

THE EU STATE AID RULES: CASE STUDY OF CROATIA

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Abstract

This thesis explains the changes in state aid policy of Croatia in terms of its forthcoming membership in the European Union. This study advances the argument that reform of state aid is influenced in particular by the EU state aid objectives of 'less and better targeted state aid.' The study draws evidence from secondary data on state aid as computed and reported by the Croatian Competition Agency. The pre-accession state aid policy in Croatia is compared with the changes in state aid policy in Poland before the EU accession. Among the sources, this thesis is based on the very few academic studies on state aid reforms in the newer member states of the EU. The available data on state aid volumes and objectives in Croatia suggests only a slow pace of change of state aid policy. Nevertheless, the analysis of the findings proves that the state aid schemes differ from previous state practices of giving aid to shipyards or steel mills without any attached conditions. The EU state aid rules and regulations are responsible for these improvements in the evolving Croatian state aid policy.

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CHAPTER 1: INTRODUCTION

The European Union controls state aid of its member states towards their economies through a system based on agreed principles. This control method marks a unique feature of the EU competition policy in comparison to the mechanisms of subsidies control which are at the disposal of other economic or regional groupings of states. The EU system of state aid control is a means to prevent distortions to competition and trade within the common market. However, the system goes beyond the distortions to trade considerations as it aims to influence the states to make progress towards less and better targeted state support measures (Buelens et al. 2007, 8). The Union encourages these member states to implement EU state aid rules and thereby reduce the wasteful spending of precious budget resources. A very inefficient use of government funds might be providing aid to failing firms in order to save jobs. Thus, Heidhues and Nitsche (2007) argue in favor of strict EU state aid control which would provide governments with a ‘commitment device’ to resist the pressures from their electorate to save the jobs while at the same time extending the life of loss-making economic undertakings.

Nevertheless, the EU state aid demands have not been so much eagerly accepted by the countries that joined the Union in 2004 due to their history of state interventionism into the economy (Hashi 2004). While, in pursuing the objectives of ‘less and better targeted state aid’ (SAAP 2005) some of the new member countries proved to be more successful compared to others, so far rather scant findings about their different strategies do not allow for any definite conclusions about the EU influence on countries’ state aid orientations. Consequently, these different strategies provide justification for undertaking this study of state aid policy in Croatia.

The state aid policy reform in Croatia is selected for this study as the country is soon to become the newest member of the EU which helps to identify the specific European influence on the observed state aid changes. This thesis seeks to respond to the question: To what extent have the European state aid rules affected changes of the state aid policy in Croatia? To contextualize the problem it is important to note that under the EU influence the country is changing its old habits of rescuing firms in difficulty, in particular the shipyards and the steel companies. Although one may think of alternative explanations for changing the state aid practices of Croatia, this thesis wants to point out on the significance of the European influence. Though there are EU rescue and restructuring guidelines¹ that do not allow member states to give aid to ailing companies in the sector of steel, Croatia has received exceptions from this. Nevertheless, Croatia is influenced by the EU state aid rules and it is beginning to impose conditions for the approval of aid to the recipient companies in the shipbuilding and steel manufacturing. These companies so far have been receiving repeated grants of assistance with almost no attached conditions. Consequently, Croatia is cutting down state aid while moving to the Union membership.

Moving on to the structure of the thesis, the thesis is structured as follows: Chapter 1 provides a background for understanding competition policy reforms in the newer EU member countries through the survey of the relevant literature in the field. Chapter 2 places state aid in the context of the EU competition policy. Chapter 3 starts with the reform of state aid policy in Croatia in overall, whereas Chapter 4 observes the changes in two sectors in particular. These are shipbuilding and steel manufacturing. In addition to this, the thesis uses findings on Polish state aid policy in the pre-accession context with an aim to confirm the general conclusion that the European influence in particular accounts for changes of a state involvement in the economy. In conclusion, the study finds that the prospects of the EU accession drive the reform of state aid policy in Croatia. Overall, the thesis offers a contribution to the understanding of the EU driven state aid reforms in countries previously marked with rather dense state interventionism.

¹ Community guidelines on State aid for rescuing and restructuring firms in difficulty (2004) Official Journal C 244

1.1 Literature review

The impact of European state aid rules on competition policies of its member states and candidate countries is an important issue due to the significance of these rules for the functioning of the European internal market and moreover their relevance for the national economies. Thus this study will review the impact of the EU competition provisions on the state aid policy in Croatia. State aid policy is one among the most important aspects of the EU competition policy, though the least researched one.

Numerous studies have pointed out to the issues related to the EU competition policy reform in the new EU member states of Central and Eastern Europe. For instance Holscher and Stephan (2004) review the competition policy in the Czech Republic, Hungary, Poland, and Slovenia with the focus on the anti-trust aspect of the competition law. Moreover, they find that these countries have transposed the laws and the necessary provisions but need to work more on effective implementation. Their study includes Romania as well as a candidate country with which the negotiations on Chapter on Competition and State Aids have not been closed. Nevertheless, Holscher and Stephan use Romania as a comparator to come to a general conclusion that the competition policy in neither of the countries is sufficiently developed. Therefore the EU should adopt a proactive country specific approach instead of insisting in general on the implementation of legislation (Holscher and Stephan 2004). This country specific approach may be applied by the EU as well as with regard to state aid.

While in a more recent study Holscher and Stephan (2009) conclude that the competition policy in the new EU member states is weak in terms of its implementation and enforcement, they see no need for any stringent policy measures. Rather, Holscher and Stephan observe that the strong competition policy implementation in the transition post-socialist economies is a learning process which eventually will lead to the policy convergence across EU member states. Nevertheless, their study predicts that the state aid policy is going to become more of a problem, in particular in the light of the economic crisis, and especially in the new member countries.

Consequently, the EU pressure will move from the strict anti-trust policy control to the control of state aid policies (Holscher and Stephan 2009). This may imply that the EU state aid rules are becoming stricter.

