Ten Years after Accession: State Aid in Eastern Europe

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In the early phase of transition that started with the 1990s, Central and Eastern European Countries (CEEC) have pursued far-reaching vertical and individual industrial policy with a focus on privatisation and restructuring of traditional industries. Foreign investment from the West and the facilitation of the development of a market economy also involved massive injections of State support. With their accession to the European Union (EU), levels and forms of State aid came under critical review by the European Commission. Now that a first decade has passed since the first Eastern enlargement in 2004, this inquiry investigates how State aid policy in the CEECs has developed during the last ten years and whether the integration of the new Member States operates on a level playing field with respect to State aid. The findings suggest that once having entered the EU as full members, the new members from the East appear to have been converging into rather stringent competition cultures.

I. Introduction

In the early 1990s and towards the start of the transition phase, Central and Eastern European countries (CEECs)[1] relied upon public sector outlays to promote industrial restructuring. State aid included e.g. tax incentives for investors, the establishment of special economic zones, with the additional aim to support inflows of foreign investments from the West. Since 2004, eleven CEECs joined the EU in three waves of enlargement. Membership in the European Union (EU) provided further access to structural funds, but at the same time accession countries were also obliged to adopt and enforce the *acquis communautaire* and thus had to comply with European State aid rules. The integration of the new Member States has come under critical review by the European Commission and their government support in the form of the many kinds of State aid that countries may use or have been using.

An earlier analysis[2] reveals that the effectiveness of implementation of competition law and policy in general and the intensity of competition do appear to run lower for CEECs compared to the EU-15 countries. The inquiry presented here aims to clarify whether this comparatively lower level of performance goes hand in hand with State aid being granted more generously (with less supervision, scrutiny, and lower levels of accountability) in the CEECs. *Röller* and *Hirschhausen* expected major implications regarding the assessment of State aid measures in former socialist countries, having in mind the experience from East Germany.[3] CEECs also have a strong tradition of government intervention resulting from the planned economy system. Even at the dawn of EU accession, their level of public support to certain industries and individual firms was significantly higher than in the EU-15 Member States. Three years after the 2004 accession with ten new members joining, a study by *Hashi et al.* found that "the general philosophy [regarding State aid policies, own additions] does not appear to have changed fundamen-

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1 In the context of this article, Central and Eastern European countries are the following ten Member States of the European Union which joined in the first and second Eastern enlargement waves: Bulgaria, the Czech Republic, Hungary, Estonia, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia. Croatia as the most recent Member State is also subject to this study but displayed seperately.

2 *Hölscher/Stephan*, Competition and Antitrust Policy in the Enlarged European Union: A Level Playing Field? *J.C.M.S.* 2009, 47(4), pp. 863-889.

3 *Röller/v. Hirschhausen*, State Aid, Industrial Restructuring and Privatization in the New German Länder: Competition Policy with Case Studies of the Shipbuilding and Synthetic Fibres Industries, Discussion Paper FS IV 96-13, 1996 WZB Berlin.

tally since the accession".[4] The authors inquire whether government intervention in the form of State aid influenced industrial competitiveness, and find that competitiveness is not improved by State aid policies. Rather, competitiveness is driven by firms' own efforts.

Since 2004, eleven CEECs joined the EU in three waves of enlargment. Thus, the first decade has passed since the first Eastern enlargement with eight new Member States from Central and Eastern Europe.[5] The aim of this study is to assess whether industrial policies before and after accession were considerably more pronounced in the East to thereby challenge the European State aid regime or whether the alleged lax enforcement in the new Member States is a myth. The analysis hence reviews how State aid policy in the CEECs has developed after accession.

Following the first introductory chapter, section two places State aid into the context of EU competition policy, whereas section three broaches the issue of CEECs industrial policies. This section further provides stylised facts of State aid in a comparative perspective providing an overview of the development of a competition culture comparing the 'old' EU-15 with the new Member Countries. This quantitative analysis is based on a careful evaluation of statistics and data provided by the European Commission and national authorities. Section four discusses State aid practice in the Member States with a focus on the different types of aid and whether the aid conforms to the strategy of less but better aid. Section five evaluates the adequacy of current procedures with a view on a level playing field for doing business in the European Union. Finally, the developments of the European shipbuilding industry are presented by analysing exemplary cases in which State aid delivered to shipyards in the West and East was declared unlawful. This delivers a concincingly clear pricture of the effectiveness of State aid control in the EU Members of the East.

II. State Aid Law in the European Union

Since its enactment in 1958, the EC Treaty always contained rules regulating industrial policy and the provision of State aid. The primary function of such a control is to ensure a free competition between enterprises from different Member States on the common market. In general, State aid is prohibited if the aid measure is granted through State resources and if it could distort competition in the internal market. However, there are also exemptions from the prohibition with a view to balance competition and trade considerations against the wider objectives of the EU (e.g. economic and social cohesion). The general block exemption regulation (GBER[6]), which was introduced in 2008, is a case in point by relaxing the rules where aid measures address horizontal objectives (e.g. aid for research and development (R&D), environmental aid).[7]

The power of State aid regulation in the EU is firmly allocated to the European Commission's Directorate General Competition. All State aid measures have to be notified to the Commission and can only be put into effect after having been authorised by the EU. Where the Commission regards a measure as not compatible with State aid rules, it will come to a negative decision. Firms that already received aid without EU consent may be liable to paying it back, if the aid proves illegal and incompatible.

