

**NATIONAL REPORT ON COMPETITION AND STATE AID
IN THE REPUBLIC OF CROATIA**

**Research work in the area of Competition and State Aid
Specific Grant Agreement RELEX I-2 190202 REG 4-14**

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Summary

The Republic of Croatia has been approved to start the negotiations for the membership to the European Union. It was the decision agreed by 25 ministers for foreign affairs of the European Council made in Luxembourg on Monday, October 3rd 2005. All 35 chapters comprised in the European Commission Opinion on the Application of Croatia for Membership of the European Union, are to be harmonized with the *acquis communautaire*.

One of the most comprehensive and difficult area to be harmonized within a process of the economy in transition toward the free market is the competition and state aid as the obligation which stands up to the Republic of Croatia to establish in its way toward a full membership to the European Union.

In the EC Croatia 2005 Progress Report, the first country report within its accession process followed by European Council decision of June 17-18, 2004 on the Croatia country candidate status, in Chapter 8, Competition Policy, it is stated that Croatia has made some progress in the area of competition and state aid schemes, and that next priorities are further legislation harmonization, strengthening of the administrative capacity, improvement toward the efficient implementation, and that special attention should be given to the shipbuilding and steel industry sector, as well as the fiscal state aid schemes.

The primary objectives of competition policy such as, promotion, protection and preservation of competition by ensuring the most efficient allocation of resources, increasing the efficiency of national economy, and ensuring maximum benefit to the consumers. The secondary one, preservation of individual rights and freedom, right to entrepreneurial undertaking, decentralisation and dispersion of power, and support to small and medium-sized enterprises, as well as the wider social objectives such as the maintenance of the employment rate, and the environmental protection, are to be strengthen and further develop.

The best way for the harmonized economic accession toward a single market is the appropriate adapt of both, the entrepreneurial activities as well as the state administration to the business rules and condition of financing that are already existing in the European Union.

The precondition for development of efficient market competition, and appropriate state aid rules, are the adequate legislative framework, efficient implementation of legal acts such as transparent rules of procedures, the right to defence and the use of legal remedies. The independent regulatory body's operational activity has been notably improved in its competence in the implementation of the adopted rules and procedures.

The Croatian Government has given all the ministries and state administration bodies the task of undertaking a thorough analysis of the Opinion of the EC and preparing proposals of measures in accordance with the conclusions of the Opinion and the priorities of the European partnership. The Government has adopted the

Pre-Accession Economic programme 2005-2007, and in its framework the National Programme of the Republic of Croatia for Integration to the EU in 2005. A new National Programme of the Republic of Croatia for Integration to the EU in 2006 has been adopted at the end of 2005 with a special chapter dedicated to antitrust and state aid policy.

II: Stabilisation and Association Process

The Stabilisation and Association Agreement (SAA) with the European Union is very important for the overall economy of Croatia.

Based on SAA provisions, Croatia establishes political and economic relationships, and foresees the establishment of the free trade sector.

SAA was a basis for the first Pre-Accession Economic Programme which has been adopted for the period 2005-2007, and the second for the next three years period 2006-2008, which has been adopted by end of December 2005, establish the area of competition and state aid to be harmonized with *acquis communautaire*.

Even in 2004 the European Union was the most important Croatian foreign trade partner with the 68% of total Croatian foreign trade balance. The enforcement of the trade section within the SAA, which is in force since 1 January 2002, is going to have a strong impact on trade conditions at Croatian market, and will contribute to and accelerate structural reforms in Croatian economy.

1. Stabilisation and Association Agreement

The Stabilisation and Association Agreement was signed in October 2001, and an Interim Agreement on trade and trade-related matters (IA) is in force since 1st January 2002.

In both documents mentioned, priority fields are established in the matter of alignment of Croatian and EU legislation. Those priorities are market competition, trade issues, consumer protection, and state aids.

Stipulations of the Stabilization and Association Agreement (SAA), as well as the Interim Agreement (IA), imposed certain obligations to Croatia. SAA Articles 69 impose to the Croatia to harmonize national legislation with *acquis communautaire*. That obligation became effective upon a signature of the SAA. Related obligations are supposed to be fulfilled within 6 years period since the SAA stipulation which happened on 29th October 2001. The field of competition is specifically mentioned as one of the highest priority which is under special attention of the European Commission.

The SAA Article 70 specify the activities incompatible with the correct implementation of the SAA (Agreement) provisions in the extent in which they might influence trade relations between EU and Croatia.

For example:

- all agreements between entrepreneurs, decision by the entrepreneurs' association, restrictions or market competition abuses;

- dominant market position abuse by one or more entrepreneurs in the Community or Croatian market, entirely or in their segments;
- any state aid which disturbs or threatens to disturb market competition giving the advantage to certain entrepreneurs or certain products.

The following quote of the SAA states:

“any attitude opposite to the provision of this Article shall be evaluated according to the criteria which result from the application of the rules on market competition within the Community, and especially by the Articles 81, 82, 86 and 87 of the European Union Foundation Agreement, and the interpretation instruments adopted by the community institutions, incompatible with the correct Agreement’s application, to the extent that they might influence the trade between the Community and Croatia”

This quote of the SAA provisions points to the system of market competition and institutional building by which a framework for the efficient implementation of its provisions will be established for the benefit of both the European Union and Croatia. In other words, the standards applied for market competition within EU member countries should be applied in Croatia as well.

In Croatia 2005 Progress Report is stated that Croatia needs to submit a proposal for a regional aid map and relative elaboration has been planned for the March 2006 as stated in the National Programme of the Republic of Croatia for Integration to the EU.

As regards fiscal aid it is high on the priority list of the legal harmonization process with the EU rules and it is related other legal acts like Value Added Tax Act, Investment Promotion Act, Free Zones Act, High Mountain Areas Act, Areas under Special State Concern Act, and Reconstruction and Development of the City of Vukovar Act.

As regards the steel sector Croatia has not fulfilled its obligation under the Stabilisation and Association Agreement and Interim Agreement, to establish restructuring programme for its steel industry by March 2004 at the latest. The adoption of the necessary restructuring programme has already been considerably delayed and no substantial progress was made in the reporting period. Given the continued state aid provided to both the steel and shipbuilding industry sectors, the related restructuring programmes need to be urgently adopted in order to comply with state aid rules and with SAA obligations. A full review of legislation and of other sector specific aid i.e. textiles and tourism industries is also needed.

2. European Assistance for Competition Policy

The European Union assistance under the Community programme for Assistance, Reconstruction, Development and Stabilisation -CARDS 2002- continued its implementation in 2004 and by the end of 2005.

The EU assistance has been provided for the preparation of the drafts of a new legislation, new act and some bylaws, guidelines for state aid regulations improvement, thematic seminars for state aid providers and capacity building seminars and workshops for the Croatian Competition Agency employees.

These activities were in the same time also a preparation for a twining project implementation in mutual cooperation between CAA, and related partners from Germany and Slovenia who continued in 2005 as well.

The main focus of this project will be on state aid legislation improvement and proper central register of the horizontal state aid schemes. The technical and data base structure analysis has been completed by the end 2004 as a basis for further equipment and software purchase under terms and finance within CARDS programme. A total project value amounts on EUR 1.2 million, of which EUR 400,000 for data base and 800,000 for technical assistance.

The technical assistance has been provided for the institutional capacity building of Croatian Competition Agency, and for the legislation alignment of this sector with the *acquis*. Apart from that, CCA financing has been provided by the state budget.

3. Competition in Croatia

3.1. Legal Framework

The legal framework of competition in Croatia has been regulated by the following acts:

Competition Act (*Official gazette* No. 122/2003)

Competition Act – amended (*Official Gazette* No.89/98)

and by following bylaws:

Regulation on the register of concentrations

(*Official Gazette* No. 30/97)

Regulation on notification and assessment of concentrations

(*Official Gazette* No. 51/04)

Regulation on the definition of relevant market

(*Official Gazette* No. 51/04)

Regulation on block exemption granted to agreements on distribution and servicing of motor vehicles

(*Official gazette* No. 105/04)

Regulation on agreements of minor value

(*Official Gazette* No. 51/04)

Regulation on block exemption granted to the entrepreneurs not acting on the same level of production or distribution

(*Official gazette* No. 51/04)

Decision on the competition agency statute approval

(*Official Gazette* No. 15/04)

In the year 2005 two new bylaws became effective:

Regulation on block exemption on technology transfer

(*Official Gazette* No.2/2005)

Regulation on block exemption on insurance

(*Official Gazette* No. 54/2005)

These two Regulations provide the conditions which are to be satisfied within agreements between entrepreneurs as regards the content they should have, limitations or conditions not permitted, and dead lines for the harmonization of existing agreements. The regulations provide a protection for both the local and foreign entrepreneurs as well

Above mentioned legislative framework has been thoroughly harmonized with the relative European Commission regulations and in order to be properly understood by the Croatian entrepreneurs the Croatian Competition Agency provided such regulation translations into Croatian language on its web site.

