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State Aid in the European Union and in Serbia

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Miroslav
*Prokopijevic**

State Aid in the European Union and Serbia

Abstract:

The paper deals with the issue of state aid to the economy in EU countries and in Serbia. High amounts of state aid are economically inefficient and undermine the common market which is one of the main results of European integration, so that is why such high amounts are undesirable. State aid which is provided in Serbia differs in amount, structure and objectives from state aid in the EU. The amount of state aid in the EU is 0.6% of GDP on average, while it amounts to 2–3% of GDP in Serbia. State aid in the EU is 80% horizontal by structure, while it is about 20% horizontal by structure in Serbia and the rest of it is either sectoral or vertical. Objectives of state aid in the EU are moving towards activities which help development, research, employment and environment protection, while in Serbia they are still related to activities which cause losses. What follows from that is that state aid in Serbia will have to be changed fundamentally if the process of accession to the EU continues, or if we want to have better solutions than the existing ones.

Keywords:
state aid, EU, Serbia, state aid limits, state aid objectives, state aid transformation

* Professor of Economics and Research Fellow at the Institute of European Studies.

Introduction

In economics it is considered that state aid to companies is useful for them, but harmful for market forces and tax payers. If companies are unable to pass the market test and survive, it is not likely that government grants and protection will help them. If such companies are being kept operative with state aid, it boils down to funding of inefficiency or privileges at the expense of efficient companies and other tax payers. Regardless of the fact that state aid is economically harmful and wrong, all companies in the world are willing to accept it. Profitable companies which receive state aid have an even better position than competitors, while such aid extends the hope of unsuccessful companies that they can be saved. Companies which receive aid gain advantage over their rivals, which means that aid disrupts competition on the market. When they do receive help, companies are no longer motivated to improve their operation and a belief that others will solve their problems becomes present, while managers of those companies spend more time knocking on state institutions' doors than doing what is supposed to be their job.

Even though state aid is economically harmful, it used to be provided frequently during the 1930s because economic policy was not pursued in accordance with economic priorities, but in accordance with political ones.

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However, regardless of narrow interests that politicians have, state aid is harmful due to waste of tax payers' money and wrong incentives that it develops, so it is better if it is present in a lesser extent. The best thing would be that there was no state aid at all.

State aid, regardless of the way in which it is granted, is a form of an indirect non-tariff barrier. Since the creation of the common market of the European Union (EU) implied that non-tariff barriers needed to be eliminated, state aid in the Union came into the spotlight as late as during the beginning of 1990s when the common market was being created. As an old industrial and economic zone in general, which thus had somewhat older and more sluggish companies, the EU (its member countries) used to pursue a policy of extensive subsidies and more general state aid during the 1960s and 1970s. Such aid system was neither in accordance with creation of the common market nor with the situation in the world. Due to globalization, the EU suffered increasing pressure from competitors from the USA, Far East, Eastern Europe and other newly-industrialized countries and the Union could not withstand the pressure without providing increasing amounts of aid. Even if it did manage to provide increasing amounts of funding for that, as the aid provided by the Union was increasing its economy was becoming more and more inefficient compared to its rivals. That is why another solution needed to be found, which is the solution that went in the opposite direction - to reduce aid.

Of course, after decades of providing extensive state aid, it could not be stopped suddenly. So the more recent regulation of state aid in the Union is actually only looking for a way in which it will still be provided, but with many limitations. According to article 107 of The *Treaty on the Functioning of the European Union*[1] from 2010 (previously article 87.1), state aid to companies or branches of industry is not allowed because it disrupts (or threatens to disrupt) competition on the market of the Union. It is actually a provision that bans extensive and non-selective aid to the economy, but allows certain forms of aid.

1. Limitation of State Aid in the EU

State aid for companies used to be very diverse from the first years of existence of the EEC and it was a "chronic problem" until common market was established. State aid is not properly limited even today, but the situation is better than what it used to be. It is understandable why it used to be like that. Revenues of companies generally come from two sources – from the market and non-market sources, primarily from different types of state aid. If a company has difficulties on the market, it still does not mean that it is not going to be in good standing, because the state can improve its business situation by providing aid to it. Aid which is provided by the state is at the expense of tax payers, because the state does not have its own funds. Therefore, there is always the same model when granting state aid – companies and individuals who are very dispersed and politically unorganized are taxed, in order to use funds collected in that way, among other things, for aid to specific companies or industries. Unlike tax payers who are dispersed and unorganized, companies which get aid are very organized and focused. If a company receives funds from the state, that influences the competitive position of the company and its rivals. That company is doing better thanks to the aid while its rivals are doing worse, which means that state aid changes the result of the market competition.

