



European Business Association

Republic of Moldova

Key Business Climate Issues Affecting Private Sector Development

Political Stability – Moldova needs to overcome the long lasting political turmoil. Political stability, including a stable and predictable foreign policy, is a key factor for private investors when taking decisions about investments in the Republic of Moldova. The effective implementation of the Association Agreement, including the DCFTA, is critical to achieve long-term political stability and economic prosperity.

Macroeconomic Stability – The Government must urgently secure access to international funding in order to overcome its serious funding constraints, which undermines the macroeconomic stability of the Republic of Moldova. Doubtful payment of salaries in the public service undermine the quality of the public service as well as the reported threat to the timely payment of pensions risk causing further public unrest. The lack of funding also causes the postponement or cancellation of investments in critical infrastructure projects. High interest rates paid by the Government in order to secure funding on the local capital market withdraw vital funding from Moldova's banks required to fund the private sector at reasonable interest rates. The possible continuing devaluation of the local currency is likely to cause an additional increase of the already considerably high inflation. Against this background it is critical for the Government to unlock the funding of international donors.

Rule of Law and Compliance with Commitments to Investors – The overdue deep reform of the judiciary and judicial process has substantially undermined the attraction of investments by the private sector. Due to frequent arbitrary interpretation of often poorly formulated legislation, sometimes abusive inspections of control bodies, lengthy non-transparent judicial processes, poorly trained, underpaid judges and civil servants combined with widespread corruption, international and local investors have lost trust in Moldova's legal system. The overall administrative burden on business is still high due to constraints in obtaining authorization, in particular from local public authorities, as well as in obtaining construction permits. The lack of rule of law and failure to meet the safeguards made to investors lead to a worsening of the situation in various sectors:

- i. **Energy Sector** – Gas Natural Fenosa (GNF), the greatest electricity provider is threatened by the authorities and state institutions. Over the last years (2012-2015), due to political pressure, election campaigns etc., ANRE (National Energy Regulation Agency) refused to update the tariff on electricity. Due to national currency devaluation, the cost of purchased energy (70% of the energy tariff to final customer) boosted and thus, the tariff for electricity increased up to 37% (September 2015, though suspended for 67 days). However, this increase covers only the indexation (which allows the retail supply company/electricity distributor to purchase energy

according to the new exchange rate), leaving aside the possibility to recover the cumulated debt of more than 90 million USD (caused by delay in tariff update) the energy sector/the state owes to GNF. No memorandum with ANRE and authorities on commitment to recover these cumulated tariff deviations has been agreed until now. This made GNF to delay its payments (about 15 million USD) to wholesale energy supply companies (Energocom and Termoelectrica – all state companies), which along with another state company, Moldelectrica (transmission company), filed lawsuits against GNF on grounds of debt and belated payments penalties recovery. At the same time, ANRE unilaterally (without consulting the affected operators) initiated the reform on modification of Tariff Methodology, though the existent Methodology approved in 2013 should have remained unchanged and valid for 5 years. Under these circumstances, in August 2015 GNF started a process in international arbitration against RM, with a preliminary stage of mediation, extended until June 1, 2016. However, on 8 June 2016, the Ministry of Economy and GNF signed an Arrangement on regularisation of tariff deviations recovery for the period of 2012-2015, facilitated by the Energy Community Secretariat. According to the arrangement, the parties agreed that the recovery of tariff deviations will begin as of 1 January 2017 and will last for 4 years, until 31 December 2020. Still, the final decision on confirmation of deviations and drafting of recovery mechanism through electricity tariff will be taken by ANRE. At a certain stage, the vote on a new draft law reforming the electricity sector and supported by World Bank, IMF and the Energy Community has been protracted in the Parliament, due to vested interests, and only recently, end of May 2016 received the final approval. Since August 2015, there were several attempts of buying GNF at a low price by doubtful “international” companies, allegedly all offers leading to the same vested interests.

