

**REPUBLIC OF CROATIA
CROATIAN COMPETITION AGENCY**

**A N N U A L R E P O R T
ON THE WORK OF THE CROATIAN COMPETITION
AGENCY CONCERNING THE STATE AID AND ANNUAL
REPORT ON STATE AID FOR 2003**

May 2004

I. REPORT ON THE WORK OF THE CROATIAN COMPETITION AGENCY CONCERNING THE STATE AID IN 2003	1
1. Introduction	1
1.1 Importance of establishing the legislative framework for the obligations assumed by the Republic of Croatia under international agreements.....	1
1.2 Adoption of the State Aid Act and the Regulation on State Aid.....	2
2. State aid in the EU	2
3. State aid under the State Aid Act.....	3
3.1 Definition of state aid.....	3
3.2 State aid providers	4
3.3 State aid beneficiaries.....	4
3.4 State aid categories	4
3.5 Responsibilities of the Croatian Competition Agency	6
3.6 Procedure of authorising, monitoring the implementation and recovery of state aid	6
3.6.1 Procedure before the Agency	6
3.6.2 Monitoring of the implementation and recovery of state aid	7
3.6.3 Subsequent approval and recovery of state aid	7
3.6.4 Budgeting.....	7
3.7 The activities of the Agency in the previous period.....	8
4. Conclusion	11
 II. REPORT ON STATE AID FOR 2002 and 2003	12
1. Introduction	12
2. Overview of state aid in 2002 and 2003.....	13
2.1 State aid by allocation instrument	14
2.2 State aid categories	16
3. Agriculture and fisheries.....	18
4. Industry and services	19
4.1 Horizontal objectives	19
4.2 Specific sectors	20
4.2.1 Transport	20
4.2.2 Shipbuilding	21
4.2.3 Tourism	22
4.2.4 Other sectors	23
4.2.5 Financial services	23
5. Regional aid	24
6. Conclusion	25

I. REPORT ON THE WORK OF THE CROATIAN COMPETITION AGENCY CONCERNING THE STATE AID IN 2003

1. Introduction

1.1 Importance of establishing the legislative framework for the obligations assumed by the Republic of Croatia under international agreements

The traditional forms of protection of free enterprise by applying competition rules, such as a ban on cartels, abuse of dominant position or prohibited concentrations cannot entirely ensure equal opportunities of undertakings for business success, simply because they ignore an entity having a major influence on the economy – the State. The transition from the state-run economy into the market economy thus involves a need to redefine the role of the State in the economic life. State interventions in the economy may take various forms (subsidies, guarantees, debt write-offs, preferential sale of state-owned real estate, etc.) and significantly influence the competitive position and the final business success of individual undertakings. It is therefore necessary to regulate the system of approval and monitoring of state aid in order to achieve the socio-economic goals of the State, while, at the same time, abiding by the principle of equal rights of all market players to success.

The Republic of Croatia, by signing the Stabilisation and Association Agreement between the Republic of Croatia and the European Communities and their Member States (Official Gazette – International Treaties, Nos. 14/01 and 14/02) and the Interim Agreement on Trade and Trade-related Issues between the Republic of Croatia and the European Communities (Official Gazette – International Treaties, Nos. 15/01, 3/02 and 14/02) has assumed the obligations to establish a state aid system conforming with the state aid system in the European Union (hereinafter: the EU).

Under Article 69 of the Stabilisation and Association Agreement, the Republic of Croatia is committed to harmonise its existing laws and prepare future legislation in conformity with the *acquis*. Regarding the harmonisation of legislation with the *acquis*, the Republic of Croatia, in agreement with the Commission of the European Communities, is defining the methods of monitoring the harmonisation process and the steps to be taken for its implementation.

The Republic of Croatia, pursuant to Article 35 of the Interim Agreement, or Article 70 of the Stabilisation and Association Agreement, had to set up a body authorised to authorise general and individual aid schemes and order the recovery of unlawfully granted state aid. Furthermore, the Republic of Croatia has undertaken, *inter alia*, to ensure transparency in granting state aid, including regular annual reporting thereon to the EU in accordance with the methods and forms used within the EU.

The Protocol on Croatia's accession to the Marrakech Treaty on the Establishment of the World Trade Organisation (Official Gazette, International Treaties, Nos. 13/00 and 14/00), as well as the signed bilateral free-trade agreements, also include assumed obligations in the area of state aid involving the existence of a state aid system.

The activities in building up and redefining the state aid system in Croatia began a few years ago in the co-ordination of the Ministry of Finance with international

financial institutions and relevant ministries within the fiscal policy. A special relationship in shaping the state aid policy was established with the World Bank and, through the SAL (Structural Adjustment Loans) programme, with the International Bank for Reconstruction and Development, as well as the International Monetary Fund. Thus, the SAL Agreement between Croatia and the International Bank for Reconstruction and Development provides for an obligation to cut back on total state aid in the economy and to make indirect aid transparent. The said obligations have been fulfilled by taking the required measures¹, and the results thereof² have been confirmed in the Final Report by the World Bank on the performance under the SAL Agreement of 22 October 2003. As a follow-up, talks are under way, co-ordinated by the Ministry of Finance, on further co-operation with the World Bank in this area, including the programmes of strengthening the competitiveness of the economy and the financial discipline of the State, all within the Programme Adjustment Loan (PAL).

1.2 Adoption of the State Aid Act and the Regulation on State Aid

The State Aid Act (Official Gazette No. 47/03, hereinafter: the Act), entered into force on 2 April 2003, and the Regulation on State Aid (Official Gazette No. 121/03, hereinafter: the Regulation), on 6 August 2003. These regulations laid down the state aid system in the Republic of Croatia in accordance with the obligations assumed under Article 35 of the Interim Agreement or Article 70 of the Stabilisation and Association Agreement in respect of state aid. Under Article 5 of the Act, the Croatian Competition Agency (hereinafter: the Agency) is designated as a responsible authority for authorising, monitoring of the implementation and recovery of general and individual state aid.

Pursuant to Articles 6 and 19 of the Act, the Agency must submit to the Croatian Parliament the Annual Report on its work in the preceding year regarding state aid and the Annual Report on state aid by the 30 April of the current year.

2. State aid in the EU

Since the Republic of Croatia, pursuant to the Stabilisation and Association Agreement, is committed to gradual adjustment of its state aid system with that in the EU, a succinct overview of the EU system of state aid is provided below.

¹ A detailed survey of state aid, direct and indirect state aid (indirect aid disappeared in 2002, i.e., their smaller part becomes transparent in the budget); state aid projections for the period 2002-2005, especially in global terms, relating to GDP growth; action plan changes with a view to ensuring fiscal viability.

² The Act on State Aid in Agriculture, Forestry and Fisheries (Official Gazette 87/02), in force since 1 January 2003; the State Aid Act; the indirect state aid became transparent; the Action Plan of State Aid in the Economy (25 October 2001) kept at HRK 5423.5 million in 2002 and for 2003 in real terms; the Register of Farmers comprising 150,000 farmers; Article 39 of the 2003 Act on State Budget Execution introduces a planned control of aid, whereby aid is denied to legal and natural persons who fail to fulfil their current obligations to the State; action programmes of using state aid ought to be prepared; potential aid for agriculture in 2003 are at the level of 2002 and will depend on the conditions prescribed by the Act (sorting cadastral records), which will take more time; a portion of aid in 2002 and 2003 is linked to two funds – The Fund for Development and Employment and the Fund for Regional Development, especially in the area of employment. In 2003 these funds became a part of the budget.

