



REPUBLIC OF CROATIA

CROATIAN COMPETITION AGENCY

ANNUAL REPORT

on State Aid for 2006

July 2007

CONTENTS

1. INTRODUCTION	3
2. STATE AID IN 2006	5
2.1. Categories of state aid	12
2.2. State aid instruments	14
3. AGRICULTURE AND FISHERIES	19
4. MANUFACTURING AND SERVICES	20
4.1. HORIZONTAL AID	21
4.1.1. <i>Research and development</i>	23
4.1.2. <i>Environmental protection and energy conservation</i>	25
4.1.3. <i>Employment</i>	27
4.1.4. <i>Culture</i>	31
4.1.5. <i>Other objectives</i>	32
4.2. SECTOR-SPECIFIC AID	32
4.2.1. <i>Steel industry</i>	34
4.2.2. <i>Shipbuilding</i>	35
4.2.3. <i>Land, maritime and air transport</i>	37
4.2.4. <i>Tourism</i>	39
4.2.5. <i>Other industries</i>	40
4.2.6. <i>Rescue and restructuring</i>	41
5. REGIONAL AID	43
6. STATE AID AT LOCAL AND REGIONAL LEVEL	45
7. DE MINIMIS AID	47
8. CROATIA COMPARED TO EU	49
9. CONCLUSION	52
10. ANNEX 1 <i>Aid instruments</i>	55
11. ANNEX 2 <i>Aid categories</i>	57

ANNUAL REPORT ON STATE AID FOR 2006

1. INTRODUCTION

Croatian Competition Agency (CCA) submits the Annual Report on State Aid for 2006 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 fourth 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 2006. It also includes the revised data for 2004 and 2005 in order to ensure better comparison of the amounts of aid granted in past three years of the application of the state aid rules.

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 between the Republic of Croatia and the European Communities and their Member States (SAA).

This annual report shows the data on state aid which have been communicated by aid providers, i.e. the data on state aid which have 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. On the other hand, it is encouraging that this changes for the better with every year together with the growing awareness in respect of the necessary control of state aid and obligatory notification to the CCA.

Once the state aid register which is now at the testing stage will have been completed and after all aid providers in Croatia, both at the national and local level, bring into compliance the system of granting state aid with the 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. Both aid providers and aid beneficiaries need some period of adjustment, which, in particular, involves education and training of aid providers, within the meaning of the EC state aid provisions and the implementation of the relevant EC state aid rules in the national legislation.

As stated above, this annual report also includes the revised data on state aid granted in 2004 and 2005. In the period concerned the most significant changes in the amounts of state aid cover those granted in the transport sector. According to the figures, the amount of state aid for railways decreased by 433.7 million HRK in 2004, whereas in 2005 this amount dropped by 857.1 million HRK. The amount of state aid for land transport decreased in 2004 by 180 million HRK while in 2005 this amount dropped by 173.1 million HRK.

In accordance with the decision of the CCA in 2006 all aid that had been awarded to Hrvatske željeznice d.o.o. (Croatian Railways) until 31 December 2005 shall not

¹ http://ec.europa.eu/comm/competition/state_aid/scoreboard/2006/autumn_en.pdf

constitute state aid within the meaning of the State Aid Act, taking into account that pursuant to the Railways Act (OG 123/03, 194/03 and 30/04) the process of liberalization of the rail transport and openness of this sector for competition began only on 1 January 2006.

Following the methodology used by the European Commission in the preparation of its reports, the level of rescue and restructuring aid granted in the previous years remained the same as in 2006. Nevertheless, it has been moved from state aid to horizontal objectives to sector specific aid. Namely, the aid amounts concerned have not been granted under aid schemes earmarked for previously unknown beneficiaries but to individual beneficiaries – firms in difficulty where such ad hoc aid may not be considered aid to horizontal objectives.

In addition, in accordance with the data established in the Report on the execution of the state budget, the total amounts of state aid for agriculture and fisheries have also been accordingly revised.

In compliance with the EU methodology this annual report does not include de minimis aid granted in 2006. Nevertheless, for the reason of comprehensiveness of the annual report, de minimis aid has been dealt with in a separate chapter of this annual report.

Finally, it must be pointed out here that the CCA did not receive the necessary data and documentation on state aid for the purpose of this annual report from all ministries, the Croatian Privatisation Fund and the Development and Employment Fund. Thus, the relevant data on state aid granted by the listed aid providers for the purpose of this annual report have been submitted to the CCA by the Ministry of Finance.

2. STATE AID IN 2006

State aid granted in Croatia in 2006 amounted to HRK 8.587,8 million, which is 63 % more than in 2005. The share of total state aid in GDP in 2005 amounted to 2.3 %, whereas in 2006 this share was 3.4 %, which is 49.1 % more than in the previous year.

The increase of the total state aid in 2006 compared to 2005 has been due to significant rise of rescue aid awarded to shipyards, aid to transport sector (Croatian Railways), aid to agriculture and fisheries and regional aid.

At the same time, the rise in total state aid affected the rise in state aid per employee, from 3.708,9 HRK in 2005, to 5.852,4 HRK in 2006, which is an increase of 57.8 %. The rise of per capita state aid was from 1.197,4 HRK in 2005 to 1.951,8 HRK in 2006, which is an increase of 63 %.

Table 1: Total state aid granted 2004 – 2006

	Measure	2004	2005	2006	Indices	
					2005/2004	2006/2005
State aid	mil HRK	5.145,8	5.268,7	8.587,8	102	163,0
State aid	mil EUR ²	686,6	712,0	1.172,7	104	164,7
GDP ³	mil HRK	207.028,0	229.031,0	250.590,0	111	109,4
GDP	mil EUR	27.621,5	30.949,4	34.220,3	112	110,6
Government expenditure	mil HRK	83.145,1	89.686,3	95.948,4	108	107,0
Government expenditure	mil EUR	11.093,2	12.119,5	13.102,6	109	108,1
Employees	number	1.409.633,8	1.420.574,0	1.467.398,0	101	103,3
State aid share in GDP	%	2,49%	2,30%	3,43%	93	149,0
State aid per employee	HRK	3.650,5	3.708,9	5.852,4	102	157,8
State aid per employee	EUR	487,0	501,2	799,2	103	159,5
State aid share in government expenditure	%	6,19%	5,87%	8,95%	95	152,4
Per capita state aid ⁴	HRK	1.169,5	1.197,4	1.951,8	102	163,0
Per capita state aid	EUR	156,0	161,8	266,5	104	164,7

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

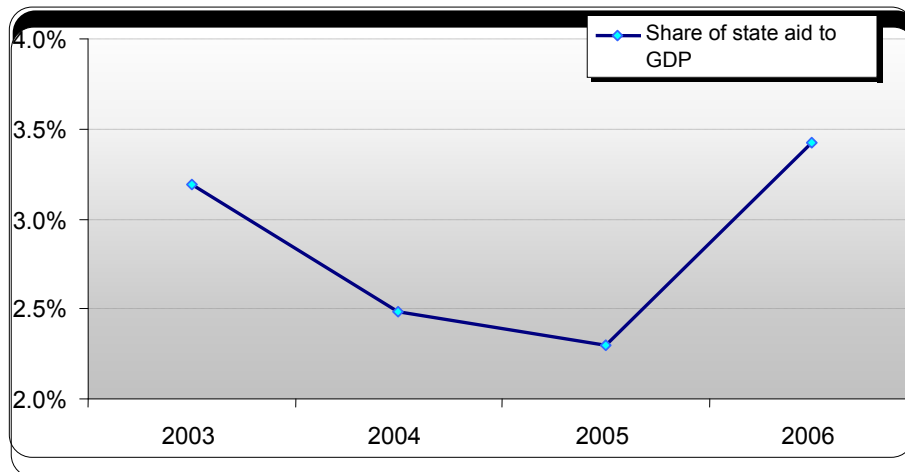
One of the features of the year 2006 is also an increase of the share of state aid in the state expenditures compared to 2005, which grew from 5.9 % to 8.9 %.

² In 2004 the Croatian National Bank average rate against 1 EUR was 7.495169 HRK, in 2005 this rate was 7.400185 HRK and in 2006 it amounted to 7.322849 HRK.

³ GDP (market current prices); Source on GDP: Croatian Bureau for Statistics and Ministry of Finance.

⁴ Population size 4.4m according to the 2001 census (Source: Croatian Bureau for Statistics)

Picture 1: The share of total state aid to GDP 2003 – 2006



Source: Croatian Bureau of Statistics, Ministry of Finance; data processed in CCA.

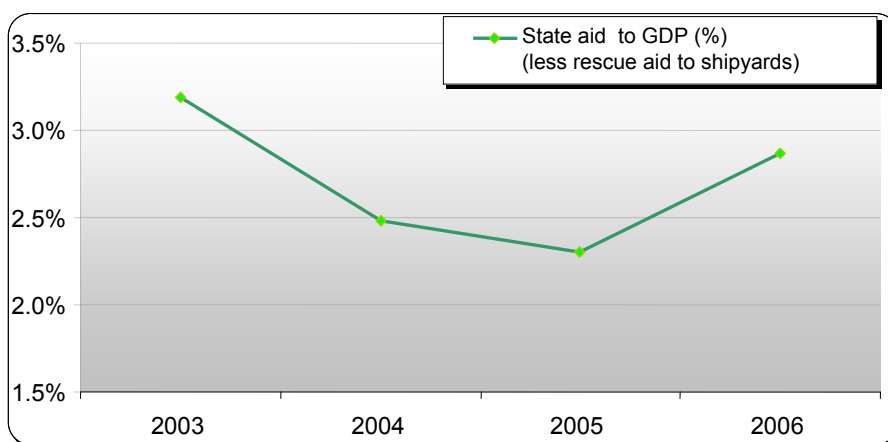
The process of restructuring of the Croatian shipyards began in 2006 and rescue aid for the shipyards concerned has been granted in the total amount of 4.2 billion HRK, whereas 1.4 billion HRK hereof had been spent by the end of the year 2006. This appreciably contributed to the growth of the absolute level of state aid in 2006. Without the rescue aid concerned the total amount of state aid would have reached 7.184,9 million HRK which is an increase of 36.4 % compared to the year 2005, whereas the share of state aid to GDP would have amounted to 2.9 % instead of the recorded 3.4 %.

Table 2: Total state aid 2004 – 2006 (less state aid guaranties for rescue of shipyards in 2006)

	Measure	2004	2005	2006	Indices	
					2005/2004	2006/2005
State aid	mil HRK	5.145,8	5.268,7	7.184,9	102	136,4
State aid	mil EUR	686,5	712,0	981,2	104	137,8
GDP	mil HRK	207.028,0	229.031,0	250.590,0	111	109,4
GDP	mil EUR	27.621,5	30.949,4	34.220,3	112	110,6
Government expenditure	mil HRK	83.145,1	89.686,3	95.948,4	108	107,0
Government expenditure	mil EUR	11.093,2	12.119,5	13.102,6	109	108,1
Employees	number	1.409.633,8	1.420.574,0	1.467.398,0	101	103,3
State aid share in GDP	%	2,49%	2,30%	2,87%	93	124,6
State aid per employee	HRK	3.650,5	3.708,9	4.896,3	102	132,0
State aid per employee	EUR	487,0	501,2	668,6	103	133,4
State aid share in government expenditure	%	6,19%	5,87%	7,49%	95	127,5
Per capita state aid	HRK	1.169,5	1.197,4	1.632,9	102	136,4
Per capita state aid	EUR	156,0	161,8	223,0	104	137,8

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

Picture 2: State aid to GDP (%) 2003 – 2006 (less rescue aid to shipyards in 2006)



Source: Croatian Bureau of Statistics, Ministry of Finance; data processed in CCA.

Taking into account the fact that the State Aid Act does not apply to state aid to agriculture and fisheries and the fact that the majority of state aid to transport sector relates to compensation costs in carrying out services of general economic interest (which do not constitute state aid), the following tables indicate the amounts of state aid less agriculture and fisheries and transport and less state aid to railways.

Table 3: State aid from 2004 – 2006 (less agriculture and fisheries and transport)

Measure		2004	2005	2006
Amount of state aid	mil HRK	2.903,1	2.534,3	4.212,5
Amount of state aid	mil EUR	387,3	342,5	575,2
GDP	mil HRK	207.028,0	229.031,0	250.590,0
GDP	mil EUR	27.621,5	30.949,4	34.220,3
State aid share in GDP	%	1,40%	1,11%	1,68%

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

State aid in 2006 less agriculture and fisheries and transport amounted to 4.212,5 million HRK which is 66.2 % more than in 2005 when the same state aid amounted to 2.534,3 million HRK and 45.1 % more than in 2004 when state aid amounted to 2.903,1 million HRK.

Table 4: State aid from 2004 – 2006 (less agriculture and fisheries and transport, less rescue aid in form of state guarantees for shipyards in 2006)

Measure		2004	2005	2006
Amount of state aid	mil HRK	2.903,1	2.534,3	2.809,5
Amount of state aid	mil EUR	387,3	342,5	383,7
GDP	mil HRK	207.028,0	229.031,0	250.590,0
GDP	mil EUR	27.621,5	30.949,4	34.220,3
State aid share in GDP	%	1,40%	1,11%	1,12%

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

If rescue aid for shipyards were excluded, the share of state aid to GDP would drop from 1.7 % to 1.1 % of GDP and it means that the share of state aid to GDP would remain the same as in 2005.

The railway sector in the Republic of Croatia indicates the same specificity as in the EU, since state aid to a public activity is always directly related to the liberalization process of the services in the railway industry. Given their special status, state aid granted to railways is for the purposes of certain analyses excluded from the total state aid.

