

A Brief Overview of State Aid Policy in the Republic of Serbia*

REVIEW ARTICLE

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Summary: *State aid is an awarded subsidy or other form of government assistance that distorts competition or the free market functioning. The rules on granting state aid are strictly regulated by the Treaty on the Functioning of the European Union (EU), while Serbia must comply with them on its way to EU membership. This article analyses the nature, scope and structure of state aid in Serbia granted in the period from 2012 to 2020. Although Serbia spends significantly more funds and has a less favourable state aid structure than the EU-27 average, it nevertheless made favourable shifts towards increasing horizontal and decreasing vertical state aid. Nevertheless, in the future, the country will have to encourage the further allocation of non-selective horizontal aid, especially one that is intended for training, the development of SMEs and innovation.*

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INTRODUCTION

State aid can be best described as an approved subsidy or other form of government assistance that distorts competition or the functioning of a free market. The importance of state aid for the development of contemporary companies is all the greater if one takes into account the fact that that today's business environment is characterized by rapid globalization, increased competition, new technologies and information asymmetry (1, p. 73). The definition of state aid usually implies the fulfilment of the following four cumulative criteria: a) financial means of support derived from public sources, b) securing of economic advantage, c) selectivity, and d) the proved negative impact on competition and trade flows (7, p. 2). Article 107 of the Treaty on the Functioning of the European Union (TFEU) strictly prohibits the granting of state aid, with the exception of those measures approved by the European Commission, usually for broader developmental and environmental protection purposes. In this way, once granted state aid provides an unfair market advantage to a given company on a selective basis. Moreover, according to European Union (EU) legislation, subsidies granted to individuals and

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general measures intended for all companies² are not covered by this ban and do not constitute state aid (2).

State aid measures usually have the following characteristics (6):

- they represent government intervention financed from public funds that usually occurs in the form of direct grants, subsidized interest rates, tax benefits, approved credit guarantees, state ownership of the whole or a part of the company, provision of goods and services on preferential terms, short-term export credit insurance, etc.,
- they provide its recipient with a selective market advantage, and
- they lead to disruption of free market competition, as well as trade flows among the observed countries.

Despite the general prohibition of state aid, there are also some circumstances in which government intervention is justified and even necessary with the aim of establishing and developing a functional economy. Therefore, the TFEU provides for certain group exemptions for which state aid can be considered permissible and compatible with the objectives of the EU's development policy. In EU member states, only in the period from 2015 to 2018, more than 96% of state aid was granted in accordance with the General Block Exemption Regulation (4). In EU countries, permitted state aid is mainly approved for the needs of balanced regional development, environmental protection, risk financing, training and development of human resources, and investments in research, development and innovation, but more recently also for helping companies affected by the *COVID-19* coronavirus pandemic, energy goals and the development of broadband networks (3). Since it is based on the assumption that small amounts awarded do not distort competition, the European Commission (EC) also introduced a rule on *de minimis* state aid that is awarded to a given company in the amount of up to 300,000 euros for a period of 3 years (17).

The reform of the state aid system in the Central and Eastern Europe countries was initiated in the early 1990s of the 20th century by the process of transition and liberalization of administratively determined prices, which led to the gradual abolition of subsidies. However, these significant changes caused by the transition to a market economy had a negative impact on certain sectors.³ These processes encouraged the further application of various forms of state intervention, especially in public enterprises. In addition to the Stabilization and Association Agreement (SAA), an additional incentive for the reform of the state aid system comes from the Copenhagen criteria for EU accession. The process of EU enlargement had a significant impact on the reduction of the state aid level in the countries of Central and Eastern Europe, but also on a change in the types and instruments

² Such as tax policy measures and employment regulations.

³ Mining, steel industry, energy, agriculture, and manufacturing industry were particularly damaged by these measures.

of aid. More precisely, over time there has been a change in the structure of state aid, i.e. a decrease in the share of sectoral (vertical) state aid and an increase in the share of horizontal and regional aid, in accordance with EU rules (8, p. 1).

