



REPUBLIC OF CROATIA

CROATIAN COMPETITION AGENCY

ANNUAL REPORT

on State Aid for 2005

September 2006

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ANNUAL REPORT ON STATE AID FOR 2005

1. INTRODUCTION

Croatian Competition Agency (CCA) submits the Annual Report on State Aid for 2005 to the Croatian Parliament (in this text referred to as: *annual report*) within the meaning of Article 20 of the State Aid Act (OG 140/05). This is the third Croatian annual report on state aid since the first State Aid Act entered into force in 2003.

This annual report provides for an analytical overview of state aid granted in the last three years. Namely, it includes apart from the data on state aid for 2005, also the subsequently collected and revised data for 2003 and 2004 in order to ensure transparency and comparison of the amounts of aid granted in the report periods. This in the first place refers to the data and calculation of aid granted in the form of state guarantees.

The annual report has been drafted in accordance with the method used for such reports by the European Commission (scoreboard)¹ and in accordance with the commitments undertaken by the Republic of Croatia under Article 70 par 5 of the Stabilization and Association Agreement (SAA).

It must be taken into account that this annual report shows the data on state aid which have been communicated by aid providers, i.e. the data on state aid which has been notified to the CCA. Nonetheless, given that the state aid monitoring system needs some time of getting under way, it has been observed that aid providers, especially at the local level, still fail to notify state aid to the CCA, it must be understood that state aid data shown in this annual report do not fully reflect the position of state aid in our country. It is encouraging that this has been changing for the better with every year and every annual report, in line with the growing awareness in respect of the necessary control of state aid and obligatory notification to the CCA.

The CCA is at this moment completing its own state aid register. After all aid providers in Croatia, both at the national and local level, bring into compliance the system of granting state aid with state aid rules as laid down by the State Aid Act, it will only then be possible for the CCA to comply a comprehensive report covering all state aid granted. The first condition for the implementation of a successful monitoring process is the notification of state aid, i.e. the application for approval of particular state aid before it has been awarded. The process in question needs some time for adjustment of both aid providers and aid beneficiaries, which was also the case in the EU Member States some time ago, which in the first place involves education and training of all stake holders, particularly aid providers, concerning the obligations stipulated by the EU state aid control system.

Some tables in the annual report show data on granted state aid less aid to railways, agriculture and fisheries, on the account of the separate status given to railways under the EC rules and on the account of the fact that the State Aid Act does not apply to aid to agriculture and fisheries.

¹ http://ec.europa.eu/comm/competition/state_aid/scoreboard/2004/autumn_en.pdf

2. STATE AID IN 2005

State aid granted in Croatia in 2005 amounted to HRK 6.514,2 million, which is 13.2% more than in 2004 and 8% more than in 2003. The share of state aid in GDP in 2005 amounted to 2.84%, which is 2.4% more than the share realized in 2004 (2.78%).

The increase of the total state aid in 2005 compared to 2004 has been due to significant rise of state aid awarded to transport sector and agriculture.

At the same time, there is a rise in state aid per employee, from 4.080,9 HRK in 2004 to 4.585,6 HRK in 2005, which is an increase of 12.4%, as well as the rise of per capita state aid from 1.296,4 HRK to 1.468,0 HRK, which is an increase of 12.2%.

The feature of the year 2005 is also an increase of the share of state aid in the state expenditures compared to 2004, which grew from 6.9% to 7.3%.

Table 1 shows the total amount of state aid granted in the Republic of Croatia in 2003, 2004 and 2005 compared to basic macroeconomic indicators.

Table 1: State aid (including agriculture and fisheries) in 2003, 2004 and 2005

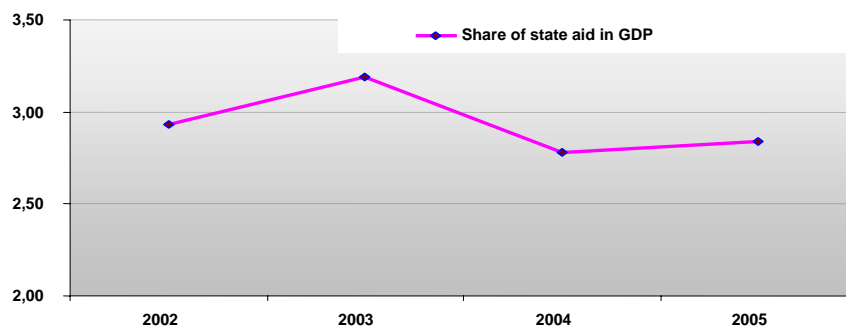
	Measure	2003	2004	2005	Indices	
					2005/2003	2005/2004
State aid	mil HRK	6.030,6	5.752,5	6.514,2	108,0%	113,2%
State aid	mil EUR ²	797,3	767,5	880,3	110,4%	114,7%
GDP	mil HRK	189.040,0	207.028,0	229.031,0	121,2%	110,6%
GDP	mil EUR	24.994,0	27.621,5	30.949,4	123,8%	112,0%
Government expenditure	mil HRK	77.075,5	83.145,1	89.686,3	116,4%	107,9%
Government expenditure	mil EUR	10.190,6	11.093,2	12.119,5	118,9%	109,3%
Employees	number	1.392.509,8	1.409.633,8	1.420.574,0	102,0%	100,8%
State aid share in GDP	%	3,19	2,78	2,84	89,2%	102,4%
State aid per employee	HRK	4.330,7	4.080,9	4.585,6	105,9%	112,4%
State aid per employee	EUR	572,6	544,5	619,7	108,2%	113,8%
State aid share in government expenditure	%	7,82	6,92	7,26	92,8%	105,0%
Per capita state aid ³	HRK	1.359,0	1.296,4	1.468,0	108,0%	113,2%
Per capita state aid	EUR	179,7	173,0	198,4	110,4%	114,7%

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

² In 2003 Croatian National Bank average rate against 1 EUR was 7.563414 HRK, in 2004 this rate was 7.495169 HRK and in 2005 it amounted to 7.400185 HRK.

³ Population size 4.4m according to the 2001 census.

Picture 1: State aid share in GDP in the period 2002 – 2005



Picture 1 shows that the share of aid to the Croatian GDP was the highest in 2003, the year 2004 indicates a significant falling trend of the share of aid to GDP, whereas in the year of 2005 this trend stopped, or more precisely, a slightly rising trend of the share of aid to GDP is demonstrated.

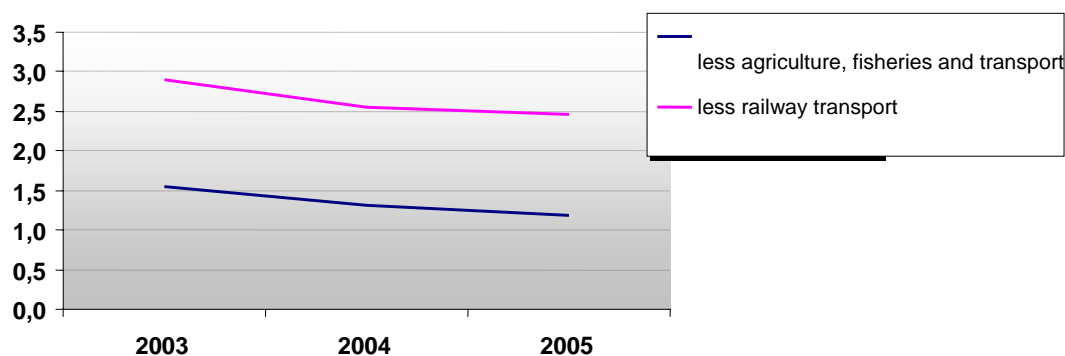
Table 2: Total state aid in Croatia (less agriculture, fisheries and transport) in 2003, 2004 and 2005

Measure		2003	2004	2005
Total state aid (less agriculture, fisheries and transport)	mil HRK	2.922,6	2.732,2	2.730,9
Total state aid (less agriculture, fisheries and transport)	mil €	386,4	364,5	369,0
GDP	mil HRK	189.040,0	207.028,0	229.031,0
GDP	mil €	24.994,0	27.621,5	30.949,4
State aid share in GDP (less agriculture, fisheries and transport)	%	1,55%	1,32%	1,19%

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

State aid in 2005 (less agriculture, fisheries and transport) amount to 2.730,9 million HRK or 369,0 EUR, which is 0.05% less than in 2004 when this figure amounted to 2.732,2 million HRK, or 6.6% less than in 2003 when this figure was 2.922,6 million HRK.

Picture 2: State aid to GDP (%) in 2003, 2004 and 2005



Picture 2 shows the share of state aid to GDP less agriculture, fisheries and transport and less railway transport in order for the positive falling trend of other forms of state aid as share to GDP to be indicated.

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

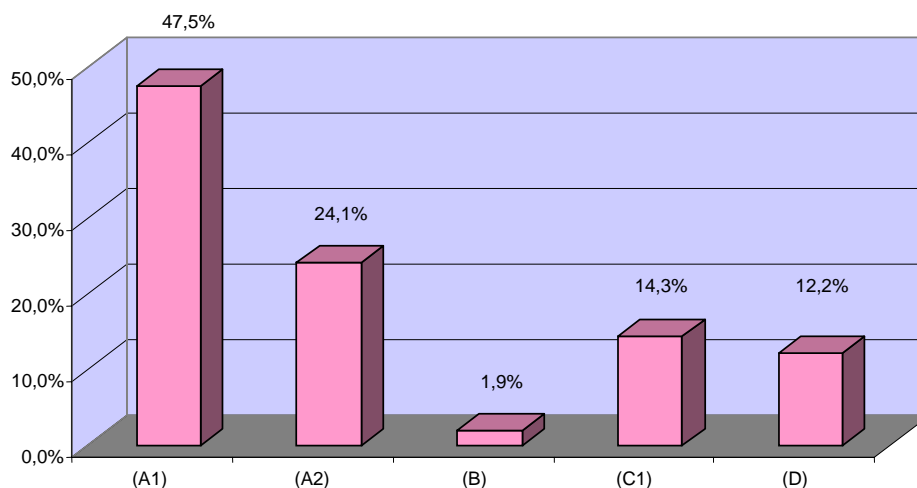
Table 3: Total state aid in Croatia (including agriculture and fisheries but less rail transport) in 2003, 2004 and 2005

Measure		2003	2004	2005
Total state aid (less rail transport)	mil HRK	5.458,1	5.290,8	5.627,5
Total state aid (less rail transport)	mil €	721,6	705,9	760,5
GDP	mil HRK	189.040,0	207.028,0	229.031,0
GDP	mil €	24.994,0	27.621,5	30.949,4
State aid share in GDP (less rail transport)	%	2,89%	2,56%	2,46%

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 guarantee to railways given that the data on all issued guarantees to railway transport were not available to the CCA.

Picture 3: State aid in Croatia by aid instruments (less agriculture, fisheries and transport) in 2005⁴



⁴ A1 (grants), A2 (tax relief, tax exemption, tax and contributions remission and tax allowances), B (equity participation), C1 (soft loans), D (aid in financial guarantees)

2.1. CATEGORIES OF STATE AID

Pursuant to the provisions under the Regulation on state aid (OG 121/03; hereinafter: *Regulation*) state aid is basically divided into the following categories of aid: horizontal aid, sector-specific and regional aid⁵ and state aid to agriculture and fisheries.