The state aid system in the EU is covered by Articles 87 and 88 of the Treaty Establishing the European Community (hereinafter: the Treaty). Article 87, paragraph 1 of the Treaty, stipulates that a state aid is considered aid which:

1. is awarded from state resources;
2. gives an economic advantage to a particular undertaking, sector or region;
3. is selective in that it distorts the existing equilibrium between the undertaking and its competitors;
4. affects competitiveness and trade among the Member States.

According to the EU methodology, the following are not considered to be state aid: aid extended to beneficiaries other than undertakings (aid to households, disabled persons, aid for infrastructure, aid to educational institutions and hospitals, aid for public housing, aid to public educational centres, aid to developing countries), general state interventions (quotas, public procurements, technical standards, VAT cuts), aid granted by supranational or multinational organisations, EU funds, individual aid (defence, public works).

The procedure of notification and control of state aid is defined in Article 88 of the Treaty. The European Commission (hereinafter: the EC), in cooperation with the Member States, continuously monitors all the state aid systems existing in the Member States and proposes appropriate measures required for step-by-step development or action.

Should the EC believe that aid approved by a Member State or approved through state resources fails to comply with the common market or is misused, it will take a decision requesting the Member State concerned to either revoke or modify the aid within a specified period of time. If the Member State concerned fails to comply with the EC decision within the specified period of time, the matter shall be referred directly to the European Court of Justice.

In exceptional cases, however, the Council of the European Union (hereinafter: the Council) decides at a request whether or not the state aid is in compliance with the common market, but unless the Council makes its position public within three months after the submittal of the request in question, the final decision rests with the EC.

3. State aid under the State Aid Act

3.1 Definition of state aid

In order to ensure a correct approach to the issues of state aid in Croatia a brief account will be given of the legal framework within which state aid in Croatia is regulated and how it defines state aid in a way compatible with that in the EU. Essential in this respect is the very concept of state aid, because the scope and the content of the concept determine, *inter alia*, the scope and the content of the Annual Report on State Aid.

State aid, within the meaning of the Act, is any real and potential expenditure or reduced revenue of the State granted by a state aid provider which distort or may distort competition by giving an advantage to a state aid beneficiary, irrespective of the form of state aid.

The Act provides that state aid that contravenes the Act, irrespective of its form, distorts or may distort competition by giving a market advantage to a state aid beneficiary, particularly to an extent which may affect Croatia's capability to honour its international obligations.

As an exception to the above, state aid granted for the purpose of alleviating or eliminating damage caused by natural disasters, extraordinary or war events shall be considered conforming to the Act. As conforming with the Act may also be considered state aid stimulating the economic growth of areas with a very low standard of living or excessive unemployment, or state aid intended for the promotion of culture and the protection of heritage, state aid intended for carrying out major projects or addressing economic problems, state aid intended as incentives to specific economic activities or specific economic areas, state aid to legal and natural persons who are entrusted under special regulations to provide services of general economic interest or conferred the exclusive right to provide specific services, who would without state aid be unable to perform duties entrusted to them, as well as state aid which is introduced under a special regulation by the Government of the Republic of Croatia and which does not contradict the purpose of this Act. The Regulation deals with the requirements and criteria for using the described exceptions in more detail.

State aid can be awarded in the form of direct aid from the state budget, loans under more favourable terms, state guarantees, tax exemptions or write-offs, lower mandatory contributions, etc.

State aid is divided into general state aid, determined through schemes and regulations for non-specified beneficiaries, and individual aid for specified beneficiaries.

3.2 State aid providers

The state aid provider, within the meaning of the Act, is the Republic of Croatia through authorised agencies and state administration bodies, local and regional self-government units, and any legal person designated by virtue of the Act to grant or administer state aid.

3.3 State aid beneficiaries

State aid beneficiaries are legal and natural persons using some form of state aid and taking part in the trade of goods and services.

3.4 State aid categories

The Regulation on State Aid provides for special rules applicable to specific types of state aid which are brought in line with the EU methodology. In terms of the intended use, state aid is classified into three categories:

- horizontal state aid,
- regional state aid, and
- state aid for specific industries, i.e., sectoral state aid.

Horizontal state aid is intended for all undertakings acting on the market, and not for chosen sectors and regions, and is considered less selective than sectoral aid. Due to the all-embracing impact of the horizontal state aid, its positive effects outweigh their negative effects in terms of competition constraints.

According to the Regulation, horizontal state aid is intended for research and development, environmental protection, rehabilitation and restructuring, for small and medium-sized undertakings, employment, specialisation and culture.

State aid for research and development is intended for fundamental research, applied research, development research, as well as technical feasibility studies being a precondition for conducting applied and development research. The general state aid for research and development is administered by the ministry responsible for science and technology.

State aid for environmental protection is intended for the elimination or prevention of damage caused to the environment and natural resources, for attaining the required environmental protection standards, or encouraging rational utilisation of natural resources. The general state aid for environmental protection is administered by the ministries responsible for environmental protection and energy.

State aid for rehabilitation and restructuring is intended for businesses confronted with difficulties. The general state aid for rehabilitation and restructuring is administered by the ministry responsible for economic affairs.

State aid to small and medium-sized businesses is intended for initial tangible and intangible investments, consulting services and participation in trade fairs and exhibitions. The general state aid to small and medium-sized businesses is administered by the ministries responsible for trades, small and medium-sized enterprises, tourism and commerce.

State aid for employment is intended for the opening of new or retaining the existing jobs. The general state aid for employment is administered by the ministry responsible for labour and social welfare.

State aid for specialisation is intended for specialised or general staff training.

State aid for the promotion of culture and the conservation of heritage is intended for projects of relevance to the development of Croatian culture. The general state aid for the promotion of culture and the conservation of heritage is administered by the ministries responsible for culture and tourism.

Regional state aid is granted as development incentives to underdeveloped areas defined in the map of regional state aid. Regional state aid is administered by the ministry responsible for economic affairs. Regional state aid may not be granted for steel production. State aid providers support regional businesses by various measures: transfers from the state budget, profit tax relieves applicable to the Areas of Special State Concern, favourable loans within the reconstruction schemes available at the Croatian Bank for Reconstruction and Development, and guarantees.

State aid for specific industries is relating to steel production, land, sea and air transport, and shipbuilding. The state aid for specific industries is considered to distort competition to a degree higher than the horizontal aid. Rather than helping to

solve the competition problems, they just defer structural adjustments to be made in the industries facing difficulties.

3.5 Responsibilities of the Croatian Competition Agency

According to the State Aid Act, the Agency shall authorise, monitor the implementation and recovery of general and individual state aid, as well as perform other duties provided by the Act, such as: the study and assessment of proposed state aid and state aid programmes within the annual and multi-annual authorisation plans; the monitoring of the implementation and effects of the state aid granted and ordering of the recovery of state aid granted or used in contravention to current regulations; collection, processing and recording of data on state aid and data on the use and effects of state aid granted; keeping records of state aid; issuing annual reports to be submitted to the Croatian Parliament; co-operation with the authority responsible for state aid in agriculture, the authorities responsible for budgeting, and international authorities; participation in drafting laws and other proposed bylaws relating to state aid.

3.6 Procedure of authorising, monitoring the implementation and recovery of state aid

3.6.1 Procedure before the Agency

The Agency gives opinions on the proposals on establishing general state aid, whereas it issues decisions on the proposed approval or granting of individual state aid, whereby the proposal of individual state aid can be approved, rejected or dismissed.

Before submitting the act proposals and proposals of other regulations relating to the proposed general state aid to the Government, ministries and other state administration bodies shall, under the Act, submit the proposed general state aid to the Agency for prior opinion. The opinion, after being given by the Agency, is forwarded to the Government together with the act proposal or proposal of other regulations relating to the proposed general state aid. The proposals presented to the Government for further procedure, if not accompanied by a positive opinion of the Agency, should be returned to the proponent for elaboration.