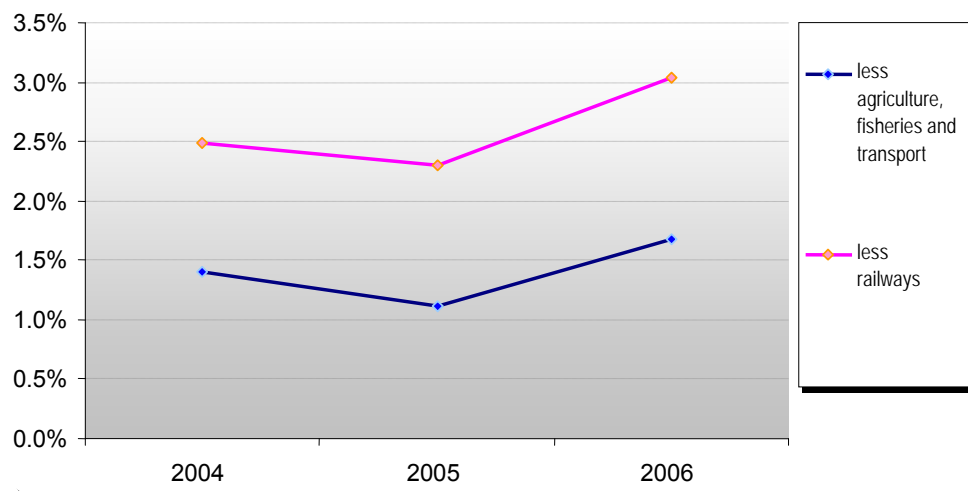
Table 5: Total state aid from 2004 – 2006 (including agriculture and fisheries, less railways)

Measure		2004	2005	2006
Amount of state aid	mil HRK	5.145,8	5.268,7	7.619,5
Amount of state aid	mil EUR	686,6	712,0	1.040,5
GDP	mil HRK	207.028,0	229.031,0	250.590,0
GDP	mil EUR	27.621,5	30.949,4	34.220,3
State aid share in GDP	%	2,49%	2,30%	3,04%

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

In 2006 state aid to railways amounted to 968.2 million HRK.

Picture 3: Share of state aid to GDP from 2004 – 2006

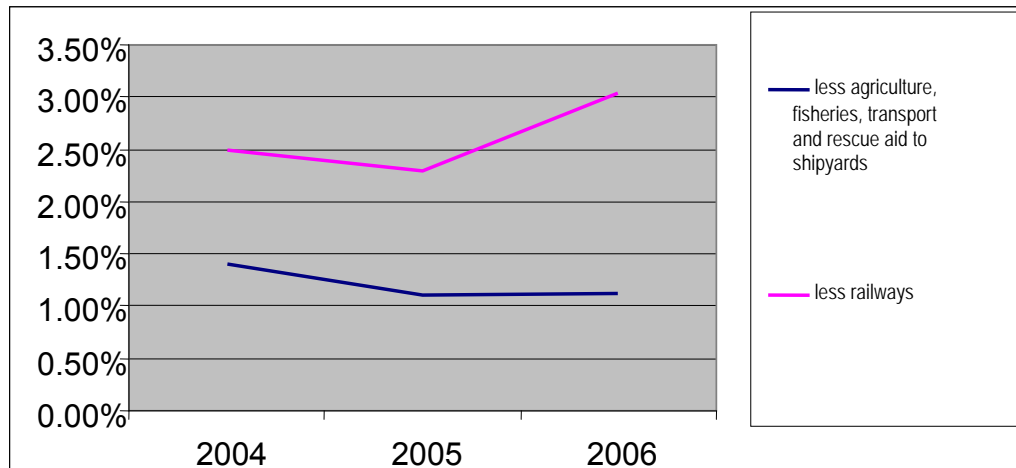


Source: Ministry of Finance, other state aid providers; data processed in CCA.

Picture 3 indicates both figures relating to the share of state aid to GDP less agriculture and fisheries and transport and excluding only railways.

Picture 4 shows the share of state aid to GDP after agriculture and fisheries and transport as well as rescue aid for shipyards have been deducted from the total state aid.

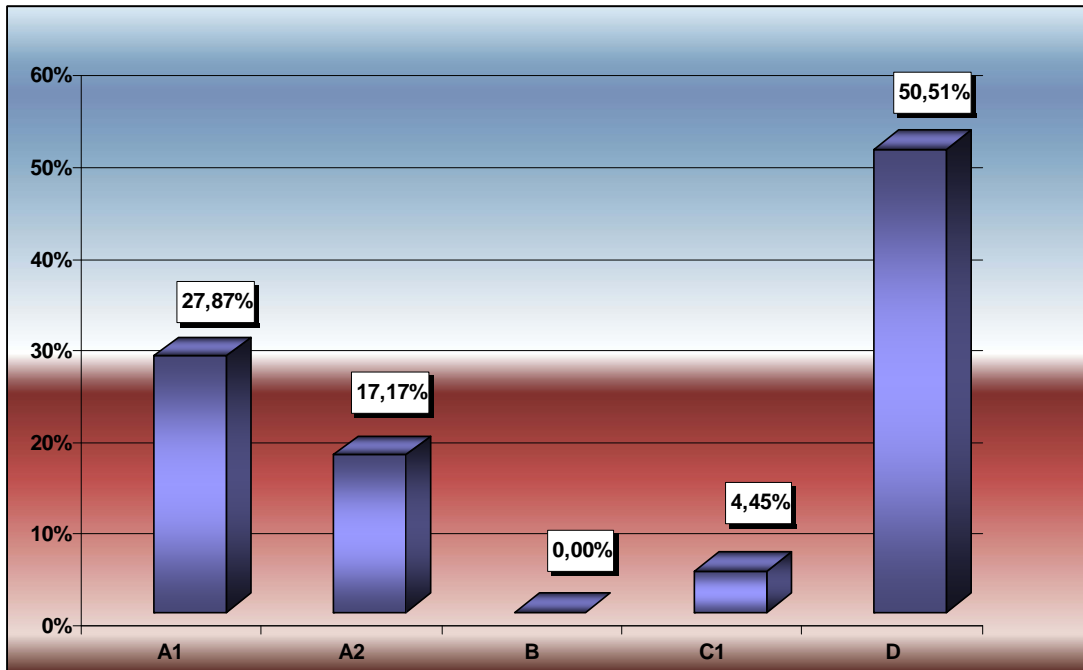
Picture 4: Share of state aid to GDP from 2004 – 2006 (less rescue aid for shipyards in 2006)



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

State aid (less agriculture and fisheries and transport) has been granted in 2006 in different forms. The most represented aid instruments have been state guarantees (50.5 %) and grants (27.9 %) as indicated in Picture 5 below. The high share of aid contained in state guarantees primarily addresses state guarantees containing rescue aid for shipyards. For the sake of comparison, in 2005 the most represented aid instrument had been grants (59.7 %) whereas state guarantees had had its share of 13.4 % in total aid. Nonetheless, it must be kept in mind that state guarantees given to shipbuilding in 2005 had not been in their entirety calculated as state aid (this must be taken attention of when state aid data for 2004 and 2005 are compared with the relevant data for 2006).

Picture 5: State aid by aid instruments in 2006 (less agriculture and fisheries and transport)⁵



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

⁵ 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) which remains applicable under Article 10 of the 2006 Regulation on state aid (OG 50/2006), state aid is basically divided into the following categories of aid:

- horizontal aid,
- sector-specific,
- regional aid⁶ and
- state aid to agriculture and fisheries.

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

- research and development,
- environmental protection and energy conservation,
- small and medium-sized enterprises (SMEs),
- employment,
- training,
- culture,
- other horizontal objectives.

Separate **sector-specific aid** may be granted to:

- steel manufacturing,
- transport sector (land, maritime and air transport),
- shipbuilding,
- tourism,
- rescue and restructuring and
- other activities.

Given the fact that state aid towards horizontal objectives affects competition appreciably less than other categories of aid, it is necessary also for Croatia in the view to raising competitiveness and a well balanced regional development must continue to redirect aid towards horizontal objectives. At the same time the level of sector-specific aid must be reduced taking into account its anticompetitive effects and its generally unappreciable contribution to overall economic development.

Regional state aid is aimed at promoting economic development of disadvantaged areas, i.e. areas of the economy which lag behind the national average. In the sense of state aid rules regional aid should be granted on the basis of the established regional aid map. 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 possible the application of more favourable state aid rules than those applicable in the areas with higher employment rate and standard of living. Hence, given that this status expired as of 1 March 2006 and the regional map has not been established at the moment of the conclusion of this annual report, in this very moment Croatia does not fulfil the necessary criteria for the award of regional state aid.

⁶ *Annex 2: Aid categories*

Table 6: State aid amounts specified by aid categories 2004 – 2006

Category		2004			2005			2006		
		in mil HRK	in mil EUR	share (%)	in mil HRK	in mil EUR	share (%)	in mil HRK	in mil EUR	share (%)
1.	<i>Agriculture and fisheries</i>	1.819,82	242,8	35,36	1.992,10	269,2	37,81	2.528,27	345,3	29,44
2.	<i>Manufacturing and services</i>	2.836,5	378,4	55,12	2.971,1	401,5	56,39	5.693,0	777,4	66,29
	<i>Horizontal objectives</i>	1.151,2	153,6	22,37	921,2	124,5	17,48	1.073,8	146,6	12,50
	R&D	123,98	16,5	2,41	129,30	17,5	2,45	138,83	19,0	1,62
	Environmental protection and energy saving	0,20	0,0	0,00	6,88	0,9	0,13	23,89	3,3	0,28
	SMEs	54,97	7,3	1,07	96,25	13,0	1,83	244,92	33,4	2,85
	Training	130,42	17,4	2,53	80,86	10,9	1,53	101,21	13,8	1,18
	Employment	474,97	63,4	9,23	297,74	40,2	5,65	334,47	45,7	3,89
	Culture	40,84	5,4	0,79	75,10	10,1	1,43	90,17	12,3	1,05
	Other objectives	325,81	43,5	6,33	235,03	31,8	4,46	140,36	19,2	1,63
	<i>Specific sectors</i>	1.685,3	224,9	32,75	2.050,0	277,0	38,91	4.619,1	630,8	53,79
	Steel manufacturing	29,40	3,9	0,57	51,84	7,0	0,98	0,00	0,0	0,00
	Transport	422,94	56,4	8,22	742,35	100,3	14,09	1.847,04	252,2	21,51
	Shipbuilding	529,64	70,7	10,29	506,60	68,5	9,62	2.607,47	356,1	30,36
	Tourism	86,70	11,6	1,68	189,39	25,6	3,59	117,98	16,1	1,37
	Other sectors	25,67	3,4	0,50	57,92	7,8	1,10	40,60	5,5	0,47
	Rescue and restructuring	590,97	78,8	11,48	501,88	67,8	9,53	6,02	0,8	0,07
3.	<i>Regional aid</i>	145,98	19,5	2,84	170,54	23,0	3,24	301,02	41,1	3,51
4.	<i>Aid at local level</i>	343,52	45,8	6,68	134,94	18,2	2,56	65,51	8,9	0,76
TOTAL		5.145,8	686,6	100,00	5.268,7	712,0	100,00	8.587,8	1.172,7	100,00

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

As indicated in Table 6, the highest share of state aid from 2004 – 2006 has been attributed to sector-specific aid, particularly aid to transport industry and agriculture and fisheries and shipbuilding. Despite the evident growth in the nominal amount, the share of horizontal aid in the total state aid shows a decreasing trend: in 2006 the share of horizontal aid in the total aid was 12.5%, whereas in 2005 it amounted to 17.5% and in 2004 22.4 %.

One of the reasons for this decrease in levels of horizontal aid was an exceptionally high growth in state aid to transport sector and shipbuilding. State aid in the sectors concerned have increased in 2006 by 3.205,6 million HRK whereas the growth of state aid towards horizontal objectives has been significantly lower than the growth of sector-specific aid compared to 2005.

2.2. State aid instruments

State aid is awarded from the state budget and may take various forms (aid instruments). Aid may be direct (increase in state expenditures) and indirect (decrease in state expenditures) and is awarded through the following main aid instruments⁷:

- 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 7: State aid amounts specified by aid instruments in 2004 (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	0,0	1.819,8
2.	<i>Manufacturing and services</i>	2.186,9	370,2	136,1	54,2	89,2	2.836,6
	2.1. <i>Horizontal objectives</i>	780,4	370,2	0,0	0,0	0,5	1.151,1
	R&D	0,0	124,0	0,0	0,0	0,0	124,0
	Environmental protection and energy saving	0,2	0,0	0,0	0,0	0,0	0,2
	SMEs	55,0	0,0	0,0	0,0	0,0	55,0
	Training	0,0	130,4	0,0	0,0	0,0	130,4
	Employment	359,1	115,8	0,0	0,0	0,0	474,9
	Culture	40,3	0,0	0,0	0,0	0,5	40,8
	Other objectives	325,8	0,0	0,0	0,0	0,0	325,8
	2.2. <i>SPECIFIC SECTORS</i>	1.406,5	0,0	136,1	54,2	88,7	1.685,5
	Steel manufacturing	0,0	0,0	0,0	0,0	29,4	29,4
	Transport	321,1	0,0	101,9	0,0	0,0	423,0
	Shipbuilding	484,3	0,0	20,0	0,0	25,4	529,7
	Tourism	86,7	0,0	0,0	0,0	0,0	86,7
	Other sectors	20,7	0,0	0,0	5,0	0,0	25,7
	Rescue and restructuring	493,7	0,0	14,2	49,2	33,9	591,0
3.	<i>Regional aid</i>	34,9	111,0	0,0	0,1	0,0	146,0
4.	<i>Aid at local level</i>	268,6	0,0	25,2	39,3	10,4	343,5
TOTAL		4.310,2	481,2	161,3	93,6	99,6	5.145,9

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

⁷ Annex I gives a list of aid instruments and respective aid element calculations.

