CENTER FOR SOCIAL AND ECONOMIC RESEARCH

Sienkiewicza 12, 00-944 Warsaw, Poland **tel. (+48 22) 622-66-27**
e-mail: case@case.com.pl **tel. (+48 22) 828-61-33**
http://www.case.com.pl **fax (+48 22) 828-60-69**

The Comparative Analysis of State Aid and Government Policy in Poland, Hungary and the Czech Republic (Deliverable 2.3)

Revised version (28 January 2004)

Project title: Changes in Industrial Competitiveness as a Factor of Integration: Identifying Challenges of the Enlarged Single European Market

Contract No. HPSE-CT-2002-00148

Project title: **Changes in Industrial Competitiveness as a Factor of Integration: Identifying Challenges of the Enlarged Single European Market**

Contract No.: **HPSE-CT-2002-00148**

Work Package 2, Deliverable 3

Work Package Leader: Iraj Hashi

D R A F T 3

The Comparative Analysis of State Aid and Government Policy in Poland, Hungary and the Czech Republic

Iraj Hashi

with contributions from Ewa Balcerowicz, Marcin Sowa, Miklos Szanyi, and Marie Bohata

INTRODUCTION

The transformation of centrally planned economies to market economies meant that the omnipresent state which, for decades, had controlled all aspect of economic organisation had to withdraw from direct and active intervention in the affairs of the enterprise sector. The government's major role was to facilitate the transition to the market system by establishing appropriate institutions and a macroeconomic environment in which private sector development could proceed freely. Stabilisation, liberalisation, privatisation and institution building constituted the four pillars of the programme which guided the governments in the three countries under consideration.

While at macroeconomic level, all three countries scored major successes in the early period of transition, the developments at microeconomic level were more complicated and much slower. The transformation process was accompanied by major shocks to the economic system and resulted in financial distress in a majority of enterprises, at that time mostly state owned. These enterprises faced unknown new conditions in which they had to survive on their own, without the variety of subsidies and state support they had previously received. For some, the markets for their products had changed or vanished altogether, especially when the economy was opened to foreign competition. For others, the lack of managerial skill, especially in areas such as marketing and finance, resulted in losses and mounting debts.

The poor microeconomic situation and the threat of large scale bankruptcy, led to the discussion of 'industrial policy' in almost all newly transforming countries. 'Industrial policy', in this period, referred to different forms of intervention aimed at revitalising the enterprise sector and changing the financial position of enterprises, especially the large and politically important firms. In the early years, of course, the policy was not well articulated and had a strong 'crisis management' feature. It was, to a large extent, ad-hoc and unfocused. But, gradually, it was elaborated with specific medium term aims in mind. The intervention was sometimes targeted at certain industries (coal mining and steel, for example) and sometimes only at certain enterprises depending on the circumstances.

In addition to microeconomic problems which were largely related to the previous system, and arose as a consequence of the transition process, the development of a market economy itself also necessitated direct government action to respond to other problems arising from market failure: externalities, spill-over effects, R & D financing, environmental projects, information asymmetries, structural adjustments caused by technological change, etc. These problems are the target of industrial policy in all market economies including the EU states.

The policy instruments used for both types of industrial policy were similar and included measures such as: direct subsidies, tax allowances, writing-off or rescheduling of enterprise debts to banks, writing-off or transferring banks' bad debts to specialist agencies, writing-off or reducing penalties for delayed payments to the state, allowing enterprises to build arrears to the state, providing investment incentives for domestic and foreign firms, providing free or cheap credit for certain activities, etc. Although the term 'industrial policy' was used to explain both kinds of policies, the actual mechanisms used were essentially those of 'state aid' (a concept which became better known once the negotiations on Association Agreements started in the accession countries).

The aim of this paper is to compare the government microeconomic policies aimed at the enterprise sector in the three accession countries under consideration and analyse the similarities and differences between these policies, and how they have changed over time. The paper uses the data and assessments presented in the country papers on state aid and government policies prepared by Marcin Sowa (on Poland), Miklos Szanyi (on Hungary) and Marie Bohata (on the Czech Republic).[1] The ultimate aim is, of course, to investigate the impact of these policies on competitiveness, a task that will be undertaken in the next stage of this research project. Section 1 discusses the early industrial policies, aimed at responding to consequences of transition in the three countries. Section 2 discusses the evolution of state aid policies in the context of Association Agreements and negotiations for accession, which involved the setting up of appropriate monitoring institutions. Here, the structure of state aid, and the financing instruments, in the three countries are compared. Section 3 concludes.

[1] Details of these papers can be found in the References section,

1. INDUSTRIAL POLICIES IN THE EARLY TRANSITION PERIOD

The three countries under consideration started from different initial conditions and the political make up of their governments varied significantly in the early 1990s.[2] But there were many similarities in their approach to resolving problems of the enterprise sector. All three countries employed direct intervention through 'industrial' policy measures aimed at rescuing enterprises in financial difficulty (even when the normal operation of market forces would have led to their closure) despite their unequivocal commitment to the establishment of a market economy. All three countries used industrial policy tools to save large loss making enterprises as well as writing off enterprise debts through the banking system. Here, we shall briefly review the similarities and differences of a number of similar industrial policy measures in the three countries during the period under consideration.

a. Poland. The 'rescue and restructuring' policies were implemented within two specific programmes, the Industrial Development Agency (IDA) and Enterprise and Bank Financial Restructuring Programme (EBFRP).[3] IDA was established as a state agency in 1991 with the aim of contributing to the restructuring of the Polish industry by financing restructuring projects, and extending credit and collateral to state owned enterprises in financial distress. However, because of the absence of a government long term policy on enterprise support, IDA's activities were not directly linked to the restructuring efforts of enterprises, which were usually undertaken very late and under conditions of crisis. In ten years, IDA supported some 700 enterprises and conducted 63 bank conciliation agreements (Bałtowski 2002, p. 153). IDA has also been managing two special economic zones (in Mielec and Tarnobrzeg)[4] and has been a financial investor in a number of companies and financial institutions. Unfortunately the information on the total resources channelled through IDA is not available, and its annual reports do not reveal the data that could give a comprehensive picture of its financial involvement or the effectiveness of the aid extended to enterprises.

One of the enterprises in the IDA remit was the Ursus, the largest Polish tractor manufacturer. Between 1991 and 1996, Ursus received PLN 189 m (approximately US$ 67 m) as well as ECU 1.74 m in the form of direct subsidies and soft loans. However, as the Supreme Chamber of Control (1997) found, these measures did not result in the effective restructuring of Ursus and its return to profitability.

The Polish National Railways was another major recipient of state support, though the total volume of support is not known due to the variety of forms of support and the manner of reporting. Yet, despite the large amount of support, the still state-owned enterprise is in a critical financial position with the technology and equipment and the quality of service largely unchanged.

---

[2] Poland, e.g., suffered most seriously from macroeconomic disequilibrium, inflation, foreign debt and shortages at the end of the socialist period.

[3] For details of the EBFRP, see Gray and Holle (1998) and Blacerowicz and Bratkowski (2001).

[4] Special economic zones are briefly discussed in Section 2.