In one of their following inquiries, Holscher and Stephan along with Nulsch take the issue of state aid in an enlarged European Union aiming to provide an overview of the developments in the field. Their findings suggest that a level playing field with respect to state aid has emerged. Accordingly, the new member states seem to be converging into the competition culture (Holscher, Nulsch, and Stephan 2010). Precisely the lack of competition culture is often cited by the scholars in the field as a reason for lower effectiveness of competition policy implementation in the post-socialist new EU member states. Hashi's analysis (2004) identifies some of the characteristics of the early post-socialist transition in Hungary, Poland and the Czech Republic as the countries under consideration, and explains partly the misfit between the European state aid rules and post-socialist government support policies in the three accession countries. In these countries the state support measures were widespread and were aimed at helping those enterprises and sectors in difficulty, which under the EU rules in principle no longer is allowed. Accordingly, the countries under consideration had to reform their support and state aid policies during the period of accession to the EU. The existent distortive aid schemes had to be abolished. This has been difficult as these support programs always have their political and electoral reasons, besides purely economical ones. The similar difficulties pertain also in Croatia.

Moving to economical justifications for state aid it is hard to find them. More reasons exist for state aid not being a good policy to follow. That is why strict state aid rules should be in place. The enforcement of these rules should be encouraged, as it requires a state to give up of supporting those debt-burdened and loss-making market actors. The study by Hashi, Hajdukovic and Luci (2005) provides support to these claims as it finds out that government intervention in form of taxes and subsidies does not improve the competitiveness of the industries in Poland and

the Czech Republic. Yet the scope of government intervention remains significant, although formally at least these countries have brought their state support policies under the European general rules governing state aid (Hashi et al. 2005). In Croatia which is aligning its state aid regime with the EU rules the scope of state involvement remains significant.

While some studies find the new member countries to have converged into the competition cultures (Holscher, Nulsch, and Stephan 2010), some others identify a lack of the true enforcement of competition policy in the new EU member states. Blauberger (2007) evaluates the impact of European state aid control in Poland and the Czech Republic in the period since their fourth year of EU membership. He finds different national strategies of these countries in dealing with the European state aid law but nevertheless notes the tendency in both countries towards the convergence with the European state aid policy. Blauberger (2007) considers the state aid control by the Commission in the post-accession period as the main factor contributing to the policy convergence, while in the pre-accession period it was the anticipated control by the Commission that led to the changes, rather than the accession conditionality.

Moving to the state aid compliance the record in Poland and in the Czech Republic has however varied. Blauberger (2007) interprets the variation possibly as a question of time. Other than Blauberger there are very few studies analyzing the issue of state aid enforcement and compliance that would enable one to make any definite conclusions. For instance, Hashi (2004) states that the member countries continue to support their industries despite the criticism by the Commission and in contrast to the EU state aid rules. The reason why these countries are disregarding the EU competition policy regulations may have something to do with their post-socialist tradition of state intervention into the economy. Moreover, this state interventionism which marks these countries makes them difficult to adept to the EU rules. As well as these countries Croatia is also marked with a history of state interventionism in the economy.

The issue of post-socialist transition and economic integration in Europe is a subject of Estrin and Holmes's edition 'Competition and Economic Integration in Europe' (1998). Estrin

and Holmes note that the required state aid reform in the Central and Eastern European countries (CEECs) is a constituting element of the competition policy reform in these EU acceding countries which is especially difficult. Nevertheless, this issue fails to be more extensively described in the above edition. Estrin and Holmes note that the harmonization with the EU competition law has its possible disadvantages, but still they argue in favor of effective application of the policy as the way to promote market relations, and competitive business orientations by the firms.

The CEECs have been implementing the policy since signing the Europe Agreements (EA) in the 1990s. Thus Jakob (1998) fittingly raises the question whether the approximation of legislation in the competition field took place in these countries. Jakob's findings confirm that the CEECs changed their competition practices according to the EC competition rules and did even better than expected. Moreover, he seems to stress the economic soundness of the EU competition rules. He considers these rules are flexible enough to be able to accommodate the special needs of the transition economies. One may note that the EU conducts country-specific discussions with the new member states as well as with the new candidate countries which can be taken to confirm the flexibility of the EU competition provisions. Though with time these provisions may have become more stringent, the Union still makes an effort to accommodate the specific national concerns by approving transitional state aid regimes and allowing some support schemes in case of specific national industries. This is also observable in the Croatian example.

As such the EU competition policy is seen as supporting structural adjustment policies in transition countries, for instance in Poland. According to Saryuz-Wolski (1998) the structural adjustment processes in Poland are highly complementary with the EU competition policy. This is because industrial restructuring and privatization have been following the EU competition provisions. The structural adjustment policies in Poland were tried to be balanced with the EU competition law (Saryuz-Wolski 1998). Similar balancing processes are noticeable in Croatia.

Furthermore, Vissi (1998) describes the approximation of the Hungarian competition law with the European Union law and notes how much the Hungarian state aid system differs from the EU's guidelines. Nevertheless, Vissi predicts that state aid in Hungary will be brought under the EU state aid regime. Similarly to the other CEECs, Hungary reformed its state aid practices having departed from no competition regime set out to adopting the details of the EU competition law. In Croatia the similar reform is taking place. Therefore, one can assume that policy makers have their hands full trying to align the country competition practices with those in the EU, moreover as there has been no coherent state aid policy in Croatia so far.

However, Blauburger (2007) claims that the EU candidate countries only in the post-accession period start to really align their state aid practices with the EU competition regulation. He uses these countries state aid expenditures in order to confirm claims that state aid policies of the candidate states before accession have been in striking contrast with the European rules. Moreover, only in post-accession period have the new member states started to meet the requirements. Blauburger assigns this puzzling compliance record of the new EU member countries to the European Commission (EC) control powers in the competition policy enforcement in the member countries, whereas in the pre-accession period the countries had only formally been following the EC state aid guidelines. Furthermore, Blauburger in his other paper on European state aid control (2009) argues how state aid control is a very important part of the competition policy in limiting the member states ability to grant distortive subsidies and aid their industry, though he claims the states retain the possibility to award aid to specific targets by transferring the aid in some form of admissible support.