In order not to allow estimate of justifiability of state aid to be performed arbitrarily and *ad hoc*, the Union developed four principles which help estimate the scope and nature of state aid: *Selectivity* means that companies which are selected to receive state aid are those which stand a chance of being profitable after receiving aid. *Temporary nature* means that aid is limited in terms of time. *Transparency* means that aid is clearly visible and

[1] It is a consolidated version of the Contract which was created after ratification of the Lisbon Treaty in 2009

measurable. *Suitability* means that the specific form of aid is properly selected. Apart from these principles, there are certain rules for providing aid.

There are specific rules which regulate the issue of state aid to companies or activities of companies which have a privileged position in relation to the state in some countries. According to TFEU article No. 37 (previously article 31) of the Treaty, member states need to eliminate any monopolies of a commercial character so as to ensure that there is no discrimination regarding the conditions under which goods are manufactured and marketed[2]. There are also rules for services and public procurement. Public procurement amounts to 12 – 15% of the Union's GDP, which is a large segment of the market. Before common market was established in the beginning of 1990s, only 2% of public procurement was covered by companies from states other than the state in which public procurement was conducted. In other words, negative discrimination of foreign suppliers was present. That practice changed when the common market was established. Today, for example, the state is not allowed to give companies exclusive right for export or import of products.[3] Those companies, which are often considered to be companies of general economic interest, are also subject to other provisions of antitrust policy.

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EU treaties are key documents for profiling and interpretation of state aid policy, but decrees and even court cases are important as well. One of the important court decisions which had an impact on expansion of opportunities for giving aid was the one which was made in the case of *FFSA and others vs. Commission* (No. T-106/96), in which the complaint on state subsidies to the French Post Office was considered, contrary to TFEU Article No. 107 (previously article 87.1). The Court of Justice lifted the Commission's ban on state subsidies for development of postal services. Aid is considered to be legal only if its only purpose is to compensate for additional costs incurred in sparsely populated rural areas. Those costs cannot easily be differentiated from others because costs do not have to be incurred in the field, but in the French Post's headquarters. The court resorted to a formulation that can become a part of an anthology of odd explanations, saying that aid was provided up to the extent which is "necessary in order for that undertaking to be able to perform its public service obligations under conditions of *economic equilibrium*". What is hiding behind the seemingly well-versed formulation is something that actually does not exist and whose purpose is to serve as a smokescreen for this arbitrary bureaucratic decision.

[2] The Italian state, for example, was affected by this provision when it nationalized the electric power industry in the 1960s. See the case *Costa vs. ENEL* (No. 6/64).

[3] As, for example, it happened in the *Manghera* case, No. 59/1975.

Providing state aid in the Union needs to be transparent – as regulated by directives 80/723 and 2000/52 – while the measure of transparency is not public implementation of a certain procedure, which one might expect, but transparency of the procedure according to the Commission. There are several types of aid whose granting is not allowed. Prohibited categories do not only include standard subsidies, which are the first thing that comes to one's mind when it comes to state aid. The state has many mechanisms which can be used to influence the outcome of the market competition. Various types of aid are prohibited, such as subsidies, tax benefits, soft loans, loan guarantees, exemptions from customs duties, excises and parafiscal charges, debt or tax forgiveness, buying shares of companies which are experiencing difficulties, lowering of ecological or other standards, making land or services available for use below market prices. These are not all possible cases, but only those that occur most frequently.

All types of aid which either disrupt or threaten to disrupt competition on the EU market by favouring certain companies at the expense of others are nominally prohibited. Article 107.1 of TFEU (previously article 87.1) does not deal with specific ways of providing aid, but the Commission and the European Court of Justice (after signing of the Lisbon Treaty renamed to Court of Justice of the European Union) stated those cases later on. Some of the new EU members, before their accession to the EU in 2004, used to provide extensive subsidies with the aim of attracting foreign investments. Before Czech Republic, Hungary, Poland and Slovakia became members of the EU, they managed to attract significant foreign direct investments largely thanks to those subsidies, which are not allowed in the EU according to the rules. That is why those new members had to eliminate those subsidies before they joined the EU. Having anticipated that step, many investors left these countries as early as in 2002 and 2003, which is shortly before those countries joined the EU. This resulted in a drop[4] of foreign direct investments (FDI) from third countries in most countries in transition which joined the EU in 2004. That drop was compensated by larger FDI from EU15, i.e. old members of the EU. Countries that were not using prohibited subsidies or in which the level of subsidies was insignificant, such as some Baltic countries, did not experience a drop in foreign direct investment after joining the EU, but an increase in that type of investment was present instead.