Horizontal aid is earmarked for all undertakings and sectors, and as such it distorts competition less significantly than sector-specific aid, which is awarded to a particular undertaking or undertakings within a particular industry.

Horizontal aid is aimed at research and development, environmental protection and energy conservation, rescue and restructuring, SMEs, employment, training, culture etc.

Pursuant to the Regulation, separate sector-specific aid may be granted to steel manufacturing, transport (land, maritime and air transport), shipbuilding, tourism and financial services.

Regional state aid is granted on the basis of the established regional aid map with the objective of promoting economic development of disadvantaged areas, i.e. areas the economy of which lags behind the national average. Within the meaning of the SAA, the Republic of Croatia was until 1 March 2006 considered one region and defined as an area with abnormally low standard of living and serious underemployment (region A), which actually made the application of more favourable state aid rules possible. Thus, given that this status expired as of 1 March 2006, and that in the meantime the division into NUTS II level regions has not been carried out, which is the prerequisite for the establishment of the regional map, in this very moment Croatia does not fulfil the necessary criteria for the award of regional state aid.

⁵ *Annex 2: Aid Categories*

Table 5: Categories of state aid in 2003, 2004 and 2005

Category	2003			2004			2005		
	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	1.950,4	257,9	32,34	2.073,8	276,7	36,05	2.182,0	294,9	33,50
2 Manufacturing and services	3.701,8	489,4	61,38	3.189,4	425,5	55,44	4.029,0	544,4	61,85
2.1. Horizontal objectives	991,9	131,1	16,45	1.383,2	184,6	24,04	1.593,6	215,4	24,46
R&D	27,8	3,7	0,46	111,5	14,9	1,94	129,3	17,45	1,98
Environmental protection	6,0	0,8	0,10	0,0	0,0	0,00	6,9	0,9	0,11
Rescue and restructuring	184,2	24,4	3,05	343,8	45,9	5,98	499,8	67,5	7,67
SMEs	32,8	4,3	0,54	37,5	5,0	0,65	96,3	13,0	1,48
Training	0,0	0,0	0,00	62,6	8,4	1,09	137,2	18,5	2,11
Employment	485,0	64,1	8,04	456,8	61,0	7,94	297,7	40,2	4,57
Culture	16,1	2,1	0,27	41,0	5,5	0,71	75,3	10,2	1,16
Other objectives	240,0	31,7	3,98	330,0	44,0	5,74	351,2	47,5	5,39
2.2. SPECIFIC SECTORS	2.709,9	358,3	44,94	1.806,2	241,0	31,40	2.435,4	329,1	37,39
Steel manufacturing	4,4	0,6	0,07	29,4	3,9	0,51	51,8	7,0	0,80
Transport	1.157,6	153,1	19,20	946,6	126,3	16,45	1.601,3	216,4	24,58
Shipbuilding	1.046,8	138,4	17,36	540,3	72,1	9,39	519,8	70,2	7,98
Tourism	213,2	28,2	3,54	254,4	33,9	4,42	188,3	25,4	2,89
Other sectors	157,9	20,9	2,62	35,6	4,8	0,62	74,2	10,0	1,14
Financial services	130,0	17,2	2,16	0,0	0,0	0,00	0,0	0,0	0,00
3 Regional aid	89,2	11,8	1,48	137,0	18,3	2,38	169,5	22,9	2,60
4 Aid at local level	289,2	38,2	4,80	352,3	47,0	6,12	133,7	18,1	2,05
TOTAL	6.030,6	797,3	100,00	5.752,5	767,5	100,00	6.514,2	880,3	100,00

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

As indicated in Table 5, the highest share of state aid from 2003 – 2005 is attributed to sector-specific aid, particularly aid to transport industry and agriculture and fisheries. At the same time the share of regional aid slightly increased from 1.5% in 2003 to 2.6% in 2005. The figures also show a growing trend of horizontal aid: in 2003 the share of horizontal aid in the total aid was 16.5%, whereas in 2005 it grew to 24.5%. The growing trend of horizontal state aid in 2004 inclined a relative decrease in sector-specific aid in the same year. Nevertheless, this trend did not remain constant and in 2005 the growing trend in sector-specific aid was again evident. This was the result of an exceptionally high share of transport aid which increased by 654,7 million HRK in 2005 compared to 2004.

2.2. STATE AID INSTRUMENTS

As already mentioned above, state aid is awarded from the state budget and may take various forms. Aid may be direct (increase in state expenditures) and indirect (decrease in state expenditures) and is awarded through the following instruments⁶:

- (A1) – grants
- (A2) – tax exemptions, tax deferral, tax rate relieves and reduction in social security contributions
- (B) – equity participation
- (C1) – soft loans
- (C2) – other instruments
- (D) – guarantees

Table 6: State aid in Croatia by aid instruments (including agriculture and fisheries) in 2003 indicated in mil HRK

Category		A1	A2	B	C1	D	TOTAL
1.	<i>Agriculture and fisheries</i>	1.595,9	0,0	0,0	211,3	143,2	1.950,4
2.	<i>Manufacturing and services</i>	2.013,8	56,9	205,0	951,5	474,6	3.701,8
	2.1. <i>Horizontal objectives</i>	510,8	56,9	0,0	240,0	184,2	991,9
	R&D	27,8	0,0	0,0	0,0	0,0	27,8
	Environmental protection	6,0	0,0	0,0	0,0	0,0	6,0
	Rescue and restructuring	0,0	0,0	0,0	0,0	184,2	184,2
	SMEs	32,8	0,0	0,0	0,0	0,0	32,8
	Training	0,0	0,0	0,0	0,0	0,0	0,0
	Employment	428,1	56,9	0,0	0,0	0,0	485,0
	Culture	16,1	0,0	0,0	0,0	0,0	16,1
	Other objectives	0,0	0,0	0,0	240,0	0,0	240,0
	2.2. SPECIFIC SECTORS	1.503,0	0,0	205,0	711,5	290,4	2.709,9
	Steel manufacturing	0,0	0,0	0,0	0,0	4,4	4,4
	Transport	879,9	0,0	75,0	80,3	122,4	1.157,6
	Shipbuilding	468,7	0,0	0,0	507,5	70,6	1.046,8
	Tourism	118,8	0,0	0,0	1,4	93,0	213,2
	Other sectors	35,6	0,0	0,0	122,3	0,0	157,9
	Financial services	0,0	0,0	130,0	0,0	0,0	130,0
3.	<i>Regional aid</i>	27,5	61,7	0,0	0,0	0,0	89,2
4.	<i>Aid at local level</i>	282,3	0,0	0,0	0,0	6,9	289,2
TOTAL		3.919,5	118,6	205,0	1.162,8	624,7	6.030,6

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

⁶ Annex I. gives a list of aid instruments and respective aid element calculations.

Table 7: State aid in Croatia by aid instruments (including agriculture and fisheries) in 2004 indicated in mil HRK

Category		A1	A2	B	C1	D	TOTAL
1.	<i>Agriculture and fisheries</i>	1.819,8	0,0	0,0	0,0	254,0	2.073,8
2.	<i>Manufacturing and services</i>	1.874,1	271,8	101,9	365,8	575,8	3.189,4
	2.1. <i>Horizontal objectives</i>	459,3	271,8	0,0	342,2	309,9	1.383,2
	R&D	0,0	111,5	0,0	0,0	0,0	111,5
	Environmental protection	0,0	0,0	0,0	0,0	0,0	0,0
	Rescue and restructuring	22,4	0,0	0,0	12,2	309,2	343,8
	SMEs	37,5	0,0	0,0	0,0	0,0	37,5
	Training	0,0	62,6	0,0	0,0	0,0	62,6
	Employment	359,1	97,7	0,0	0,0	0,0	456,8
	Culture	40,3	0,0	0,0	0,0	0,7	41,0
	Other objectives	0,0	0,0	0,0	330,0	0,0	330,0
	2.2. SPECIFIC SECTORS	1.414,8	0,0	101,9	23,6	265,9	1.806,2
	Steel manufacturing	0,0	0,0	0,0	0,0	29,4	29,4
	Transport	816,7	0,0	101,9	0,0	28,0	946,6
	Shipbuilding	504,8	0,0	0,0	0,0	35,5	540,3
	Tourism	62,7	0,0	0,0	18,6	173,1	254,4
	Other sectors	30,6	0,0	0,0	5,0	0,0	35,6
	Financial services	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	137,0
4.	<i>Aid at local level</i>	343,5	0,0	0,0	0,0	8,8	352,3
TOTAL		4.072,3	373,9	101,9	365,8	838,6	5.752,5

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

Table 8: State aid by instruments (including agriculture and fisheries) in 2005 indicated in mil HRK

Category		A1	A2	B	C1	D	TOTAL
1.	<i>Agriculture and fisheries</i>	2.049,4	0,0	0,0	0,0	132,6	2.182,0
2.	<i>Manufacturing and services</i>	2.559,1	522,7	151,8	105,4	360,0	4.029,0
	2.1. <i>Horizontal objectives</i>	598,4	522,7	10,3		132,2	1.593,6
	R&D	4,8	124,5	0,0	0,0	0,0	129,3
	Environmental protection	6,9	0,0	0,0	0,0	0,0	6,9
	Rescue and restructuring	357,4	0,0	10,3	0,0	132,1	499,8
	SMEs	96,3	0,0	0,0	0,0	0,0	96,3
	Training	6,8	130,4	0,0	0,0	0,0	137,2
	Employment	30,0	267,7	0,0	0,0	0,0	297,7
	Culture	75,1	0,0	0,0	0,0	0,2	75,2
	Other objectives	21,2	0,0	0,0	330,0	0,0	351,2
	2.2. SPECIFIC SECTORS	1.960,7	0,0	141,5	105,4	227,8	2.435,4
	Steel manufacturing	0,0	0,0	0,0	0,0	51,8	51,8
	Transport	1.418,1	0,0	100,2	53,3	29,6	1.601,2
	Shipbuilding	444,4	0,0	20,8	0,0	54,5	519,8
	Tourism	58,3	0,0	9,0	29,2	91,8	188,3
	Other sectors	39,9	0,0	11,5	22,9	0,0	74,2
	Financial services	0,0	0,0	0,0	0,0	0,0	0,0
3.	<i>Regional aid</i>	33,8	135,7	0,0	0,0	0,0	169,5
4.	<i>Aid at local level</i>	123,0	0,7	0,0	7,4	2,6	133,7
TOTAL		4.765,3	659,1	151,8	112,8	495,2	6.514,2

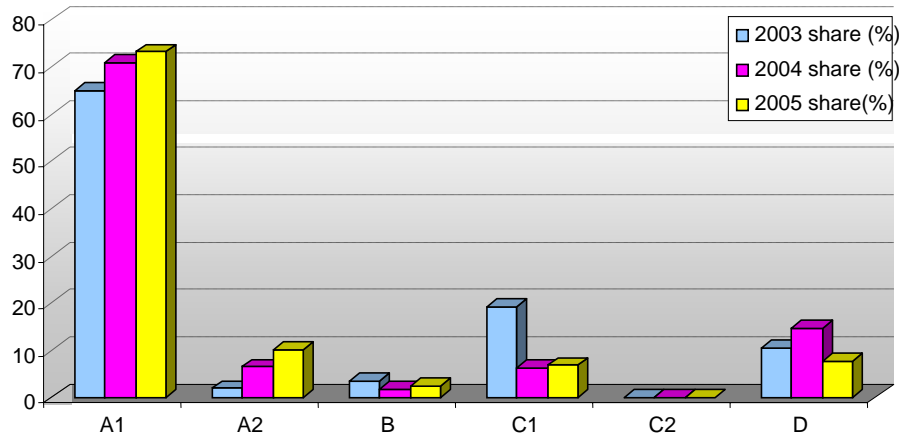
Source: Ministry of Finance, other state aid providers, data processed in CCA.

