid on local level</i>	205,1	0,0	0,0	0,0	0,0	13,2	218,3
TOTAL		3.448,3	86,3	421,2	180,0	0,0	1.041,3	5.177,2

Source: Ministry of Finance, other state aid providers, data processed in CCA.

⁸ Annex, II List of aid instruments and Aid element calculation.

Table 8: State aid in Croatia by instruments in 2003

In mil HRK

Category		A1	A2	B	C1	C2	D	TOTAL
1.	<i>Agriculture and fisheries</i>	1.595,9	0,0	0,0	211,3	0,0	142,1	1.949,4
2.	<i>Manufacturing and services</i>	2.013,8	56,9	205,0	951,4	0,0	657,8	3.884,9
2.1.	<i>Horizontal objectives</i>	510,8	56,9	0,0	240,0	0,0	0,0	807,7
	R&D	27,8	0,0	0,0	0,0	0,0	0,0	27,8
	Environmental protection	6,0	0,0	0,0	0,0	0,0	0,0	6,0
	Rescue and restructuring	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	SMEs	32,8	0,0	0,0	0,0	0,0	0,0	32,8
	Training	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Employment	428,1	56,9	0,0	0,0	0,0	0,0	485,0
	Culture	16,1	0,0	0,0	0,0	0,0	0,0	16,1
	Energy saving	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Other objectives	0,0	0,0	0,0	240,0	0,0	0,0	240,0
2.2.	SPECIFIC SECTORS	1.503,0	0,0	205,0	711,4	0,0	657,8	3.077,2
	Steel manufacturing	0,0	0,0	0,0	0,0	0,0	4,0	4,0
	Transport	879,9	0,0	75,0	80,3	0,0	258,0	1.293,2
	Shipbuilding	468,7	0,0	0,0	507,5	0,0	10,9	987,1
	Tourism	118,8	0,0	0,0	1,4	0,0	93,0	213,2
	Other sectors	35,6	0,0	0,0	122,3	0,0	291,8	449,7
	Financial services	0,0	0,0	130,0	0,0	0,0	0,0	130,0
3.	<i>Regional aid</i>	27,5	61,7	0,0	0,0	0,0	0,0	89,2
4.	<i>Aid on local level</i>	282,3	0,0	0,0	0,0	0,0	126,3	408,7
TOTOAL		3.919,6	118,6	205,0	1.162,7	0,0	926,2	6.332,2

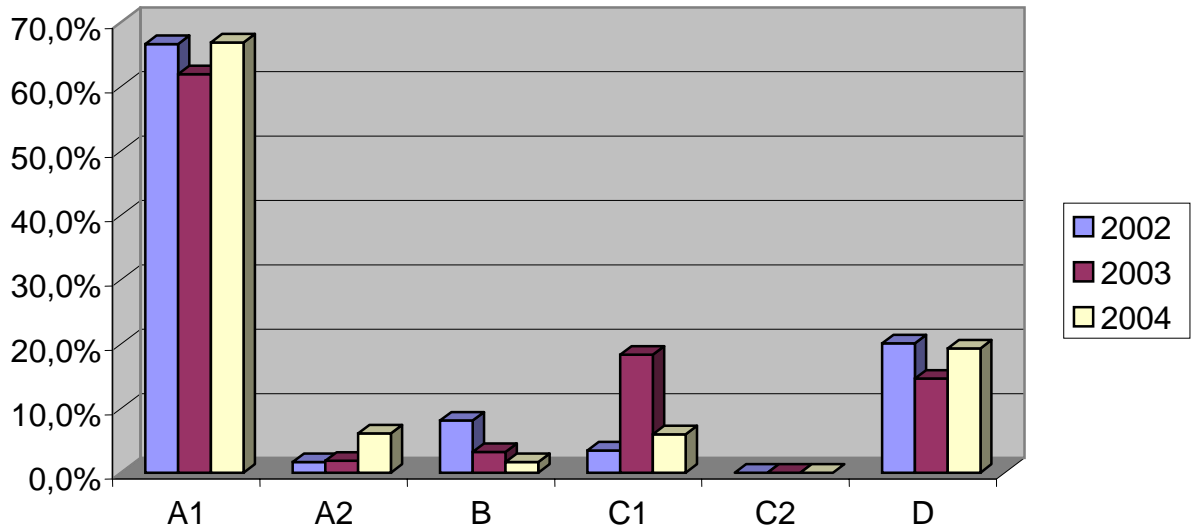
Source: Ministry of Finance, other state aid providers, data processed in CCA.

