

ČLANCI I RASPRAVE

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UDK 341.232.3:61.1EC
str.5 - 24.
izvorni naučni rad

STATE AID CONTROL TO EU STANDARDS - EXPECTATIONS AND IMPLICATIONS IN THE CONTEXT OF A STABILISATION AND ASSOCIATION AGREEMENT

Abstract

This article reviews the nature and development of EC law and policy regarding state aids in its political, legal and economic context with particular reference to the likely requirements on Yugoslavia under a future Stabilisation and Association Agreement with the EU to develop a credible national system of supervision and control. The development of such a system is also connected with Yugoslavia's efforts to re-join the WTO.

The article traces the development of the EU state aid control system and highlights its main focus and method of operations. It notes

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that, even while the EU is progressively insisting upon comparable systems in all regions with which it is establishing new treaty-based trade relations, state aid levels remain problematic within the EU itself and the enforcement efforts against EU Member States are increasing.

The Croatian and Macedonian Stabilisation and Association Agreements contain commitments regarding the development of national systems of state aid control in both countries that broadly reflect the earlier process with the present candidate countries for EU membership under the Europe Agreements. An overview of the Croatian and Macedonian commitments gives reason to suggest that a reasonably strict regime of state aid control will also be expected in the case of a Stabilisation and Association Agreement between the European Union and Yugoslavia. This will necessitate substantial action in Yugoslavia (including legislation, training, political will and international reporting) to ensure credible compliance with new international commitments. Accordingly, it will be particularly important to design and develop a Yugoslav competence in this field and to design a system of regulation that makes sense and can work in Yugoslavia. This will take both time and effort and the article considers that it is of some importance that these efforts are commenced sooner rather than later in Yugoslavia. In overall terms, the development of suitable controls over state supports to the private sector can be a good thing for Yugoslavia, ensuring that government funds are well spent, now and in the future, that competition is not unduly affected and that there is transparency and rationality in regard to what is available in the form of government supports to business and economic development.

Key Words: *Aid, elements of national systems, EU state aid control system, exemptions, stabilisation and association agreements, state aid, impacts and effects, types of aid, Yugoslavia, Croatia, Macedonia.*

Introduction

The European Union has operated a system of centralized legal regulation on state aid for the last 45 years² and government subsidies are regulated internationally by the World Trade Organisation³. Nonetheless, the regulation of Government supports to industry remains particularly complex

² Articles 87 to 89 of the EC Treaty

³ Principally by the Subsidies and Countervailing Measures Agreement, 1994.

and contentious in international relations for a variety of political, economic, legal and social reasons. In addition, after nearly half a century of the EU prohibition system, the levels of state aid within the European Union remain very high.

Whether from a political, legal or economic perspective, there is no clear consensus among international experts or practitioners as to whether or when subsidies are a good or a bad thing. However, the prevailing consensus, which recognizes a wide margin for exceptions, suggests that (in the absence of clear market failure arguments), state aids and subsidies are generally likely to be harmful (and wasteful of public funds) as they –

- hinder the smooth operations of market mechanisms of supply and demand;
- create artificial advantages which damage competition and competitiveness,
- generate a subsidies culture where businesses facing difficulties (or even starting up) expect to be supported by the State, and
- interfere with the system of comparative advantages upon which free international trade is based.

Of course, the existence (and prevalence) of Government supports to industry represent a half-way position between centrally planned economic philosophy and that of free market economics. Despite initial ideas in the 1940's that subsidization by Governments would be banned under a United Nations mandate, the regulation of Government supports to industry under international law vacillates widely in terms of its logic, scope and effectiveness. Systems of regulation range from almost zero in the USA to the increasingly strictly enforced EU system of state aid control. The latter is developing rapidly in terms of its regulatory content and impact on Government economic policy decisions. It is also spreading rapidly in all of the new geopolitical regions where the EU is establishing new treaty based trade and political relations e.g. Central & Eastern Europe, Russia and the Balkan States. Somewhere between the highly liberal approach to subsidies in the US and the increasingly strict EU system lies the subsidies control regime of the World Trade Organisation. The forthcoming WTO Doha Round of

international negotiations is planning to further strengthen the international subsidies regulatory system⁴.

