

The State Aid Requirements under the Stabilization and Accession Agreement between B&H and EU

Summary

The Stabilization and Accession Agreement for Bosnia and Herzegovina came into force on July 1, 2008, and provisions concerning State aid are part of the Interim Agreement. On July 1, 2010 Bosnia and Herzegovina made the first concrete breach of the requirement defined by a two-year transitional period in which B&H was supposed to pass legislation and establish an independent operational entity for State aid at the national level.

Bosnia and Herzegovina needs a comprehensive insight into categories, amounts and purposes of State subsidies that are granted at various levels of government in order to identify priorities, analyze the effects of State subsidies and strategically coordinate industrial and development policies of the country. Within this, competition between B&H and the EU will be preserved, meaning that State subsidies must not have a negative impact on trade with the EU.

Having in mind that the State of B&H has competence over foreign trade and that the EU wants to have a single interlocutor in B&H, an independent agency in charge of establishing an equitable control over State aid in B&H, a national Law on State Aid is to be adopted and an independent regulatory body at the national level is to be established.

Introduction

The Stabilization and Accession Agreement for Bosnia and Herzegovina came into force on July 1, 2008, and provisions concerning State aid are subject to the Interim Agreement. So on July 1, 2010 Bosnia and Herzegovina made its first official breach of obligation defined by a two-year transitional period within which B&H was supposed to pass legislation and establish an independent operational entity for State aid at the national level.

Given the fact that Euro Atlantic Integrations are the pivotal multilateral foreign policy priority of Bosnia and Herzegovina, this requires that institutions at all levels of government in B&H provide full support in fulfilling the obligations under the Stabilization and Accession Agreement. However, Bosnia and Herzegovina still faces a series of problems in meeting the requirements under SAA, which is a kind of concretization of the "Copenhagen Criteria". Thereto, market economy issues in Bosnia and Herzegovina, due to the nature of the country's establishment, tend to create political problems. This is also the case with establishing a State aid system and adopting the necessary legislation.

Having in mind the complexity of the international requirements concerning State aid and subsidies, it is important to mention that since early 2006 considerable efforts have been invested in preparing the foundations for the B&H State Aid Supervision System. The B&H Ministry of Foreign Trade and Economic Relations (MoFTER) received substantial technical support of the EU through the project of "Support to Competition and State Aid in B&H". By May 2008 progress was made in a number of very important areas related to establishment of the B&H State Aid Supervision System. This included:

- Developing of a Preliminary State Aid Inventory (PSAI) for Bosnia and Herzegovina, covering all State aid granted by some 100 different public administration bodies across the 14 different levels of government in B&H.
- Drafting a preliminary draft Law on State Aid in B&H in cooperation with MoFTER, which formed a working group for drafting final legislative solutions for introduction of the State Aid system in B&H.
- Developing a Report on provisional mapping of State aid in Bosnia and Herzegovina, which indicates, *inter alia*, how this mapping exercise is to be conducted in the future.
- Producing a draft Annual Report on State Aid in Bosnia and Herzegovina, which should serve as a methodological template for future reporting to the EU.

Finally, apart from meeting the international requirements concerning reporting on State aid, Bosnia and Herzegovina needs a comprehensive insight into categories, amounts and purposes of State subsidies that are granted at various levels of government in order to identify priorities, analyze the effects of State subsidies and strategically coordinate industrial and development policies of the country, which according to the current constitutional set-up are shared jurisdictions of the three different levels of government.

Development of the State aid system in B&H is a compulsory part of the EU integration process. The State aid system in B&H, with very similar features, is also required under the 2006 CEFTA¹ Agreement and South East European Energy Community Treaty. Accession to WTO² will also require a thorough and regular reporting on subsidies granted to industry. International reporting on State aid must become a regular annual process for B&H in the near future.

¹ Central European Free Trade Agreement

² World Trade Organization

Why is a State Aid Law so important?

The EC Treaty in Article 87 (1)³ creates a prohibition of “any aid granted by a Member State by 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 . . . insofar as it affects trade between Member States”.

In this context, disputable State aid implies an amount of EUR 200 000 or more granted to a private or public company during the period of three years or tax exemption of the same amount.

This means that there are four cumulative requirements that qualify as prohibited State aid:

- Aid granted in any form by any level of government
- Distorting or threatening to distort competition on EU market that affects trade between the Member States
- Favouring certain undertakings or the production of certain goods
- Amount of EUR 200 000 or more granted to a company within a period of three years or tax exemption of the same amount

When these four requirements are found in a certain aid granted to a company by the institution, this aid becomes a “State aid” subject to prohibition, i.e. if it really has an actual or potential impact on competition and foreign trade and if it is selective in the sense that it creates an advantage by favouring certain undertakings or the production of certain goods.