Table 9: State aid in Croatia by instruments in 2004

		In mil HRK						
Category		A1	A2	B	C1	C2	D	TOTAL
1.	<i>Agriculture and fisheries</i>	1.819,8	0,0	0,0	0,0	0,0	0,0	1.819,8
2.	<i>Manufacturing and services</i>	1.874,1	271,8	101,9	365,8	0,0	1.176,3	3.789,7
	2.1. <i>Horizontal objectives</i>	459,3	271,8	0,0	342,2	0,0	0,0	1.073,3
	R&D	0,0	111,5	0,0	0,0	0,0	0,0	111,5
	Environmental protection	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Rescue and restructuring	22,4	0,0	0,0	12,2	0,0	0,0	34,6
	SMEs	37,5	0,0	0,0	0,0	0,0	0,0	37,5
	Training		62,6	0,0	0,0	0,0	0,0	62,6
	Employment	359,1	97,7	0,0	0,0	0,0	0,0	456,8
	Culture	40,3	0,0	0,0	0,0	0,0	0,0	40,3
	Energy saving	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Other objectives	0,0	0,0	0,0	330,0	0,0	0,0	330,0
	2.2. SPECIFIC SECTORS	1.414,7	0,0	101,9	23,6	0,0	1.176,3	2.716,5
	Steel manufacturing	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Transport	816,7	0,0	101,9	0,0	0,0	1.053,9	1.972,4
	Shipbuilding	504,8	0,0	0,0	0,0	0,0	12,0	516,8
	Tourism	62,7	0,0	0,0	18,6	0,0	0,7	82,0
	Other sectors	30,6	0,0	0,0	5,0	0,0	109,7	145,3
	Financial services	0,0	0,0	0,0	0,0	0,0	0,0	0,0
3.	<i>Regional aid</i>	34,9	102,1	0,0	0,0	0,0	0,0	137,0
4.	<i>Aid on local level</i>	343,5	0,0	0,0	0,0	0,0	0,0	343,5
TOTAL		4.072,3	373,9	101,9	365,8	0,0	1.176,3	6.090,1

Source: Ministry of Finance, other state aid providers, data processed in CCA.

Picture 2: Shares of state aid by instruments* in 2002, 2003 and 2004



* A1 (subsidies), A2 (tax relief, tax exemption, tax and contributions remission and tax allowances), B (equity participation), C1 (soft loans), C2 (other instruments), D (aid in financial guarantees)

In the reviewed three-year period the most part of aid instruments was represented by subsidies, the share of which in the total of aid instruments amounted to 66, 6% in 2002, 61, 9% in 2003 and 66, 9% in 2004. The share of tax concessions shows an upward trend, whereas the share of equity participation decreases. Financing guarantees compared to all other aid instruments had a share in the total of 20, 1% in 2002, 14, 6% in 2003 and 19, 3% in 2004. Unlike so, soft loans accounted for 18, 4% in 2003, whereas in 2004 they dropped to 6, 0%.

The issued state guarantees account for a significant proportion within the total of aid instruments. In calculation of the aid element in the guarantee a special method is used, which is established in the Ordinance on the form and content of the notification and the method of data collecting and keeping the state aid register.

Table 10: State guarantees in 2002, 2003 and 2004

		In mio HRK		
		2002	2003	2004
1	Total financing guarantees issued	8.388,0	9.002,8	5.772,6
2	Total construction financing guarantees issued	2.856,3	2.721,6	4.773,6
3	Total guarantees issued	11.244,4	11.724,4	10.546,2
4	Protested – paid (less the sum returned to the budget)	620,4	549,4	778,8*
5	Risk rate (4/3)	5,52%	4,69%	7,38%
6	Premiums paid 0,5%	41,9	45,0	28,9
7	Amount (1 x 5 - 6) ⁹	420,9	376,8	397,4
8	TOTAL	1.041,3	926,2	1.176,3

Source: Ministry of Finance, data processed in CCA.

* In 2004 protested (paid) guarantees in the amount of 900 million HRK refer to rail transport issued for short-term loans to cover current liquidity and the losses of the Croatian Railways and financing of working capital, whereby the rest refers to the repayment of the loan taken by the Croatian Privatisation Fund. A total of 121.2 million HRK was returned to the state budget (900 million HRK – 121.2 million HRK = 778.8 million HRK).

Article 74 of the Regulation on state aid sets the conditions under which state guarantees may not, as a rule, constitute state aid¹⁰. The decision if a state guarantee constitutes state aid and the calculation of the aid element therein can be made only by the Agency within the assessment procedure of the guarantees in question. However, all issued guarantees were not submitted to the Agency and thus only the protested (paid) guarantees were considered state aid for the purposes of this Report, as well as the projections of aid elements in the guarantees with respect to the calculations made by the Agency.¹¹ So calculated amounts were distributed accordingly to aid categories in compliance with sector ponders represented in total issued guarantees.

2. Agriculture and fisheries

⁹ The calculation concerned applies the risk rate only to financing guarantees. The construction financing guarantees refer only to guarantees issued to shipyards, and taken into account that almost all shipyards are in financial difficulty, the total amount of the guarantees issued, within the meaning of Article 74, should constitute state aid, which would on the other hand increase the share of aid to GDP. Risk factors were not taken into account when calculating construction financing guarantees, on the account of the fact that no construction financing guarantee issued to shipyards has been protested (paid) within the report period of last three years.