In early 1993, the government introduced a new and innovative policy in the form of Enterprise and Bank Financial Restructuring Programme (EBFRP) to deal with the rising volumes of enterprise debt. The programme consisted of a decentralised conciliation process led by banks in which each bank negotiated a restructuring plan with each of its debtor enterprises. The plan involved rescheduling of debt to the bank, including some write-offs, in return for the implementation of specific restructuring measures – reorganisation of the company, closing down unprofitable parts, reducing employment, etc. The advantage of this programme was its decentralised nature – each bank had to deal with its own debtor enterprises for whom the bank possessed adequate information and could make informed judgement on their restructuring plans. The resources needed to finance the programme (recapitalisation of banks), amounted to approximately US$2.3 bil (PLN 4.7 bil) and were provided by the state in the form of treasury bonds (Balcerowicz and Bratkowski, 2001, pp. 15-16). Although the outcome of this programme was below the original expectation of its authors, it nevertheless resolved some of the enterprise debt problem, bank's liquidity and debt portfolio, and facilitated the restructuring of some firms. However, none of the large loss making state owned enterprises in the programme were either restructured or declared insolvent.

In addition to the above-mentioned IDA and EBFRP, there were also the separate sectoral support programmes, largely aimed at coal mining and iron & steel industries. During the first decade of transition, the coal mining industry received some PLN 34 m (75% of which came from the state budget and 11% was in the form of debt forgiveness). But, as in the case of other loss making industries, the figure for total support only refers to the direct support and does not include the unpaid tax and other liabilities to the state (the size of which are not known). Although coal mining underwent significant downsizing, with employment having been reduced from 388,000 to 146,000 (a reduction of 62.4%) between 1990 and 2001, the sector has still not reached profitability (Supreme Chamber of Control, 2002a).[5]

The iron and steel industry received both sectoral aid as well as support for restructuring through other programmes. Of the 25 units involved in the iron and steel sector, 7 have been liquidated or declared insolvent and the restructuring of the remaining 18 is still continuing. Although the employment in the sector reduced by 64% (from 123,000 in 1992 to 44,000 in 2002), the bulk of reduction was in the 1999-2001 period, and leading the Supreme Chamber of Control (2002b) to observe that none of the goals of the original programme had been reached and the performance of steel enterprises had not improved significantly.

As mentioned earlier, the bulk of state support to enterprises was not connected to any long term development policy but to rescuing enterprises in difficulty. The support came from not only the Ministry of Finance by also tax chamber and many other institutions and organisations. Moreover, as Neneman and Sowa (2002) point out, much of the support provided to enterprises were not reported properly (especially when the reporting of state aid was regularised).

[5] With the exception of 2001 in which the sector made a small profit.

The state support policy for distressed enterprises was, to a large extent, motivated by political and electoral considerations. Strong trade unions, particularly in coal, steel and enterprises like Ursus, Stocznia Gdańska (former Lenin Shipyard), etc., and the frequency of parliamentary elections in the early 1990s, meant that successive governments would use their financial resources to intervene in the competitive process in order to bolster some firms or sectors in financial difficulty. As the literature on industrial policy and strategic trade policy as well as the outcome of these policies show, direct intervention in favour of some firms not only is anti-competitive but also reduces the pressure on these firms to engage in deep restructuring. Consequently, the state would find it necessary to continue subsidising these firms in one form or other – particularly the large, state owned monopolies. Indeed, as a recent study of over 10,000 enterprises by Kopczewski, et al. (2003), shows, the soft-budget constraint regime was present in Poland even as late as the 1998-2000 period and was more pronounced in large, state owned firms in more concentrated industries.

b. Hungary. Despite the less traumatic initial conditions, the need for the restructuring of enterprises was no less urgent in Hungary than in Poland as hundreds of enterprises found themselves in financial distress at the onset of transition. As in Poland, the government was concerned about the future of large enterprises and enterprises heavily indebted to banks. After an initial period characterised by the absence of a strategic view of the economy, by 1992 the government embarked on active intervention aimed at the large loss making enterprises, initially 12 companies, known as the 'dirty dozen', later increased to 15. These were firms from automotive, electrical appliances, metallurgical and chemical industries, some of them former industrial flagships, and some with important regional employment implications. Some were in declining industries while others were in growing industries with expected better prospects (all in need of rescue and restructuring). The lack of a well thought-out policy was demonstrated by the application of the same policy tools and approach to both declining and growing industries (Szalavetz, 2003).

The restructuring programme for these enterprises was the joint effort of several ministries (especially the Ministry of Finance), the State Property Agency (which managed the privatisation programme) and banks. Instead of a specialist agency (as in Poland), a 'task force' was created to oversee the process. The Hungarian Investment and Development Bank (HIDB)[6], as a major vehicle of government's economic policy, was also brought into the programme and charged with buying shares of enterprises selected for reorganisation programmes (see below) and overseeing their restructuring. The resources used for the restructuring of the 15 large companies came from a variety of

[6] HIDB had replaced the Hungarian Investment and Development Corporation (HIDC) in 1993. HIDC itself had been set up in 1991 by the State Property Agency to participate in the debt conciliation programme and restructuring of enterprises. It had itself replaced another development agency from the socialist period, the State Development Agency (SDA), which had been involved in setting up development projects under the previous regime and, as a result of its activities, had accumulated large non-performing debts.

sources (state budget, the State Property Agency[7] as the representative of enterprise owners, etc.) and took the form of direct cash subsidy, write-off of arrears, and use of the resources of development and restructuring funds. The total amount spent on the programme has been estimated at approximately US$ 1.5 bil (Torok, 1997), though the outcome was less spectacular: about half of the firms survived and were privatised, some were broken up and sold in small units and some parts remained in the portfolio of the state-owned Hungarian Development Bank (Szanyi, 1996).

Apart from the large, loss making 'strategic' firms, the government's rescue and restructuring included two rounds of debt conciliation under the Bank and Debtor Conciliation Programme, affecting some 150 firms between 1993 and 1996. HIDB participated in this programme actively, converting some of its loans to equity in order to influence and facilitate the restructuring process. The introduction and implementation of the bankruptcy law resulted in an increase in the number of firms in financial distress and the size of the bad loan portfolio of banks. This highlighted the need for urgent state intervention in the form of conciliation arrangements. Agreements involved work out arrangements between banks and their debtor enterprises to rearrange their debt in return for restructuring. The arrangements included the write-off of some of the enterprise debts and the pro-rata recapitalisation of banks by the state, the transfer of some of the debts to the Hungarian Investment and Development Bank (and their later conversion to equity), and the rescheduling of some of the debt as part of the restructuring plan. In some cases the creditor bank brought in other affiliates to take over the ownership of some of the enterprises in the conciliation programme.[8] The cost of this programme is estimated at US$ 4-4.5 bil though, for a variety of reason, this figure is only an approximation (Szanyi 1996).

HIDB was responsible for managing a portfolio of assets including the non-performing loans inherited from its predecessors and shares obtained in the restructuring programme. In 1996, it was later changed to Hungarian Development Bank (HDB) and gradually became the major tool of government economic policy, channelling state subsidies as well as EU funds to various recipients. Its portfolio management role was thus somewhat diminished.

c. Czech Republic. The financial distress facing Czech enterprises in the early transition period manifested itself in massive enterprise debt, largely to banks and other enterprises. Without any long term policy, the government's main concern was to reduce the level of indebtedness and speed up the privatisation and restructuring of the enterprise sector. Firstly, a limited amount of enterprise debts (to the tune of CSK 50 bil, or US$ 1.7 bil)[9]

---

[7] State Property Agency was the in charge of the privatisation programme and acted as the *de facto* owner of all state owned enterprises.

[8] For example the Hungarian Credit Bank transferred the ownership of 4 large canning factories to a daughter company which took on the task of reorganisation followed by sale to other buyers.

