

1. REPORT ON GRANTED STATE AID IN THE REPUBLIC OF SERBIA IN 2007

1.1. Summary

The Report on Granted State Aid in the Republic of Serbia in 2007 (hereinafter referred to as 2007 Report) is an analytical (comparative) overview of granted state aid in 2007. Data regarding years 2005 and 2006 has been set out for the purposes of comprehensiveness and the monitoring of trends, including data for 2003 and 2004 referring to certain elements.

The 2007 Report contains information provided directly from state aid grantors, collected by means of separate questionnaires (forms). Starting from the 2005 Annual Report, the methodology specified by the European Commission in the area of state aid reporting has been applied to the greatest possible extent. As highlighted in the two previous reports, a complete application of this methodology was not possible, given that a legal framework in the area of state aid control is still non-existent, including by-laws to establish rules, methodology and time limits in detail for the development of reports on granted state aid. The aforementioned will be established by passing the Law on State Aid Control (hereinafter referred to as the Law) and supporting by-laws. In late 2008 the Government endorsed the proposed Law that, in turn, entered the Parliament procedure where it still remains.

In 2007 state aid granted in the Republic of Serbia amounts to a total of RSD 47,892 million, i.e. €598,75 million¹⁾ being by 29.4% higher in relation to a total granted state aid in 2006 (RSD 37,005 million or €439,53 million), i.e. by 80.6% higher in relation to the same parameter in 2005 (RSD 26,516 million, i.e. €319,82 million).

The share of state aid in GDP has increased from 1.86% in 2006 to 2.00% in 2007.

In accordance with the European Union methodology, having been applied in the development of the 2007 Report, state aid is categorised according to the primary aid targets as follows:

- horizontal state aid,
- sectoral state aid,
- regional state aid

The structure of state aid in 2007 shows a positive trend reflected, particularly, in the increase of share of horizontal state aid in the total state aid granted, taking into account that this category of state aid causes the least possible distortion of the competition in the market.

In 2007 the **horizontal state aid** was granted in the absolute levels, amounting to **RSD 36,453 million, or €455,73 million**, resulting in an increase by 44.8% in relation to 2006, and in an increase by 193.3% in relation to 2005. The share of this category in the total state aid granted in 2007 has grown to 76.1 %. To make a comparison: in 2006 the share of the horizontal state aid amounted to 68.0%, whereas in 2005 it was 46.8 % in the total granted state aid.

1) Average exchange rate for EUR in 2007 – RSD 79.9809 – data source: Statistical Office of the Republic of Serbia

Within the horizontal state aid structure, the largest portion is directed towards the development of small-and medium-sized enterprises, and to the social programme for addressing issues of staff redundancy in companies undergoing the restructuring and rescue process.

In 2007 **the sectoral state aid** is lower by 13.5% in absolute levels than it was in 2006, and lower by 20.9 % in relation to 2005. For these purposes **in 2007 the amount of RSD 9,350 million was granted, i.e. € 116,90 million** largely to the transport sector (railway transport). The share of the sectoral state aid in the total granted state aid was reduced from 44.6% in 2005 and 29.2% in 2006, to 19.5 % in 2007. It is highlighted that a decrease in share of the sectoral state aid is, primarily, the result of changes in the amount of the total granted state aid because the absolute amount of the state aid granted to the transport sector did not significantly change in the last period. The main feature of this category of state aid includes selectiveness which distorts or threatens to distort competition in the market to a greater extent, hence the share of this category of state aid in the total state aid granted being reduced is certainly a positive trend.

The regional state aid, as a separate form of horizontal state aid, in the total granted state aid participates with 4.4 %, whereas in 2006 this share amounted to 2.8%, and 8.6% in 2005.

Investments in the regional development in 2007 amounts to **RSD 2,089 million or € 26,12 million**, with the following funds granted:

- from the Republican level, a total of RSD 653 million was granted, and implemented by means of favourable loans through the Republic of Serbia Development Fund - RSD 2,214 million (a total of approved loans, whereas the net effect of a more favourable interest rate, that is, the amount of state aid amounts to RSD 604 million) and tax incentives amounting to RSD 49 million, and

- from the level of the Autonomous Province of Vojvodina amounting to a total of RSD 1,436 million by means of: subsidies amounting to RSD 1,177 million and favourable loans through the Development Fund of the AP Vojvodina, totalling RSD 1,803 million, with the net effect, that is, the amount of state aid being RSD 259 million.

1.2. Methodology for the Development of State Aid Inventory

In developing the 2007 Report, the starting point was the methodology specified in the European Union in the area of reporting on granted state aid, being applied by the Member States in designing their annual reports. The quoted methodology has been implemented to the largest possible extent in developing the 2007 Report given that the Law has not been passed yet, including a by-law to regulate in more detail the methodology for developing annual reports, and time limits for the submission of data. At the same time one should bear in mind that the inventory of state aid has not been established yet for the aforementioned reasons, that would be a complete database for the development of an annual report, being based on mandatory notifying of intended state aid before it is granted.

Baselines for the development of the 2007 Report include as follows:

- data for 2005 and 2006, taken from the Report on Granted State Aid in the Republic of Serbia in 2006 (hereinafter referred to as 2006 Report);

- data on granted state aid in 2007, acquired by means of an appropriate questionnaire from state aid grantors (Ministries, Ministry of Finance – Tax Directorate, the Republic of Serbia Development Fund, the Guarantee Fund, Export Credit and Insurance Agency (AOFI), Serbia Investment and Export Promotion Agency (SIEPA); the Executive Council of the Autonomous Province of Vojvodina;

- regulation of the European Commission in the sphere of reporting on granted state aid, specifying the reporting methodology, (Article 21 of the Council Regulation (EC) No. 659/99).

What is State Aid?

State aid is regulated in the European Union under Articles 87 through 89 of the Treaty Establishing the European Community (hereinafter referred to as EC Treaty). As the EC Treaty does not contain a formal definition of state assistance, the latter may be derived under the elements contained in the provision of Art. 87, paragraph 1 – state aid is considered to be any measure that is based on the programme – scheme of state aid, or that is granted to a single (individual) beneficiary under a single act, provided that the following requirements are cumulatively met:

- it is granted from public resources in any form and it involves not only measures referring to the expenditure side of the budget, but also to measures which decrease budget revenue in any manner, that is, the measures increasing public expenditure or decreasing public revenue;
- it is selective as it provides an economic advantage to a company, sector or region, that is, to the manufacturing of some products or to the provision of some services;
- the granting of state aid distorts or threatens to distort market competition;
- the beneficiary of state aid is any legal or natural person who, manufacturing and/or exchanging goods and/or providing services in the market, uses state aid in any form, irrespective of its legal status and the manner of funding. Even non-profit subjects may be beneficiaries of state aid if they perform any activity in the market.

According to type, that is, the manner of reporting to the competent state aid control body (the State Aid Control Committee, to be established by the Government in accordance with the Law – hereinafter referred to as Committee) state aid is divided into: state aid schemes and individual state aid

The state aid scheme is a set of all regulations constituting legal grounds for granting state aid to beneficiaries who are not identified (known) beforehand, and/or drafts and/or proposed regulations which will, once they are passed, constitute grounds for granting state aid to beneficiaries who are not identified (known) beforehand.