Table 9: State aid by aid instruments (including agriculture and fisheries) in 2003, 2004 and 2005

	2003			2004			2005		
	mil HRK	mil EUR	share (%)	mil HRK	mil EUR	Share (%)	mil EUR	mil EUR	share (%)
A1	3.919,5	518,2	64,99	4.072,3	543,3	70,79	4.765,3	643,9	73,15
A2	118,6	15,7	1,97	373,9	49,9	6,50	659,1	89,1	10,12
B	205,0	27,1	3,40	101,9	13,6	1,77	151,8	20,5	2,33
C1	1.162,8	153,7	19,28	365,8	48,8	6,36	442,8	59,8	6,80
C2	0,0	0,0	0,00	0,0	0,0	0,00	0,0	0,0	0,00
D	624,7	82,6	10,36	838,6	260,9	14,58	495,2	66,9	7,60
	6.030,6	797,3	100,00	5.752,5	916,5	100,00	6.514,2	880,3	100,00

In respect of aid instruments the above figures show the highest share of subsidies which was 65% in 2003 and rose to some 73% in 2005. At the same time state aid in the form of tax exemptions shows an upward trend, from 2% in 2003 to some 10% in 2005, whereas the share of equity participation decreased from 3.4% in 2003 to 2.3% in 2005. The share of soft loans accounted for 19.3% in 2003 and dropped to 6.8% in 2005. State guarantees accounted for 10.4% in 2003, whereas its proportion in the total of aid instruments dropped to 7.6% in 2005.

Picture 5: Total state aid by aid instruments⁷ in 2003, 2004 and 2005



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

The issued state guarantees account for a significant portion of the total of aid instruments. In the calculation of aid element in 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 (OG 11/05) and in line with the calculation method used in the EU.

⁷ A1 (grants), 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)

Table 10: State guarantees in 2003, 2004 and 2005 in million HRK

No.	Description	2003	2004	2005
1.	Total end-financing guarantees issued	9.002,79	5.805,55	3.709,77
2.	State guarantees which are not state aid	6.467,24	5.393,90	2.707,50
3.	Total end-financing guarantees containing aid elements (1-2)	2.535,55	411,65	1.002,27
4.	Total construction financing guarantees issued	2.721,60	4.773,60	3.458,31
5.	Total state guarantees containing aid elements issued (3+4)	5.257,15	5.185,25	4.460,58
6.	Invoked guarantees (less sum returned to the budget)	429,97	778,83	408,44
7.	Risk rate(6/5)	8,18%	15,02%	9,16%
8.	Premiums paid 0.5% (3x0.5%)	12,68	2,06	5,01
9.	Amount of aid involved in guarantee (3x7-8)	194,70	59,77	86,76
10.	TOTAL STATE AID (9+6)	624,67	838,60	495,20

Source: Ministry of Finance, data processed in CCA.

Article 74 of the Regulation on state aid sets the conditions under which state guarantees do not, as a rule, constitute state aid⁸. The decision if a state guarantee constitutes state aid and the calculation of the aid element therein can be made only by the CCA within the assessment procedure relating to the guarantees in question. However, all issued guarantees were not submitted to the CCA and thus only the invoked (paid) guarantees were considered state aid for the purposes of this annual report (excluded are also guarantees to shipbuilding) and projections of aid elements in guarantees in accordance with the calculations made by the CCA. So calculated amounts were distributed accordingly to aid categories in compliance with sector ponders represented in total issued guarantees.

The amounts of state guarantees which do not constitute state aid are shown in Table 10 under point 2 and they cover:

- infrastructure (construction and maintenance of motorways and roads, railway infrastructure, gas pipelines, coastal infrastructure),
- state guarantees of the Croatian Privatisation Fund, Croatian Institute for Health Insurance, Croatian HEP (electricity, gas, heat), Zagreb Hospital and Clinic Centre),
- state guarantees for the reconstruction of war damaged buildings.

⁸ 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.

3. AGRICULTURE AND FISHERIES

Within the meaning of the State Aid Act, the provisions of the State Aid Act and Regulation on state aid do not apply to state aid to agriculture and fisheries and as such does not fall under the competence of the CCA. However, state aid to agriculture and fisheries has been included in this annual report in the sense of awards granted within the report period, in accordance with the data received from the Ministry of Finance and data on the execution of the state budget.

State aid to agriculture and fisheries amounted to 1,950.4 million HRK in 2003, 2,073.8 million HRK in 2004, and 2,182.0 million HRK in 2005. The figures show a continuous upward trend in respect of state aid to agriculture and fisheries. In comparison to 2003 its share in 2005 increased by 10.6%, whereas in comparison to 2004 this increase amounts to some 5%.

In the period from 2003 to 2005 state aid to agriculture and fisheries amounted to 34% of the total state aid.

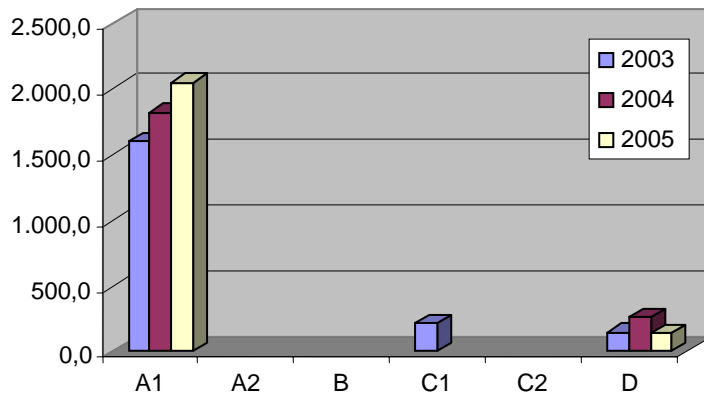
The most represented aid instrument in this area was direct subsidies, followed by occasional soft loans and state guarantees. The CCA has no knowledge of any debt write-offs and other forms of state aid which might have been awarded by the competent ministry or the Croatian Government to firms in difficulty in the agricultural sector including the food industry, given that state aid to the above mentioned sectors is not covered by the State Aid Act and is consequently not subject to the CCA assessment procedure.

Table 11: Total state aid and share of aid to agriculture and fisheries in 2003, 2004 and 2005

Agriculture and fisheries	2003		2004		2005		Index in %	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR	2005/2003	2005/2004
Total state aid	6.030,6	797,3	5.752,5	767,5	6.514,2	880,3	108,02	113,24
Aid less agriculture and fisheries	4.080,2	539,5	3.678,7	490,8	4.332,2	585,4	106,18	117,76
Aid to agriculture and fisheries	1.950,4	257,9	2.073,8	276,7	2.182,0	294,9	111,88	105,22
Share (%) in total state aid	32,34%		36,05%		33,50%		103,57	92,92
Share (%) in GDP	1,03%		1,00%		0,95%		92,34	95,11

Source: Ministry of Finance, data processed in CCA.

Picture 6: State aid to agriculture and fisheries by aid instruments⁹ in 2003, 2004 and 2005 in mil HRK



Source: Ministry of Finance, data processed in CCA.

During the report period 2003 – 2005 a continuous upward trend has been established in respect of state aid to agriculture and fisheries granted in the form of subsidies, whereas when total of state aid is taken into account, negligent amounts of state aid has been granted in the form of soft loans and state guarantees. In 2004 subsidies rose by 28.4% in comparison to 2003 while in 2005 they increased by 12.6% compared to 2004.

By comparison, the share of state aid to agriculture and fisheries in the total state aid in the EU Member States amounts to 23.8%.

⁹ A1 (grants), 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)

4. MANUFACTURING AND SERVICES

When, on the grounds of the above mentioned reasons, total state aid is shown less aid to agriculture and fisheries, the major part of state aid has traditionally been allocated to manufacturing and services sector (93% in 2005), whereas a much lower share is attributed to regional aid and aid at the local level (3.1% in 2005). Nevertheless, it must be taken into account, that the data and reports received by the CCA from the ministries and other public authorities are considered credible and more reliable than the documents and the relevant data submitted by the local and regional administrations which still fail to communicate complete and updated data. Therefore, the latter cannot be regarded as reliable and may not be taken for granted.

In 2005 state aid granted to the manufacturing and services sector amounted to 4.029,0 million HRK or 544,5 million EUR, which is 26.3% more than in 2004. This increase of state aid in the report period is mainly in the area of transport, the share of which amounted to more than 60% (2.435,4 HRK) of the above mentioned total.

The selectivity principle in granting state aid was abandoned in 2004 and more state resources have been redirected to state aid which is not only compatible with the EU state aid system but is also to the advantage of the economy as a whole, and in the long run, contribute to promotion of the competitiveness of Croatian economy. 2005 was characterized by a significant increase of state aid to the transport sector, which should also have positive effects on the rest of the economy, taking into account that the development of the transport infrastructure is one of the basic prerequisites for the development of entrepreneurship.

At the same time, although the share of horizontal state aid increased in 2004, and it was considered to be an indicator of abandonment of the selectivity principle in granting state aid, the figures in 2005 showed a certain decrease in state aid awards to horizontal objectives when compared with sector-specific aid. Nevertheless, taking into account a number of aid schemes to horizontal objectives (employment, research and development, SMEs etc.) which have been authorized during 2005 and 2006, it is realistic that the above positive upward trend relating to state aid with horizontal objectives may be expected again in 2006.