Therefore, there exists a space for the new member states to adjust their state aid policies in a less substantive manner. It follows that when analyzing the relevant state aid policy changes in Croatia, the challenge will be, besides identifying these changes also relating them to the country's EU membership prospects and to the European influence excluding other possible

explanations. The next section states the research question and the methodology which will be used in this study.

1.2 Research question and the methodology

The research question this thesis seeks to respond is: To what extent have the European state aid rules affected the changes in state aid policy in Croatia? In order to depict the European influence on the observed changes in state aids, the following methodology is used. Firstly, the changes in the state aid expenditures along with the related changes in the legislative and institutional state aid environment are observed in Croatia in the time period from 2002 till 2009, for which the data are available. Secondly, this study looks at the two sectors, steel manufacturing and shipbuilding industry, which are both given state aid and identifies the changes in the same 2002-2009 period. Thirdly, this study includes a comparison of the state aid changes in Croatia with the EU related changes of state aid policy in Poland, in order to depict primarily the EU influence on altering the policy in Croatia.

The choice of Poland is based on several factors. First, both Croatia and Poland have been implementing the reforms in the eve of the EU accession in order to fulfill the EU membership criteria. Second, as regards the state aid policy both countries could be grouped into the same category as the state aid structure in the pre-accession period is characterized by high aid levels and mainly sectoral aid objectives (Blauberger 2007, 15). Third, in both countries shipbuilding industry as well as steel manufacturing is of a high economic relevance given their share in countries' exports and in generated employment. With regard to the differences, Poland is the member of the EU since 2004, whereas Croatia is holding the status of a candidacy and is waiting for the EU membership.

Therefore, the empirical data that will be used in this study are those from the pre-accession period of both countries. The available data for Poland in the period of the EU membership will be used to make assessments about the consequences for Croatia upon

accession. This study benefits from the reports of the Croatian Competition Agency (CCA) and the quantitative analysis statistics the CCA provides. These data enable conclusions on the amounts and the structure of state aid in Croatia during the time period of 2002 till 2009. Sources from the print media will be used to picture the background of the reforms in Croatia, particularly in the cases of shipyards and steel industry, as the reasons are direct access to print media reports. Following the methodology described this study will provide an answer on the research question about the specific impact of the EU state aid rules on the changes of state aid policy in Croatia.

CHAPTER 2: EUROPEAN RULES ON STATE AID

This chapter will define the concept of state aid, provide insight into the basic EU rules governing state aid and explain the application of these rules in Croatia. The concept of state aid is very broad and it encompasses different types of state support measures towards economic actors. These measures range from direct financial grants, guarantees and government holdings in companies, taxation benefits and preferential interest rates, from provision of goods and services by the state on preferential terms, all to the debt relief measures (Vesterdorf and Nielsen 2008, 11; Cini and McGowan 2009, 165). Nevertheless the EC sets guidelines and provisions in order to make the state aid control system follow the rules. These rules are described in the next paragraphs.

2.1 State aid concept and rules

In general countries of the EU are not permitted to give state support. In the EU state aid is prohibited under the Article 87(1) of the Treaty establishing the European Community. Art 87(1) states

“Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market“
(Vesterdorf and Nielsen 2009, 1).

The prohibition of state aid is enforced by the EC. The Commission is expected to cooperate closely with the member states in enforcing the state aid rules. The cooperation aspect is seen in the example of the EU enlargement when the acceding countries are expected to implement the state aid guidelines set up by the Commission. Besides implementing the necessary legislation among their first steps is also to establish national state aid authorities for monitoring

and enforcing state aid prohibitive rules². Accordingly, Croatia established the national competition agency.

Moving on to the meaning of the prohibition of aid it restricts the possibilities for national governments to award support to their own economies. For instance, Cini and McGowan point out that state aid control has been referred to as 'the death-knell of purely national industrial strategies'(2009, 162). It follows that the countries accepting state aid rules are not allowed to benefit their own enterprises contrary to the EU rules. The rationale of these rules, as Oldale and Piffaut (2009) state is to prevent distortions to competition and trade and maintain a level playing field for companies. Thus state aid control introduced in the new EU member states supports economic reforms since government policy needs to stop using state aid to benefit their own enterprises when this is contrary to the EU state aid rules. Consequently the acceding countries are required to abolish or align incompatible support measures to their ailing national industries. This proved to be particularly demanding for most of the new EU member states whose previous economic systems were marked with dense record of market intervention by the state which was as Kaufman (2009) notes due to their previous political systems. Although most of the acceding countries, including Croatia, are usually approved transitional periods to align their support measures with the European rules these periods are limited in scope and duration. On these transitional periods expiry all incompatible aid measures need to be phased out. Accordingly, each of the countries needs to develop policy of state aid bearing in mind the limited time and scope of the approved transitional regimes, as well as the prohibitive state aid regulations.

The EU state aid provisions do not mean a complete prohibition of state aid. Besides general state aid prohibition under the Art 87(1) the subsequent articles³ set up exemptions from

² The EC Treaty rules on state aid are administered by the Commission in case of EU Member States, while in Croatia's case which is not yet an EU member the adopted state aid legislation is administered by the national surveillance authority (Vesterdorf and Nielsen 2008, 39, 11; Kaufman 2009, 157).

³ Articles 87(2) and 87(3) of the EC Treaty contain a number of exemptions to the prohibition of state aid (Vesterdorf and Nielsen 2009, 2).

the general prohibitive rule. Accordingly, the Commission approves some forms of aid as long as it finds them to be compatible with the common market. Among acceptable forms of aid is aid awarded for social reasons, for damages caused by natural disasters or exceptional occurrences, aid for economically disadvantaged regions, for projects of common European interest, aid to remedy serious disturbances in the Member States' economies, rescue and restructuring aid, as well as aid to promote culture and heritage conservation (Vesterdorf and Nielsen 2008, 27-35). Specifically, in case of acceding countries as Croatia the EU may approve additional exceptions to the prohibition of state aid as it is the allowed steel sector restructuring aid.