The individual state aid is aid which, under an act of a state aid provider, is granted to a beneficiary who is identified (known) beforehand (*ad hoc* state aid), and which is not based upon the state aid scheme, as well as aid which is based upon the state aid scheme, previously approved by the Committee, but which is subject to previous reporting to that Committee, before it is eventually granted to an individual beneficiary.

According to the European Commission methodology, any aid granted to beneficiaries who are not business entities, and/or who do not deal in manufacturing and/or exchanging goods and/or providing services in the market **is not considered as state aid**. In accordance with the aforementioned, the 2007 Report does not contain information on aid:

- granted to households, disabled persons, educational institutions, hospitals, for the purposes of public housing, for the purposes of the construction of infrastructure within public sector (if access to the infrastructure is secured for all potential beneficiaries under equal conditions);
- that has a character of general measures and that is available to all subjects under equal conditions (quotas, public procurement, technical standards, general measures of a tax policy),
- for the purposes of defence and public works

The 2007 Report does not contain data on granted state aid in the Sector of Agriculture, Hunting and Forestry, and the Fishery Sector.

2. GRANTED STATE AID IN THE REPUBLIC OF SERBIA IN 2007

2.1. State aid in the Republic of Serbia in relation to basic macro-economic indicators

Table 1

Indicator	Ref. Unit	2005	2006	2007	Indices	
					06/05	07/06
State Aid	RSD mil.	26,516	37,005	47,892	180.6	129.4
State Aid	EUR mil. ¹⁾	319,82	439,53	598,75	140.1	136.2
GDP ²⁾ (in current prices)	RSD mil.	1,691,900	1,987,800	2,329,400		
GDP	EUR mil.	20,408	23,610	29,125		
State Aid share in GDP	in %	1.57	1.86	2.00		
Public Expenditure ⁴⁾	RSD mil.	706,800	899,300	1,046,900		
Public Expenditure	EUR mil.	8,526	10,681	13,089		
State Aid share in Public Expenditure	in %	3.7	4.1	4.5		
Employees ²⁾	number	2,069,000	2,026,000	2,002,000		
State Aid per Employee	RSD	12,816	18,265	23,921	142.5	130.9
State Aid per Employee	EUR	154	217	299	85.4	137.7
Population ³⁾	number	7,463,000	7,450,000	7,366,000		
State Aid per Inhabitant	RSD	3,560	4,967	6,501	139.5	130.8
State Aid per Inhabitant	EUR	43	61	81	137.2	132.7

Table 1 sets out data on the total granted state aid in the Republic of Serbia in 2005, 2006 and 2007, in relation to basic macro-economic indicators.

Data source:

¹⁾ The Republican Statistical Office; an average Euro exchange rate in 2007. € 1= RSD 79, 9809

^{2), 3)} Data sources for 2007: revised Memorandum on the budget and economic and fiscal policy for 2009, with projections for 2010 and 2011 (adopted on December 2008), Table 19 and Annex I, Table 2.

⁴⁾ 2005, 2006 and 2007 public spending data: Ministry of Finance, Public Finance Bulletin October/2008, according to GFS-1986 methodology.

Relative to the 2006 Report, basic macro-economic indicators are revised: on the basis of data from the Statistical Office of the Republic of Serbia, in the table entitled Gross Domestic Product (GDP) of the Republic of Serbia 1997-2007, data published earlier for the period 1997-2006 was revised under the FISIM method (Financial Intermediation Services Indirectly Measured). The Ministry of Finance has, under the application of the GFS methodology, conducted revisions of the amount of public expenditure. Derived data on the relation between state aid and macro-economic indicators has been aligned with the quoted revisions.

In 2007 the Republic of Serbia was granted state aid totalling RSD 47,892 million, which is by 29.4 % higher than the overall granted state aid in 2006, and by 80.6 % higher in relation to the same parameter in 2005.

The state aid share in GDP in 2007 amounts to 2.0%, whereas in 2006 it was 1.86% and 1.57% in 2004.

Trend of state aid share in GDP in the period between 2003 and 2007

Figure 1

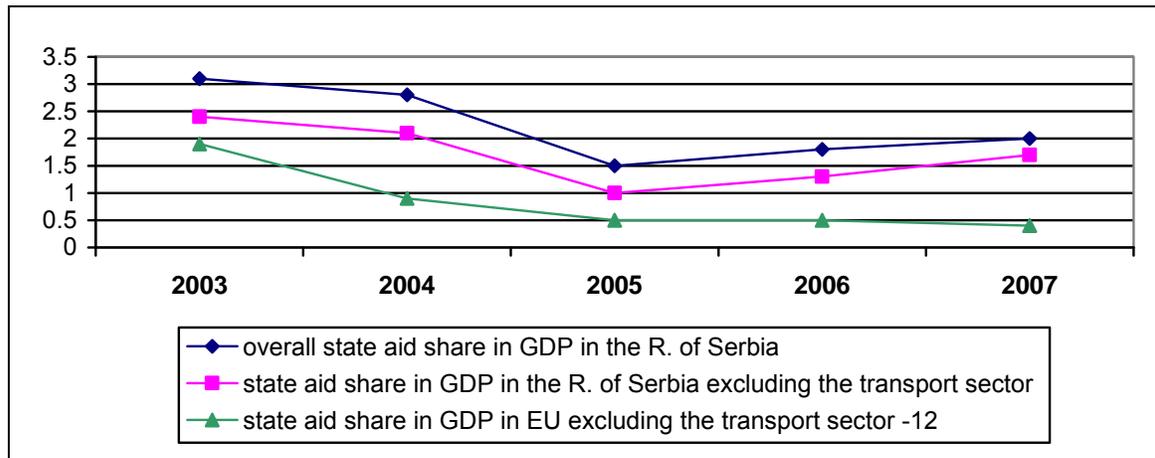


Figure 1 sets out the trend of the total state aid share in GDP in the Republic of Serbia in the period between 2003 and 2007, that is, for all years for which the report on the overall granted state aid has been developed (a single annual report was developed for years 2003 and 2004). In addition to data for the Republic of Serbia on the share in GDP granted state aid in the period between 2003 and 2007, excluding the transport sector, data is provided also for the countries which acceded to the European Union in 2004 and 2007 (EY-12). One may conclude that the said aid retained the share of 0.4% of GDP following a relatively high share in the year before and directly after the accession to the European Union.

2. 2. Granted State Aid in the Republic of Serbia compared with the European Union Member States

Table 2

State Grantor	Aid	Total State Aid excluding the transport sector, agriculture sector and fishery sector	
		in mil. EUR	share in GDP in %
R. Serbia 2003		428,4	2.4
R. Serbia 2004.		423,2	2.1
R. Serbia 2005.		223,3	1.0
R. Serbia 2006.		334,3	1.4
R. Serbia 2007.		508,2	1.7
EU - 27 Member States		49,214	0.40
EY-15 old Member States		45,406	0.40
EY-12 new Member States		3,808	0.43
Hungary		879	0.87
Slovenia		115	0.34
Czech Republic		767	0.60
Slovakia		223	0.41
Bulgaria		27	0.09
Romania		296	0.24
Poland		1,261	0.41

In accordance with the European Union methodology in the sphere of reporting, member states' annual reports also set out an overview of granted state aid excluding the transport sector, the agriculture sector and the fishery sector. The transport sector is specific and as such it is regulated under Articles 70 through 80 of the Treaty which directly link the process of liberalisation of transport services to state aid.