Table 8: State aid amounts specified by aid instruments in 2005 (in mil HRK)

Category		A1	A2	B	C1	D	Total
1.	<i>Agriculture and fisheries</i>	1.992,1	0,0	0,0	0,0	0,0	1.992,1
2.	<i>Manufacturing and services</i>	1.914,8	466,4	151,8	73,3	364,9	2.971,2
	2.1. <i>Horizontal objectives</i>	454,9	466,4	0,0	0,0	0,0	921,3
	R&D	4,8	124,6	0,0	0,0	0,0	129,4
	Environmental protection and energy saving	6,9	0,0	0,0	0,0	0,0	6,9
	SMEs	96,3	0,0	0,0	0,0	0,0	96,3
	Training	6,8	74,1	0,0	0,0	0,0	80,9
	Employment	30,0	267,7	0,0	0,0	0,0	297,7
	Culture	75,1	0,0	0,0	0,0	0,0	75,1
	Other objectives	235,0	0,0	0,0	0,0	0,0	235,0
	2.2. <i>SPECIFIC SECTORS</i>	1.459,9	0,0	151,8	73,3	364,9	2.049,9
	Steel manufacturing	0,0	0,0	0,0	0,0	51,8	51,8
	Transport	559,2	0,0	100,2	53,3	29,6	742,3
	Shipbuilding	431,2	0,0	20,8	0,0	54,5	506,5
	Tourism	88,6	0,0	9,0	0,0	91,8	189,4
	Other sectors	26,4	0,0	11,5	20,0	0,0	57,9
	Rescue and restructuring	354,5	0,0	10,3	0,0	137,2	502,0
3.	<i>Regional aid</i>	34,8	135,7	0,0	0,0	0,0	170,5
4.	<i>Aid at local level</i>	123,0	0,7	0,0	7,4	3,8	134,9
TOTAL		4.064,7	602,8	151,8	80,7	368,7	5.268,7

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

Table 9: State aid amounts specified by aid instruments in 2006 (in mil HRK)

Category		A1	A2	B	C1	D	Total
1.	<i>Agriculture and fisheries</i>	2.528,3	0,0	0,0	0,0	0,0	2.528,3
2.	<i>Manufacturing and services</i>	2.260,0	462,7	417,8	424,7	2.127,8	5.693,0
	2.1. <i>Horizontal objectives</i>	446,8	456,7	0,0	165,4	5,0	1.073,9
	R&D	17,3	121,5	0,0	0,0	0,0	138,8
	Environmental protection and energy saving	19,6	0,0	0,0	4,3	0,0	23,9
	SMEs	78,8	0,0	0,0	161,1	5,0	244,9
	Training	1,9	99,3	0,0	0,0	0,0	101,2
	Employment	98,6	235,9	0,0	0,0	0,0	334,5
	Culture	90,2	0,0	0,0	0,0	0,0	90,2
	Other objectives	140,4	0,0	0,0	0,0	0,0	140,4
	2.2. <i>SPECIFIC SECTORS</i>	1.813,2	6,0	417,8	259,3	2.122,8	4.619,1
	Steel manufacturing	0,0	0,0	0,0	0,0	0,0	0,0
	Transport	1.188,9	0,0	417,8	240,3	0,0	1.847,0
	Shipbuilding	484,7	0,0	0,0	0,0	2.122,8	2.607,5
	Tourism	102,1	0,0	0,0	15,9	0,0	118,0
	Other sectors	37,5	0,0	0,0	3,1	0,0	40,6
	Rescue and restructuring	0,0	6,0	0,0	0,0	0,0	6,0
3.	<i>Regional aid</i>	37,5	260,6	0,0	2,9	0,0	301,0
4.	<i>Aid at local level</i>	65,5	0,0	0,0	0,0	0,0	65,5
TOTAL		4.891,3	723,3	417,8	427,6	2.127,8	8.587,8

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

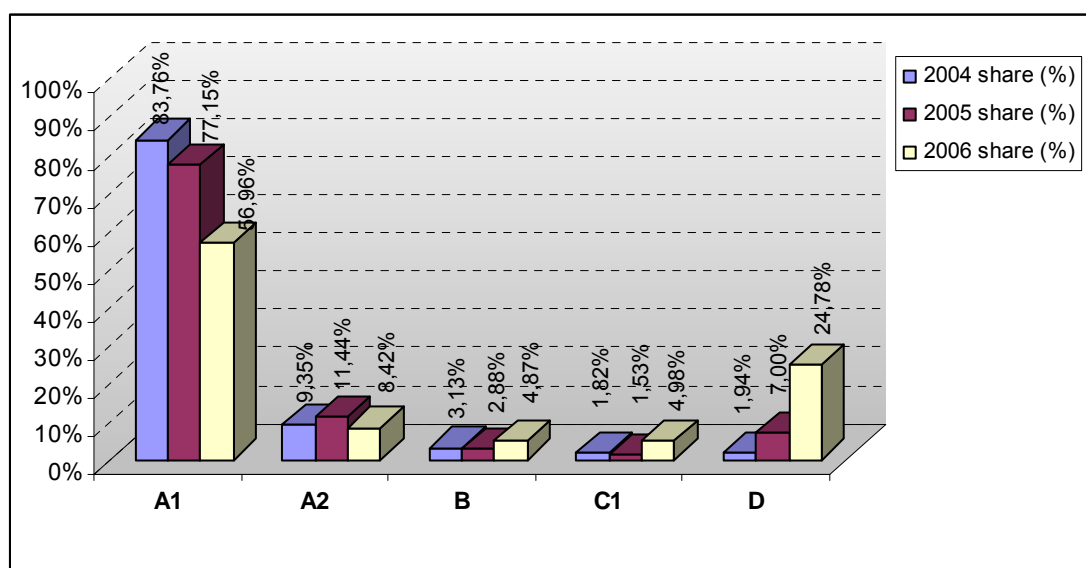
Table 10: State aid amounts specified by aid instruments from 2004 - 2006 (including agriculture and fisheries)

	2004			2005			2006		
	mil HRK	mil EUR	share (%)	mil HRK	mil EUR	share (%)	mil HRK	mil EUR	share (%)
A1	4.310,2	575,1	83,76	4.064,7	549,3	77,15	4.891,3	668,0	56,96
A2	481,2	64,2	9,35	602,8	81,5	11,44	723,3	98,8	8,42
B	161,3	21,5	3,13	151,8	20,5	2,88	417,8	57,1	4,87
C1	93,6	12,5	1,82	80,7	10,9	1,53	427,6	58,4	4,98
D	99,6	13,3	1,94	368,7	49,8	7,00	2.127,8	290,6	24,78
	5.145,9	686,6	100,00	5.268,7	712,0	100,00	8.587,8	1.172,7	100,00

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

In respect of aid instruments the above figures show the highest share of grants in the total state aid in 2006 which was 57 %. These are followed by state guarantees (24.8 %) and tax exemptions (8.4 %). The share of equity participation in total state aid increased from 2.9 % in 2005 to 4.9 % in 2006. The growing trend of the share of soft loans accounted for 5 % in 2006 compared with the 1.5 % in 2005.

Picture 6: Total state aid by aid instruments⁸ from 2004 – 2006



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

Given that the given state guarantees account for a significant portion of the total of aid instruments the calculation of aid element in a guarantee uses a special method as defined in the Ordinance on the form and content of the notification and the method of

⁸ 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)

data collecting and keeping the state aid register (OG 11/05) which is in line with the calculation method used in the EU. The calculation of aid contained in a state guarantee is shown in Table 11.

Table 11: State guarantees from 2004 - 2006 (in mil HRK)

No.	Description	2004	2005	2006
1.	Total end-financing guarantees issued	5.805,55	3.709,77	9.370,47
2.	End-financing guarantees issued for rescuing the shipyards	0,00	0,00	1.402,95
3.	Total end-financing guarantees issued not including guarantees for rescuing the shipyards (1-2)	5.805,55	3.709,77	7.967,52
4.	State guarantees which are not state aid	3.081,32	2.707,51	6.480,81
5.	Total end-financing guarantees containing aid elements (1-4)	2.724,22	1.002,27	2.889,66
6.	Total construction financing guarantees issued	4.773,57	3.458,31	1.147,52
7.	Total state guarantees containing aid elements issued (5+6)	7.497,80	4.460,58	4.037,18
8.	Invoked guarantees (less sum returned to the budget)	778,83	349,21	427,97
9.	Risk rate (8/7)	10,39%	7,83%	10,60%
10.	Premiums paid 0,5% (5x0,5%)	13,62	5,01	14,45
11.	Amount of aid involved in end-financing guarantees (5x9-10)	269,36	73,45	291,87
12.	Total state aid contained in state guarantees (2+8+11)	1.048,19	422,66	2.122,79

Source: Ministry of Finance, data processed in CCA.

State guarantees do not generally constitute state aid. Article 74 of the Regulation on state aid sets the conditions under which state guarantees do not, as a rule, constitute state aid⁹. 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 particular case in question.

The amounts of aid in state guarantees which do not constitute state aid are shown in Table 11 under point 4 and they particularly 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 objects damaged by war.

⁹ 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.

In addition, Table 11 under point 6 shows the respective amounts of construction financing guarantees relating entirely to shipbuilding. Taking into account that these guarantees have not been invoked in the past five years loss given default rate has not been calculated.

3. AGRICULTURE AND FISHERIES

Within the meaning of the State Aid Act, the provisions of the State Aid Act and the Regulation do not apply to state aid to agriculture and fisheries and as such state aid concerned 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 Agriculture, Forestry and Water Management, Ministry of Finance and data on the execution of the state budget.

State aid to agriculture and fisheries amounted to 1,819.8 million HRK in 2004 and 1,992.1 million HRK in 2005. In 2006 the amount of state aid to agriculture increased by 27 % compared with 2005 and was 2,528.3 million HRK.

In 2004 the share of state aid to agriculture and fisheries in total state aid amounted to 35.4 %, in 2005 38 %, whereas in 2006 this share was some 30 %. Although the nominal amount of state aid to agriculture and fisheries actually rose in 2006, the relative drop of the share concerned is a result of considerable growth of sector-specific state aid, particularly in respect of the shipbuilding sector.

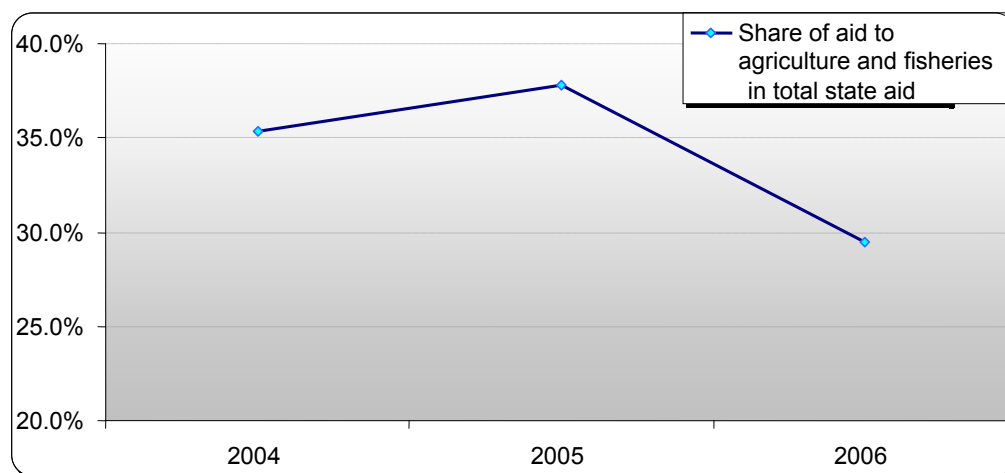
In accordance with the data received from the Ministry of Agriculture, Forestry and Water Management the exclusively represented aid instrument in this area was direct subsidies. The CCA has not been communicated on any other aid instruments that might have been awarded to undertakings in the form of tax exemptions or write-offs and other forms of state aid.

Table 12: Total state aid and share of aid to agriculture and fisheries from 2004 – 2006

Agriculture and fisheries	2004		2005		2006		Index	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR	2005/2004	2006/2005
Total state aid	5.145,8	686,6	5.268,7	712,0	8.587,8	1.172,7	102,39	163,00
Aid less agriculture and fisheries	3.326,0	443,8	3.276,6	442,8	6.059,5	827,5	98,51	184,93
Aid to agriculture and fisheries	1.819,82	242,8	1.992,10	269,2	2.528,27	345,3	109,47	126,91
Share (%) in total state aid	35,36%		37,81%		29,44%		106,91	77,86
Share (%) in GDP	0,88%		0,87%		1,01%		98,95	116,00

Source: Ministry of Finance, Ministry of Agriculture, Forestry and Water Management; data processed in CCA.

Picture 7: Share of aid to agriculture and fisheries in total state aid from 2004 – 2006



Source: Ministry of Finance, Ministry of Agriculture, Forestry and Water Management; data processed in CCA.

4. MANUFACTURING AND SERVICES

When, on the basis of the reasons listed in Chapter 2 of this annual report, 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 (some 94 % in 2006), whereas a much lower share is attributed to regional aid (some 5 % in 2006) and aid at the local level (1.1 % in 2006).