In relation to the above stated provisions the task of the Commission is to examine whether an actual aid measure is compatible with the internal market. As regards the member states for them it is important to familiarize themselves with the various provisions and frameworks 'to get a good idea in advance of what aid measures the Commission will be inclined to approve' (Vesterdorf and Nielsen 2008, 35). In general the Commission is more inclined to approve aid for horizontal objectives such as environmental protection or innovation, while views much more unfavourably towards aid awarded to particular sectors i.e. to shipbuilding or steel sector. Therefore it is important to analyze the state aid objectives of the countries to establish whether state aid policies of these countries are following the EC state aid rules.

2.2 State aid objectives

The EU state aid policy contains three main elements: regional aid policy, sectoral aid policy and horizontal aid policy (Cini and McGowan 2009, 182). Whereas aid awarded for regional and horizontal objectives is in general more compatible with the EU state aid rules, sectoral aid constitutes more of a problem. This is because sector-specific aid is most likely to be in contradiction with the Art 87(1) that prohibits forms of aid which favour the production of

certain goods. In regards to the sectoral aid the Commission has adopted so called 'framework' approach that regulates provision of aid to certain sectors.

For instance, state aid to shipbuilding sector needs to comply with the provisions of the 'Framework on State aid to Shipbuilding.' This Framework sets the rules on aid that can be provided to this sector. Accordingly, shipbuilding sector is eligible for innovation aid, closure aid, export credits, development assistance and regional aid as well as for other forms of aid under the horizontal aid rules, for instance rescue and restructuring aid (Davey and Waite 2009, 347-351). Shipbuilding is among the most controversial sectors receiving state subsidies due to its specific features which include overcapacity, low prices and global scale trade distortions (Vesterdorf and Nielsen 2008, 207). Thus aid awarded to shipbuilding industry is subject to high scrutiny by the Commission in order to determine whether it is justified taking into account economic, political and social considerations. If the aid awarded is found to be illegal it needs to be repaid. This is what happened with the two Polish shipyards being awarded with rescue and restructuring aid⁴. In addition in the case of Croatia's EU accession the Commission is scrutinizing the aid received by its shipyards.

Another sector in which the grant of state aid has been problematic is the steel sector. Therefore specific state aid rules apply to this sector allowing aid only for research and development, environmental protection and for closure (Watson-Doig 2009, 406). Closures or privatization of steel companies is among the Commission's priorities, but due to the importance of steel industry in some of the newer member countries these countries as Watson-Doig (2009) points out have not been willing to easily give up supporting their steel companies. Again Poland provides an example because the Commission had to allow it to continue to support its steel industry. This was done through transitional arrangement made under the

⁴ In case of aid awarded to two Polish shipyards, Szczecin and Gdynia the Commission concluded that aid is unlawfully granted and had to be repaid (Davey and Waite 2009, 351).

Europe Agreement and the extension of it under the Protocol 8 of the Accession Treaty with Poland (Lienemeyer 2005). Thus Poland could continue to grant aid to its steel sector.

Moving again to Croatia, both the shipbuilding sector and the steel industry have been 'sensitive' issues in the EU negotiations related to competition and state aid (EC Progress Reports). State aid criteria for Croatia are set out in Article 70 of the Stabilisation and Accession Agreement(SAA). This article means introducing the same concept of state aid and the EU state aid rules and regulations in Croatia. Although the SAA came into effect in 2003, Croatia has not till 2010 opened the negotiations with the EC on the chapter on competition and state aid. This long lag implies that there are pertaining difficulties in implementing the EU state aid competition provisions in Croatia. Therefore, Croatia is taken as a case study to investigate the influence of the EU state aid rules on forming the country's state aid policy. The next chapter will introduce the process of state aid reform in Croatia.

CHAPTER 3:

PROCESS OF STATE AID REFORM

In the later chapter an overview of the EU state aid rules was provided whereas this chapter is about the application of these rules in Croatia. Croatia accepted to apply for the European state aid rules in the making of its state aid policy through the ‘Stabilization and Association Agreement between the Republic of Croatia and the European Communities and their Member States’ signed in 2001(‘Official Gazette-International Treaties’, No.: 14/01, 14/02, 1/05 and 7/05; hereinafter: SAA). Among many of the other obligations, Croatia as well took the obligations about the state aid, i.e to align its competition legislation with the European competition law, to establish an independent national authority for monitoring and implementing state aid, and finally to demonstrate credible enforcement of state aid regulation. Therefore, the following sections will draw attention on these three issues central for forming a state aid policy in accordance with the EU state aid rules. In addition, the state aid developments in Poland before the EU accession are addressed in order to support the central claim that state aid policy is influenced primarily by the EU state aid rules and regulations.

3.1 Forming a state aid regime in Croatia

As legislative alignment is concerned the State Aid Act was first adopted in March 2003 along with the Regulation on State Aid. Further on, an independent agency was set up and entrusted with the task of controlling national state aid measures. Among its activities of monitoring and enforcing state aid rules, the Croatian Competition Agency (CCA) is also entrusted with the task to inventory all state aid in order for the aid schemes to be brought into compliance with the EU criteria. Thus, the Agency published its first Annual Report on State Aid in 2004, comprising the data for the years 2002, 2003 and 2004.

The above data and the data for the following years till year 2009 will be described here and the rationale for the methodology of reporting of state aid seems necessary.

Every subsequent State Aid Report publishes revised data for the last two years of reporting along with the data for the year that the report refers to, so for instance the Annual Report on State Aid for 2009 comprises the data on state aid for 2007, 2008 and 2009, but the data for 2007 and 2008 are to be found as well in the Annual Report for 2008.

Table 1 presents data on amounts of state aid awarded for the years 2002 till 2009. Note that the data come from the national annual reports on state aid published by the CCA since 2004. As can be seen in Table 1 different reports report different amounts of aid for the same year.

Table 1: Amounts of state aid in the period from 2002 to 2009

Amounts of state aid EUR million						
Year	Report 2004	Report 2005	Report 2006	Report 2007	Report 2008	Report 2009
2002	276,4					
2003	408,5	386,4				
2004	306,6	364,5	387,3			
2005		369,0	342,5	340,2		
2006			575,2	543,5	756,6	
2007				590,3	828,5	901,5
2008					528,9	622,1
2009						505,7

Source: adapted from the Croatian Competition Agency

It is possible to explain the differences by reference to the methodology of state aid reporting, wherein the agency in every report builds on the data from the previous reports, in order to present as accurate as possible the volumes of state aid. The problem the agency is confronted with is that the not all aid providers are delivering the data on state aid provided or are not delivering the data on time for them to be included in the report (CCA Annual Report 2009, 5). Thus the agency might include the information received with delay in the report which is to be published in the year after, and will include the years for which the data were received with delay. Therefore, the revised data on state aid are more accurate.