Table 2 sets out data on granted state aid in 2007, excluding the transport sector, the agriculture sector and the fishery sector, for certain EU Member States in accordance with data at the level of the European Union,¹⁾ whereas data set out for the Republic of Serbia covers the period between 2003 and 2007.

As regards the absolute amounts, in comparison with the European Union Member States, the Republic of Serbia has not granted a high absolute amount of state aid, but its share in GDP continues to be high, amounting to 1.7%, whereas in the European Union (all 27 Members States) it is 0.40%, and in 12 countries which became European Union Member States in 2004 and/or 2007 the share of state aid in GDP, excluding the transport sector, amounts to 0.43%.

1) Data source: EU/Competition-State Aid-Scoreboard, 2007

2.3. State Aid Categories

In accordance with the European Union methodology, state aid is categorised according to the primary aid targets as follows:

- horizontal state aid,
- sectoral state aid, and
- regional state aid.

Horizontal state aid is intended for the largest number of beneficiaries not identified beforehand, distorting the market competition to a significantly lesser extent unlike the sectoral state aid. Positive effects of this category of state aid are multiple, hence being considered as less selective than the sectoral state aid.

Sectoral state aid is intended for companies in certain activities and/or sectors, identified (known) beforehand. This category is much more selective than that of the horizontal state aid, hence distorting or threatening to distort the market competition to a greater extent. For the quoted reasons, the European Commission applies special rules for granting state aid in sensitive sectors, such as sectors of steel, coal, synthetic fibres, shipbuilding, which is regulated by separate protocols as a rule during negotiations on the Stabilisation and Association Agreement. Also, separate and very strict a rule applies in the area of the restructuring and rescue of companies.

Regional state aid is a form of the horizontal state aid granted to promote economic development of underdeveloped and/or less developed regions and/or areas, in particular those where the living standard is especially low or where unemployment is considerable. This category of state aid is granted to companies in the regions where investments are considered as justified due to the existence of a number of economic, natural, social, demographic and/or other deficiencies.

For the purposes of this Report, the term "region" is aligned with the European Union terminology and standards (economic, that is, statistical parameters). With the Stabilisation and Association Agreement, ratified by the National Parliament of the Republic of Serbia in October 2008, but not been confirmed by the European Union, i.e. by the Interim Trade Agreement, which the Republic of Serbia started to apply one-sidedly in early 2009, the Republic of Serbia has assumed an obligation to develop, within an agreed timeframe, the so-called regional maps under the NUTS standards ("Nomenclature des Units Territoriales Statistiques" - Nomenclature of Territorial Units for Statistics eligible for state aid disbursement). The aforementioned will allow a complete implementation of the European Union criteria for a proper directing of funds intended for the regional development. The term "regional state aid" is compulsory in setting out data on state aid within the annual report, where the basic criterion for selecting this term and the term "region" and/or "regional development" is in line with the European Union standards, and not the existing territorial organisation of the Republic, established by the Constitution, the Law on Territorial Organisation and the Law on Local Self-Government.

**Total Granted State Aid in the Republic of Serbia in 2005, 2006 and 2007
by Categories**

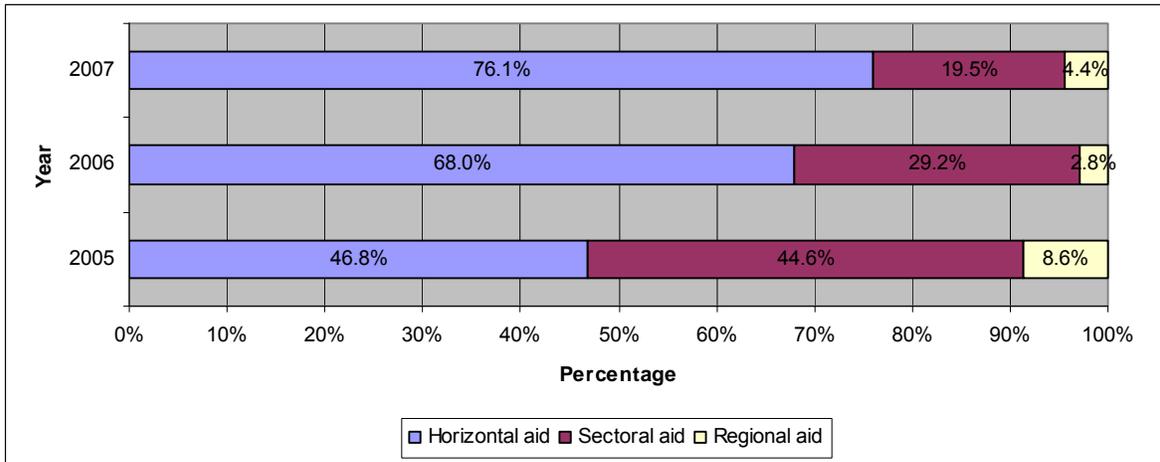
Table 3

Category	2005			2006			2007		
	RSD mil.	EUR mil.	share in %	RSD mil.	EUR mil.	share in %	RSD mil.	EUR mil.	share in %
1. Horizontal State Aid	12,425	149,86	46.8	25,157	298,80	68.0	36,453	455,73	76.1
Research and Development	-	-	-	-	-	-	22	0,28	0.0
Training	1,283	15,48	4.8	6	0,07	0.1	2,985	37,32	6.2
Employment	661	7,96	2.4	4,646	55,18	12.5	3,077	38,47	6.4
SMEs ¹⁾	2,749	33,16	10.3	10,913	129,62	29.5	17,268	215,90	36.1
Environment protection	-	-	-	-	-	-	-	-	-
Rescue and restructuring	6,732	81,20	25.3	9,430	112,00	25.5	12,771	159,64	26.7
Export promotion	-	-	-	162	1,93	0.4	330	4,12	0.7
Export incentives	1,000	12,6	3.8	-	-	-	-	-	-
2. Sectoral State Aid	11,816	142,52	44.6	10,799	128,27	29.2	9,350	116,90	19.5
Mining	1,150	13,87	4.3	1,000	11,87	2.7	1,440	18,00	3.0
Steel	0,0	0,0	0.0	0,0	0,0	0.0	-	-	-
Transport	8,006	96,56	30.2	8,858	105,21	24.0	7,239	90,50	15.1
Culture and Information	2,135	25,75	8.1	-	-	-	-	-	-
Tourism	95	1,15	0.4	561	6,66	1.5	379	4,74	0.8
Ship building	0,0	0,0	0.0	0,0	0,00	0.0	0,0	0,0	-
Other Sectors	430	5,19	1.6	380	4,51	1.0	293	3,66	0.6
3. Regional State Aid	2,275	27,44	8.6	1,049	12,46	2.8	2,089	26,12	4.4
Total	26,516	319,82	100.0	37,005	439,54	100.0	47,892	598,75	100.0

1) SMEs - small-and medium-sized enterprises

State Aid Structure in the Republic of Serbia in 2005, 2006 and 2007

Figure 2



Data set out in Table 3 and in Figure 2 on the share of respective state aid categories in the total amount of granted state aid in the Republic of Serbia shows that in 2007 the horizontal and sectoral state aid had the largest share (95.6%), whereas the regional aid showed the smallest share (4.4%).