[9] We use CSK for Czechoslovak Koruna and CZK for Czech Koruna.

was written off.[10] Secondly, a new state-owned *Konsolidacni banka* (KOB) was formed in February 1991 to act as a kind of debt restructuring agency. It took over a part of commercial banks' credit to enterprises (at much reduced interest), thus reducing the bad debt portfolio of commercial banks. The volume of credit transferred to this bank amounted to CSK 120 bil or US$ 4 bil (80 bil in the Czech Republic and 40 bil in Slovakia).[11] Thirdly, the application of the new bankruptcy law was postponed until April 1993 in order to give enterprises in distress more time to adjust themselves to new conditions. Fourthly, a computerised clearing of inter-enterprise debt (cancelling some the liabilities of many enterprises against their claims) was undertaken on two occasions in May and September 1993. Some 5000 Czech enterprises participated in this innovative exercise and had their liabilities reduced by some CZK 15 bil (US$ 500 m). The scheme was organised by the Czech National Property Fund and used up nearly CZK 1 bil (US$ 330 m) of its resources.[12]

The Czech government's support for enterprises in financial difficulty continued in an indirect manner for many years. Enterprises were indebted to banks (in which the state was a significant minority shareholding, at least until the late 1990s). Their inability to service their debt did not lead to the bankruptcy process but was accommodated by banks. When banks themselves got into financial difficulty, the state embarked on rescue operations designed to prevent the collapse of the banking system. In 1996, when a number of small private banks had collapsed and financial crisis was looming, the non-performing loans of participating banks were transferred to *Konsolidacni banka* (KOB). The cost of this programme was put officially at CZK 100 bil (US$ 3.7 bil) and unofficially at CZK 240 bil (US$ 8.8 bil).[13] Later on, in 2000 and 2001, when Czech banks were in the process of real privatisation (i.e., the large remaining shares of the state was being sold to foreign banks), KOB helped the clean up of the portfolio of these banks by enabling them to dispose of non-performing loans. When *Komercni banka* (KB) was taken over by *Societe Generale*, the state transferred some CZK 60 bil (US$ 1.6 bil) of KB's bad debts to a subsidiary of KOB (KONPO s.r.o.). Similarly, when the *Investicni Postovni banka* (IPB) was on the verge of bankruptcy, the government provided a guarantee worth CZK 50-200 bil (US$ 1.3-5.2 bil) to CSOB (the bank which took over the crashing IPB) to cover its classified debts.

The 'industrial policy' debate was rekindled in 1998, when the Social Democratic Party came to power and decided to deal with the problem of heavily indebted large loss making enterprises which, though privatised in the early 1990s, had accumulated huge debts to the banking system (largely state controlled). The so-called 'Revitalisation Programme' effectively amounted to the *de facto* re-nationalisation of these enterprises, the restructuring of their debts and their re-privatisation. The scheme involved the

---

[10] The Czech and Slovak National Property Funds issued CZK 50 bil of government bonds (US$ 1.7 bil) – 10 bil to strengthen the capital position of commercial banks and 40 bil to write off some of the poorest performing debts of enterprises to banks. For details, see Hashi, et al. (1996), p. 5.

[11] After the separation of Czech Republic and Slovakia, KOB was also divided into two separate banks, Czech KOB and Slovak KOB. Czech KOB started its own activities in February 1993.

[12] For details of these support programmes see OECD (1991), pp. 113-114 and Hashi, et al. (1996), pp. 11-14.

[13] For details, see *Central European Business Weekly*, October 25-31, 1996.

establishment of a Revitalisation Agency (as a subsidiary of *Konsolidacni banka*) in 1999 which would take a controlling stake in the companies in the scheme from their existing owners, work with the creditors' committees to develop a restructuring plan which may include some debt write off (especially to state controlled banks), debt rescheduling, injection of new capital and managerial expertise and the restructuring of companies' operations. The agency would then sell the ownership stakes in the restructured companies to new strategic investors. The Revitalisation Programme was designed for very large and heavily indebted companies. They had to employ over 2000 employees and have a debt of over CZK 3 bil (over US$ 78 m) to the state. Some 8-15 enterprises qualified for the programme. The total amount of support provided for the Revitalisation Programme is unknown.

During the 1990s, the role of KOB expanded significantly: from administering some of the bad loans of commercial banks to engaging in the restructuring of enterprises, managing the financing of selected projects, cleaning the banking sector and providing technical assistance for the privatisation of banks. Together with *Ceska financni* and *Ceska inkasni*, they constituted a group of 'transformation institutions'. At the same time, the National Property Fund (which had originally been set up to manage the state property in the process of privatisation) also was involved in providing bail out for banks and financing programmes implemented by KOB as well as assistance to the health insurance companies, public hospitals in financial trouble and the Czech Railways.
Clearly, the relative share of resources channelled through KOB (i.e., 1.5-4.1% of GDP) is of the same order of magnitude as the whole of reported state aid, indicating the importance of this organisation in the funding of government policies.

After ten years of operation as the main arm of the state aid policy, *Konsolidacni banka* was transformed to *Ceska konsolidacni agentura* (CKA) on 31 August 2001, 'losing' its banking license. Its development role was transferred to CMZRB and its 'asset management', together with all its assets remaining in the CKA. The Agency was given the mandate to specialise in the management and work-out of bad loans and non-performing assets with a view to maximise the proceeds of sale of these assets for the state. CKA is authorised to use all the tools that were available to KOB and its liabilities are guaranteed by the state. CKA has already managed to sell some of its bad debt to private sector institutions at large discounts (11-18 per cent of their nominal value) though its remaining assets are still very significant - with a value of some CZK 300 bil (US$ 11 bil). Although the exact final amount of support channelled through them to Czech banks, enterprises and other organisations remains unclear, the following table provides an approximate indication of the relative value of resources used by KOB and its related institutions between 1993 and 1998 (i.e., before the large injection of funds to resolve the financial crisis and privatisation of banks).

Table 1 - State Support Channelled through KOB-Related Institutions, 1993-98 (CZK m)

Net public expenditures through each institution:	1993	1994	1995	1996	1997	1998
Konsolidacni banka	7.7	7.3	4.5	0.9	10.6	28.8
Ceski Inkasni	20.1	6.6	4.9	4.8	3.1	2.7

Ceski financni	-	-	-	-	0.6	1.8
National Property Fund	4.2	8.2	4.3	1.9	2.0	2.6
State guarantees	0.1	-0.4	1.3	14.9	51.5	26.7
Total as % of GDP	3.2	1.9	1.9	1.5	4.1	3.5

Source: Mladek (2003)

To sum up: in the early transition period all three countries embarked on similar rescue and restructuring policies in order to speed up the adjustment process and save as many of their enterprises as possible though the institutional set up and the overall approach were different in the three countries. In Poland, the Industrial Development Agency and the decentralised Enterprise and Bank Financial Restructuring Programme were the main vehicles of the policy. In Hungary, the restructuring of enterprises combined with bank conciliation process was less centralised though the Hungarian Investment and Development Bank played a major role. In the Czech Republic, the *Konsolidacni banka* was the main institution through which the policy was implemented. In all three countries, the state support came from a variety of sources and in a variety of forms, with its total amount unclear.

Indeed major features of this type of industrial policy were its unplanned and reactive character and its non-transparency. The exact magnitude of support is extremely difficult to estimate as, at least in some cases, these were not reported comprehensively. For example while the direct subsidy to coal mining in Poland was reported, the arrears for taxes and contributions were not – thus confusing the totality of state support. Another major feature of the industrial policy in this period was its political character: political and electoral considerations, lobbies and powerful trade unions, and party loyalties all had their influences on how this type of industrial policy was implemented. In many cases, the intervention went far beyond what was economically justified. Open 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.

2. STATE AID POLICIES SINCE EUROPE AGREEMENTS

In transition countries, as in other market economies, state aid in favour of particular firms, industries, activities or regions may be justified on the ground of market failure. The problem facing transition countries was that they had to undertake 'transition-related' policies (already discussed) at the same time as policies designed to counter market failures. The EU, while in principle sympathetic to the problems facing these countries, wanted to make sure that various forms of intervention were limited in both duration and scale and, in time, would be brought into line with EU practices.

