Chapter 11

Croatia: The Long and Winding Road Towards Compliance With the EU State Aid Law

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Abstract

This chapter examines the evolution of state aid and subsidy policies in Croatia against the backdrop of the European Union (EU) law. In doing so, it aims to contribute to the broader discussion on the convergence of state aid practices within the EU. It emphasises how the EU accession process impacted Croatia's subsidy landscape. Three distinct stages in Croatian subsidy policies are identified: pre-Stabilisation and Accession Agreement (SAA) era, the accession period marked by alignment with EU competition policy, and the post-accession stage where Croatia shares competence with the EU institutions. The chapter describes the challenges, legal reforms, and achievements of Croatia in aligning with the EU state aid law. On analysing Croatian policy and practice in the area of subsidies, it concludes that a remarkable degree of compliance with the EU law has been achieved. Conversely, there exists plenty of room for improvement from an economic perspective, given that Croatia still has an unfavourable state aid structure and a substantial total aid expenditure relative to its GDP.

Keywords: *subsidies, state aids, EU law, public finance law*

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1. Overview of Croatian subsidy policies

State aid and subsidies are deeply linked to the fundamentals of a country's economic system. Since subsidies provided by the public sector to private actors amount to a particular – and very visible – form of state interventionism, they should be largely absent from the economies based on laissez-faire and free-market principles. However, history teaches us that the transformations in individual countries often defy pure economic theories. In any case, in post–World War II period, countries of Western Europe embraced a 'mixed economy' model, combining free trade policies and the private market with a large degree of state interventionism.[1] This economic model continues to dominate the European Union (EU) Member States, under the guise of 'social market economy', even being explicitly introduced to the Lisbon Treaty.[2]

Croatia has been a latecomer in this regard, with its economy transitioning from a centrally planned socialist model to a market-based approach after the breakup of Yugoslavia in 1991. The legal underpinnings of the new economic model are enshrined in the Croatian Constitution.[3] Notably, Art. 49 para. (1) of the Constitution states that free enterprise and free markets shall form the foundation of the economic system of the Republic of Croatia. However, Art. 49 para. (3) envisages the state playing a role in promoting the economic development and social welfare of its citizens, as well as ensuring the economic development of all regions. In practice, more than three decades of mixed economy in Croatia have been marked by a high level of state interventionism, regardless of the political party in power. Many studies have pointed out how the role of the state (public sector) in Croatian economy is relatively high compared to EU Member States, especially in relation to other post-Communist countries at similar levels of economic development (e.g. Hungary, Poland and Estonia).[4]

It must be noted that the accession procedure to the EU played a major role in shaping the Croatian economy as it stands today. In 2000, Croatian political elites – parties from both left and right of centre – arrived at a consensus that joining the EU is the paramount political goal that needs to be pursued by the country.[5] Important legal steps in this regard were taken as follows: (i) stabilisation and Accession Agreement (hereinafter: SAA) was signed in May 2001; (ii) official application for the membership in the EU was submitted in February 2003; (iii) candidate status was granted in June 2004; (iv) negotiations began in October 2005; (v) screening process was completed in October 2006; (vi) the Treaty of accession to the EU was signed in December 2011; (vii) the Croatian people approved the accession treaty via a referendum held in January 2012.

1 See: Berend, 2016, pp. 190–191.

2 Art. 3 para. (3) of the Treaty on European Union (TEU). See: Claassen et al., 2019, pp. 4–5.

3 Constitution of the Republic of Croatia, Official Gazette No. 56/90, 135/97, 08/98, 113/00, 124/00, 28/01, 41/01, 55/01, 76/10, 85/10, 05/14.

4 See for example: Šimović and Deskar-Škrbić, 2021, pp. 44–51; Buturac, 2014, pp. 521–523.

5 See: Šeperić, 2011, p. 464.

After the Treaty of accession came into force on 01 July 2013, Croatia officially became the newest EU Member State.[6]

For the purposes of the present chapter, it is important to note that – as is the case with other 'new EU Member States' – during this arduous accession procedure, Croatia had to satisfy the so-called Copenhagen criteria.[7] The economic criterion requires the candidate country to have a functioning market economy and producers that have the capability to cope with the competitive pressure and market forces within the EU. This entails more specific requirements with regard to antitrust and state aid.[8] In fact, among the 35 chapters into which the EU *acquis* has been divided for the purposes of negotiations with Croatia, the most contentious was chapter 8, devoted to competition policy. While rather quick progress has been made in modernising the legislative and institutional framework related to state aid in Croatia (e.g. adoption of the State Aid Act and improved enforcement record of the Croatian Competition Agency), the more challenging task was to align existing aids in the steel and shipbuilding sector with the EU law.[9] These issues were resolved by 2011, with the privatisation of five shipyards and the adoption of a restructuring plan for the steel sector companies.[10]