For example, in the case of the **Regulation on block exemption granted to the entrepreneurs not acting on the same level of production or distribution**, it is provided the translation of the European Commission Notice – Guidelines for the vertical limitations (Official Journal C 291, 13/10/2000), as well as the translation of the European Commission Notice- Recommendations about application of the Article 81. of the European Commission Treaty on horizontal co-operation agreements.

For better understanding the government **Regulation on block exemption on technology transfer CCA** provided a translation of the European Commission Notice – Guidelines on application of the Article 81. of the European Commission Treaty on technology transfer agreements (Official Gazette C 101 27/04/04).

For better understanding of the **Regulation on block exemption granted to agreements on distribution and servicing of motor vehicles** it has been translated the European Commission Brochure about the application of the Article 81 of the European Commission Treaty on vertical categories agreements and harmonized activities on a motor vehicles.

The same approach for better understanding of the **Regulation on block exemption on insurance**, CCA has provided a text of the European Commission Regulation no. 358/283 about application of the Article 81 of the EC Treaty on certain agreements categories, decisions in a field of the insurance.

3.2. Restriction of competition

The Competition Act has been established with the objective to protect free competition of enterprises in the market. Free competition is of essential importance for all countries that base their economies on the free market principle where the distribution of resources depends on the relationship between supply and demand, and is not a result of state-related measures aimed at intervening in the affairs of enterprises.

Competition rules are applied with the objective to create a market where enterprises are equally represented and perform their activities under the same conditions, with the aim of their market position to be evaluated primarily by the quality of goods or services they provide. In this sense, the Competition Act undertakes the task to prevent particular

practices and business activities that may place some enterprises at a competitive disadvantage and thereby challenge free competition between enterprises.

3.3. Anti-trust violations

The Competition *acquis* covers anti-trust policy which includes rules and procedures to fight anti-competitive behaviour by companies.

For the next four regulations, being in force since 29 April 2004, the Croatian Competition Agency is responsible.

The first one is the **Regulation on Notification and Assessment of Concentration**, which was adopted according to Article 19 of the Act. It contains detailed provisions on the procedure of notification and assessment of concentration.

The second one is the **Regulation on the Definition of Relevant Market**, adopted pursuant to Article 7 of the Act. It stipulates methods, criteria and procedure in defining the relevant market, which represents the basis for the calculation of market shares in the proceedings before the CA.

The next one is the **Regulation on Block Exception Granted to Certain Categories of Vertical Agreements**. The provisions of the Regulation make it possible to switch to the system of block exemption granted to certain categories of vertical agreements being in line to the Commission Regulation No. 2790/99.

The fourth is the **Regulation on Agreements of Minor Value**.

The EC Croatia 2005 progress Report states that Croatia has made some progress in this area, but important further alignment is still necessary. The Report states that, in addition to the need for general fine-tuning of the provisions, a single competition regime still needs to be created by ensuring that the Competition Act applies to all sectors. The Government's power to overturn decisions on the basis of Article 266 of the General Administrative procedures Act should cease to be applied.

3.4. Cartel agreements and abuses of dominant position of enterprise

The Competition Act since 2003 regulates all impediments, limitations, or abuses of competition rules on the territory of Croatia, or abroad if they have impact in Croatia, and such regulation of the competition issues is as the *lex generalis* with the exemption of those issues regulated by a special act, *lex specialis*.

As different state interventions in the economy i.e. subsidies, guarantees, debts write-off, preferential sale of state-owned real estate, may significantly influence the competitive position and the business success of enterprises on the market, through out of 2005 in the Official Gazette there were published all issued final documents by the CCA.

As the Competition Act applies to companies, sole traders, craftsmen, and other legal and private businesses that undertake business activities and participate with their products and/or services in business transactions producing impact on domestic market, it is their obligation to advise the Croatian Competition Agency on regular base upon such business activities.

The Competition Act provisions imply, on the other hand, the CCA to publish regularly in Official Gazette all issued resolutions, opinions, and related documents.

3.5. Mergers and acquisitions

The Competition Act enforces the obligation to the entrepreneur to announce to the CCA the intention of concentration. The procedure is very similar to that in other European countries. In 2004 it has been introduced and applied the “silent administration” in the case that the CCA does not respond within 30 days from the date of written request. In that case the concentration is permissible.

The Regulation on Notification and Assessment of Concentrations as a bylaw document provides separate provisions stipulating the acquisition of shares or share capital in the normal course of business of banks, insurance companies, and other financial institutions. Banks, insurance companies and other financial institutions have to communicate to the CAA the acquisition of shares or share capital in other enterprises, carried out in their normal course of business, which includes transactions and dealing with securities, on their own account or on the account of third parties.

3.6. Relevant market

This term defines which market is the relevant market for particular products or services as the object of entrepreneurial activity. It is the task of the Competition Agency to suggest to Croatian Government what the relevant market is within the terms of the Competition Act provisions.

This novelty in the law has provided a great deal of help in practical provision implementation. It became a common practice in number of cases the CCA dealt with in the last year period. The benefits are both, continued alignment with the EU *acquis* and safe legal environment for entrepreneurs in their undertakings.

3.7. Anti-trust control of state monopolies in the process of privatisation

A dominant position on the market has been regulated within the legal framework of Article 82 of the Treaty, and by Competition Act. Market conditions for dominant position criteria are met when there are no competitors, the enterprise has a significant market share and financial power, dictates unfair market conditions, through its behaviour it excludes other competitors from the market, and, finally, its market share does not exceed 40% of dominant position.

The entrepreneur is in a dominant position if she or he can act in a manner independent from their real or potential competitors, consumers, buyers etc. The CA provisions define the most frequent situations related to dominant market position. Finally, when defined 40% market share assumption of dominant position its not a fact but an abatable presumption.

The Competition Act prohibits abuse of the dominant position especially as concerns unfair pricing or other trade conditions, production restriction, market or technological development, unequal business criteria for the same business activity, agreements stipulation under additional conditions not in direct relation to the main contract. The strict role of the Competition Agency has been provided by Article 17 of the Competition Act, which accordingly gives to the CA all necessary instruments and measures aimed to prevent and prohibit the abuse of the dominant position on the market.

3.8. Concentrations

During 2004 and 2005 a regular procedure on concentration notification has been established on the basis of the Regulation on Notification and Assessment of Concentrations (*Official Gazette* No. 51/04). The main procedure involves the obligatory notification to the Competition Agency within 8 days from the date of public offer or conclusion of the agreement at the latest.

The following conditions are to be met:

- total turnover of all entrepreneurs that participate in the concentration amounts up to 1 billion Kuna or more on the worldwide market;
- total turnover of each of at least two entrepreneurs in the concentration is 100 million Kuna or more at Croatian market.

The Competition Agency introduced a fast procedure of concentration assessment, and the Agency will not call for entrepreneurs to notify of the concentration unless it is a prohibited concentration.

By the Competition Act, prohibited is a concentration that creates a new or dominant market position for one or a group of entrepreneurs, if doing that creates an impediment, limitation or disturbance in the market competition.

However, there are exemptions to the rule, in cases when entrepreneurs can prove that there will be a competition improvement, or that the positive impact of such concentrations would be more important than the negative one.

The legal framework for that lays in the Regulation on the concentrations within EU, and the respective Act, as within their provisions the case of concentrations has been defined. Within a business activity, a joint venture is also considered as concentration if it shall continue to act as a business unit with permanent business activity.

It is the role of the Competition Agency to regulate the emerging market concentrations. The mechanism has been regulated by the Competition Act in such a way that it is compulsory to notify the Competition Agency of the intention to create a concentration within eight days from the date of the public announcement, or the relevant contract stipulation which makes possible the control or the dominant position of the entrepreneur.