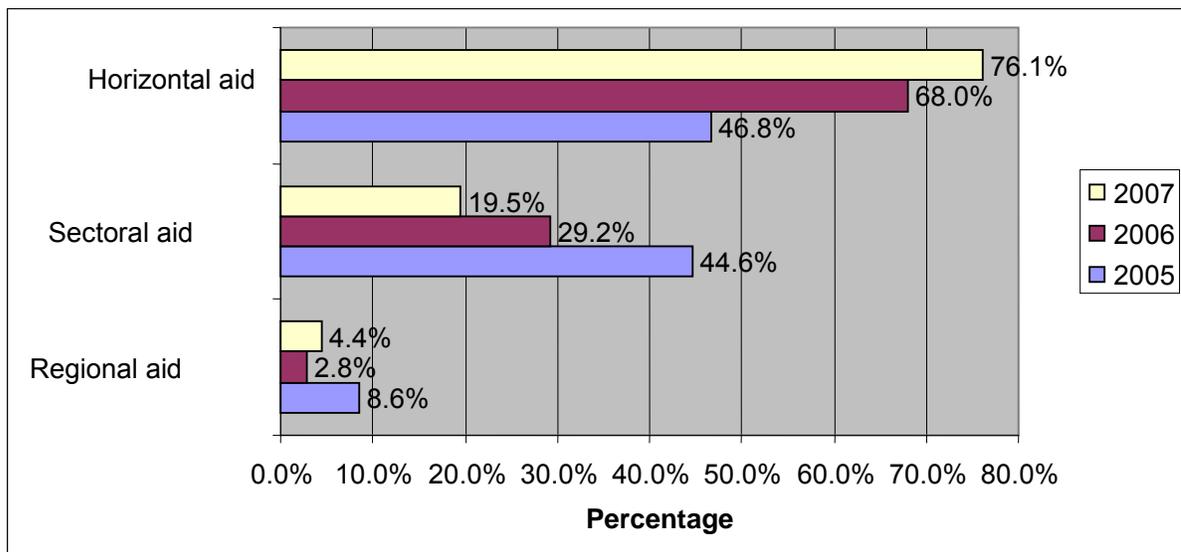
Within the structure of the total granted state aid in 2007, the share of the **horizontal state aid** is 76.1%, whereas in 2006 it was 68.0%, and 46.8% in 2005.

Although the **sectoral state aid** in absolute amount is somewhat smaller than the amount granted in 2006, the share is significantly smaller, amounting to 19.5% of the total granted state aid in 2007.

The share of state aid in the total granted state aid, intended for the regional development in 2007, is 4.4%, with 2.8% in 2006, and 8.6% in 2005.

Overview of the share of certain state aid categories in the total granted state aid in the Republic of Serbia in 2005, 2006 and 2007

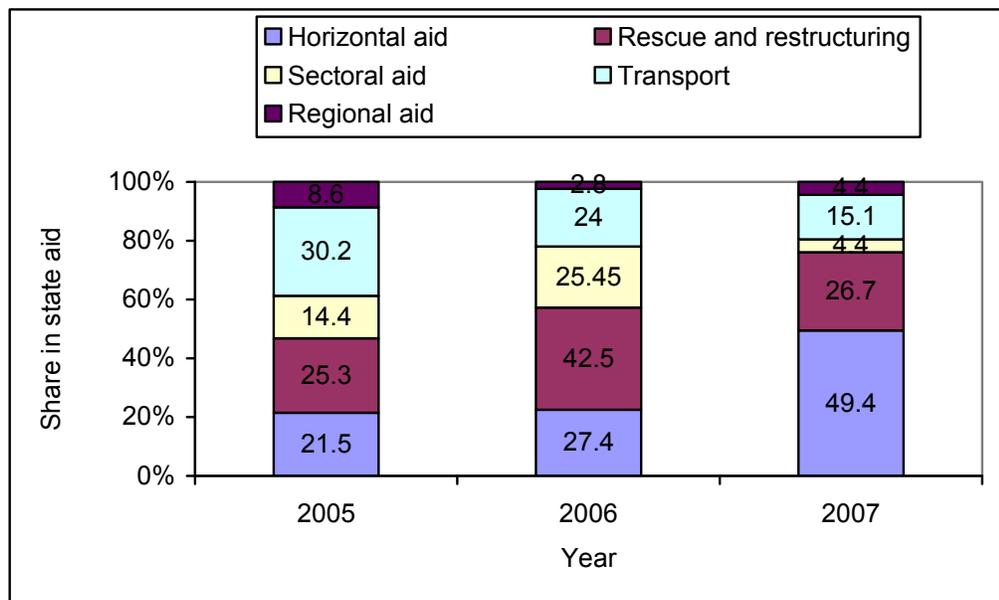
Figure 3



Data set out in Figure 3 on the share of certain state aid categories in the total granted state aid in 2005, 2006 and 2007, shows a positive trend reflected in an increase of the share of the horizontal state aid and a decrease of share of the sectoral state aid, which is in line with the European Commission's recommendations even though the Republic of Serbia is not an EU Member State. The share of the horizontal state aid in the total granted state aid showed the ascending trend - in 2005 it amounted to 46.8%, in 2006 it was 68.0% and in 2007 the share is 74.1%. At the same time, the share of sectoral state aid showed a declining trend, i.e. from 44.6% in 2005, to 29.2% in 2006, to 19.5% in 2007.

State Aid Structure according to Certain Aid Targets

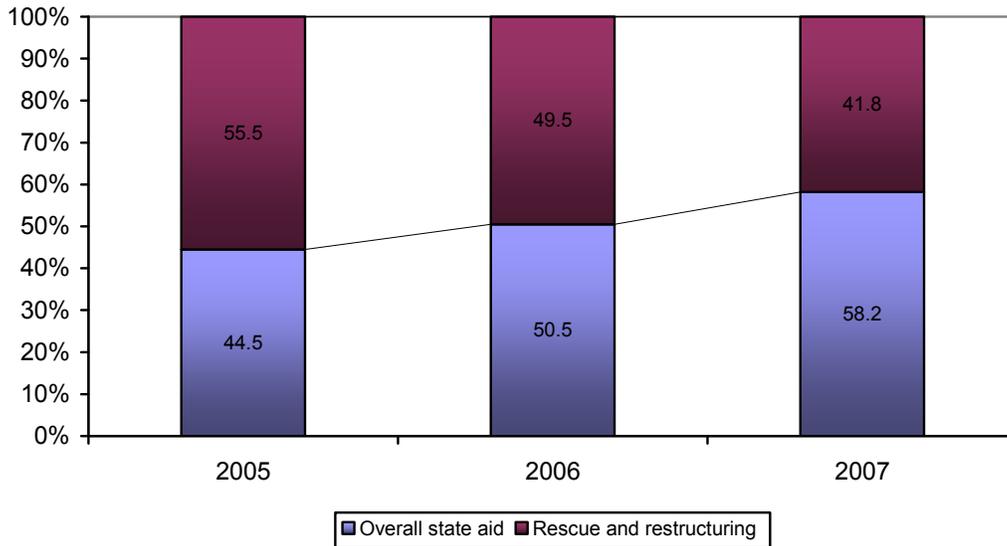
Figure 4



Data set out in Figure 4 shows the ascending trend of the state aid directed to development programmes, whether to investing to encourage development of underdeveloped regions (areas), improved employment, development of SMEs or development of certain sectors, whereas the share of granted state aid in the development of railway transport is dropping, including rescue and restructuring of companies and entrepreneurs, which is specifically notable in 2007.