In the early 1990s, all three countries entered into negotiation with the European Commission in order to prepare themselves for the eventual accession to the Union. The Association Agreements were signed in the first years of transition with all three countries, giving them some time to bring their legislation and practices into conformity with EU legislation and regulations. State aid was an important element of negotiations

on the competition chapter and was referred to explicitly in all the Agreements. The Europe Agreement with Poland was signed in 1991 and came into effect in 1994. Article 63.1 of the Agreement states:

> *The following are incompatible with the proper functioning of the Agreement, insofar as they may affect trade between the Community and Poland:*
> *…(iii)any public aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods.*

In the Czech Republic, the Agreement was signed in 1993 and became effective in February 1995. In Hungary, the Agreement was signed in 1991 and became effective in 1994. Both of these agreements also contained explicit articles on state aid.[14] In all three countries, much of the state support for the enterprise sector in the three countries was in conflict with the Europe Agreement and had to be gradually reduced. EU negotiators pressed the governments of the three countries hard in order to ensure that they take appropriate measures to reduce state support and make it compatible with EU rules.[15] Moreover, given the fact the state support was provided by a variety of institutions and in many different forms with the magnitudes of support unclear, and sometimes unknown, it was also necessary to establish monitoring procedures and institutions with sufficient authority and clout. The Agreements also identified the institutional framework for the monitoring and referral of state aid. In Hungary, following the decision of the government on the implementation of Article 62 of the Agreement, the first State Aid Monitoring Office (TVI, in Hungarian) was established in the Ministry of Finance in 1996. In Poland, the Office for Competition and Consumer Protection (OCCP) became responsible for monitoring state aid. In the Czech Republic, the task was initially given to an Office within the Ministry of Finance (as in Hungary) but, in 2000, the responsibility was transferred to the Office for Protection of Competition (OPC).

In addition to the external pressure for change, the establishment and development of a market economy also required a reduction in the level of state support for enterprises. The commitment of different governments to this principle, of course, was neither very strong nor consistent. Depending on the political leaning of the particular government and its susceptibility to lobbying and pressure, their view on the role of state varied significantly. But, in the end, all governments had to take binding legal decisions at the highest level to commit themselves to a state aid policy in conformity with EU rules by setting up the legislative framework, the administrative system and the enforcement mechanism. Negotiations on the 'competition chapter' of the *acquis* were completed with all three countries in October and December 2002 and EU negotiators satisfied that the three aforementioned requirements were in place.

[14] Article 62 in the Hungarian Europe Agreement and Article xxx in the Czech Agreement.

[15] Needless to say that the EU also wanted to create a level playing field in which EU producers could compete with domestic firms on a more equal footing. A glance at the recipients of largest grants in Hungary shows that they are well-known multinationals such as Caterpillar Hungary, Curver, Denso Hungary, Ford Hungary, GE Lighting Tungsram, Philips Monitor, Sony Hungary, etc. (Antaloczy, 2000).

In Poland, a State Aid Act was passed in 2000 and became effective in 2001[16] (i.e., seven years after the Europe Agreement became effective), giving the authority to collect, monitor and make judgement on state aid to OCCP. The situation was similar in other countries – a long gap between the Agreement and the necessary legislation and enforcement mechanism. In the Czech Republic, the Law on State Aid, No. 59/2000 (Coll. 1.34) was passed and became effective in May 2000, transferring the monitoring task to OPC. In Hungary, the 1998 Law on the Transformation of State Aid System and the Government Decree No. 76/1999 (V.26) brought the state aid system in conformity with EU rules. The government decision put TVI in charge of aid monitoring and established the principle of 'prior notification' of state aid.. In this way, all three governments committed themselves to the principle of an independent institution in charge of monitoring and reporting of state aid in line with EU rules. More importantly, all state institutions offering support to enterprises and other organisations were required to notify the monitoring institution and the institutions were empowered to demand information on state aid and give opinion on the admissibility of individual aid cases. The problem facing these institutions, however, has been that too many government organisations are empowered to offer state aid to enterprises and other economic and socio-political entities. In Poland, for example, according to the Reports on state aid, six ministries, seven agencies and four funds at national level, all voivoids, starosts, mayors and heads of municipalities have offered state aid to entrepreneurs and enterprises. It is therefore quite difficult for the monitoring organisation to collect the information on the actual granted aid from all these authorities.

Despite these commitments, there are still shortcomings in the process of notification and reporting, often motivated by political considerations, though sometimes by the arbitrary nature of allocation of aid to a particular category. For example, aid to railways may be reported under horizontal aid (labour restructuring) in order to make it more acceptable to monitoring institutions than under sectoral aid which would attract the attention of these institutions. Similarly, aid to SMEs in less developed regions of the country may be reported both under horizontal aid and regional aid, depending on which one suits the reporting authorities. More importantly, there is still concern by researchers that not all state aid is reported by the respective governments. For example, in some sectors in Poland, while officially announced grants to undertakings are reported clearly, their tax or social contributions arrears are not (as they were not planned). After some time, these arrears may be quietly dropped. Neneman and Sowa (2002) have raised serious concern about the reporting of state aid in Poland. In their view, in the year 2000, only 20% of fiscal aid was officially reported. The situation in other countries has not been well investigated and similar non-observance of rules may not be uncommon.

a. Total State Aid in the Three Accession Countries and EU

[16] This act was soon to be superseded by State Aid Act 2002.

In general, the relative volume of state aid in the three countries has been reducing since the Europe Agreement was signed by them.[17] This was in response to external pressure by the EU as well as the internal requirements of building a competitive market economy. The granting of state aid has evolved over the first decade of transition and, in many ways, approached the EU situation. Table 2 summarises the aggregate state aid and its sectoral breakdown in the three countries and compares it with the EU averages in 2000.[18]

Table 2 – Total and Per Capita State Aid in 2000

	Czech Rep	Hungary	Poland	EU15
Total aid (m Euro) Out of which (in %)	770	843	1869	69,460
- Manufacturing	42	62	42	35
- Coal mining	11	2	19	11
- Transportation	26	36	0[a]	46
- Services	19	0	13	3
- Others	2	0	26	5
Total aid in % of GDP	1.5	1.7	1.1	0.8
Total aid per capita (PPS)	174	190	98	185

[a] This does not mean an absence of aid for transportation but the classification of aid under another category. See text for explanation.

Source: Commission of the European Communities (2002).

The relative size of state aid (as a percentage of GDP) has been slowly approaching the EU average in recent years though it is still higher, but per capita state aid is lower than the EU average (except in Hungary where it is slightly higher). The dynamics of state aid is interesting. In 1996, one of the earlier years for which comparable data is available, state aid as a percentage of GDP in Hungary and Poland were 1.6% and 2.6% respectively. Since then, Poland has managed to reduce this ratio to 1.1% but Hungary experienced an increase to 2% by 1998 before a gradual fall to 1.7% in 2000. The sectoral breakdown shows similarities and differences, with more aid going to the manufacturing, coal mining and services, and less to transport, in the three accession countries than in the EU (with some exceptions, especially in the coal mining sector). As we shall discuss shortly, the aid to the transport sector was certainly not zero in Poland (as suggested in Table 2) – railways have always received substantial amounts of state subsidies, which have been classified under a different category.

[17] In Poland, for example, it reduced from 4% of GDP in 1994 to 1.2% in 2002. In Hungary, there is no official data on state aid in 1994 but the level of state subsidies to the economy was 6.8% of GDP (Szanyi, 2003, Table 1).