The provider of individual state aid presents the proposal for approving or granting the state aid to the Agency in the form of a notification and accompanying statement of reasons. The legally prescribed period for the Agency to decide on the proposal on the individual state aid is 60 days upon the receipt of the complete proposal.

No complaint can be lodged against the Agency's decision, but an administrative dispute can be initiated before the Administrative Court of the Republic of Croatia.

The Agency's decisions giving approval, rejecting approval or revoking approval of the proposed individual aid, or decisions ordering recovery of funds used on the basis of approved or granted individual aid, as well as the rulings of the

Administrative Court of the Republic of Croatia passed on the basis of these administrative acts shall be published in the Official Gazette.

3.6.2 Monitoring of the implementation and recovery of state aid

The Agency monitors the implementation of state aid *ex officio*, on the proposal of the state aid beneficiary, the state aid provider or any legal or natural person having a legal interest therein. Monitoring of the implementation means assessing whether or not state aid is used in accordance with the criteria contained in the pertaining regulation or programme. If any irregularities are found, the Agency shall issue a decision giving the provider and/or beneficiary of state aid a maximum of three months to eliminate the irregularities. Should the provider and/or beneficiary of state aid fail to eliminate the irregularities within the specified period, the Agency shall issue a decision revoking the given approval and order the provider and/or beneficiary of state aid to return the granted aid in the part in which the irregularity has been found, increased by the amount of interest on arrears running as of the day established as the day after which the irregularity was commenced.

3.6.3 Subsequent approval and recovery of state aid

If individual state aid has been approved or granted without the Agency's consent, because the provider of state aid failed to submit the proposal for justified reasons, the Agency may subsequently issue a decision approving the proposed aid, if it is found to be in compliance with the provisions of the Act.

If aid is found by the Agency not to be in compliance with the provisions of the Act, the Agency shall issue a decision revoking the approved or granted aid and ordering the recovery of the amount of used aid, increased by the amount of interests on arrears running as of the day the aid was first used.

3.6.4 Budgeting

Preparing the state budget, the budgets of local and regional self-government units or the financial plan of an extra-budgetary beneficiary is also important for timely co-ordination of the government policy in respect of allocations of state aid for the following year. For that reason, the state aid provider intending to have a state aid proposal included in the said budgets or financial plans is required under the Regulation to submit such proposals to the Agency for approval by 15 June of the current year. On the other hand, under the Budget Act, the services responsible for drafting budgets and the consolidated budget of the state as well as local and regional self-government units should not include a state aid proposal in the draft budgets and consolidated budgets unless this is accompanied by the Agency's approval. Also, under the Regulation, state aid may be included in the proposed state budget or the budgets of local and regional self-government units if they meet the requirements prescribed by the Regulation, which falls within the competence of the authority responsible for managing the respective general state aid in accordance with the Regulation.

3.7 The activities of the Agency in the previous period

As mentioned in the introductory section above, following the adoption of the State Aid Act and the Regulation on State Aid, the powers of authorising, monitoring of implementation and recovery of general and special state aid have been delegated to the Agency. However, it was not until the end of 2003 that the Agency was able to start the activities related to the application of the Act and the Regulation³, because it was in its session of October 2003 that the Croatian Parliament appointed the Competition Council, the first session of which took place at the end of the same month. The reorganisation of the Agency pursuant to the new Competition Act and the State Aid Act entailed the passage of the new Statute of the Agency, which was adopted in the session of the Competition Council held on 4 December 2003, and confirmed by the Croatian Parliament in its session of 30 January 2004. Under the Statute, a special State Aid Division was set up, consisting of two departments: the State Aid Assessment Department and the State Aid System Department. This is how formal requirements were met for the performance of duties relating to state aid.

The internal organisation of the Agency was completed by the internal acts of the Agency, whereby seven employees are planned for the performance of activities related to state aid. For the time being, due to limited office space and finances available to the Agency, these jobs are carried out by four employees, to be joined by two more by the year's end.

In the period from the appointment of the Competition Council to the filing of this Report, the Agency, in order to establish a state aid system in compliance with the Act, was primarily concentrated on co-operation and regular communication with the competent public administration authorities – the Government, relevant ministries and government offices, in order to create conditions for the application of the Act. The parties concerned have been briefed in detail on their share of obligations in respect of state aid arising from the Act, the Regulation, and the Stabilisation and Association Agreement.

In 2003 the Agency received from the competent public administration authorities 11 proposals of acts relating to general and individual aid, requesting opinions on: the Award of co-ordination and management works on the development and construction of the Marijanci Municipal Water Supply System to the undertaking *Kombel d.o.o.*; US\$ 4.6 million severance pay loan to the shipyard *Brodosplit-Brodogradilište d.o.o.*; the Government's decision allowing the State Agency for the Security of Savings Deposits and Rehabilitation of Banks to write off claims against *Kompas Hotel d.d.*, *Mlini Hotel d.d.*, *Lero Hotel d.d.*, *Neptun Hotel d.d.*, *Grand Park Hotel d.d.* and *Kaštelanska Rivijera d.d.*; the Government's decision underwriting borrowings by *Hrvatske autoceste* (Croatian Motorways) *d.o.o.*; the proposed method of subsidising the company *Vjesnik d.d.*; and the Proposed measures for improving the difficult economic position of the manufacturers of components being installed for the first time in the cars in Croatia.

Furthermore, in order to keep to the binding schedules and for a continued development of the state aid system, the Agency has channelled a part of its activities to the preparation of instructions, forms, registers and other documentation required for bringing the existing aid in line with the Act and the Regulation.

³ The Agency's duties within the 2003 Implementation Plan for the Stabilisation and Association Agreement, specifically Measure 193 – List of State Aid Schemes, have been transferred to the Ministry of Finance.

In order to meet the time limits set forth in the 2004 National Programme of the Republic of Croatia for Integration into the EU, make necessary adjustments of the provisions of the Act to the new organisation of the Agency, and amend particular provisions of the Act, the Agency drafted amendments to the Act and forwarded them to the responsible ministry as its initiative towards the changing the Act. This has resulted in the adoption of the Act on the Amendments to the State Aid Act in the Parliament session in April this year.

Pursuant to the obligations arising from the 2004 National Programme for Integration of the Republic of Croatia into the EU and the 2004 Implementation Plan for the Stabilisation and Association Agreement concluded between the Republic of Croatia and the European Communities and their Member States, the Competition Council has adopted two programmes: the Alignment Programme of the existing state aid schemes to the criteria under Article 70, paragraph 2 of the Stabilisation and Association Agreement between the Republic of Croatia and the European Communities and their Member States, and the Programme for Adjusting the state aid system in the Republic of Croatia to that in the European Community.

The Agency has established the co-operation with the scientific institutions, e.g., the Institute for Public Finances with which it is currently working on a number of projects in the area of state aid.

The Agency has also established international co-operation, primarily with the Division for Supervision of State Aid of the Ministry of Finance of the Republic of Slovenia. Several meetings have been held with the Division, with a view to sharing experience in the area of state aid and ensuring its correct application. The state aid system was established in the Slovenian legislation as early as in 1998.

Furthermore, considering the fact that the matter in question had been entirely new and until the adoption of the Act and the Regulation not legally regulated, capacity building is conducted at the Agency as well as other public administration authorities. This project task is handled through the CARDS Programme.

The CARDS Project started in March 2004 and will be carried out until mid-October 2004. Conceived as a twinning project, it comprises assistance in establishing of the legal and institutional framework for the implementation of state aid (including the integrated database used for keeping the register, authorising and monitoring the implementation of state aid in Croatia). The general purpose of the CARDS Project is to meet the criteria relating to state aid specified in the Stabilisation and Association Agreement.