The data from the Table 1 indicate that the CCA faces the lack of enforcement capabilities. Consequently, the agency cannot sanction those aid providers that fail to deliver

information requested, and can only repeatedly ask for data. For instance, Haid notes the lack of enforcement capabilities when states that even though the CCA is capable to perform its tasks very well, it is limited by not having needed enforcement mechanisms, what hopefully is going to change after the amendments of the Croatian Competition Act were adopted in 2009, and entered into force in 2010 (2010, 104).

Further on, data from Table 1 also suggest that aid providers as well as aid beneficiaries with time are becoming more acquainted with the general rules on state aid and are more ready to work with the agency. It is the agency that needs to approve the aid and can as well order the recovery of unlawfully granted aid. For example as seen in Table 1 take the year 2007, and the amounts of state aid reported for that year, the volume of aid amounted to EUR 825,5 million according to the 2008 Report, whereas the aid reported by the 2007 Report for the same year was EUR 509,3 million. This provides support for the first claim about the stakeholders involved getting more familiar with the 'rules of the game' and the need to report the aid to the Agency.

Aid found unlawfully awarded in principle needs to be repaid. As Croatia's EU membership approaches the Commission will overtake the role of the national agency in enforcing state aid rules. The Commission might be seen as more successful in state aid enforcement. This seems to be in place with the argument of Blauburger (2007) in his study on state aid in Poland and in the Czech Republic. He concludes that rather than the accession conditionality it was the anticipated control by the Commission that led to changes in state aid levels and objectives in the EU pre-accession period of the countries under investigation.

The harmonization of Croatian state aid regime with the European rules started with the adoption of the relevant legislation and with founding of the national competition agency as this is described earlier. As regards the third criteria, the one on enforcement, aims were to reduce the amounts of aid granted and to redirect the aid schemes towards the acceptable aid. The section below investigates did this happen.

3.2 Overview of state aid in the period from 2002 to 2009

The EU demands made on Croatia with regards the state aid are to downsize the overall state aid amount and in particular to cut aid for selected sectors, e.g. steel, shipbuilding, transport, tourism. Consequently, the EU influence on Croatian state aid policy could be tested by observing the amounts and the structure of state aid during the accession period that is in this study by observing the state aid numbers in the period from 2002 to 2009, for which the data are available. If the volume of total aid was reducing and the aid was redirected from sector specific objectives to horizontal ones, these changes are possible to assign to the EU influence.⁵

As seen in Table 1 on the amounts of state aid the observations on the state aid expenditures do not fit with the above stated expectations. Volumes of state aid instead of decreasing under the EU influence they are increasing. However, the last three rows of the Table 1 show that the amounts of total aid decreased, so that in 2009 the volume of aid awarded to the economy was by 17,41 percent lower in comparison to aid granted in 2008, and 43, 88 percent lower when compared to aid in 2007 (CCA Annual Report 2009). Therefore this recent trend of a decrease in the volume of state aid can confirm the hypothesis that under the EU influence state aid expenditures in Croatia are decreasing. This decreasing trend mostly is due to reducing aid to shipyards and steel manufacturing, since the launch of their restructuring process. These sectors will be analyzed in Chapter 4.

Moving on to the structure of state aid awarded Table 2 reports amounts of state aid granted for sectoral and horizontal objectives for years 2002 till 2009. In principle relevant EU state aid rules prohibit state aid to special sectors. The data from Table 2 tend to deviate from above expectations, as they show that sectoral aid has been increasing, though this increase has not been continuous.

⁵ Blauburger (2007) has a similar point of departure in his study of state aid before and after the accession in Poland and the Czech Republic.

Table 2: Structure of state aid in the period from 2002 to 2009

	2002	2003	2004	2005	2006	2007	2008	2009
Horizontal aid in Mil E	52,2	131,1	153,6	112,6	127,0	91,1	91,8	89,7
-as a share of total aid in %	11,3	16,45	22,37	16,48	9,81	5,91	6,93	7,58
Sectoral aid in Mil E	367,6	358,3	224,9	245,2	763,4	929,2	663,8	521,0
-as a share of total aid in %	80,1	44,94	32,75	36,88	58,98	60,35	50,14	143,99

Source: adapted from the Croatian Competition Agency

As can be seen in Table 2, the amount of sectoral aid in 2004 was lower for EUR 133, 4 million in comparison to sectoral aid amount in 2003. However, one can notice an increase of sectoral aid especially in 2006 when aid for sectoral objectives reached the level of some EUR 763, 4 million, which is EUR 538, 5 million more than in 2004. Nevertheless, one can also find a recent trend of a decrease in sectoral aid in the three last columns of Table 2. This confirms above stated expectations on less aid granted for sectoral objectives, i.e. to shipyards and steel mills, that is in accordance with the EU state aid rules and demands made on Croatia. Though, as can be seen in Table 2 sectoral aid still remains at high levels. As regards the aid granted for horizontal objectives Table 2 shows that the horizontal aid is increasing although this trend of an increase is not constant.

The results suggest that structure of state aid in Croatia apparently has not been following the EU state aid criteria of low sectoral aid and more acceptable horizontal aid. Nevertheless, the developments might be taken to confirm EU influence, as the increase of sectoral support was mainly due to restructuring aid awarded to shipyards and the steel industry. Restructuring of these two sectors is among the principal EU demands made on Croatia with regard state aid. In sum, state aid policy in Croatia is characterized by high levels of mainly sectoral aid. This is comparable to the state aid policy orientation of Poland before the EU accession that also was

characterized by high aid levels and mainly sectoral aid objectives (see Blauberger 2007). Therefore, the next section will briefly describe the state aid policy changes in Poland as these can be used to explain the EU influence on changes of the policy in Croatia.