- ii. **Insurance Sector** – Moldova risked to be suspended from the Green Card System as of June 1, 2016. However, the General Assembly of the members of the Council of Bureaux in Bruxelles, that took place on 2 June 2016, has decided to revoke the decision of suspension of the Moldovan National Bureaux of Car Insurers (BNNA) from the Green Card System. Therefore, Moldova will keep the status of *monitored member* of the International Green Card System, provided that immediate measures to restore the financial stability and security of BNAA will be undertaken with the involvement of relevant Moldovan authorities. The actions to be taken in order to avoid further suspension are beyond BNAA’s control and depend on political and judicial institutions. Suspension would cause severe troubles for the whole economy and people in the country. Lack of transparency in the share ownership in insurance companies and banks has led to monopolization of the market and major infringements. CNPF (regulatory body of the financial market) is reluctant to act in solving these issues, proving to be politically affiliated and remains for more than a year without a nominated president. The recent amendments to the Law on insurance, which waits for the final approval in the Parliament, regulating the process of issuing of licenses, the possibility to put the companies with financial irregularities under special administration in order to establish a trustworthy and functioning market, and that financial reports regarding solvability and liquidity are prepared by independent actuary. Ongoing criminal investigations connected to possible fraudulent claims in handling international cases, as well as to illegal actions of certain banks against BNAA with the purpose of blocking access to a substantial part of its funds are still under investigation and the final judgement is purposefully protracted. Prevention of frauds and irregularities is inter alia possible under the conditions that border control police checks the validity of incoming/outgoing Green Cards. The Ukrainian Bureaux filed several complaints to the Green Card Bureaux Council on the basis that the Green Cards issues in Ukraine are not accepted at the border with Transnistria.
- iii. **Telecommunications** – The major problem for private ICT companies in Moldova, is that Moldtelecom (national state owned operator) refuses to negotiate and sign an agreement for termination of the international calls to their network, based on the fact that Moldtelecom has signed an exclusive agreement with a Swiss company (Switchover AG), which was delegated all the attributions of intermediation of the international traffic. By the Decision of ANRCETI

(National Regulatory Agency for Electronic Communications and Information Technology) Moldtelecom was declared an operator with significant power on telephony market and has the obligation to negotiate any request of interconnection. In August 2015, this Decision was repealed, with violation of procedural terms and rules. At this stage, the act of repealing is appealed in the court. Instead of impartially regulating conflicts, ANRCETI in a biased manner protects the interests of Moldtelecom.

Another issue is the 2,5% income tax which is paid monthly according to the Law on social and republican funds. This tax has been introduced in 2000 when it was called “tax for luxury service”, but unfortunately it is paid in our days too, even though mobile communication is far from being a luxury service now. According to ANRCETI statistics (<http://anrceti.md/telmob>), the average penetration rate for Moldova in 2015 was of 121.97%, meaning Moldovans have at least one, but also 2 active mobile telephone numbers. Mobile telephony is certainly not a luxury any more, but a basic need and the payment of this monthly tax is considered to be discriminatory toward other service providers by the private telecom sector. Mobile telecoms sector also demands a revision of portability tariffs, the amount of which was objected even in the moment of their establishment. The tariffs haven't been justified accordingly, contrary to legal provisions: p. 109 from Regulation on portability “The Administrator will publish the Methodology of calculation for all the tariffs that should be sufficiently detailed in order to ensure that the operators would not cover other expenses than the costs for implementation, administration and operation of the data base.” Another issue worth mentioning is the disproportion between mobile companies' expenses and revenues. Most operational costs, including state frequency taxes are set in strong foreign currencies, while the tariffs are set in local currency. Considering exchange rate severe fluctuation during the last period of time, the telecom companies find it harder to keep the balance and strive to maintain affordable tariffs for the customers.

- iv. **Abusive Inspections** – Currently abusive controls and inspections performed by various law enforcement agencies like General Prosecutor's Office, National Anticorruption Centre, Ministry of Internal Affairs etc., may paralyse the activity of the most credible and legally functioning companies in Moldova. Considering that it requires less efforts to inspect a well-functioning and transparent company, instead of companies which under-declare their profits and are constantly engaged in tax evasion schemes, there is a need to streamline the state control/inspection function and make the process much more accurate and transparent. One of the options to enable that – is the practical application of the electronic Register of state inspections that should cover all the control bodies (State Revenue Service, National Anticorruption Centre, General Prosecutor's Office etc.) and list all the planned inspections by relevant institutions over the year, including to avoid simultaneous inspections. Unplanned inspections should take place under well determined and clear conditions, being endorsed and monitored by an additional body (e.g. business ombudsman). The Law on state inspections needs to be amended and encompass all control bodies. Any inspection should be driven based on risk evaluation. Recently, in June 2016, the Government approved a new legislative package regulating state inspections which aims at optimizing the number of control institutions and of inspections and install the principle of risk evaluation criteria (health, environment and property). Nevertheless, more adjacent laws need to be amended, such as the Contravention Code, Criminal Code and Criminal Procedure Code, in order to clarify the involvement of law enforcement agencies under this new reformed control methodology, and to envisage the possibility of re-examining the concept of economic crimes.