In the course of the CARDS Project, the Agency will together with the EU experts, co-operate with all authorities and, through technical assistance seminars organized at the ministries which have traditionally been the leading state aid providers, organise capacity building aimed at enhancing state aid advocacy, the understanding and further development of the state aid system in conformity with current legislation and practices in the EU.

Within the 2002 CARDS Programme the Agency, together with the EU experts, plans to hold five to seven topic oriented seminars in 2004. The first technical seminars – workshops in co-operation with the EU experts will take place in mid-May this year at the Ministry of the Economy, Labour and Entrepreneurship. The seminars are intended for state officials and civil servants who will organise and carry out work on state aid at the ministry or the Fund. The topic of the first, introductory seminar is the analysis of legal grounds for the implementation of state aid in Croatia, as well as the

adjustment programme and the compilation of the final list of state aid. Other seminars will be relating to the specific industries. Thus the next seminar will be devoted to state aid granted for the shipbuilding industry.

4. Conclusion

The enforcement of state aid regulations is exceptionally important not only in terms of honouring the international obligations assumed by Croatia, but also for timely adaptation of some sectors of the economy to market conditions where the approach to various forms of state aid is regulated in new ways and subject to the criteria in force on the common market of the European Union. Apart from the efficiency required under the competition conditions with undertakings from 25 EU Member States, the implementation of the regulations governing this area contributes to a higher level of transparency of the state aid granting process, as well as to the operational awareness raising concerning the allocation and distribution role of central and local authorities and other government agencies under the conditions of defined competition rules. State resources are to be used in a rational way and for intended purposes, with the tendency of decrease in the total sum allocated. Adherence to the notification procedure relating to the proposal of state aid as well as the professional presentation of arguments in favour of the proposed aid contribute to establishing of the financial discipline on the part of both the aid beneficiary and the aid provider in the strategic planning for the coming periods. Eventually, the implementation of the state aid system and the state aid rules should be brought to a level that can be described in terms of *smaller and quality aid*, as concluded at the European Council in Lisbon in 2000.

In the Opinion on the application of Croatia for membership of the European Union (*Avis*), dated 20 April 2004, in the part relating to competition, it is stated that in 2003 Croatia took important steps required to create the legal framework for its state aid system. Emphasis, however, is on the implementation of the system in practice, which requires the strengthening of the Agency's administrative capacities, the imposition of the official powers vested in the Agency by way of creating conditions for keeping records of legal casuistry, professional training of persons involved in the process, and continued work on ensuring a higher level of transparency of the data concerning state aid, as well as reshaping state aid so as to make the negative effects less anti-competitive. Once the above outlined tasks have been accomplished, the Croatian state aid system will meet requirements for full conformity with the part of the *acquis* regulating to the area of state aid.

The Agency's task, within the scope of its responsibilities and in full co-operation with the state aid providers, is to upgrade the application of regulations on state aid and thus help that the effects of an enforced state aid system are felt in practice. In other words, for the system to take root, it is needed first of all that the state aid providers, in co-operation with the Agency, contribute to adjusting the general state aid within the given time schedules. The matter is elaborated in more detail in the Adjustment Programme of the Croatian State Aid System to the EU State Aid System and the Alignment Programme of the Existing State Aid Schemes to the Criteria Stipulate in Article 70, paragraph 2 of the Stabilisation and Association Agreement. The whole process will be accompanied by further capacity building aimed at facilitating the implementation of the mentioned tasks.

II. REPORT ON STATE AID FOR 2002 and 2003

1. Introduction

The description of state aid in this Report partly follows the methodology used by the European Commission in preparing its reports on state aid within the European Union.

Considering the fact that it is the first report prepared by the Agency since the Act entered into force, the data given herein are generally based on the data of the Ministry of Finance gathered as a part of monitoring of the budgeting process at the state level.

At present, only the amount of total state aid at local level is available to the Agency, the data illustrating the structure of this aid being not yet available. Likewise, no data are available to the Agency on the write-off of debt, profit tax relieves as incentives for employment, investment, etc., which under certain conditions are also considered state aid.

Furthermore, as regards state guarantees, also due to the lack of data, this Report involves state aid only in the form of protested guarantees, and not the approved guarantees which contravene with Article 74 of the Regulation.

An integral and transparent overview of granted state aid, as required by the European Commission and the Croatian legislation, will thus be possible once the Agency has agreed with the relevant ministries – the state aid providers - upon all programmes and criteria for authorising general and individual aid. In the course of 2004, the Agency will create, in co-operation with the relevant ministries, its own database which will meet all the requirements regarding the adjustment of granted state aid as requested by the European Commission.

State aid in agriculture and fisheries are subject to special regulations, and the provisions of the Act and the Regulation on State Aid are not applicable. The amounts of the state aid mentioned above are included in this Report and they correspond to the data available and collected thanks to the co-operation between the Agency and the responsible ministry pursuant to Article 19 of the Act.

Overall, the present Report should be considered as the first step in determining the value and volume of state aid granted in Croatia. Full transparency of the data relating to state aid will be possible once the state aid allocation system has become fully operational and the Agency has assessed all the state aid schemes in Croatia. Like other countries in transition, which have now become Member States, Croatia needs some time for adjustments to the new state aid system. Thus, the data provided in this Report should not be considered final. On the contrary, as the system evolves, by collecting and processing the missing data, the next Report may already offer revised and supplemented figures.

2. Overview of state aid in 2002 and 2003

The data presented in this Report refer to state aid paid from the state budget in 2002 and 2003. The summary data for 2001 are also given for easier comprehension of trends shown in Table 1.

Table 1: State aid in Croatia in 2001, 2002 and 2003, compared with the GDP, state budget expenditures and employment

	Measure	2001	2002	2003	Indices		
					02/01	03/01	03/02
State aid ⁴	in HRK mil	6,388.7	4,911.5	5,987.0	76.9	93.7	121.9
State aid	in € ⁵ mil	855.4	663.1	791.6	77.5	92.5	119.4
GDP ⁶	in HRK mil	165,639.5	176,429.0	189,040.0	106.5	114.1	107.1
GDP	in € mil	22,177.0	23,820.0	24,994.0	107.4	112.7	104.9
Government expenditure ⁷	in HRK mil	57,812.8	73,369.6	80,446.6	126.9	139.2	109.6
Government expenditure	in € mil	7,740.4	9,905.7	10,636.3	128.0	137.4	107.4
Employed persons ⁸	number	1,348,308.0	1,359,015.0	1,392,509.8	100.8	103.3	102.5
State aid share in GDP	%	3.9	2.8	3.2	72.2	82.1	113.8
State aid per employee	HRK	4,738.3	3,614.0	4,299.4	76.3	90.7	119.0
State aid per employee	€	634.4	487.9	568.5	76.9	89.6	116.5
State aid share in government expenditure	%	11.1	6.7	7.4	60.6	67.3	111.2
<i>Per capita</i> ⁹ state aid	HRK	1,452.0	1,116.3	1,360.7	76.9	93.7	121.9
<i>Per capita</i> state aid	€	194.4	150.7	179.9	77.5	92.5	119.4

The state aid granted in Croatia in 2003 amounted to HRK 5,987.0 million, which is by 6.3% less than in 2001, but by 21.9% more than in 2002. A comparison of their values in € equivalents shows a 7.5% reduction in relation to 2001, and a 19.4% increase in relation to 2002.

The share of state aid in GDP, 3.9% in 2001, dropped to 2.8% in 2002, whereas in 2003 it grew to 3.2%. Equally so, the share of state aid in government expenditure dwindled in 2002, and grew in 2003.

Per capita state aid in 2003 amounted to HRK 1,360.7, which is a 6.3% reduction in relation to 2001, and a 21.9% increase in relation to 2002.