In 2005, the Commission published a so-called State aid Action Plan (SAAP[8]) with the objective of 'less and better targeted State aid'. Its objective was to encourage Member States to reduce their overall volumes of State aid, whilst redirecting State aid resources towards objectives with a clear community interest. The attitudes towards State aid were influenced by the Lisbon Agenda, with the Council of Ministers taking a growing interest in the scale and efficiency of government intervention. This is pronounced in the objective of 'less aid, but better'.[9]

4 *Hashi/Hajdukovic/Luci*, Can Government Policy Influence Industrial Competitiveness? Evidence from Poland, Hungary and the Czech Republic. in: Hashi/Welfens/Wziatek-Kubiak (eds), Industrial Competitiveness and Restructuring in Enlarged Europe. How Accession Countries Catch Up and Integrate in the European Union, Palgrave Macmillan, 2007, p. 51.

5 Malta and Cyprus also joined the EU in 2004 but are not subject of this study as these two countries have no history as centrally planned economy. Bulgaria and Romania joined the EU in 2007, and the most recent Member State, Croatia, just joined the EU in 2013.

6 Regulation 800/2008, OJ 2008 L 214/3.

7 This contribution will not analyse the usefulness or consistency of the GBER. Such an analysis would not contribute to the objectives targeted here, because these rules apply both to East and West to the same extent. Whether they had been applied more or less in East or West is of interest here.

8 See Commission Press Release No. 680/05, 7 June 2005.

9 *Wishlade*, EU State Aid Control, in: Clarke/Morgan (eds): New Developments in UK and EU Competition Policy, Edward Elgar, 2006, at p. 233.

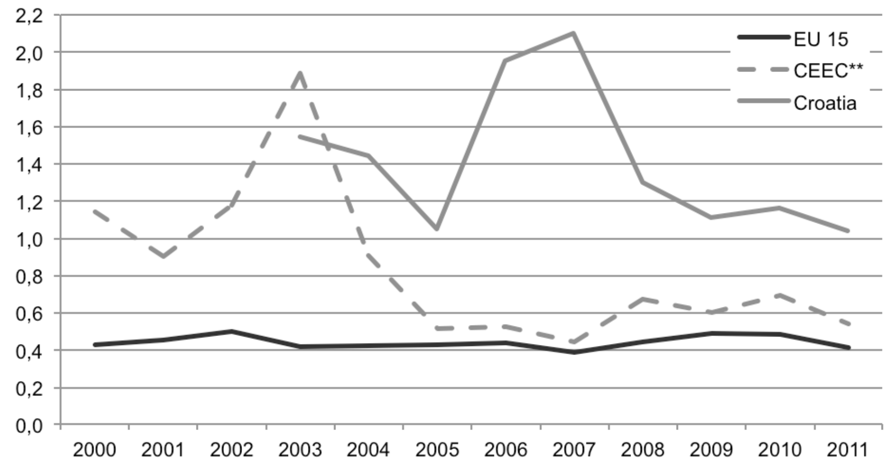

Figure 1: Total State aid, 2000–2011*
** Less agriculture, fisheries and transport, as % of GDP (excluding crisis measures).*
*** CEEC includes Bulgaria and Romania from 2002 onwards only.*
Source: State Aid Scoreboard, Autumn 2011; Annual Report 2011 by the Croatian Competition Agency.

Thus, the notation of 'better aid' comprises public support directed at projects focusing on R&D, environmental issues or support for small and medium-sized enterprises (SME).

Even though the amount of State aid in Europe has steadily declined over recent decades, the level of State aid in some Member States is still considerable. In some cases, State aid is not even well targeted at the Lisbon objectives and hence may threaten a level playing field in the European common market.

III. State aid in Central and Eastern Europe

In the East European centrally planned economies, State aid had been an essential instrument: budgetary subsidies were necessary to compensate firms for the losses incurred by producing under a distorted price system. At the beginning of the transition period, these subsidies were reduced in line with price liberalization. However, the decline of budgetary subsidies was paralleled by the emergence of a series of indirect and less transparent forms of State support to inefficient firms and sectors; State aid has become an important instrument during the process of economic transformation in most CEECs.[10] In these times, governments supported enterprises with massive injections of State aid.[11] Yet, the bulk was not connected to any long-term development policy but to rescuing enterprises in difficulty in order to 'speed up the adjustment process and rescue as many enterprises as possible'. This was motivated to a large extent by political and electoral considerations.[12] Rescue and restructuring policies of the early transition period may be described as unplanned, reactive and non transparent and had a strong 'crisis management' feature: "[o]pen and hidden subsidies flowed to some enterprises and sectors even when it was established that many of them had no future in a competitive market economy and had to exit anyway."[13] Thus, there has been a tremendous misfit between post-communist State aid practices and the State aid policy of the European Union[14] with its subsequent equally tremendous need for adjustment of State aid rules according to the *acquis communautaire* in the pre-accession period.

10 *Atanasiu*, State Aid in Central and Eastern Europe, *W.Comp.* 2001, 24(2), at p. 263 et seq.

11 *Hashi*, The Comparative Analysis of State Aid and Government Policy in Poland, Hungary and the Czech Republic, 2004, Center for Social and Economic Research, Working Paper.

12 *Hashi*, *op.cit.*

13 *Hashi*, *op.cit.*, at p. 3.

14 *Blauberger*, European State Aid Control in the New Member States – The Examples of Poland and the Czech Republic, Paper prepared for the EUSA Tenth Biennial Conference, Montreal 17–18 May 2007.