¹⁰ An individual state guarantee does not constitute state aid if the borrower is not in financial difficulty, if he would in principle be able to obtain a loan on market conditions from the financial markets without any intervention by the state, if the guarantee is linked to a specific financial transaction, is for a fixed maximum amount, does not cover more than 80% of the outstanding loan or financial obligation and if the market price for the guarantee is paid.

¹¹ The calculation is carried out in several steps. First, the depreciation plan of the issued guarantee is drafted. The cash grant equivalent of a loan guarantee in a given year can be taken to be the difference between the outstanding sum guaranteed and any premium paid. However, as long as the system mentioned above has not been established, risk factor shall be calculated as a share of protested guarantees (less amount of loan guarantee repaid) in the sum of issued guarantees in a given year. Risk factor shall be calculated as a share of protested guarantees in a year t (for which state aid is calculated) in the outstanding sum guaranteed in a year $t-1$. The risk factor obtained is applied to the sum of financial guarantees issued during the year t . The amount obtained is the element of aid.

The State Aid Act and Regulation on state aid do not apply to state aid in agriculture and fisheries. However, state aid to agriculture and fisheries has been included in this Report in the sense of awards granted within the report period, in accordance with the data on the execution of the state budget.

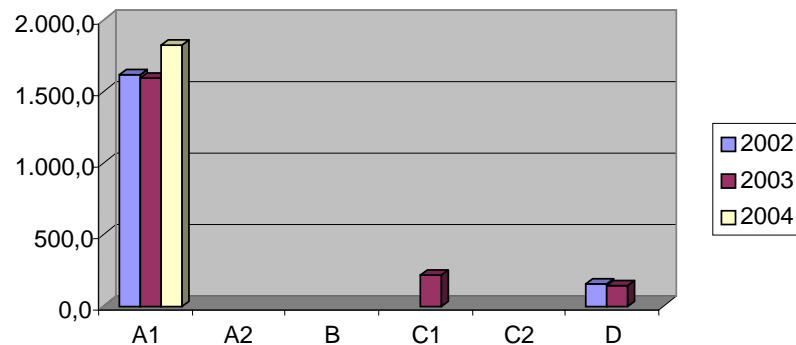
State aid to agriculture and fisheries amounted to 1,779.2 million HRK in 2002, 1,949.4 million HRK in 2003, and 1,819.8 million HRK in 2004. The most represented aid instrument in this area was subsidies. The following table shows the amounts of the total aid in comparison with the total aid less agriculture and fisheries.

Table 11: Total aid and aid to agriculture and fisheries

	In mil HRK					
	2002	2003	2004	Index 03/02	Index 04/02	Index 04/03
Total aid	5.177,2	6.332,2	6.090,1	122,3	117,6	96,2
Aid to agriculture and fisheries	1.779,2	1.949,4	1.819,8	109,6	102,3	93,4
Total aid less agriculture and fisheries	3.398,0	4.382,8	4.270,3	129,0	125,7	97,4

Source: Ministry of Finance, data processed in the CCA.

Picture 3: State aid to agriculture and fisheries by aid instruments* in 2002, 2003 and 2004 in mil HRK



* A1 (subsidies), A2 (tax relief, tax exemption, tax and contributions remission and tax allowances), B (equity participation), C1 (soft loans), C2 (other instruments), D (aid in financial guarantees)

In 2002 and 2003 the amounts of aid are nearly equal, whereas other instruments of aid (guarantees and soft loans) were less represented. In 2004 subsidies constituted a sole instrument of aid the amount of which grew by 14% compared to the figures relating to the previous year.

3. Manufacturing and services

3.1. Horizontal objectives

The share of horizontal aid in 2002 accounted for 7.4%, in 2003 this share was 12.8% whereas in 2004 it accounted for 17.6% of the overall state aid structure in Croatia, which reduced the share of sectoral aid in the total state aid. Horizontal aid in 2002 was granted only as aid to small and medium-sized enterprises and employment aid, whereas in 2003 and 2004 horizontal aid was earmarked for a number of categories, especially increased were aid for research and development and culture. At the same time, this type of aid also includes aid relating to "other objectives" which refer to the Preferential funding programme under loans for the promotion of exports, i.e. subsidised interest rates through the Croatian Bank for Reconstruction and Development (HABOR).