Table 12: State aid less agriculture and fisheries in 2003, 2004 and 2005

Category	2003			2004			2005		
	mil HRK	mil EUR	share (%)	mil HRK	mil EUR	share (%)	mil HRK	mil EUR	share (%)
Manufacturing and services	3.701,8	489,4	90,73	3.189,4	425,5	86,70	4.029,0	544,5	93,00
<i>Horizontal objectives</i>	991,9	131,1	24,31	1.383,2	184,5	37,60	1.593,6	215,4	36,78
<i>Specific sectors</i>	2.709,9	358,3	66,42	1.806,2	241,0	49,10	2.435,4	329,1	56,22
Regional state aid	89,2	11,8	2,19	137,0	18,3	3,72	169,5	22,9	3,91
State aid at local level	289,2	38,2	7,09	352,3	47,0	9,58	133,7	18,1	3,09
TOTAL	4.080,2	539,5	100,00	3.678,7	490,8	100,00	4.332,2	585,4	100,00

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

4.1. HORIZONTAL AID

The shift in aid towards horizontal objectives indicates that since 2003, when the share of horizontal aid amounted to some 1 billion HRK and subsequently increased to 1.6 billion HRK in 2005, there has been a change of approach of aid providers and raising awareness that further growth and development can be ensured only through measures and instruments which allow advantages to a larger number of undertakings and produce long-term positive effects.

The data on granted horizontal aid indicate that rescue and restructuring process in Croatia has not yet been completed. In 2005 the most part (31.4% or 500 million HRK) of the total aid granted in this category was earmarked for restructuring. Employment and training aid follow with 27.3%.

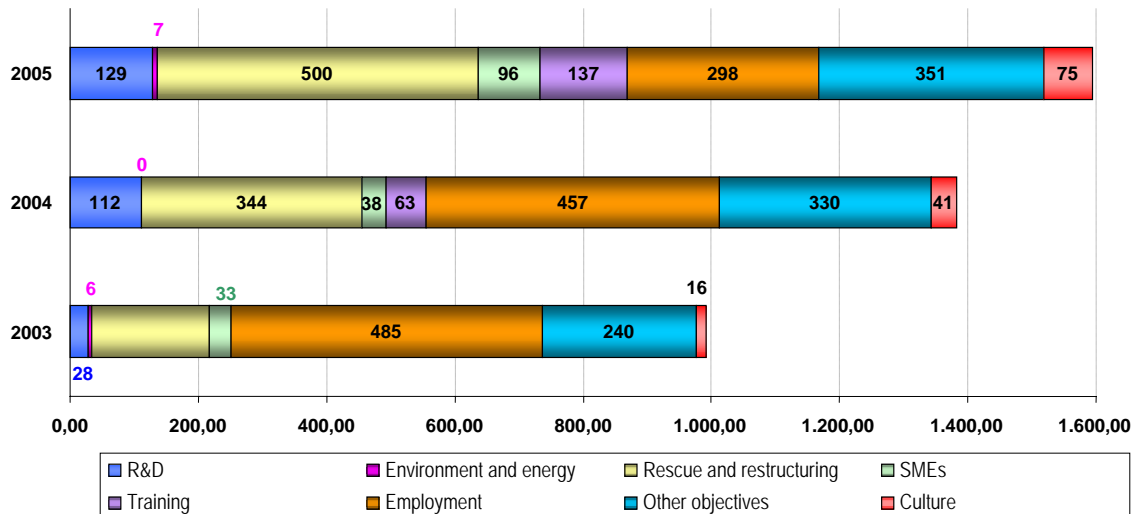
Interest rebates for different purposes which are authorized by the Croatian Bank for Reconstruction and Development (HBOR) on the basis of its development programmes are specified in the table below as "other objectives" which in absolute terms amounted to 351,2 million HRK or 22% of the total horizontal aid granted.

Table 13: Horizontal aid in the Republic of Croatia in 2003, 2004 and 2005

Horizontal aid	2003			2004			2005		
	mil HRK	mil EUR	Share in GDP (%)	mil HRK	mil EUR	Share in GDP (%)	mil HRK	mil EUR	Share in GDP (%)
R&D	27,8	3,7	0,01%	111,5	14,9	0,05%	129,3	17,5	0,06%
Environmental protection and energy saving	6,0	0,8	0,00%	0,0	0,0	0,00%	6,9	0,9	0,00%
Rescue and Restructuring	184,2	24,4	0,10%	343,8	45,9	0,17%	499,8	67,5	0,22%
SMEs	32,8	4,3	0,02%	37,5	5,0	0,02%	96,3	13,0	0,04%
Training	0,0	0,0	0,00%	62,6	8,4	0,03%	137,2	18,5	0,06%
Employment	485,0	64,1	0,26%	456,8	60,9	0,22%	297,7	40,2	0,13%
Culture	16,1	2,1	0,01%	41,0	5,5	0,02%	75,3	10,2	0,03%
Other objectives	240,0	31,7	0,13%	330,0	44,0	0,16%	351,2	47,5	0,15%
TOTAL	991,9	131,1	0,52%	1.383,2	184,5	0,67%	1.593,6	215,3	0,70%

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

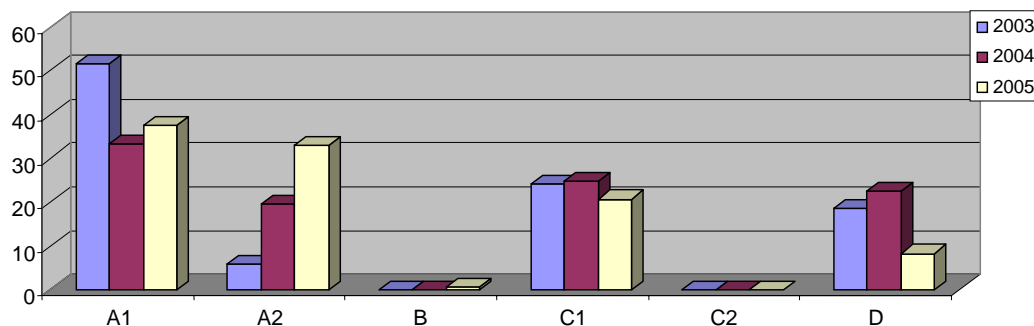
Picture 7: Horizontal aid in 2003, 2004 and 2005 in million HRK



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

It can be observed that the share of horizontal aid in the total state aid granted has been slightly but continuously rising since 2003. In 2003 this share was 16.5%, in 2004 it rose to 24% and in 2005 it amounted to 24.5%.

Picture 8: Horizontal aid by aid instruments¹⁰ in 2003, 2004 and 2005 in %



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

The most often used aid instrument in 2005 was as indicated above subsidies (37.5%). On the other hand, it is obvious that the share of tax exemptions which amounted to almost the same percentage (32.8%) has significantly risen in 2005. Soft loans represented 20.7% of all aid instruments.

¹⁰ A1 (grants), 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)

4.1.1. Small and medium-sized enterprises

State aid to SMEs is earmarked for investment in tangible and intangible assets, consultancy and other services and participation in fairs and exhibitions. In accordance with the Regulation it may not be granted to undertakings in the shipbuilding and maritime transport sector.

In areas eligible for regional state aid the aid intensity will not exceed the ceiling of regional investment aid determined by the regional map, provided 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% and it does not contain any aid.

The level of state aid to SMEs is calculated as a percentage of the investment's eligible costs or as a percentage of the wage costs of employment created by the carrying out of an investment.

In cases where the aid is calculated on the basis of jobs created it is necessary that the following criteria are satisfied: job creation must be linked to the carrying out of the investment project and jobs must be created within three years of the investment's completion, the investment project must lead to a net increase in the number of employees in the establishment concerned, compared with the average over the previous twelve months, and the employment created must be maintained during a minimum period of five years.

Eligible costs of state aid to SMEs are as follows: initial investment's costs (eligible costs of tangible investment: land, buildings and equipment and intangible investment such as acquisition of patents, operating or patented know-how licences, unpatented know-how, job creation costs and wage costs for the jobs created and linked to the investments over a period of two years.

The purpose of state aid to SMEs is to promote and encourage small and medium-sized business start-ups and to facilitate investment. Therefore the state aid rules in this particular area are much more flexible than the relevant rules applicable to large companies.

The data indicated in Table 14 show the positive trend in granting state aid to SMEs in Croatia since 2003. During the last three years the necessity to invest into and importance to encourage the development of small and medium-sized entrepreneurship has been recognized and resulted in a constant increase of the public resources granted under this aid category.

Table 14: State aid to SMEs in 2003, 2004 and 2005

SMEs	2003		2004		2005	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 subsidies	32,8	4,3	37,5	5,0	96,3	13,0
TOTAL	32,8	4,3	37,5	5,0	96,3	13,0
share (%) in horizontal objectives	3,31%		2,71%		6,04%	
share (%) in total state aid (less agriculture and fisheries)	0,80%		1,02%		2,22%	
share (%) in total state aid	0,54%		0,65%		1,48%	
share (%) in GDP	0,02%		0,02%		0,04%	

Source: Ministry of Finance, data processed in CCA.

An amount of 32,8 million HRK state aid to SMEs has been awarded in Croatia in 2003, which was 0.5% of the total state aid granted. In 2004 37,5 million HRK has been awarded or 0.7% of the total state aid, whereas in 2005 there was 96,3 million HRK state aid to SMEs or 1.5% of the total state aid. The most represented aid instruments were subsidies, guarantees by the Croatian Agency for Small Entrepreneurship (HAMAG) and interest rebates by the Croatian Bank for Reconstruction and Development (HBOR).

As stated above, it is evident that the share of state aid to SMEs has been constantly rising in the past three years, whereby the amount awarded in 2005 was three times the state aid level awarded in 2003.

State aid to SMEs has been granted under the programmes (aid schemes) of the Ministry of the Economy, Labour and Entrepreneurship, Ministry of the Sea, Tourism, Transport and Development, Ministry of the Family, Veterans and Intergenerational Solidarity, HBOR, HAMAG and at the level of local and regional administrations.

4.1.2. Rescue and restructuring

Within the meaning of the rules laid down under the Regulation, state aid for rescuing and restructuring is aimed at firms in difficulty.

A firm is considered to be in difficulty where it is unable, whether through its own resources or with the funds it is able to obtain from its owner/shareholders or creditors, to stem losses which, without outside intervention by the public authorities, will almost certainly condemn it to going out of business. A newly created firm is not eligible for rescue or restructuring aid, where a new firm emerges from the liquidation of a previous firm or where it is a part of a large business group. State aid for rescuing and restructuring may not, as a rule, be granted to undertakings in the steel manufacturing sector.

In order to be approved rescue aid must: consist of liquidity support in the form of loan guarantees or loans; in both cases, the loan must be granted at an interest rate at least comparable to those observed for loans to healthy firms; any loan must be reimbursed and any guarantee must come to an end within a period of not more than 12 months after the disbursement of the last instalment to the firm; be warranted on the grounds of serious social difficulties; must be accompanied by a restructuring plan no later than six

months after the first implementation of a rescue aid measure; be restricted to the amount needed to keep the firm in business for the period during which the aid is authorised; respect the one time last time condition.

Restructuring aid is a part of the restructuring plan which must restore the long-term viability of the firm on the basis of realistic assumptions as to future operating conditions. Restructuring aid must therefore be linked to a viable restructuring plan which must describe the circumstances that led to the company's difficulties, provide how to resolve the difficulties, financial resources, duration and economic and social consequences of restructuring. The amount and intensity of the aid must be limited to the strict minimum of the restructuring costs necessary to enable restructuring 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 from their own resources. Restructuring aid may be granted after not less than 10 years have elapsed since the last restructuring aid.