State Aid Structure in Relation to Separate Sectors and Investments

Figure 5



If the total granted state aid is analysed, as set out in Figures 4 and 5, where in Figure 4 the state aid for the transport sector (Public Company "Serbian Railways") is separately shown, including the state aid for rescue and restructuring in Figure 5, the following trend can be noted: absolute amounts of state aid granted to the railway transport in the last three years were approximately equal, but the percentage of share was changing because of changes to the amount of the total granted state aid in monitored years. The positive trend of the horizontal aid share is related to a decrease of the aid amount for rescue and restructuring, that is, to the end of the process of privatisation of enterprises with social capital which should be undertaken in 2009 bearing in mind Article 14 of the Law on Privatisation ("Official Gazette of the Republic of Serbia", No. 38/01, 18/03, 45/05 and 123/07).

Overview of Aid Share for Rescue and Restructuring in Total State Aid in the Republic of Serbia and European Union Countries in the Period between 2003 and 2007

Figure 6

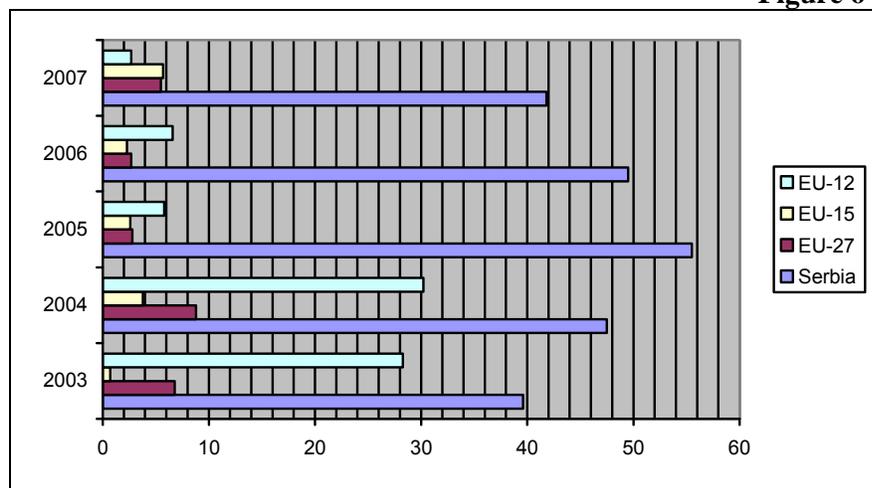


Figure 6 sets out an overview of the state aid share granted for rescue and restructuring of enterprises in relation to total granted state aid in the Republic of Serbia and European Union Member States in the period between 2003 and 2007. At the European Union level the percentage ranged from 8.8% in 2004, to 2.7 % in 2007.

If we look at new Member States separately (EU-12), which most influenced an increase in share of state aid for rescue and restructuring, we can see that the privatisation process in those countries ended by 2004. Consequently, the share of the quoted form of state aid in the total state aid granted in those countries was 30.2% in 2004, with an apparent and significant decrease of this form of state aid since then.

2.3.1. Horizontal State Aid

Horizontal State Aid Structure in the Republic of Serbia in 2005, 2006 and 2007

Table 4
Amounts in millions of dinars

Type of Horizontal State Aid	2005	2006	2007	Index 07/05	Index 07/06
Research and development	-	-	22	-	-
Training	1,283	6	2,985	232.6	49.75
Employment	661	4,646	3,077	465.5	66.2
SMEs	2,749	10,767	17,268	628.1	160.3
Environment protection	-	-	-	-	-
Rescue and restructuring	6,732	9,430	12,771	189.6	135.3
Export promotion	-	308	330	-	107.1
Export incentives	1,000	-	-	-	-
Total	12.,425	25,157	36,453	293.3	144.8

According to data set out in Table 4, in relation to 2006 the horizontal state aid in absolute amount in 2007 is by 44.8% higher, and by 193.3% higher than in 2005. The increase in absolute amount of the horizontal state aid is, primarily, the result of a significant growth of amounts of tax incentives directed towards the promotion of development of small-and medium-sized enterprises and employment. The significant discrepancy in amounts of state aid intended for training of staff, for the same beneficiary ("Zastava zapošljavanje i obrazovanje" d.o.o.) in 2005 and in 2007 in relation to the amount in 2006, results from the fact that the funds granted in 2006 are earmarked as funds intended for rescue and restructuring.

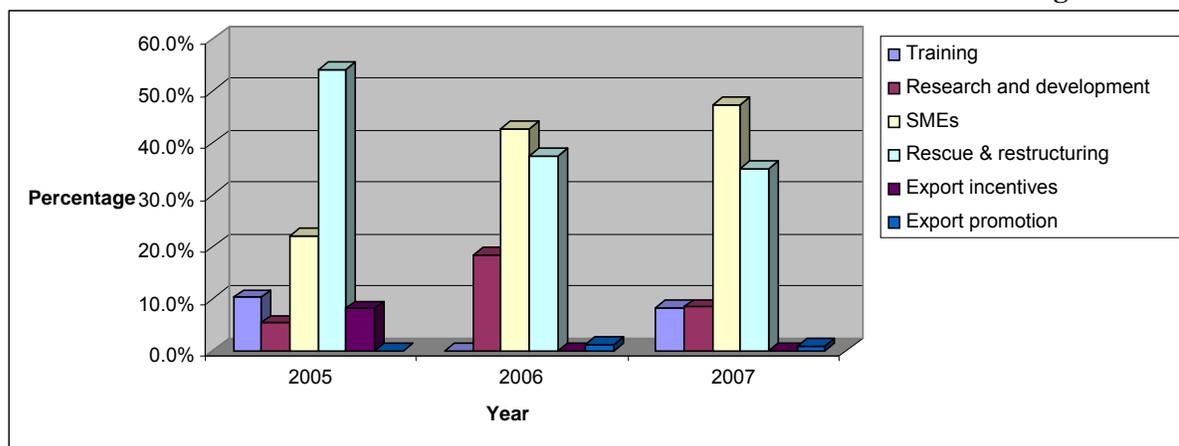
Share of Certain Types of State Aid in Total State Aid in the Republic of Serbia in 2005, 2006 and 2007

Table 5
Amounts in millions of dinars

Year	2005.		2006.		2007.	
	Amount	in%	Amount	in %	Amount	in %
Research and development	-	-	-	-	22	0
Training	1,283	10.3	6	0	2,985	8.2
Employment	661	5.3	4,646	18.5	3,077	8.5
SMEs	2,749	22.1	10,767	42.8	17,268	47.4
Environment protection	-	-	-	-	-	-
Rescue and restructuring	6,732	54.2	9,430	37.5	12,771	35.0
Export promotion	-	-	308	1.2	330	0.9
Export incentives	1,000	8.1	-	-	-	-
Total	12,425	100.0	25,157	100.0	36,453	100.0

Horizontal State Aid Structure in 2005, 2006 and 2007

Figure 7



Within the horizontal state aid structure in 2007, as well as in 2005 and 2006, the largest amount of granted state aid is directed towards the development of small-and medium-sized enterprises and the social programme, that is, for the purposes of addressing issues of staff redundancy in companies undergoing rescue and restructuring. In 2007 state aid thus granted constitutes 82.4% of the total granted horizontal state aid, in 2006 it was 80.3% and 76.3% in 2005. Investments, with the primary aim to promote employment, train staff and promote export, make for a total of 17.6% of the total horizontal aid in 2007, that is, 19.7% in 2006 and 23.7% in 2005. State aid for the promotion of development and research, and for environment protection has not been granted (according to data from the competent Ministry).

