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# Minimizing Distortive Incentives and State Aid in Moldova

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## PROJECT AT A GLANCE

COUNTRY/REGION MOLDOVA/EUROPE AND CENTRAL ASIA

PRODUCT PRIVATE PARTICIPATION IN INFRASTRUCTURE AND SOCIAL SECTORS

THEME COMPETITION POLICY

Many developing economies still do not fully enjoy the benefits of competitive markets. Distorted markets reduce investment opportunities, increase business risks, raise the cost of essential business inputs needed to compete in domestic and international markets, and lessen the benefits of private sector participation for economic development and poverty reduction.

The World Bank Group's Investment Climate Competition Policy team is helping the government of the Republic of Moldova design mechanisms that minimize the distortive effects of incentives and state aid. Selective government aid targeting only a few firms diminishes the incentive for firms to be more efficient and negatively impacts productivity in those sectors. By reducing selectivity and increasing transparency in the granting of state aid, the project aims to level the playing field and maximize benefits for all market players. This project will also facilitate a more effective use of state resources.

## RESULTS AND IMPACTS

- An online information portal for state aid will help to increase transparency and level the playing field for all firms, including new entrants and small and medium enterprises.
- Systematic screening of state aid is expected to produce at least 5 percent savings of public state aid funds and a better allocation of government resources.
- Criteria for the design and evaluation of state aid that does not hinder a competitive economy will benefit all market participants.

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## CONTEXT

Most governments provide state aid with the intention of correcting market failures and supporting policies that benefit their citizens (such as initiatives to support education or foster innovation). However, targeting aid toward specific firms can negatively impact market competition. Firms that unduly receive state aid may enjoy a comparative advantage over their competitors that is not necessarily reflective of their efficiency or contribution to policy objectives.

State aid granted in Moldova accounts for around 8 percent of the government's budget expenditure and 3 percent of gross domestic product (excluding agriculture, fisheries and transport). The government of Moldova directs state aid to support regional development, small and medium enterprises, research and development, services of general interest, and other policy objectives. While most of Moldova's state aid schemes are meant to target a broad number of beneficiaries, lack of transparency has resulted in state aid benefiting only a few market players. For example, on average, 12 percent of aid administered from 2009–2011 was documented as aid to individual firms, but much more individual aid was likely granted as unplanned or "ad hoc" aid. In addition, around 90 percent of state aid is in the form of tax exemptions and subsidies— instruments that, when combined with lack of transparency, can be used to provide benefits to just a few firms.

**"The Republic of Moldova is in transition towards a market economy, and its main goal is building a competitive economy. Thus, a careful evaluation and monitoring of state aid is of paramount importance to achieving development results in the most efficient and least distortive ways, especially in light of European integration. To achieve this task, the technical assistance provided by the World Bank Group is crucial as it will help us implement the state aid control framework and set up a web-based record-keeping system of state aid in Moldova."**

VIORICA CARARE

President, Competition Council of the Republic of Moldova

## OUR ROLE

Promoting policies that enable a competitive economy is a key objective for the government of Moldova. It is one of seven medium-term objectives of the National Development Strategy for 2012–2020 and an important component of Moldova's efforts to join the European Union. In light of this policy commitment, the government of Moldova is working with the World Bank Group's Investment Climate Competition Policy team to reduce the market distortive impacts of its state aid.

With the support of the Bank Group team, the government adopted the Law on State Aid in 2012, which regulates the procedures for authorizing, granting, monitoring, and reporting state aid provided to various entities of the national economy, in line with the EU's rules on state aid.

The Moldovan Competition Council (CCRM), an autonomous agency, was created in 2013. The Bank Group is helping CCRM develop and implement a competition and state aid control framework by supporting amendments and targeting state aid instruments that create the most distortion in the economy, such as those that (i) benefit only a few competing firms or unevenly distribute the amount given to each firm, (ii) offer repeated benefits, and (iii) directly affect the aid recipient's variable costs and, thus, pricing and output decisions which can create an undue advantage in the market. The Bank Group is also supporting these changes by:

- Developing an online information portal to aid in record keeping, strengthening collaboration between CCRM and other public entities that grant state aid, and increasing transparency on how public resources are spent.
- Advising on the tools needed to evaluate and monitor state aid and ensuring all eligible market players benefit from available resources.
- Supporting communications strategies, creating media products, and hosting events to increase awareness of state aid rules and regulations among public and private sector stakeholders.
- Helping to build the capacity of CCRM and other agency staff through on-the-job training and workshops to help them appropriately analyze state aid and minimize the negative impact on market competition.

## CONTACT

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