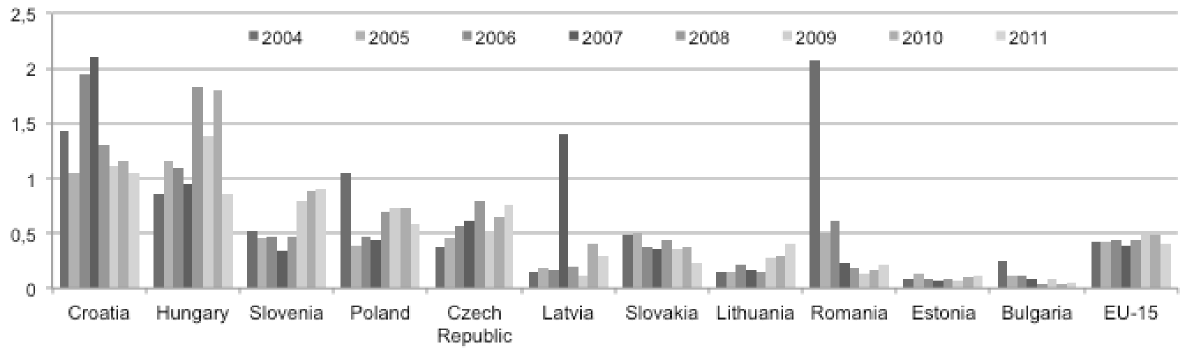

Figure 2: Total State aid for CEECs, 2004–2011*
** Less agriculture, fisheries and transport, as % of GDP.*
Source: State Aid Scoreboard, Autumn 2009; Annual Report 2011 by the Croatian Competition Agency.

This policy change was initiated with the beginning of the accession negotiations with the EU. The CEEC's commitment to adapt national State aid policies according to European rules dates back to the entry into force of the Europe Agreements.

The Europe Agreements contained State aid provisions closely following the model of the EC Treaty (general ban), which instructed the CEECs to eliminate State aid if it distorted trade with the EU and to make their State aid expenditures transparent.[15] Prior to their accession, all CEECs adopted national State aid legislation and established national competition authorities since the Commission was not authorized to decide on State aid issues until accession of the CEECs. Those national State aid rules and enforcement authorities served as a learning and test arena for the time after EU accession: 'Harmonisation in this context takes on a specific character, one that is more about learning to play the game than about borrowing rules'.[16] Still, this did not necessarily result in a competition culture already comparable to the old EU Member States. In fact, the amount of State aid granted in the CEECs exceeded the intensity that was common amongst the EU-15 Member States: in the year 2000, total State aid amounted to some 1.1 % of GDP (measured in purchasing power standard) amongst the CEECs against only 0.4 % amongst the EU-15 (Figure 1). The gap even increased until 2003, peaking at 1.9 % versus 0.4 % in the West. In the following years, the aid level among the CEECs converged to West European levels, even if it still remains somewhat higher (0.5 % in 2011) than in the EU-15 countries (0.4 % in 2011). In the youngest Member State, Croatia, this peculiar development is mirrored with a three year delay, but the amount of State aid relative to GDP still remains twice as large as in the other CEECs. The following years will show whether EU accession will bring substantial changes in the level of State aid in Croatia, as observed among most CEECs.[17]

There are other important variations between CEECs regarding State aid levels: Croatia, Hungary, the Czech Republic, Slovakia, Poland, and Slovenia are at the higher end of the spectrum, whilst Estonia, Bulgaria, and Lithuania offer much less aid to their industries (Figure 2): CEECs are not at all homogeneous in this respect.

These differences may already raise the preliminary expectation that State aid policy in some CEEC Member States is, in general, more lenient than in the West. Institution-building, importance attached to FDI with the expectation of international technology transfer, the apparent difficulties in negotiations with the EU over the acquis communautaire, and a playing field with respect to competition policy slightly tilted towards the East[18] all serve to nourish this assumption. Further, the intensity of use of State aid in industrial policy will in general tend to be more pro-active in economies with larger productivity

15 *Atanasiu*, *op.cit.*, at p. 259.

16 *Cremona*, State Aid Control: Substance and Procedures in the Europe Agreements and the Stabilisation and Association Agreements, *E.L.J.* (2003) 9(3), at p. 287.

17 See *Kesner-Skreb*, What will happen to state aid in Croatia after EU accession?, Institute of Public Finance Zagreb, No. 70-2012.

18 *Hölscher/Stephan*, *op.cit.* and *Hölscher/Stephan*, Competition policy in Central Eastern Europe in the light of EU accession, *J.C.M.S.*, 2004, 42(2), pp. 321-345.

gaps, lower sectoral diversity or adjustment to international division of labour and structural flexibility in general. Whilst this comparative issue is rather underrepresented in the literature,[19] and no clear answer can be given so far, the compliance literature in other policy-fields does maybe surprisingly suggest that there is no significant lag in institutional enforcement amongst the CEECs: they find a good pattern of transposition of EU law into national law in the four investigated CEECs but rather flawed enforcement (which incidentally could also be observed in two old Member States, namely Italy and Ireland).[20]

On the other side, evaluations of innovation policies in CEECs suggest that their emergence after EU accession largely followed the same pattern as in Western Europe (the countries do generate very good basic research, alas they lack positive results in terms of commercialisation of research results or inventions).[21] Furthermore, the application of instruments even produced a much stronger horizontal bias than was common in Western Europe at the same time. This may be attributed both to the way that policy makers in the East apparently understood EU State aid regulations,[22] and to a general neo-liberal perspective and macro-policy bias of policy makers during the early 2000s.[23] Both interpretations tend to suggest a tendency towards a level playing field. Yet, this issue remains undecided, and it is the task of the following sections to test this by providing a quantitative overview and by way of qualitative analysis. The results generated are rounded off by a review of a particularly insightful case study.