Data on state aid over the previous three years show the state aid volume to be the highest in 2001, the lowest in 2002.

⁴ Source: Ministry of Finance – List of state aid schemes in 2002, Report on central government state aid in 2003

⁵ Croatian National Bank's average rate against 1 € was 7.468966 HRK in 2001, 7.406773 HRK in 2002, 7.563414 HRK in 2003

⁶ Source: Croatian Bureau of Statistics

⁷ Source: Statistical survey of the Ministry of Finance – Budgetary expenditure

⁸ Source: Croatian Bureau of Statistics

⁹ Population size 4.4 million according to the 2001 census

2.1 State aid by allocation instrument

State aid constitutes an increase in government expenditure or a decrease in the revenues. It can be allocated by way of various instruments. In the European Union the state aid allocation instruments fall into four basic groups according to whether the ultimate financial benefit for the state aid beneficiary equals the gross or net amount of the aid¹⁰:

- (A) subsidies and tax exemptions,
- (B) proprietary interest,
- (C) favourable loans and tax deferrals,
- (D) state guarantees.

Tables 2 and 3 give a breakdown of state aid in Croatia by most often represented allocation instruments.

Table 2: State aid in Croatia in 2002, by instrument

						in 000 HRK
Category		subsidies	prop. int.	payment against loans, write-offs	guarantees	TOTAL
1.	<i>Agriculture and fisheries</i>	1,617,022.4	0.0	0.0	148,979.8	1,766,002.2
2.	<i>Industry and services</i>	2,230,867.0	421,218.0	0.0	458,256.5	3,110,341.6
2.1	<i>Horizontal objectives</i>	287,235.1	0.0	0.0	0.0	287,235.1
	R&D	0.0	0.0	0.0	0.0	0.0
	Environmental protection	0.0	0.0	0.0	0.0	0.0
	Rehabilitation and restructuring	0.0	0.0	0.0	0.0	0.0
	Small and medium-sized undertakings	27,235.1	0.0	0.0	0.0	27,235.1
	Specialisation	0.0	0.0	0.0	0.0	0.0
	Employment	80,000.0	0.0	0.0	0.0	80,000.0
	Arts	0.0	0.0	0.0	0.0	0.0
	Energy saving	0.0	0.0	0.0	0.0	0.0
	Additional horizontal objectives	180,000.0	0.0	0.0	0.0	180,000.0
2.2	<i>SPECIFIC SECTORS</i>	1,943,631.9	421,218.0	0.0	458,256.5	2,823,106.5
	Steel production	0.0	0.0	0.0	0.0	0.0
	Transport	1,414,869.1	150,000.0	0.0	13,425.0	1,578,294.1
	Shipbuilding	399,148.0	0.0	0.0	253,593.1	652,741.1
	Tourism	101,794.8	0.0	0.0	-39,867.1	61,927.7
	Other sectors	27,000.0	0.0	0.0	231,105.5	258,105.5
	Financial services	820.0	271,218.0	0.0	0.0	272,038.0
3.	<i>Regional aid</i>	22,000.0	0.0	0.0	13,194.4	35,194.4
TOTAL		3,869,889.4	421,218.0	0.0	620,430.8	4,911,538.1

Source: Ministry of Finance – List of state aid schemes in 2002

¹⁰ All state aid constitutes government expenditure and a benefit for the state aid beneficiary. However, ultimate financial benefit for the beneficiary, comprised in the aid's nominal value, largely depends on the allocation instruments, thus being often smaller than the nominal value.

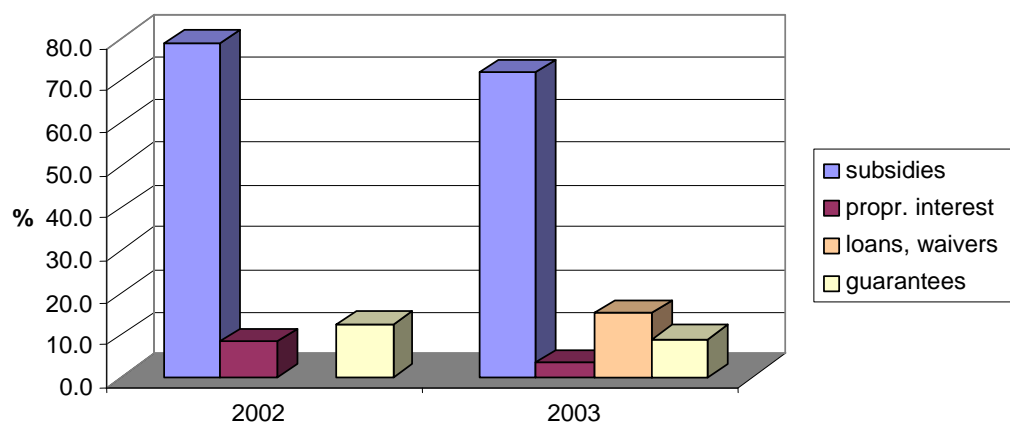
Table 3: State aid in Croatia in 2003, by instrument

In 000 HRK

Category		subsidies	propr. int.	payment against loans, write-offs	guarantees	TOTAL
1.	Agriculture and fisheries	1,595,898.3	0.0	211,328.1	140,891.6	1,948,118.0
2.	Industry and services	2,277,706.8	205,000.0	711,420.9	282,165.6	3,476,293.3
2.1	Horizontal objectives	412,687.2	0.0	0.0	0.0	412,687.2
	R&D	27,800.0	0.0	0.0	0.0	27,800.0
	Environmental protection	6,000.0	0.0	0.0	0.0	6,000.0
	Rehabilitation and restructuring	0.0	0.0	0.0	0.0	0.0
	Small and medium-sized businesses	32,787.2	0.0	0.0	0.0	32,787.2
	Specialisation	0.0	0.0	0.0	0.0	0.0
	Employment	90,000.0	0.0	0.0	0.0	90,000.0
	Arts	16,100.0	0.0	0.0	0.0	16,100.0
	Energy saving	0.0	0.0	0.0	0.0	0.0
	Additional horizontal objectives	240,000.0	0.0	0.0	0.0	240,000.0
2.2	SPECIFIC SECTORS	1,865,019.6	205,000.0	711,420.9	282,165.6	3,063,606.1
	Steel production	0.0	0.0	0.0	0.0	0.0
	Transport	1,241,937.2	75,000.0	80,253.3	5,709.9	1,402,900.4
	Shipbuilding	468,726.5	0.0	507,451.2	10,948.1	987,125.8
	Tourism	118,760.5	0.0	1,417.1	93,003.8	213,181.3
	Other sectors	35,595.5	0.0	122,299.4	172,503.8	330,398.6
	Financial services	0.0	130,000.0	0.0	0.0	130,000.0
3.	Regional aid	136,295.9	0.0	0.0	126,332.7	262,628.6
4.	Local aid¹¹	300,000.0	0.0	0.0	0.0	300,000.0
TOTAL		4,309,901.0	205,000.0	922,749.0	549,389.9	5,987,039.9

Source: Ministry of Finance – Report on central government state aid in 2003

Fig. 1: State aid shares by instrument in 2002 and 2003



¹¹ At present the Agency is acquainted only with the amount of total state aid at local and regional levels, not yet with the data illustrative of their structure in terms of allotment.

In 2002 and 2003 subsidies accounted for the largest proportion of state aid allocation instruments, with the share of subsidies in the structure of overall aid allocation instruments reduced from 78.8% in 2002 to 72.0% in 2003. The share of proprietary interests and guarantees in 2003 also dropped in relation to 2002. Proprietary interests were reduced from 9.2% in 2002 to 3.4% in 2003. The share of guarantees dwindled from 12.6% in 2002 to 9.2% in 2003. The trend of loans and write-offs was reverse: in 2003 they accounted for 15.4% of the instrument structure, whereas in 2002 they were non-existent.