Table 12: Horizontal aid in 2002, 2003 and 2004

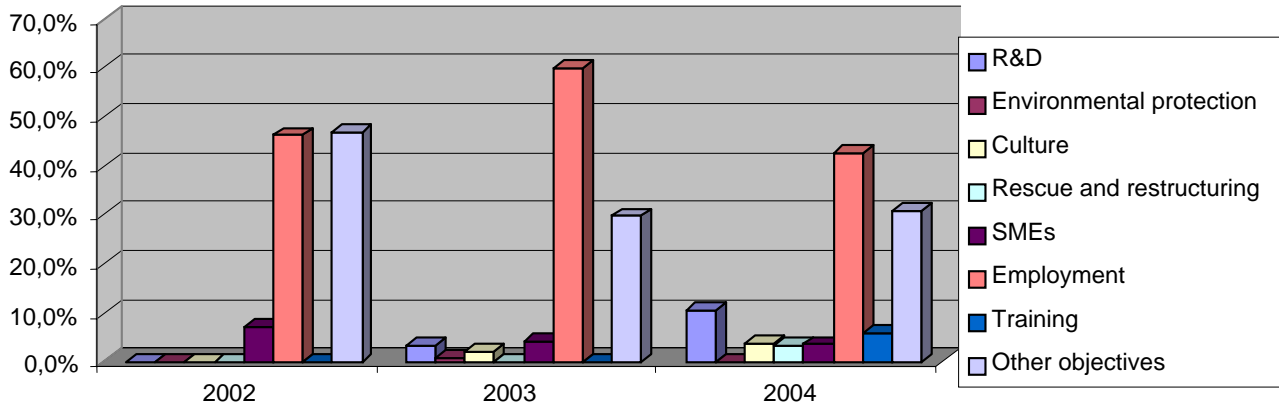
Category	In mil HRK					
	2002	2003	2004	Index 03/02	Index 04/02	Index 04/03
R&D	-	27,8	111,5	--	-	400,9
Environmental protection	-	6,0	-	-	-	0,0
Culture	-	16,1	40,3	-	-	250,4
Rescue and Restructuring	-	-	34,6	-	-	-
SMEs	27,2	32,8	37,5	120,4	137,6	114,3
Employment	177,6	485,0	456,8	273,0	257,2	94,2
Training	-	-	62,6	-	-	-
Other objectives	180,0	240,0	330,0	133,3	183,3	137,5
TOTAL	384,9	807,7	1.073,3	209,9	278,9	132,9

Source: Ministry of Finance, other state aid providers, data processed in CCA.

In the period from 2002 to 2004 the share of aid to horizontal objectives as a percentage of total aid (less agriculture and fisheries) increased by 120%, and as such represents a significant upward trend in comparison to 2002. Nevertheless, the increase in question cannot ensure that the aid structure has been significantly changed or that the aid providers redirected aid to horizontal objectives in comparison to sectoral aid (see Table 6).

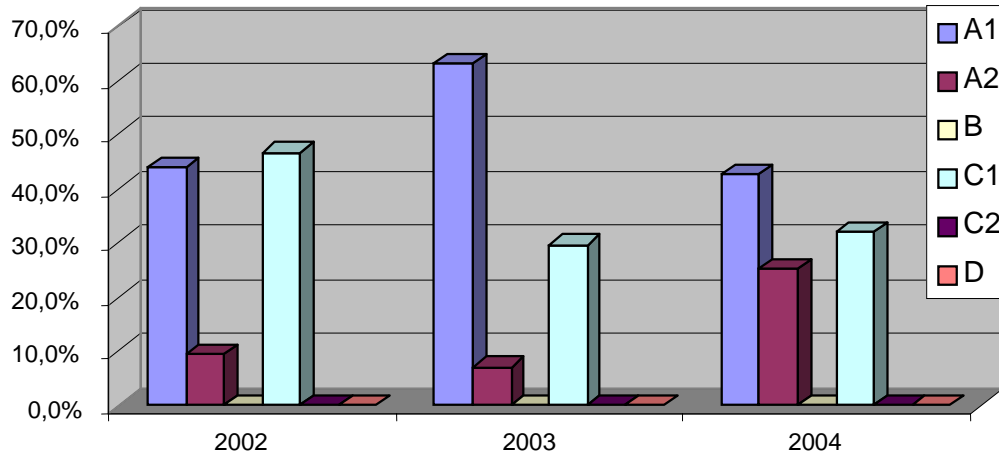
By way of illustration, the share of aid to horizontal objectives as a percentage of total aid (less agriculture and fisheries) amounted in 2003 in Croatia 26.1% whereas in the EU – 15 this share was 79%.

Picture 4: Shares of particular categories of horizontal aid in 2002, 2003 and 2004



The highest share indicates the employment aid.

Picture 5: Shares of horizontal aid by aid instruments in 2002, 2003 and 2004



* A1 (subsidies), A2 (tax relief, tax exemption, tax and contributions remission and tax allowances), B (equity participation), C1 (soft loans), C2 (other instruments), D (aid in financial guarantees)

3.2. Specific sectors

3.2.1. Transport

Transport sector includes land, maritime and air transport. Within the meaning of the Regulation on state aid, land transport refers to rail, road and inland waterways transport. Some 50% of total aid in the transport sector is earmarked for land transport.

In the structure of aid earmarked for land transport the most part of aid has been granted to Croatian Railways.

As to maritime transport, the majority of aid has been awarded to promote shipping lines and modernization of passenger fleet. In air transport the majority of aid was directed to the increase of equity share in Croatia Airlines.