IV. State Aid Practice

In terms of the objectives of State aid, the European Commission distinguishes two broad categories: sectoral and horizontal State aid. Sectoral aid is considered to be an important instrument in the course of restructuring and privatizing State-owned enterprises.[24] State aid for horizontal objectives, i.e. not granted to a certain industry sector but to R&D or environmental projects for all industries alike, is considered as being better suited to address market failures and thus less distortive than sectoral aid and thus largely synonymous with 'well-targeted' State aid.[25] Regional aid is classified by the European Commission as 'horizontal', suggesting such aid is in line with the shift to more broadly-based objectives. However, much of regional State aid ends up in the hands of individual firms and investors.[26]

In the mid Nineties, only around 50 % of aid was granted for horizontal objectives in the old Member States. As it was one of the key Lisbon purposes to redirect State aid towards horizontal objectives, this share increased rapidly in the EU-15 countries. In the CEECs, data only exists from the year 2000 onwards: here, the share of horizontal aid decreased prior to accession. After accession, the share increased rapidly and reached a level of 50 % in 2007. Yet, the share of horizontal aid in EU-15 Member States amounts to more than 60 % since 2005 (Figure 3). The level of sectoral aid fell enormously after accession but still exeeds the EU-15 level: in 2011, CEECs spent 18 % of aid to sectoral objectives whereas in the EU-15 Member States the share of sectoral aid amounted to only 9 %. In 2011 regional aid accounted for 39 % of all aid in CEECs and 25 % among the EU-15 Member States.[27]

Disparities between East and West before accession can be explained in part by the restructuring of industries in order to reach viability and to complete privatization. Furthermore, CEECs took advantage of the transitional rules and the rules on existing aid,

19 *Blauberger*, Compliance with rules of negative integration: European state aid control in the new member states, *J.E.P.P.*, 2009, 16(7), pp. 1030–1046.

20 See e.g. *Falkner/Treib*, Three Worlds of Compliance or Four? The EU-15 Compared to New Member States, *J.C.M.S.*, 2008, 46(2), pp. 293-313.

21 See e.g. *Kattel/Reinert/Suurna*, Industrial Restructuring and Innovation Policy in Central and Eastern Europe since 1990, 2009, Working Papers in Technology Governance and Economic Dynamics No. 23, the other canon foundation, Norway and Tallinn University of Technology, at p. 25.

22 *Reid/Peter*, Sectoral Innovation Systems – The Policy Landscape in the EU-25, 2008, Final report for the project Europe Innova initiative (www.europe-innova.org) of the European Commission's Enterprise and Industry Directorate-General, Brussels.

23 See e.g. *Kattel et al.*, *op.cit.*, at p. 25)

24 *Ellison*, Competitiveness Strategies, Resource Struggles and National Interest in the New Europe, Paper prepared for the EUSA Ninth Biennial Conference, Austin 31 March-2 April 2005 at p. 26.

25 European Commission, "State Aid Scoreboard" (Autumn 2005 update), at p. 19.

26 *Ellison*, *op.cit.*, at p. 25.

27 The distinction of aid between horizontal and secoral objectives is not always exact. This holds especially for CEECs: prior to accession their national authorities were the sole source of information (e.g. aid to the national railway companies could have been reported as sectoral or, in order to act in line with EU policies, as horizontal for employment aid). Furthermore, there are concerns that not all aid was reported, especially tax and social contribution arrears (*Hashi*, *op.cit.*, at p. 12).

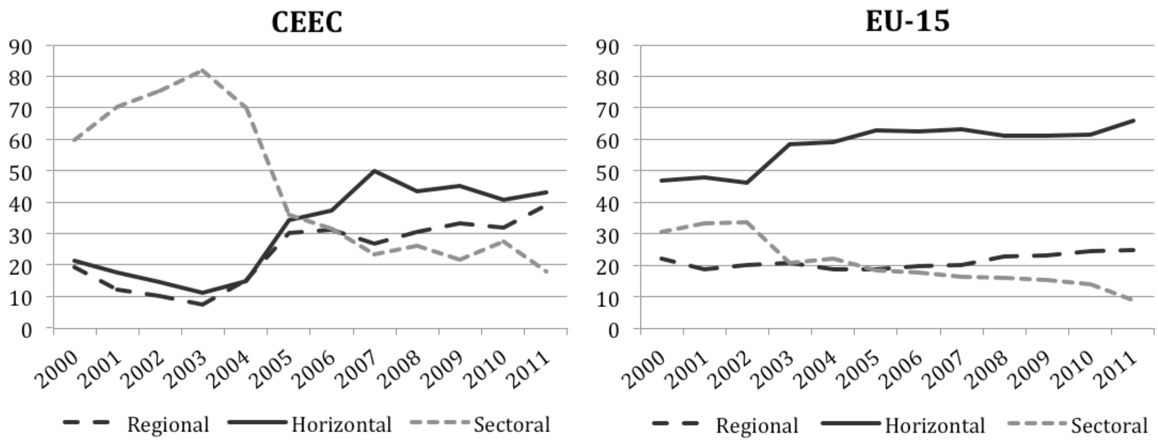

Figure 3: Share of Horizontal, Regional and Sectoral Aid in EU-15 and CEEC, 2000-2011*
** Bulgaria and Romania from 2002 onwards.*
Source: European Commission, State Aid Scoreboard, Own Calculations.