Nevertheless, it must be taken into account, that only the data and documents received by the CCA from the ministries and other central public authorities may be considered credible and reliable, whereas the relevant data and documentation submitted by the local and regional administrations are still incomplete and fail to be updated. Therefore, the data on state aid at local level cannot be regarded as reliable and may not be taken for granted. Nevertheless, a principle part of state aid awarded at local level (excluding big cities) is de minimis aid which by the nature of the methodology used would not have been included in the annual report anyway.

In 2006 state aid granted to the manufacturing and services sector amounted to 5.692,9 million HRK or 777, 4 million EUR, which is 91.6 % more than in 2005. This increase of state aid in the report period is mainly related to aid to shipbuilding, transport and regional aid. The year 2006 was marked by significant growth in sector-specific aid, particularly aid to shipbuilding, in the form of state guarantees contained in rescue aid for shipyards and state aid awarded to railway industry.

Here one has to take into account the position of the Croatian economy, particularly the current restructuring process of the Croatian shipyards. In other words, it could have actually been expected that the beginning of the restructuring process of the Croatian shipyards and the implementation of state aid rules in the area in question would result in the growth of state aid levels. The restructuring process will require further resources

in the form of state aid, transparent state aid control regimes and relevant obligations which would include all forms of aid that may be granted in this sector and which had not existed before the state aid rules came into force.

Table 13: State aid from 2004 – 2006 (less agriculture and fisheries)

Category	2004			2005			2006		
	mil HRK	mil EUR	share (%)	mil HRK	mil EUR	share (%)	mil HRK	mil EUR	share (%)
<i>Manufacturing and services</i>	2.836,5	378,4	85,28	2.971,2	401,5	90,68	5.692,9	777,4	93,95
<i>Horizontal objectives</i>	1.151,2	153,6	34,61	921,2	124,5	28,11	1.073,8	146,6	17,72
<i>Specific sectors</i>	1.685,3	224,9	50,67	2.050,0	277,0	62,56	4.619,1	630,8	76,23
<i>Regional state aid</i>	146,0	19,5	4,39	170,5	23,0	5,20	301,0	41,1	4,97
<i>State aid at local level</i>	343,5	45,8	10,33	134,9	18,2	4,12	65,5	8,9	1,08
TOTAL	3.326,0	443,8	100,00	3.276,6	442,8	100,00	6.059,4	827,5	100,0

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

4.1. HORIZONTAL AID

State aid towards horizontal objectives is aimed at tackling certain problems which may arise in any undertaking, industry and region. In order to solve the problems concerned, the market and the undertakings concerned may receive support from the state. Under certain criteria these are categories of aid such as aid for research and development and innovation, aid for environmental protection and energy conservation, aid for SMEs, risk capital, employment, and training. Although specific in its nature, aid to culture is also considered horizontal aid.

State aid to horizontal objectives amounted in 2005 to 921.2 million HRK, whereas in 2006 this amount was in total 1.073,9 million HRK, which is an increase of 16.6 % compared with the previous year.

The structure of horizontal aid shows that the most represented form was aid to employment with 31.2 % or 334.5 million HRK in the total horizontal aid, followed by aid for SMEs with 22.8 %, aid towards other horizontal objectives¹⁰ with 13.1 %, aid for research and development with 12.9 % etc.

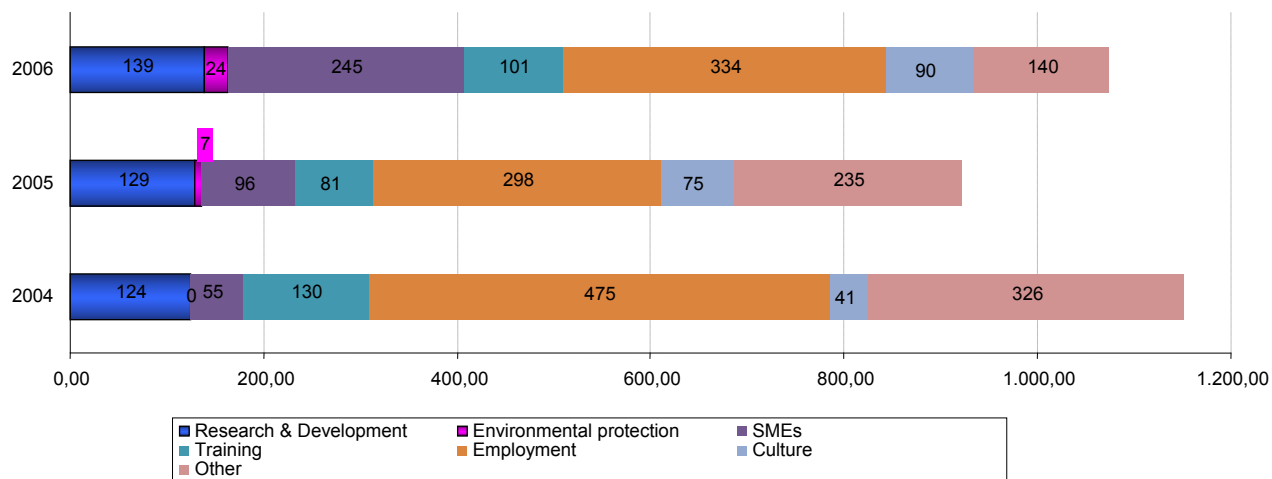
¹⁰ Aid towards other horizontal objectives means aid granted in 2006 which is used for interest rebates on loans available under various programmes implemented by the Croatian Bank for Reconstruction and Development, the amounts which are not directly apportioned to other categories of horizontal aid. The total amount of other horizontal aid granted on the basis of the programmes of the Croatian Bank for Reconstruction and Development in 2006 was 300 million HRK.

Table 14: Horizontal aid in the Republic of Croatia from 2004 – 2006

Horizontal aid	2004			2005			2006		
	mil HRK	mil EUR	share in GDP (%)	mil HRK	mil EUR	share in GDP (%)	mil HRK	mil EUR	share in GDP (%)
R&D	124,0	16,5	0,06%	129,3	17,5	0,06%	138,8	19,0	0,06%
Environmental protection and energy saving	0,2	0,0	0,00%	6,9	0,9	0,00%	23,9	3,3	0,01%
SMEs	55,0	7,3	0,03%	96,3	13,0	0,04%	244,9	33,4	0,10%
Training	130,4	17,4	0,06%	80,9	10,9	0,04%	101,2	13,8	0,04%
Employment	475,0	63,4	0,23%	297,7	40,2	0,13%	334,5	45,7	0,13%
Culture	40,8	5,4	0,02%	75,1	10,1	0,03%	90,2	12,3	0,04%
Other objectives	325,8	43,5	0,16%	235,0	31,8	0,10%	140,4	19,2	0,06%
TOTAL	1.151,2	153,6	0,56%	921,2	124,5	0,40%	1.073,9	146,6	0,43%

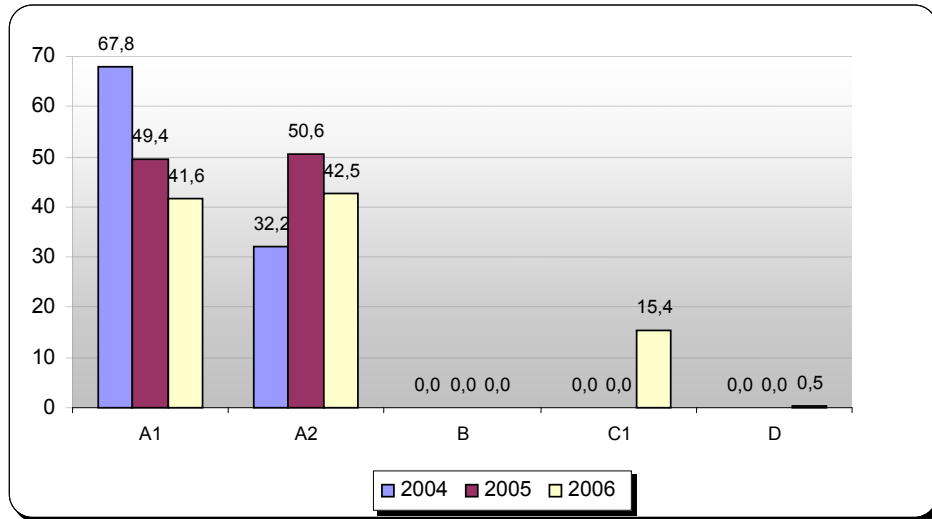
Source: Ministry of Finance, other state aid providers; data processed in CCA.

Picture 8: Horizontal aid from 2004 – 2006 (in million HRK)



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

Picture 9: Horizontal aid by aid instruments¹¹ from 2004 – 2006 (%)



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

The most represented aid instruments relating to state aid towards horizontal objectives in 2006 have been tax exemptions (42.5 %) and grants (41.6 %) whereas state aid in the form of soft loans indicated a growing trend (15.4 %).

4.1.1. Research and development

Pursuant to state aid rules state aid for research and development may be granted to:

- fundamental research, which is meant an activity designed to broaden scientific and technical knowledge not linked to industrial or commercial objectives;
- industrial research, which is aimed at the acquisition of new knowledge, the objective being that such knowledge may be useful in developing new products, processes or services or in bringing about a significant improvement in existing products, processes or services;
- precompetitive development activity, which is meant the shaping of the results of industrial research into a plan, arrangement of design for new, altered or improved products, processes or services, whether they are intended to be sold or used, including the creation of an initial prototype which could not be used commercially. This may also include initial demonstration projects or pilot projects and technical feasibility studies preparatory to industrial research activities.

State aid for research and development may be granted for certain amounts of eligible costs. As a general rule, the gross aid intensity for fundamental research may amount to 100 % of the eligible costs, if its results are widely available for exploitation on a non-

¹¹ 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)

discriminatory basis and at market rates. Industrial research must not exceed 50 % of the eligible costs of the project. In the case of precompetitive development activities the permissible gross aid intensity is fixed at 25 % of the eligible costs for the project. Technical feasibility studies preparatory to industrial research activities may qualify for aid amounting to 75 % of study costs, while such studies preparatory to precompetitive development activities may qualify for support amounting to 50 % of study costs.

Eligible R&D costs for the purpose of calculating the aid intensity are:

- personnel costs (researchers, technicians and other supporting staff employed solely on the research activity),
- costs of instruments, equipment, and land and premises used solely and on a continual basis for the research activity,
- cost of consultancy and equivalent services used exclusively for the research activity,
- additional overheads incurred directly as a result of the research activity and
- other operating expenses incurred directly as a result of the research activity.

Table 15: State aid for research and development from 2004 – 2006

R&D	2004		2005		2006	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	0,0	0,0	4,7	0,6	17,3	2,4
A2 tax exemptions	124,0	16,5	124,6	16,8	121,5	16,6
TOTAL	124,0	16,5	129,3	17,5	138,8	19,0
share (%) in horizontal objectives	10,77%		14,04%		12,93%	
share (%) in total state aid (less agriculture and fisheries)	3,73%		3,95%		2,29%	
share (%) in total state aid	2,41%		2,45%		1,62%	
share (%) in GDP	0,06%		0,06%		0,06%	

Source: Ministry of Finance; data processed in CCA.

Table 15 indicates a continuously growing trend relating to research and development aid in our country since 2004. In 2004 the R&D aid amounted to 124 million HRK, in 2005 there was 129.3 million HRK granted towards that objective, whereas in 2006 an amount of 138.8 million HRK was awarded. In 2004 and 2005 R&D aid was granted in the form of tax advantages, whereas in 2006 R&D aid took the form of grants.

In 2006 the Ministry of Science, Education and Sports awarded to the Business Innovation Centre of Croatia (BICRO d.o.o.) state aid in the amount of 17.3 million HRK. The aid concerned is aimed at the implementation of the RAZUM programme which has been established on the basis of the Guidelines for the promotion of innovation and technology system (Programme for the promotion of technological research projects and Programme for the promotion of entrepreneurship based on innovation and new technologies).

121. 5 million HRK have been granted for aid measures in the form of tax advantages and reductions of tax rate payable which are aimed at the promotion of research and development within the meaning of the Corporate Tax Act (Official Gazette No. 127/00, 163/03, 177/04, 90/05 and 57/06).

4.1.2. Environmental protection and energy conservation

State aid for environmental protection and energy conservation is aimed at any action designed to remedy or prevent damage to our physical surroundings or natural resources, or to encourage the efficient use of these resources and to adapt to the binding ecological standards.

State aid for environmental protection may be granted:

- to SMEs, for adapting to new binding standards up to a maximum of 15 % of eligible costs for a period of three years from the adoption of such standards;
- to large firms, where it serves as an incentive to achieve levels of protection which are higher than those required by the standards or investments in environmental protection as long as no binding standards exist up to not more than 30 % of the eligible costs, whereas SMEs are eligible for the aid concerned up to a maximum of 40 % of the eligible costs;
- for energy efficiency and investments in the combined production of electric power and heat and aid to renewable sources of energy to large firms up to a maximum of 40 % of the eligible costs and to SMEs up to not more than 50 % of the eligible costs.

State aid for the rehabilitation of polluted industrial sites may be granted only where the person responsible for the pollution is not identified or cannot be made to bear the cost. The eligible costs are equal to the cost of the work less the increase in the value of the land.

Operating aid may be granted:

- under the rules applicable to all operating aid to promote waste management and energy saving;
- under the rules applicable to all operating aid in the form of tax reductions or exemptions;
- under the rules applicable to operating aid for renewable energy sources, and
- under the rules to operating aid for the combined production of electric power and heat.