In the meantime, the European Commission has introduced a series of rules on the allocation of sectoral and horizontal state aid. While the rules on vertical state aid are applied to specific industrial branches, horizontal state aid is intended for all industrial branches (18), thus highlighting the non-selectivity in its allocation. The latest reforms of the EU state aid system are aimed at the goals of net zero industrial production carbon emissions, climate neutrality and green transition with the aim of better coping with international competition and preventing the migration of companies to third countries, especially in strategic industrial branches such as the production of batteries, solar panels, wind turbines, thermal pumps, as well as equipment for capturing, using and storing carbon (14).

THE NATURE OF STATE AID POLICY IN THE REPUBLIC OF SERBIA

In the period from March 2022 to June 2023, the EU approved about 730 billion euros of its official state aid, of which about 141 billion euros (19.3%) were allocated to various European companies. At the same time, this amount represents 0.6% of the EU-27 gross domestic product (GDP) from 2022 and the first half of 2023 (5, p. 1). Contrary to the EU, Serbia spends far more financial resources for state aid, where 2.2% of domestic GDP was spent in 2016 alone, i.e. almost 3.5 times more than the EU-27 average. In order to comply with the EU legislation in this domain, Serbia should significantly reduce its vertical state aid and subsidies intended to encourage foreign direct investments (FDIs), with a special emphasis on those providing support for stumbling industrial branches, which the country abundantly supports through its tax benefits and tax credits for attracting FDIs.

In the economy of Serbia, sector-specific state aid had played a dominant role, which has been proven to limit competition and put certain market participants in a privileged position compared to other ones. On the other hand, horizontal state aid, which is aimed at meeting common economic goals of general economic interest such as environmental protection, but also encouraging research and development, inventions, innovations and regional development, was far lower in Serbia compared to EU member states. Today, the Serbian state aid policy is mostly directed towards public companies, which receive about 60% of all corporate subsidies, while it is not intended for small and medium-sized enterprises (SMEs) as a proven engine of economic growth. Also, Serbia allocates symbolic aid for the development of innovations, while the share of subsidies intended for domestic innovative firms amounts to 8% and is even lower than their share in the country's total value added generation (12%). Finally, although so far subsidies aimed at attracting FDIs have helped to create new jobs, their economic benefits are

mostly reflected in the facilitation of technology transfer, the spillover of new knowledge and the creation of long-term connections among foreign firms and domestic suppliers or corporate clients (19, pp. 3-4).

The nature of Serbian state aid policy appears as a consequence of the socialist economic system in which state aid was a key element of the country's development policy. The distribution of state aid in Serbia also differs from its distribution in EU countries since in Serbia it is used for different purposes, even for those that are not aligned with EU rules. Therefore, Serbia, as an official candidate for EU membership, still faces serious obligations regarding the revision of its state aid policy. In addition to vertical state aid that is directly awarded to certain companies unable to withstand market competition, Serbia's problem is also reflected in the award of so-called *ad hoc* state aid, which is awarded under insufficiently clear conditions and insufficiently transparent criteria (12).