Table 13: State aid to the transport sector in 2002, 2003 and 2004

In mil HRK						
Type of transport	2002	2003	2004	Index 03/02	Index 04/02	Index 04/03
Rail transport	493,1	450,1	437,4	91,3	88,7	97,2
Other land transport	6,0	44,3	52,1	738,3	868,3	117,6
Maritime transport	388,4	388,8	329,1	100,1	84,7	84,6
Air transport	168,9	152,0	100,0	90,0	59,2	65,8
TOTAL	1.056,4	1.035,2	918,6	98,0	87,0	88,7
State aid in guarantees	294,3	258,0	1.053,9	87,7	358,1	408,5
TOTAL	1.350,7	1.293,2	1.972,5	95,7	146,0	152,5

Source: Ministry of Finance, Ministry of the Sea, Tourism, Transport and Development, data processed in the CCA.

Regarding the state aid instruments, subsidies accounted for the largest portion, 67% in 2002 and 2003. In 2004 the share of subsidies amounted for 46. 6% and the share of state aid in the form of guarantees 53. 4%.

3.2.2. Shipbuilding

State aid instruments represented in the shipbuilding sector are subsidies and state guarantees.

The subsidies in the shipbuilding sector in 2004 amounted to 504.8 million HRK, which is an increase of 26.5% compared to the year 2002, or 7.7% compared to 2003. Subsidies are earmarked for the promotion of shipbuilding in Croatian shipyards, and amount, in accordance with the Ordinance on subsidies to shipbuilding, about 10% of the ship contract value.

Table 14: Aid to shipbuilding by aid instruments* in 2002, 2003 and 2004

In mil HRK						
Instrument	2002	2003	2004	Index 03/02	Index 04/02	Index 04/03
A1	399,1	468,7	504,8	117,4	126,5	107,7
C1	-	507,5	-	-	-	0,0
D	253,6	10,9	12,0	4,3	4,7	110,1
TOTAL	652,7	987,1	516,8	151,2	79,2	52,4

Source: Ministry of Finance, data processed in the CCA.

* A1 (subsidies), C1 (soft loans), D (aid in financial guarantees)

The following table shows the total of financing and construction financing guarantees granted in the shipbuilding sector in 2002, 2003 and 2004. Construction financing guarantees are released relating to the ship construction, until the moment of delivery of the ship. In the past three years no construction financing guarantees have been protested.

Table 15: Granted end-financing and construction-financing guarantees in the shipbuilding sector

In mil HRK		
	End-financing guarantees	Construction-financing guarantees
2002	162,7	2.856,3
2003	776,4	2.721,6
2004	174,6	4.773,6
TOTAL	1.113,7	10.351,5

Source: Ministry of Finance, data processed in the CCA.

State aid to shipbuilding (subsidies, guarantees) is not yet brought into compliance with the State Aid Act and Regulation on state aid and the relevant EC rules. The shipbuilding issue relating to state aid can be resolved once the uniform national programme for restructuring in the area of shipbuilding has been adopted. Given that almost all big shipyards make losses the harmonization process in this particularly important industry cannot be expected to be continued before it has undergone restructuring. During the restructuring process the aid to shipbuilding should be based on the rules applicable to state aid for rescue and restructuring.

The comprehensive rescue and restructuring programme for the entire Croatian shipbuilding should establish strategic guidelines for further operations of the national shipbuilding and define concrete measures for its recovery. This would enable the Croatian shipyards to continue with its operations in the way which, in the very beginning, would not fully comply with the state aid rules and commitments undertaken under the Stabilization and Association Agreement (SAA), nevertheless, the compatibility in question would be ensured within a prescribed transitional period, which is on the other hand, an issue that has to be agreed with the EU. The matter is of urgent nature given that Croatia under the SAA undertook the commitment of bringing into compliance its state aid with the criteria stipulated in Article 70 thereof¹², including also the shipbuilding sector.

¹² Pursuant to Article 70 paragraph (2) of the SAA any practices contrary to proper functioning of the Agreement, in so far as they may affect trade between the Community and Croatia, shall be assessed on the basis of criteria arising from the application of the state aid rules applicable in the Community, in particular from Article 87 of the Treaty establishing the European Community and interpretative instruments adopted by the Community institutions.

3.2.3. Steel

According to the data available to the Agency, in Croatia in 2004 there was no state aid granted to steel manufacturing.

In the period from 2002 to 2003 two state aid awards in the form of guarantees were granted to Željezara Split:

1. In 2002 – guarantee for a loan amount of 38 million HRK (5.1 million EUR) for the completion of the investments into modernization and reconstruction of the steel plant. The guarantee is due on 31 December 2012.
2. In 2003 – guarantee for a loan amount of 57 million HRK (7.5 million EUR) for the start of production. The guarantee is due on 31 December 2010.

In compliance with the methodology used for calculation of state aid in financial guarantees set in Chapter 1.2., state aid in 2002 amounts to 2 million HRK (276,000 EUR), and in 2003 4 million HRK (526,000 EUR).

The rules applicable to state aid to steel industry have been established by the State Aid Act and Regulation on state aid, but also by the provisions of Protocol 2 of the Stabilization and Association Agreement.