Once the application on the intended concentration is submitted to the CCA, all further implementation must stop until the CCA issues a resolution stating that the concentration has been approved, disapproved or approved conditionally.

As in other European countries, there is the provision of "silent administration". In case that the Competition Agency does not issue the relevant document within a period of 30

days after the submission of the application on the concentration to the applicant, the concentration is considered granted.

4. State Aid

4.1. Control of State Aid

Within a field of anti-trust the state aid policy has a major importance. It is a leverage to decrease the influence of state aid on adequate resources distribution on free market.

The activities aimed at raising awareness among state aid providers are under way, particularly the notification of the procedure obligations which are to be abided by and the relevant laws.

The existing and any future Croatian legislation that may be of concern in view of its compatibility with state aid rules laid down in the State Aid Act, particularly mentioned in the European Commission Avis, is to be submitted to Croatian Competition Agency for review, as potential existing aid will be assessed and accordingly aligned with the state aid rules.

The Croatia is the first among transitional countries that introduced a regular procedure of Regulation Impact Assessment. Two government documents, Standing rules of regulation impact assessment and Procedure on impact assessment, became effective in May 2004, imply to all state administration bodies, prior to submit any new law or bylaw regulation, to make and submit the relative report, *inter alia*, on the competition and state aid impact.

Croatian Competition Agency provided already the second Annual Report on State Aids for the period 2004. In this public document, the description of state aid follows the methodology used by the European Commission in preparing its reports on state aid within the European Union.

An advanced overview of granted state aid schemes, as required by the European Commission and Croatian legislation, has been presented in it.

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

Overall, the second Annual Report should be considered as the advanced step in determining the value and extent of state aid being granted in Croatia. Like other countries in transition, now new EU Member States, Croatia still needs some time and adjustments to the new state aid system.

4.2. Overview of state aid in 2002, 2003 and 2004

The data presented in this Report are related to the state aid in 2002, 2003, and 2004 from the State Budget.

Table 1: State aid in Croatia in 2002, 2003 and 2004, compared with GDP, state budget expenditures and employment

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

Sources: Central Statistics Bureau, Ministry of Finance – Statistics on central government expenditure

¹ Croatian National Bank's average rate against 1 € was 7.406773 HRK in 2002, 7.563414 HRK in 2003, and 7,495169 HRK in 2004.

² Total population was 4,4 million according to the year 2001 census.

The state aid granted in Croatia in 2004 amounted to HRK 6,090.1 million, which is 3.8% less than in 2003, but 17.6% more than in 2002.

The share of state aid in GDP was 2.9% in 2002, which is 12,2% less than share of GDP in 2003 (3.3%).

The major impact in the year 2004 was a notable decrease of state aid share in central government expenditure.

Per capita state aid in 2004 amount to HRK 1.384,1 that is a small 3.8 % reduction in relation to 2003.

The European Union state aid methodology makes exemptions for the agriculture, fisheries, and transport, thus the tables below show the state aid in the last three years period without them.

Table 2: Total state aids in Croatia in 2002, 2003, 2004, (without agriculture, fisheries and transport)

Measures		2002	2003	2004
Total state aids (without agriculture, fishery, transport)	in mil. HRK	2.047,3	3.089,6	2.297,9
Total state aids (without agriculture, fishery, transport)	in mil. EUR	276,4	408,5	306,6
GDP	in mil. HRK	176.429,0	189.040,0	207,028,0
GDP	in mil. EUR	23.820,0	24.944,0	27.621,5
Share of state aids in GDP (without agriculture, fishery, transport)	in %	1,16	1,63	1,11

Table 3: Total state aids in Croatia in 2002, 2003, 2004, (with agriculture, without railway transport)

Measures		2002	2003	2004
Total state aids (without railway transport)	in mil. HRK	4.684,1	5.882,1	5.652,7
Total state aids (without railway transport)	in mil. EUR	632,4	777,7	754,2
GDP	in mil. HRK	176.429,0	189.040,0	207.028,0
GDP	in mil. EUR	23.820,0	24.994,0	27.621,5
Share of state aids in GDP (without railway transport)	in %	2,65	3,11	2,73

4.3. Administrative Capacity of the Antitrust Regulator

Pursuant to the SAA, Croatia has established an independent operational body to act with regard to market competition protection, and an independent body entrusted to act in the capacity of state aid provider. This is the Croatian Competition Agency.

Croatian Competition Agency (CCA) was first established by the Decision of Croatian Parliament of 20 September 1995, but it started to operate early in 1997 as an independent and autonomous legal entity with public authorizations. Croatian Competition Agency performs administrative and professional activities relating to protection of competition as well as the authorization, monitoring and recovery of general and individual state aid. The Competition Agency competence mentioned here has been regulated by the Competition Act (*Official Gazette*, No 122/2003) and the State Aid Act (*Official Gazette*, No. 47/2003).

That independent body is entrusted to release state aid programmes and individual state aid, and to enforce the reimbursement of illegally released state aid.

There are also other commitments Croatia is obliged to enforce by the SAA provisions, such as gradual alignment of the existing and future legislation with European Union legislation, the *acquis communautaire*.

4.4. Operational Framework

4.4.1. Competition Council

The managing body of Croatian Competition Agency is the Competition Council, consisting of five members, one of which is the appointed President of the Council. The president and the members of the Council are appointed for a five-year-term of office and may be re-appointed by Croatian Parliament on the proposal of the Government of the Republic of Croatia.

The expert team of the Competition Agency performs administrative and professional activities in the area of competition, and state aid.

The expert team of the Competition Agency consists of lawyers and economists holding a university degree and having specific knowledge in the area of competition and state aid. At present, the Competition Agency has 34 employees with a plan to increase that number with about 30 more new jobs by the end 2007.

The Competition Council had its 45th session on September 15, 2005 confirming its operative attitude with related decisions regular published on CCA web site for a wide public transparency use. On this very session an important decision has been agreed. The draft of Cooperation Agreement between the Croatian Competition Agency and Croatian Telecommunication Agency, has been adopted. This agreement's provision relies to Telecommunication Act under which the anti-trust competence has been divided between these two bodies.

4.4.2. Competition Law Enforcement

Competition Law has been established with the objective to protect free competition of enterprises in the market. Free competition is of essential importance for all countries which base their economies on the principle of free market where the distribution of resources depends on the relationship between supply and demand, and is not a result of state-related measures aimed at intervening in the affairs of enterprises. Competition rules are applied with the objective to create a market where all enterprises are equally represented and perform their activities under the same conditions, with the goal of evaluating their market position primarily by the quality of goods or services they provide. In this sense, the Competition Law undertakes the task of preventing particular practices and business activity that may place some enterprises at a competitive disadvantage and thereby challenge free competition between enterprises.

4.4.3. Ensuring Independence and Professional Literacy of the Regulator

Further to the Opinion of the EC related to Croatian application for EU membership (*avis*) since April 2004, in the part dedicated to market competition, it is stated that Croatia has to improve the administrative capacity of the Croatian Competition Agency.

The governance of the CCA is in accordance with the Agency statute and especially for work related to state aid and the enforce of the State aid Act provisions, is being provided by two departments, Department for state aid evaluation and Department for state aids schemes.

The implementation of the State Aid Act provisions has been executed by six employees (2 lawyer and 4 economist). For the future plan of the agency activities, and especially for the system of state aid applications the agency should employ at least 15 new employees. It is certain that the finance of this new employee should be secured.

4.4.4. Enforcement record of the regulator

A solid and satisfactory enforcement record of the regulator has been established in the past one year period which is in line with the same practice in the EU, and is a part of the constant monitoring of the readiness of Croatia to join the EU community as a member state.

A technical cooperation between European Commission's DG for Competition Policy has been established on a regular basis like, technical consultations, briefings, meetings, and written correspondences on a matters related to some problems in every day working activities of the Croatian Competition Agency. There is also a EC's request to be regular informed on state aid related issues i.e. statistics on a total number of applied request for the state aid, as well as the total number of approved requests and opinions issued by Croatian Competition Agency.

4.5. State Aid Legal Framework

It is clear that aids provided by the state have to be in harmony with both, the Croatian legislation related to the state aids, and **acquis communautaire**, as well. Any other approach contrary to these obligations could jeopardize the Croatian process of negotiations for the EU membership.