SCOPE AND STRUCTURE OF STATE AID IN THE REPUBLIC OF SERBIA

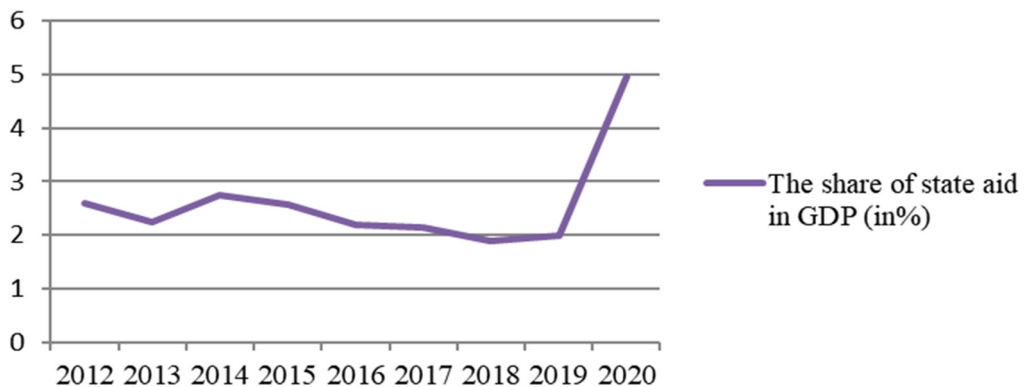
The legislation of the Republic of Serbia (RS), i.e. Article 5 of the Law on the Control of State Aid, recognizes coordinated state aid as aid that has a social character, intended for consumers without discrimination regarding the origin of goods, services or products, and which is awarded to repair damage caused by natural disasters or other emergency situations. State aid can be coordinated, and therefore permitted, if it is also granted for the purposes of balanced regional development, removal of major economic disruptions, implementation of strategic investment projects of special interest, improvement of certain industries and enhancement of protection and preservation of cultural heritage, assuming that these measures do not distort market competition and do not affect trade flows among Serbia and EU member states (16).

According to the latest available RS Report on State Aid Allocation from 2022, in the *COVID-19* 2020 year, the share of state aid in the country's GDP was 4.96%, which represented a growth of 2.96% compared to the previous 2019 and an increase of 3.06% compared to 2018. In 2020 alone, the share of state aid in total public expenditures was 10.1%, unlike in 2019, when this indicator was 4.8%, and in 2018, when it amounted to 4.9%. The state aid of 356.3 million euros was granted to the agriculture sector in 2020, which represents a growth of 23% and 52% compared to 2019 and 2018, respectively. State aid granted to industry and services amounted to 702 million euros, with its share of 30.2% in the total state aid awarded, being a subject to reduction due to the crisis aid measures introduced to rehabilitate the economic consequences of the coronavirus pandemic. The following Table 1 indicates a slightly more detailed structure of granted state aid in relation to the basic macroeconomic indicators of Serbia in the period from 2012 to 2020.

Table 1. Trend of state aid in the Republic of Serbia in the period from 2012 to 2020 (in euros)

Indicator	2012	2013	2014	2015	2016	2017	2018	2019	2020
State aid in millions of euros	778	720	904,0	863	750	792	818	939,6	2,319
GDP in millions of euros	29.933	31.981	33.059	33.491	34.142	36.838	42.901	45.892	46.796
State aid in GDP in %	2,6%	2,25%	2,74%	2,58%	2,2%	2,15%	1,9%	2%	4,96%
State aid in public expenditures in %	5,12%	4,65%	5,65%	5,45%	4,86%	5,0%	4,9%	4,8%	10,1%
State aid per employee in euros	450	420	533	455	392	400	400	447	1.079
State aid per inhabitant in euros	109	101	127	122	107	113	117	135	338

Sources: (9-11)

**Chart 1.** Trend of state aid in Serbia's GDP in the period from 2012 to 2020 (in %)

Sources: (9-11)

As can be seen from the table above, state aid in Serbia remained relatively stable during this period, with its average value of 2.6% of GDP, and with the exception of the pandemic year 2020, when it amounted to 4.96% of GDP. In this way, the state aid measured by its share in GDP was at the same time about 4.3 times higher than the EU-27 average. State aid per employee fluctuated, achieving its average value of 508.4 euros, while the average value of state aid per inhabitant in the observed period amounted to 141 euros. Observed by all parameters, in this period the only exception was 2020, in which the RS Government launched the Program of Supportive Economic Measures during the state of emergency caused by the pandemic. These measures mainly included tax policy measures, direct aid to the private sector, measures to preserve the liquidity of companies, as well as other measures such as a moratorium on the payment of dividends until the end of the year and fiscal incentives to stimulate domestic demand. The overall value of these measures was estimated at 5.1 billion euros, that is

11% of national GDP (13, p. 38). The following Chart 1 shows the state aid percentage trend in the Republic of Serbia in the observed period.