Generally, the eligible costs shall be concerned additional costs of land, buildings, plant and equipment and of intangible investments intended to reduce or eliminate pollution and nuisances or to adapt production methods in order to protect the environment.

Table 16: State aid for environmental protection and energy saving from 2004 – 2006

Environmental protection and energy saving	2004		2005		2006	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	0,2	0,0	6,9	0,9	19,6	2,7
C1 soft loans	0,0	0,0	0,0	0,0	4,3	0,6
TOTAL	0,2	0,0	6,9	0,9	23,9	2,7
share (%) in horizontal objectives	0,02%		0,75%		2,23%	
share (%) in total state aid (less agriculture and fisheries)	0,01%		0,21%		0,39%	
share (%) in total state aid	0,00%		0,13%		0,28%	
share (%) in GDP	0,000%		0,003%		0,010%	

Source: Ministry of Finance; data processed in CCA.

In accordance with the data available to the CCA in 2004 state aid for environmental protection and energy saving amounted to 200.000 HRK, whereas in 2005 this amount increased to 6.9 million HRK and in 2006 to 23.9 million HRK. As a rule, this category of aid has been granted in the form of grants. In 2005 the Environmental Protection and Energy Saving Fund was established in 2005 and since then it provides support to the Ministry for Environmental Protection, Physical Planning and Construction in granting aid concerned.

The submitted documentation and the data available to the CCA show that in 2006 the Environmental Protection and Energy Saving Fund awarded state aid in compliance with the Ordinance on the conditions and methods for granting aid from the resources of the Fund. The aid so awarded amounted to 17.1 million HRK and consisted of grants and soft loans for environmental protection (cleaner production, recycling and hazardous waste disposal) and energy saving (energy efficiency, renewable energy sources and viable energy efficient construction).

Ministry of the Economy, Labour and Entrepreneurship awarded in 2006 an amount of 5.8 million HRK on the basis of the Programme for state aid for development and manufacturing of the equipment for the use of renewable energy sources with the view to raising competitiveness and creating conditions for the use of renewable energy resources in the Republic of Croatia.

In 2006 the Croatian Bank for Reconstruction and Development awarded 1 million HRK of state aid on the basis of the Loan Programme for environmental projects, energy efficiency and renewable energy sources which is in compliance with the Ordinance on general conditions for financing of particular target groups.

4.1.3. Employment

Pursuant to state aid rules state aid for employment may be granted for job creation or job maintenance. The rules in question explicitly exclude the possibility of granting employment aid in the shipbuilding sector and in the sector of maritime transport.

State aid for job creation may be granted for employment of the persons who have not previously been employed, who have lost or are about to lose their jobs. In the areas eligible for regional state aid employment aid may be granted to all undertakings in compliance with the maximum aid intensities as established by the regional state aid map, provided that the aid beneficiary makes at least 25 % contribution from its own resources.

State aid for job creation in the areas which are not eligible for regional state aid may be granted exclusively to small and medium-sized undertakings, whereby small undertakings may receive aid not exceeding 15 % of the eligible costs, whereas medium-sized undertakings may be awarded aid in the amount of up to 7.5 % of the eligible costs. **Eligible costs** for job creation are gross wage costs calculated over a period of two years and aid is subject to the maintenance of the employment created during a minimum period of two years.

State aid to maintain jobs may be authorised:

- where it is intended to make good the damage caused by natural disasters or exceptional or war occurrences;
- where, under the conditions applying to operating aid, it is aimed at the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;
- where such aid is granted in the context of the rescue and restructuring of a company in difficulty, in accordance with the provisions of state aid rules covering rescue and restructuring.

The amount of state aid to maintain jobs is calculated in respect of the number of workers employed at the time when aid is granted.

Table 17: State aid for employment from 2004 – 2006

Employment	2004		2005		2006	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	359,1	47,9	30,0	4,1	98,6	13,5
A2 tax exemptions	115,9	15,5	267,7	36,2	235,9	32,2
TOTAL	475,0	63,4	297,7	40,2	334,5	45,7
share (%) in horizontal objectives	41,26%		32,32%		31,15%	
share (%) in total state aid (less agriculture and fisheries)	14,28%		9,09%		5,52%	
share (%) in total state aid	9,23%		5,65%		3,90%	
share (%) in GDP	0,23%		0,13%		0,13%	

Source: Ministry of Finance; data processed in CCA.

In 2004 475 million HRK state aid for employment was granted, in 2005 it amounted to 297.7 million HRK, whereas in 2006 employment aid amounted to 334.5 million HRK. In respect of aid instruments and in accordance with the data submitted by aid providers in 2005 and 2006 there was a trend of growing share of tax advantages which replaced the formerly most represented aid instruments – grants – in the area of employment aid.

On the basis of the Programme for the promotion of employment in 2006 – 58.7 million HRK aid was granted, on the basis of the Programme for the promotion of employment of disabled persons 0.3 million HRK, whereas in compliance with the Investment Promotion Programme 176.8 million HRK.

Within the meaning of the Annual Plan for the Promotion of Employment for 2006 state aid has been awarded by the Ministry of the Economy, Labour and Entrepreneurship, Ministry of Family Affairs, War Veterans and Intergenerational Solidarity, Ministry of the Sea, Tourism, Transport and Development, Ministry of Health and Social Welfare, Ministry of Science, Education and Sports, Croatian Employment Service and the Fund for Professional Rehabilitation and Employment of Disabled Persons.

In addition, in 2006 state aid for employment in the amount of 235.9 million HRK has been awarded through tax advantages applicable under the Corporate Tax Act.

4.1.4. Small and medium-sized enterprises

State aid to SMEs is earmarked for initial investment, consultancy and other services and participation in fairs and exhibitions. In accordance with state aid rules it may not be granted to the shipbuilding and maritime transport sector.

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 firms.

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%.

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), and
- job creation costs and wage costs for the jobs created and linked to the investments over a period of two years.

The data indicated in Table 18 show that the importance of investment and promotion of this type of entrepreneurship has become generally recognized also in Croatia. The growing trend in granting state aid to SMEs in Croatia in the last three years is shown below.

Table 18: State aid to SMEs from 2004 – 2006

SMEs	2004		2005		2006	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	55,0	7,3	96,3	13,0	78,8	10,8
C1 soft loans	0,0	0,0	0,0	0,0	161,1	22,0
D1 guarantees	0,0	0,0	0,0	0,0	5,0	0,7
TOTAL	55,0	7,3	96,3	13,0	244,9	33,4
share (%) in horizontal objectives	4,78%		10,45%		22,81%	
share (%) in total state aid (less agriculture and fisheries)	1,65%		2,94%		4,04%	
share (%) in total state aid	1,07%		1,83%		2,85%	
share (%) in GDP	0,03%		0,04%		0,10%	

Source: Ministry of Finance; data processed in CCA.

An amount of 55 million HRK state aid to SMEs has been awarded in Croatia in 2004, in 2005 this amount was 96.3 million HRK, whereas in 2006 there was 244.9 million HRK state aid to SMEs granted. The most represented aid instruments in 2004 and 2005 were subsidies; in 2006 more soft loans were awarded which is a positive trend in the state aid policy in the area of SMEs.

It is evident from the specified data that the share of state aid to SMEs has been constantly growing in the past three years, whereby the amount awarded in 2006 was 4.5 times higher than the state aid level awarded in 2004.

In 2006 state aid to SMEs has been mostly granted by the following aid providers:

- Croatian Agency for Small Entrepreneurship awarded 5 million HRK state aid guarantees under the aid schemes such as: *New Entrepreneur, Growth and Development, Area of Special State Concern*, all in compliance with the Small Business Promotion Act (Official Gazette No. 29/2002);
- Croatian Bank for Reconstruction and Development awarded 82.1 million HRK state aid in the form of soft loans under the following aid schemes: *Programme for the Revision of Terms of Payment, Programme for Financing Innovations, Loan Programme for the Promotion of Development of SMEs (direct loans), Loan Programme for the Promotion of Development of SMEs (commercial*

- banks), *Loan Programme for the Development of Economic Activities*, *Loan Programme for the Promotion of Small Business Start-ups*;
- Development and Employment Fund awarded a total amount of 151.5 million HRK in the form of grants and soft loans which have been aimed at the *Promotion of Business and Development Centres and SMEs Centres* and for the *Promotion of the Development of Export Oriented Companies and Job Creation*.
 - Ministry of the Economy, Labour and Entrepreneurship awarded 6.3 million HRK grants on the basis of the *20 Keys Programme for the Improvement of Competitiveness of the Croatian Industry*, for the *Promotion of Education in Business* and for *Business Centres*.

4.1.5. Training

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

Within the meaning of the Regulation on state aid **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.

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.

In 2006 training aid was awarded in the amount of 101.2 million HRK which is 25.1 % more than in 2005 when this amount was 80.9 million HRK. The major aid instruments in 2006 were grants and tax advantages.

Table 19: Training aid from 2004 – 2006

Training	2004		2005		2006	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	0,0	0,0	6,8	0,9	1,9	0,3
A2 tax exemptions	130,4	17,4	74,1	10,0	99,3	13,6
TOTAL	130,4	17,4	80,9	10,9	101,2	13,8
share (%) in horizontal objectives	11,33%		8,78%		9,42%	
share (%) in total state aid (less agriculture and fisheries)	3,92%		2,47%		1,67%	
share (%) in total state aid	2,53%		1,54%		1,18%	
share (%) in GDP	0,06%		0,04%		0,04%	

Source: Ministry of Finance; data processed in CCA.

Croatian Employment Service awarded on the basis of the Annual Programme for the Promotion of Employment for 2006 1.9 million HRK training aid in the form of grants.

Under the Programme for the Promotion of Education and Professional Training and within the meaning of the Corporate Tax Act further 99.3 million HRK state aid towards the objective in question have been awarded to that end.

4.1.6. Culture

State aid to promote culture and heritage preservation involves cultural support schemes which are aimed at preserving national heritage and promoting culture.

In 2006 the total of 90.2 million HRK of state aid to promote culture and heritage preservation was awarded. This is 20.1 % more than in 2005 when 75.1 million HRK had been granted, which is 121.1% more than in 2004 when this amount was 40.8 million HRK.

The aid in question was granted almost exclusively in the form of grants 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.

State aid provider in the area of culture is the Ministry of Culture which has awarded state aid in compliance with the *Ordinance on the Selection and Definition of Public Programmes in Culture, Programme for the Financing of Publishers in 2006* and *Film Financing Programme for 2006*.

Table 20: State aid to promote culture from 2004 – 2006

Culture	2004		2005		2006	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	40,3	5,4	75,1	10,1	90,2	12,3
D guarantees	0,5	0,1	0,0	0,0	0,0	0,0
TOTAL	40,8	5,4	75,1	10,1	90,2	12,3
share (%) in horizontal objectives	3,54%		8,15%		8,40%	
share (%) in total state aid (less agriculture and fisheries)	1,23%		2,29%		1,49%	
share (%) in total state aid	0,79%		1,43%		1,05%	
share (%) in GDP	0,02%		0,03%		0,04%	

Source: Ministry of Finance; data processed in CCA.

4.1.7. Other objectives

State aid in this section is granted under the Loan Programmes¹² 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 in 2004 amounted to 325.8 million HRK; in 2005 it was 235 million HRK whereas in 2006 the figure was 140.4 million HRK. Aid instruments in this area were exclusively subsidies.

Table 21: State aid towards other objectives from 2004 – 2006

Other objectives	2004		2005		2006	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	325,8	43,5	235,0	31,8	140,4	19,2
C1 soft loans	0,0	0,0	0,0	0,0	0,0	0,0
TOTAL	325,8	43,5	235,0	31,8	140,4	19,2
share (%) in horizontal objectives	28,30%		25,51%		13,08%	
share (%) in total state aid (less agriculture and fisheries)	9,80%		7,17%		2,32%	
share (%) in total state aid	6,33%		4,46%		1,63%	
share (%) in GDP	0,16%		0,10%		0,06%	

Source: Ministry of Finance; data processed in CCA.

4.2. SECTOR-SPECIFIC AID

In line with the Regulation on state aid, and subordinately the EC *acquis*, separate state aid rules apply in the following sectors:

- steel manufacturing,
- land, maritime and air transport sector,
- shipbuilding.

Given the importance of the tourism industry in the Croatian economy for the purpose of this annual report tourism has been dedicated a separate section although no separate state aid rules apply but only the ones applicable to state aid towards horizontal objectives.

The group of sector-specific aid also covers **state aid for rescuing and restructuring firms in difficulty**. State aid in question is granted under no particular aid schemes concerning aid to unknown beneficiaries but as ad hoc aid to a particular aid beneficiary.

In 2006 there was a significant upward trend concerning sector-specific aid. The aid level in question reached over 4.6 billion HRK, which is an increase of 125.3% compared

¹² For example, Loan Programme for the Promotion of 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.

with 2005. The highest share of sector-specific aid in 2006 was that of the shipbuilding sector (56.5%), followed by the transport sector (about 40%).