The policy of state aid in the EU is to limit sectoral (vertical) aid to certain branches and companies as much as possible, but to allow regional and horizontal help. The explanation for that is that vertical help is intended for precisely defined companies and branches of industry, which disrupts both competition on the market and trade relations. Unlike vertical or structural aid, horizontal aid refers to state support which can be used by

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[4] The other key factor that caused the drop of foreign direct investments were the extensive EU regulations which needed to be adopted by these countries before 2004 or immediately afterwards

companies from different industries and is not in advance intended to be received by specific companies. Apart from vertical and horizontal aid, there is regional aid which is mostly of territorial nature and is related to undeveloped and sparsely populated areas of the EU. It is allowed if it is provided according to certain development criteria which are mainly related to level of development. We will see what indicators of state aid look like later on. Of course, if there are general rules, there are exceptions as well.

2. Exceptions to State Aid in the EU

If we set aside the part related to the economy from regional and structural aid, allowed exceptions can be systematized within the following principles which were adopted in 1972:

a) Selective aid for development and reorganization to companies which are expected to be competitive in the long run. This type of aid includes a level of arbitrariness because it is expected from bureaucracy to anticipate market development of such companies, which is in fact impossible.
b) Aid needs to decrease over time, i.e. its percentage or absolute amount need to decrease and need to be limited in terms of time by stating the date when aid is going to stop.
c) Aid needs to be as transparent as possible and needs to be under constant supervision and evaluation of effectiveness performed by competent institutions of the EU.
d) Aid needs to be formed and directed in a way that disrupts the common market in the least extent possible.

There are, of course, frequent attempts to abuse exceptions from limitations to state aid by trying to grant aid in cases in which it is not permitted. That is why exceptions are specified. There are several exceptions and they are regulated by TFEU article 107 (previously article 87):

1) Social aid granted without discrimination related to the origin of goods.
2) Aid to make good the damage caused by natural disasters.
3) Aid granted to East Germany, which is a specific case, due to low level of development and its communist past.[5]
4) Aid for improvement of economic development of areas where the standard of living is “abnormally low” or where there is “serious underemployment”.

[5] In the beginning of the 21st century total aid that Germany provided to its eastern provinces was 50–60 billion EUR annually, while total aid from 1989 amounted to 1,600 billion EUR or 1.8 trillion EUR. This form of aid is becoming increasingly limited because Brussels considers that key disturbances in the former GDR have been eliminated.

5) Aid for execution of projects of “common European interest” or to remedy difficulties which are a “serious disturbance in the economy of a member state”.
6) “Aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest.”
7) Aid to promote culture and heritage conservation under the same terms as the ones in item 3.
8) Other categories of aid that may be adopted by the Council of Europe by a qualified majority on a proposal from the Commission.

The first three categories of aid are unconditionally allowed, while other forms of aid can be allowed. Exceptions always somehow find their way in, so according to the aid programme for the period of 2005 – 2006, aid covered about 42.7% of population in the EU, which is a decrease of 4 percentage points (pp) compared to the previous period. State aid was thus granted to a bit lower number of residents of the EU than in the previous period, but it still covered more than 2/5 of the population.

3. The Scope of State Aid

Before the common market was established in 1992, state aid was widely used in countries of the European Community (as of 1992 the name was changed into European Union). The common market would function poorly had those old habits been continued, because some companies would have a more privileged position than others, which would disrupt their normal competition. Granting state aid would also disrupt relations between governments of member countries because they would accuse each other of protectionism and taking over investments and jobs.

The common market project successfully limited state aid which dropped from several per cent of GDP during the decades before the 1990s to 1.1% in 1992 and then to 0.5% in 2008. There always used to be countries in which the level of aid was slightly higher (usually Scandinavian countries and Greece). However, aid in some member countries was very low, almost insignificant. The crisis in 2008 has changed a lot. Total amount of aid was already increased in 2008, and additionally in 2009 and 2010. Member countries which are responsible for this increase are existing members, not new ones. Countries that are most responsible are Belgium, Greece, Germany, Spain, Ireland and Great Britain. While main “destinations” of aid used to be agriculture, transport and fishing, those destinations are now the financial sector and to a small extent industry.

In the period of September 2008 – end of 2010, banks in some EU countries were granted a total of 1,240 billion EUR of aid, which is about 10.5% of EU27’s income, while the real sector was granted only 21 billion EUR, which is 0.2% of the Union's GDP.[6] The largest amounts of aid during that period were granted to banks in Great Britain (295 billion EUR), Germany (282 billion EUR), France (141 billion EUR), Ireland (117 billion EUR), Spain (98 billion EUR) and Netherlands (95 billion EUR), while banks in Eastern European countries were either given nothing or a couple of billion euros each.[7] That was not regular, but *ad hoc* aid which was justified by severity of the crisis.