The **State Aid Act** is in force since 2 April 2003. The bylaw, **Regulation on State Aid** (*Official Gazette*, No 121/2003) was adopted pursuant to the provisions of the State Aid Act and entered into force on 1 August 2003.

In order to implement efficiently the obligations pursuant to the SAA in a part related to the appropriate harmonization of the general state aids schemes issued before the State Aid Act came into force at the beginning of 2003 with the **acquis**, the Croatian Competition Agency provided two relevant documents: Programme of the dynamics on harmonization of the existent state aids schemes with a new Act's provisions, and programme of adjustment of the state aid schemes in the republic of Croatia with European communities

state aid schemes. These documents has been confirmed by the Government decision in July 2004. These two programmes have been described in detailed further on¹.

4.6. Notification System

The regular procedure on general state aid scheme suggestion all the ministries and other state administration bodies, should supply the related state aid scheme proposal to the CCA for their official opinion. Only with the issued CCA opinion the relative act or other bylaws contained the state aid proposal, should be submitted to the Government. In case such agency opinion is not included the government should return the related document to the institution provider.

The agency is issuing two different documents. The first one is opinion in a case of a general state aid scheme. In other case when there are individual state aid, the agency is issuing the relative resolution in which is it stated whether this state aid has been approved, disapproved or rejected.

There is no legal remedy against the agency resolution, but administration dispute could be set in motion at the Administration Court of the Republic Croatia. All resolutions issued by CCA are regular published in Official Gazette. The procedure previously described will be changed when Croatia shall be a full member of the European Union, than all the CCA competences for state aid scheme approval shall pass from the Agency to the European Commissions competences. That means the adjustment of both, the state aid providers and state aid recipients, should be ready to adapt their business activities to the rules relevant in the European. The main goal is to diminish state aid schemes as much as possible, and to harmonize the rules of the competition for the Croatian entrepreneurs make them ready for the free market competition.

The future to be reached is the current situation within EU states, the EC controls the spending of the state aids amounts. Some analyses showed that the member states over the years have diminished state aid amounts. The state aid schemes have been targeted to the increase of competitiveness of the member states, as well as the European Union.

4.7. Control Bodies and Co-ordination

Pursuant to the obligation provided in Pre-Accession Economic Programme of the Republic of Croatia to the European Union and SAA between Croatia and European Communities, the Competition Council has adopted two new programmes who are regulating the activities and dynamics of the harmonization of the state aid schemes being effective before the signature of SSA agreement.

Two new programs are as follows:

1. Programme of the harmonization dynamics of the existing state aid schemes with a criteria pursuant to the Article 78, point 2, of the SSA (further on as: Program of harmonization dynamics).

¹ See part 4.7

2. Programme of adjustment of the state aid schemes in the Republic of Croatia with European communities state aid schemes (further on as: Program of adjustment).

Above mentioned programmes have been approved by Government of the Republic of Croatia, and by this government decision, became obligatory to all state aids providers. The program of dynamics harmonization imposes to the providers of the harmonization process the proper procedure and adequate deadlines. The state aid harmonization providers are the Croatian Competition Agency, state administration bodies and local government units, as well as other authorized legal entities.

There are three steps of the procedure. The first one is registration, second is approval and third is harmonization of the programme with other legal acts used by the state aid providers before a new act on state aid became effective. Deadline for this procedure is the 1st January 2006, and according to obligations pursuant to SAA by 1st March 2006.

The above mentioned program imply to the CCA to forward a request to all state aid providers to submit their state aid schemes in order to make a final list of all state aid schemes by each provider. This is related to the old programs being effective since 2nd April 2003, the date in which the state aid act came into force. Such stipulated list has been sent to all ministries and other state administration bodies on their approval.

In this procedure lies special importance as per European Communities rules which underlines that if on that list old state aid schemes not appeared, they shall be consider as new state aid schemes. Difference between old and new state aid schemes is rather relevant, because new state aid schemes must be harmonized with state aid rules. If there is no confirmation, than such state aid is considered illegal, and should be returned.

The Programme of adjustment evaluates the level of the legislative harmonization between state aid schemes in Croatia and European Communities. This program provides basic obligation to the Agency, state administration bodies, local government units, and other legal authorized persons to implement pursuant to the provisions of the State Aid Act. The Croatian Competition Agency issued official opinions on all acts and bylaws in which general state aids schemes are provided. The all inline ministries have set in motion the procedure of the harmonization of there programs in accordance with state aid regulation.

4.8. Impact of State Aid on Market Economy

Pursuant to the provision state aid act it is a task given to the Croatian Competition Agency to consider each single state aid i.e. those state aid assigned to named recipient, the Agency should issue a resolution indicating whether this state aid is approved or rejected, depending whether they are in accordance with the provisions of the Act. There are also rejected cases when the request of the provider is not in accordance with the State Aid Act. Such cases often involve certain general economic policy measures. The Agency is also considering different programmes and documents according to witch financing from state budget or local government budget is included. Those are the programmes in which the final recipients are unknown.

The Agency competence in that case is to issue relative opinion that evaluates the accordance of these programmes with both, the State Aid Act, and *acquis communautaire*.

During 2004 the Agency received 41 requests for single state aid and 50 requests for the opinion on some submission that contains suggestions for certain general state aid. In its Annual Report the Agency underlines that the major part of those submissions are mostly in formation about requests addressed to the Ministry of Finance or to the Croatian Government and such submissions are not enough documented to be thoroughly analysed with a purpose to evaluate whether such state aid is permitted one.

The state aid control system should be further improved what is a visible in CCA Annual Report. This year there were certain improvements in administrative capacity building of the Agency, but still it is a period of adjustment in which the state aid provider should be educated in that sense that submissions of aids to the Agency become a common practice. Further education is also needed for civil servant sector as those providing different state aid schemes and programmes and they need to be specialised. The same specialization is needed for Agency employees with focused area like shipbuilding, transport, small and medium enterprises.

The number of the cases submitted to the Agency in one year period in major part were related to the sectors like infrastructure, tourism, small and medium enterprises, shipbuilding and transport.

4.9. Preparation for annual report on state aid

The second Annual report on state aid in the Republic of Croatia has been published in May 2005 and it covers all state aid issued by the end of 2004. Good approach is parallel revision of data in 2002, and 2003 that made easy the comparison between all issued state aids and indicated trends.

There are four main parts of the second Annual Report. The first covers total state aid during last three years, state aid categories and instruments. Second covers state aid in agriculture and fisheries. Third the state aids in industry and services including horizontal objectives and sectoral one. The fourth part is dedicated to regional state aid schemes.

The state aids are listed as categories and instruments in accordance to the Regulation on state aid forms and content, data collecting and evidence on state aid (Official gazette No. 11/05).

It is important to underline that in this second Annual Report the EC methodology has been implied in a wider extent on the way of state aid forms, data collecting, and evidence.

The big part of the last year activities the CCA has consumed in process of harmonization of different state aids programs, criteria, measures, and rates by the national state aid providers. Still, the state aids providers has to advise and apply to the Agency on time, and prior to state aid issuing, and Agency itself has to improve its administrative and technical capacity as well.

For the purpose of the second Annual Report preparation was necessary to use the data provided from other resources than the Agency itself, like Ministry of Finance, and other state aid providers.

The biggest changes since last year Annual Report are as follows:

- no state aid for infrastructure inclusion
- direct financial transfer from state budget toward local government units exclusion
- different calculation of the element of guarantee included in state aid
- regional state aid evidenced only from those local government units which submitted their reports
- inclusion of state aid contained in tax incentives pursuant to Tax on profit Act

However, the second Annual report showed a big step forward in the transparency of state aid schemes in the Republic of Croatia. Still is needed some time for the whole system of state aids to be completely functional. The Agency have to established own state aid register, and state aid providers have to harmonize their schemes, rules and procedures according to the provisions of State Aid Act. In the reality these harmonization need some time as noticed from the experience of the transition countries new EU members, the time for all adjustments of new state aid schemes, education, culture and adequate knowledge on state aid.

5. State Aid Categories

Pursuant to the provisions of the State Aid 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 it is considered to be distorting competition to a much lesser extent than the sectoral one, which is 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.