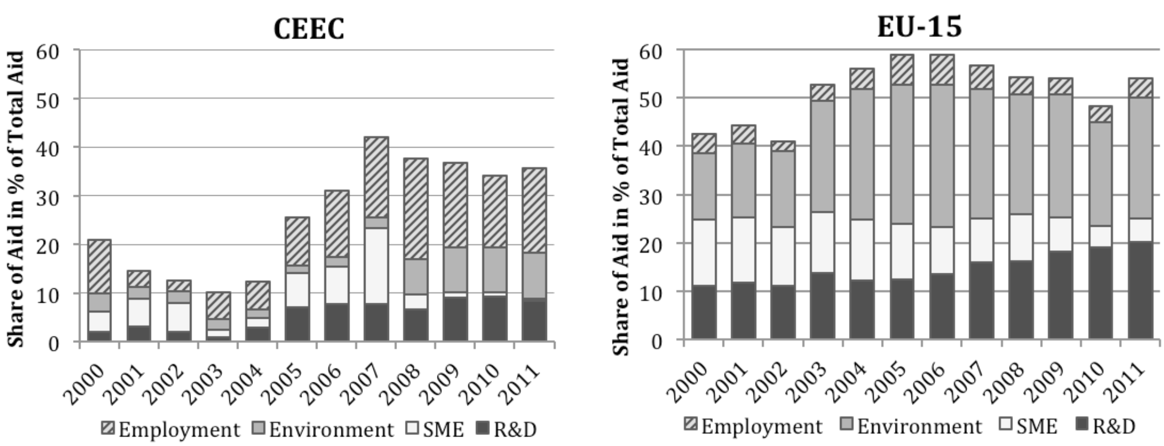

Figure 4: Distribution of Horizontal Measures in EU-15 and CEEC, 2000–2011*
Source: European Commission, State Aid Scoreboard, Own Calculations.

agreed upon in the accession negotiations. The previous more lenient treatment of State aid became more difficult after accession as the CEECs had to comply with the European State aid rules. Thus, in several Member States, the last chance for sectoral aid was exploited. After accession, the speed of adjustment of national State aid policies however differed between CEECs. Horizontal policies in general did not generate much interest in Poland as compared to other countries prior to accession. State aid in Poland had a bias on large enterprises with a share of around 60 %.[28] The Polish government seemed to give precedence to national policy goals over European State aid policy (most prominent examples include the shipyards, see case study in section six).[29] Other CEECs, as Estonia and Slovenia, reached a share of horizontal aid above 75 % already in the year 2000. The government in Estonia always spent public support solely for horizontal measures.

However, comparing the allocation of aid measures among the Member States shows that the largest differences exist between North-West and South-East Countries. Whereas the countries in Northern Europe (including the Baltic States) spend

28 *Blauberger, op.cit.*, fn. 19, at p. 163.

29 *Blauberger, op.cit.*, fn. 14, at p. 25.

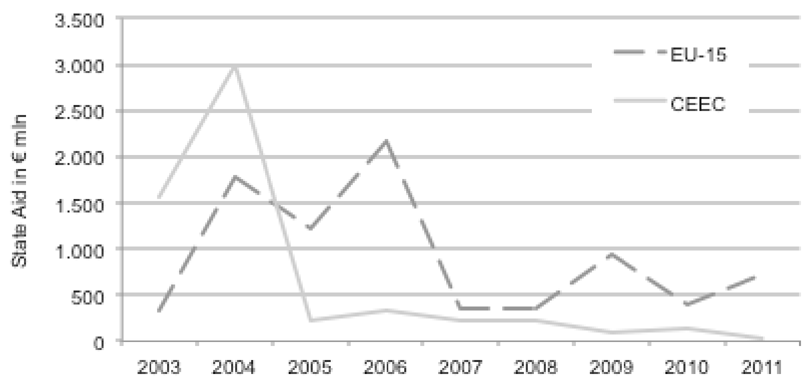

Figure 5: Rescue and Restructuring aid (R&R), in million €, 2003-2011*
** without crisis measures.*
Source: State Aid Scoreboard: Statistical Tables, Autumn 2012, Own Calculation.

nearly 100 % of all aid to horizontal measures like R&D and environmental protection, the countries of Southern Europe allocate a large proportion of aid to sectoral or regional objectives. And Croatia also seems to follow this scheme. Situated in the South-East of Europe the majority of state support (73 % in 2011) is granted to sectoral aid measures with a focus on shipbuilding and transport while horizontal aid accounts for only 15 % and regional aid for a mere 8 %.

In 2005, the Commission published a so-called State aid Action Plan (SAAP) with the objective of 'less and better targeted state aid'. It shall encourage Member States to reduce their overall State aid levels, whilst redirecting State aid resources to objectives with a clear community interest. 'Better aid' in this sense comprises public support directed at projects focusing on research and development (R&D), environmental objectives or support for small and medium-sized enterprises (SME). The share of these objectives in EU-15 Member States and CEECs is represented in Figure 4. Whereas the share of aid for R&D projects and environmental issues consistently increased among the EU-15 Member States, the largest attention in CEECs still is focused upon employment aid. Furthermore, the share of SME support programmes decreased rapidly since 2008 among CEECs. During the transition phase, SME programmes assumed a central role in all post-communist governments: the expectation was that SMEs are key players in a market economy, as they can respond quickly to market signals and thereby help to promote competitiveness.[30]

Regardless of whether the SAAP has produced any more suitable environment for the governance of State aid is of course a matter of debate, but that remains beyond our objectives here. Our interest, focussed upon a comparison between East and West has produced a clear message: the line of division does not run East-West, it appears to run North-South.