Table 22: Sector-specific aid from 2004 – 2006

Specific sectors	2004			2005			2006		
	mil HRK	mil EUR	share in GDP (%)	mil HRK	mil EUR	share in GDP (%)	mil HRK	mil EUR	share in GDP (%)
Steel production	29,4	3,9	0,01%	51,8	7,0	0,02%	0,0	0,0	0,00%
Transport	422,9	56,4	0,20%	742,4	100,3	0,32%	1.847,0	252,2	0,74%
Shipbuilding	529,6	70,7	0,26%	506,6	68,5	0,22%	2.607,5	356,1	1,04%
Tourism	86,7	11,6	0,04%	189,4	25,6	0,08%	118,0	16,1	0,05%
Other sectors	25,7	3,4	0,01%	57,9	7,8	0,03%	40,6	5,5	0,02%
Rescue and restructuring	591,0	78,9	0,29%	501,9	67,8	0,22%	6,0	0,8	0,00%
Total	1.685,3	224,9	0,81%	2.050,0	277,0	0,90%	4.619,1	630,8	1,84%

Source: Ministry of Finance; data processed in CCA.

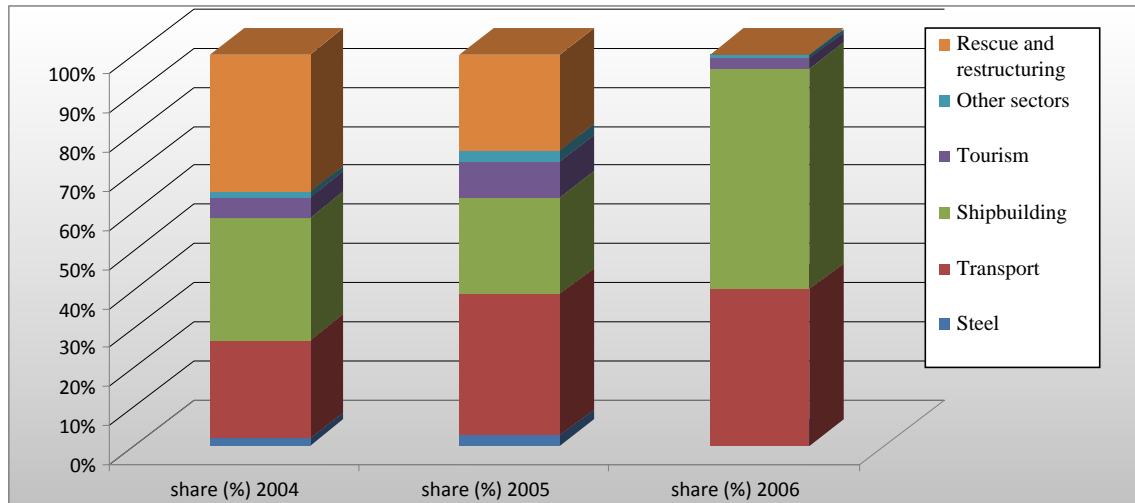
Since 2005 an upward trend of state aid to shipbuilding is evident. In 2005 state aid which was granted in the sector concerned amounted to 506.6 million HRK, whereas it soared to the amount of 2.6 billion HRK in 2006.

The data so indicated would mean that the shipbuilding sector received five times more state aid in 2006 than in the previous year. Nevertheless, here we deal with a so called "legalisation" of state aid to shipbuilding which had been granted in the previous years on the basis of the resolutions passed by the Government of the Republic of Croatia in 2000 and 2002 in accordance to which state aid had been awarded to the sector in question in the form of state guarantees and grants. In the sense of the provisions of the SAA and the State Aid Act these resolutions of the Government are considered existing aid schemes which as of 1 March 2006 should have been brought into compliance with the obligations undertaken under the SAA and the relevant state aid rules. Consequently, this annual report covers all state aid that has been granted in the form of rescue aid contained in state guarantees, on the account of the fact that within the meaning of state aid rules all major Croatian shipyards are considered firms in difficulty where the whole amounts contained in state guarantees constitute state aid. Similarly as in the previous years, total amount of state aid to shipbuilding includes apart from rescue aid also grants and the relevant amounts of guarantee associated with the risk factor.

It is important to say that in 2006 no state aid to the iron and steel industry has been granted.

The structure of state aid for transport reveals that the most significant share has been held by Hrvatske željeznice in the amount of 968.2 million HRK which makes 52.4 % of total aid granted to this sector.

Picture 10: Sector-specific aid granted from 2004 – 2006 (%)



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

4.2.1. Steel industry

State aid to the steel industry is subject to the rules laid down in the State Aid Act, Regulation on state aid 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 the sense of the above mentioned, the Republic of Croatia had been able to authorise rescue and restructuring aid for the steel industry until 1 March 2007 which is generally prohibited in the EU Member States. Nevertheless, state aid for rescuing and restructuring in the steel industry could have been granted only under the following conditions: first, after the conclusion of the restructuring period the undertaking must be able to operate under normal market conditions without aid; second, aid must be restricted to the minimum amount and aid intensity necessary to restore the firm's long term viability and progressively decreased; third, capacity reductions in Croatia must be achieved in accordance with the restructuring plan and connected to global rationalization.

The rescue and restructuring process in the steel industry started on 1 December 2005 when the Government of the Republic of Croatia adopted the Decision on the establishment of the Commission for the Drafting of the proposed National Restructuring Programme for the Steel Industry. Valjaonica cijevi Sisak d.o.o. (*Sisak Rolling Mill*) and Željezara Split d.d. (*Split Iron Works*) are considered firms in difficulty and the only possible way for these undertakings to become eligible for aid was the drafting of the National Restructuring Programme for the Steel Industry and of the individual restructuring plans. The National Restructuring Programme for the Steel Industry in question was adopted by the Croatian Government on 28 February 2007.

The activities in the privatization process of the iron works in question started late in 2006 and were concluded in mid 2007.

Table 23: State aid to steel manufacturing sector from 2004 – 2006

Steel production	2004		2005		2006	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
D guarantees	29,4	3,9	51,8	7,0	0,0	0,0
TOTAL	29,4	3,9	51,8	7,0	0,0	0,0
share (%) in specific sectors	1,74%		2,53%		0,00%	
share (%) in total state aid (less agriculture and fisheries)	0,88%		1,58%		0,00%	
share (%) in total state aid	0,57%		0,98%		0,00%	
share (%) in GDP	0,014%		0,023%		0,000%	

Source: Ministry of Finance; data processed in CCA.

According to the data available to the CCA state aid to the steel sector in 2004 and 2005 had been mainly granted in the form of state guarantees.

In 2004 the undertakings in question had been authorised state guarantees in the amount of 29.4 million HRK, while in 2005 this guarantees amounted to 51.8 million HRK.

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.

The rules on aid to shipbuilding are applicable to "self-propelled seagoing commercial vessels" where these 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 2004 amounted to 529.6 million HRK. In 2005 aid to shipbuilding was granted in the amount of 506.6 million HRK, whereas in 2006 this aid amounted to 2.6 billion HRK. It has been already stated before in this text that the share of aid to this sector was almost five times higher than in the previous years on the account of the fact that this annual report for the first time included state guarantees in the calculation of overall state aid.

In the shipbuilding sector aid is awarded in the form of grants and state guarantees¹³.

¹³ The indicated data have been calculated so as to include aid in the form of direct subsidies based on the data received from the Ministry of Finance and aid in the form of state guarantees granted for rescue aid for the Croatian shipyards within the meaning of the CCA decision as of September 2006. Construction financing guarantees have not been calculated as state aid given

Table 24: State aid to shipbuilding by aid instruments from 2004 – 2006

Shipbuilding	2004		2005		2006	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	484,3	64,6	431,2	58,3	484,7	66,2
B equity participation	20,0	2,7	20,8	2,8	0,0	0,0
D guarantees	25,3	3,4	54,6	7,4	2.122,8	289,9
TOTAL	529,6	70,7	506,6	68,5	2.607,5	356,1
share (%) in specific sectors	31,42%		24,71%		56,45%	
share (%) in total state aid (less agriculture and fisheries)	15,92%		15,46%		43,03%	
share (%) in total state aid	10,29%		9,62%		30,36%	
share (%) in GDP	0,26%		0,22%		1,04%	

Source: Ministry of Finance; data processed in CCA.

Construction financing guarantees are released for the purpose of ship construction, until the moment of delivery of the ship. Table 25 shows overall end-financing and construction financing guarantees granted in the shipbuilding sector in the period from 2004 – 2006.

In the past three years no guarantees have been invoked.

Table 25: End-financing and construction-financing guarantees granted in the shipbuilding sector (in mil HRK)

Year	End-financing	Construction-financing
2004	174,6	4.773,6
2005	629,8	3.458,3
2006	2.889,7	1.147,5

Source: Ministry of Finance; data processed in CCA.

The process of restructuring of the Croatian shipyards started in September 2006 when the CCA authorised rescue aid proposed by the Ministry of the Economy, Labour and Entrepreneurship – aid provider.

The Competition Council authorised rescue aid in the form of state guarantees for shipyards in the amount of 4.2 billion HRK on 21 September 2006. Out of the above mentioned total sum 1.7 billion HRK was granted to Brodosplit Brodogradilište d.o.o., 625 million HRK to Brodotrogir d.d., 1.7 billion HRK to 3. Maj brodogradilište d.d. and 221 million HRK to Brodogradilište Kraljevica d.d.

the fact that they have not been invoked in the past few years. End-financing guarantees were calculated on the basis of state aid associated with 10 % risk factor.

On 18 January 2007 the CCA additionally authorised rescue aid to Brodosplit Brodogradilište specijalnih objekata d.o.o. in the form of state guarantees covering the loans in the amount of 140 million HRK.

Out of the total amount of authorised rescue aid to shipyards in 2006 the Government of the Republic of Croatia has taken decisions on state guarantees covering state aid in the amount of 1.4 billion HRK.

In 2006 state guarantees to shipbuilding amounted to the total of 2.1 billion HRK.

The Ministry of the Sea, Tourism, Transport and Development awarded in 2006 to the shipbuilding sector grants for the promotion of shipbuilding for the Croatian ship owners, construction of fishing vessels and construction and reconstruction of the excursion ships in the Croatian shipyards in the amount of 68.6 million HRK.

The Ministry of the Economy, Labour and Entrepreneurship awarded at the same time to the shipbuilding sector grants for the promotion of the constructions of small ships and for employment in the amount of 416.1 million HRK.

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. State aid in this sector generally covers the additional costs incurred on commercially unviable shipping lines connecting the coast with the islands.

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 26: State aid to the transport sector from 2004 – 2006

Transport	2004		2005		2006	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
Rail transport	0,0	0,0	0,0	0,0	968,2	132,2
Other land transport	3,3	0,4	268,9	36,3	403,1	55,0
Maritime transport	319,6	42,6	370,4	50,1	419,8	57,3
Air transport	100,0	13,3	73,5	9,9	56,0	7,6
TOTAL	422,9	56,4	712,8	96,3	1.847,1	252,2
Guarantees	0,0	0,0	29,6	4,0	0,0	0,0
TOTAL	422,9	56,4	742,4	100,3	1.847,1	252,2
share (%) in specific sectors	25,09%		36,21%		39,99%	
share (%) in total state aid (less agriculture and fisheries)	12,71%		22,66%		30,48%	
share (%) in total state aid	8,22%		14,09%		21,51%	
share (%) in GDP	0,20%		0,32%		0,74%	

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 742.4 million HRK, whereas it doubled to 1,847.1 million HRK in 2006.

The highest share in 2006 was that of state aid granted to railways which amounted to 968.2 million HRK. This was followed by aid to other land transport which in 2006 rose by some 50 % in comparison with the previous year, whereas aid to maritime transport increased by 13.3 %. At the same time aid to air transport dropped by 23.8 %.

Aid to maritime transport consists mainly of incentives to liner shipping and passenger fleet renewal. In 2006 the incentives in question amounted to 419.8 million HRK.

Aid to air transport amounted in 2006 to 56 million HRK in the form of grants. This was given to the undertaking Croatia Airlines d.d. for the maintenance of the domestic air transport.

As already mentioned before, the most part of aid in the sector of land transport has been granted to Hrvatske željeznice (Croatian railways) – 968.2 million HRK. The Ministry of the Sea, Tourism, Transport and Development awarded in 2006 grants earmarked for the promotion of passenger railway transportation and combined transport as well as subsidies for payments to workers made redundant in the amount of 564.7 million HRK, whereas 403.5 million HRK was granted for the modernisation of Hrvatske željeznice in the form of capital injections.

The Railway Act (Official Gazette No 123/03, 194/03 and 30/04), which applies since 1 January 2006, and the Act on the Dissociation of the Company HŽ – Hrvatske željeznice

d.o.o., set up a new legal and institutional framework for the railway operation and thereby anticipated the liberalization of railway transport which then implies that particular support of the state granted to Hrvatske željeznice d.o.o. constitutes state aid. This is a major change given that in the past, when pursuant to the relevant rules then in effect the market was closed and only the undertaking HŽ d.o.o was assigned special rights to perform rail transport services in the Republic of Croatia.

State aid in the railway transport sector is aimed at redundancy payments, promotion of passenger railway transportation and combined transport, purchase of new railway rolling stock and modernisation.

Table 27: State aid to transport sector by aid instruments 2004 – 2006 (in mil HRK)

	2004	2005	2006
A1 grants	321,1	559,2	1.188,9
B equity participation	101,8	100,3	417,8
C1 soft loans	0,0	53,3	240,3
D guarantees	0,0	29,6	0,0
Total	422,9	742,4	1.847,0

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

As shown in Table 27, the most popular aid instrument in this sector in 2006 was direct grants – 64.4 % of the total state aid granted in this sector.

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 the promotion of small and medium-sized enterprises in tourism, strengthening of competitiveness and alike¹⁴.

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 (granted to SMEs), Programme for subsidizing organized foreign and domestic tourist transport (to all undertakings), Programme "Incentives for Success" (to SMEs).