According to the SAA Article 70, the whole territory of the Croatia is considered as one region i.e. area with extremely low standard of living and high unemployment rate.

In the three years period after SAA signature the Croatia has to supply to the EU the amount of GDP per capita harmonized with the second level of NUTS (Nomenclature of Territorial Units for Statistics).

The next task of both, the Croatian Competition Agency and European Commission is to evaluate the aptness of the Croatian regions and related regional state aid amount. The aim of these activities according to EU guidelines is the regional state aid mapping.

The regional map will represent the appropriate area A and area B with related state aid amount to be granted. The whole territory of the Republic of Croatia is considered as area A, and the relative Regulation is valid up to 1st January 2006.

5.1. State Aid in Croatia in 2004, by instrument

State subsidies are to be considered as expenditure increase or decrease of state income, and they are divided into different instruments.

1. subvention
2. tax exemption
3. equity share
4. favourable loans
5. other instruments
6. state collateral

5.2. Overview of State Aid in Croatia

In the following Tables 2 and 3, state aid in Croatia is shown according to the most frequent instruments.

Table 4. State aid in Croatia in 2003, by instruments

Category		1	2	3	4	5	6	Total
1. Agriculture and fisheries		1.595,9	0,0	0,0	211,3	0,0	142,1	1.949,4
2. Industry and services		2.013,8	56,9	205,0	951,4	0,0	657,8	3.884,9
2.1	<i>Horizontal Objectives</i>	510,8	56,9	0,0	240,0	0,0	0,0	807,9
	R & D	27,8	0,0	0,0	0,0	0,0	0,0	27,8
	Environmental protection	6,0	0,0	0,0	0,0	0,0	0,0	6,0
	Rehabilitation and restructuring	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Small and medium-sized enterprises	32,8	0,0	0,0	0,0	0,0	0,0	32,8
	Specialisation	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Employment	428,1	56,9	0,0	0,0	0,0	0,0	485,0
	Arts	16,1	0,0	0,0	0,0	0,0	0,0	16,1
	Energy saving	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Additional horizontal objectives	0,0	0,0	0,0	240,0	0,0	0,0	240,0
2.2	<i>SPECIFIC SECTORS</i>	1.503,0	0,0	205,0	711,4	0,0	657,8	3.077,2
	Steel production	0,0	0,0	0,0	0,0	0,0	4,0	4,0
	Transport	879,9	0,0	75,0	80,3	0,0	258,0	1.293,2
	Shipbuilding	468,7	0,0	0,0	507,5	0,0	10,9	987,1
	Tourism	118,8	0,0	0,0	1,4	0,0	93,0	213,2
	Other sectors	35,6	0,0	0,0	122,3	0,0	291,8	449,7
	Financial services	0,0	0,0	130,0	0,0	0,0	0,0	130,0
3.	<i>Regional aid</i>	27,5	61,7	0,0	0,0	0,0	0,0	89,2
4.		282,3	0,0	0,0	0,0	0,0	126,3	408,7
TOTAL		3.919,6	118,6	205,0	1.162,7	0,0	926,2	6.332,2

Sources: Ministry of Finance, other state aid providers, Croatian Competition Agency

Table 5. State aid in Croatia in 2004, by instruments
In mil HRK

Category		1	2	3	4	5	6	Total
1. Agriculture and fisheries		1.819,8	0,0	0,0	0,0	0,0	0,0	1.819,8
2. Industry and services		1.874,1	271,8	101,9	365,8	0,0	1.176,3	3.789,7
2.1	Horizontal Objectives	459,3	271,8	0,0	342,2	0,0	0,0	1.073,3
	R & D	0,0	115,5	0,0	0,0	0,0	0,0	111,5
	Environmental protection	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Rehabilitation and restructuring	22,4	0,0	0,0	12,2	0,0	0,0	34,6
	Small and medium-sized enterprises	37,5	0,0	0,0	0,0	0,0	0,0	37,5
	Specialisation		62,6	0,0	0,0	0,0	0,0	62,6
	Employment	359,1	97,7	0,0	0,0	0,0	0,0	456,8
	Arts	40,3	0,0	0,0	0,0	0,0	0,0	40,3
	Energy saving	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Additional horizontal objectives	0,0	0,0	0,0	330,0	0,0	0,0	330,0
2.2	SPECIFIC SECTORS	1.417,7	0,0	101,9	23,6	0,0	1.176,3	2.716,5
	Steel production	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Transport	816,7	0,0	101,9	0,0	0,0	1.053,9	1.972,4
	Shipbuilding	504,8	0,0	0,0	0,0	0,0	12,0	516,8
	Tourism	62,7	0,0	0,0	18,6	0,0	0,7	82,0
	Other sectors	30,6	0,0	0,0	5,0	0,0	109,7	145,3
	Financial services	0,0	0,0	0,0	0,0	0,0	0,0	0,0
3.	Regional aid	34,9	102,1	0,0	0,0	0,0	0,0	137,0
4.		343,5	0,0	0,0	0,0	0,0	0,0	343,5
TOTAL		4.072,3	379,9	101,9	365,8	0,0	1.176,3	6.090,1

Source: Ministry of Finance, other state aid providers, Croatian Competition Agency

Above Tables are showing that in two last years, 2003 and 2004, in state aids instruments dominant share have the subventions, but their share in the state aid structure moved from 61,9% in 2003 to 66,9% in 2004.

The share of tax incentives has increase tend in both last two years, but in the same period the equity share is decreased. The state aid share of financial guarantees in comparison to other state aid instruments is increasing from 14,6% in 2003 to 19,3% in 2004. In the favourable loans share the situation is quite opposite, from 18,4% in 2003 is decreased to 6,0% in 2004.

5.3. State Guarantees in Croatia

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:

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

Table 6: State guarantees in 2002, 2003 and 2004

In mil. HRK

	2002	2003	2004
Total issued financial guarantees	8.388,0	9.002,8	5.772,6
Total issued performance guarantees	2.856,3	2.721,6	4.773,6
Total issued guarantees	11.244,4	11.724,4	10.546,2
Protested guarantees	620,4	549,4	778,8*
Risk rate (protested / total)	5,52 %	4,69 %	7,38 %
Premium paid 0.5 %	41,9	45,0	28,9
Amount (1 x risk rate – premium paid)**	420,9	376,8	397,4
TOTAL	1.041,3	926,2	1.176,3

Sources: Ministry of Finance, Croatian Competition Agency

* In 2004 protested guarantees in amount of HRK 900 mill are related to short terms loans for current liquidity for railway transport and debt cover to Croatian Railway Company

The Table 4 makes visible that in the state aid structure by instruments, issued state guarantees accounts for a quite big share. Thus, a special methodology is being applied according to the Standing Rules on the Form and Content of collected data and evidence register of the state aids.

6. State Aid Categories—examples

Pursuant to the provisions of the Act and in line with 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 it is considered to be distorting competition to a much lesser extent than the sectoral one, which is allocated to specific branches 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 7: Shares of state aid in 2003 and 2004, by category

Category		2003			2004		
		in mil HRK	In mil EUR	share %	in mil HRK	in mil EUR	share %
1. Agriculture and fisheries		1.949,4	257,7	30,8	1.819,8	242,8	29,9
2. Industry and services		3.884,9	513,6	61,4	3.789,7	505,6	62,2
2.1	<i>Horizontal Objectives</i>	807,7	106,8	12,8	1.073,3	143,2	17,6
	R & D	27,8	3,7	0,4	111,5	14,9	1,8
	Environmental protection	6,0	0,8	0,1	0,0	0,0	0,0
	Rehabilitation and restructuring	0,0	0,0	0,0	34,6	4,6	0,6
	Small and medium-sized enterprises	32,8	4,3	0,5	37,5	5,0	0,6
	Specialization	0,0	0,0	0,0	62,6	8,4	1,0
	Employment	485,0	64,1	7,7	456,8	60,9	7,5
	Arts	16,1	2,1	0,3	40,3	5,4	0,7
	Energy saving	0,0	0,0	0,0	0,0	0,0	0,0
	Additional horizontal objectives	240,0	31,7	3,8	330,0	44,0	5,4
2.2	<i>SPECIFIC SECTORS</i>	3.077,2	406,9	48,6	2.716,5	362,4	44,6

	Steel production	4,0	0,5	0,0	0,0	0,0	0,0
	Transport	1.293,2	171,0	20,4	1.972,4	263,2	32,4
	Shipbuilding	987,1	130,5	15,6	516,8	69,0	8,5
	Tourism	213,2	28,2	3,4	82,0	10,9	1,3
	Other sectors	449,7	59,5	7,2	145,3	19,4	2,4
	Financial services	130,0	17,2	2,1	0,0	0,0	0,0
3.	Regional aid	89,2	11,8	1,4	137,0	18,3	2,3
4.	State aid on local level¹	408,7	54,0	6,5	343,5	45,8	5,6
	TOTAL	6.332,2	837,1	100,0	6.090,0	812,5	100,0

Sources: Ministry of Finance, other state aids providers, Croatian Competition Agency

Viewed by category, it is obvious that the sectoral aid accounts for the bulk of state aid in 2003 and 2004, making up 48,6 % in 2003 and 44,6 % in 2004 of the overall state aid structure. What is noticed in 2004 is growing trend of the horizontal state aids. The horizontal aids share of 12,8 % in 2003 amount to 17,6 % in 2004. The growing trends of the horizontal state aids made strong influence on the sectoral aids decrease, from 52,6% in 2002, to 48,6 % in 2003, and to 44,6% in 2004.