[18] A point of caution: the statistics for total aid are sometimes expressed as ‘total excluding agriculture’, sometimes as ‘total excluding agriculture and transport’ and sometimes in other forms. The comparison of breakdowns by objective or by instrument has to be done carefully to ensure the comparison of like with like.

b. State Aid by Objective

In addition to the 'rescue and restructuring' interventions, all three accession countries also embarked on a wide range of policies designed to speed up the development of a market economy in areas (such as R & D expenditure and small and medium sized enterprises) where the free operation of market forces would have produced unsatisfactory outcomes due to externalities, asymmetric information, and increasing returns. The intervention, following the language of EU state aid policies, is divided into horizontal, sectoral and regional policies according to the objective of the specific intervention. Horizontal policies apply to a wide range of enterprises meeting a particular criteria, e.g., support for SME development, R & D, employment, education and training, environmental protection, energy saving, investment incentives, etc. It also includes rescue and restructuring of enterprises subjected to unexpected shocks such as technological change. However, given the particular feature of transition economies (and the problems discussed earlier), the last type of support is distinguished from other horizontal policies and presented as a separate category.[19] Sectoral policies aim at resolving problems of specific sectors such as steel, coal mining, transportation (largely railways), shipbuilding, automotive industry, and synthetic fibres. We have already referred to the particular policies aimed at the steel and coal mining industries in the three countries in the previous section as the bulk of resources spent on these sectors were to deal with the particular economic structure inherited from the past. Finally, regional support programmes are concerned with influencing the development of regions suffering from special problems (high unemployment, low levels of development, etc.), which will not be resolved by market forces automatically. We will now briefly compare these policies in the three countries.

i. Horizontal Aid. All three countries had various horizontal aid schemes, in particular SME support, R & D support and employment support schemes. Horizontal aid is, in principle, less distorting than other forms of aid as it affects all, or a large number of enterprises, in the same way. It is generally assumed that the positive effect of aid, in reducing the impact of externality, is greater than its negative distorting effect on competition. Apart from the areas mentioned earlier, horizontal aid also includes aid for 'rescue and restructuring', i.e., support for enterprises beset by financial difficulties (in theory, temporary difficulties). This type of aid, however, is different from previous categories in that it has a potentially strong distorting effect on competition. We have already discussed this type of state support and will not dwell on it longer. With the exception of this category, on the whole, the amount of resources spent on horizontal aid schemes have accounted for a small fraction of state aid. Table 3 summarises the structure of horizontal aid and how it has changed in the three accession countries.

[19] See for example the Commission of the European Communities (2002), special edition of State Aid Scoreboard for candidate countries where comparable data on all forms of aid are presented for all candidate countries.

Table 3 - Horizontal Aid as % of Total State Aid

	1996	1997	1998	1999	2000	2001	2002
Hungary[a]							
Total aid (m Euro)	336.1	509.3	523.2	381.2	483.4		
Horizontal (as % of total)	13.2	14.2	11.9	8.3	9.4	12.0	
-- SME development	4.0	3.8	4.5	2.9	4.7	3.6	
-- R and D support	1.5	1.9	1.6	0.6	1.0	6.2	
-- Environment	1.2	4.8	4.8	4.8	3.7	2.1	
-- Employment	4.2	3.4	1.0	0.0	0.0	0.0	
-- Education, training	0.3	0.4	0.0	0.0	0.0	0.1	
-- others	2.0	0.0	0.0	0.0	0.0	0.0	
Rescue and restructuring	14.7	2.9	0.0	0.0	0.0	0.0	
Poland							
Total aid (m Euro)	3,013.5	2,711.2	1,649.7	1,924.7	1,868.8	2,960.0	2,665.6
Horizontal (as % of total)	n.a.	n.a.	40.0	71.9	55.0	11.8	10.4
-- SME development	n.a.	n.a.	n.a.	0.0	0.1	0.6	1.3
-- R and D support	n.a.	n.a.	0.9	1.6	1.3	0.9	1.3
-- Environment	n.a.	n.a.	5.8	2.7	4.5	0.7	1.4
-- Employment	n.a.	n.a.	7.9	31.4	24.2[d]	1.0	2.2
-- Education, training	n.a.	n.a.	n.a.	n.a.	0	4.2	3.6
-- Others	n.a.	n.a.	25.4	30.8	25.0[e]	4.2	0.5
Rescue and restructuring	n.a.	n.a.	n.a.	5.5	6.8	20.2	23.4
Czech Republic							
Total aid (m Euro)[b]		852.5	1055.6	1383.1	409.9	1464.7	852.5
Horizontal (as % of total)					28.1		
-- SME development		3.7	2.1	2.1	16.2		
-- R and D support		3.0	3.5	2.3	6.7		
-- Environment		1.5	0.3	0.3	0.6		
-- Investment support					4.0		
-- Employment					0		
-- Education, training[c]					2.5		
-- others (esp. energy saving and export promotion)		0.9	10.5	5.7	1.0	1.2	
Rescue and restructuring					6.2		

[a] For Hungary the 1996-2001 figures and percentages refer to state aid in the manufacturing sector only.
[b] The figures for the Czech Republic are from OPC and are quite different from those in CEC (2002).
[c] State aid for this objective is included in other programmes, mainly SME development and investment support.
[d] About 40% of this was spent on the rehabilitation of persons with disabilities.
[e] This is largely for 'investment' support.
Source: TVI (2002), p.17; Office for Competition and Consumer Protection (2003); Commission of the European communities (2002); Office for the Protection of Competition Czech Republic, Annual Report, various issues.

The table also shows the official amount of aid for 'rescue and restructuring' as a separate category to ensure it is clearly distinguished form other, less distorting, categories. This category of state support was particularly important in the earlier years of transition and is expected to decline over time – though in practice it has not in all countries. A serious shortcoming of the table is that the coverage of state aid is very different in the three countries, with the Czech Republic having the smallest amount of data in comparison with the other two countries. More importantly, the published by the national monitoring office is very different from that published by the EU (see footnote to the table).

The Czech Republic has, in general, allocated a larger amount of state aid to horizontal policies. In particular, it has developed the most extensive range of programmes for SME support schemes and earmarked a significant amount of funds for them. Starting from 1992 and the passage of the law on state support for SMEs, the governments established the *Ceskomoravska zarucni a rozvojova banka* (*CMZRB*) as a financial institution providing new and existing SMEs with: short term credit; short, medium and long term guarantees for investment projects; support for payment of interest; and consultancy and advice on state assistance programmes. Between 1992 and 1997, the volume of state support to SMEs through CMZRB alone was approximately CZK 5 bil (in constant 1992 prices)[20] – and of course there were other mechanisms such as fiscal measures through which the state support was channelled to SMEs. To encourage the establishment and development of SMEs, a number of specialised programmes were set up and CMZRB took on the responsibility for their funding. These programmes were:

START - to help small start-ups (employing less than 10 people) and development of smaller firms (with less 25 employees);
ROZVOJ - to provide capital for promising development projects;
REGION - to help problematic regions hit badly by structural changes[21];
KONZULT - to provide information and advice centres for SMEs;
TRANSFER - to enable access to new technologies and know-how transfer;
PARK - to help set up science and technology parks;
GARANT - to offer guarantees for long term bank credit in selected areas of activity; and
ZARUKA - to assist small firms with collateral.[22]

'Rescue and restructuring' has continued to be of some importance in the Czech Republic (to be developed after some data is available).