Table 4: State guarantees in 2002 and 2003

	in 000 HRK		
	2002	2003	Index 03/02
Issued	6,495,024.9	9,430,267.1	145.2
Protested – paid	754,778.7	696,198.0	92.2
Returned to the budget	134,348.0	146,808.1	109.3
Net state aid	620,430.8	549,389.9	88.5

Source: Ministry of Finance – List of state aid schemes in 2002, Report on central government state aid in 2003

Pursuant to Article 74 of the Regulation on State Aid, issued state guarantees are not considered state aid if the following requirements have been met:

- that the loan beneficiary is not in financial difficulties,
- that the loan beneficiary could obtain a loan under market conditions on the financial market without the state's mediation,
- that the state guarantee is related to a specific financial transaction, limited in amount and duration,
- that the state guarantee does not cover more than 80% of the specific commitment,
- that the state guarantee is calculated at a market price.

An assessment as to which state guarantee shall in line with these criteria be considered state aid can only be made within the procedure of approving these guarantees by the Agency. However, since in the course of 2001, 2002 and 2003 the Agency was not able to do so (there was no Act), for the purposes of this Report only the protested guarantees have been considered state aid, as already mentioned in the introduction.

Therefore, in the forthcoming period it will be necessary to adjust and present those state guarantees which are to be considered 100 per cent state aid, not just the protested guarantees, which will certainly require some corrections of given data.

2.2 State aid categories

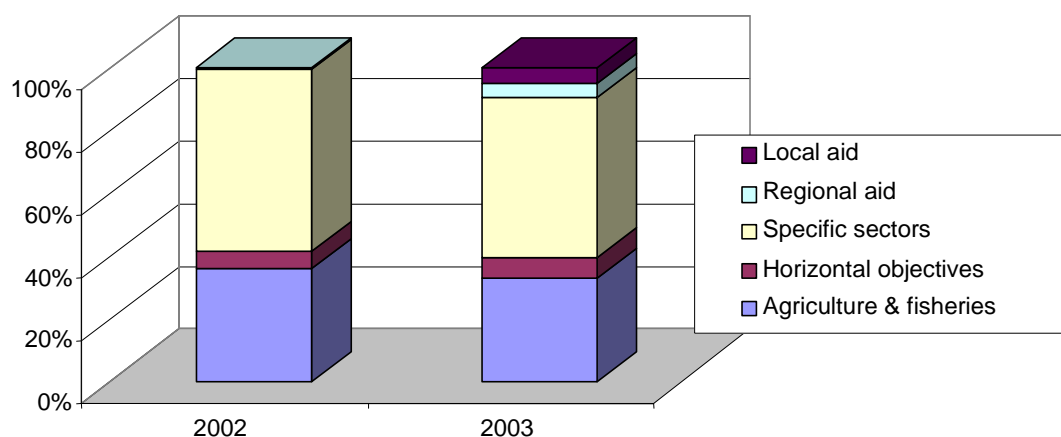
Pursuant to the provisions of the Act and in line with the EU methodology, state aid is divided into horizontal, sectoral and regional, and state aid to agriculture and fisheries. Horizontal state aid is intended for all sectors and businesses, hence they are considered to be distorting competition to a much lesser extent than the sectoral ones, which are allocated to specific branches of, and groups in the economy. The purpose of regional state aid is to prevent the concentration of production in specific areas and to encourage the economic development of low-income regions or those lagging behind in development compared with the overall economy.

Table 5: Shares of state aid in 2002 and 2003, by category

Category		2002			2003		
		in 000 HRK	in 000 EUR	share (%)	in 000 HRK	in 000 EUR	share (%)
1.	Agriculture and fisheries	1,766,002.2	238,430.7	36.0	1,948,118.0	257,571.2	32.5
2.	Industry and services	3,110,341.6	419,932.1	63.3	3,476,293.3	459,619.6	58.1
2.1	Horizontal objectives	287,235.1	38,780.1	5.8	412,687.2	54,563.6	6.9
	R&D	0.0	0.0	0.0	27,800.0	3,675.6	0.5
	Environmental protection	0.0	0.0	0.0	6,000.0	793.3	0.1
	Rehabilitation and restructuring	0.0	0.0	0.0	0.0	0.0	0.0
	Small and medium-sized businesses	27,235.1	3,677.1	0.6	32,787.2	4,335.0	0.5
	Specialisation	0.0	0.0	0.0	0.0	0.0	0.0
	Employment	80,000.0	10,800.9	1.6	90,000.0	11,899.4	1.5
	Arts	0.0	0.0	0.0	16,100.0	2,128.7	0.3
	Energy saving	0.0	0.0	0.0	0.0	0.0	0.0
	Additional horizontal objectives	180,000.0	24,302.1	3.7	240,000.0	31,731.7	4.0
2.2	SPECIFIC SECTORS	2,823,106.5	381,152.0	57.5	3,063,606.1	405,056.0	51.2
	Steel production	0.0	0.0	0.0	0.0	0.0	0.0
	Transport	1,578,294.1	213,088.0	32.1	1,402,900.4	185,485.1	23.4
	Shipbuilding	652,741.1	88,127.6	13.3	987,125.8	130,513.3	16.5
	Tourism	61,927.7	8,361.0	1.3	213,181.3	28,185.9	3.6
	Other sectors	258,105.5	34,847.2	5.3	330,398.6	43,683.8	5.5
	Financial services	272,038.0	36,728.3	5.5	130,000.0	17,188.0	2.2
3.	Regional aid	35,194.4	4,751.6	0.7	262,628.6	34,723.6	4.4
4.	Local aid	-	-	-	300,000.0	39,664.6	5.0
TOTAL		4,911,538.1	663,114.4	100.0	5,987,039.9	791,579.0	100.0

Source: Ministry of Finance – List of state aid schemes in 2002, Report on central government state aid in 2003

Fig. 2: Shares of state aid in 2002 and 2003, by category



Viewed by category, it is obvious that the sectoral aid account for the bulk of state aid in 2002 and 2003, making up 57.5% in 2002, 51.2% in 2003 of the overall state aid structure. Second large is the aid to agriculture and fisheries, accounting for 36.0% in 2002 and 32.5% in 2003, respectively. The share of horizontal aid is almost negligible, accounting for 5.8% in 2002, 6.9% in 2003 of the overall state aid structure. What is encouraging is a growing trend of horizontal state aid in 2003. A significant rise in the share of regional aid is also noticeable, from 0.7% in 2002 to 4.4% in 2003. Since the Agency does not have data on the allotment of aid granted from local and regional budgetary sources, such aid has been presented in an aggregate amount as a separate category.

3. Agriculture and fisheries

The provisions of the Act and Regulation on State Aid do not apply to state aid in agriculture and fisheries. However, the state aid to agriculture and fisheries has been included in this Report in terms of amounts allocated within the period covered by this Report, consistent with data obtained from the competent Ministry.

State aid to agriculture and fisheries amounted to HRK 1,766.0 million in 2002, HRK 1,948.1 million in 2003, respectively. The correlation between total aid and aid exclusive of agriculture and fisheries is given in the table below.