On the other hand, the following Table 2 indicates the detailed structure of the granted state aid according to the forms of aid and economic sectors in 2018, 2019 and 2020.

Table 2. Total awarded state aid in the Republic of Serbia according to forms of aid and economic sectors in the period from 2018 to 2020

Years		2018		2019		2020	
	State aid category	in millions of euros	in %	in millions of euros	in %	in millions of euros	in %
A	Agriculture	232,5	28,4	288,4	30,7	356,3	15,4
B (I+II+III+IV)	Industry and services	585,3	71,6	651,2	69,3	702,0	30,2
I	Horizontal state aid	281,5	34,4	362,8	38,6	300,2	12,9
	Research and development	0	0	4,6	0,5	3,7	0,2
	Training	0	0	0	0	0	0
	Employment	51	6,2	63,3	6,7	105,3	4,5
	SMEs	0	0	0	0	0	0
	Environmental protection	83,3	10,2	146,7	15,6	163,5	7,1
	Culture and informing	24,5	3,3	25,1	2,7	19,8	0,8
	Rehabilitation and restructuring	10,3	1,3	2,3	0,2	0	0
	Other purposes	112,6	13,7	120,9	12,9	7,9	0,3
II	Services of general economic interest	0	0	0	0	163,1	7,0
III	Vertical state aid	74,7	9,1	74,2	7,9	33,2	1,4
	Mining	41,8	5,1	40,6	4,3	0	0
	Transportation	32,9	4,0	33,6	3,6	33,2	1,4
	Steel industry	0	0	0	0	0	0
IV	Regional investment state aid	229,0	28,0	214,2	22,8	205,2	8,8
C	COVID-19 measures	0	0	0	0	1.261	54,4
	Total (A+B+C)	818,0	100	939,6	100	2.319	100

Source: (11, p. 32)

From the table above, it can be seen at first glance that the structure of state aid in Serbia, with the exception of the pandemic year 2020, is finally dominated by horizontal state aid, followed by allocations for agriculture, regional investment aid and vertical state aid. However, an unfavourable structure of horizontal state aid can be still observed, especially in terms of zero allocations for training and the SMEs sector, as well as in symbolic financial allocations for research and development needs. In 2020, the state aid granted to the industry and services sector amounted to 702 million euros, which accounted for 30.2% of the total state aid awarded. The agriculture sector received state aid in the amount of 356.3 million euros, with its share of 15.4% in the total state aid granted, which represents a relative decrease compared to the previous years 2019 and 2018. In addition to services of general economic interest, as a special category of state aid introduced in 2020, Serbia also recognised the aid for the economic rehabilitation of the *COVID-19* pandemic

consequences, which was paid at the expense of vertical, horizontal and regional investment state aid. During 2020, this aid was awarded in the amount of 1,261 million euros, i.e. 54.4% of the total state aid granted. Horizontal state aid amounted to 300.2 million euros (12.9% of the total state aid granted), and together with the newly introduced services of general economic interest, it was still lower than in 2019 and 2018. Sectoral, i.e. vertical, state aid amounted to 33.2 million euros, making up 1.4% of the total allocated state aid. Finally, in 2020, the regional investment state aid also experienced a significant decrease, with its magnitude of 205.2 million euros and share in the total state aid of 8.8%.