Unlike the two preceding reporting years, when a larger portion of state aid was directed towards issues of staff redundancy in companies undergoing rescue and restructuring (37.5% in 2006 and 54.2% in 2005 of the total horizontal aid), investments into the development of small-and medium-sized enterprises in 2007 increased by six times in relation to 2005 and by 1.5 times in relation to 2006, constituting 47.5 % of the total granted horizontal aid, being higher in the second consecutive year than investments in the social programme for tackling issues of staff redundancy in companies undergoing rescue and restructuring whose share in the horizontal state aid is 35.0%.

Horizontal State Aid by Aid instruments in 2007

Table 6
Amount in millions of dinars

State Aid Instruments	Subsidies	in%	Tax incentives	in %	Favour. loans	in %	Total
1.Horizontal state aid	12,352	100	15,468	100	8,633	100	36,453
Training	2,985	24.2	-	-	-	-	2,985
Employment	2,518	20.3	-	-	559	6.5	3,077
SMEs	207	1.7	15,420	99.7	1,641	19.0	17,268
Research and development	-	-	-	-	22	0.2	22
Rescue and restructuring	6,569	53.2	48	0.3	6,154	71.3	12,771
Export promotion	73	0.6	-	-	257	3.0	330
Total	12,352	33.8	15,468	42.4	8,633	23.8	36,453

Aid instruments for the horizontal state aid, as set out in Table 6, show that this category of state aid, as one that is least selective, has been implemented largely through tax incentives. Those incentives, in their comprehensiveness, by clearly set long-term objectives (employment, SMEs development, promotion of investments in underdeveloped areas, investments in environmental protection, research and development) as well as the possibility to monitor and oversee authorising, represent the best instrument. The horizontal state aid is financed through tax incentives with 42.4%, and if the state aid granted for rescue and restructuring is excluded which has been realised by means of subsidies, write-off of liabilities under authorised loans and of outstanding tax charges, then the share of this instrument is 65.3%.

2.3.2. Sectoral State Aid

Sectoral State Aid in the Republic of Serbia in 2005, 2006 and 2007

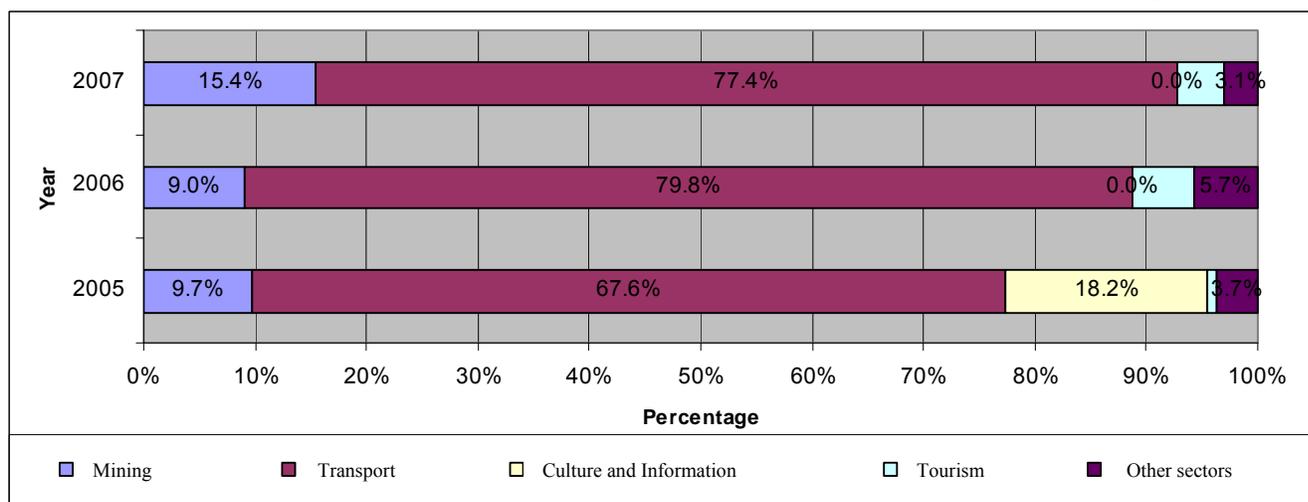
Table 7
Amounts in millions of dinars

Sector	2005	2006	2007	Index 07/05	Index 07/06
Mining	1,150	1,000	1,440	125.2	144.0
Steel	0	0	0	-	-
Transport	8,006	8,858	7,239	90.4	81.7
Culture and Information	2,135	-	-	-	-
Tourism	95	561	379	398.9	67.5
Other sectors	430	380	293	68.1	77.1
Total	11,816	10,799	9,350	79.1	86.5

Absolute amount of granted sectoral state aid in 2007 are by 13.5% lower than in 2006, and by 20.9% lower in relation to 2005.

Sectoral State Aid Structure in the Republic of Serbia in 2005, 2006 and 2007

Figure 8



The aid granted to the transport sector (still only to the railway transport as it was the case in the two preceding reporting years) has the largest share in the sectoral state aid. In 2007, state aid to this sector amounts to 77.4 % of the total sectoral state aid, whereas it was 79.8 % in 2006 and 67.6 % in 2005.

2.3.3. Regional State Aid

Regional state aid is granted to promote the development of less developed areas, that is, underdeveloped areas and/or regions, directed towards the mitigation of structural problems and regional uneven development. This category of state aid includes measures promoting economic activity with a view to reducing economic, natural, social, demographic and other differences in those areas and/or regions.

Regional State Aid in the Republic of Serbia in 2005, 2006 and 2007

Table 8

Indicator	2005	2006	2007	Index 07/05	Index 07/06
Total State Aid	26,516	37,005	47,892	180.6	129.4
Regional state aid	2,275	1,049	2,089	91.8	199.1
% of share of regional state aid in total state aid	8.6	2.8	4.4		

Investments in the regional development, **total of RSD 2,089 million**, were undertaken through the following aid instruments: subsidies (RSD 1,177 million), tax incentives (RSD 49 million), favourable loans through the Republic of Serbia Development Fund (RSD 604 million) and through the Development Fund of the AP of Vojvodina (RSD 259 million).

State aid granted from the level of the Autonomous Province of Vojvodina has been set out in general as the regional state aid.

According to data from annual balance sheets of local self-government units (municipalities, cities and the City of Belgrade), it has been established that in 2007 no aid was granted that would be characterised as state aid. From this level of authority, only subsidies were granted in 2007 to private companies providing public transportation services and under equal conditions applicable to state-owned companies providing the same type of services.

2.4. State Aid Disbursement Instruments

State aid is granted from public funds, and it is set out, depending on the aid instrument, as actual or potential public expenditure or it effects a diluted generation of public revenue.