Against the preceding backdrop, three main stages can be identified in the development of Croatian subsidy policies: (i) the pre-SAA stage (1991–2001), in which the EU law played no role in shaping state policies toward subsidies; (ii) the accession stage (May 2001–June 2013), which was marked by a complete overhaul of the competition and state aid framework, in order to align it with the *acquis*; (iii) the membership stage (1 July 2013 onwards), in which Croatian authorities share competence in this area with the EU institutions, and granting of any new state aid must adhere to the rules enshrined in the primary and secondary EU legislation.[11]

The period preceding the signing of the SAA (May 2001) was marked largely by a lack of clear policy objectives regarding subsidies. Remarkably, before the SAA, no legal framework existed to regulate this area.[12] One of the most prominent features of the subsidy practice has been a low degree of transparency, with limited publicly available data on the grantors (e.g. central government, municipalities, and state agencies), beneficiaries, as well as on the subsidy amounts.[13] Sectoral aids – aids provided to companies operating in a specific sector of the economy – clearly dominated in this period, with the highest amounts directed to four sectors: transport,

6 See: *Chronology of important dates in the EU accession process* [Online]. Available at: https://www.sabor.hr/en/European-affairs/croatias-path-eu/chronology/chronology-important-dates-eu-accession-process (Accessed 20 June 2023).

7 On the Copenhagen criteria, see for example: Marktler, 2006.

8 See: Hancher, Ottervanger and Slot, 2016, p. 163.

9 Hancher, Ottervanger and Slot, 2016, pp. 164–165.

10 See: Šeperić, 2011, pp. 468–469.

11 For an overview of the EU state aid framework, see: Hancher, Ottervanger and Slot, 2016, pp. 49–122.

12 Bodiroga-Vukobrat and Pošćić, 2016, p. 488. Cf. Spevec, 2012.

13 Kesner-Škreb and Mikić, 2003, p. 108.

communications, tourism, and shipbuilding.[14] In terms of the instrument type, direct subsidies from the public budgets played a central role. The high degree of state interventionism in this period may be best illustrated by the fact that direct subsidies alone provided from the central government budget in the year 2000 amounted to 2.4% of the Croatian GDP, while the EU average for all types of state aid in that year was 0.99% of a Member State's GDP.[15] It must be noted that in this respect, the Croatian experience has not been dissimilar to that of other European transition countries, or Central and Eastern European countries (CEECs). As explained by Hölscher, Nulsch, and Stephan:

> Prior to their accession to the EU, most CEECs pursued high levels of sectoral aid, as these countries first had to overcome the problems resulting from transition. Thus, disparities between East and West before accession can be explained in part by the restructuring of industries in order to reach commercial viability and to complete the process of privatization.[16]

Undoubtedly, Croatia finally becoming a Member State of the EU on 01 July 2013 was a watershed moment in terms of Croatian policy regarding subsidies. The new State Aid Act (*Zakon o državnim potporama)* was adopted to ensure alignment with the EU legislation.[17] Notably, as per the State Aid Act, the priority goals of state aid policy have to be set by the government and publicised on a yearly basis in the form of the so-called guidelines for state aid policy (*smjernice politike državnih potpora*; hereinafter: Guidelines).[18] As expressly stated in Art. 7 para. (2) of the State Aid Act, Croatian state aid policy is drafted on the lines of the EU state aid policy. Interestingly, this encroachment into the sovereignty of the national legislator has not been debated much in the Croatian academic community.[19] In any case, even the first policy document, adopted for the period 2014–2016, emphasised the need to establish a coherent system for granting state aid and for achieving a higher degree of convergence with the EU in terms of the structure of aid, by reducing the share of sectoral aid favouring horizontal aids.[20]

The latter still remains the main goal of Croatian state aid policy, as explained in the latest edition of the Guidelines, adopted for the period 2023–2025.[21] More precisely, the main goal is to reduce the share of sectoral aids in the total aid expenditure,

14 Kesner-Škreb and Mikić, 2003, p. 127.
15 Kesner-Škreb and Mikić, 2003, p. 128.
16 Hölscher, Nulsch and Stephan, 2017, p. 786.
17 State Aid Act, Official Gazette No. 72/2013. This act has been repealed and replaced in 2014 by the new State Aid Act, Official Gazette No. 47/2014, 69/2017, that is currently in force.
18 See: Art. 7 of the State Aid Act. Compare also Bodiroga-Vukobrat and Pošćić, 2016, p. 490.
19 See: Butorac Malnar et al., 2021, pp. 510–511.
20 See: *Odluka o donošenju Smjernica politike državnih potpora za razdoblje 2014–2016*, Official Gazette No. 130/2013.
21 *Odluka o donošenju Smjernica politike državnih potpora za razdoblje 2023–2025*, Official Gazette No. 19/2023 (hereinafter: Guidelines 2023–2025).