Faced with an abrupt increase of state aid and even more requests for aid, the Commission tried to regulate aid as of mid-2008 and thus give at least a semblance of legality to the granted aid. Aid was not allowed to be granted to export companies, but only companies that did not have difficulties before July 1, 2008, while any granted aid had to be terminated by the end of 2010. The amount of aid was temporarily increased under the *de minimis* clause to 500,000 EUR per company (up to that amount the Commission does not interfere with providing aid if it had been informed about it prior to that). However, regardless of the regulation, there were several cases of granting big amounts of aid, such as the aid for the six biggest European banks, Germany's aid for its *Commerzbank*, the aid that was granted to *Fortis* bank by Belgium, the aid that Great Britain granted to large banks such as *Northern Rock*, aid to automotive industry in France, Germany, Sweden, etc. However, there were no new regulations which could conceal that the competition policy and the common market suffered a major blow with the onset of the crisis and onslaught of state aid cases. That can be seen by taking a mere glimpse at Table 1.

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We can indirectly see how big the amounts of state aid in 2009–2010 were from data on total government spending at the EU27 level. They were 50.8% of GDP in 2009 and 50.3% of GDP in 2010.[8] Some countries had enormous government spending in 2010, such as Ireland with 67% of GDP, France with 56% of GDP – just like former socialist countries. The increase compared to standard government spending which is 45–47% was mostly used for state aid and in a lesser extent for social aid. Big amounts of funds were spent on guarantees. There is no other explanation for the abrupt increase of aid in the EU in 2008 but political and economic panic caused by the economic crisis. Even though it obviously violates rules of the common market, extensive aid was granted in order to prevent a fall of banks and thus a drop in

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[6] European Commission 2011b, pp. 11, 21.
[7] Ibid., pg. 11
[8] Eurostat. Statistcs in focus, 42/2011, pg. 2

employment and income. This circumstance cannot be concealed by a series of Commission's litigations against certain countries because those litigations, even though they are numerous, virtually apply only to extremely small parts of the total aid that was granted. By the end of November 2012, Eurostat had not yet published data on state aid for 2011, which, according to existing data, in EU member countries had the scope which is shown in table 1.

Countries	**200**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Belgium	0.5	0.5	0.4	0.3	0.3	0.4	0.4	0.4	6.6	10.2	0.6
Bulgaria	-	-	0.5	0.8	0.2	0.1	0.1	1.4	1.2	2.1	0.1
Czech Republic, XVII, 2005;	2.4	1.9	3.9	2.9	0.6	0.6	0.8	0.8	1.0	0.7	0.8
Denmark	0.9	1.0	0.8	0.7	0.8	0.8	0.7	0.8	24.9	4.6	0.9
Germany	0.8	0.9	1.1	0.8	0.8	0.8	0.8	0.6	2.7	4.8	0.6
Estonia	0.1	0.1	0.1	0.1	0.4	0.3	0.3	0.2	0.3	0.3	0.3
Greece	1.1	1.1	1.4	0.4	0.4	0.5	0.5	0.7	1.2	7.7	0.8
Spain	0.6	0.5	0.3	0.5	0.5	0.4	0.4	0.4	0.6	6.3	0.5
France	0.9	0.9	0.6	0.5	0.5	0.5	0.5	0.5	0.6	1.2	0.8
Ireland	0.6	0.6	0.5	0.5	0.6	0.6	1.7	0.5	2.0	2.2	1.0
Italy	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.3	0.4	0.7	0.3
Cyprus	2.6	3.0	3.3	2.3	1.6	1.4	0.6	0.7	0.6	2.4	0.7
Latvia	0.6	0.6	0.4	0.5	0.6	1.1	1.3	1.0	5.0	5.8	0.9
Lithuania	0.2	0.4	0.3	0.6	0.5	0.5	0.5	0.6	0.8	0.8	0.6
Luxembourg	0.3	0.3	0.4	0.4	0.3	0.2	0.2	0.2	7.3	2.8	0.2
Hungary	1.1	1.0	1.0	1.3	2.8	3.2	2.2	1.9	2.3	2.1	2.3
Malta	3.4	4.3	4.4	2.1	3.7	3.6	2.8	2.4	2.0	2.0	1.4
The Netherlands	0.5	0.4	0.5	0.5	0.4	0.4	0.4	0.4	2.7	2.1	0.5
Austria	0.7	0.7	0.3	0.5	0.5	0.5	0.8	0.5	0.9	4.1	0.8
Poland	0.9	0.6	0.4	3.0	1.4	0.8	0.8	0.6	0.9	0.9	0.9
Portugal	0.8	1.1	0.8	0.9	0.8	0.9	0.9	1.3	1.2	1.0	0.2
Romania	-	-	1.6	1.6	2.1	0.5	0.6	1.2	0.6	0.7	0.2
Slovenia	1.0	1.0	0.6	0.7	3.0	2.7	0.7	0.7	0.7	1.5	1.1
Slovakia	0.4	0.3	0.3	0.4	0.5	0.6	0.5	0.4	1.1	0.5	0.5
Finland	1.4	1.4	1.2	1.3	1.3	1.3	1.3	1.1	1.1	1.2	1.1
Sweden	0.4	0.4	0.2	0.5	0.9	1.0	1.0	0.9	1.1	3.8	0.8
Great Britain	0.2	0.2	0.3	0.2	0.3	0.2	0.2	0.3	4.0	7.9	0.3
EU27	0.5	0.5	0.6	0.5	0.5	0.4	0.5	0.4	2.4	3.5	0.6