Table 28: State aid to tourism by aid instruments 2004 – 2006

Tourism	2004		2005		2006	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	86,7	11,6	88,6	12,0	102,1	13,9
B equity participation	0,0	0,0	9,0	1,2	0,0	0,0
C1 soft loans	0,0	0,0	0,0	0,0	15,9	2,2
D guarantees	0,0	0,0	91,8	12,4	0,0	0,0
TOTAL	86,7	11,6	189,4	25,6	118,0	16,1
share (%) in specific sectors	5,14%		9,24%		2,55%	
share (%) in total state aid (less agriculture and fisheries)	2,61%		5,78%		1,95%	
share (%) in total state aid	1,68%		3,59%		1,37%	
share (%) in GDP	0,04%		0,08%		0,05%	

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

In 2006 tourism received 118 million HRK state aid which is 37.7 % less than in the previous year. Tourism mainly received state aid in the form of grants - 102.1 million HRK or 86.5 % of total aid to tourism.

The Croatian Bank for Reconstruction and Development awarded in 2006 to the sector concerned the amount of 55.1 million HRK in the form of interest rebates and soft loans.

The Ministry of the Sea, Tourism, Transport and Development awarded in the same period the amount of 62.9 million HRK grants. The grants in question have been awarded on the basis of the Programme for subsidizing organized foreign and domestic tourist transport in 2005, Development of Tourism in Small Businesses Programme for 2001 – 2003 and Incentives for Success Programme aimed at financing of small family businesses in tourism.

4.2.5. Other industries

Other than the above mentioned sector-specific aid in 2006 state aid was granted for the deconstruction of the undertaking TEF d.d. Šibenik, for automotive industry and parts manufacturers and for the financing of the development and improvement of the textile and leather processing industry.

Total state aid in this category has been reduced in 2006 compared with 2005 by some 30 % and amounted to 40.6 million HRK.

Table 29: State aid to other sectors by aid instruments 2004 – 2006

Other services	2004		2005		2006	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	20,7	2,8	26,4	3,6	37,5	5,1
B equity participation	0,0	0,0	11,5	1,6	0,0	0,0
C1 soft loans	5,0	0,7	20,0	2,7	3,1	0,4
TOTAL	25,7	3,4	57,9	7,8	40,6	5,5
share (%) in specific sectors	1,52%		2,82%		0,88%	
share (%) in total state aid (less agriculture and fisheries)	0,77%		1,77%		0,67%	
share (%) in total state aid	0,50%		1,10%		0,47%	
share (%) in GDP	0,01%		0,03%		0,02%	

Source: Ministry of Finance; data processed in CCA.

State aid in this area has been mainly granted in the form of direct grants, especially in 2006, only exceptionally soft loans have been awarded.

4.2.6. Rescue and Restructuring

Within the meaning of the state aid rules, state aid for rescuing and restructuring may be granted to 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.

Rescue aid may be awarded for the time needed to work out a restructuring or liquidation plan. The general principle is that rescue aid makes it possible temporarily to support a company confronted with an important deterioration of its financial situation. Such temporary support may not exceed six months and it may be granted only once. In order to be approved rescue aid must:

- consist of liquidity support in the form of loan guarantees or loans under market conditions;
- 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 restricted to the amount needed to keep the firm in business for the period during which the aid is authorised.

Restructuring aid is linked to the restructuring plan which must restore the long-term viability of the firm. The restructuring plan 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. What is most important, 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.

In 2004 restructuring aid has been awarded in the amount of 591 million HRK, whereas in 2005 the amount of aid for rescue and restructuring was 501.9 million HRK. In 2006 the amount of aid for the same purpose was only 6 million HRK given the fact that rescue and restructuring aid for the shipbuilding sector has been separately calculated and reported within the shipbuilding section.

Table 30: State aid for rescuing and restructuring firms in difficulty from 2004 – 2006 (less shipbuilding)

Rescue and restructuring	2004		2005		2006	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	493,7	65,9	354,5	47,9	0,0	0,0
A2 debt write-off	0,0	0,0	0,0	0,0	6,0	0,8
B equity participation	14,2	1,9	10,2	1,4	0,0	0,0
C1 soft loans	49,2	6,6	0,0	0,0	0,0	0,0
D guarantees	33,9	4,5	137,2	18,5	0,0	0,0
TOTAL	591,0	78,9	501,9	67,8	6,0	0,8
share (%) in specific sectors	35,07%		24,48%		0,13%	
share (%) in total state aid (less agriculture and fisheries)	17,77%		15,32%		0,10%	
share (%) in total state aid	11,49%		9,53%		0,07%	
share (%) in GDP	0,29%		0,22%		0,00%	

Source: Ministry of Finance; data processed in CCA.

The Croatian Pension Insurance Fund awarded in 2006 state aid for rescue and restructuring in the amount of 6 million HRK in the form of debt write-offs. A debt relief has been granted to the firms in difficulty: Vodičanka d.d. from Vodice and Borovo d.d. from Vukovar within the meaning of Article 14 of the Act on Due Payments of Outstanding Taxes, Tariffs, Contributions and State Guarantees (Official Gazette No 117/01, 95/02 and 19/03).

While in 2004 and 2005 state aid for rescuing and restructuring of the firms in difficulty had been awarded in the form of state guarantees and grants, in 2006 debt-write offs have been the prevailing aid instrument.

5. REGIONAL AID

Regional aid is designed to develop the less-favoured regions of the Republic of Croatia where standard of living is abnormally low and with serious underemployment¹⁵. In compliance with the state aid rules it may be granted for initial investment and job creation linked with the 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 in 2006 amounted to a total of 301 million HRK. Tax advantages and tax reliefs have been awarded in the areas of special state concern in the amount of 171.7 million HRK, the town of Vukovar received 37.1 million HRK, whereas free zone users have been eligible for 51.8 million HRK. Regional aid in question is based on the Profit Tax Act (OG 177/04, 90/05 and 57/06), Free Zones Act (OG 44/96), Investment Promotion Act (OG 73/00), Act on Hilly and Mountainous Areas (OG 12/02, 117/03, 42/05 and 90/05), Act on Areas of Special State Concern (26/03, 42/05 and 90/05) and Act on Reconstruction and Development of the Town of Vukovar (OG 44/01 and 90/05).

At the same time, the Croatian Bank for Reconstruction and Development awarded in 2006 regional aid in the form of interest rebates and soft loans in the amount of 21.5 million HRK on the basis of the following aid schemes: Loan Programme for the Promotion of the Development of Small and Medium-Sized Entrepreneurship (direct loans), Loan Programme for the Development of the Economy, Loan Programme for Incentives to SMEs' Start-ups.

The Ministry of the Sea, Tourism, Transport and Development awarded in 2006 regional state aid in the form of grants in the amount of 19 million HRK for drinking water supply on the islands on the Adriatic and for the promotion of economic development on the islands.

Table 31: Regional state aid by aid instruments¹⁶ from 2004 – 2006

Regional aid	2004		2005		2006	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
Regional aid	146,0	19,5	170,5	23,0	301,0	41,1
share (%) in total state aid (less agriculture and fisheries)	4,39%		5,20%		4,97%	
share (%) in total state aid	2,84%		3,24%		3,50%	
share (%) in GDP	0,07%		0,07%		0,12%	

Source: Ministry of Finance - Tax Administration; data processed in CCA.

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)

There is a significant upward trend in the regional state aid award in the report period. In 2006 regional state aid grew by 76.5 % in comparison with the year 2005. At the same time it can be observed that their share in the total state aid rose from 2.8 % share in 2004 to 3.5 % in 2006. In the following years even more intensive growth of regional aid is foreseen, particularly after the adoption of the new Investment Promotion Act.

Aid instruments in this area in the three-year report period have remained grants and tax advantages, whereas in 2006 a small portion thereof has been covered also by soft loans.

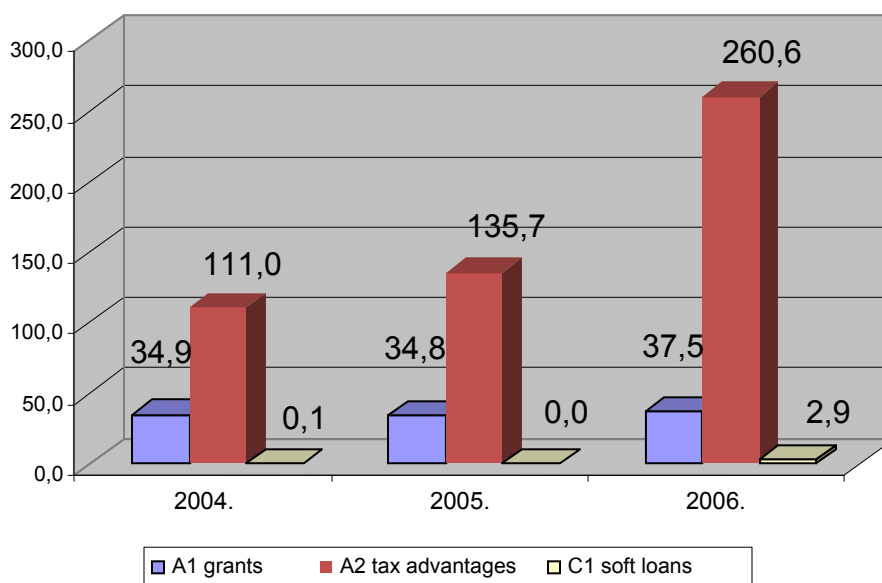
Tax advantages granted within the meaning of the Profit Tax Act indicate a significant share which has been constantly growing throughout the three-year report period.

Table 32: Regional state aid in the Republic of Croatia by aid instruments¹⁷ in the period from 2004 – 2006 (in million HRK)

Instrument	2004	2005	2006	Index 05/04	Index 06/04	Index 06/05
A1 grants	34,9	34,8	37,5	99,71	107,45	107,76
A2 tax exemptions	111,0	135,7	260,6	122,25	234,77	192,04
C1 soft loans	0,1	0,0	2,9	0,00	0,00	0,00
TOTAL	146,0	170,5	301,0	116,78	206,16	176,54

Source: Ministry of Finance - Tax Administration; data processed in CCA.

Picture 11: Regional state aid by aid instruments¹⁸ in the period from 2004 – 2006 (in million HRK)



Source: Ministry of Finance - Tax Administration; data processed in CCA.

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 (guarantees)

6. STATE AID AT LOCAL AND REGIONAL 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 134.9 million HRK in 2005 to 65.5 million HRK in 2006. This is appreciably less than the amount of aid recorded in this category in 2004 when state aid at local level amounted to 343.5 million HRK.

In compliance with the methodology used in the European Community in respect of state aid reports the CCA excluded from its annual report on state aid for 2006 de minimis aid (state aid the amount of which does not exceed 750.000 HRK per aid beneficiary in the period of three years).

As already mentioned before, local and regional self-government units other than big cities often award this category of aid. Consequently, the exclusion of de minimis aid from the annual report on state aid for 2006, although methodologically justifiable, nevertheless influences the data on the level of state aid at the local and regional level.

In addition, taking into account the activities of local administration aimed at the promotion of entrepreneurship – especially those of bigger counties, towns and municipalities – it is evident that 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. A number of local aid providers fail to communicate to the Agency data on state aid granted. The Agency's request for data submittal was answered only by 15 out of 20 counties, the City of Zagreb, 96 out of 123 towns and 305 of a total of 420 municipalities.

Although the response of local administrations can in no way be considered satisfactory there were still 9 % more cities and towns and 18 % more municipalities which notified the award of state aid in 2006 than in the previous year.

Table 33: State aid awarded at local and regional level by aid instruments¹⁹ in the period from 2004 – 2006

Aid at local level	2004		2005		2006	
	mil HRK	mil EUR	mil HRK	mil EUR	mil HRK	mil EUR
A1 grants	268,6	35,8	123,0	16,6	65,5	8,9
A2 tax exemptions	0,0	0,0	0,7	0,1	0,0	0,0
B equity participation	25,2	3,4	0,0	0,0	0,0	0,0
C1 soft loans	39,3	5,2	7,4	1,0	0,0	0,0
D guarantees	10,4	1,4	3,8	0,5	0,0	0,0
TOTAL	343,5	45,8	134,9	18,2	65,5	8,9
share (%) in total state aid (less agriculture and fisheries)	10,33%		4,12%		1,08%	
share (%) in total state aid	6,68%		2,56%		2,56%	
share (%) in GDP	0,17%		0,06%		0,03%	

Source: Ministry of Finance - Tax Administration; data processed in CCA.

When processing the relevant data the CCA excluded the incentives to infrastructure investment, which, as a rule, do not constitute state aid, and financial transfers from the state budget to the local and regional self-government units, which also cannot constitute state aid.

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 (guarantees)

7. DE MINIMIS AID

De minimis aid is deemed state aid granted to any one beneficiary which may not exceed 750.000 HRK over any period of three years. This ceiling applies irrespective of the form of the aid or the objective pursued. These aid measures do not fall under the notification requirement and consequently do not need to be authorised by the CCA.

Where aid provider grants de minimis aid to an enterprise, it shall inform the enterprise about the de minimis character of the aid. It shall also inform the CCA on any de minimis aid granted within the period of 15 days from the day it was granted.