thus achieving more convergence of aid structure with other EU Member States. To put things in perspective, in 2020, the share of sector-specific aids was 57.2% of all state aid measures provided to industries and services (excluding agriculture and fisheries).[22] While this is significantly lower than that in the pre-accession period – for example, in 2011, the share of sectoral aid in the total state aid expenditure for industries and services was 73.9% – it is still much higher than the EU average of around 10%. Furthermore, according to the Guidelines, grantors of state aids in Croatia should ensure that the planned aid instruments are well-designed and have minimal impact on the market competition. More specifically, grantors are encouraged to spend more on (i) environmental protection, (ii) research, development, and innovation, (iii) training, (iv) employment, and (v) investment, focusing on regional aids.[23] One may note that such a policy is aligned with that pursued by the EU ever since 2005 and the presentation of European Commission's 'State Aid Action Plan (SAAP)', which focuses on 'better-targeted aid'.[24]

Further, it is important to note that Croatia and other EU Member States converge more on the levels of the total state aid expenditure relative to GDP. In other words, in 2021, total state aid granted for non-COVID-19 objectives in Croatia amounted to 1.4% of the national GDP. While only three Member States (Denmark, Hungary, and Malta) spent more in relative terms, the share of Croatia in this aspect is much lower than that in the pre-accession period.[25] Again, this fits the experience of other CEEC countries in the years following the accession to the EU.[26]

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2. Croatian state aid law in times of crisis

2.1. COVID-19-related state aid measures

The outbreak of the COVID-19 pandemic in early 2020 and its persistence throughout 2021 and 2022 resulted in individual governments in Europe taking severe control and containment measures, leading to one of the biggest economic downturns in modern history. Among other tools aimed to alleviate this economic shock, the EU had to quickly adapt its approach toward state interventions in the internal market, including the state aid policy. In March 2020, the European Commission (hereinafter: EC) indicated that it would take all measures at its disposal to ease the socio-economic impact of the pandemic, with the adaptations of the EU

22 See: para. 2 of the Guidelines 2023–2025.
23 See: para. 4.1 of the Guidelines 2023–2025.
24 Hölscher, Nulsch and Stephan, 2017, p. 783.
25 See: Mađarević-Šujster, 2014, pp. 109–110.
26 See: Hölscher, Nulsch and Stephan, 2017, pp. 783–786.

state aid framework at the centre of its efforts.[27] This is a consequence of the fact that the EU budget is extremely small compared to the total GDP of the Union, and the financial brunt of the COVID-19 measures had to be borne by Member States in their budgets.

Notably, solid legal bases exist in the primary EU law under which state aid measures granted in exceptional circumstances may be considered compatible with the internal market.[28] Most notably, under Art. 107 para. (3) point (b) of the Treaty on the Functioning of the European Union (TFEU), the EC may declare aid granted to remedy a serious disturbance in the economy of a Member State compatible with the internal market. On 19 March 2020, the EC issued a Communication on the Temporary Framework for state aid measures to support the economy during the ongoing COVID-19 outbreak.[29] The main aim of this soft law instrument was to establish the compatibility conditions that the EC could apply to the pandemic-related aid granted by Member States under Art. 107 para. (3) point (b) of the TFEU.[30] Accordingly, the Temporary Framework cleared the path for quicker and more flexible approval of state aid that could tackle problems relating to liquidity and access to finance faced by undertakings as a consequence of the COVID-19 outbreak.[31] In fact, the following period saw probably the most intense wave of state aid notifications by Member States and corresponding decisions by the EC since the foundation of the EU.[32] Nevertheless, for most of the envisaged instruments, the Temporary Framework was withdrawn on 30 June 2022.

Tourism and transport were among the most important sectors of the Croatian economy hit particularly hard by the pandemic. Accordingly, the period between March 2020 and June 2022 was marked by large state interventions in the economy, primarily aimed at ensuring liquidity for businesses and maintaining employment levels. More importantly, Croatia enacted a variety of state aid measures approved by the EC under the COVID-19 Temporary Framework.[33] The most significant ones are briefly described as follows: (i) A liquidity guarantee scheme for companies affected by the coronavirus outbreak, which was approved on 6 April 2020.[34] This measure took the form of state guarantees on loans and was accessible to all companies whose exports represent at least 20% of their yearly revenue. The scheme

27 See: Buendía and Dovalo, 2020, p. 3.

28 See: Correia, 2022, p. 9.

29 Communication from the Commission – Temporary Framework for state aid measures to support the economy in the current COVID-19 outbreak, OJ C 91I, 20.3.2020, 1–9, as amended by Commission Communications C(2020) 2215, OJ C 112I, 4.4.2020, 1–9; C(2020) 3156, OJ C 164, 13.5.2020, 3–15; C(2020) 4509, OJ C 218, 2.7.2020, 3–8; C(2020) 7127, OJ C 340I, 13.10.2020, 1–10; C(2021) 564, OJ C 34, 1.2.2021, 6–34; and C(2021) 8442, OJ C 473, 24.11.2021, 1–11.