Contrary to such 'better aid', European governments regularly grant aid to individual firms in order to rescue or restructure companies in difficulties. This clearly is among the most distortive type of State aid: State aid to rescue ailing companies typically does not result in their restructuring but rather prevents market adjustments that are or will become necessary at some point, because inefficient companies are artificially kept in the market at the cost of competitive firms. Prior to accession, the level of such rescue and restructuring (R&R) aid had been high among most CEECs. *Hashi* reports that in Poland, 20 % of all aid in 2001 and even 23 % in 2002 were used for this objective.[31] And yet after accession, the level of R&R aid dropped sharply to a level even lower than among EU-15 Member States (Figure 5). Of course, one has to bear in mind that R&R aid is sometimes supposed to be reported under employment

30 OECD, Industrial Policy in OECD Countries, 1992, Annual Review.

31 *Hashi op.cit.*

Table 1: Formal Investigation Procedures in CEECs, Years 2004–2011*

	2004	2005	2006	2007	2008	2009	2010	2011	Total
State Aid Proceedings	46	113	124	80	95	103	88	41	632
No objections	9	72	115	55	72	112	92	64	591
Formal Investigations	14	06	13	7	10	9	5	1	65
Share of Formal Investigations	30%	5%	10%	9%	11%	9%	6%	2%	9%

* only procedures of DG Competition. Agriculture and Fisheries are not included.
Source: State Aid Register (Online Database). Own Calculations.

Table 2: Share of Positive and Negative Decisions, Share of Un-notified Aid, Years 2000–2011

	Positive*	Negative	Un-notified aid
EU-15	94.5%	5.5%	13.6%
CEECs	97.4%	2.6%	9.1%

* This figure includes not only "positive decisions", but also all other decisions with a positive outcome (e.g. Art. 4(3) decision not to raise objections)
Source: State Aid Register, own calculations.

schemes, e.g. in Poland in 2000: R&R aid amounted to only 7 % whereas employment aid levelled at 24 %.[32] Thus, the total amount of R&R aid might be higher. From a country perspective, in the period 2006 to 2011, Poland and Romania spent the highest amounts in attempts to rescue or restructure individual companies. Among the EU-15 Member States France, UK, and Austria had the highest levels of R&R aid.

V. Law Enforcement

Another indicator for the establishment of a level playing field in State aid is the number of decisions taken to open formal investigations on individual State aid incidences. Such in-depth investigations are started if the Commission has doubts about the compatibility of an aid measure with the objectives of the common market. A decision to open a formal investigation must already summarise the relevant issues of fact and law. It further must be preceeded by a preliminary assessment as to the aid character of the measure and set out the Commission's doubts in more detail.

The share of State aid cases, in which a preliminary assessment was followed by a formal investigation procedure, significantly fell after 2004 and in 2011 reached a mere 2 % in comparison to over 30 % in 2004 (Table 1). Yet, huge differences among the CEECs exist: whereas the share in Romania, Hungary and Poland is above average (26 %, 12 % and 10 %), other Member States were not yet confronted with a formal investigation procedure at all (Lithuania). Some of these formal investigation procedures concern State aid measures adopted before accession. Yet, although the CEECs already established State aid enforcement prior to accession the Commission had doubts as to the compatibility of certain measures.[33]

As Table 2 shows, the share of un-notified aid is lower in the case of the CEECs as compared to the old EU-15. As it can be assumed that the EU Commission and not least competitors will keep a close eye on State aid granted, this does indicate that the governments in CEECs play by the rules. This is mirrored in the share of negative decisions, which is also lower in CEECs than in the EU-15 countries (2.6 % compared to 5.5 %).

We should not expect the EU Commission to take a more permissibly stance towards State aid in the CEECs: since accession, DG Competition released 17 negative decisions[34] regarding State aid measures in CEECs. Thereof, 10 cases required recovery of unlawful aid. The 17 decisions concerned aid measures in Poland (6), Hungary (6), Slovakia (3), Bulgaria (1) and

32 *Hashi*, *op.cit.*, at p. 16.

33 *Kuik*, State Aid and the 2004 Accession. Overview of Recent Developments, EStAL 2004, 3(3) pp. 365-373.

34 The observation period ended on 31/12/2011.

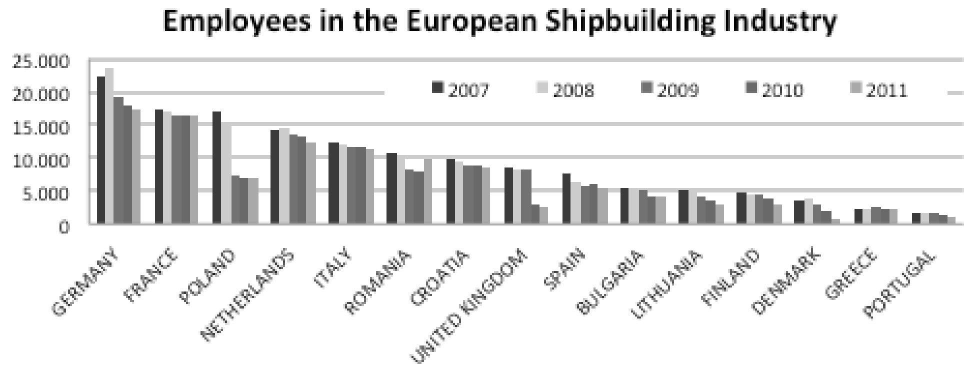

Figure 6: The European shipbuilding industry
Source: CESA Annual Report 2011/2012, Own Presentation.

Romania (1). Most of these cases concern the restructuring of companies (8) or sectoral development (3), both objectives which are assumed to cause most distortionary effects on competition.