So far, the responsible institutions have neither taken into consideration documents already prepared nor have they finalized their work on drafting the Law on the State Aid System and establishing an independent regulatory body. To the contrary, the Entity of Republika Srpska adopted its entity legislation on State aid which is not complementary to EU provisions, while at the same time opposing adoption of the national State Aid Law and the establishing of a national State aid institution. The reasons for this are the two completely opposing opinions. In the opinion of Republika Srpska the matter of State aid is within the exclusive jurisdiction of the entities because according to the Constitution the entities have jurisdiction over economic policy, taxes and economic development and in their budgets they have funds for subsidies, unlike the State of B&H, which has neither jurisdiction nor funds for this purpose. The budget of the State of B&H is in fact the budget of the institutions and international obligations. In other words, it covers the costs of administration and loan repayments and it does not have any investment or development component. Accordingly, the institutions in charge of State aid control should be established at the entity, not the national level.

The opinion of local and international legal and economic experts in the area of State aid is in conformity with provisions of Article 71 of SAA and the definition of State aid, which includes any form of aid that distorts competition and trade between EU Member States, i.e. in the case of B&H, a potential candidate and EU Member States. It is not the source of aid that is relevant, but the element of distortion of competition in foreign trade. Having in mind that the State of B&H has jurisdiction over foreign trade and that the EU wants to have a single interlocutor in B&H, there is to be an independent agency in charge of establishing an equitable control over State aid in B&H, a national law on State Aid is to be adopted and an independent regulatory body at the national level is to be established.

State Aid Projections in B&H

Data collected through EU funded project of technical assistance for the period 2004-2006 suggest that B&H State aid represented 1.5% of GDP in 2004, increasing to 1.8% in 2005 and 2% in 2006. Deducting the aid for the agriculture, fishery and transport sectors, the ratios of overall aid in GDP were 0.63% in 2004, 0.85% in 2005 and 0.88% in 2006. These figures are realistic when compared to the general benchmark of an average State aid and GDP ratio in EU of 0.4 % in the period of 2004-2005 (excluding agriculture, fishery and transport).

At the time, grants were the main instruments for distribution of State aid in B&H, followed by loans. Although there were other State aid instruments available, their participation in State aid was insignificant.

Observing the pattern of aid distribution, the amount of horizontal aid (beneficial to all commercial sectors) granted over the three-year period was fairly low. The share of horizontal aid fluctuated between 25-30% of the total amount of State aid distributed in the period 2004-2006.

Some 70-75% of total aid was directed to support specific sectors (sectoral aid, incl. agriculture) or individual companies (ad-hoc aid). This was in contrast to the EU trend, where horizontal aid was much more dominant. On the other hand, over 90% of the aid granted was below *de minimis* threshold of EUR 200.000. This means that State aid granted by the B&H institutions at that time generally did not fall under the qualification of prohibited State aid.

Having these data in mind, it is important not to create the B&H State Aid System as particularly restrictive, in a sense to strangle the need for new initiatives for economic development policy in the future – especially before the expiry of the 2015 deadline, until which time all amounts of State aid granted in B&H are allowable because B&H is considered a particularly underdeveloped country and as a potential candidate for EU membership. Nevertheless, implementation of the obligations under Article 71 of the SAA are to be continued without any further delay.

³ Save as otherwise provided in this Treaty, 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.

SAA requirements concerning State Aid

In short, the main provisions of Article 71 of the Stabilization and Accession Agreement between Bosnia and Herzegovina and the European Union concerning State aid can be summarized as follows:

Any state aid which distorts or threatens to distort competition by favouring certain undertakings or certain products is incompatible with the SAA insofar as such state aid may affect trade between the EU and B&H;

Any state aid under Article 71 shall be assessed based on criteria arising from the application of Article 87 of the EC Treaty and the imperative instruments adopted by the European Commission for the application of Article 87 of the Treaty;

B&H should establish an independent operational body (by July 1, 2010) to apply the State aid rules in B&H from 2011 with the power to authorize the granting of State aid and, if necessary, to order the recovery of illegally granted State aid;

Both the EU and B&H should regularly report their State aid situation to one another;

A comprehensive inventory of existing State aid in B&H is to be established before the competent body is established (this was to be done by 2010). This body, which should be in charge of control and approximation of such aid with EU norms, should start operating by 2012;

B&H is classified as a considerably underdeveloped country, and as such it is eligible to apply minimal limitations in terms of the intensity of State aid up to 2015;

Bosnia and Herzegovina and the European Commission should undertake mapping of State aid by 2014 in order to assess the need for different State aid maximum limits in different parts of Bosnia and Herzegovina before expiration of the status of a considerably underdeveloped country;

A special five-year transitional period is allowed for the steel sector in B&H for the State aid focused on any necessary additional restructuring of the industry (Protocol 4 of SAA).

Steps to be undertaken in accordance with the Interim Agreement

Establishing an Inventory is only the first step in the developing of a State aid system. The process of developing a national State aid system primarily requires an internal assessment of national (government) actions focused on supporting economic activities. In the terminology of EU integrations this is known as a State Aid Inventory. The inventory sets the foundation for review, monitoring and international reporting. It thus provides the baseline data for development of a State aid system.