30 On the legal nature of the Temporary Framework, see: Buendía and Dovalo, 2020, p. 4.

31 Buendía and Dovalo, 2020, p. 3.

32 Bouchagiar, 2021, p. 1.

33 A full account of the Croatian state aid measures enacted under the Temporary Framework is provided here: European Commission, 2024.

34 Commission Decision SA.56877 (2020/N).

was aimed at limiting the risk associated with issuing operating loans to companies most severely affected by the economic impact of the coronavirus outbreak, thus ensuring continuation of their activities. The guarantees supported lending to those companies, but they did not take the form of export aid contingent on export activities. The scheme was administered by the Croatian Bank for Reconstruction and Development (Hrvatska banka za obnovu i razvitak; HBOR), with the total budget of the scheme amounting to EUR 790 million; (ii) Two schemes to support pandemic–affected companies, in the form of zero-interest loans and loans with subsidised interest rates, which were approved on 9 April 2020.[35] The schemes were aimed at enhancing access to liquidity by companies most severely affected by the economic impact of the coronavirus outbreak, thus ensuring continuation of their activities. These schemes were also administered by the HBOR, with a total budget of EUR 1 billion; (iii) A scheme for loan guarantees and subsidised loans targeted at micro companies and small- and medium-sized enterprises (SMEs), which was approved on 12 May 2020.[36] The measure took the form of subsidised loans and state guarantees on loans, thus allowing targeted companies access to external financing. The scheme was administered by the Croatian Agency for SMEs, Innovations and Investments (HAMAG-BICRO), with a total budget of EUR 322 million; (iv) A scheme to support enterprises active in the maritime, transport, travel, infrastructure, and related sectors, which was approved on 30 June 2020.[37] The measure took the form of state guarantees on new loans from banks or other financial institutions, with the guarantee covering up to 90% of the loans. This scheme was administered by two state agencies – HBOR and HAMAG-BICRO – with a total budget of approximately EUR 80 million; (v) A scheme to support enterprises of all sizes active in the sports and tourism sectors and in the sectors directly related to them (e.g. hotels and restaurants), which was approved on 11 January 2021.[38] The measure took the form of guarantees on new working capital and investment loans and subsidised interest rates for new loans, aiming to help eligible companies access liquidity and continue with their economic activities; (vi) A scheme to support companies active in certain primary agricultural sectors (e.g. cattle, pig, poultry, and sheep producers), which was approved on 17 November 2021.[39] The aid was provided in the form of direct grants, addressing the liquidity needs of the beneficiaries. This scheme was administered by the Ministry of Agriculture of Croatia, with a total budget of EUR 22.7 million; (vii) A wage subsidy scheme (officially called as the ‘job preservation aid scheme’) to support employers and self-employed persons, which was approved on 9 December 2022.[40] The aid took the form of wage subsidies, aimed at reducing the wage costs of eligible employers and at supporting low-earning self-employed

35 Commission Decision SA.56957 (2020/N).
36 Commission Decision SA.57175.
37 Commission Decision SA.57711.
38 Commission Decision SA.60265.
39 Commission Decision SA.100417.
40 Commission Decision SA.103801.

individuals. Accordingly, the scheme's primary aim was to preserve the employment levels and to avoid layoffs, especially in sectors of the economy that were seriously affected by the pandemic.

Two further measures enacted by Croatian authorities and approved by the EC under Art. 107 para. (2) point (b) of the TFEU, which are deemed compatible with the internal market, refer to the aid granted to compensate damage caused by natural disasters or exceptional occurrences.[41]

First, an EUR 11.7 million grant to compensate the national airliner (Croatia Airlines) for the damage caused by the pandemic was approved by the EC on 1 December 2020.[42] Bearing in mind the requirements for the approval of the measure under Art. 107 para. (2) point (b) of the TFEU, the Commission found in particular that the grant would compensate damage directly linked to the coronavirus outbreak. For the approval of the measure, Croatian authorities confirmed that an independent audit firm would verify that the aid does not exceed the amount of damage suffered between 19 March 2020 and 30 June 2020. Notably, this case was the only occurrence in which a Croatian state aid measure has been tested before the Court of Justice of the European Union (CJEU). Following one of several actions taken by Ryanair to annul EC's decisions regarding COVID-19-related aid provided to rival airline companies, the General Court decided on 9 November 2022 to dismiss Ryanair's action and to confirm the validity of the pertinent measure from the perspective of EU law.[43]

Second, the measure approved on the basis of Art. 107 para. (2) point (b) of the TFEU concerned the state aid measure enacted by Croatia to compensate Zagreb International Airport for the damage suffered due to the pandemic. The measure took the form of a write-off of the concession fees amounting to a total of EUR 14.3 million. It was approved by the EC on 13 December 2022, finding that it compensates the damage suffered by the beneficiary and is proportionate.[44]