The following section will discuss in more detail selected State aid cases in the shipbuilding industry. The latter has gone through major structural changes during the past decades. Increasing competition from Asia forced the European industry to enormous adjustments regarding the number of employees and the strategy of each shipyard. During that time many European Governments supported their shipbuilding industry with massive State injections. Thus, many of these measures were subject to State aid proceedings by the European Commission and will be subject in the next chapter.

VI. The European Shipbuilding Industry

For the last couple of years, the European shipbuilding industry had to cope with fierce competition mainly from Asian shipyards. The industry boomed at the end of the nineties and at the beginning of the new millenium which made the shipbuilding industry attractive for new entrants mainly from Asia. In South Korea and China several new shipyards opened doors. However, at the end of 2008, the financial markets collapsed, also affecting the entire maritime sector. The European shipbuilding industry has lost more than 25 % of its employees since 2007 (Figure 6). The largest number of lay-offs occured in Poland and the UK.

Yet these overcapacities and the rapidly increased market shares of Asian competitors tempted European governments to grant national shipyards operating aid above the regular ceilings.[35] Thus, it is not astonishing that European shipyards are consistently subject to formal investigation procedures regarding the legality of State aid measures.

Since 2000, the European Commission released more than 90 decisions concerning aid measures in favour of individual shipyards in the EU. In 23 cases, public support aimed at rescuing or restructuring a shipyard in difficulty, 11 of theses cases ended with a negative decision by the Commission, as the aid measure was not in line with EU rules. Reasons leading to these negative decisions often include a not fully implemented restructuring plan and unrespected capacitiy limitations (Hellenic Shipyards[36], Kvaerner Warnowwerft[37]).

Figure 6 also shows that the shipbuilding industry is vitally important for the Polish economy. Yet, compared to the old Member States, and prior to accession of CEECs, Polish shipyards were completely State-owned and characterized by massive overca-

35 European Commission, “Framework on State aid to shipbuilding” OJ 2011 C364/9. Yet, the Commission revises its Guidelines continuously. The current framework came into force on 1.01.2012 and no longer contains any specific provisions related to closure, employment or development aid as it has been provided by the previous version.

36 Case C 16/2004 “Hellenic Shipyards”, OJ 2009 L 225/104.

37 Case C 66/1998, C 46/1999 and C 6/2000 “Kvaerner Warnow Werft”, OJ 2000 L 156/39; OJ 2000 L 120/12 and OJ 2005 L 120/21.

pacities and not competitive without public support. Restructuring took place only after Poland joined the EU and it involved massive financial support by the Polish government. This clearly had attracted the attention of the EU.

On 1st June 2005, the Commission published its decision to open a formal investigation examining State aid measures in favour of three Polish shipyards in Gdynia,[38] Gdansk,[39] and Szczecin.[40] Since 2002, the shipyards have benefited from several aid measures such as capital injections, guarantees, loans, and tax write-offs totalling several billions of Euros. Contrary to other sectors, Poland, with its relatively large shipbuilding industry, did not negotiate any transitional arrangements for the application of State aid rules to this sector. The investigation lasted more than three years; the case was in the meantime also negotiated between Commissioner Kroes and the Polish prime minister.[41] In November 2008, the Commission published its first two decisions coming to the conclusion that the aid granted to Gdynia and Szczecin constitute unlawful aid and subsequently have to be repaid.

The two yards have been in difficulties since the 1990s. In April 2004, Poland notified restructuring aid for the two yards whereupon the Commission opened formal investigations in June 2005.[42] As EU State aid rules require such kind of aid to be based on far-reaching restructuring plans, the Commission required Poland to submit such restructuring plans, which the government submitted with substantial delay in September 2005 and September 2006. The Commission came to the conclusion that none of the plans would have ensured long-term viability of the yards whilst restructuring would have been financed entirely by State aid and not, as required, also by private investments. In December 2006, Poland decided to privatise the shipyards, a process, delayed several times, that finally led to potential investors submitting restructuring plans for the two yards on 12 September 2008. However, despite further large amounts of State aid and substantial job losses foreseen in these plans, the Commission found that the yards would still not have been commercially viable. Hence, the subsidies received by the Gdynia and Szczecin shipyards did not comply with the guidelines on R&R aid but were rather deemed to constitute illegal operating aid. The Commission decision required repayment of the illegal aid totalling € 3.3 billion. Poland committed that the recovery will be implemented by way of a sale of assets. However, no investor was found and only a few assets of the shipyards could be sold. Thus, the repayment of unlawful aid never happened to any satisfying extent could not have been complied with and the two shipyards had to declare bankruptcy at the end of 2009.[43]

Croatia also has a noticable employment in the shipbuilding industry. In 2011, the Croatian shipbuildung industry employed 8.500 people and thus ranked sixth in Europe (Figure 6). As it has been already the case for Poland, Croation shipyards were State-owned and heavily subsidized by the government (Figure 7). Thus, during Croatia's EU accession negotiations, the shipbuilding industry has been the most critical subject in the negotiation chapters on competition and State aid policy. Therefore, the Commission required that Croatian shipyards needed to be restructured, privatised, and the subsidies to be phased out by the date of accession, 1 July 2013. Otherwise, the Commission would order recovery of all aid paid out ever since 2006.[44] Consequently, the privatization process of the shipyards has been set into operation.