As Yugoslavia prepares to re-join the WTO and to enter into a Stabilisation and Association Agreement with the European Union, it will be required to appropriately receive and implement regulatory controls in the national context that are compatible with and reflect the principles of prevailing international rules on government supports to industry. These requirements create new conditions for the development of government policies on matters as diverse as new greenfield foreign investment, the negotiation of bilateral investment or trade agreements, the formulation of national industrial policies, the rescue and restructuring of firms or industries, the development of small business policy, regional development, the enforcement of competition law and the commercial acceptance of a government grant or industrial incentive by a business entity.

The importance of the reception into Yugoslav law and practice of the principles and approaches of the EU state aid control regime for the strengthening of relations with the EU in the future is underlined by the recommendations of the April 2002 Annual Report by the European Commission on Yugoslavia –

"An EU compatible competition law and legislation on state aids should be adopted and implemented as rapidly as possible. Other legislation should be amended to respect such principles"⁵.

In this EU and WTO context, this article traces the development of the EU system of state aid control and explains its substantive content. It also examines the Stabilisation and Association commitments in respect of state aids entered into by Macedonia and Croatia. The purpose, in short, is to explain in general terms what compliance with EU and WTO requirements is likely to involve for government and for business in Yugoslavia.

⁴ The agenda for the DOHA Round specifically includes consideration of the reduction and eventual phasing out of agricultural subsidies, strengthening the disciplines of the SCMA and the creation of new rules on fisheries subsidies.

⁵ European Commission Stabilisation and Association Report on FRY, April 2002.

The origins of EU State Aid Control and the key rules

As early as 1945, attempts were made to regulate government subsidies to industry and economic sectors. The discussions leading up to the Havana Charter, which preceded the creation of the United Nations, presented the first proposals to regulate industrial subsidies in the interests of world peace and world trade. However, this was not accepted at that time by world leaders.

In the 1950's when the original six European countries were preparing the creation of the European Coal and Steel Community and the European Economic Community, the issue again came to international attention. In regard to the coal and steel community, the view was that one country's ability to subsidise its coal or steel sectors would undermine the necessary degree of free competition in a single coal and steel market. In regard to the EEC, the drafters of the Treaty of Rome decided at an early stage to introduce competition rules for business undertakings operating in the newly created common market. The drafters of the Treaty of Rome also created the legal basis for what later became a number of important common policies in the EEC – notably the common agricultural policy (CAP), the Common Transport Policy (CTP) and the Common Commercial Policy (CCP) dealing with trade issues. At the same time, there was some discussion about the creation of a common industrial policy and a common taxation policy. However, on industrial and taxation policy there was no agreement and, despite some minor shifts in position over the years, this largely remains the position to the present day⁶.

The lack of agreement on a common industrial policy, in particular, created a problem in relation to the agreed and important measures of competition policy⁷. Put simply, if anti-competitive behaviours of businesses in the EEC were regulated and prohibited, there was nothing to stop state

⁶ EU competence in regard to industrial policy is generally limited to the promotion of framework conditions and e.g. encouraging common national efforts based on EU recommendations, studies etc. Indeed, it is noteworthy that the agenda of the Industrial Council of the EU has been traditionally dominated by state aids issues. Taxation policy remains limited by the Treaty requirement of unanimity by Member States for direct taxation initiatives.

⁷ Articles 85 and 86 of the EEC Treaty (now Articles 81 and 82 under the renumbering of the Amsterdam Treaty).

subsidies recreating similar protective barriers and other barriers to competition by supporting key industries whether they were competitive or not. The solution to this dilemma was found by the Treaty rules on state aid in Articles 92 to 94 of the EEC Treaty which are now Articles 87 to 89 under the new numbering of the Amsterdam Treaty.

In brief the system created by the EEC Treaty prohibits any aid which distorts competition or affects trade under the supervision of a notification system operated by the European Commission. The key provisions of the EC Treaty are as follows –

"...any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market"⁸.

"The (European) Commission shall, in cooperation with Member States, keep under constant review all systems of aid existing in those States. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the common market."⁹

If, after giving notice to the parties concerned to submit their comments, the (European) Commission finds that aid granted by a State or through State resources is not compatible with the common market having regard to Article 87, or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid within a period of time to be determined by the Commission. If the State concerned does not comply with this decision within the prescribed time, the Commission or any other interested State may, in derogation from the provisions of Articles 226 and 227, refer the matter to the Court of Justice direct"¹⁰.