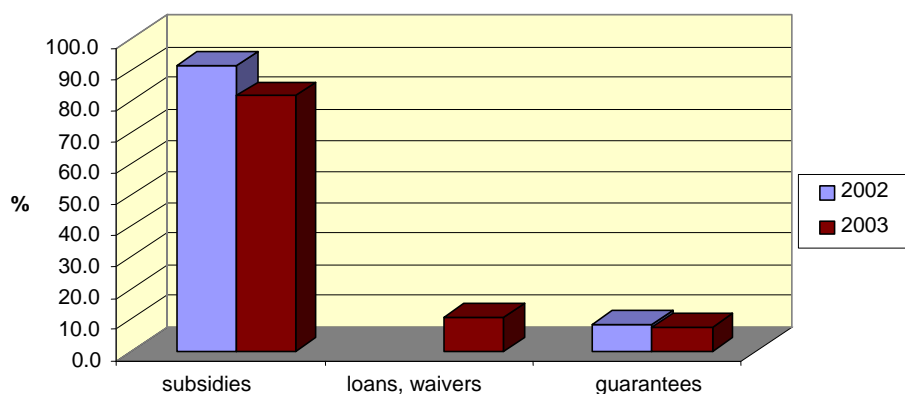
Table 6: Total aid, aid to agriculture and fisheries

	in 000 HRK		
	2002	2003	Index 03/02
Total aid	4,911,538.1	5,987,039.9	121.9
Aid to agriculture and fisheries	1,766,002.2	1,948,118.0	110.3
Aid exclusive of agriculture and fisheries	3,145,535.9	4,038,921.9	128.4

Source: Ministry of Finance – List of state aid schemes in 2002, Report on central government state aid in 2003

State aid to agriculture and fisheries was increased by 10.3% in 2003 compared with 2002. The reason behind this apparent increase largely lies in the write-off of claims by the Croatian Privatisation Fund against the agribusiness *PIK Vrbovec*, the industrial farm *IPK Ratarstvo-stočarstvo d.o.o.*, the sugar factory *IPK Tvornica šećera d.o.o.* and the cereals storage & processing company *IPK Croatia d.o.o.*, amounting to HRK 211.3 million. The amounts of allocated subsidies and issued guarantees were approximately equal in both years, as visible in the graph below.

Fig. 3: State aid to agriculture and fisheries in 2002 and 2003, by instrument



4. Industry and services

4.1 Horizontal objectives

As already mentioned, the share of horizontal state aid accounted for 5.8% in 2002, 6.9% in 2003 of the overall state aid structure in Croatia in 2002 and 2003, significantly below the sectoral ones. Within the horizontal objectives in 2002, aid was allocated only to small and medium-sized enterprises, plus state aid for employment, whereas in 2003 aid were also provided for R&D, the environmental protection and the arts. This group of aid also includes those indicated under «additional horizontal objectives», which refer to the Preferential funding programme under loans for export incentives, i.e., subsidised interest rates through the Croatian Bank for Reconstruction & Development (HBOR). In terms of instruments, subsidies constituted an exclusive allocation instrument in 2002 and 2003.

Table 7: Horizontal state aid in 2002 and 2003

Category	in 000 HRK		
	2002	2003	Index 03/02
R&D	-	27,800.0	-
Environmental protection	-	6,000.0	-
Arts	-	16,100.0	-
Small and medium-sized businesses	27,235.1	32,787.2	120.4
Employment	80,000.0	90,000.0	112.5
Additional horizontal objectives	180,000.0	240,000.0	133.3
TOTAL	287,235.1	412,687.2	143.7

Source: Ministry of Finance – List of state aid schemes in 2002, Report on central government state aid in 2003

The share of horizontal aid in the overall volume of state aid in the EU in 2002 accounted for 50.7%. Since the horizontal aid is most effective in the economy as a whole, in subsequent state aid allocation the share of horizontal aid in the overall volume of state aid should be increased, and that of the sectoral aid decreased.

4.2 Specific sectors

4.2.1 Transport

The transport sector comprises land, maritime and air transport. Under the Regulation on State Aid, land transport comprises railway and road transport, as well as inland waterways transport.

In the structure of aid earmarked for land transport in 2002, those directed to railway transport accounted for the largest portion, amounting to HRK 626.5 million. Within the aid to maritime transport, incentives to shipping lines accounted for HRK 303.3 million, while the aid to seaports amounted to HRK 85.1 million. In air transport the bulk of provided state aid refers to a proprietary interest in Croatia Airlines.

In 2003 again within the aid earmarked for land transport, those directed to railway transport accounted for the largest portion, amounting to HRK 812.1 million. In air transport the write-off of claims and a proprietary interest in Croatia Airlines accounted for the funds amounting to HRK 150 million. In maritime transport the bulk of state aid was provided for incentives to shipping lines and a renewal of the passenger fleet.

Table 8: State aid to the transport sector in 2002 and 2003

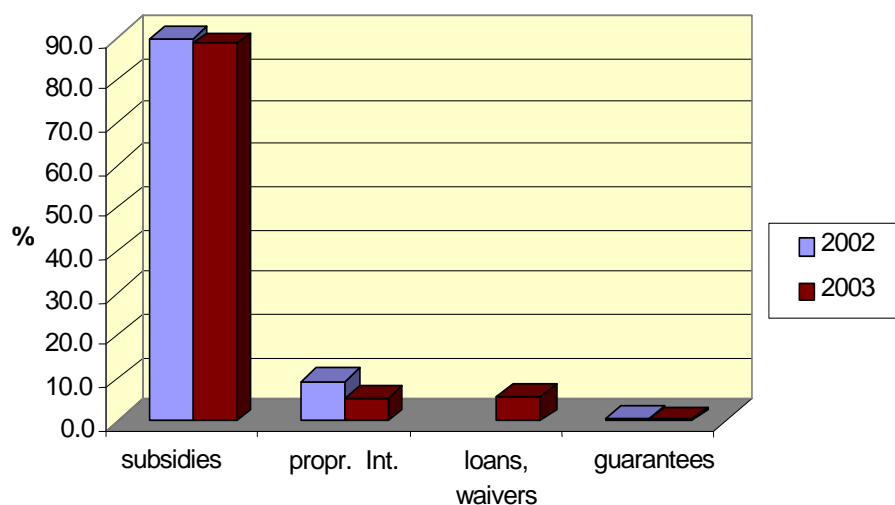
in 000 HRK			
Type of transport	2002	2003	Index 03/02
Land transport	1,007,553.8	856,374.9	85.0
Maritime transport	388,435.1	388,817.1	100.1
Air transport	168,880.2	151,998.4	90.0
Guarantees	13,425.0	5,709.9	42.5
TOTAL	1,578,294.1	1,402,900.4	88.9

Source: Ministry of Finance – List of state aid schemes in 2002, Report on central government state aid in 2003

According to state aid allocation instruments, subsidies accounted for the largest portion, 89.6% in 2002, 88.5% in 2003. Proprietary interests accounted for 9.5% in 2002, and 5.3% of the structure in 2003.

Under the «guarantees» category, overall protested guarantees issued in the transport sector have been quoted, because data are lacking as to the number of protested guarantees issued per a specific type of transport.