For the yards of Brodosplit, Brodotrogir, and 3.Maj private investors were found. The European Commission has authorised the restructuring plans and the privatisation contracts for all three shipyards in difficulty. The amount of restructuring aid totalled € 1,028 million in case of Brodosplit, € 408 million in case of Brodotrogir, and € 808 million for the yard 3.Maj. The share of own contribution of private investors were set between 40 and 67 % of the total restructuring costs, which is in line with the required minimum of 40 %. Croatia increased the restructuring aid for all yards, which was still authorised by the European Commission. The increase was justified by Croatia with a higher number of employees, higher

38 Case C 17/2005 "Stoczni Gdynia", OJ 2010 L33/1.

39 Case C 18/2005 "Stoczni Gdansk", OJ 2010 L 81/19.

40 Case C 19/2005 "Szczecin Shipyard", OJ 2010 L 5/1.

41 *Blauberger op.cit.*, fn. 19.

42 See Commission Press Release No. 644/05, 1 June 2005.

43 In contrast, in July of 2009 the European Commission has authorised the various support measures in favour of the Gdansk shipyard worth €251 million. The company had been successfully privatised in 2007 to a Ukrainian industrial group (ISD).

44 Commission Decision of the Council of the European Union of 5 December 2011 on the admission of the Republic of Croatia to the European Union, Annex VIII: "Commitments undertaken by the Republic of Croatia on the restructuring of the Croatian shipbuilding industry" OJ 2012 L 112/89.

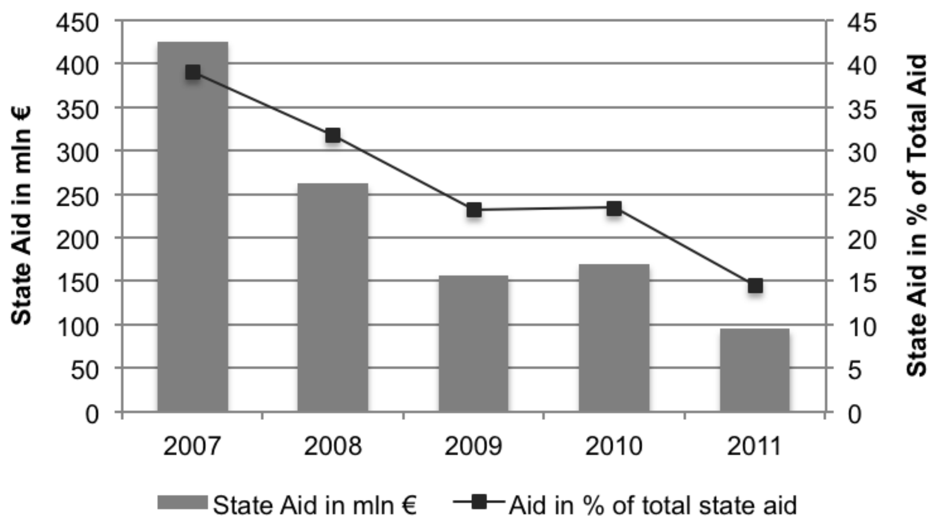

Figure 7: State aid to the Croatian shipbuilding industry
**Total Aid less Agriculture and Fisheries*
Source: Annual Reports by the Croatian Competition Agency for 2009 and 2011.

operational losses than predicted and unused capacity. Yet, Croatia offered to further reduce the annual production ceilings for the yards. The privatisation contracts were signed in February, April and for 3.Maj just in time on 1 July 2013, just allowing for completion of the privatisation process for all yards by 1 July 2013, the date of accession.

In sum, the cases of the shipbuilding industry reviewed here are cases in point to highlight in detail the strict enforcement of State aid policy in the CEECs. It became apparent that the EU Commission executes strict State aid control in CEECs that even extends to the period before accession to the EU and adoption of the EU *acquis communautaire*.

VII. Conclusions

For the Members States from Central and Eastern Europe, State aid is a sensitive issue in particular for politicians and also for society at large: large employers, for which previously the State was responsible, carry not only the largest burden in the process of industrial restructuring during transition to a market economy. They also carry this burden over a much longer period of time than smaller firms in the privatization process. The call to assist large employers by way of extending previous state subsidies into the process of transtion and even accession to the EU is hence politically a pressing issue.

Still, once having entered the EU as full members, the CEECs appear to have been converging into rather stringent competition cultures: State aid may well be slightly higher than in the old Member States, but comparative analysis does suggest that enforcement has gradually become as effective and strict in the East as is the case in the West, this despite the rather different economic situations that would have suggested that the pressure to use State aid is much larger in East than West. An adjustment of State aid in Croatia, which still exceeds the EU-average by 2.4 times is expected in the following years, as it has been the case for the other CEECs. Our quantitative analysis has also shown that State aid does assume an increasingly horizontal character, in particular with regional cohesion objectives. The share of formal investigation procedures has fallen sharply in CEECs and the share of negative decisions is lower than in the West, as is notably the share of un-notified aid.

The additional analysis using the cases reviewed here was able to re-iterate the hypothesis that enforcement of State aid policy in the CEECs is already strict – and even included State aid paid out in the time before accession and the adoption of the EU *acquis communautaire*. No special treatment is granted to the CEECs with their particular needs for industrial restructuring – the gloves are off. In fact, State aid enforcement has been rather draconic: the Polish shipyard example, where the inability of repayment of aid that was *ex-post* deemed unlawful has led to bankruptcy and unemployment could hardly have been more drastic.

We hence conclude that State aid in the new member countries of the European Union is today not granted more generously than amongst the old members, it appears not to be more targeted at individual firms or industries. Our initial suspicion that State aid enforcement may be rather more lax in the East could not be corroborated, instead State aid policy has become at least as strict as in the West and a level playing field can today be assumed.