In 2007 state aid in the Republic was granted through the following instruments:

- subsidies,
- tax incentives (tax reduction, cessation of tax liabilities, tax write-off),
- favourable loans - credits.

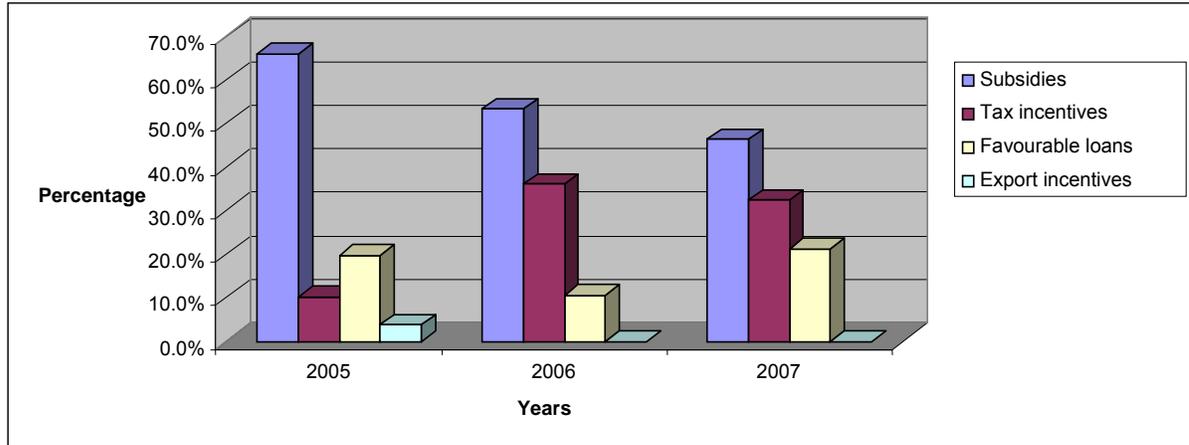
**Total State Aid Granted in the Republic of Serbia in 2005, 2006 and 2007
by Aid instruments**

Table 9

Instrument	2005	in	2006	in	2007	in	Indices	
		%		%		%	07/05	07/06
Subsidies	17,538	66.1	19,745	53.4	22,208	46.4	126.6	112.4
Tax incentives	2,728	10.3	13,369	36.1	15,517	32.4	568.6	116.0
Favourable loans	5,250	19.8	3,891	10.5	10,167	21.2	193.6	261.2
Export incentives	1000	3.8	-	-	-	-	-	-
Total	26,516	100.0	37,005	100.0	47,892	100.0	180.6	129.4

Instrument Structure of State Aid in the Republic of Serbia in 2005, 2006 and 2007

Figure 9



Trend of Share of State Aid Disbursement Instruments in 2005, 2006 and 2007

Figure 10

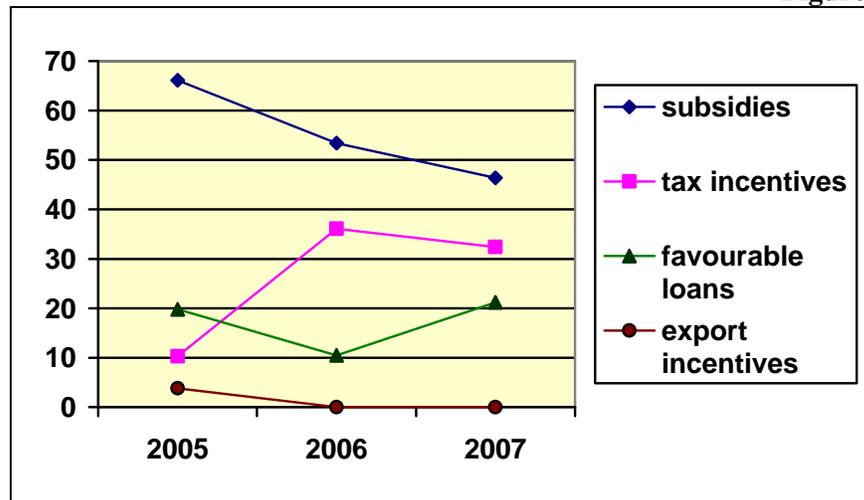


Table 10 and in Figures 9 and 10 set out an overview of total granted state aid in the Republic of Serbia in 2005, 2006 and 2007 by aid instruments, as well as the trend of share of the instrument of granted state aid in the same period.

The quoted overviews do not contain state aid data by issued guarantees, given that in the period observed no issued guarantees were activated or payments debited to the Guarantee Fund. As no other criteria that would characterise an issued guarantee as state aid were established in the authorising procedure, there is no possibility, therefore, to set out amounts that fall under state aid within all issued guarantees.

**Total State Aid Granted in the Republic of Serbia in 2007
by Aid instruments**

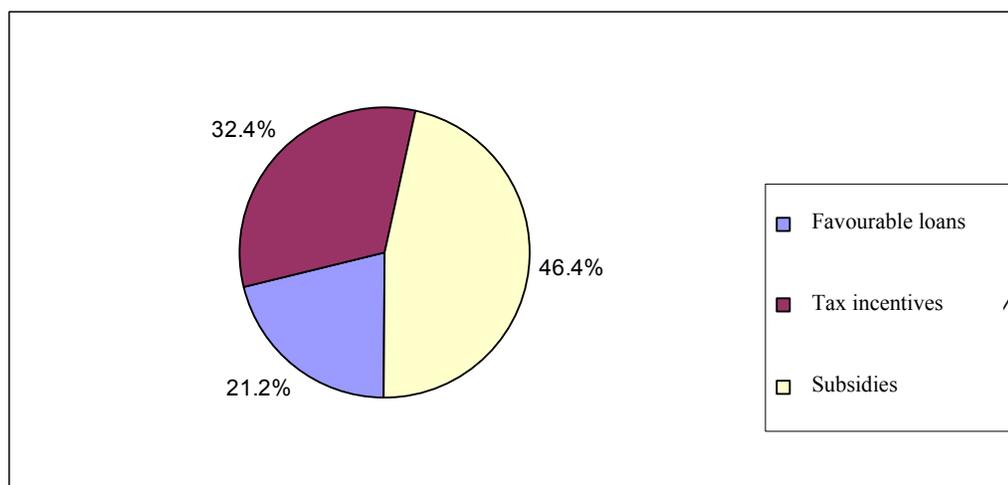
Table 10
Amount in millions of dinars

State Aid Category	Subsidies	Tax incentives	Favourable loans	Export incentives	Total
1.Horizontal State Aid	12,352	15,468	8,633	-	36,453
Training	2,985	-	-	-	2,985
Employment	2,518	-	559	-	3,077
SMEs	207	15,420	1,641	-	17,268
Research and development	-	-	22	-	22
Rescue and restructuring	6,569	48	6,154	-	12,771
Export promotion	73	-	257	-	330
2.Sectoral State Aid	8,679	-	671	-	9,350
Mining	1,440	-	-	-	1,440
Transport	7,239	-	-	-	7,239
Culture and Information	-	-	-	-	-
Tourism	-	-	378	-	378
Other sectors	-	-	293	-	293
3.Regional State Aid	1,177	49	863	-	2,089
Total	22,208	15,517	10,167	-	47,892

In 2007 the Guarantee Fund issued guarantees amounting to €1,305,680, 23 for nine beneficiaries, and there was no protest under guarantee in 2007.