⁸ Article 87(1) of the EC Treaty. This general prohibition is subject to other Treaty rules which create a *lex specialis* in regard to the agriculture, transport and defence industry sectors. Moreover, under the terms of Article 87(2), non-discriminatory consumer subsidies and state relief for natural disasters are stipulated as *per se* instances where the prohibition of Article 87(1) does not apply.

⁹ Article 88(1) of the EC Treaty.

¹⁰ Article 88(2) of the EC Treaty.

"The Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the common market having regard to Article 87, it shall without delay initiate the procedure provided for in (Article 88 paragraph 2). The Member State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision"¹¹.

Although the ordering of these provisions is somewhat out of sequence, there is a clear obligation on national governments to notify new or altered aid proposals to the European Commission and not to implement them until a positive decision has been received as regards their compatibility with the common market. In appropriate cases, the European Commission may also force a Member State to abandon its plans to grant state aid or change the content of particular aid measures.

Secondly, it is to be noted that there is no definition of "aid"¹² in the Treaty rules nor is the more common term "state aid" actually used¹³. The case law of the European Commission and the European Court of Justice refers to the "notion of aid" in a very dynamic way. The caselaw recognizes that there is no definition and that aid is identified by its effects on competition and trade and by the extent to which it confers a selective benefit on certain firms or industries. The continuing absence of a definition is also justified by the European Commission for the reason that any definition could be or would be circumvented readily by the very ingenuity of Member State industrial policies.

¹¹ Article 88(3) of the EC Treaty.

¹² In regard to the definition of aid, the European Court of Justice has clarified that an aid is a broader idea than a subsidy and that aid includes both state expenditure (direct and sometimes indirect) and the foregoing of public revenue e.g. in the form of tax write-offs or the agreed non-payment of social security contributions. The WTO, on the other hand, regulates subsidies and the SCMA 1994 has an extensive definition of a subsidy and especially when a subsidy is selective and subject to particular regulation. For most practical purposes, an EU "aid" and a WTO "subsidy" emerge as the same thing. The OECD, which has carried out an amount of comparative public policy analysis in this field, uses the useful and generic term "government supports to industry".

¹³ Interestingly, as will be seen later in this article, the term "state aid" is used in the Stabilisation and Association Agreements.

As well as examining new aids or alterations in existing aids, the European Commission is also empowered to keep existing aids under constant review. An existing aid is one that existed either before the Treaty rules came into force in a Member State (typically before accession to the EU) and aids which have previously been approved or exempted. This important power allows the Commission to indicate that things have changed¹⁴ and, on that basis, to re-open an investigation into existing aid. In proper cases, the Commission may issue "appropriate measures" requiring the abolition or alteration of existing aid measures.

In the context of the basic prohibition, Commission decisions typically focus on whether or not a notified proposed government measure is, in fact, aid within the meaning of Article 87(1) and, if it is aid, whether or not there are adequate grounds to exempt the measure from the basic prohibition on aid. In practice most notified government measures are either found not to be aid or to be capable of exemption¹⁵. Under the EC Treaty, various grounds exist which allow the European Commission to exempt state aid. In brief the main grounds for exemption¹⁶ relate to aid measures or schemes of government aid which –

- § promote economic development in seriously deprived regions of the EU (i.e. those with per capita gdp at less than 75% of the EU average);
- § facilitate economic development in areas of Member States experiencing major economic difficulties by comparison with national averages;
- § promote major projects of common European interest;
- § promote culture and heritage

The Treaty rules are supplemented by a wide range of Commission Guidelines, notices and, more recently, Regulations setting out detailed rules for "sensitive" economic sectors¹⁷, trying to balance the development needs of

¹⁴ Based specifically on an interpretation by the European Commission of the reference to the progressive development or the functioning of the common market in Article 88(1) of the EC Treaty.

¹⁵ Normally, under EC Law, Treaty exemptions are to be strictly and restrictively applied. The extent of practical non-opposition to notified aid measures raises the question, therefore, of whether the state aid rules are a de facto exception, or whether the case records indicate a significant degree of ineffective, or perhaps politically skewed, enforcement.

¹⁶ EC Treaty Article 87(3).