Table 34: De minimis aid granted in 2006

	2006	2006
	mil HRK	mil EUR
Environmental protection and energy saving	1,52	0,21
Rescue and restructuring	6,59	0,90
SMEs	67,36	9,20
Training	0,60	0,08
Employment	21,17	2,89
Transport	2,96	0,40
Tourism	5,76	0,79
Aid at local level	143,74	19,63
Total aid of small value	249,71	34,10

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

Pursuant to the data and documentation received by the CCA the following aid providers granted de minimis aid in 2006:

- Environmental Protection and Energy Saving Fund which awarded state aid in compliance with the Ordinance on the conditions and methods for granting aid from the resources of the Fund. The Fund awarded 1.5 million HRK in the form of grants and soft loans. The objectives of aid scheme on the basis of which aid has been granted are environmental protection (cleaner production, use of waste and hazardous waste disposal) and energy saving (energy efficiency, renewable energy sources and viable energy efficient construction);

- The Croatian Pension Insurance Fund awarded de minimis aid for rescue and restructuring in the amount of 6.6 million HRK in the form of debt write-offs and relief from social security contributions within the meaning of Article 14 of the Act on Due Payments of Outstanding Taxes, Tariffs, Contributions and State Guarantees (Official Gazette No 117/01, 95/02 and 19/03).
- The Fund for Professional Rehabilitation and Employment of Disabled Persons awarded de minimis aid in the form of grants amounting to 3.6 million HRK;
- The Ministry of Family Affairs, War Veterans and Intergenerational Solidarity awarded 9.7 million HRK grants for employment and 0.6 million HRK for training. Aid in question has been awarded on the basis of the Programme for professional training and employment of the unemployed Croatian veterans and children of the killed, imprisoned or missing Croatian veterans, under the aid measures for individual business projects, self-employment and promotion of establishment of veterans' cooperatives;
- The Croatian Agency for Small Entrepreneurship awarded aid in the amount of 3.5 million HRK in the form of grants to SMEs in compliance with the 2006 Programme *Entrepreneurship for Target Groups*;
- The Croatian Bank for Reconstruction and Development awarded aid to SMEs and tourism in the form of interest rebates and soft loans in the amount of 5.2 million HRK within the Loan Programme for the preparation of the tourist season and Loan Programme for development of economic activities;
- The Ministry of the Sea, Tourism, Transport and Development awarded a total of 12.2 million HRK in the form of grants earmarked for employment in the tourism and maritime transport sector in accordance with the Financing project for building and reconstruction of passenger and excursion ships for the needs of the Croatian ship owners – small enterprises in the maritime transport sector, for the maintenance of jobs on the islands – aid for employment aimed at the employers on the islands, and, in the sector of tourism, under the Programme for the promotion of protection and reconstruction of the cultural heritage in the underdeveloped areas and its inclusion in the tourist offer;
- The Ministry of the Economy, Labour and Entrepreneurship awarded an amount of 63 million HRK in the form of grants to SMEs under different aid schemes, such as: Promotion of Cluster Investment, Incentives to Target Groups, Development of Cooperatives through Incentives, Co-financing of Companies for Participation on International Fairs (export incentives), New Cooperatives, Incentive Measures for Production, New Technologies and Products, Technical Adjustments for 2006, Pilot project for 2006: *Innovation and Production Clusters – Knowledge Centres*, Pilot project for 2006: *Promotion of Marketing*, Additional training and Re-training in Trades, Trades Preservation, Traditional Crafts and Trades 2006, Artistic Crafts (development of crafts and training of craftsmen) and Interest Rebates for Loans and Aid Measures (development of SMEs);
- Counties, municipalities and towns awarded grants to enterprises in the amount of 143.7 million HRK.

8. CROATIA COMPARED TO EU

The following chapter provides a comparative insight into the levels of state aid in the EU and its Member States.

Taking into account that EU scoreboards on state aid exclude aid to agriculture and fisheries and 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 2006 were not available at the moment of the conclusion of this report, the comparison has been made using the relevant EU data for 2005 (State Aid Scoreboard autumn 2006 update)²⁰.

²⁰ http://ec.europa.eu/comm/competition/state_aid/scoreboard/2006/autumn_en.pdf

Table 35: State aid in Croatia compared with EU Member States 2005

	2005				
	Total aid less railways		Total aid less agriculture, fisheries and transport		
	mil EUR	share in GDP (%)	mil EUR	share in GDP (%)	share of horizontal aid (%)
2004	686,60	2,49	387,30	1,40	39,65
Croatia 2005	712,00	2,30	342,50	1,11	36,35
Croatia 2006	1.040,50	3,04	575,20	1,68	25,49
EU - 25	63.750,33	0,59	45.093,60	0,42	83,62
EU Old Member States (15)	58.697,39	0,57	42.185,19	0,41	85,02
EU New Member States (10)	5.052,94	0,93	2.908,40	0,52	63,35
BE	1.193,65	0,40	699,54	0,23	99,87
CS	529,85	0,54	386,95	0,39	99,57
DA	1.322,34	0,64	1.074,49	0,52	97,00
DE	20.331,72	0,90	15.172,19	0,68	80,61
ET	48,78	0,46	13,95	0,13	100,00
EL	361,35	0,20	257,12	0,14	97,15
ES	3.753,17	0,41	3.283,77	0,36	65,87
FR	9.650,41	0,56	6.486,13	0,38	88,23
IE	1.004,07	0,63	424,25	0,26	73,81
IT	6.390,50	0,45	5.327,64	0,37	95,94
CY	192,47	1,43	134,57	1,00	44,82
LV	107,36	0,84	28,81	0,23	97,05
LT	119,16	0,58	25,66	0,12	81,14
LU	43,01	0,15	43,01	0,15	100,00
HU	1.609,91	1,83	948,69	1,08	48,23
MT	142,24	3,16	117,35	2,61	3,08
NL	1.986,59	0,40	1.182,88	0,24	96,62
AU	1.369,88	0,56	596,86	0,24	95,26
PL	1.874,12	0,82	907,57	0,37	70,40
PT	984,75	0,67	956,50	0,65	25,73
SL	228,84	0,83	126,44	0,46	88,90
SK	253,03	0,66	245,10	0,64	60,58
FI	2.677,53	1,75	559,00	0,38	97,46
SE	3.110,69	1,08	2.613,27	0,91	100,00
UK	4.517,74	0,26	3.508,55	0,20	90,51

Source: DG Competition

The data indicated in Table 35 show the absolute amounts of state aid granted in Croatia compared to the relevant data of EU Member States, where Croatia awards state aid at the level comparable to that of Austria and Finland (particularly when aid to the transport sector and agriculture and fisheries is excluded). Nevertheless, the share of aid to GDP of the Republic of Croatia appreciably exceeds the shares reported for the EU Member States (besides Malta). There is also an important difference in the structure of aid. The relevant data show that the prevailing share of sector-specific aid in the total state aid is observable, apart from Croatia, only in Malta, Portugal, Hungary and Cyprus.

In EU-25 the highest level of state aid is that of Germany where it makes 33 % of the total state aid granted in the EU. The share of aid to GDP of the country in question is also relatively high and amounts to 0.7 % which is higher even from the EU average. One of the highest shares of state aid in the GDP is also held by Sweden, 0.9 % which is

mostly earmarked for environmental protection and energy saving. Cyprus with 1 % and Malta with 1.1 % share of aid to GDP are countries where the major part of state aid is aimed at transition measures of limited duration which are aimed at the necessary adjustments of some industries, such as for instance shipbuilding, to the EU criteria. On the other hand, there are countries with exceptionally low shares of aid to GDP (less than 0.3 %), such as Baltic countries, Greece, Netherlands, Austria, Great Britain and Luxemburg.

More than a half of the EU Member States reacted positively on the European Council and European Commission initiative for less and better targeted aid. State aid towards horizontal objectives makes meanwhile more than 90 % of their state aid, whereas the most significant increase has been reported in the area of incentives in the form of tax relieves earmarked for environmental protection and energy saving. These aid measures make for as much as 28 % of total aid granted (less agriculture and fisheries and transport). State aid to other horizontal objectives is distributed as follows: research and development aid holds a share of 12 % in the total aid, 19 % is allocated to regional development, 10 % to SMEs, employment aid holds 8 % and training aid 2 %. At the same time, the level of state aid granted towards horizontal objectives remained the same when compared to previous years.

The EU state aid scoreboard shows that in the area of sector-specific aid in 2005 aid to the manufacturing and services sector amounted to 65 %, aid to agriculture and fisheries held a 26 % share, the coal sector 6 %, the transport sector (less railways) 2 % whereas 1 % was allocated to other non-manufacturing sectors. Member States which award 80 % and more state aid to industry and services are Luxemburg, Slovak Republic, Portugal, Sweden, Italy, Malta and Denmark, whereas Latvia, Finland and Estonia allocate 60 % or more of total state aid to agriculture and fisheries. In the coal sector relatively high shares of state aid are held by Spain (29 %), Germany (13 %) and Poland (12 %).

9. CONCLUSION

The data for 2006 show that in this report period the Republic of Croatia allocated 8,587.8 million HRK state aid while its share in the GDP was 3.43 %.

In comparison with the previous two years in 2006 there was an upward trend relating to both absolute level of state aid and its share in the GDP. Nevertheless, it must be taken into account here that taken aside the actual rise of state aid to agriculture and fisheries, transport and shipbuilding, a certain part of the rise in the level of state aid is statistically underpinned.

This explanation is particularly valid in the case of aid to shipbuilding. As previously stated in this report, rescue aid contained in state guarantees that had been given to shipbuilding until the first half of 2006 had not been entirely included in the total amount of state aid and as such had not been integrated in state aid reports for 2004 and 2005. State guarantees in question had been based on the resolutions of the Government of the Republic of Croatia from 2000 and on aid schemes that had been in force before the State Aid Act became applicable in April 2003. Within the meaning of the provisions of the SAA, the Republic of Croatia had undertaken the commitment in respect of the alignment of the existing aid schemes with state aid rules under the State Aid Act and the relevant EC acquis until April 2006.

Therefore, until the above mentioned deadline the amounts of direct subsidies to shipbuilding had been included in state aid reports, whereas state aid contained in state guarantees had been included only in the part calculated on the basis of default risk linked to state guarantees concerned and invoked guarantees in accordance with state aid rules which provide for particular criteria where state guarantees do not constitute state aid. Only after the competent ministry requested from the CCA to authorize rescue aid to shipbuilding and after the start of the restructuring process of the Croatian shipyards, it became evident that the undertakings in question are firms in difficulty. Consequently, the total amount of state guarantees in the "rescue package" in 2006 of 1.4 billion HRK out of the total of 4.2 billion HRK that have been granted, had to be calculated as state aid within the meaning of state aid rules.

In a nutshell, the rise in state aid based on the inclusion of rescue aid contained in state guarantees significantly affected the total level of state aid which was granted in 2006. Without this state aid to shipbuilding, the total amount of state aid, less agriculture and fisheries and transport, would have been 2,809.5 million HRK and its share in the GDP would then have reached 1.12 %.

The beginning of the restructuring process in the shipbuilding industry which marked the year 2006 is actually taken as a positive step towards the solution of the problems in this sector, regardless of the fact that this brought about the statistical rise in state aid, in other words its "legalisation" in the report year.

The data on the share of state aid to shipbuilding for 2006 but also in the previous years very clearly indicate that further operations of the sector concerned became unviable under the existing conditions. The former regime of granting state aid would not only prevent Croatia from its membership in the EU. Moreover, under the market conditions it is not justifiable to have such a state aid regime which gives incentives to the shipbuilding sector, neither from the economic, nor from the fiscal point of view.

Particularly in respect of other industries and economic activities which base their survival on the market exclusively on their own efficiency and competitiveness.

In 2006 no state aid to the iron and steel sector has been granted, despite the fact that this was the time when the national restructuring plan in the industries concerned was prepared and there have been no legal obstacles to grant aid to this sector. On the contrary, the restructuring in this area will be carried out by private investors who bought Valjaonica cijevi Sisak d.o.o. (*Sisak Rolling Mill*) and Željezara Split d.d. (*Split Iron Works*).

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 from 2004 to 2006 and the relevant amounts are similar to those granted in the EU.

An upward trend in state aid towards horizontal objectives continued also in 2006. It is particularly important that the level of aid in question rose in respect of almost all objectives, especially for employment, environmental protection and energy saving and SMEs. Yet, due to the already mentioned rise in state aid to shipbuilding the relevant data show a lower share of horizontal aid in the total amount of state aid.

It is observable from the data in this annual report that the majority of state aid has been granted on the basis of aid schemes which for the most part have been notified to the CCA by aid providers, who on their part, have adjusted the existing aid schemes with state aid rules and respected the relevant rules when they awarded aid pursuant to aid schemes in question. In other words, excluding state aid for rescuing and restructuring of the shipyards in difficulty, ad hoc aid to individual beneficiaries has not, in principle, been granted without the necessary authorisation of the CCA.

In conclusion, the data shown in this annual report indicate that the Republic of Croatia still allocates an appreciable amount of the state budget to state aid. This state aid is generally directed to three sectors: agriculture and fisheries, transport and shipbuilding. Only a minor part of aid is directed to compensate for market failures and raising of the competitiveness of the Croatian economy through the promotion of investment in research and development and innovation, environmental protection and energy efficiency, employment and training, small and medium-sized enterprises etc. In the pre-accession period it is therefore of uttermost importance to sustain with and speed up the restructuring of the sectors, such as the shipbuilding industry and Croatian railways, and to enable the undertakings from these sectors to get prepared for competition in the European and global market.

At the same time, state aid must be redirected to horizontal objectives such as research and development and innovation, environmental protection, promotion of SMEs and other horizontal objectives with the view to raising efficiency and effectiveness of the economy as a whole.

10. 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 also fall under A 2.

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
Revoked payments guarantees	Full payments of guaranteed obligations

11. 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