In Poland, horizontal policies did not generate as much interest as in other countries.[23] The most important of these policies, the SME support programmes, were talked about in great detail and drew the attention of all post communist governments, but attracted a

[20] Annual Reports of CMZRB.
[21] It should be pointed out that sometimes policies aimed at SMEs also had a regional character, and can easily be also classified under 'regional' objective. The REGION scheme is an example.
[22] For more details on these policies, see the Country Report on State Aid in the Czech Republic; Hoshi and Mladek (2003); and Sumpikova (2000). All of the programmes referred to above are still in existence.
[23] The large amount of 'employment' aid in 2000 arose because of a large amount of resources spent on employment schemes for disabled persons in that year, and not repeated later.

relatively small amount of resources (1.5%, 0.6% and 1.3% of all state aid in 2000, 2001 and 2002 respectively). The low level of resources devoted to SME support has been highlighted in a number of studies and surveys (e.g., Balcerowicz 2003, p. 226) and constitute a bone of contention between the government and proponents of SME support policies.

'Rescue and restructuring' aid has remained very high in Poland, especially in 2001 and 2002. Given the incompatibility of some of the measures in this category of aid with EU rules, governments sometimes try to hide their support policy for specific firms or industries under different, and more acceptable, heading. The small figure for this category of aid in Poland in 2000 is clearly not an indication of a decline in this type of aid, only that it is reported under a different category (in this case, most probably under 'employment schemes').

Measures designed to attract foreign investment have been prominent in Poland since the early days of transition – and with significant success. Again, the amount of public support for these measures remains unclear. But in the last few years, their amount has reduced to insignificant levels. They are classed under 'others' in Tables 2 and 3.

In Hungary, the horizontal support policies, especially those for SMEs and FDI, date from early 1990s, though they were systematically elaborated in the 1995 industrial policy discussions. The support for R & D, SMEs, and regions, and investment promotion were the main orientation of these policies. Later, by the year 2000 (the Szechenyi Plan and National Development Plan), the support for FDI promotion schemes and the Smart Hungary programme and the development of SME support policies became the dominant dimensions of horizontal policies. Additional aid under 'R & D support' objective in 2001 reflects the shift of emphasis from sectoral aid to horizontal aid under the SMART Hungary scheme.

Rescue and restructuring aid, at least in official terms, came to an end in 1998 largely as a result of the completion of privatisation. However, there is no doubt that state support has been channelled to 'needy' enterprises in covert forms, like investment by development agencies. An EU report (CEC, 2002) showed, the huge increase in 'other horizontal aids' in 2000 to cover various tax subsidies which were deemed incompatible with EU rules and had to be withdrawn later. The CEC (2004??) on which Table 3 is based, does not show this increase at all.

ii. Sectoral Aid. The state support for specific sectors of the economy (steel, coal, railways, etc.), almost always, has distorting effect on competition and resource allocation because it favours a small number of enterprises in few sectors against other enterprises and sectors, some of them competitors – at least in the market for resources. Sectoral aid is distributed to the so-called 'sensitive' sectors (specifically, steel, coal mining, automotive industry, synthetic fibres, and ship-building). These were selected because they were facing problems in all EU countries. Because of its distorting effect, sectoral aid is scrutinised in greater detail and is treated more harshly and is subject to more stringent rules. Most of the sectoral aid in the three accession countries was granted

in the early 1990s, and aimed at the restructuring of enterprises in specific sectors of the economy which were most strongly affected by the systemic change (coal mining, shipbuilding, steel, etc.). Some sectors, however, received support for specific reasons as special cases. The financial services sector in the Czech Republic, which faced particular problems in 2000-2001, is an example. This type of aid has been declining in the more recent times. Table 4 shows the proportion of state aid spent on sectoral aid programmes in the three countries.

Table 4 - State Aid according to Sectoral and Regional Objectives

	1996	1997	1998	1999	2000	2001	2002
Hungary							
Total aid (m Euro)	577.7	765.0	836.8	689.0	800.1	800.5	
Sectoral aid (as % of total)		43.1	40.8	45.7	39.6	36.5	
-- Steel	2.2	9.5	3.3	1.1	0	0	
-- Coal mining	3.6	4.2	2.8	2.3	1.6	2.0	
-- Transport	38.2	29.2	34.7	42.3	38.0	34.5	
Regional aid (as % of total)		44.6	51.2	48.9	54.3	48.6	
Poland							
Total aid (m Euro)	3,013.49	2,711,16	1,649.7[a]	1,924,7[b]	1,868.8	2,960, [c]	2,665,6[c]
Sectoral aid (as % of total)	n.a.	83.67	59.7	23.7	34.4	24.1	17.9
-- Steel	n.a.	n.a.	2.4	0.44	0.7	0.2	0.1
-- Coal mining	n.a.	n.a.	26.1	15.86	18.8	23.6	16.7
-- Transport	n.a.	n.a.	4	4.52	13.3		
Regional aid (as % of total)	n.a.	n.a.	0,3	1,28	3.8	3.4	4.6
Czech Republic							
Total aid (m Euro)		852.5	1055.6	1383.1	409.9	1464.7	
Sectoral aid (as % of total)					75.8		
-- Steel					n.a.[d]	23.6	
-- Coal mining					21.0	6.1	
-- Transport					48.6	1.3	
-- Financial services					1.0	59.4	
-- Tourism					-	0.2	
Regional aid (as % of total)					0.7	1.3	

[*] The figures for Hungary are taken from two sources (the EU and Hungarian publication. The figures are slightly different except for 'steel' where the EU source gives figures of zero for the steel sector from 1997 onwards. The Hungarian source seems to be more accurate here.

[a] The summary of objectives refers to the nominal amount of aid, i.e. prior to the establishment of the aid element.

[b] Excepting the aid granted by communes.

[c] Includes aid to agriculture.

[d] Some approved projects in 2000 were postponed. As a result the total state aid in 2000 is much smaller than initially thought. This explains the big difference between the data from OPC, CzR and CEC (2002).

Source: TVI (2002), p.17; Office for Competition and Consumer Protection (2003); Commission for the European communities (2002); Office for the Protection of Competition, various years.

Sectoral aid is generally not aimed at market failure but at the consequences of structural change caused by technological developments or, as in the case of transition countries, systemic change. More importantly, the effectiveness of sectoral aid is highly questionable. It is generally given under strong political pressure from the recipients of the aid. The expectation of bail out and public support prevents the recipients from engaging in deep restructuring and ensures that aid is continued far beyond a necessary initial period. Finally resources spent on these sectors are diverted from other parts of the economy where they may have been more productive. Although EU rules allow sectoral aid in principle, it needs to be justified on specific grounds.

We have already mentioned the iron and steel and coal mining in the earlier discussion of industrial policy. The latter is obviously a more significant sector in Poland than in the other two countries and its problem is still continuing (despite some successes in the restructuring process). The steel sector also attracted a high percentage of aid in Poland and the Czech Republic, though not so much in Hungary. Aid for transport sector (principally for railways) is a major element of state aid in all three countries, absorbing between 15 and 40 percent of total state aid. The aid is spent partly on investment in infrastructure and partly on subsidies on current operations (and keeping prices down for customers).

iii. Regional Aid. The share of state aid allocated to regional aid was presented in Table 3. While all three countries were interested in, and elaborated, policies to support the development of regions with higher unemployment or lower levels of social and economic development, the proportion of total resources were very different in individual countries. In Hungary, regional aid attracted a greater proportion of state aid than in other countries (about 12% of the total in 2000). The Czech Republic, on the other hand, allocated a very small proportion (about 1% in 2000) of its total support to regional aid. In Poland, too, the regional policy attracted a small, though not insignificant, share of state aid resources, despite the importance given to it by all concerned – only 3.8%, 3.4% and 3.6% of total state aid in 2000, 2001 and 2002 respectively.