¹⁷ i.e. Steel, Coal, Shipbuilding, Agriculture, Transport, Fisheries, synthetic fibres, motor vehicles.

parts of the EU with the state aid regime (especially in the context of regional policy)¹⁸, setting a de minimis threshold below which aid is not a problem¹⁹, codifying procedural rules on the notification, approval and recovery of aid²⁰ developed by the European Courts and providing various degrees of lenient²¹ or strict interpretation²² of the rules for aid of particular types.

The development of EU policy, practice and enforcement

From 1957 until the first Enlargement of the EEC in the early 1970s there were very few cases taken up in regard to the state aids of the original 6 Member States. The first Enlargement which saw the entry of the United Kingdom, Denmark and Ireland into the EEC, however, re-opened concerns about state subsidies. The existing Member States were concerned that subsidies would be used to undermine the effects of the dismantling of tariffs (ostensibly for the purposes of industrial restructuring). For their part, the new countries (Ireland, UK and Denmark) feared that their economic development efforts would be curtailed by a strict application of the state aid rules or by new state aids emerging in the existing Member States.

¹⁸ Important guidelines here include those on aid to Small and Medium sized enterprises (Commission Regulation EC/70/2001 of 12 January 2001, *OJ L* 10 of 13 January 2001, pp 33-42), the EU regional aid guidelines (Guidelines on national regional aid, *OJ C* 74 of 10 March 1998, 9-31 as amended by *OJ C* 258 of 9 September 2000, p. 5), guidelines on aid to large investment projects (Multisectoral framework on regional aid for large investment projects, *OJ C* 107 of 7 April 1998, 7-18), aid for R&D (Community Framework for state aid for research and development, *OJ C* 45 of 17 February 1996 as amended by Commission Communication 98/C48/02) and environmental aid (Community Guidelines on state aid for environmental protection, *OJ C* 37 of 3 February 2001, 3-15).

¹⁹ Currently, under the terms of Commission Regulation EC/69/2001, *OJ L* 10 of 13 January 2001, this is 100,000 euros to a single enterprise over a three year period provided it does not breach sensitive sector rules or take the form of prohibited export aid.

²⁰ Council Regulation (EC) No 659/1999 of 22 March 1999, *Official Journal L* 83 of 27 March 1999, pp 1-9.

²¹ For example in regard to scientific research (under the R&D Guidelines) and in regard to the employment of handicapped workers under Guidelines on aid to employment, *OJ C* 334 of 12 December 1995, p. 4.

²² For example in regard to aid for rescue or restructuring of firms in economic difficulty under the Community Guidelines on state aid for rescuing and restructuring firms in difficulty, *OJ C* 288 of 9 October 1999.

Whether by accident or design, therefore, the 1970's saw the first phase of active application of the state aid rules by the European Commission. Moreover, in the 1970's a more rigorous enforcement of state aid policy in the EU was politically reinforced by the view that state aid control could assist governments in dealing with the hyper-inflationary effects of the oil crises of that era. Further enlargement in the 1980s saw an even greater recourse to the state aids rules and the detailed development of the legal powers of the European Commission as a result of several important decisions by the European Court of Justice²³. Policy in this period emphasized that state aid control could assist governments in reducing unemployment or, at least, in ensuring that the burden of unemployment was equitably shared based on market forces.

In the 1990s as the EU expanded its horizons towards further Enlargement, a strict system of state aid control in the candidate countries was insisted upon as a pre-condition for membership negotiations. The Europe Agreements with the candidate countries provide for the operation of a similar system to that of the European Commission in each candidate country and for reporting to the EU on levels of state aid and the controls applied. The policy emphasis of state aid control within the EU also shifted again – the new view being that a strong regime of state aid control helped Member States to control levels of public expenditure and thus facilitated their readiness to join the Eurozone. In the 1990s, the European Commission more publicly admitted that, despite its efforts, levels of state aid in Member States remained high and renewed efforts were made to ensure progressive reductions in overall levels. The system of EU state aid reporting developed for this reason and has been enhanced by the "State Aid Scoreboard" which was first launched by the European Commission in July 2001. This is intended to provide a transparent and publicly accessible source of information on the overall State aid situation in the European Union, on the Commission's current State aid control activities and on the comparative State aid situation across EU Member States²⁴. Moreover, in an important political development at EU level, the Stockholm Council of the Heads of State of the EU Member States committed the governments of the Member States to a type of voluntary code of practice on state aids. In the Summit Conclusions, the Member States agreed that –

²³ For example, Case 70/72, *Commission v. Germany* (Kohlegesetz), [1973] ECR 813 dealing with the recovery and repayment of unlawful aid.