The next step involves development of a monitoring system to track changes in the baseline inventory over the coming years. This requires a legal mandate for collecting all data from all levels of government in the State in one place (usually at the Ministry of Finance), so that the new support for economic activities can be entered into the Inventory.

The Inventory and the monitoring system together will enable national authorities to report to the EU and WTO on State aid and subsidies in the country. Internally, the same elements of the system will enable the Government to have insight into most of its economic policies. Only then will the Government be in a position to raise key questions about internal impacts (e.g. competition), and whether or not specific interventions could be changed or abolished in favour of greater value for money and real results of economic development.

A third process in development of a EU compatible State aid system is referred to as "State Aid Mapping". The idea behind this process is to have the institutions in charge of State aid agreeing, at certain points in the course of the system development, that some areas of the country are more developed than others. Accordingly, the maximum amounts of certain types of State aid should be granted to particularly underdeveloped parts of the country, while lower amounts should be granted to those areas in which economic disadvantages are less compelling.

The final stage in development of a State aid system is introduction of the State aid measures control. At this stage it is expected that a fully operational State aid control should be in place, which can be tested considerably before accession to the EU. In general, State Aid legislation should ensure that:

- International rules are not infringed (whether or not applied in this phase);
- State aid and subsidies do not unduly impact competition on the national market;
- Excessive measures of state intervention are examined and, if necessary, changed;
- Economic policies are in line with best international practice and actually achieve their intended results.

There to a parallel process of education and awareness raising is needed in order to:

- explain the logic behind the EU State aid and pre-accession requirements;

- avoid delays in adoption of necessary legislation;
- ensure a group of trained officials who have understanding of future legal requirements and the system in which they will have to execute their tasks;
- eliminate fears concerning future functioning of the system; and
- demonstrate the future benefits of the system for the State.

Co-ordination and involvement across different fields of economic policy in B&H and different levels of government, even if in the same field of economic activity, will also be a particular challenge for a small country such as B&H.

Recommendations:

Preliminary draft Law on State Aid in B&H, drafted in the course of EU-funded technical assistance project and in collaboration with MoFTER should be adopted with possible technical changes that would not distort the concept of State aid by the end of the first half of 2011.

The B&H Council of Ministers should adopt a Preliminary State Aid Inventory for B&H, covering all State aid granted by some 100 different public administration bodies across the 14 different levels of government in B&H in the period 2004-2006. Once this done, a new Inventory for the period 2007-2010 should be produced.

The Coordination Committee for Economic Development and European Integrations should adopt a model report on preliminary State Aid Mapping in Bosnia and Herzegovina and propose that the Council of Ministers in cooperation with the Entity governments and Government of Brcko District should start preparing a study on State Aid Mapping in line with the deadlines from SAA.

The Coordination Committee for Economic Development and European Integrations should examine and propose that the B&H Council of Ministers should adopt the annual Report on State Aid in B&H, which was produced by the EU-funded Technical Assistance project in cooperation with local institutions based on a Preliminary Inventory. The Council of Ministers should pass the adopted annual Report on State aid in B&H to European Commission, thus fulfilling its reporting obligation under the Stabilization and Accession Agreement. The fact that this report would cover the period of 2004-2006 should not be a problem, given that Bulgaria submitted its 2004 State Aid Report only in 2007 and EC accepted it.

Based on adopted Law, the B&H Council of Ministers should establish an independent body for State aid control, which is to be responsible for deciding on recovery of unlawfully granted State supports when the time comes pursuant to deadlines from SAA. This also implies that appointment of a director and defining of job positions in the newly established institution should be completed by the end of 2011.

The B&H Council of Ministers should apply with the European Commission for funding under IPA funds for technical support projects aimed at supporting the development of a State aid system. EU experts could assist B&H institutions in drafting relevant by-laws and handling first cases of law infringements.

Bosnia and Herzegovina should take advantage of establishing a State aid system to acquire comprehensive insight into categories, amounts and purposes of State aid granted at different levels of government in order to identify priorities, make analysis of State aid effects and strategically coordinate the industry and development policies of the country.

National State Aid Systems outside the EU first appeared in the 1990s under the European Agreements concluded with most of the candidate countries that applied for membership. The key idea was to familiarize those countries and to get them used to the State aid regime, especially its reporting requirements, so that the EC could launch the State aid control immediately upon accession to EU. However, in the case of the Western Balkan countries establishing of operational State aid control is required prior to membership, while upon full membership in the EU, the authority to approve State aid shall be transferred to the European Commission, i.e. DG for Competition. The general idea is to have the EU opening free trade arrangements only with those countries that can provide an assurance that their companies will receive adequate subsidies to cope with the competition of EU companies.

About FPI BH:

The Foreign Policy Initiative BH (FPI BH; www.vpi.ba) is a BiH, nongovernmental and non-profit organization founded in Sarajevo in 2004, which is dedicated to analysing international relations and Euro-Atlantic integration processes of BiH. The goal of the FPI BH is to offer assistance to state institutions in removing weaknesses and promoting values present in those processes in order to increase the efficiency of BiH institutions in fulfilling the upcoming obligations.