3.3 State aid in Poland before accession

Poland accepted to bring its state aid policy in conformity with the European state aid rules by signing the Europe Agreement in 1991 which came into effect in 1994. The identical commitments of legislative alignment, setting up administrative system and system of monitoring and enforcement of state aid were adopted in order to fulfill state aid related criteria for EU membership. Unlike in Croatian case Poland took seven years since EA came into effect to pass its national state aid 'Law on conditions of admissibility and supervision of State aid for entrepreneurs'. This law was passed by Polish government in 2000 and it became effective in 2001. With passing the State Aid Law in Poland the Office for Competition and Consumer Protection was entrusted with the task of monitoring and reporting state aid measures before accession. Hashi (2004) reports that in response to the external pressure by the EU volume of state aid in Poland in general has been reducing since the EA was signed.

Table 3 below shows data on state aid amounts in Poland from 2000 till 2005. The results indicate the decrease in the volume of state aid granted before Poland joined the EU in 2004, although the progress before accession was rather slow.

Table 3: State Aid in Poland in the period from 2000 to 2005

	2000	2001	2002	2003	2004	2005
State aid in (mio E)	1850,1	1465,4	997,9	6005,8	2033,7	907,6
-as a share of GDP (%)	0,88	0,63	0,44	2,93	0,97	0,37

Source : adapted from Blauberger 2007

As can be seen in Table 3, especially high volume of aid was granted in the year 2003. Blauberger (2007, 9) reports that this high aid level is mainly due to high amount of aid granted for the restructuring of the Polish coal sector. In general, the rescue and restructuring aid in Poland has

been high (EC State Aid Scoreboard). Moreover, its reported level has been even higher as reporting of state aid in Poland has not been entirely transparent (Hashi 2004). Again, as can be seen from Table 3, in 2003 the aid amount reached its peak, as Poland right before accession to the EU notified many of its aid schemes to the EC. In addition, Poland used the end of the transitional periods to aid its industry.

Comparing and contrasting data on state aid in Croatia and in Poland in the pre-accession context as these are reported in Table 1 and Table 3 respectively, one finds many similarities. In both countries state aid amounts overall are decreasing. As can be seen in the above tables the progress in reducing volumes of state aid is slow. Nevertheless, the observed changes in the amounts of state aid in both countries seem to confirm that under the EU influence changes of state aid policy orientations are taking place. In order to find additional support for the significance of the EU influence, the following chapter will address the changes of state aid policy in the two so called 'sensitive' sectors within the EU competition negotiations (EC Progress Reports). These sectors are shipbuilding and steel industry

CHAPTER 4:

STATE AID TO SHIPYARDS AND STEEL MANUFACTURING

Whereas the later chapter provided an overview of state aid in Croatia in general, this chapter analyzes state aid granted to two sectors in Croatia in particular. These are shipbuilding and steel sector for which the state aid data are observed in the pre-accession period. Thereafter, state aid to the same sectors in Poland is observed in the EU pre-accession context in order to find additional support for the claim that the state aid changes in steel industry and shipbuilding are due specifically to the influence of EU state aid rules and regulations.

4.1 State aid to shipbuilding sector in Croatia

The Croatian shipbuilding industry is referred by the EC as the key component of the Croatia's EU accession talks in the area of competition and state aid policy. The reason behind is that major state-owned Croatian shipyards are heavily subsidized by the government in contrast to the EU state aid rules. Therefore, Brussels asks for these ailing shipyards to be restructured and the subsidies to be phased out. Consequently, the Croatian government under the EU influence launched the privatization process of the shipyards asking the bidders to submit restructuring plans in accordance with the EU rules.

In order to analyze the changes in the shipbuilding sector, one can analyze the data shown in Table 4. These data are on state aid granted to the Croatian shipyards in the period from 2002 to 2009. State aid is calculated by summing up grants and guarantees received by the major shipyards in Croatia: Brodosplit – Brodogradilište d.o.o., 3. Maj Brodogradilište d.d., Brodogradilište Kraljevica d.d., Brodotrogir d.d., Uljanik Brodogradilište d.d. i Brodosplit – BSO d.o.o. (CCA Annual Reports on State Aid).

Table 4: State aid to shipbuilding sector in the period from 2002 to 2009

	Years							
	2002	2003	2004	2005	2006	2007	2008	2009
State aid in million HRK	652,7	1046,8	529,6	642,8	2797,8	3125,3	1892	1152,7

Source: Croatian Competition Agency

As can be seen in Table 4 shipbuilding sector was granted with different volumes of aid in each year, ranging from HRK 652, 7 million in 2002 to HRK 3125, 3 million in 2007 and then to HRK 1152,7 million in 2009. The calculated amounts of aid are dependent on the character of state issued guarantees to the shipbuilding. The CCA sometimes calculates state guarantees in their full amount as state aid, while at other times, considers these guarantees not to contain state aid.⁶ Again, as can be seen in Table 4, in 2006 and 2007 the amount of state aid is the highest for the shipbuilding sector in Croatia. The data indicate that in these years high amounts of state guarantees were given for rescue of the shipyards which significantly affected the total amount of aid granted to this sector (CCA Annual Report 2008). Moreover, the issued state guarantees were taken in their full amount to constitute rescue aid which is considered state aid. This was because the Agency considered the situation in shipbuilding sector as an indication that the state will eventually pay the total amount of guarantees. However, the compatibility of this aid with the EU state aid rules to shipbuilding remained questionable. Moreover, the EC found Croatia to be in a breach of the Article 70 of the SAA (Progress Report 2007).

With no restructuring plans in place and with the shipyards continuing to benefit from the state aid, the EU scope of influence tended to be limited. The Croatian government followed the strategy of keeping the yards afloat through granting them operating aid and the extensive

⁶ The total amount of state aid in issued state guarantees is calculated by summing up the amount of state aid contained in each issued state guarantee for loans and for rescue and for guarantees for advance payments. Unlike the guarantees for advance payments, the guarantees issued for loans and for rescue of shipyards are taken in their hundred-percent value to constitute state aid. This is because the Ministry of Finance will most likely repay the obtained loans (Annual Report 2009, 45-46).

guarantees. The non-compliance was most evident in the lack of a national restructuring plan for this sector. Although restructuring programs were submitted by six major Croatian yards in 2008, all of these programs were assessed negatively by the CCA and had to be revised. Following the negative decision of the Agency about the yards' restructuring plans the Croatian government eventually reached a decision that these shipyards in losses need to be privatized. Thereafter, the international tendering process was launched in 2009 which marked the start of the restructuring process through privatization.