**Structure of State Aid Disbursement Instruments
in the Republic of Serbia in 2007**

Figure 11



2.4.1. Subsidies

In the Republic of Serbia as well as in the European Union ¹⁾, subsidies are the most represented instrument granting state aid. In 2007 in European Union Member States subsidies made for 50% of total state aid. In 2007 in the Republic of Serbia the share of this instrument in total granted state aid was 46.4%.

Following inclusion of a relatively large number of activities and beneficiaries, the largest state aid grantor in the form of subsidies is by the Ministry of Economy and Regional Development. In order to solve the staff redundancy problem, the said Ministry has granted, through the implementation of the social programme within rescue and restructuring of companies, subsidies in total of RSD 6,569 million, RSD 2,518 million for employment, the amount of RSD 2,985 million for training and education of employees who were left without job ("Zastava zapošljavanje i obrazovanje" d.o.o.), and RSD 207 million for the promotion of small and medium-sized enterprises, clusters and business incubators, amounting to a total of RSD 12,279 million from the level of the said Ministry.

The Energy Ministry has granted subsidies for the Resavica mine amounting to RSD 1,440 million, whereas the Infrastructure Ministry has granted funds for Public Company "Serbian Railways" amounting to RSD 7,239 million.

Autonomous Province of Vojvodina has granted subsidies amounting to a total of RSD 1,177 million for the following purposes: employment promotion, tourism development, small and medium-sized enterprises, introduction of new technologies and export promotion by co-financing participation in international fairs.

The Serbia Investment and Export Promotion Agency has provided donation in total of RSD 73 million.

2.4.2. Tax Incentives

For the purposes of this Report, the term "tax incentives" includes as follows:

- tax incentives approved under Articles: 47 and 48 of the Corporate Profit Tax Law ("Official Gazette of the RS", No. 25/01, 80/02 and 84/04);
- tax incentives approved under Article 39 of the Personal Income Tax Law, ("Official Gazette of the RS", No. 24/01, 80/02, 135/04), through the reduction of personal income tax on the basis of investments in fixed assets;
- cessation of tax liabilities under the statute of limitation, based on Article 114 of the Law on Tax Procedure and Tax Administration ("Official Gazette of the Republic of Serbia", No. 80/02), and tax write-off by the Government for companies that are sold in the privatisation process, that is, those which undergo the restructuring procedure, under Article 115 of the same Law.

According to quoted grounds, in 2007 tax incentives totalled RSD 15,517 million, with their share in total granted state aid amounting to 32.4 %.

The tax incentives structure is as follows:

1) According to the Corporate Profit Tax Law and the Personal Income Tax Law, companies were granted as follows:

- RSD15,420 million for the promotion of investments in existing companies and for setting up new companies, for a total of 16,476 beneficiaries;
- 49 million for regional development objectives, for 49 beneficiaries;
- 26 million under the Law on Tax Procedure and Tax Administration (Article 114.), according to which 53 tax payers saw the cancellation of their tax debt under the statute of limitation;
- under Article 115 of the same Law, tax amounting to 22 million of dinars has been written off by a separate Government decision for 14 companies undergoing the privatisation process and/or the restructuring.

2.4.3. Favourable Loans

Favourable loans are represented with 21.2 % in total granted state aid.

When it comes to loans under more favourable conditions than those in the banking capital market the amount of state aid represents a positive effect of a more favourable interest rate under which loans were approved in relation to the reference (average) interest rate¹⁾ in the banking capital market, calculated by application of the simple linear method for the loan period.

Approved loans amounts to a total of RSD 26,348 million, and the positive effect of a more favourable interest rate, that is, the amount of granted state aid, totals RSD 4,699 million.

Written off liabilities under loans approved earlier amounting to RSD 5,469 million represent in its entirety the amount of granted state aid, hence total state aid referring to loans under more favourable conditions being RSD 10,168 million.

The Republic of Serbia Development Fund has granted short-term and long-term loans¹⁾, whereas the AP of Vojvodina Development Fund has granted only long-term loans. The Export Credit and Insurance Agency has granted only short-term loans. According to data of this Fund by 31st December, 2007 a total of RSD 19,428 million in loans was disbursed as follows:

- short-term loans amounting to RSD 1,672 million, under the interest rates of 1% and 5% and the net effect of RSD 54 million, of which RSD 49 million is related to the development of small-and medium-sized enterprises, and RSD 5 million to rescue and companies in difficulties;

- long-term loans amounting to RSD 17,756 million, under the interest rates of 0%,1% and 3%, and the net effect of RSD 4,129 million.

The Development Fund of the AP Vojvodina has granted a total of RSD 1,803 million of long-term loans, with an average interest rate of 3.5%, whereas the positive net effect, that is, state aid amounts to RSD 259 million.

In 2007 the Export Credit and Insurance Agency granted short-term loans totalling RSD 5,406 million (excluding the agriculture sector), under an average interest rate of 4.66% , with the effect of a more favourable interest rate, that is, state aid amounting to RSD 258 million.

1) According to data of the National Bank of Serbia an average interest rate for short-term loans granted by business banks in 2007 amounts to 11.26%, and 10.09 % for long-term loans (Statistical Bulletin of NBS 1/2008)

3. FINAL CONSIDERATIONS

The 2007 report is the fourth annual report on state aid granted in the Republic of Serbia prepared by the Ministry of Finance. Comparative data speaks best about amounts of state aid granted in the Republic of Serbia, but also of its share in GDP. From the aspect of the European Union rules in the field of state aid, absolute levels of state aid are not so significant, but their share in GDP. Even small amounts of state aid can distort competition. Only the so-called *de minimis* state aid is exempt from this rule in the European Union. The former implies that an amount exceeding € 200 000 per beneficiary is not granted within a three year period.

Although the state aid control system, in line with European Union rules, has not been established yet in the Republic of Serbia, the development of annual reports on granted state aid ensures transparency in granting state aid.

The Law on State Aid Control is undergoing the Parliament procedure, and it is expected to be passed as soon as possible given that it is very important law from the set of the "European laws". The passing of this Law and the beginning of its implementation (the implementation to start as of 1st September, 2009 as foreseen), will finally allow a completely new, but very complex state aid control system to be established. In the implementation of the said Law an ongoing cooperation between all stakeholders is necessary above all, in order to avoid potential problems.

The establishment of the control system in the area of state aid will create legal and institutional grounds for acceleration of reforms, follow-up of economic policy that guarantees the macro-economic stability and the strengthening of competitiveness of the economy, the directing of public funds to the place where they are most indispensable, with a view to realising a sustainable economic development as a whole, and a special focus on regional development.

The inventory of state aid is the first significant step towards establishing the legal and institutional framework for the state aid control. The reporting on categories, instruments and on amounts of state aid granted, will ensure transparency of the state aid system. Full transparency of data on granted state aid will be ensured only by the passing of the Law and by-laws, i.e. once all existing schemes (programmes) of state aid are aligned with quoted regulations and once new schemes (programmes) and individual state aid are previously notified to a body competent for the state aid control, which will be established by the Law (State Aid Control Commission).

The obligation of reporting on granted state aid at all levels of authority in the Republic of Serbia will be also specified by Law, whereas by-laws will regulate in more detail the methodology of development and time limits for the submission of data in order to collect comprehensive and best quality data from state aid grantors.