Access to Financing / Stability of the Banking Sector – Private companies have great difficulties to have access to financing for investments and for working capital purposes. The banking sector has required liquidity to support lending, at the same increased risks, macroeconomic and political situation, as well as market volatility imposed more prudential

approach to lending from banks. The cost of financing has increased as a result of increased inflation, which imposed NBM to adopt restrictive monetary policy. The banking sector needs better governance and enforcement of prudential rules to enhance its capacity to support business and to balance risks.

- i. **Bank transparency** – in terms of shareholders and the outcome of the supervision initiated by the NBM, as well as of the diagnostic missions led by international auditing firms over top 3 banks, is another issue to be addressed. Based on the reported findings, the NBM and other relevant authorities shall take the necessary measures to minimise any identified risks and the problem of transparency.
- ii. **Microfinance** – Current challenges deal with the transfer of supervision from National Commission of Financial Market (NCFM) to the National Bank of Moldova (NBM). Although the private sector strives for a reform by promoting a bill aimed at introducing more transparency in the sector, the industry believes that NCFM succeeded at regulating this market, therefore stimulating its development. Regardless of the regulator, microfinance sector needs implementation of prudential rules and improve the governance of its activity, thus ensuring a balanced development of the sector, taking into account potential market risks and challenges.

Facilitating International Trade – In order to achieve the government’s objective to transform a consumption driven economy financed primarily by remittances to an export lead economy as well as for the successful implementation and utilization of the DCFTA, the Government must continue to remove obstacles to international trade. This requires especially a deep reform of Moldova’s customs services, the reform and capacity building of certification bodies (i.e. ANSA), the break-up of implicit import/export monopolies.

- i. **Meat Imports** – The major issue affecting transparent and credible meat processing companies is the monopoly on imports of meat from Ukraine held by a couple of companies. ANSA (National Food Safety Agency) favours this monopoly by issuing specific indications which impose local operators to import meat from a concrete list of companies in Ukraine that already entered exclusive contracts with those very Moldovan companies that hold the monopoly on imports. These practices infringe the rules set by WTO and DCFTA, as they constitute barriers to trade. This scheme on meat imports began to operate during the communist government, then in 2009 this market was more or less liberalized, and now this very scheme started to operate again being controlled by vested interests.
- ii. **Retail trade** – A major problem for Moldovan retail trade is the arbitrary interpretation of the new tobacco control regulation by Ministry of Health and National Public Health Centre in particular. As a consequence, National Public Health Centre has launched compliance inspections generating confusion and affecting activity of tobacco traders. The recommended solution to this issue is cessation of abusive and intimidating ad-hoc inspections and an open dialogue between Ministry of Health and trade to reach a common understanding with accurate interpretation of tobacco control regulation. It is suggested to involve line ministries and market players to use their expertise in applying trade-related legislation and their industry knowledge.”

Tax Legislation and Administration - Whereas the overall low level of taxes are a considerable incentive for private investors in Moldova, the complex and bureaucratic administration for the payment of these taxes, obscure rules of deductible and non-deductible expenses for tax purposes, corruption among poorly paid tax inspectors and severe delays in the settlement of VAT returns are causing major problems. Narrowing down the grey economy

should be the key priority of the fiscal administration in order to ensure a level-playing field for all companies and eradicate the unequal treatment. At the same time, poor administration of state entities decreases significantly the state revenues balance.

Lack of Qualified Personnel – The overdue reform of Moldova’s education system and widespread corruption within the system has led to a severe shortage of qualified personnel in potential growth sectors. For example, the lack of qualified engineers is undermining efforts to develop Moldova’s manufacturing industry and delays the effective and overdue implementation of European technical standards. More emphasis should be given to engineering and technical professions, including to improving of the national certification mechanism in the education system, to enable the operation in various areas – solar engineering, oil facilities and different types of infrastructure. There is a need for a strategic approach towards education with clear focus on areas that are market driven. It is crucial to explore the opportunities and match the market conditions and evolutions in order to sustain a growth economy.

Quality of Road Infrastructure – The road rehabilitation program is considerably delayed and is implemented without a coherent strategy. Lack of clear prioritization has led to the delay in the rehabilitation of critical national roads linking Moldova to international markets and linking Chisinau to the country’s only port.

Quality of Services of State Railway - The condition of the state railway network and the railway’s rolling stock is poor. The restructuring and modernization of the railway, including the modification of the railway’s tariff methodology and the opening of sector to private operators, is overdue. Improved services of the railway can significantly facilitate Moldova’s international trade and establish Moldova as a reliable and efficient country for the transit of goods.

Undermined Competition Regime – Limited institutional capacities, weak operational and financial independence of the Competition Council and reluctance to play a stronger role in preventing and sanctioning anti-competitive practices, hinder the liberalisation of several markets – banking, energy, insurance, telecommunications, meat imports etc.