A small rise in the share of regional aid is also noticeable, from 1.4% in 2003 to 2.3% in 2004. Croatian Competition Agency has underlined in its Annual Report 2005 that the state aid amount on local level is not a total, but rather comprised only those aids notified from the local government units.

Also, the state aid in agriculture and fisheries are not presented in detail in the CCA Annual report, as regulated by lege specialis, and are not under CCA'a control.

6.1. Agriculture and fisheries

Even though the provisions of the Act and Regulation on State Aid do not apply to state aid in agriculture and fisheries they have been included in the Report 2005 in terms of amounts allocated within the period covered by this Report.

State aid to agriculture and fisheries moved from HRK 1,779.2 million in 2002, HRK 1,949.4 million in 2003, to HRK 1,819.8 million in 2004 respectively. The biggest state aid instrument goes to the subventions. The correlation between total aid and aid to agriculture and fisheries is given in the table below.

Table 8: Total state aid, and state aid to agriculture and fisheries

In mil HRK

	2002	2003	2004	Index 03/02	Index 04/02	Index 04/03
Total aids	5.117,2	6.332,2	6.090,1	122,3	117,6	96,2
Aids to agriculture and fisheries	1.779,2	1.949,4	1.819,8	109,6	102,3	93,4
Aids without agriculture	3.398,0	4.382,8	4.270,3	129,0	125,7	97,4

Sources: Ministry of Finance., Croatian Competition Aid

6.2.. Industry and services

6.2.1. Horizontal objectives

As previously stated, the share of horizontal state aid accounted for 7.4% in 2002, 12.8% in 2003, and 17,6% in 2004 of the overall state aid structure in Croatia, which significantly made the sectoral aids decreased. Within the horizontal objectives in 2002, aid was allocated only to small and medium-sized enterprises, plus state aid for employment, whereas in 2003 and 2004 aid was additionally provided for R&D, environment protection and the arts.

This group of aid also includes those indicated under «others», which refer to the preferential funding programme under loans for export incentives, i.e., subsidised interest rates through Croatian Bank for Reconstruction & Development (HBOR).

If viewed the state aid structure in the last three years period is visible increase of 120% of the horizontal instruments, which represents a notable step forward since 2002. Yet, it is not enough to be considered as the complete state aid structure change in favour of the horizontal instruments of those state aid providers.

Table 9: Horizontal state aid in 2002, 2003 and 2004

in mil HRK

Category	2002	2003	2004	Index 03/02	Index 04/02	Index 04/03
R & D	-	27,8	111,5	-	-	400,9
Environment protection	-	6,0	-	-	-	-
Art	-	16,1	40,3	-	-	250,4
Small and medium enterprises	27,2	32,8	37,5	120,4	137,6	114,3
Employment	177,6	485,0	456,8	273,0	257,2	94,2
Skills availability	-	-	62,6	-	-	-
Others	180,0	240,0	330,0	133,3	183,3	137,5
Restructuring	-	-	34,6	-	-	-
TOTAL	384,9	807,7	1.073,3	209,9	278,9	132,9

Source: Ministry of Finance , other state aids providers, Croatian Competition Agency

The share of horizontal aid in the overall volume of state aid, without agriculture and fisheries, in 2003 in Croatia accounted for 26,1 % . In the same time the average horizontal state aid was 79% in the 15 EU states.

6.2.2. Specific sectors

6.2.2.1. Transport

The transport sector comprises land, maritime and air transport. Pursuant to 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 directed to railway transport accounted for the largest portion provided directly to Croatian railway Company.

Within the aid to maritime transport, incentives to shipping lines and new transport vehicles accounted for the biggest share.

In air transport, the bulk of provided state aid refers to proprietary interest in Croatia Airlines.

Table 10: State aid to the transport sector in 2002, 2003 and 2004

in mil HRK

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

Source: Ministry of Finance, Ministry of Sea, Tourism, Transport and Development, Croatian Competition Agency

According to state aid allocation instruments, subsidies accounted for the largest portion of 67% in 2002 and 2003.

In 2004 the share of subventions decreased to 46,6%, and state aid share contained under the guarantees is 53,4%.

6.2.2.2. Shipbuilding

The most frequent state aid instruments in shipbuilding are subventions and state collateral. State aid to the shipbuilding sector in 2004 amounted to HRK 504.8 million. In 2003 was HRK 987.1 million, and in 2002 amount was HRK 652,7 million.

Subventions were used for new ships constructions, and they amount up to 10% of the contracted ship price according to the Book of Rules on Shipbuilding Subventions.

Table 11: State aid to the shipbuilding sector in 2002, 2003 and 2004, by instruments

in mil HRK

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

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

The Table below indicates total amounts of financial and performing guarantees issued to shipbuilding sector in year 2002, 2003, and 2004. The performing guarantees are issued within a period of the new ship construction, and are valid up the ship delivery. In the last three year period there was no protested performing guarantees.

Table 12: Financial and performing guarantees issued to ship building

In mil HRK

	Financial	Performing
2002	162,7	2.856,3
2003	776,4	2.721,6
2004	174,6	4.773,6
TOTAL	1.113,7	10.351,5

Source: Ministry of Finance, Croatian Competition Agency

6.2.2.3. Tourism

State aid to the tourist sector continued also in 2004 and has been approved mostly for programmes listed below:

- 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 in 2004 was decreased in comparison to 2003 for 61,5%. The main reason was a fact that in 2004 was no subsidies in state aid instruments.

Table 13: State aid to tourist sector in 2002, 2003 and 2004, by instruments

in mill HRK

Instruments	2002	2003	2004
Subsidies	101,8	120,2	62,7
Loans	0	0	18,6
Guarantees	39,6	93,0	0,7
TOTAL	62,2	213,2	82,0

Source: Ministry of Finance, other state aid providers, Croatian Competition Agency

6.2.2.4. Other sectors

In 2004 the subventions were issued for two plants pulling down, coke plant Koksar from Bakar, and aluminium plant TEF from Šibenik. Diona Company received a favourable loan for its revitalization.

The Table below shows in 2002 protested guarantees for economy sector as well as subsidies to Croatian Post for severance pays and new post offices construction. In 2003 there were also included the write-offs of claims by Croatian Privatisation Fund against other industry branches, outright grants to entrepreneurs endorsed by Croatian Small Business Agency .

Total amount of this state aid category was decreased in 2004 in comparison with two previous years.

Table 14: State aid to other sectors in 2002, 2003 and 2004, by instruments

in mil HRK

Instrument	2002	2003	2004
Subsidies	27,0	157,9	30,6
Loans	0	0	5,0
Guarantees	355,7	291,8	109,7
TOTAL	382,7	449,7	145,3

Source: Ministry of Finance, Croatian Competition Agency

6.2.2.5. Financial services

The current transfers of 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 Croatian Postal Bank.

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

In 2004 there was no evidence on state aid to the financial sector services.