Following the launch of the privatization tenders the Commission noted that Croatia made substantial progress with regard to the shipbuilding sector. This is clearly a sign of the EU's opinion that Croatia is on a good track to comply with the EU state aid rules on shipbuilding sector. Following these rules the acceptable forms of state aid include aid for horizontal objectives as well as closure aid. With regard to rescue and restructuring aid special requirements are set in place:

“that there exists a sustainable restructuring programme, that for coverage of costs of restructuring own contribution of undertaking is required, that aid is reduced to the minimum of required resources, that there are reduced capacities, and that such type of aid is awarded once in ten years“(CCA Annual Report 2009, 47-48).

These requirements are mainly not met by the Croatian shipbuilding sector. Moreover, upon the realization of the launched privatization process and the contributions by potential private investors to the restructuring of the shipyards, the government may continue to support the aid dependent shipbuilding industry. As such, state aid to this sector may moreover increase.

It is important to stress the significance of shipbuilding for Croatia. The shipbuilding sector is “one of the most important industrial sectors of the Republic of Croatia both by its share in employment (2, 5%), by its GDP share (1, 4%) and by exports (12 to 15%)” (CSC). Consequently, its privatization is socially and politically sensitive issue. Whereas the EC welcomes the privatization of the shipyards, the trade unions and the workers of the shipyards that fear job losses show significant resistance. This resistance is among the reasons that took so long for the

privatization to be launched in the first place. More importantly, privatization of the Croatian shipyards is still an ongoing process. Consequently, shipyards are continuing to benefit from state aid though to a lesser degree.

4.2 State aid to steel sector in Croatia

The steel sector along with the shipbuilding industry is referred by the EC as a key component for the successful completion of the Croatia's accession negotiations in the competition field with the EU. The issue of continued state aid granted to this sector constituted the breach of the EU state aid rules, similar to the state aid in the shipbuilding industry.

Table 5: State aid to steel sector in Croatia from 2002 to 2009

State aid in mill HRK	Years							
	2002	2003	2004	2005	2006	2007	2008	2009
	2,0	4,4	29,40	16,5	1,0	196,3	0,00	2,2

Source: Croatian Competition Agency

The Table 5 shows the amounts of state aid awarded to the Croatian steel industry in the period from 2002 to 2009. As can be seen from the table in 2008 the steel industry was not given aid, whereas in 2007 the share of state aid was the highest given to the steel companies. The reason that in 2007 the amount of state aid reached its peak is because Croatia till 2007 was allowed to grant aid to this sector according to the Protocol 2 of the SAA. Aid could be awarded for rescue and restructuring provided that this aid aimed to restore the viability of the undertaking, that it was limited, gradually reduced and included the reduction of capacities (CCA Annual Report). The restructuring of steel sector was carried out through privatization. Unlike the ongoing privatization of the Croatian shipyards the privatization in the steel sector was completed in 2007. Nevertheless, as can be seen from Table 5, in 2009 the steel industry got state aid. These were loans by the Croatian Privatization Fund for payments of wages to workers of one of the steel companies which found itself in business difficulties. Consequently, this steel mill is in search for a buyer with a new business plan to restore it. In all, under the European influence the Croatian government carried out the privatisation of its steel sector. The government used the

transitional period till 2007 to award aid to this sector. Upon expiry of this period the state is not awarding restructuring aid to steel companies.

The example of Poland helps to understand the relation between the relevant EU state aid rules and the changes caused by these rules in sectors of shipbuilding and steel manufacturing.

4.3 State aid to shipyards and steel industry in Poland before accession

The EU state aid rules for Poland were similar to that for Croatia. Moreover, the shipbuilding and steel industry in the Croatian example were also in the Polish case among the sectors highly affected by the relevant EU state aid rules. In case of shipbuilding industry Polish shipyards attracted a lot of attention both in the pre-accession context, but even more since the period of the Polish EU membership. Unlike the restructuring process of the Croatian shipbuilding industry, the restructuring in Poland started in the period after accession to fully comply with the relevant state aid rules of the Union.

Upon the requests of the EC Poland delivered restructuring plans for its shipbuilding industry, though with delay. Furthermore, the Commission did not approve these plans. Consequently, the EC found no basis to approve restructuring aid to the shipyards. As Holscher, Stephan and Nulsch (2009) state, the two Polish shipyards, Gdynia and Szczecin went bankrupt as they could not repay the state aid for which the Commission found that it had been unlawfully awarded to them. Exceptionally, the EC authorized EUR 94 million of aid already received by Gdansk shipyard, as well as additional EUR 35 million planned for its restructuring, that is to be financed also by the contributions of the new private owner of the yard (Mazurkiewicz-Gorgol and Bomhoff 2009). These developments in the Polish shipbuilding industry point out the priorities of the EU with regard to the shipbuilding sector. European rules on state aid to shipbuilding are aimed at improving the competitiveness of European shipyards by allowing for innovation and development aid, export credit facilities and closure aid for capacity reduction (Vesterdorf and Nielsen 2009, 207). As Holscher, Stephan and Nulsch (2010)

note, the restructuring process requires a private capital in order to be in line with the EU state aid rules. This explains that the aid was approved only to the Gdansk shipyard.

In short, after years of subsidizing its shipbuilding industry⁷, Poland started to comply with the EU rules on state aid to shipbuilding only after accession. This resulted in the bankruptcy of the two largest Polish shipyards whereas the aid was approved only to the third shipyard. As far as Croatian shipyards are concerned, the privatization process is still ongoing and the restructuring plans have been submitted to the EC for approval. The same issues of the shipyards long term viability may appear not excluding the capacity reduction of the Croatian shipbuilding industry as a compensation for the approved restructuring aid. The privatization process in Poland also resulted with significant job losses as well as with the Polish government continuing to grant considerable amounts of aid to this sector. Precisely the fear of job losses is among the reasons for the high resistance from the part of trade unions to the privatization launched in the Croatian yards. In addition to that, due to the experience with the Polish shipyards, the Commission scrutinizes the Croatian case with far more care.