The cap amount of state aid for rescue and/or restructuring may not exceed the permissible 75 million HRK, after the cumulation with other types of state aid on the basis of an aid scheme. Higher levels of state aid may be granted only on the basis of a particular restructuring plan and the relevant authorisation within the meaning of the State Aid Act.

The state aid data indicate that aid for rescuing and restructuring has been permanently granted by aid providers. In 2005 aid in question amounted to 500 million HRK, whereas in 2003 the amount of aid for the same purpose was about 184 million HRK.

Table 15: State aid for rescuing and restructuring firms in difficulty in 2003, 2004 and 2005

Rescue and restructuring	2003		2004		2005	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	0,0	0,0	22,4	3,0	357,4	48,3
B equity participation	0,0	0,0	0,0	0,0	10,3	1,4
C1 soft loans	0,0	0,0	12,2	1,6	0,0	0,0
D guarantees	184,2	24,4	309,2	41,3	132,1	17,8
TOTAL	184,2	24,4	343,8	45,9	499,8	67,5
share (%) in horizontal objectives	18,57%		24,86%		31,36%	
share (%) in total state aid (less agriculture and fisheries)	4,51%		9,35%		11,54%	
share (%) in total state aid	3,05%		5,98%		7,67%	
share (%) in GDP	0,10%		0,17%		0,22%	

Source: Ministry of Finance, data processed in CCA.

In 2005 the share of state aid for rescue and restructuring increased by 45.4% compared to 2004. The same share was by some 171% higher than in the year 2003.

In 2003 and 2004 the major part of rescue and restructuring aid has been granted in the form of state guarantees, whereas in 2005 the prevailing form of aid were subsidies which amounted to 357,4 million HRK or 71.5% of the total rescue and restructuring aid

granted, followed by equity participation in the amount of 10,3 million HRK or 2.1% and guarantees which amounted to 132,1 million HRK or 26.4%.

The undertakings which asked for the approval of the CCA and have been granted aid for rescue and restructuring in 2005 are Slavonija modna konfekcija d.d. Osijek, Papuk d.d. Pakrac and Borovo d.d. from Vukovar.

4.1.3. Training

Training aid is earmarked for tuition in the form of specific training and general training of employees.

Within the meaning of the Regulation specific training means training involving theoretical and practical knowledge applicable to the employee's present or future position in the assisted firm, whereas general training involves acquisition of general knowledge which is applicable to the employee's present or future position in the assisted firm, but which is transferable to other firms or fields of work and thereby substantially improve the employability of the employee.

The eligible costs of a training aid project are: trainers' personnel costs, trainers' and trainees' travel expenses, other current expenses, depreciation of tools and equipment, to the extent that they are used exclusively of the training project, cost of guidance and counselling services with regard to the training project and trainees' personal costs up to the amount of the total of the other eligible costs referred to above.

State aid granted in the maritime transport sector may reach an intensity of 100%, whether the training project concerns specific of general training, provided that the trainee is not an active member of the crew, and the training is carried out on board ships entered in the Croatian Register of Shipping.

Table 16: Training aid in 2003, 2004 and 2005

Training	2004		2005	
	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	0,0	0,0	6,8	0,9
A2 tax exemptions	62,6	8,4	130,4	17,6
TOTAL	62,6	8,4	137,2	18,5
share (%) in horizontal objectives	4,53%		8,61%	
share (%) in total state aid (less agriculture and fisheries)	1,70%		3,17%	
share (%) in total state aid	1,09%		2,11%	
share (%) in GDP	0,03%		0,06%	

Source: Ministry of Finance, data processed in CCA.

In 2005 the amount of 137,2 million HRK has been granted in the form of training aid, whereas in 2004 the level of training aid amounted to 62,6 million HRK. In 2005 aid instruments were subsidies (6,8 million HRK) and tax exemptions (130,4 million HRK).

4.1.4. Culture

Within the meaning of the Regulation, State aid to promote culture and heritage preservation involves cultural support schemes which are aimed at preserving national heritage, whereby aid providers must provide evidence on the importance of the project for the preservation of national heritage and culture.

State aid to promote audiovisual industry may be granted provided that the aid is directed to a cultural product (the content of the aided production is cultural), aid intensity is limited to 50% of the production budget and the producer (right-holder) is free to spend at least 20% of the film budget outside the territory of the Republic of Croatia.

Table 17: State aid to promote culture in 2003, 2004 and 2005

Culture	2003		2004		2005	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	in mil EUR
A1 grants	16,1	2,1	40,3	5,4	75,1	10,1
D guarantees	0,0	0,0	0,7	0,1	0,2	0,0
TOTAL	16,1	2,1	41,0	5,5	75,2	10,2
share (%) in horizontal objectives	1,62%		2,96%		4,72%	
share (%) in total state aid (less agriculture and fisheries)	0,39%		1,11%		1,74%	
share (%) in total state aid	0,27%		0,71%		1,16%	
share (%) in GDP	0,01%		0,02%		0,03%	

Source: Ministry of Finance, data processed in CCA.

In 2005 the total of 75,2 million HRK of state aid to promote culture and heritage preservation was awarded. This is 83.4% more than in 2004 when 41,0 million HRK had been granted, 367.1% (!) more than in 2003 when this amount was 16,1 million HRK. The share of aid to promote culture in the total aid granted in 2005 was 1.2%, and the same share to GDP was 0.03%. The aid in question was granted almost exclusively in the form of subsidies and they were directed to: publishing of books and magazines, international cooperation programmes, multimedia programmes, promotion of young and alternative cultures, literal events, visual arts programmes, cinematographic industry and satellite broadcasting program.

4.1.5. Other objectives

State aid in this section is granted under the Loan Programmes¹¹ which provide financial support under favourable terms and interest rebates for credits authorised by the Croatian Bank for Reconstruction and Development (HBOR).

State aid in this area continually grows. In 2003 it amounted to 240,0 million HRK, in 2004 it was 330,0 million HRK and in 2005 the figure was 351,2 million HRK. The share of this aid to GDP is some 0.2%.

¹¹ For example, Loan Programme for the Development of SMEs, Loan Programme for the Development of Islands, Loan Programme for Small Family Businesses in Tourism (Incentives for Success), Loan Programme for Pre-Season Preparation of Tourist Facilities etc.

Aid instruments in this area in 2005 were subsidies in the amount of 21,2 million HRK or 6.0%, and soft loans in the amount of 330,0 million HRK which is 94% of the total aid with other objectives.

Table 18: Share of aid with other objectives in 2003, 2004 and 2005

Other objectives	2003		2004		2005	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	0,0	0,0	0,0	0,0	21,2	2,9
C1 soft loans	240,0	31,7	330,0	44,0	330,0	44,6
TOTAL	240,0	31,7	330,0	44,0	351,2	47,5
share (%) in horizontal objectives	24,20%		23,86%		22,04%	
share (%) in total state aid (less agriculture and fisheries)	5,88%		8,97%		8,11%	
share (%) in total state aid	3,98%		5,74%		5,39%	
share (%) in GDP	0,13%		0,16%		0,15%	

Source: Ministry of Finance, data processed in CCA.

4.2. SECTOR-SPECIFIC AID

In line with the Regulation, and subordinately the EC acquis, separate state aid rules apply in the following sectors: steel manufacturing, land, maritime and air transport sector, shipbuilding, tourism, financial services etc.

In granting state aid, and subject to the provisions under the Regulation, the sectors concerned may apart from the aid which must be compatible with the separate state aid rules in question also receive state aid to horizontal objectives and regional aid.

In 2005 there was a significant upward trend concerning sector-specific aid. The aid level in question reached the level of some 2,4 million HRK, which is an increase of 35% compared with 2004, but still almost 300 million HRK less than in 2003. The highest share of sector-specific aid in 2005 was that of the transport sector (some 66%), followed by shipbuilding (21%) and tourism (7.7%).

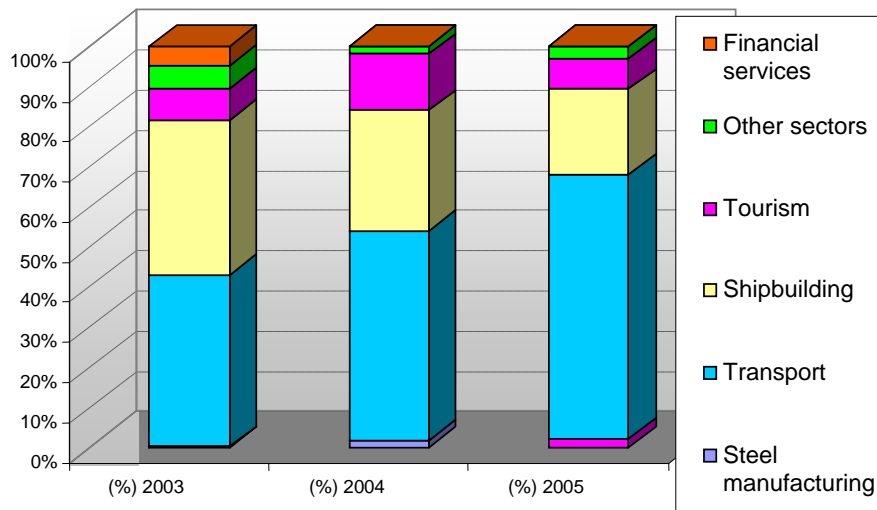
Table 19: Sector-specific aid in 2003, 2004 and 2005

Specific sectors	2003			2004			2005		
	mil HRK	mil EUR	Share in GDP (%)	mil HRK	mil EUR	Share in GDP (%)	mil HRK	mil EUR	Share in GDP (%)
Steel production	4,4	0,6	0,00%	29,4	3,9	0,01%	51,8	7,0	0,02%
Transport	1.157,6	153,1	0,61%	946,6	126,3	0,46%	1.601,3	216,4	0,70%
Shipbuilding	1.046,8	138,4	0,55%	540,3	72,1	0,26%	519,8	70,2	0,23%
Tourism	213,2	28,2	0,11%	254,4	33,9	0,12%	188,3	25,4	0,08%
Other sectors	157,9	20,9	0,08%	35,6	4,7	0,02%	74,2	10,0	0,03%
Financial services	130,0	17,2	0,07%	0,0	0,0	0,00%	0,0	0,0	0,00%
Total	2.709,9	358,3	1,43%	1.806,2	241,0	0,87%	2.435,4	329,1	1,06%

Source: Ministry of Finance, data processed in CCA.

Since 2003 a downward trend of state aid to shipbuilding is evident. State aid which was granted in the amount of 1.1 billion HRK in 2003, decreased to the level of some 520 million HRK in 2005. At the same time an upward trend of state aid to steel and iron industry as well as to the transport sector is obvious. The structure of aid to transport reveals that the major line item was state aid granted to the railways (Hrvatske željeznice) which amounted to no less than 56% of the aid granted to transport sector.