Table 15: State aid to the financial sector services in 2002, 2003 and 2004, by instruments

in mil HRK			
Instrument	2002	2003	2004
Subsidies	0,8	0,0	-
property share	271,2	130,0	47,9
TOTAL	272,0	130,0	47,8

Source: Ministry of Finance, other state aid providers, Croatian Competition Agency

6.2.2.6. Regional Aid

Regional state aid is allocated with the view to encouraging the development of less developed regions of the Republic of Croatia in accordance with following acts: Act on Areas of Special State Concern, Act on Mountain Area, and Profit Tax Act.

The regional aid for such areas promotes many different innovative production programs and supports small business start-ups. This is of great importance for balanced regional development and is indispensable for sustainable support of economic activities, for new jobs creation, new investments, and preservation of the existing job and businesses in long term run.

The volume of subsidies designed for the regional development in 2004 was HRK 34,9 million, and tax exemptions in amount of HRK 102,1 million. The instruments of allocating state aid in 2004 were subsidies and tax exemptions.

Table 16: Regional state aid in 2002, 2003 and 2004 by instruments

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

Source: Ministry of Finance – Taxation Division, Croatian Competition Agency

Regional aid policy within the process of Croatia's integration to the EU need to be formulated for the balanced regional development of the country.

Therefore a rise should be expected in the volume of state aid intended for the development of less developed regions. The EU budget for regional state aid in 2003 was EUR 7,6 billion.

V: Summary of the Recommendations

This is the second Annual Report on state aid that the Agency has prepared in compliance with Article 19 of the State Aid Act. The Report covers the state aid granted in Croatian economy for the year 2004, and 2002 and 2003 for the reason of proper comparison and follow up.

The Agency still does not possess its own database on state aid, so all data presented herein have been taken from the Ministry of Finance, other state aid providers sources, from the Report on state budget implementation during a three years period, and from data evidenced by CC Agency in its regular activities performance.

The State Aid Act and the Regulation on State Aid entered into force in 2003, so the reporting methodology of the European Union was not wholly applied in the 2004 Report, but in the 2005 Report on state aid, certain data corrections has been made.

As shown by data given in the Report, sectoral aid still accounts for the bulk of aid, thus further efforts in their rational and proper used should be considered.

However, the share of sectoral state aid in total state aids is decreasing.

Such positive trends are to be improved further on especially for shipbuilding sector financing.

Encouraging is state aid allocated in accordance with horizontal objectives. The ratio already is changed in 2004 and the policy of state aids granted to the small and medium sized enterprises should be supported on sustainable basis.

The share of state aids in GDP in 2004 is decreased, but still relatively high if compared with EU average. Decreasing trend is also notable in total amount of state aids if compared year 2004 with 2003.

The Agency and state aid providers still must put a lot of efforts to maintain the positive trends as shown in the 2005 Report. Three last year period showed adjusting of 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.

a) Short-term recommendations

The competition and state aid in the process of the association of Croatia in the EU is very high on the list of policy priorities because of adequate preparation of Croatian entrepreneurs to the business conditions existing on the internal European market.

The continuous alignment of Croatian legislation with *acquis communautaire* is a first priority, and proper implementation of the legislation, thus still there are few bylaws which have to be adopted by the end of 2005, like block exemption on licence issuing, and know how transfer.

In order to reach these objectives the institutional capacity building of Croatian Competition Agency as the main regulator should be further improved in its administrative and technical capacities.

In 2005 and 2006 further secondary legislation relative to state aid application rules, approval procedure, monitoring, and evidence should be improved. It is foreseen an guidelines for horizontal and some sectoral state aid schemes, and procedures of complaints to be published.

The importance of policy, role and the law on the competition for the future economic development of the country should be strongly promoted through a wide society. The sensitivity of public awareness should be improved continually with adequate knowledge of governmental and other state administration bodies in the same time.

b) Long-term recommendations

In a long term an advantage is given to the basic legal acquest (*acquis*) regulating internal market and trade-related matters. More profound improvement in legislation is still needed in order to strengthen the implementation of the competition and state aids rules especially related to the sanctions against some committed violation.

During a process of the negotiations for the EU membership the Republic of Croatia has to implement the rules of market competition, and state aid valid within the EU.

For the purpose of an efficient and effective implementation of competition law and state aid an friendly environment is an condition sine qua non. A broad promotion of the competition culture among a wider society is an prerequisite. The activities related to this mission are full information provision, adequate knowledge dispersion, and public awareness level increase.

VI: Conclusions

In conclusion to this Report it should be emphasized that the formal opening of the negotiation process for EU membership in October 2005 get started the process of *screening i.e.* analysis, survey and evaluation of the level of the harmonization of national legislation with *acquis*.

In the Stabilisation and Accession Agreement of the Republic of Croatia to EU the issues of the market competition and state aid are among the major priorities. The legislation alignment of these issues with the *acquis communautaire* is defined in the National Programme of Accession to EU 2006 as well.

In EC Croatia 2005 Progress Report the priorities within competition and state aid area are: further legislation harmonization, strenghtehing of the administrative capacity and efficient enforcement. Special attention is given to the state aid schemes for shipbuilding and steel industry sectors, and fiscal aid as well.

Special regulatory body the Croatian Competition Agency has even more strengthen competencies in approving the requests for state aid, in controlling the implementation as well as the state aid pay-back.

The administrative capacity building of Croatian Competition Agency is to be further improved, as well as the training of stakeholder representatives. Furthermore, a constant awareness on the transparency of all state aids in public should be raised.

On the basis of data presented in this research is visible that the positive trends are in due course. The conclusion could be that both, the business community entities, and state aids providers, are gradually abandoning a selective approach in state aids schemes granting.

The state budget sources are forwarded much more into horizontal objectives which is in accordance with European state aids schemes. The impact of horizontal state aids schemes benefits more to the overall economy development, and on long term are good precondition for the growth of competitiveness of the Croatian economy. That means more investment in education, skills availability, training, environment protection, and new jobs creation.

APPENDIX 1

Extract from Croatian Competition Agency 2005 Report

This Appendix 1 contains a few characteristic survey of cases submitted to the Agency and processed by the end of 2004.

Classification	UP/I 430-01/2004-01/18
Provider	Ministry of Finance
State aid case	Draft Collateral Agreement between Croatia and EBRD for the construction of costal infrastructure in Dubrovnik port
Recipient	Dubrovnik Port administration Board
General / single aid	Single aid
Date and type of request	10.18.2004.
Legal basis	Act on Maritime and Act on Maritime Ports (OG 158/03)
Sector, category, purpose	Public sector – Maritime ports
Instrument	Guarantees
Duration period	
Plan in HRK – state budget 2004	
Amount in HRK	198.485.000
Amount in EUR	26.500.000
Amount in USD	
Date and procedure termination type	Resolution on request rejection by December 22,2004 on Collateral agreement (no. 580-03-04-17-05). This state collateral is investment in infrastructure and does not felt under provisions of State Aid Act.

Classification	UP/I 430-01/2004-06/02
Provider	Ministry of Sea, tourism, transport and development
State aid case	Decision on state collateral upon the loan issued to Croatian Highway Co. at Private Export Funding Corporation along with insurance by Overseas Private Investment Corporation (OG 92/04)
Recipient	Croatian Highway Company, Zagreb
General / single aid	Single
Date and type of request	06-16-2004
Legal basis	Act on Public Highways (OG 180/04), Transport Development Strategy of Croatia (OG 139/99)
Sector, category, purpose	Highway Administration and Management
Instrument	Guarantee
Duration period	
Plan in HRK – state budget 2004	
Amount in HRK	1.507.500.000
Amount in EUR	201.268.358
Amount in USD	250.000.000
Date and procedure termination type	Resolution on request approval by October 18,2004 on Collateral agreement (no. 580-03-04-17-02). This state collateral is in accordance with provisions of State Aid Act as it is related to the implementation of the important public projects

Classification	UPI/I 430-01/2004-07/10
Provider	Regional Development Fund
State aid case	Investment in infrastructure – water supply for the areas Garešćica – Karbuni Zaglav
Recipient	Community of Blato (Dubrovnik – Neretva County)
General / single aid	Single
Date and type of request	09-03-2004
Legal basis	Book of rules on conditions and criteria of the Regional Development Fund (OG 65/02, 81/04), and Conditions on Infrastructure and Economic projects loans (OG 101/02, 81/04)
Sector, category, purpose	Infrastructure
Instrument	Subventions
Duration period	
Plan in HRK – state budget 2004	
Amount in HRK	747.421
Amount in EUR	99.789
Amount in USD	
Date and procedure termination type	Resolution on request rejection by Sept. 17,2004 on Collateral agreement (no. 580-03-04-17-02). This state collateral is investment in infrastructure and does not felt under provisions of State Aid Act.