In both Hungary and Poland, regional policy was, to a large extent, conducted through the 'special economic zones' (SEZ) schemes, with grants, tax exemptions and investment support was used to attract domestic and foreign investment to these areas. Although the Czech Republic did not have any special economic zones, the concept of 'industrial zones', which was very similar to SEZs, was promoted by the Ministry of Industry and Trade in 1999. Special economic zones were treated by policy makers and researchers as an effective instrument of regional policy which would enhance investment in regions and bring down the unemployment level substantially. In practice, the expectations regarding SEZs were not always materialised and the effectiveness of the state aid in this area remains unclear. The literature on state aid, of course, has already shown that this type of policy may be successful in attracting investment but only from a neighbouring city, region or country. A study by Krynska (2000), showing that many enterprises operating in SEZs in Poland had moved to SEZs from somewhere else, a move that entailed a reduction of resources in other places, confirms this view.

iv. State Aid by Instrument of Financing

We have already referred to mechanisms by which the state support is channelled to enterprises (subsidies, tax exemption, tax arrears, etc.). In the language of EU state aid, these instruments have been formally classified as follows:

- Group A: Grants and tax relieves
  - A1 – Grants, non-refundable subsidies , subsidies to the interest rate
  - A2 – Tax relief, tax exemption, amortisation of debt to state budget
- Group B: Equity participation
  - B1 – Contribution to a company's capital, purchase of shares
  - B2 – Debt to equity swap
- Group C: Soft credit
  - C1 – Preferential credit, conditional credit remittance
  - C2 – Accelerated depreciation, tax deferrals
- Group D: Guarantees and credit warranties

Table 5 shows how different countries used different instruments to finance their state aid policies. The table also shows the instruments for EU15 (for 2000 only).[24] Although the data for Hungary, and EU15 refers to the manufacturing sector rather than the economy as a whole (as in Poland and the Czech Republic), significant divergences can still be observed both within the accession countries and between them and EU15. In the Czech Republic (and EU15) grants are the principal form of state aid (accounting for over 60% of total).[25] In Hungary (and to a lesser extent Poland), tax exemptions play this role.[26] In the Czech Republic, unlike other countries, equity participation is quite significant – indicating the impact of the revitalisation programme after 1998. In the Czech Republic and Poland, soft loans also played a part in the state aid programme – though not in Hungary or EU15.

---

[24] It should be pointed out that comparison with the average for EU15 should be treated with some caution. The average hides many disparities between different countries.

[25] Grants accounted for the highest share of total aid in the UK (with 96%) and the lowest share in Ireland (with 19%) (Commission of the European Communities, 2003).

[26] Tax exemption had the highest share in Ireland (77%) and the lowest share in Finland (1.5%) (Commission of the European Communities, 2003).

Table 5 - State Aid by Instruments

		1996	1997	1998	1999	2000	2001	2002
	Hungary[a]							
A1	Grants (non refundable subsidy, interest subsidy)	35.74	27.92	23.04	13.08	19.07	26,3	
A2	Tax exemptions	58.76	58.28	72.90	77.30	77.48	71.0	
B	Equity participation	0	0	0	0	0	0.0	
C	Soft loans	2.86	4.60	3.60	7.69	2.03	0.4	
D	Guarantees	2.64	9.20	0.46	1.93	1.42	2.3	
	Poland							
A1	Grants (non refundable subsidy, interest subsidy)	19.3	20.4	25.7	32.8	46.0	25.6	37.8
A2	Tax exemptions	61.7	59.5	50.2	53.2	38.5	31.0	26.9
B1	Equity participation	0.0	0.1	0.1	2.1	1.3	0.2	0.2
B2	Debt to equity swaps	0.6	0.3	0.3	0.5	0.2	0.0	0.0
C1	Soft loans	5.6	9.1	7.8	7.3	9.6	15.0	4.0
C2	Other soft credits, deferrals	10.2	8.8	15.0	0.9	1.8	5.3	7.1
D1	Guarantees	2.6	1.7	1.0	3.2	2.6	16.1	21.8
	Czech Republic							
A1	Grants (non refundable subsidy, interest subsidy)					83.8	16.5	
A2	Tax exemptions					n.a.	n.a.	
B	Equity participation					4.6	82.3	
C	Soft loans					7.7	0	
D	Guarantees					3.9	1.2	
	EU15[a]							
A1	Grants (non refundable subsidy, interest subsidy)					62		
A2	Tax exemptions					20		
B	Equity participation					0		
C1	Soft loans					5		
C2	Tax deferrals					1		
D	Guarantee					3		

a For the manufacturing sector only.
Source: TVI. 2002, p.20; Office for Competition and Consumer Protection (2003); Commission for European Communities (2002); Commission of the European Communities (2003); Office for Protection of Competition, Czech Republic, various years.

3. CONCLUSIONS

The quantitative analysis of state aid, its structure and trend in the first decade of transition in the three accession countries is problematic. Not only there is confusion about the definitions used and methodologies followed, there have also been many changes in the methodology of allocation of state aid to different objectives and the time period when comparable statistics were collected. A particular area of confusion is whether a particular aid programme should be treated as horizontal, 'sectoral' or 'regional'. In the Czech Republic, EU methodology has been used only in the past two or three years, following the establishment of the legal framework. Before that, statistics are patchy and available only in highly aggregated form and are not always comparable with EU definitions. In Hungary, the Monitoring Office appointed in 1998 began to use EU methodology so the data for 1995-98 (prepared by the previous monitoring office) is not quite comparable with the subsequent data. In Poland, although the monitoring process started earlier than other countries and comparable data was collected, the reporting problems mean that only a proportion of real state aid was reported. More significantly, these shortcomings have enabled governments to provide aid to enterprises and sectors for political reasons which cannot be justified under EU rules.

Government policies in the three countries since the early transition have aimed partly at resolving the problems of enterprise sector which arose because of the systemic change and partly at facilitating the development of a market economy. The former policies targeted enterprise restructuring concentrated in few overgrown sectors, while the latter targeted areas of market failure. Both policies involved massive injection of state support to enterprises and sectors in financial difficulty in overt and covert manner. There was some overlap between the two sets of policies (especially under the 'rescue and restructuring' activities) and the manner of funding these policies was sometimes covert and often non-transparent. The support mechanism was often *ad hoc* and unfocused and changed frequently. Although the first set of policies was specifically relevant to early transition expected to disappear gradually, they have continued to date – albeit under different guises. The instrument of these policies were mostly fiscal (subsidies and tax exemptions), supplemented by other means such as soft credits, equity participation and guarantees.

These policies, and the instruments used for their implementation, clearly fell within the definition of 'state aid' policies, something which was of much interest to the EU. They clearly had an impact on the state of competition on the domestic and EU markets of supported enterprises and on their ability to attract labour and capital. Many of them would not have been able to withstand competition without the state support. The Europe Agreement signed in the early 1990s required all three countries to bring their state support policies into line with the principles of EU treaties. The agreements included a specific reference to the need for a reduction in state aid which *distorts or threatens to distort* competition on the EU market.

The laws (or government decrees) on state aid were particularly important because they committed the governments to new rules on state aid and provided a legislative

framework for granting aid and procedures for monitoring it. The reporting and monitoring of state aid has remained a major problem in all three countries largely because of the numerous aid granting authorities and the weak mechanism to ensure that all state aid is reported to the relevant institution. The competition authorities in the Czech Republic and Poland, and the special Monitoring Office in the Ministry of Finance in Hungary, became responsible for monitoring, reporting and giving opinions on state aid. It is expected that after the accession, the European Commission will take on the responsibility for monitoring and making judgements on state aid issues – as in the case of other member states.