Moving on to the restructuring of the Polish steel sector, the conditions for the restructuring were similar to that of Croatia. Although under the EU rules on state aid to steel sector aid for rescue and restructuring is not acceptable, in both of the countries transitional arrangements were negotiated laying down the exceptions which allowed state aid to steel industry. These exceptional rules aimed to provide time for the countries to restructure and privatise their steel industry which confirms the flexibility of state aid regime with regard to candidate countries. As Lienemeyer notes there is a common understanding that strict state aid rules on steel which prohibit any kind of rescue and restructuring aid cannot immediately be applied to acceding member states (Lienemeyer 2005, 94).

⁷ Data on state aid to shipbuilding as Sowa notes (2003) do not reveal the actual amount of aid received by Polish shipyards, but for the year 2001 aid amounted to 9,3 mil PLN, and for 2002 101,2 mil PLN.

Nevertheless, restructuring aid is permitted only under specific conditions in order to avoid distorting competition. These conditions as set out for Poland are almost identical to the conditions set out for the Croatian steel sector in the described Protocol 2 of the SAA. Similarly, the granting of aid to the Polish steel sector is made subject to several conditions as set out in the Protocol 2 of the EA. These conditions are that granting of restructuring aid is acceptable only when it leads to the viability of the benefiting company at the end of the restructuring period; next this aid is admissible only in the minimum amounts necessary to achieve the company viability; and the last condition is that reduction of production capacities is required as a compensation for the awarded aid (Lienenmeyer 2005, 95). Lienenmeyer (2005) states that the steel restructuring process in Poland in general was successful and moreover that this process met the relevant EU state aid rules. As the restructuring began in 1990s and lasted till 2006 when the transitional period ended, it was also due to more favorable economic conditions that the process was successful. Unlike in Poland, in Croatia restructuring of the steel companies due to the economic and financial crisis faced difficulties. In particular one of the two major steel mills is in a search for a new investor that would rescue the company out of difficulties, while the other mill is unable to realize its business plan. Thus the both steel mills are no longer awarded restructuring aid (Government Report 2011).

In conclusion, this chapter showed that the restructuring process of both the shipyards and the steel mills in Croatia follows the relevant EU state aid rules. More importantly, the state aid for restructuring of steel mills is phased out, whereas aid for shipyards is gradually reduced. The Polish shipyards and steel sector underwent similar changes. Therefore, the initial statement about the impact of specifically the EU state aid regulations on national state aid policy is confirmed.

CHAPTER 5:

CONCLUSION

In the EU, state aid policy is a rule-based system, aimed at preventing distortions to competition in the context of the common market. The EC system of state aid control affects the behavior of the countries joining the Union, which thereafter need to justify their support measures towards their economies. Even though these state support measures have been among the main forms of government involvement in the economy, nevertheless these have not been explicitly regulated in most of the new EU member countries. Thus, the EU accession of these countries meant reconsideration of their support mechanisms, in particular to certain industries and individual enterprises. Moreover, the Commission's role of a supranational regulator in the state aid issues provides these countries with the 'commitment device' to resist pressures for giving aid to particular companies.

The first major finding for Croatia, as it has been shown, is that the prospects of the EU accession drive the reform of state aid based on the rationale of less and better targeted aid measures. In 2009 Croatia gave EUR 505, 7 million of state aid to the economy, whereas in 2007 state aid was EUR 901, 5 million. This recent trend of decreasing volume of state aid is explained by the increasing prospects of the country's EU membership, which in turn speed up the reforms in the competition chapter of the Croatia's EU negotiations. Thus Croatia initiated major changes of its support measures towards certain recipients of aid. As it was shown, the steel companies are no longer benefiting from state aid, whereas the restructuring and privatization process of the state-owned shipyards is continuing. The important novelty as regards the restructuring of the shipbuilding is that for the first time aid is conditioned according to the EU rescue and restructuring guidelines for the firms in difficulty. This changes the role of the state's involvement into the shipyards' operations. So far, state-owned shipyards benefited almost unconditionally from state support. This in turn has been deterring the loss-making and debt-burdened undertakings from embarking upon deeper restructuring.

5.1 Some implications

On a close analysis of the findings of this thesis, it remains to be seen how the privatization of the shipyards will be finalized, but the conditions⁸ imposed on the potential buyers allow certain conclusions. First, the shipyards must bear on their own a set forth amount of at least 40 percent of total costs of restructuring. Second, set out conditions include the potential buyer to submit a sustainable business plan, which in turn needs the approval of the CCA and the Commission in order for any additional restructuring aid to be approved. From this it follows that the shipyards in Croatia may continue to legally benefit from state aid only if they demonstrate to be ready to implement a restructuring plan, approved thereafter by the Commission and which would include the reorganization and rationalization of their activities. There are two likely outcomes of the privatization and restructuring of the shipyards: the reduction of the shipbuilding capacities as well as layoffs of the workers. This is based on the EU state aid rules and the evidence presented so far, as well as on the example of Polish shipyards. Still, if viable restructuring plans are in place and approved by the Commission, Croatia may support the restructuring of its shipyards and in accordance with the EU state aid law.

All in all, the EU state aid rules and regulations provide the Croatian government with a commitment device thus enabling the rationalization of the state support measures. These from now on need to be justified on specific grounds. For a long time nonexistent domestic political consensus along with the negative social externalities of abolishing certain state support measures prevented changes in the policy of state aid. The state aid policy in Croatia is assuming a new shape in terms of less and better targeted state aid. There are two influences: the EU state aid rules and compulsion to change in Croatia because of the candidacy. This research could be further advanced by assessing the impact and thus the effectiveness of the specific aid instruments to the economy.

⁸ The privatization conditions are cited in the 'Gouvernement Report on the Chapter 8-Competition Policy' from May, 2011

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