In 2020, the total expenditure in Croatia for COVID-19 state aid measures amounted to EUR 220.3 million (16.3% of the total state aid expenditure); in 2021, it amounted to EUR 459.9 million (35.7% of the total state aid expenditure).[45] Both in 2020 and 2021, this was the lowest share of pandemic-related measures in the overall state aid expenditures among all EU Member States. Furthermore, if one considers the scale of the economic shock suffered amidst the pandemic (measured by the real loss of GDP), Croatia was among the Member States that spent the least on COVID-19 state aid measures (less than 25% of the GDP loss).[46] With regard to the

41 More on the role of Art. 107 para. (2) point (b) of the TFEU as the legal basis for pandemic-related measures see: Rosanò, 2020, pp. 626–629.

42 Commission Decision SA.55373.

43 See: CJEU, 9 November 2022, Case T-111/21, *Ryanair v. Commission*, ECLI:EU:T:2022:699. For an analysis of other related cases see: Correia, 2022, pp. 11–22.

44 Commission Decision SA.102197.

45 See: European Commission, 2023.

46 European Commission, 2023, pp. 43–44.

type of instrument used, Croatia was among the Member States that spent the least in direct grants. Contrarily, the government showed clear preference to channel aid through guarantees and loans.[47]

2.2. State aid measures related to the war in Ukraine

As if one crisis were not enough, February 2022 witnessed the beginning of the Russian invasion of Ukraine, resulting in a brutal, still-ongoing war. Since this too caused major disruptions in the EU economy, the EC very soon adopted – similar to the above-mentioned COVID-19 framework – a Temporary Crisis Framework (hereinafter: TCF).[48] Its main goal was to specify the criteria for assessing compatibility of state aid measures (that Member States may take to remedy the economic effects following the Russian aggression against Ukraine) with the internal market and the ensuing sanctions imposed by the EU and international partners. While the TCF was amended on 20 July 2022 and on 28 October 2022, on 9 March 2023, the EC adopted a new Temporary Crisis and Transition Framework (hereinafter: TCTF).[49] The TCTF not only amends and prolongs the TCF partially, but also serves to foster support measures in sectors that are key for the transition to a net-zero economy in light of the European Green Deal.

A short overview of the Croatian state aid measures enacted under TCF and TCTF is provided as follows: (i) A EUR 1 million scheme to support maize seed producers was approved on 23 March 2022.[50] The measure was open to companies of all sizes active in the maize seed production sector affected by the price rise of electricity, animal feed, and fuel caused by the current geopolitical crisis and the related sanctions. Under this scheme, eligible beneficiaries were entitled to receive limited amounts of aid in the form of direct grants; (ii) A EUR 414 million scheme to support exporters was approved on 1 July 2022.[51] The measure took the form of (i) guarantees covering part of new eligible loans granted by commercial banks and (ii) direct grants covering the loan guarantee premiums (not exceeding EUR 400,000 per beneficiary). It was open to companies whose revenues from export activities represented at least 10% of their total income over the previous year; (iii) a EUR 500 million scheme to support companies across all sectors, except credit and financial institutions, which was approved on 7 July 2022.[52] Under this measure,

47 European Commission, 2023, pp. 40–43.

48 Communication from the Commission Temporary Crisis Framework for State Aid measures to support the economy following the aggression against Ukraine by Russia 2022/C 131 I/01, OJ C 131I, 24.3.2022, 1–17.

49 Communication from the Commission Temporary Crisis and Transition Framework for State Aid measures to support the economy following the aggression against Ukraine by Russia 2023/C 101/03, C/2023/1711, OJ C 101, 17.3.2023, 3–46.

50 Commission Decision SA.103217.

51 Commission Decision SA.103167.

52 Commission Decision SA.103003.

administered by the HBOR, limited amounts of aid or liquidity support took the form of (iiia) direct loans, (iiib) subsidised loans, or (iiic) interest rate subsidies; (iv) A EUR 437 million scheme to support companies across all sectors was approved on 23 March 2022 and amended on 20 July 2022.[53] The scheme was meant to remedy the liquidity shortage that Croatian companies were facing as a result of the serious disturbance of the economy caused by Russia's invasion of Ukraine. Under the scheme, aid took the form of (iva) direct grants covering guarantee premiums and (ivb) guarantees covering part of new loans; (v) A EUR 40 million scheme to support companies processing agricultural products was approved on 23 March 2022 (and amended on 20 July 2022 and on 28 October 2022).[54] The scheme took the form of (va) limited amounts of aid in the form of direct grants to compensate companies for the cost increase of energy sources other than natural gas and electricity and (vb) direct grants for the additional costs incurred due to severe increases in natural gas and electricity prices; (vi) A EUR 31 million scheme to support the livestock and crop production sectors was approved on 12 June 2023.[55] The scheme, which is still operational, consists of limited amounts of aid in the form of direct grants. Its purpose is to support the liquidity needs of livestock farmers and crop producers affected by the current geopolitical crisis.