CONCLUSION

The Government of the Republic of Serbia improved its legal framework for granting state aid by adopting the new Law on State Aid Control at the end of 2019, as well as the Regulation on Regional Investment State Aid. This document provides detailed conditions and criteria for granting state aid intended for a country's more even regional development and aimed at the improvement of areas with a low standard of living. These new regulations ensure transparency and incentive ability for the regional state aid, focusing on financing the establishment of new companies, expansion of their production capacities, diversification of production and reduction of operating costs of companies from sparsely populated areas (15). This move was obviously an attempt to harmonize the domestic legal system with the EU state aid control policy, as well as a visible step forward towards final encouragement of the country's regional policy implementation.

However, unlike the EU countries, Serbia spends significantly more funds for the allocation of state aid and has its less favourable structure. In the benchmark pre-pandemic year 2019, total state aid, including the agricultural sector, amounted to 2% of GDP, which is more than triple the EU-27 average of 0.6%. In this context, it should also be noted that the new EU member states spent more funds on state aid before their entry into this regional integration, but even then to a much lesser extent compared to Serbia at the moment. The World Bank (2019) noted that state aid in Serbia in 2016 was still dominated by sectoral, i.e. vertical aid (on average 38% of total types of state aid), often intended for failing industries and followed by horizontal aid (33%) and regional allocations (29%) (19, p. 8). Yet, it could be said that this trend was still changing favourably in the direction of growth of horizontal and reduction of vertical state aid.

While transport companies receive about half the amount of all direct corporate subsidies, the largest percentage (85%) of corporate income tax incentives refers to manufacturing, agricultural, mining, retail, and wired telecommunication companies. At the same time, state enterprises receive the largest percentage of all corporate subsidies (about 60%), but participating with only 19% in the creation of new value added and formal jobs and harvesting huge disproportionate benefits from state aid. While subsidies in Serbia often cover business losses, private domestic companies, which account

for the majority of national GDP and jobs, receive fewer corporate subsidies and tax breaks. It is also observed that state aid bypasses start-up companies, as well as that it does not sufficiently encourage the development of the SMEs with the greatest potential for growth, innovation and creation of new jobs (19, pp. 7-15).

Based on everything said, it can be concluded that in the future, state support should be carefully directed towards the development of small and medium-sized enterprises, especially those with potential for innovation, insisting on improving their ability to adopt new technologies, innovative concepts, managerial skills and export capabilities. In order to align with the EU legal framework as successfully as possible, Serbia should continue to reduce its vertical state aid and subsidies intended to attract FDIs, especially those that provide support to failing industries. Also from the analysis follows the conclusion that in the future, Serbia should encourage to a greater extent the awarding of non-selective horizontal aid, which is mainly intended for goals of general interest such as environmental protection, investment in research, development and innovation, training and development of human resources, providing support to SMEs, encouraging employment, rescuing and restructuring companies, and protecting cultural heritage. Only in this way Serbia could get closer to the EU's state aid policy and thus boost the productivity of its economy and its sustainable economic growth and development.

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Kratak pregled politike državne pomoći u Republici Srbiji

Rezime: *Državna pomoć predstavlja odobrenu subvenciju ili neki drugi oblik vladine pomoći koji narušava konkurenciju ili funkcionisanje slobodnog tržišta. Pravila o dodeljivanju državne pomoći su strogo regulisana Ugovorom o funkcionisanju Evropske unije (EU), dok Srbija mora da im se prilagodi na svom putu ka članstvu u EU. Članak analizira karakter, obim i strukturu državne pomoći u Srbiji u periodu od 2012. do 2020. godine. Iako Srbija troši znatno više sredstava i ima manje povoljnu strukturu državne pomoći od proseka EU-27, ona je ipak sačinila povoljna pomeranja u pravcu rasta horizontalne i smanjivanja vertikalne državne pomoći. Ipak, zemlja će ubuduće morati da podstiče dalju dodelu neselektivne horizontalne pomoći, posebno one namenjene obuci, razvoju MSP i inovacija.*

Ključne reči: državna pomoć, horizontalna i vertikalna državna pomoć, Srbija, tržišna konkurencija, mala i srednja preduzeća (MSP)