As far as the actual policies were concerned, the three countries had many similarities and differences. In the early transition period, all of them embarked on the policy of enterprise debt restructuring and bank capitalisation. Sometimes, as in Poland, this was done in a decentralised manner with debt write-off or rescheduling linked to financial and organisational restructuring through the involvement of creditor banks. At other times, it was done through centralised programmes and specialised agencies such as *Konsolidacni banka* (in the Czech Republic), the Investment and Development Bank (in Hungary) or Industrial Development Agency (in Poland). In all cases, a very large amount of resources was spent on helping these enterprises (and banks) to restructure their operations. It is very difficult to judge whether or not these resources were used effectively and efficiently. What is certain is that the resources were sometimes used to bail out politically powerful enterprises and prolong their life (or agony), rather than to facilitate and speed up their restructuring. Much of these policies were unsuccessful and many of the recipients of this type of support eventually failed. The reports by the Polish Supreme Chamber of Control maintain that, in general, these resources were not used efficiently and the original aims of many of these programmes were not met. However, further studies in Poland, and other countries, are needed to shed light on the efficacy of state support for enterprises in the early transition.

In comparison with EU member states, the three transition countries enjoyed wider room for manoeuvre and broader authority in providing state support to the economy, especially the so-called 'off budget' support. In particular guarantees issued were not subject to strict limits, thus encouraging financial indiscipline. Over time, of course, the volume of state aid declined in all countries. The share of aid in GDP was about 4% in 1994 (in Poland) and reached 1.2% by 2002. **[add data on other countries]** Although on the eve of accession, the share of state aid in GDP in the three accession countries is still higher than the EU average, it has declined to a range comparable with those in some member states (the ratio for Finland, Denmark and Belgium in 2001 was 1.58, 1.36 and 1.34). However, per capita aid in Poland was lower than all EU states and that in the other two countries was lower than the majority of EU states.

In terms of the structure of aid, manufacturing and coal mining in accession countries received a greater proportion of aid than in EU states (with minor exception) whereas transport (specifically rail transport) received a larger share of aid in EU states than in accession countries. More striking is the share of horizontal aid in total aid which is the lion share of state aid in EU countries (up to 99% in Belgium) but a much smaller share

in the accession countries. Aid by sectors, on the other hand, was in reverse order. Finally, in terms of instruments of state aid, grants and subsidies were the main form of support in the EU whereas tax exemptions and deferrals, followed by soft loans and guarantees were larger and more common in accession countries. Multinational companies investing in accession countries have been a major beneficiary of tax exemptions and investment subsidies.

The comparison of state aid and its structure in the three countries and with EU has to be treated with caution as the classification of aid is not necessarily always the same in all countries. For example, the countries find it more in line with EU policies (and thus more acceptable) to report a low proportion of aid going to sectoral objective and a higher to horizontal objectives. Thus the very small figures for aid to the steel sector in Poland, compared to other countries (Table 4) do not mean that this sector no longer receives aid. It only means that the aid has been classified under a different (and politically more acceptable) category such as 'labour restructuring'.

REFERENCES

Antalóczy, K. (2000), FDI policy and incentives in Hungary at the end of the nineties, mimeo.

Balcerowicz, E. (2003), Barriers to Entry and their Impact on Private Sector Growth in Poland, chapter 7 in Hoshi, I., Balcerowicz, E. and Balcerowicz, L. (2003), *Barriers to Entry and Growth of New Firms in Early Transition,* Boston: Kluwer Academic Publishers.

Balcerowicz, E. and Bratkowski, A. (2001), Restructuring and Development of the Banking Sector in Poland. Lessons to be Learnt by Less Advanced Transition Countries, CASE Reports 44, Center for Social and Economic Research, Warsaw.

Bałtowski, M. (2002), Przekształcenia własnościowe przedsiębiorstw państwowych w Polsce (Ownership changes in state enterprises in Poland), Warsaw: Wydawnictwo Naukowe PWN.

Bohata, Marie (2003), Country Report on State Aid in the Czech Republic, December (mimeo)

Commission of the European Communities (2002), *State Aid Scoreboard, Autumn 2002 Update, Special Edition on Candidate Countries*, COM(2002) 638 final, Brussels.

Commission of the European Communities (2003), *State Aid Scoreboard, Spring 2003 Update,* COM (2003) 225 final, Brussels.

Gray, C. W. and Holle, A. (1998), Poland's Bank-Led Conciliation Process, Chapter 8 in Balcerowicz, L., Gray, C.W. and Hoshi, I. (1998), *Enterprise Exit Process in Transition Economies*, Budapest: Central European University Press.

Hashi I., Mladek J. and Sinclair, A. (1996), The Process of Exit in the Czech Republic 1990-1994, *Studies and Analyses,* No. 75, Warsaw: CASE Foundation.

Kopczewski T., Rogowski W. and Socha J. (2003), Soft Budget Constraints in Polish Manufacturing: Evidence from Panel Data, paper presented at the National Bank of Poland Conference on Potential Output and Barriers to Growth, Zalesie Gorne, 2003.

Kryńska, E. (2000), Polskie Specjalne Strefy Ekonomiczne (Polish Special Economic Zones), Wydawnictwo Naukowe Scholar: Warsaw.

Mladek, J. (2003), State Support to Economic Subjects in the Czech Republic, mimeo.

Neneman J., Sowa M. (2002) Miękkie ograniczenia budżetowe w Polsce (Soft Budgetary Constraints in Poland), in S. Krajewski, T. Tokarski (eds), "Wzrost gospodarczy, restrukturyzacja i bezrobocie w Polsce. Ujecie teoretyczne i empiryczne" (Economic Growth, Restructuring and Unemployment in Poland. Theoretical and Empirical Approach), Łódź University, Łódź.

OECD (1991), *Economic Survey of the Czech and Slovak Republic,* Paris: OECD.

Office for the Protection of Competition Czech, *Annual Report on State Aid*, various years, 1999-2001.

Sowa, Marcin (2003), State Aid and Government Policy in Poland, 1994-2002, November (mimeo).

Sumpikova, M. (2000), To Support or Not to Support, that is the Question, ICRE Working Paper No. 21, Institute for the Integration of the Czech Republic into European and World Economy: Prague.

Supreme Chamber of Control (1997), Informacja o wynikach kontroli gospodarki finansowej Agencji Rozwoju Przemysłu S.A. (Report on the results of audit on economic performance of Industrial Development Agency), 217/1997: Warsaw.

Supreme Chamber of Control (2002a), Informacja o wynikach kontroli restrukturyzacji finansowej i organizacyjnej górnictwa węgla kamiennego w latach 1990 – 2001 (Report on the results of audit on financial and organisational restructuring of hard coal mining between 1990-2001), 178/2002: Warsaw.

Supreme Chamber of Control (2002b), Informacja o wynikach kontroli restrukturyzacji i przekształceń własnościowych w hutnictwie żelaza i stali (Report on the results of audit on restructuring and ownership changes of iron and steel sector), 169/2002: Warsaw.

Szalavetz, A. (2003), A hagyományos és a gyorsan növekvő ágazatok támogatására alkalmazott iparstratégiai eszközök (Industrial strategy tools used for the support of traditional and fast growing sectors), Institute for World Economics, H.A.S., mimeo.

Szanyi, M. (1996), Market Exit in Hungary 1990-1994: Formal and Informal Mechanisms and State Accommodation, mimeo.

Szanyi, M. (2003), State Aid to Hungarian Manufacturing Sector 1990-2000, November, mimeo.

Török, A.(1997), Ipar- és versenypolitika az Európai Unióban és Magyarországon, (Industrial- and competition policy in the EU and in Hungary), in *Európai, Tükör,* No. 2, ISM: Budapest.