Classification	UPI/I 430-01/2004-07/13
Provider	Regional Development Fund
State aid case	Investment in infrastructure – Small Business Centre Pakrac
Recipient	City of Pakrac (Požega – Slavonia County)
General / single aid	Single
Date and type of request	09-03-2004
Legal basis	Book of rules on conditions and criteria of the Regional Development Fund (OG 65/02, 81/04), and Conditions on Infrastructure and Economic projects loans (OG 101/02, 81/04)
Sector, category, purpose	Infrastructure
Instrument	Subvention
Duration period	
Plan in HRK – state budget 2004	
Amount in HRK	2.000.000
Amount in EUR	267.023
Amount in USD	
Date and procedure termination type	Resolution on request rejection by Sept. 17,2004 on Collateral agreement (no. 580-03-04-17-02). This state collateral is investment in infrastructure and does not felt under provisions of State Aid Act.

Classification	UPI/I 430-01/2004-07/15
Provider	Regional Development Fund
State aid case	Investment in infrastructure – Pipeline construction – Ždrilo – Vinjerac – Slivnica Gornja
Recipient	Community of Posedarje (Zadar – County)
General / single aid	Single
Date and type of request	09-03-2004
Legal basis	Book of rules on conditions and criteria of the Regional Development Fund (OG 65/02, 81/04), and Conditions on Infrastructure and Economic projects loans (OG 101/02, 81/04)
Sector, category, purpose	Infrastructure
Instrument	Subvention
Duration period	
Plan in HRK – state budget 2004	
Amount in HRK	1.100.000
Amount in EUR	146.862
Amount in USD	
Date and procedure termination type	Resolution on request rejection by Sept. 17, 2004 on Collateral agreement (no. 580-03-04-17-02). This state collateral is investment in infrastructure and does not felt under provisions of State Aid Act.

Classification	UPI/I 430-01/2004-07/16
Provider	Regional Development Fund
State aid case	Investment in infrastructure – reconstruction of costal barrier and collector in city of Novigrad
Recipient	Community of Novigrad
General / single aid	Single
Date and type of request	09-03-2004
Legal basis	Book of rules on conditions and criteria of the Regional Development Fund (OG 65/02, 81/04), and Conditions on Infrastructure and Economic projects loans (OG 101/02, 81/04)
Sector, category, purpose	Infrastructure
Instrument	Subvention
Duration period	
Plan in HRK – state budget 2004	
Amount in HRK	1.500.000
Amount in EUR	200.267
Amount in USD	
Date and procedure termination type	Resolution on request rejection by Sept. 17, 2004 on Collateral agreement (class. UP/I 030-02/204-01/64, no. 580-03-04-17-02). This state collateral is investment in infrastructure and does not felt under provisions of State Aid Act.

Classification	430-01/2004-03/45
Provider	Ministry of Economy Labour and Entrepreneurship
State aid case	Project "Traditional Crafts Development"
Recipient	
General / single aid	General
Date and type of request	07-19-2004 – upon official request
Legal basis	Small Business Incentives Act (OG. 29/02), Act on Crafts (OG 49/03)
Sector, category, purpose	Small and Medium Enterprises
Instrument	Subvention
Duration period	Up to December 31, 2004
Plan in HRK – state budget 2004	
Amount in HRK	2.000.000
Amount in EUR	267.023
Amount in USD	
Date and procedure termination type	Resolution on request rejection by Sept. 17, 2004 on Collateral agreement (class. UP/I 030-02/204-01/64, no. 580-03-04-17-02). This state collateral is investment in infrastructure and does not felt under provisions of State Aid Act.

Classification	430-01/2004-03/47
Provider	Ministry of Economy Labour and Entrepreneurship
State aid case	Project "Craftsman Skills Training"
Recipient	
General / single aid	General
Date and type of request	07-19-2004 – upon official request
Legal basis	Small Business Incentives Act (OG. 29/02), Act on Crafts (OG 49/03)
Sector, category, purpose	Small and Medium Enterprises – state aid de minis
Instrument	Subvention
Duration period	Up to December 31, 2004
Plan in HRK – state budget 2004	
Amount in HRK	
Amount in EUR	
Amount in USD	
Date and procedure termination type	Opinion on request by Dec. 22,2004 (no. 580-03-04-29-02). This state aid is de minis type with a main goal to support training craftsman skills availability and as such is not obligatory the Agency's opinion. Provider of this state aid is obligated to inform the Agency and to make evidence in proper register of state aid <i>de minimis</i> .

Classification	430-01/2004-03/48
Provider	Ministry of Economy Labour and Entrepreneurship
State aid case	Project "Incentives for Crafts who trains students for craftsmen skills"
Recipient	
General / single aid	General
Date and type of request	07-19-2004 – upon official request
Legal basis	Small Business Incentives Act (OG. 29/02), Act on Crafts (OG 49/03)
Sector, category, purpose	Small and Medium Enterprises – state aid <i>de minimis</i>
Instrument	Subvention
Duration period	Up to December 31, 2004
Plan in HRK – state budget 2004	
Amount in HRK	
Amount in EUR	
Amount in USD	
Date and procedure termination type	Opinion on request by Dec. 22,2004 (no. 580-03-04-29-02). This state aid is <i>de minimis</i> type with a main goal to support training craftsman skills availability and as such is not obligatory the Agency's opinion. Provider of this state aid is obligated to inform the Agency and to make evidence in proper register of state aid <i>de minimis</i> .

Classification	430-01/2004-03/50
Provider	Ministry of Economy Labour and Entrepreneurship
State aid case	
Recipient	
General / single aid	General
Date and type of request	07-19-2004 – upon official request
Legal basis	Small Business Incentives Act (OG. 29/02), Act on Crafts (OG 49/03)
Sector, category, purpose	Small and Medium Enterprises – state aid <i>de minis</i>
Instrument	Subvention
Duration period	Up to December 31, 2004
Plan in HRK – state budget 2004	700.000
Amount in HRK	
Plan in EUR	93.458
Amount in USD	
Date and procedure termination type	Opinion on request by Dec. 22,2004 (no. 580-03-04-29-02). This state aid is <i>de minis</i> type with a main goal to support training craftsman skills availability and as such is not obligatory the Agency's opinion. Provider of this state aid is obligated to inform the Agency and to make evidence in proper register of state aid <i>de minimis</i> .

Classification	430-01/2004-55/95
Provider	Ministry of Economy Labour and Entrepreneurship
State aid case	Croatian shipbuilding Jadran brod – Draft on regulation of the state aid for shipbuilding in a adjustment period
Recipient	
General / single aid	General
Date and type of request	11-29-2004 – upon recipient request
Legal basis	
Sector, category, purpose	Shipbuilding
Instrument	Subvention
Duration period	Up to December 31, 2004
Plan in HRK – state budget 2004	
Amount in HRK	
Amount in EUR	
Amount in USD	
Date and procedure termination type	Opinion on request by Dec. 22, 2004 (no. 580-03-04-17-02). This state aid for shipbuilding sector could not apply on yacht, small boats, firm costal and floating objects construction, nor for new employment. Thus, proposed Regulation is not in accordance with State Aid Act, nor with articles 67-71of Regulation on State Aid

List of Abbreviations and acronyms

HRK	- Croatian currency Kuna
SAA	- Stabilisation and Accession Agreement
CCA	- Croatian Competition Agency
CC	- Competition Council
MF	- Ministry of Finance
MELE	- Ministry of Economy, Labour and Entrepreneurship
EU	- European Union
EC	- European Commission
GDP	- Grosse Domestic Product
GAPA	- General Administrative Procedure Act
AOR	- Act on Obligatory Relations
TREATY	- European Commission Treaty
AVIS	- European Commission Opinion on the Application of Croatia for Membership of the European Union
COMMISSION	- European Commission
ACQUIS	- acquis communautaire
IA	- Interim Agreement on trade and trade –related matters
PF	- Croatian Privatisation Fund
OECD	- Organization for Economic Cooperation and development
SEE Countries	- South East Europe Countries
WTO	- World Trade Organization

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