²⁴ This was most recently updated in May 2002.

The level of state aids in the European Union must be reduced and the system made more transparent... To that effect... Member States should demonstrate a downward trend in State aid in relation to GDP by 2003, taking into account the need to redirect aid toward horizontal objectives of common interest, including cohesion objectives²⁵.

A further important trend since the late 1990s concerns policy on tax incentives which is now particularly high on the EU state aid control agenda. It was not always clear that a tax benefit was a state aid in terms of the EC Treaty. This was resolved by the European Court of Justice case of *Sloman/Neptun*²⁶ which held that a benefit from public expenditure or from a tax saving were both equally state aid in certain circumstances.

While the EU has for a long time aspired to a common tax system in respect of business taxes, certain Member States strongly resist this as an encroachment into their national sovereignty. One effect of differences in tax systems is that major industries sometimes decide to relocate to lower tax countries creating jobs in the second country and losing jobs in the first country. The EU and the OECD have both been developing policies regarding unfair tax competition to try and combat these economic effects of globalization and, in 1997, the EU adopted a Code of Conduct on Unfair Tax Competition²⁷ to try and bring the state aid rules to bear in this situation to the maximum degree. The basic idea was that all previously approved tax aids and any national tax measures complained of by another EU Member State would be reviewed in detail. This process of review has produced a major Report on tax competition²⁸ within the EU and resulted in the opening of a large number of state aid cases involving the tax systems of Member States²⁹.

In recent years, the state aid control regime has been extended to the Balkans via Europe Agreement - style provisions of the Stabilisation and

²⁵ Conclusions of the Stockholm European Council, 23 - 24 March 2001 at paragraph 20 and 21, SN 100/01.

²⁶ Joined Cases C-72/91 and C-73/91, *Sloman-Neptun Schiffahrts AG and Seebetriebsrat Bodo Ziesmer der Sloman-Neptun Schiffahrts AG*, [1993] I ECR 887.

²⁷ Council Code of Conduct on business taxation, *OJ C 2* of 6 January 1998.

²⁸ The (unpublished) Primarolo Report of 1998.

²⁹ In an address to the Universiteit Nyenrode in the Netherlands on 22 January 2002, EU Competition Commissioner Mario Monti points out that, since 11 July 2001, the European Commission has initiated 15 state aid procedures regarding the corporation tax regimes of 12 Member States, primarily concerning special tax regimes put in place for inward investment or financial services companies.

Association Agreements with Macedonia and Croatia and into the countries of the former Soviet Union via similar provisions in the Partnership and Cooperation Agreements³⁰. Even though this is often tough medicine for transition economies, the basic idea is that the EU will only open free trade arrangements with countries which can provide a level of assurance that their firms are not being unduly subsidized to face competition from EU firms.

The EU system of State Aid Control today.

It has already been noted that EU Member States are required by the EC Treaty to notify to the European Commission any plans to introduce or grant aid and not to put such measures into effect until a positive decision is reached by the Commission. Major changes since the mid-1980s and especially since 1996 have created a new situation where the state aid rules now have more teeth and are being taken increasingly seriously by Member States and are more fully developed in the legislation of the EU. Among the most important changes are the following –

- § The new powers of the European Commission to recover illegal state aid;
- § The legal burden placed on recipients of aid to know whether or not it is legal;
- § The improved practices and enforcement efforts of the European Commission itself reflected, not least, in a detailed procedural regulation adopted in 1999;
- § Increased transparency regarding state aid control by the Commission and regarding the actual state aids operating in Member States;
- § The increased number of "guidelines" and other forms of EU secondary legislation setting out EU policy and the Commissions approach to what will be and what will not be allowed in regard to different types of aid, different EU regions and different economic sectors.

³⁰ For example, Agreement on Partnership and Cooperation establishing a partnership between the European Communities and their Member States, of the one part, and the Russian Federation, of the other part, *JOCEL* 327, Nov. 27, 1997, Article 53.