2.3. RRF and state aids

Recovery and Resilience Facility (RRF) lies at the centre of the innovative fiscal architecture established by the EU in response to the pandemic-induced economic downturn.[56] More precisely, the RRF, finding its legal basis in Art. 175 para. (3) of the TFEU, is a temporary instrument through which most of the distribution envisaged by the Next Generation EU (NGEU) is channelled.[57] In short, the RRF – which entered into force on 19 February 2021 – finances reforms and investments in EU Member States on the basis of national recovery and resilience plans (hereinafter: RRPs), lay down the reforms and investments that individual Member States must implement by the end of 2026, with clear milestones and targets.[58] Croatian RRP, consisting of 146 investments and 76 reforms, which are to be supported by a total amount of EUR 6.3 billion, has been approved by the Council on 20 July 2021.[59]

53 Commission Decision SA.103558.
54 Commission Decision SA.10478.
55 Commission Decision SA.107858.
56 For an overview, see: Fromage, 2020.
57 See: Leino-Sandberg and Ruffert, 2022, p. 443.
58 See: Recital 30 of the Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility, OJ L 57, 18.2.2021, 17–75 (hereinafter: the RRF Regulation).
59 See: Council Implementing Decision of 28 July 2021 on the approval of the assessment of the recovery and resilience plan (RRP) for Croatia, ST 10687/21.

The RRF Regulation clarifies that all reforms and investments included in national RRPs must comply with the relevant EU state aid rules and follow all state aid procedures.[60] The Commission published a document containing practical guidance for the swift implementation of RRF-related state aid notifications,[61] as well as a number of state aid guiding templates to assist Member States in the design of their RRPs.[62] In this regard, the Croatian RRP makes it clear that a number of projects will be assessed in the light of the EU state aid rules and, subject to this preliminary assessment, they will be notified to the EC. So far, only three decisions, all positive, have been adopted: (i) A EUR 101.4 million Next Generation Network (NGN) Broadband plan, aiming to provide fast Internet access to places where it is currently not available, particularly rural areas, was approved on 10 December 2021.[63] The scheme funds new infrastructure, mainly through the European Regional Development Fund and partly through national funds. While the network remains in public ownership, a public undertaking (OiV) will offer long-term leasing agreements for the infrastructure to all interested operators; (ii) A EUR 783 million scheme to support the production of electricity from renewable energy sources was approved on 9 December 2021.[64] Under this scheme, aid will take the form of a premium higher than the electricity market price, and the beneficiaries will be selected through tenders, for a period of 12 years; (iii) A EUR 54 million scheme to support investments in logistics and distribution centres for fruits and vegetables was approved on 21 April 2022.[65] The aim of the scheme is to support producer organisations in the fruit and vegetables sector to invest in building and equipping logistics and distribution centres to improve the competitiveness of the sector. Under this scheme, support is in the form of direct grants.

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3. Fiscal state aid

The power to tax is at the core of the concept of state sovereignty.[66] Indeed, taxation may be deemed an attribute of sovereignty without which no sovereignty can be called as such.[67] However, in the context of the EU, it is by now well established

60 Recital 8 of the RRF Regulation.
61 See: European Commission, 2021.
62 See: *Recovery and resilience facility (RRF) guiding templates* [Online]. Available at: https://competition-policy.ec.europa.eu/state-aid/legislation/rrf-guiding-templates_en (Accessed: 10 June 2023).
63 Commission Decision SA.41065.
64 Commission Decision SA.57089.
65 Commission Decision SA.101504.
66 See: Gadžo, 2018, pp. 42–45; Christians, 2009, pp. 104–106.
67 See: Separate Opinion by Judge M. Séfériadès in PCIJ, 8 October 1937, *Lighthouses in Crete and Samos*, PCIJ Series A/B. No 71, p. 136.

that Member States may exercise their taxing powers only within the limitations posed by the EU law.[68] In the last decade or so, the EU state aid law was particularly effective in restraining the fiscal sovereignty of Member States, as evidenced by the volume of negative decisions of the Commission and cases appearing before the CJEU.[69] While a more detailed overview of the interaction between tax measures and the EU state aid law falls outside the ambit of this chapter, it should be emphasised that the broad definition of state aid under Art. 107 para. (1) of the TFEU necessarily calls for the scrutiny of a variety of national tax law provisions and their application in practice. This is particularly necessary in the case of so-called tax expenditures, that is, provisions by virtue of which a state fails to collect a part of tax revenue that it is normally entitled to collect.[70] In practice – as affirmed by the CJEU on multiple occasions – the crux of applying state aid rules to domestic tax measures is the criterion of selectivity.[71] In this regard, the EC and the CJEU rely on a three-step derogation test to evaluate whether a tax scheme is selective.[72] A further point of contention is regarding the role of tax rulings, that is, binding statements of the tax authority's interpretation and future application of tax laws to a taxpayer's arrangement.[73] These individual administrative acts may confer selective advantage to their addressees, thus violating the EU state aid law.[74]