Article 5 of the Protocol 2 lists the basis criteria for the authorisation of state aid for rescue and restructuring in the steel sector.

Apart from other provisions, Article 5 item 3) of the Protocol 2, and within the meaning of Article 70 of the SAA, the Republic of Croatia may, as an exception, and in the period of the next five years (until March 2007) authorize state aid for restructuring in the steel industry under the following conditions:

- viability – the undertaking concerned must be able to operate under normal market conditions after the end of the restructuring period;
- minimum amount of state aid necessary to restore viability – the intensity of aid should be strictly limited to the necessary amount to reach the objective of the restructuring programme and progressively decreased;
- capacity reductions – in the Republic of Croatia the capacities are to be reduced over the restructuring period and connected to global rationalization.

3.2.4. Tourism

State aid to tourism was in the most number of cases granted to the following programmes (aid schemes):

- Creation of new jobs aimed at promotion of the development of small and medium-sized enterprises;
- Subsidies to foreign and domestic organized tourist transport;
- Raising competitiveness of tourist agencies.

The amount granted in the form of subsidies in 2004 was reduced by half in comparison with 2003, and the total amount of aid to tourism was cut by 61. 5%. The observable downward trend in the total aid to tourism was also influenced by the fact that in 2004 were no state guarantees given to the sector concerned.

Table 16: State aid to tourism by aid instruments* in 2002, 2003 and 2004

Instrument	In mil HRK		
	2002	2003	2004
A1	101,8	120,2	62,7
C1	0,0	0,0	18,6
D	-39,6	93,0	0,7
TOTAL	62,2	213,2	82,0

Source: Ministry of Finance, other state aid providers, data processed in CCA.

* A1 (subsidies), C1 (soft loans), D (aid in financial guarantees)

3.2.5. Other sectors

In 2004 subsidies were granted for the deconstruction of the companies Koksar d.o.o. Bakar and TEF Šibenik, and a soft loan was granted for the recovery of the undertaking Diona d.d. in bankruptcy.

The Table showing state aid amounts granted to other sectors in 2002 consists of sums for protested guarantees covering the area of economy and subsidies granted to Hrvatske pošte for the payments to workers made redundant or retired before legal retirement age and the construction of post offices.

In 2003 apart from the guarantees and subsidies granted to Hrvatske pošte, the amounts also include write-offs on the part of Croatian Privatization Fund in other industries and non-repayable financial aid to undertakings authorised by the Croatian Agency for Small Entrepreneurship.

Total amount of state aid concerning this category was appreciably reduced in 2004, compared with the two preceding years, 2002 and 2003 respectively.

Table 17: State aid to other sectors by aid instruments* in 2002, 2003 and 2004

Instrument	In mil HRK		
	2002	2003	2004
A1	27,0	157,9	30,6
C1	0,0	0,0	5,0
D	355,7	291,8	109,7
TOTAL	382,7	449,7	145,3

Source: Ministry of Finance; data processed in the CCA.

* A1 (subsidies), C1 (soft loans), D (aid in financial guarantees)

3.2.6. Financial services

In this category of state aid in 2002 shows the current transfers of the Croatian Guarantee Agency. The indicated equity shares in 2002 and 2003 refer to Hrvatska poštanska banka.

State aid for financial services shows a significant downward trend in 2003. The fall from 272 million HRK to 130 million HRK expressed in percentage amounted to 52%.

In 2004 there was no state aid specified in the sector of financial services.

Table 18: State aid to financial services in 2002 and 2003

Instrument	In mil HRK		
	2002	2003	Index 03/02
subsidies	0,8	0,0	-
equity shares	271,2	130,0	47,9
TOTAL	272,0	130,0	47,8

Source: Ministry of Finance, other state aid providers, data processed in CCA.

4. Regional aid

Regional aid is designed to develop the less-favoured regions of the Republic of Croatia¹³. It promotes the expansion, modernisation and diversification of the activities of establishments located in those regions and encourages new firms to settle there. In order to foster this development and reduce the potential negative effects of any relocation, it is necessary to make the granting of such aid conditional on the maintenance of the investment and the jobs created during a minimum period in the less-favoured region.

In 2003 the share of regional aid in the EU amounted to 7.6 billion EUR, whereby 3.1 million EUR were awarded in compliance with the Guidelines on national regional aid. The above mentioned amount of 7.6 billion EUR stands for approximately one fifth of the total state aid granted, less agriculture and fisheries, and transport¹⁴.