Since 1995 there have been 109 state aids judgments by the European Courts. This is approximately the same number for the entire period 1957 to 1994 and clearly demonstrates the increasing importance of state aid control. Moreover, at present, there are 60 active EU decisions for state aid recovery against 8 Member States and with a total value of 2 billion euros. 28 such orders are outstanding against Germany and 13 against Spain. Of the total of 60, 8 are before the national courts of the Member States and 6 are on appeal to the European Court of Justice³¹.

Nonetheless, the level of state aid in the EU remains high causing continuing doubts about the effectiveness of the system. According to the latest EU data, some 90 billion euros of state aid is disbursed annually by the 15 EU Member States. In Finland aid per capita is 387 euros (and 1.74% of GDP) while in the UK it is 128 euros per capita (and 0.6% of GDP). At the same time overall state aid in the EU is down by 10% since 1993 and all Member States have committed themselves to a programme of reducing aid by 2003.

State Aid control commitments under the Stabilisation and Association Agreements

Consistent with the present EU approach to all new economic and trade agreements, the Stabilisation and Association Agreements (SAAs) in the Balkan countries include requirements for the control of state aids in those countries in line with the EU system and approach.

The Croatian Interim SAA³² provides that any state aid which distorts or threatens to distort competition by favouring certain undertakings or certain products shall be incompatible with the proper functioning of the Agreement, in so far as it may affect trade between the European Union and Croatia. Moreover, any aid actually or potentially contravening the Agreement shall be assessed on the basis of criteria arising from the application of the competition rules applicable in the Community, in particular from Articles 81, 82, 86 and

³¹ State Aid Scoreboard, second edition, European Commission, COM (2001) 782 Final of 20 December 2001, pp. 14-15.

³² Draft Council Decision of 9 July 2001 concerning the signature of the Stabilisation and Association Agreement between the European Communities and its Member States and the Republic of Croatia, at Article 70. The Interim Agreement was initialed on 14 May 2001.

87 of the Treaty establishing the European Community and interpretative instruments adopted by the Community institutions.

In addition, Croatia is required to establish an operationally independent authority which is entrusted with the powers necessary for the full application of the state aids commitments under the Agreement within one year from the date of its entry into force. According to specific SAA terms, this authority must have, inter alia, the powers to authorise State aid schemes and individual aid grants in conformity with the SAA as well as the powers to order the recovery of State aid that has been unlawfully granted.

The EU/Croatian SAA further provides that Croatia shall establish a comprehensive inventory of aid schemes instituted before the establishment of the state aid control authority and shall align such aid schemes with the EU rules within a period of no more than four years from the entry into force of the Agreement. Croatia must also provide the EU with a regular annual report, or equivalent (following the methodology and the presentation of the Community survey on State aid) and provide information on particular cases of state aid at the request of the EU. These transparency requirements are reciprocal.

To deal with how to approach economic development (regional aid) in the context of exemptions based on under-development, the SAA declares that Croatia shall be regarded, for a period of four years from the entry into force of the Agreement, as –

"...an area identical to those areas of the Community described in Article 87(3)(a) of the Treaty establishing the European Community".

In the same context, it is provided that, within three years from the entry into force of the Agreement, Croatia shall submit to the European Commission its GDP per capita figures harmonised at NUTS II level. The Croatian state aid control authority and the European Commission will then jointly evaluate the eligibility of the regions of Croatia as well as the maximum aid intensities for each region to create a regional aid map on the basis of the relevant Community guidelines. Agriculture and fisheries products are excluded from the scope of these commitments.

As regards the enforcement of these rules, the EU/Croatia SAA provides that –

If one of the Parties considers that a particular practice is incompatible with the terms of paragraph 1 of this Article, it may take

appropriate measures after consultation within the Stabilisation and Association Council or after thirty working days following referral for such consultation...Nothing in this Article shall prejudice or affect in any way the taking, by either Party, of antidumping or countervailing measures in accordance with the relevant Articles of GATT 1994 and WTO Agreement on Subsidies and Countervailing Measures or related internal legislation.

The EU/Macedonian SAA contains similar provisions³³ requiring compliance within a period of five years from the entry into force of the Agreement. It is notable, however, that the Macedonian Agreement does not require an independent state aid controlling authority to be established nor does it provide for regional state aid mapping in Macedonia.

A number of these provisions are not obvious in their meaning and warrant a brief explanation to clarify their importance and significance in the SAAs. The more recent and more extensive Croatian text provides the point of reference for the comments which follow.