Regarding the Croatian tax system, interestingly, tax advantages have never been a prominent instrument of state aid. As already noted above, in the period preceding the signing of the SAA, direct grants dominated in the overall structure of state aid in Croatia. More recently, guarantees and loan subsidies have played a prominent role, along with direct grants.[75] In comparison to other Member States, Croatia relies much less on tax advantages as aid instruments: during 2019-2021, the respective shares of tax advantages in the total state aid expenditure were 8.6% (2019), 7.9% (2020), and 7.4% (2021).[76] Again, one should not underestimate the role of EU accession negotiations in this regard. It was during the accession period that the Croatian tax law framework was scrutinised from the perspective of the EU State aid *acquis*. Accordingly, the Croatian authorities committed to amend certain tax incentives that were identified as problematic by the EC, such as schemes related to

68 See: Terra and Wattel, 2012, p. 1.
69 See: Luja, 2016, p. 324.
70 Luja, 2003, pp. 8–10.
71 See: Luja, 2016, pp. 315–319.
72 See: Micheau, 2011, pp. 201–204.
73 See: Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union C(2016) 2946, OJ C 262, 19.7.2016, 1–50, paras. 169–174.
74 For an overview see: for example, Mason, 2017.
75 See: European Commission, 2023.
76 As stated in the yearly reports on state aids compiled by the Croatian Ministry of Finance. See: *Godišnja izvješća o državnim potporama* [Online]. Available at: https://mfin.gov.hr/istaknute-teme/koncesije-i-drzavne-potpore/drzavne-potpore/godisnja-izvjesca-o-drzavnim-potporama/464 (Accessed: 02 June 2023).

the 'free zones' and disadvantaged regions.[77] Further developments in the EU state aid law were taken into consideration during the process of drafting tax incentive schemes currently found in the Croatian tax system.

One example is the 'tonnage tax' regime, introduced by virtue of the 2011 amendments to the Maritime Code (*Pomorski zakonik*).[78] This scheme aimed to stimulate the domestic shipping industry. Put simply, qualifying taxpayers (i.e. companies engaged in shipping business registered in Croatia or having their place of management therein) may, upon their own request, be exempt from the general corporate income tax system and instead pay a lump-sum tax determined by reference to the total tonnage of the vessels they have in operation. While a more in-depth analysis of this regime is beyond the scope of this chapter, it is important to note that its design was heavily influenced by the EU *acquis* on state aids to the shipping industry.[79] In 2021, the amount of aid granted via this preferential tax regime was estimated at just above EUR 1 million, with only three beneficiary companies.[80]

Regarding the tax incentive for research and development (R&D) – which is, notably, one of the desired horizontal goals of the national state aid policy (see Section 1. above) – in 2018, Croatia introduced a special scheme by virtue of the Act on State Aid for Research and Development (*Zakon o državnoj potpori za istraživačko – razvojne projekte*). It is a horizontal scheme involving a tax allowance or a super deduction for enterprises engaged in R&D activities.[81] It is available to all corporate and individual taxpayers, and the level of allowance depends on the type of research conducted, with SMEs getting more beneficial treatment in some cases. Monetary ceilings for maximum aid available are outlined. Most importantly, for the purposes of this chapter, this R&D tax incentive was designed in line with the provisions of the EU General Block Exemption Regulation (GBER).[82] Interestingly, even the government acknowledges that the effects of this scheme have been underwhelming. In other words, from February 2019 to January 2021, only 55 requests have been granted for such aid. The procedure of approval has proven to be very slow and takes up to six months from the time of the taxpayer's initial request.[83] Hence, a comprehensive reform of this scheme is planned within the framework of the Croatian RRP (see: Section 2.3. above). The expenditure for this scheme amounted to EUR 7.7 million in 2019, EUR 7.2 million in 2020, and EUR 2.5 million in 2021.[84]

77 See: European Commission, 2007.

78 See: Ćorić, 2011.

79 See in particular: Commission Communication C(2004) 43 – Community guidelines on state aid to maritime transport, OJ C 13, 17.1.2004, 3–12. Cf. Commission Decision SA.37912.

80 See: Government of the Republic of Croatia, 2022, p. 58.

81 For an overview see: Arbutina et al., 2022, pp. 105–106.

82 See: notifications of state aid SA.51843 and SA.59979.

83 See: Government of the Republic of Croatia, 2021.

84 As stated in the yearly reports on state aids compiled by the Croatian Ministry of Finance. See: *Godišnja izvješća o državnim potporama* [Online]. Available at: https://mfin.gov.hr/istaknute-teme/koncesije-i-drzavne-potpore/drzavne-potpore/godisnja-izvjesca-o-drzavnim-potporama/464 (Accessed: 02 June 2023).