Table 19: Regional aid by aid instruments* in 2002, 2003 and 2004

Instrument	In mil HRK					
	2002	2003	2004	Index 03/02	Index 04/02	Index 04/03
A1	22,0	27,5	34,9	125,0	158,6	126,9
A2	50,5	61,7	102,1	122,3	202,4	165,5
TOTAL	72,5	89,2	137,0	123,1	189,1	153,6

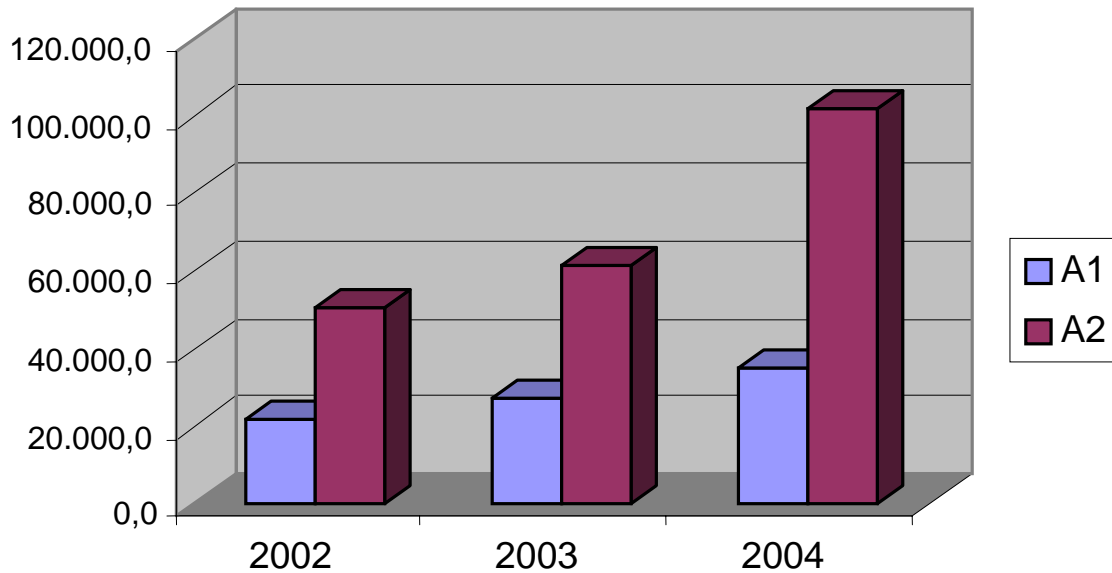
Source: Ministry of finance – Tax Administration, data processed in the CCA.

* A1 (subsidies), A2 (tax relief, tax exemption, tax and contributions remission and tax allowances)

¹³ Regional state aid are granted pursuant to the Act on Areas of Special State Concern, Act on Hilly and Mountainous Areas, Islands Act and the Profit Tax Act.

¹⁴ Source: DG Competition (scoreboard)

Picture 6: Shares of regional aid by aid instruments* in 2002, 2003 and 2004



** A1 (subsidies), A2 (tax relief, tax exemption, tax and contributions remission and tax allowances), B (equity participation), C1 (soft loans), C2 (other instruments), D (aid in financial guarantees)*

The share of regional aid in the total state aid in 2003 amounted to 1.4%. In 2004 the share in question increased to 2.3% of the total aid. Nominal values show an even more significant increase, of 53.6% in 2004 compared to the previous year of 2003. Aid instruments in all report years are subsidies and tax concessions.

Within the meaning of the provisions of the Profit Tax Act tax concessions represent a considerable share to different incentives and indicate an upward trend during the whole three-year period.

5. Conclusion

The data presented in the second Annual Report on State Aid which was compiled by the Croatian Competition Agency pursuant to Article 19 of the State Aid Act, refer to state aid to the economy of the Republic of Croatia awarded from the state budget in 2002, 2003 and 2004.

Given that the Agency has not yet established its own data base concerning the state aid granted, which on its part depends on the timely notification of aid proposals by the aid providers, this Report was based on the data received from the aid providers as well as on the data from the Report on the Execution of the State Budget in the previous the report period of three years, which were on the part of the Agency completed with the data collected in the regular procedure for authorization and monitoring of the awarded state aid.

In this Report, compared with the Report on state aid for 2003, the Agency also proceeded with necessary corrections of the data indicated in the former Report, due to the fact that at the time of drafting, particular data relating to particular categories and instruments of state aid were not available to the Agency.

This Report shows that the most part of state aid is still earmarked for sectoral aid. It is therefore necessary to proceed with the rationalization and its purposeful spending. Nevertheless, it is observed that the share of sectoral aid in the total aid gradually decreases. Further downward trends are expected, especially once the issue concerning state aid to shipbuilding has been resolved, given that the shipbuilding sector represents one of the biggest aid beneficiaries in a sustainable market context. At the same time, there is an upward trend and redirection of state aid towards horizontal objectives, the trend which should also remain positive especially in the case of small and medium-sized enterprises. The relative share of state aid to GDP in 2004, although still rather high in comparison with the relevant EU figures, shows also a downward trend. Absolute amounts of state aid have been also reduced compared to 2003.