Table 1: State aid in EU countries, 1999–2010 in % of GDP.

Source: Eurostat, State aid. Data taken on November 16, 2011, for the period of 2000 – 2009. Data for 2010 is from November 2012, when Eurostat removed a part of data for 2009, so data left in the table is only data on regular state aid in 2010. That is why earlier Eurostat data ending with 2009 was used because earlier Eurostat data *provide a more realistic image of the scope of state aid than these from which ad hoc aid from 2008 to 2010 was left out.*

As it can be seen from the table, there is no clear rule on the amount of state aid. The long-lasting trend of low average amount of state aid in the EU was interrupted by high amounts of aid during 2008–2009. There are countries with both high and low amounts of state aid among old and new member countries. Old member countries which had high amounts of state aid are Scandinavian countries, Greece, France and Portugal, while new ones are Malta, Hungary, Cyprus, Latvia, Lithuania... Old member countries which had low amounts of state aid are Belgium, Germany, Spain, Italy, Luxembourg, The Netherlands, Austria, while new member countries with low amounts of state aid are Bulgaria, Estonia, Poland and Slovakia. Regular state aid was in 2010 restored to the level at which it was before the onset of the crisis. The amount of state aid depends on many factors which often come from solutions that date back decades, sometimes even so far back to the time when those countries were not even members of the EU.

The Commission is responsible for implementation of regulations related to competition policy. The Commission needs to be informed about all forms of state aid in a timely manner, including those forms of aid which are obviously legal at first sight. "In a timely manner" is a flexible concept, so in the dispute *Germany vs. Commission* (No. 84/82), the Court of Justice ruled that the period of two months is long enough for assessment of legality of state aid initiatives. If the European Commission does not respond to a submitted request within two months, member country can implement the specific aid programme. The Commission needs to be informed about the beginning of implementation of the programme. If the Commission finds that planned state aid is not in accordance with EU regulations, the aid programme cannot be implemented. Member countries can try to change the Commission's decision in direct contact with it, but if they fail to do so, the only thing left is to file a complaint against the Commission with the EU Court of Justice.[9] If the Commission finds that it was misled by the government of a member country in terms of purpose, manner, amount or any other important aspect of granting state aid, that member country would have to pay the amount to the budget of the Union. There is no data on how frequent such payments are. The Commission is not the only body interested in discovering such violations. Companies which are rivals to those which received aid are interested as well, because aid changes competitive relations. That is why rival companies often file complaints on decisions of the Commission which permit or authorize a form of aid.

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> The European Commission has prepared state aid reform and adopted new regulations that will become effective by the end of 2013.

[9] Regulation No. 659/1999 specifies the rules for granting aid, starting from application to the EC to final implementation.

by the end of 2013.[10] The main purpose of this is to avoid waste of funds on inefficient companies which will be eliminated by the market sooner or later, and to direct those funds to more likely objectives. Those new and more probable objectives include encouragement of economic growth, elimination of market failures and rationalization of use of public funds. While basic fields of activity to which aid should be directed are research and development, environment protection, employment and regional development. These changes will cause significant effects on the state aid policy for all members of the EU and for candidate countries as well.

4. State Aid in New EU Member Countries

A couple of years before their accession to the EU, twelve member countries still had a level of state aid which was twice higher than old member countries – about 1.2% in new member countries compared to 0.5 to 0.6% of GDP in case of EU15.[11] However, state aid at that time in future member countries was greatly reduced compared to the time at the end of the socialist period when it used to be 5 - 6% of GDP. What also contributed to such decrease are transitional changes such as privatization, transition to market prices and changes in the general policy and the state aid policy. However, decrease of state aid did not go as smoothly as it was expected due to several reasons: firstly, influence of stakeholders who resisted changes, secondly, election cycles when the government is always more generous than usual in terms of granting state aid and thirdly, government's fear that there might be social problems.