Picture 9: Sector-specific aid in 2003, 2004 and 2005



4.2.1. Steel

State aid to the steel industry is subject to the rules laid down in the State Aid Act, Regulation and in Protocol 2 on steel products (SAA). Article 5 of the Protocol provides for the conditions under which rescue and restructuring aid may be granted to the steel sector in Croatia provided that the National Restructuring Programme of the Steel Industry is adopted by the end of 2006. Within the meaning of Article 5 (3) of Protocol 2, the Republic of Croatia may, exceptionally, in the period within the next five years (until March 2007) authorize state aid for restructuring in the steel industry under the following conditions:

- long-term viability of the undertaking concerned must be ensured – after the conclusion of the restructuring period the undertaking must be able to operate under normal market conditions without aid;
- aid must be restricted to the minimum amount necessary to restore the firm's long term 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 must be achieved in accordance with the restructuring plan and connected to global rationalization.

According to the data available to the Agency state aid to the steel sector has been mainly granted in the form of state guarantees to *Željezara Split (Split Iron Works)* and *Valjaonica cijevi Sisak (Sisak Rolling Mill)*.

In 2003 the undertakings in question were authorised state guarantees in the amount of 4,4 million HRK, in 2004 this guarantees amounted to 29,4 million HRK, whereas in 2005 state guarantees to the same undertakings were 51,8 million HRK.

Table 20: State aid to steel manufacturing sector in 2003, 2004 and 2005

Steel production	2003		2004		2005	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
D guarantees	4,4	0,6	29,4	3,9	51,8	7,0
TOTAL	4,4	0,6	29,4	3,9	51,8	7,0
share (%) in specific sectors	0,16%		1,63%		2,13%	
share (%) in total state aid (less agriculture and fisheries)	0,11%		0,80%		1,20%	
share (%) in total state aid	0,07%		0,51%		0,80%	
share (%) in GDP	0,002%		0,014%		0,023%	

Source: Ministry of Finance, data processed in CCA.

4.2.2. Shipbuilding

State aid rules in the area of shipbuilding apply to undertakings engaged in shipbuilding, ship repair and ship conversion and undertakings directly or indirectly connected to the undertakings in question. Under the rules on aid to shipbuilding "self-propelled seagoing commercial vessels" mean vessels of not less than 100 gt used for the transportation of passengers and/or goods, vessels of not less than 100 gt for the performance of specialised service, tugs of not less than 365kW, fishing vessels of not less than 100 gt and unfinished shells of the abovementioned vessels that are afloat and mobile.

Aid to shipbuilding in 2005 amounted to 519,8 million HRK (about 8% of the total state aid granted). In 2004 aid to shipbuilding was granted in the amount of 540,3 million HRK, whereas in 2003 this aid amounted to 1.05 billion HRK. It is evident that aid to shipbuilding in absolute terms has been progressively reduced as well as its share in the GDP. In 2003 the share of aid to shipbuilding to GDP was 0.6%, in 2004 0.3% and in 2005 0.2%.

Aid instruments in the area concerned are grants and state guarantees¹². Subsidies are earmarked for the promotion of shipbuilding in Croatian shipyards, and amount, in accordance with the Ordinance on subsidies to shipbuilding, to about 10% of the ship contract value.

¹² The indicated data must be taken in respect of the calculation of aid in the form of direct subsidies based on the data received from the Ministry of Finance and the calculation of aid in the form of state guarantees granted (method used by the Agency is described on page 38 of this report). Nevertheless, under the strict application of the EC rules in this area, if all issued guarantees (end-financing and construction financing guarantees) were calculated as state aid to shipyards in difficulty, the amount of state aid to Croatian shipyards would be significantly higher than the one calculated and indicated on the basis of the method used by the Agency.

Table 21: Aid to shipbuilding by aid instruments in 2003, 2004 and 2005

Shipbuilding	2003		2004		2005	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	468,7	62,0	504,8	67,4	444,4	60,1
B equity participation	0,0	0,0	0,0	0,0	20,8	2,8
C1 soft loans	507,5	67,1	0,0	0,0	0,0	0,0
D guarantees	70,6	9,3	35,5	4,7	54,5	7,4
TOTAL	1.046,8	138,4	540,3	72,1	519,8	70,2
share (%) in specific sectors	38,63%		29,91%		21,34%	
share (%) in total state aid (less agriculture and fisheries)	25,66%		14,69%		12,00%	
share (%) in total state aid	17,36%		9,39%		7,98%	
share (%) in GDP	0,55%		0,26%		0,23%	

Source: Ministry of Finance, data processed in CCA.

The following table shows the total of end-financing and construction financing guarantees granted in the shipbuilding sector in 2003, 2004 and 2005. Construction financing guarantees are released for the purpose of ship construction, until the moment of delivery of the ship. In the past three years no construction financing guarantee has been invoked.

Table 22: End-financing and construction-financing guarantees granted in the shipbuilding sector (in mil HRK)

Year	End-financing	Construction-financing
2003	776,4	2.721,6
2004	174,6	4.773,6
2005	629,8	3.458,3

Source: Ministry of Finance, data processed in CCA.

As mentioned in footnote 12, the calculation of state aid granted to the shipbuilding sector did not involve all state guarantees granted nor was the award of the guarantees in question in 2005 compatible with the state aid rules.

In the forthcoming period it is necessary to introduce changes to the existing aid award system, carry out the overall restructuring of Croatian shipyards and grant any future aid in compliance with the relevant rules which promote innovation in shipbuilding, technological reconstruction and overall competitiveness.

For the sake of comparison, state aid to shipbuilding in the EU shows a downward trend. The amount of aid granted to shipbuilding in the period from 2000 to 2002 which met the annual average of 1.127 billion EUR, decreased to 690 million EUR in the period from 2002 to 2004. The highest amount of aid - more than 1 billion EUR - was granted in 2000 in Spain for restructuring of the public shipyard. In 2004 EU-25 awarded 540

million EUR aid to shipbuilding, whereas the share of aid to shipbuilding in the EU-25 as a percentage of total aid was 27% in Germany, 25% in Italy and 22% in Poland.

4.2.3. Land, maritime and air transport

Land transport – State aid rules concerning land transport apply to undertakings engaged in the provision of services in railway and road transport and inland waterway transport, which also include SAA Protocol 6 rules. State aid to land transport may also be granted in compliance with the rules on horizontal aid and regional state aid.

Maritime transport – State aid rules concerning maritime transport apply to undertakings – ship owners and ship operators engaged in maritime transport.

Air transport – State aid rules concerning air transport apply to air carriers and other activities accessory to air transport which could benefit airlines such as flight schools, duty free shops, airport facilities, franchises and airport charges. Rules covering air transport do not apply to air craft production.

Table 23: State aid to the transport sector in 2003, 2004 and 2005

Transport	2003		2004		2005	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
Rail transport	450,1	59,5	433,7	57,9	857,1	115,8
Other land transport	44,3	5,9	52,1	7,0	266,4	36,0
Maritime transport	388,8	51,4	332,8	44,4	372,8	50,4
Air transport	152,0	20,1	100,0	13,3	75,4	10,2
TOTAL	1.035,2	136,9	918,6	122,6	1.571,7	212,4
Guarantees	122,4	16,2	28,0	3,7	29,6	4,0
TOTAL	1.157,6	153,1	946,6	126,3	1.601,3	216,4
share (%) in specific sectors	42,72%		52,41%		65,75%	
share (%) in total state aid (less agriculture and fisheries)	28,37%		25,73%		36,96%	
share (%) in total state aid	19,20%		16,45%		24,58%	
share (%) in GDP	0,61%		0,46%		0,70%	

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

In 2005 the transport sector received state aid in the amount of 1,6 million HRK, which is 25% of total state aid granted. Aid to the transport sector increased by some 70% compared with the year 2004.

The highest increase is indicated in state aid granted to railways (98%) which went up by more than 400 million HRK in comparison with 2004. This is followed by aid to other land transport (road transport) which rose more than fivefold in comparison with the previous year, whereas aid to maritime transport which consisted mainly of incentives to liner shipping and passenger fleet renewal increased by 12%.

The most part of aid in this sector has been granted to Hrvatske željeznice (*Croatian railways*). State aid in question was earmarked for the modernization of railways, subsidies for passenger railway transportation and combined transport as well as subsidies for payments to workers made redundant.

The main portion of state aid in the air transport sector referred to the rise in equity assets in Croatia Airlines.

Table 24: Aid to transport sector by aid instruments in 2003, 2004 and 2005 (in mil HRK)

	2003	2004	2005
A1 grants	879,9	816,7	1.418,1
B equity participation	75,0	101,9	100,2
C1 soft loans	80,3	0,0	53,3
D guarantees	122,4	28,0	29,6
Total	1.157,6	946,6	1.601,2

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

As indicated in Table 24, the most popular aid instruments in this sector are direct grants (88.5%), whereas state guarantees amount to only 1.8% of the total aid granted¹³.

¹³ This overview does not contain all financial transfers to the transport sector, for example road construction funds, necessary railway infrastructure etc, given that the issues in question do not constitute state aid.

4.2.4. Tourism

State aid to tourism industry is granted mainly through programmes (aid schemes) of the Ministry of the Sea, Tourism, Transport and Development with the aim of promotion of small and medium-sized enterprises in tourism, strengthening of competitiveness etc¹⁴.

Table 25: State aid to tourism by aid instruments in 2003, 2004 and 2005

Tourism	2003		2004		2005	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	118,8	15,7	62,7	8,4	58,3	7,9
B equity participation	0,0	0,0	0,0	0,0	9,0	1,2
C1 soft loans	1,4	0,2	18,6	2,5	29,2	3,9
D guarantees	93,0	12,3	173,1	23,1	91,8	12,4
TOTAL	213,2	28,2	254,4	33,9	188,3	25,4
share (%) in specific sectors	7,87%		14,08%		7,73%	
share (%) in total state aid (less agriculture and fisheries)	5,23%		6,91%		4,35%	
share (%) in total state aid	3,54%		4,42%		2,89%	
share (%) in GDP	0,11%		0,12%		0,08%	

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

In 2005 tourism received 188,3 million HRK state aid which is some 25% less than in the previous year.

Tourism mainly receives state aid in the form of guarantees (some 92 million HRK or 49%), direct subsidies (31%) and soft loans (15,5%). The latter show an upward trend in comparison with the previous two years.

4.2.5. Financial services

Equity participation data in 2003 as indicated in the following Table are in respect of equity shares of Hrvatska poštanska banka. In 2004 and 2005 there was no state aid recorded in the financial services sector.

Table 26: State aid to financial services in 2003

Financial services	2003	
	mil HRK	mil EUR
B equity participation	130,0	17,2
TOTAL	130,0	17,2
share (%) in specific sectors	4,80%	
share (%) in total state aid (less agriculture and fisheries)	3,19%	
share (%) in total state aid	2,16%	
share (%) in GDP	0,07%	

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

¹⁴ Programmes of the Ministry of the Sea, Tourism, Transport and Development are as follows: Programme for employment, promotion of development of SMEs and combat of grey economy (SMEs), Programme for subsidizing organized foreign and domestic tourist transport (all undertakings), Programme "Incentives for Success" (SMEs).