A comparative analyses is also possible on the level of state aid in Croatia and that of the EU average taking into consideration the relative share of aid to the GDP, not including railways or agriculture and fisheries, on the account of the fact that rail transport holds a particular status in the EC acquis, whereas agriculture and fisheries hold the same particular status relating to state aid under the Stabilization and Association Agreement. In accordance with the above mentioned the share of aid to GDP in Croatia less railways amounts to 2.73%, compared to 0.57% in the EU, whereas the share of aid to GDP less agriculture and fisheries amounts to 1.11% and 0.40% respectively.

The period from 2002 to 2004 covered by this Report is a relatively short one to ensure reliable conclusions on the trends and possible relevant changes in the state aid policy. Given that there were certain disparities spotted on the annual levels as regards the data included in the Report in question, the eventual and doubtless conclusions on the prevailing trends in the area of state aid in Croatia should be given some more time. Nevertheless, the time may not be wasted but used to continue with further systematic enforcement policy relating to the adjustment of the relative amounts of aid to the ones in the EU, achieving the transparency in the state aid enforcement system and establishment of the efficient monitoring system concerning the administration of state aid control and use of aid. This Report reveals positive shifts towards even better indicators in the future.

ANNEX

I Categories of state aid

1. Agriculture and fisheries
 - 1.1. Agriculture, hunt and forestry
 - 1.2. Fisheries

2. Horizontal aid
 - 2.1. Research and development
 - 2.2. Environmental protection
 - 2.3. Energy saving
 - 2.4. SMEs
 - 2.5. Employment
 - 2.6. Training
 - 2.7. Culture
 - 2.8. Other objectives

3. Regional aid
 - 3.1. Areas A (less favoured areas)
 - 3.2. Areas B

4. Sectoral aid
 - 4.1. Steel manufacturing industry
 - 4.2. Land transport
 - 4.3. Maritime transport
 - 4.4. Air transport
 - 4.5. Shipbuilding
 - 4.6. Tourism
 - 4.7. Financial services
 - 4.8. Other sectors

II Instruments of state aid

1. A – Direct grants and tax exemptions;
 - A1 – State aid awarded through budgetary expenditure: grants;
 - A2 – State aid awarded through budgetary revenue (tax relief, tax exemption, tax and contributions remission and tax allowances);
2. B – Equity participation;
 - B1 – Financial transfers to public enterprises;

3. C – Financial transfers:
 - Soft loans (C1);
 - Other instruments (C2);

4. D – Guarantees.

Methodology - Calculation of the aid element

Group	Instrument	Aid element
A1	Grants	Total value of the grant received
A1	Interest rate subsidies received directly by the recipient	Total value of the subsidies received (or unpaid interest)
A1	Fundamental R&D projects	Total amount of funds allocated to such projects
A1	Other R&D projects and activities	The amount of state funds used for co-financing of the projects, irrespective of whether the funds are allocated directly to the beneficiary or research institution
A1	Remission of loan-related debts for operating undertakings	The value of the written-off debt
A1	Compulsory settlement and bankruptcy of undertakings	The estimated decreased settlement payment or the recovered value from the bankruptcy estate with respect to other creditors due to wilfully caused deterioration in the position of the state as a creditor in the settlement or bankruptcy procedure
A2	Tax deferrals	Interest payable for the deferred period calculated at current values and based on the annual reference interest rate* (linear calculation method)
A2	Tax remission, tax relieves, exemptions and allowances	This does not include general tax credits (such as profit tax which is a general measure within the meaning of the Profit Tax Act) but only allowances which are specific for a particular undertaking or a group of undertakings (e.g. advantages for undertakings employing disabled persons); The element of aid is the total amount of tax exemption or allowance
A2	Reductions in social security contributions, relieves and exemptions thereof	With respect to reductions, relieves and exemptions of social security contributions the same principle as for tax exemptions applies – state aid does not involve general allowances; The aid element is the total estimated amount of exemption or relief
B1	Equity investments	The aid element is present in all state investments the primary objective of which is not the creation of profit; The aid element is the estimated benefit value for the aid beneficiary
B1	Conversion of debt into equity participation	The aid element exists where the state is in a less favourable position than that of other creditors; The aid element is the estimated benefit value for the aid beneficiary resulting from the less

		favourable position of the state
B1	Sale of state property under favourable terms	The aid element is the balance between the market value of the property and its sales price
B1	Participation in a company's profits	A share in the distributed profit deriving from the equity share held by the state in the undertaking and which the state renounces, represents in full the amount of state aid
C1	Soft loans	The balance between the loan costs (interest) with an annual reference interest rate and a more favourable interest rate; The calculation is made for the whole period of the loan and relates to its current value (linear calculation method)
C1	Loans to the firms in difficulty	To (restructuring) firms in difficulty which cannot obtain loans on the market, the aid amounts to 20% of the loan value, irrespective of whether the loan was paid off under the market or less favourable conditions
C2	All other instruments	The estimated value of the aid (e.g. tax debt)
D	Guarantees	The balance between the price of the market guarantee and the state guarantee which is lower; The aid element is calculated on the basis of the guaranteed debt amount and the reference risk rate (which in 2003 amounted to 4.49%)
D	Revoked guarantees payments	Full payments of guaranteed obligations