You can see the trend of the level of state aid in new member countries in table 1. Some of these countries had reduced the level of aid a couple of years before their accession, but they abruptly increased it right before the accession. That is how Czech Republic and Poland took advantage of the last moment before the accession to use higher amounts of aid in 2002/2003 to save banks and mines, which is shown in table 1.

At the same time when state aid was being decreased, new member countries were also trying to change its structure by switching from sectoral or vertical aid to horizontal state aid. Horizontal aid can be used by different companies, while vertical or sectoral aid is granted to precisely defined companies. According to EU regulations, the first type of aid is allowed, while the latter is not.

Results of state aid reform in different countries in transition are different from country to country, but the biggest transformation was recorded in the Czech Republic. Six out of ten new members from 2004 requested (and were granted) a transition period of three or four years to harmonize the amount and structure of aid in accordance with EU regulations. Malta had a transition period of four years to reduce aid to shipbuilding. Poland and Czech Republic had transition periods of two years each to reduce aid to steel industry. Croatia

[10] Compare *European Commission* 2012
[11] Compare Jovic 2012

committed to privatize five shipyards and reduce their production by 21% by its accession to the Union, as well as to limit existing subsidies and not grant new ones.[12] There is no transition period for those operations, but only for harmonization of forms of aid which are recorded as “old aid” and it needs to be done until 2020.[13] There is no transition period for steel mills in Sisak and Split.[14] The fact that a country requests a transition period to solve an issue after its accession to the EU is not good for the country because it indicates that there is a problem and unconformity with conditions on the common market. Transition periods for new members from 2004 ended in 2007 or 2008. The type of aid which was particularly problematic is aid to industry and traffic. More common forms of aid such as subsidies, tax exemptions, shares in the capital of companies and state guarantees were not easy to be given up on neither by the state bureaucracy nor by beneficiary companies. The biggest problems in new member countries from Eastern Europe were, however, related to two categories of state aid. Those are tax incentives for establishment of new firms and saving companies which are experiencing difficulties, especially by conversion or forgiveness of tax debt and by giving guarantees.

You can see that the job of lowering and transforming state aid is not easy in the fact that new member countries (for example Estonia and Slovakia) rarely had lower level of state aid than the EU average (when *ad hoc* aid due to the crisis in 2009 - 2010 is excluded). In a way, new member countries from Eastern Europe had bad luck when it comes to state aid. As soon as they adapted to EU regulations after their accession, those regulations changed at the end of 2013, so it is now necessary for them to go through another period of adaptation.

The matter of state aid in European countries is dealt with by either special departments of competition protection organizations or independent national agencies whose only job is to control state aid. This applies before accession of a country to the Union. After accession, the European Commission takes charge of control of state aid, while national bodies have a minor role which is to collect information, cooperate with the Commission or enforce European legislation at the national level.

What used to happen in new member countries and problems with which they were faced are also ahead of Serbia in the process of accession to the EU during the next decade.

[12] Compare Annex VIII of the Croatian Treaty of Accession, pp. 249–254
[13] Compare ibid. pg. 254
[14] Compare Annex IX of the Croatian Treaty of Accession, pg. 255

5. State Aid in Serbia

State aid which is provided in Serbia differs in amount, structure and objectives from state aid in countries of the EU. Its percentage is similar to that which was present in the EU a couple of decades ago, which is almost 3%. However, that is much higher than the current EU average which is 0.6%, while state aid in Serbia is also higher than aid in new EU member countries as well. The distribution of state aid in Serbia is also different from its distribution in the EU, because in Serbia it is used for several different purposes, even those that are not allowed in the EU. We can compare state aid in Serbia with the evolution of state aid in Croatia which has completed its accession negotiations and is supposed to become a new member of the EU on July 1, 2013. That is a path which Serbia is yet supposed to go through. If it continues the process of accession to the EU, Serbia could have similar problems to Croatian ones in the domain of state aid. Commitments in terms of state aid are yet to be expected when membership negotiations begin. The very Stabilization and Association Agreement which Serbia signed with the EU in 2008 does not say much about state aid.[15] In the potential future Serbia's Treaty of Accession to the EU, the issue of state aid will be dealt with in much more detail.

Let us, first of all, see the level of state aid in Serbia during the last couple of years.