4.2.6. Other services

In 2005 state aid was granted for the deconstruction of the companies Koksar d.o.o. Bakar and TEF Šibenik. Soft loan was granted for the recovery of the undertaking Diona d.d. in bankruptcy, guarantees and subsidies were granted to Hrvatske pošte. The amounts also include write-offs on the part of Croatian Privatization Fund and non-repayable financial aid to undertakings authorised by the Croatian Agency for Small Entrepreneurship.

Total state aid in this category has been appreciably reduced in 2004 compared with 2003, while in 2005 the total state aid to other services amounted to 74,2 million HRK, which is a 1.14% share in the total state aid granted or 0.03% of the GDP.

Table 27: State aid to other sectors by aid instruments in 2003, 2004 and 2005

Other services	2003		2004		2005	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	35,6	4,7	30,6	4,1	39,9	5,4
B equity participation	0,0	0,0	0,0	0,0	11,5	1,6
C1 soft loans	122,3	16,2	5,0	0,7	22,9	3,1
TOTAL	157,9	20,9	35,6	4,7	74,2	10,0
share (%) in specific sectors	5,83%		1,97%		3,05%	
share (%) in total state aid (less agriculture and fisheries)	3,87%		0,97%		1,71%	
share (%) in total state aid	2,62%		0,62%		1,14%	
share (%) in GDP	0,08%		0,02%		0,03%	

Source: Ministry of Finance, data processed in CCA.

5. REGIONAL AID

Regional aid is designed to develop the less-favoured regions of the Republic of Croatia¹⁵. It may be granted for initial investment, while in exceptional cases it may be granted in order to compensate for a part of operating costs. It may not be granted for the production of steel products. Regional aid 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 of three years in the region concerned.

The ceilings of regional aid may be raised by the supplements for SMEs by 10% to 15%, whereby the final ceiling does not apply to the transport sector.

As already mentioned above, the whole territory of the Republic of Croatia was, within the meaning of Article 70 of the SAA, until 1 January 2006 considered one region – an area where the standard of living is abnormally low or where there is serious underemployment. This consequently enabled higher levels of state aid which were awarded to undertakings.

In spite of the raising trend in this aid category, considerably lower amounts of aid than those legally applicable under the state aid rules and the provision of Article 70 of the SAA have been granted in the report period.

Table 28: Regional aid by aid instruments¹⁶ in 2003, 2004 and 2005

Regional aid	2003		2004		2005	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
Regional aid	89,2	11,8	137,0	18,3	169,5	22,9
share (%) in total state aid (less agriculture and fisheries)	2,19%		3,72%		3,91%	
share (%) in total state aid	1,48%		2,38%		2,60%	
share (%) in GDP	0,05%		0,07%		0,07%	

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

Although appreciably lower amounts of state aid have been granted in the Republic of Croatia compared with the EU average (13.1%), there has been an upward trend of regional aid in the report period. Regional aid in 2005 raised by 24% compared with the previous year, while if compared to the year 2003 by 90%. At the same time the share of regional aid in the total state aid rose from 1.5% in 2003 to 2.6% in 2005. In the forthcoming period the growth in regional aid is expected, particularly after the adoption of the new Investment Promotion Act and the approximation of other relevant legislation – Act on Areas of Special State Concern and Act on Reconstruction and Development of the Town of Vukovar, which will in line with the State Aid Act and Regulation on state

¹⁵ Regional state aid is granted pursuant to the Act on Areas of Special State Concern, Act on Hilly and Mountainous Areas, Islands Act, Profit Tax Act, Investment Promotion Act, Free Zones Act and Act on Reconstruction and Development of the Town of Vukovar.

¹⁶ A1 (grants), A2 (tax relief, tax exemption, tax and contributions remission and tax allowances).

aid, ensure higher state aid levels and incentives to undertakings than those currently applicable.

Aid instruments in this three-year report period have been grants and tax exemptions.

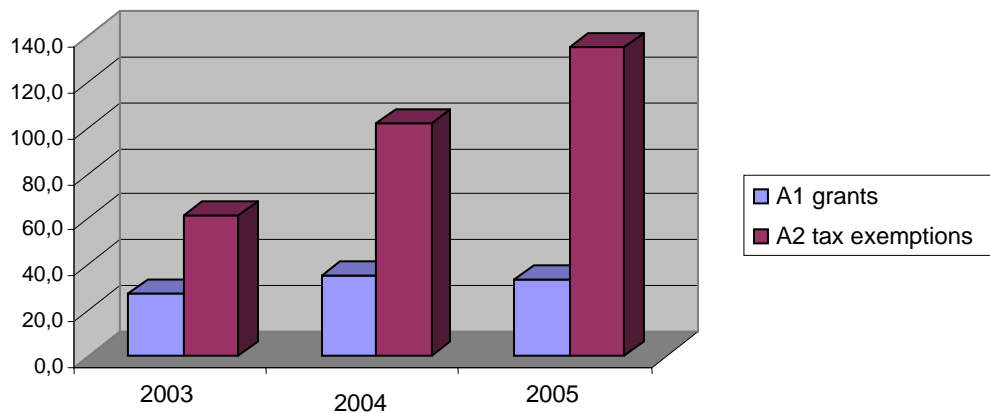
The share of tax exemptions provided for by the incentives under the Profit Tax Act is still significant and it shows a growing trend throughout the three-year report period.

Table 29: Regional aid by aid instruments¹⁷ in 2003, 2004 and 2005

Instrument	2003	2004	2005	Index 04/03	Index 05/03	Index 05/04
A1	27,5	34,9	33,8	126,91%	122,91%	96,85%
A2	61,7	102,1	135,7	165,48%	219,98%	132,94%
TOTAL	89,2	137,0	169,5	153,59%	190,05%	123,74%

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

Picture 10: Share of regional aid by aid instruments¹⁸ in 2003, 2004 and 2005 in million HRK



¹⁷ A1 (grants), A2 (tax relief, tax exemption, tax and contributions remission and tax allowances)

¹⁸ A1 (grants), 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)

6. STATE AID AT LOCAL LEVEL

Data on state aid at local and regional level (granted by local and regional self-government units) indicate a lower share of this category of aid which fell from 352,3 million HRK in 2004 to 133,7 million HRK in 2005. This is appreciably less than the amount of aid recorded in this category in 2003 when state aid at local level amounted to 290 million HRK.

Nevertheless, the data available to the Agency do not reflect the real state of affairs in the area of state aid at the level of local administrations, when the activities which are carried out by the counties, cities and municipalities, particularly the larger ones, relating to the promotion of entrepreneurship are taken into account. The problem of the local aid providers who fail to communicate to the Agency data on state aid granted seems to raise concerns. The Agency's request for data submittal was answered only by 17 out of 20 counties, 88 out of 123 cities and 258 of a total of 420 municipalities.

Taking into account that a number of local administrations which failed to submit the relevant data on state aid granted in 2005, had submitted the data relating to state aid granted in 2004, such as for example the City of Zagreb, and for which it is known from the media that they have granted aid in 2005, it can be assumed that the data on state aid at local and regional level may be considered reliable and credible only after the State Aid Act has become enforceable by the local and regional self-government units, which still do not enforce the law in the area concerned in a satisfactory manner.

The Agency excluded the data relating to infrastructure investment incentives, which, as a rule, do not constitute state aid, as well as transfers of financial resources from the state budget to the local and regional self-government units, which also cannot be considered state aid.

Table 30: State aid at local level by aid instruments¹⁹

Aid at local level	2003		2004		2005	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	282,3	37,3	343,5	45,8	123,0	16,6
A2 tax exemptions	0,0	0,0	0,0	0,0	0,7	0,1
C1 soft loans	0,0	0,0	0,0	0,0	7,4	1,0
D guarantees	6,9	0,9	8,8	1,2	2,6	0,3
TOTAL	289,2	38,2	352,3	47,0	133,7	18,1
share (%) in total state aid (less agriculture and fisheries)	7,09%		9,58%		3,09%	
share (%) in total state aid	4,80%		6,12%		2,05%	
share (%) in GDP	0,15%		0,17%		0,06%	

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

¹⁹ A1 (grants), 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)

7. CROATIA COMPARED TO EU

Taking into account that EU scoreboards on state aid exclude aid to agriculture and fisheries as well as state aid to the transport sector, for the purpose of this report the same method has been used to enable the comparison of the Croatian data with the relevant EU indicators.

Given that the relevant EU data for 2005 were not available at the moment of the conclusion of this report, the comparison has been made using the relevant EU data for 2004.

Table 4: State aid in Croatia 2005 compared with EU Member States 2004

	2004			
	Total aid less railways		Total aid less transport, agriculture and fisheries	
	In million EUR	Share in GDP (%)	In million EUR	Share in GDP (%)
Croatia 2003	721,60	2,89	386,41	1,55
Croatia 2004	705,90	2,56	364,53	1,33
Croatia 2005	760,50	2,46	369,03	1,19
<i>EU-25</i>	<i>61.426,90</i>	<i>0,60</i>	<i>45.461,40</i>	<i>0,44</i>
<i>EU-15</i>	<i>56.207,90</i>	<i>0,57</i>	<i>41.987,10</i>	<i>0,43</i>
<i>New Member States</i>	<i>5.219,00</i>	<i>1,09</i>	<i>3.474,30</i>	<i>0,70</i>
BE	971,90	0,34	685,30	0,24
CS	351,80	0,41	164,90	0,19
DA	1.375,30	0,71	1.002,60	0,52
DE	17.235,50	0,78	15.128,30	0,69
ET	34,70	0,39	8,40	0,09
EL	472,70	0,29	329,60	0,20
ES	3.975,00	0,47	3.136,00	0,37
FR	8.915,00	0,54	6.348,40	0,39
IE	951,00	0,65	393,10	0,27
IT	7.037,20	0,52	5.414,60	0,40
CY	184,00	1,48	131,50	1,06
LV	43,50	0,39	17,40	0,16
LT	121,60	0,68	22,60	0,13
LU	78,50	0,31	43,50	0,17
HU	1.015,10	1,26	696,40	0,87
MT	134,10	3,10	117,30	2,71
NL	1.813,50	0,39	853,70	0,18
AU	1.426,70	0,61	524,20	0,22
PL	2.872,80	1,47	1.972,40	1,01
PT	1.474,90	1,09	1.114,30	0,83
SL	249,80	0,96	136,60	0,53
SK	211,70	0,64	207,00	0,63
FI	2.293,10	1,66	571,40	0,38
ŠE	2.745,50	0,99	2.231,40	0,80
UK	5.442,50	0,32	4.210,60	0,25

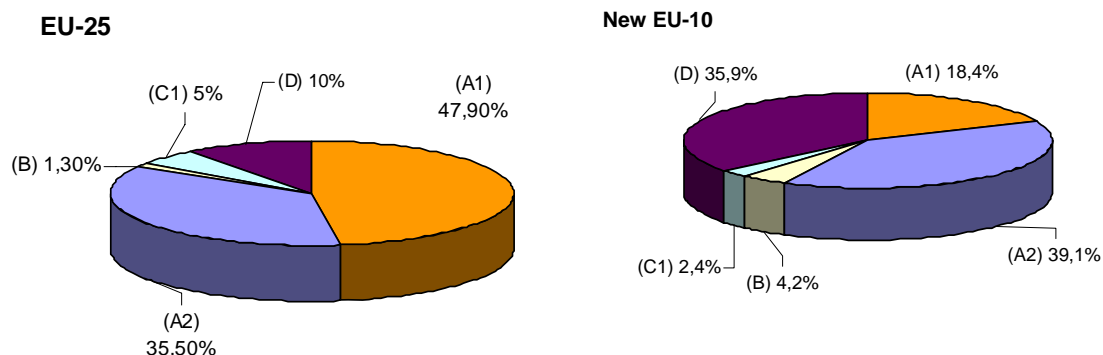
Source: DG Competition

For the sake of comparison, in 2004 the share of state aid (less aid to railways) to GDP in EU-25 was some 0.6%. The lowest share was held by Greece – 0.3%, whereas the highest share of state aid to GDP was recorded in Malta – 3.1%.