Fig. 4: State aid to transport per instrument groups in 2002 and 2003



4.2.2 Shipbuilding

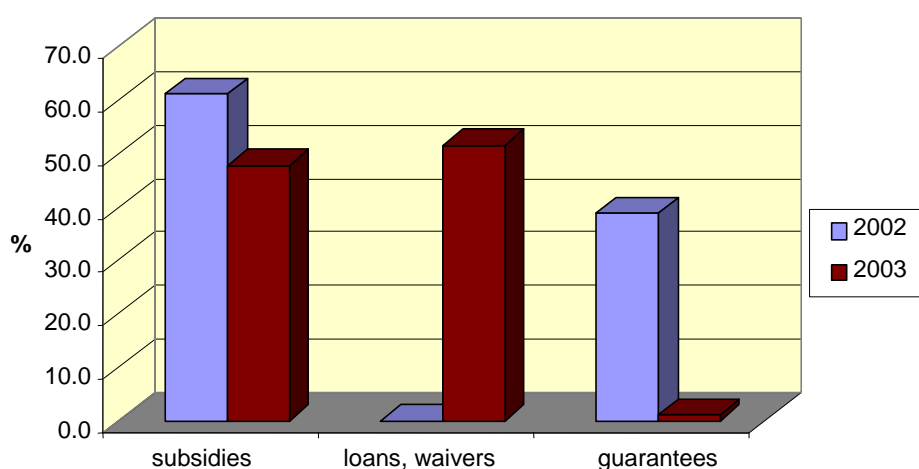
State aid to the shipbuilding sector amounted to HRK 652.7 million in 2002, and to HRK 987.1 million in 2003, thus accounting for a proportionately large share of the overall state aid. This share was 13.3% in 2002, and 17.5% in 2003. The reason for the 2003 rise was a reprogramming of loans to shipbuilding in the amount of HRK 490 million, as well as a rise in subsidies for the ship construction scheme. The volume of protested guarantees issued for shipbuilding in 2003 dropped by 95.7% compared with 2002.

Table 9: State aid to the shipbuilding sector in 2002 and 2003

<i>Instrument</i>	in 000 HRK		
	2002	2003	Index 03/02
subsidies	399,148.0	468,726.5	117.4
loans, write-offs	-	507,451.2	-
guarantees	253,593.1	10,948.1	4.3
TOTAL	652,741.1	987,125.8	151.2

Source: Ministry of Finance – List of state aid schemes in 2002, Report on central government state aid in 2003

Fig. 5: State aid to shipbuilding by instrument group in 2002 and 2003



4.2.3 Tourism

State aid to the tourist sector has largely been approved for the below listed programmes:

- creating new jobs, with a view to encouraging the development of small and medium-sized enterprises,
- subsidies for foreign and domestic organised tourist transportation,
- increase in the competitiveness of travel agencies.

State aid in tourism increased from HRK 62 million in 2002 to about HRK 213.2 million in 2003, i.e., by 244%. The share of aid to tourist sector in the overall volume of state aid increased from 1.3% in 2002 to 3.8% in 2003. The subsidies for tourism had a rise of 16.7% in 2003. A significant impact on the rise in aid to this sector in 2003 had the fact that the guarantees in 2002 had an adverse effect, i.e., the returns of paid guarantees exceeded the amounts paid against protested guarantees.

Table 10: State aid to tourist sector in 2002 and 2003

<i>Instrument</i>	in 000 HRK		
	2002	2003	Index 03/02
subsidies	101,794.8	118,760.5	116.7
loans, write-offs	-	1,417.1	-
guarantees	-39,867.1	93,003.8	-
TOTAL	61,927.7	213,181.3	344.2

Source: Ministry of Finance – List of state aid schemes in 2002, Report on central government state aid in 2003

4.2.4 Other sectors

Under «other sectors» in 2002 indicated were the funds for protested guarantees in the area of the economy, and the subsidies to the Croatian Posts for severance pays and the construction of post offices. In 2003, in addition to the guarantees and subsidies to the Croatian Posts, also included were the write-offs of claims by the Croatian Privatisation Fund against other industry branches, outright grants to undertakings, endorsed by the Croatian Agency for Small Businesses, and aid to *Vjesnik d.d.* newspaper publishing house. The volume of these funds was increased by 28% in 2003 compared with the previous year, amounting to HRK 330.4 million.

Table 11: State aid to other sectors in 2002 and 2003

in 000 HRK			
<i>Instrument</i>	2002	2003	Index 03/02
subsidies	27,000.0	35,595.5	131.8
loans, write-offs	-	122,299.4	-
guarantees	231,105.5	172,503.8	74.6
TOTAL	258,105.5	330,398.6	128.0

Source: Ministry of Finance – List of state aid schemes in 2002, Report on central government state aid in 2003

4.2.5 Financial services

Current transfers of the Croatian Guarantee Agency have been quoted under this category of state aid for 2002. Proprietary interests in 2002 and 2003 relate to the interest in the capital stock of the Croatian Postal Bank.

An essential characteristic of aid in the financial sector in 2003 is their decrease from HRK 272 million to HRK 130 million, a drop by about 52%.

Table 12: State aid to the financial services sector in 2002 and 2003

in 000 HRK			
<i>Instrument</i>	2002	2003	Index 03/02
subsidies	820.0	-	-
propr. int.	271,218.0	130,000.0	47.9
TOTAL	272,038.0	130,000.0	47.8

Source: Ministry of Finance – List of state aid schemes in 2002, Report on central government state aid in 2003

5. Regional aid

Regional state aid is allocated with a view to encouraging the development of less developed regions of the Republic of Croatia, identified as such in a map of regional state aid.

Regional aid accounted for 0.7% of the overall state aid structure in 2002, whereas in 2003 they rose significantly to a share of 4.7%. This is a result of a growing amount paid against protested guarantees, as well as the allotment of grants out of the means of the Regional Development Fund to all counties. The volume of subsidies designed for the development of the Adriatic islands in 2003 was not significantly changed compared to 2002.

The instruments of allocating state aid were subsidies and guarantees.

Table 13: Regional state aid in 2002 and 2003

<i>Instrument</i>	in 000 HRK		
	2002	2003	Index 03/02
subsidies	22,000.0	136,295.9	619.5
guarantees	13,194.4	126,332.7	957.5
TOTAL	35,194.4	262,628.6	746.2

Source: Ministry of Finance – List of state aid schemes in 2002, Report on central government state aid in 2003

In respect of regional aid it should be pointed out that within the process of Croatia's association with the EU a policy will need to be formulated, appropriate for the regional development of this country, whereby a more rapid development of the regions falling behind the country's average would be facilitated through, *inter alia*, a system of regional state aid, and thereby ensure a uniform development of the country as a whole. Therefore a rise should be expected in the volume of state aid intended for the development of less developed regions. The EU budgetary appropriations to this end account for over 20% of the total volume, right behind those for agriculture.

6. Conclusion

This is the first ever Annual Report on state aid that the Agency had to prepare in compliance with Article 19 of the State Aid Act. The Report covers the state aid from the state budget granted in the Croatian economy for the years 2002 and 2003.

At present the Agency does not possess its own database on state aid, so that all data presented herein have been taken from the Ministry of Finance.

The State Aid Act and the Regulation on State Aid entered into force in 2003, so the reporting methodology of the European Union could not be fully applied in this Report. For that reason, in the 2004 Report on state aid certain corrections of the presented data will have to be made.

The structure and amount of state aid have been determined by significant changes Croatia has undergone in the past ten years, primarily in respect of the post-war recovery, investments in agriculture, restructuring of some sectors of the economy, road construction and tourism. At the same time, these are the strategic signposts of the long-term development of the Republic of Croatia. State aid can be said to have contributed to keeping the economy afloat over the observed period.

The granted amounts of state aid are directly linked to the potentials of fiscal policy. As shown by data given in the Report, the sectoral aid account for the bulk of aid, whereas very small amounts have been granted as state aid allocated in accordance with horizontal objectives. This ratio should be changed in the nearest future, let alone the fact that according to the prevailing opinion and practice in the European Union, the share of state aid in GDP should be decreasing.

State aid surely ought to be considered as public funds which have to be used efficiently and as originally planned, and the spending of which has to be transparent at any given moment. For the Agency and the state aid providers the next period must be a period of adjusting the existing state aid schemes under which state aid is allocated. In other words, the existing schemes must be brought in line with the criteria inherent in the new system of state aid.

The specified tasks will surely be carried out in a satisfactory manner, because in this area satisfactory relations have already been established with the European Commission, co-operation is continued with the International Bank for Reconstruction and Development through the SAL programme, and so is with the World Bank and the International Monetary Fund.