Firstly, the requirement that Croatia must assess any aid actually or potentially contravening the Agreement means that Croatia must assess all aid. That the basis of assessment must be “criteria arising from the application of the competition rules applicable in the Community...and interpretative instruments adopted by the Community institutions” means that all EC law and practice, present and future, (including the increasingly important judgments of the European Courts) must be applied in the Croatian assessment of whether or not aid is compatible with the SAA commitment. Secondly, the extensively described operationally independent authority to supervise and control state aid in Croatia must, of its nature, have the power and authority to take negative decisions against state aid related government measures at all levels of government.

The inventory of existing Croatian state aid, once established, must be reviewed by the Croatian authority within 4 years and the existing aid measures brought into line with EU rules on state aid within that timescale. Accordingly, Croatia may have to abolish or amend existing government schemes to ensure their consistency with the SAA commitment.

³³ Stabilisation and Association Agreement between the European Communities and their Member States, of the one part, and the former Yugoslav Republic of Macedonia, of the other part of 26 March 2001, Article 69.

The classification of Croatia, in its entirety, as a de facto Article 87(3)(a) region refers to the application of the European Commission's Regional Aid Guidelines and the Multisectoral Framework on regional aid to Large Investment Projects in Croatia. As noted earlier, one of the main grounds under which the European Commission may exempt state aid is that the –

"aid promotes the economic development of areas where the standard of living is abnormally low or where there is serious underemployment" (Article 87(3)(a) of the EC Treaty).

Such aid is generally classified as regional aid to "A" regions. Under the Regional Aid Guidelines, the areas in question have less than 75% of EU GDP per capita in the last three years. "A" regions may benefit from the maximum levels of aid for the purposes of investment or job creation. Unless otherwise decided, the present maximum levels are generally 50% of investment costs (where investment is being subsidised) or 50% of the cost of two years wages (where job creation is being subsidised). A further 15 percentage points may be added (giving an overall 65% maximum) where the beneficiary of the investment or job creation aid is a small or medium sized enterprise³⁴.

Within the European Union, "A" regions are generally not authorized to give the maximum 50% levels under the Guidelines. At the present time, only parts of Spain, Portugal and Greece are given this maximum flexibility based on an internal assessment of relative regional handicaps within under-developed Member States and the outcome of the so-called regional aid mapping exercise with the European Commission.

As noted above, the Croatian SAA requires that Croatia submits to the European Commission, within three years, its GDP per capita figures harmonised at NUTS II level so that Croatia and the European Commission can –

"jointly evaluate the eligibility of the regions of Croatia as well as the maximum aid intensities for each region to create a regional aid map on the basis of the relevant Community guidelines".

³⁴ Small and medium-sized enterprises are defined as enterprises which have fewer than 250 employees and have either an annual turnover not exceeding EUR 40 million or an annual balance-sheet total not exceeding EUR 27 million and which are independent firms.

Under the Guidelines a regional aid map is defined as the regions (within a State) eligible for exemption and the maximum aid levels for investment and job creation approved by the European Commission³⁵. Taken together, the significance of the Article 87(3)(a) classification of Croatia and the requirement to develop regional aid mapping means that the under-developed exemption classification may not of necessity last beyond a four year period and, if it does, there may be some later requirements to reduce Croatia's right to use maximum aid levels, at least in certain parts of Croatia.

What the EU will expect of Yugoslavia

Based on the relatively standard approach to state aid control outlined in the previous section, it is to be expected that a reasonably strict regime of state aid control will also be expected in the case of a Stabilisation and Association Agreement between the European Union and Yugoslavia. It is not material in this context to argue, as some of the candidate countries for the present EU Enlargement have done, that in a country with major economic problems state aid levels are low and really do not pose a threat to other countries or a problem in their own right. It seems certain that the EU will simply expect the development of a reliable system of state aid control at national level in Yugoslavia on the basis, *inter alia*, that individual aid awards can be important and that low levels of aid at present do not preclude, nor do they guarantee against high levels in coming years.

The development of such a system poses a number of important challenges for Yugoslavia because the system must be a credible one and not merely something that represents nominal compliance with the SAA commitments on state aids. It is also clear that the creation of such systems in transition economies has been very difficult under the Europe Agreements³⁶.