In the same year the share of state aid (less agriculture, fisheries and transport) to GDP in EU-25 was 0.4%, whereby Estonia held the lowest share of total aid as percentage to GDP – 0.1%, while Malta held the highest share – 2.7%.

The relevant indicators show that Croatia compared with particular EU Member States grants relatively low absolute amounts of state aid, especially when transport, agriculture and fisheries are excluded, whereas, on the other hand, its share of state aid in the GDP appreciably exceeds the relevant shares in EU Member States (excluding Malta).

Picture 4: Share of each aid instrument in EU in 2004 (less agriculture, fisheries and transport)²⁰



The EU state aid scoreboard shows that for the first time the share of subsidies has fallen below 50%, while tax exemptions rose to nearly 36%. The share of subsidies as aid instruments is the lowest in Belgium, Denmark, Estonia, Luxemburg and Austria.

In the EU the share of aid to horizontal objectives soared, particularly relating to aid for environmental protection and energy saving, which is directly linked to the decrease in sectoral aid of some EU Member States, especially in respect of coal production. Since 2004 the share of aid to horizontal objectives has risen to 43.3% of the total state aid (less railways). Most part of horizontal aid has been earmarked for environmental protection (18.5%), R&D (9%) and SMEs (9%) of the total state aid. EU-25 Member States' share of aid to horizontal objectives is above 50%, while in the new EU-10 Member States this share is below 50%.

²⁰ A1 (grants), 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)

7. CONCLUSION

Within the meaning of the State Aid Act, the data in this third annual report cover state aid granted in 2003, 2004 and 2005.

This annual report is 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 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.

2005 annual report indicates that the total share of state aid in the Croatian GDP has stayed almost the same as in 2004. Nevertheless, there is an ongoing upward trend concerning aid to horizontal objectives and regional aid. Certain fluctuations in state aid which were evident in the altogether positive trend of 2004, continued in 2005 particularly in the part relating to sectoral aid, due to the growth of aid granted to the transport sector. The rise of the financial support in question can be explained by the ongoing preparations of the transport sector for liberalisation, modernization and technological development of the sector concerned.

Like in the EU, the most represented aid instruments remain subsidies. Tax exemptions and tax credits indicate a continuous growth through the three-year period and the relevant amounts are similar to those granted in the EU. A downward trend in state guarantees is demonstrated.

Thus, although total state aid in 2005 expressed in relative amounts or its share in the GDP is comparable to aid levels in 2004, when agriculture, fisheries and transport are excluded, the indicators of reduction of the state aid share to GDP become more evident. The share of state aid (less agriculture and fisheries) in the GDP has been continuously decreasing from 1.55% in 2003 and 1.32% in 2004, to 1.19% in 2005.

In this period of preparation for EU accession, Croatia still exceeds the share of state aid to GDP in the new EU-10 Member States which is 0.70% and particularly the average of the EU-25 where the share of state aid to GDP amounts to 0.44%. Nevertheless, compared with certain new EU Member States, Croatia is approaching the desirable shares. In the forthcoming period, strong efforts must be made on the part of aid providers in order to reduce the overall state aid levels, particularly those relating to sectoral aid, reduce the burden of the tax payers and minimize the violation of competition rules. At the same time, the structure of state aid must be changed and its efficiency and effectiveness increased with the aim of the overall increase in economic efficiency and competitiveness, which is possible to achieve only by redirecting the state resources to horizontal objectives (such as research and development, environmental protection, training) and regional aid.

9. ANNEX 1

Aid instruments

A – Grants and tax exemptions, tax rate relieves and reduction in social security contributions

Grants and tax exemptions fall under this first group of aid instruments where aid is transferred in full to the recipient and constitutes state aid. This group is divided into two subgroups:

- **A 1** – grants (subsidies, interest rate subsidies, debt write-off)
- **A 2** – tax exemptions, tax rate relieves and reduction in social security contributions and other tax allowances such as different forms of profits tax reduction, as follows: (i) lower profit tax rates in the areas of special state concern, (ii) lower profit tax rates and tax relieves for tax payers in the area of the Town of Vukovar, (iii) lower profit tax rates and tax relieves for tax payers operating in free zones, (iv) lower profit tax rates as incentives for investment, (v) lower profit tax for the employment of disabled persons, (vi) reduction in tax base relating to R&D costs for the promotion of research and development.

Beside subsidies and tax exemptions, debt write-offs, claim write-offs and assumption of indebtedness by the state.

B – Equity participation

In order for the state to provide financial advantage to an undertaking, it may convert its claims into equity (equity participation). Here are particularly meant the following: equity injections by the state, the primary objective of which is not the creation of profit, conversion of debt into equity, sale of state property under favourable terms, participation in a company's profits etc. These are mainly granted to firms in difficulty receiving state support.

C – Soft loans and tax deferrals

- **C 1 – Soft loans** – loans given by the state, directly or through officially recognized organizations or commercial banks, to undertakings under the more favourable conditions than those obtainable on the market, such as lower interest rates, longer grace periods or favourable loan repayment schedule etc. Such loans are generally aimed at firms in difficulty which would not obtain loans on the market and are usually given by the Croatian Bank for Reconstruction and Development, Development and Employment Fund and Regional Development Fund.
- **C 2 – Tax deferrals** – indebtedness by undertakings which do not settle their financial obligations in the form of taxes or social security contributions which results in reduction of state revenue. Such indebtedness actually means that the state gives credits to certain undertakings and such tax deferral may be considered the same as indirect state aid received in the form of soft loans.

D – Guarantees

State guarantees cover commercial and non-commercial risks expressed in nominal amounts. State guarantees enable aid beneficiaries to obtain loans under more favourable conditions than those applicable on financial markets. Generally, an individual state guarantee does not constitute state aid if the borrower is not in financial difficulty, the borrower would in principle be able to obtain a loan on market condition from the financial markets without any intervention by the state, the guarantee is linked

to a specific financial transaction, is for a fixed maximum amount, is not open-ended, does not cover more than 80% of the financial obligation and the market price for the guarantee is paid. All the above listed criteria must be cumulatively met as to ensure that a state guarantee does not constitute state aid.

The aid instruments described above account for the vast majority of state aid usually granted in Croatia.

Methods of assessing the aid element

Group A1	
Grants	Total value of the grant received
Interest rate subsidies received directly by the recipient	Total value of the subsidies received (or unpaid interest)
Fundamental R&D projects	Total amount of funds allocated to such projects
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
Remission of loan-related debts for operating undertakings	The value of the written-off debt
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

Group A2	
Tax deferrals	Interest payable for the deferred period calculated at current values and based on the annual reference interest rate* (linear calculation method)
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
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

Group B	
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
Conversion of debt into equity (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
Sale of state property under favourable terms	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
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

Group 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)
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

Group C2	
All other instruments	The estimated value of the aid (e.g. tax debt)

Group 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%)
Revoked payments	Full payments of guaranteed obligations

10. ANNEX 2

Aid categories

Rules	Category	Earmarked
HORIZONTAL RULES		
	Research and development	
		Fundamental research
		Industrial research
		Precompetitive development
		Feasibility studies
	Environmental protection	
		Adaptation to the binding ecological standards
		Going beyond the existing standards or investments in environmental protection as long as no binding standards exist
		Energy efficiency and investments in the combined production of electric power and heat and aid to renewable sources of energy
		Rehabilitation of polluted industrial sites
		Operating aid (under specified conditions)
	SMEs	
		Initial investment aid and aid to job creation
		Consultancy services
		Participation in fairs and exhibitions
	Employment	
		Creation of new employment in SMEs
		Aid to maintain jobs
		Aid for recruitment of disabled workers or for recruitment of disadvantaged workers
		Aid to job-sharing and the conversion of temporary or fixed-term employment contracts into contracts of indeterminate duration
	Training	
		Specific training aid
		General training aid
	Culture	
		Aid to promote culture and protection of heritage
		Aid to promote audiovisual industry

	Energy saving	
		Particular measures aimed at energy saving
PARTICULAR SECTORAL RULES		
	Steel manufacturing	
		Research and development
		Environmental protection
		Employment
		Training
		Aid to SMEs for consultancy services and participation in fairs and exhibitions
		Payments to workers made redundant or retired before legal retirement age provided that the payments arise from the partial or total closure of steel plants
		Permanent cease of steel production
		Restructuring aid (Protocol 2)
	Inland transport	
	Rail, road and inland waterways	
		Research and development
		Environmental protection
		Rescue and restructuring
		Employment
		Training
		Reimbursement for the discharge of certain obligations inherent in the concept of a public service
		Allocation of infrastructure costs, where aid is granted to undertakings which have to bear expenditure relating to the infrastructure used by them, while other undertakings are not subject to a like burden
		Eliminate excess capacity causing serious structural problems
		Compensation in respect of additional financial burdens for railway undertakings
	Maritime transport	
		Research and development
		Environmental protection
		Rescue and restructuring
		Training
		Pension, disability and medical insurance for seafarers working on

		board ships entered in Croatian registers
		Reimbursement of the costs of repatriation of seafarers
		Public service obligations
		Investment in new vessels provided that they comply with the construction and safety at sea standards
		Promote the repatriation of the strategic and commercial management of board ships not entered in Croatian registers
		Regional aid
	Air transport	
		Research and development
		Environmental protection
		Aid to SMEs
		Employment
		Training
		Rescue and restructuring
		Regional aid
	Shipbuilding	
		Research and development
		Environmental protection
		Rescue and restructuring provided reduction in capacity
		Partial or total closure of shipyards
		Investment aid for genuinely and substantially new innovation
		Regional investment aid for investment in upgrading or modernising existing yards, with the objective of improving the productivity of existing installations
	Tourism	All aid types
	Financial services	All aid types
	Other sectors	All aid types
REGIONAL RULES		
	Areas A	
		Initial tangible and intangible investments
		New employment
		Reimbursement of operating costs in exceptional cases
	Areas B	
		Initial tangible and intangible investments
		New employment

Aid level:

Level description:
1. State level
2. Regional level
3. Local level
4. Other