Indicator	2009	2010	2011
Amount of state aid (millions of EUR)	901.98	754.29	808.70
GDP (millions of EUR)	31,511		31,143
The share of state aid in GDP (%)	2.86	2.64	2.60
Public spending (millions of EUR)	13,497	13,215	14,330
The share of state aid in public spending (%)	6.68	5.70	5.75

Table 2: State aid in Serbia

Source: Ministry of Finance of the Republic of Serbia, pg. 6, a part of table 2.1.

In the period of 2009 - 2011 state aid ranged from 2 to 3% of national income, or 5.5 - 7% of total government spending, which is the amount of 800 - 900 million EUR annually. To make a comparison, state aid in Croatia in 2010 was 1.2% of GDP or 5,374 million HRK (716.5 million EUR).[16]

[15] Compare SAA, pp. 704 onwards That is the section which refers to aid to steel industry and is the only section that deals with state aid.

[16] Compare Kesner-Skreb, 2012, pg. 3.

The share of state aid in Serbia was increased in the period of 2009 - 2011 compared to 2007, 2008 and 2009 when it was 2.0%, 1.9% and 2.3% of GDP respectively.[17] The percentage share of state aid to Serbian economy in GDP was four to six times higher than in the EU just before the crisis in 2008, while it was quite similar to the level of aid in the EU during the years of crisis – 2009 – 2011. An important difference between Serbia and the EU is that the amount of aid in the EU before the onset of the crisis had decreased, which was not the case in Serbia. Moreover, the crisis was a reason to suddenly increase aid in the EU in the period of 2008 - 2010, which did not happen in Serbia (the increase was not so great), even though different governments in Serbia used to say that aid had been significantly increased. That means that lowering of levels of state aid in Serbia remains to be done. Besides the amount of state aid, it is also important for which purpose it is granted, which can be seen in table 3.

Horizontal state aid, which is allowed according to EU rules, accounted for a large part of state aid in Serbia in 2009, which was 62.6%. After that it dropped to 20% or less. That means the horizontal aid needs to be increased in the following years, while sectoral and regional aid need to be reduced. An interesting thing is that Croatia, which is supposed to become a new EU member very soon, has an even less favourable structure of aid: sectoral aid accounts for 76%, while horizontal aid accounts for 15% and regional aid accounts for 9%.[18] Horizontal aid in the EU in 2010 was 85% (including regional aid), while sectoral aid was 15%. So, proportions of different forms of state aid in Serbia and Croatia are exactly opposite to the situation in the EU, which indicates that state aid in these two countries will have to undergo significant changes. Croatia will do that during transition periods which were granted to it.

Changes are also needed in the structure of horizontal aid. The share of Research and Development needs to be increased more significantly, as well as the share of Training, while aid classified as Other, which is aid used to remedy the impact of the world crisis, needs to be terminated when the crisis is over. Sectoral state aid needs to be reduced, especially the part which refers to traffic. Those are basically subsidies for the railway. The share of regional state aid is not extremely high and such aid is desirable from the standpoint of EU regulations. Changes in the structure of state aid in Serbia will not be possible unless they are accompanied by structural reforms. For example, privatization needs to be continued, especially in the domain of liquidation through bankruptcy, privatization of public companies and public utilities and restitution. Transition to the free price system needs to be made in those domains where it is not the case at the moment. Railway traffic also needs to be privatized, cash can no longer be given to foreign companies when they create new jobs, etc. Without structural changes in the real sector, changes in the amount of state aid will be limited and mostly superficial. Structural changes are

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[17] Compare Ministry of Finance of the Republic of Serbia, pg. 5 The lowest amount of state aid in Serbia after 2000 was in 2005 when it accounted for 1.5% of GDP

[18] Kesner-Skreb, 2012, pg. 4

supposed to eliminate the previous state which requires extensive state aid. Such a solution would not be sustainable in the long run without structural changes, which aid then needs to adapt to.

	Category	2009		2010		2011	
		millions of EUR	%	millions of EUR	%	millions of EUR	%
	Agriculture	180.66	20.0	225.22	29.9	165.65	20.5
	Industry and services	721.32	80.0	529.07	70.1	643.05	79.5
I	**Horizontal state aid**	**564.42**	**62.6**	**156.63**	**20.7**	**131.85**	**16.3**
	1. Research and development	0.00	0.0	0.16	0.02	0.81	0.1
	2. Training	0.00	0.0	0.02	0.0	0.02	0.0
	3. Employment	131.40	14.6	42.51	5.6	4.59	0.6
	4. SME	301.02	33.4	4.45	0.6	0.01	0.0
	5. Environment protection	0.05	0.0	0.61	0.1	28.67	3.5
	6. Culture	-	-	0.21	0.0	1.41	0.2
	7. Rescue and restructuring	66.44	7.4	58.64	7.8	51.28	6.3
	8. Other (world crisis)	65.51	7.2	50.0	6.6	0.00	0.0
II	**Sectoral state aid**	**124.73**	**13.8**	**141.16**	**18.7**	**179.10**	**22.1**
	1. Mining	18.26	2.0	20.66	2.7	21.77	2.7
	2. Traffic	102.68	11.4	120.50	16.0	157.34	19.4
	3. Tourism	0.81	0.1	-	-	-	-
	4. Other sectors	2.98	0.3	-	-	-	-
III	**Regional state aid**	**32.15**	**3.6**	**231.28**	**30.7**	**332.09**	**41.1**
Total		**901.98**	**100.0**	**754.29**	**100.0**	**808.70**	**100.0**