Legislation on state aids will be a primary result of these commitments. Yugoslavia will need to develop a national law that allows for

³⁵ Regional Aid Guidelines, 1998, para. 5.1

³⁶ The Competition Policy Negotiating Chapter has been among the most difficult for all the present candidate countries for EU membership and the state aid control aspects of those negotiations has been the central area of difficulty.

the control and monitoring of present and future aids, subsidies and tax breaks in every form (probably excluding agriculture and fisheries) and that gives a Ministry or authority the right to block proposals to give aid if that proposed aid would contravene the letter, spirit or practice of the (present or future) EU state aid rules. A number of important issues arise in establishing national laws to set up a national state aid control system. These include the requisite political will, sufficient knowledge of what must be regulated and how, establishing the institutional responsibility for the national regulatory system, building in mechanisms to update the law and ensuring that both control and monitoring are adequately covered.

Secondly, it will be necessary to build up knowledge and expertise in Yugoslavia on the substantive content of the EU rules on state aids and the decided cases of the European Courts. Such expertise will need to develop not only within the responsible authority but also within all economic policy Ministries, the Courts and the Parliament.

Thirdly, Yugoslavia will need to develop a state aid inventory and a system of reporting to the EU and the WTO. A state aid inventory is a database of all state aids (including *de minimis* aids) operating in a country at a particular point in time e.g. at the coming into force of an agreement with the EU. The first inventory creates the baseline for existing aid. From the starting baseline discontinued or expired aid measures are removed regularly and new aids added. Adherence to the EU and the WTO regimes also requires annual reporting on state aids and subsidies. Both the EU and the WTO have standard reporting forms which assist the formal reporting of state aids and subsidies to these organizations.

Implications for Yugoslavia

A fully functioning system of state aid control will have effects on government policy and the business community. Handled carefully, these can be positive effects in overall terms.

In regard to government policy it is clear that state aids and subsidy regulation imposes limitations on government action to support industry and trade. At the same time, it ensures that important policy questions are asked before a government measure is brought forward thereby making government measures more economically rational, more focused and more results based.

As the impact of state aid and subsidy regulation may affect a wide range of government spending or taxation measures, it is important that a national competence in this field is developed as quickly as possible. As noted above, it is also necessary to establish national systems of law and supervision to allow the reception of the international rules into national practice. While some difficult decisions may have to be taken in the short term (e.g. about rescue and restructuring aid where the EU rules are now extremely strict) these can be matched in practice by creative and developmental solutions in regard to aid to small firms and aid for investment and job creation where very generous aid levels will apply based on Yugoslavia's difficult economic indicators and status³⁷.

For the business community there can be positive and negative effects from government subsidy or state aid measures relating to the competitive position of firms and industries. If a firm receives a state aid (whether or not in compliance with the state aid rules) it receives a benefit while direct competitors not receiving the aid are harmed in their competitive and trade position. Arising from the EU rules there are also legal risks for firms which accept subsidies if they are not approved subsidies. EC Law makes clear that there is a duty of care and diligence on an aid recipient to know that aid received is lawful³⁸. This is to prevent any later "ignorance" defence against any subsequent attempts to recover an unlawful aid. Finally there are opportunities to restore the competitive position of one firm if a competitor has received an unlawful state aid and a particular role for national courts developed from EC Law to facilitate this³⁹.

Conclusions

Yugoslavia, like other transition countries, faces major challenges in order to credibly sign up to commitments with the EU and the WTO in respect of the regulation of state aids and subsidies in line with prevailing international laws and standards.

³⁷ Under the EU Regional Aid Guidelines, the maximum levels of aid for Article 87(3)(a) regions is 50% of total investment or job costs or 65% if the beneficiary firm is a small or medium sized enterprise.

³⁸ Case C-5/89 Germany v. Commission, [1990] I ECR 3457.

³⁹ Commission Notice on cooperation between national courts and the Commission in the State aid field, OJ C 312, 23.11.1995, p. 8).

It will be particularly important to design and develop a Yugoslav competence in this field and to design a system of regulation that makes sense and can work in Yugoslavia. In overall terms, this can be a good thing for Yugoslavia, ensuring that government funds are well spent and that there is transparency and rationality in regard to what is available in the form of government supports to business and economic development.

Based on the experience elsewhere (that the adoption of the kind of commitments likely under the Stabilisation and Association Agreement takes time and effort), it would seem to be particularly important that those efforts are commenced sooner rather than later in Yugoslavia.