In terms of regional tax incentives, as of 1 January 2017, a preferential regime applies to corporate taxpayers engaged in business activities in the territory of the City of Vukovar, or in a municipality classified under the least-developed category according to the development index.[85] Corporate taxpayers may get either a full exemption from corporate income tax (in case of business activities in the City of Vukovar) or a 50% reduction of the statutory tax rate (in case of business activities in other qualifying municipalities), provided they have more than five employees (with a permanent contract), of which at least 50% are residents in the pertinent areas. It is important to note that this tax incentive has been introduced as a *de minimis* aid scheme.[86] Accordingly, the maximum amount of tax benefit available to a qualifying taxpayer is calculated in line with the provisions of the EU *De Minimis* Aid Regulation.[87]

4. Concluding remarks and recommendations

In the theory of public finance law, subsidies are considered a key instrument in maintaining or promoting certain economic structures or activities deemed to be in the 'public' or 'general' interest.[88] Put simply, subsidies entail a distribution of public monies in the pursuit of specific policy objectives established by the government, for example, correction of market failures, environment protection, regional development, etc. In today's 'mixed economies' of the EU, strong arguments remain for using subsidies as a particularly visible form of state intervention in the economy. The latest crises, related to the COVID-19 pandemic (2020–2023) and the war in Ukraine (February 2022–ongoing), have confirmed the importance of subsidies and their policy design.

In the context of the EU, however, important limitations to domestic legislators' subsidy policy stem from the primary EU law, particularly from the general prohibition of 'state aid' under Art. 107 para. (1) of the TFEU. Within the complex EU system of competence distribution, state aid control lies exclusively with the Commission, thus significantly restraining national spending policies of individual Member States.[89] Of course, multiple political, economic, and legal objectives underlie such erosion of 'national fiscal sovereignty': while the primary aim relates to

85 See: Art. 28a of the Profits Tax Act, Official Gazette No. 177/04, 90/05, 57/06, 146/08, 80/10, 22/12, 148/13, 143/14, 50/16, 115/16, 106/18, 121/19, 32/20, 138/20, 114/22.

86 See: Cipek, 2022, pp. 97–101.

87 Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid, OJ L 352, 24.12.2013, 1–8.

88 See: Lienhard, Mächler and Zielniewicz, 2017, p. 240; Hofman, 2016, p. 3.

89 See: Hofman, 2016, p. 5.

the creation of the internal market, one should not underestimate the role of the EU state aid rules in enforcing certain fiscal discipline standards on national governments and improving both the quality and effectiveness of public expenditures.[90] This is in line with the basic tenets of the 'EU economic constitution', ideologically rooted in the German ordoliberal doctrine.[91]

The evolution of Croatian subsidy policy and practices in the last three decades fits well within broader discussions on the pros and cons of the EU state aid law framework as it stands today. In the first decade as an independent country (1991–2000), Croatian transition from a centrally planned socialist economy to a market-based economy has been rather painful and with underwhelming economic results. In this period, the government did not shy away from implementing interventionist policies to smooth out the effects of economic and social transformations, including via large expenditure for direct, mostly sector specific, subsidies. However, the effectiveness of these subsidies has been questioned mainly owing to the lack of a coherent subsidy policy, as well as a pertinent legal framework. Important changes ensued after May 2001 and the signing of the SAA. During this 'accession stage', which lasted until 1 July 2013, the Croatian legal framework had to be aligned with the EU *acquis*, entailing, *inter alia*, a complete overhaul in the area of state aids and subsidies. The legal requirements to be met during the accession negotiations necessarily led to a change in Croatian policy-makers' approach toward direct and indirect subsidies. This is confirmed by analysing the national state aid policy guidelines that have been enacted on a yearly basis by the government since 2013. Put simply, Croatian policy-makers are rather firm in their adherence to the general aims of the EU state aid policy. More specifically, the main goal of Croatian state aid policy has traditionally been to increase the share of horizonal aids in the total aid expenditure, at the expense of sectoral aids. The limitations of state fiscal sovereignty imposed at a supranational level have, at least in this regard, played a positive role.

From a purely legal standpoint, Croatian state aid practice in the post-accession period exhibited a remarkable degree of compliance with the EU law. Notably, till date, no negative decisions have been issued by the EC; nor have Croatian state aid measures been successfully challenged before the CJEU. From an economic perspective, however, there is much room for improvement. Croatia still lags behind other Member States in terms of a desirable structure of state aid – with an outsized share of expenditures for sectoral aids – while at the same time having a substantial total aid expenditure relative to its GDP.

90 See: Hofman, 2016, p. 6; Luja, 2016; Butorac Malnar et al., 2021, pp. 508–509.

91 See: Biebricher, 2018, p. 3.

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