Table 3: State aid in Serbia by categories
Source: Ministry of Finance of the Republic of Serbia 2012, pg. 8, a part of table 2.2.

Serbia virtually needs to find its own way of going the same way as other new member countries from Eastern Europe. Some of them did not manage to complete it successfully, such as, for example, Hungary or Malta. Some steps on that path have already been made (the amount of aid compared to the socialist period is reduced, there has been partial transition to horizontal aid), but the biggest part of the job remains to be done. It is a pity that those changes will not happen because we realized that they are useful on our own, but because others (the EU) are forcing us to do so. But, if there is no other way, this will be useful as well, considering the problems that state aid creates, which are: waste of public funds, aid to companies which have special treatment, corruption, delay of changes and expectations that others will solve problems in companies. In this respect, reduction and transformation of state aid in Serbia will be a positive collateral effect of the country's accession to the European Union.

6. Conclusions and Recommendations

Basic recommendations for the state aid policy in Serbia considering the economic reasons, the country's accession to the EU and commitments which result from the process are the following:

1. Transformation of state aid in Serbia will depend on the pace of the country's accession to the European Union. It would be better if Serbia was able to reduce and transform state aid on its own, but it is very unlikely due to bad habits and strong connection between politics and interest groups.

2. There are three elements in which state aid in Serbia needs to be reformed. First of all, it is the amount of state aid which needs to be reduced from 3% of GDP to the EU average of 0.6% in the years that come after becoming a full member of the EU. Secondly, 80% of state aid in Serbia is vertical or sectoral, while 20% is horizontal, while the proportion of these two types of aid in the EU is exactly opposite. Thirdly, state aid needs to be redirected from dying economic activities to the ones which are creative and stimulating for development.

3. Serbia is supposed to reduce state aid because it is a rational standpoint of any country. State aid is inefficient and it is a form of reallocation of resources from those companies which are successful to unsuccessful ones. Rules of the EU require lower aid than the existing one in Serbia, although there are countries in the EU whose level of aid is similar to the one in Serbia (for example Hungary).

4. State aid in Serbia needs to be changed in terms of structure as well. A major part of aid needs to be transformed into horizontal aid, while sectoral or vertical state aid needs to be reduced drastically. That is the aid which is granted to precisely specified companies.

5. There is the option of being granted a transition period after joining the EU for those forms of aid which are related to particularly sensitive issues (industry, railway, public companies) during which an issue needs to be harmonized with EU regulations. Transition

periods last up to four years and it is possible to rely on them only in exceptional cases. That is why it is desirable to resolve problems of state aid before the country joins the EU.

6. In order for transformation of state aid to be possible, there need to be structural reforms in terms of privatization of public companies and public utilities, companies which have losses (bankrupt companies) and policy of price liberalization. Price freeze or price control cause losses to companies which then apply for state aid. That is why privatization and free prices are prerequisites of state aid reform.

7. Privatization of companies and free prices can create social problems, so they need to be accompanied by reform of the welfare system.

8. During transformation of state aid in Serbia, attention needs to be paid to new objectives of state aid policy in the EU, which focuses on economic growth, elimination of market failures, research and development and more efficient use of public funds.

9. The key problem that Serbia might have while adapting to the state aid policy in the EU is industry (steel mill, metal processing companies), public utilities and traffic (railway).

10. Authorities in Serbia also need to adapt to the new situation in which the key role in assessment of the state aid policy in Serbia will be given to the European Commission, the State Aid Section in the Competition Department, while the Serbian Government will keep the executive power.

11. If Serbia avoids making necessary changes in the domain of state aid, it could be faced with socio-economic problems created around companies which used to be beneficiaries of state aid on one hand, while there could be disagreements with Brussels on the other hand. That would result in penalties imposed by the European Commission on companies which would then have to pay back the aid that was illegally granted to them to the budget of Serbia. Those refunds can include periods of several years from the year when penalty was imposed and that leads companies which had to return the funds to a very bad position, which makes the socio-economic situation additionally difficult.

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