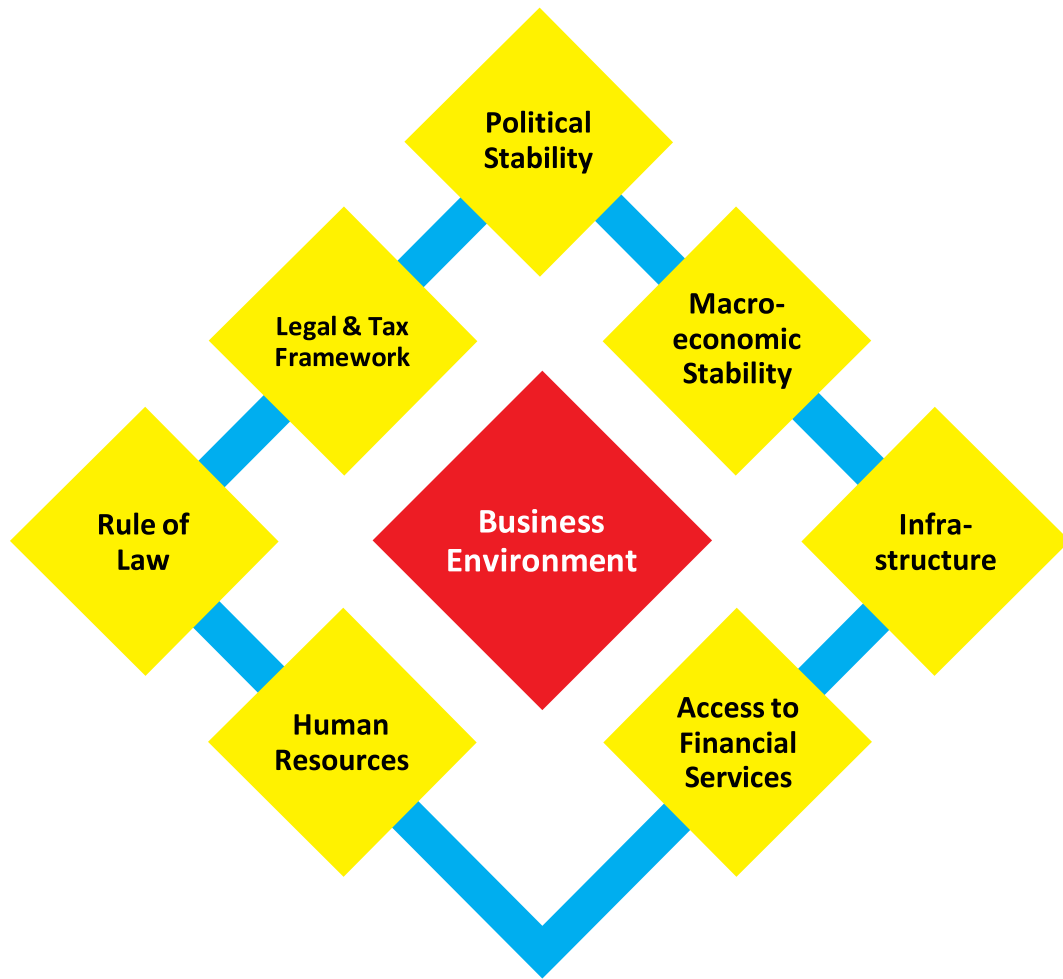


Key Business Environment Issues Affecting Private Sector Development



1. POLITICAL STABILITY

After years of political uncertainty Moldova has a stable government supported by a majority in the parliament as well as a directly elected President since 2016. The business community is concerned, however, about the uncertainty created by the President and by a major opposition party who have publically questioned the benefits of the EU-Moldova Association Agreement and contemplate its renegotiation. The EU-Moldova Association Agreement is the driving force behind Moldova's comprehensive reform program, provides Moldovan companies free access to the European single market, is critical for the attraction of foreign direct investments and therefore of great importance for the sustainable economic development of Moldova.

2. MACROECONOMIC STABILITY

Macroeconomic stability has been restored with the resumption of international budgetary and project based financial assistance as well as increased collection of tax and customs duties. The IMF Program, including comprehensive reform commitments, was signed in 2016. As a result of regaining access to international financing interest rates and the inflation rate have started to decline and the exchange rates have stabilized. Significant reforms have been implemented during the last 12 months and an ambitious reform agenda has been agreed for 2017. In the short-term the implementation of these reforms will be critical to maintain access to international financial assistance and to maintain macroeconomic stability. In order to sustain macro-economic stability in the long-term, Moldova must in particular strengthen the financial sector and in order to be less reliant on international financial assistance and remittances substantially increase the export of goods and services.

3. LEGAL FRAMEWORK

Comprehensive legal reform efforts are being undertaken in order to improve the business environment and to comply with the Association Agreement. The business community is primarily consulted on these reforms via the Prime Minister's Economic Council. The Government as well as international donors should, however, prioritise quality over speed when changing legislation. In this context it is important that regulatory impact assessments are prepared and reasonable consultation periods complied with. The following on-going legal reforms are of particular interest of the business community:



Labour Code Reform - The business community welcomes Prime Minister's initiative to reform the Labour Code, which is out-dated and in regard to numerous aspects unreasonable for employers. The reform of the labour code is therefore essential to stimulate additional investments in the export-oriented, labour-intensive manufacturing (e.g. automotive, textile) and service sectors (e.g. ICT, BPO).

Enormous efforts have been undertaken within the Prime Minister's Economic Council Working Group on Labour Code aimed at developing necessary amendments to the existing labour legislation framework. The final draft, including these amendments is being circulated now among the ministries for approval. Companies are in particular interested in achieving greater flexibility in order to be able to adjust to often-fast changing circumstances, for example:

- ◆ The up to 6-year time obligatory period for the preservation of a workplace for women after childbirth is unreasonably long and should be reduced to maximum of 3 years;
 - ◆ The use of fix-term contracts should be liberalized to allow project-based employment contracts;
 - ◆ The regulation that abolished workplaces can only be reinstated after one year, should be replaced a provision that gives employees a preferential right for re-employment in case the workplace is reinstated within one year.
 - ◆ The dismissal of employees who are members of trade unions should no longer require the consent of the trade union;
 - ◆ The obligation to reduce the working hours on the day before public holidays should be abolished and the Government's practice of declaring public holidays on short notice stopped.
 - ◆ Optimisation of the list of acts requested by the Labour Inspection;
 - ◆ Regulation of specific clauses, such as confidentiality and non-competition clauses, according to the best regulatory practices, especially of EU Member States;
 - ◆ The unreasonably cumbersome and costly documentation requirements must be reduced.
- The regulations for the employment of foreigners should be simplified.

Classification of Permissive Acts Reform - An ambitious reform on revision and optimisation of permissive acts such as authorisations, licenses and certificates issued for business operation has been initiated in 2016. After the first phase of this reform about 100 permissive acts have been eliminated and following the second phase, the number of permissive acts is supposed to decrease to 180. This measure is connected to the implementation of the electronic “single window” mechanism at the national level, which is supposed to include all the permissive acts. Several public authorities already started to implement the “single window” even before completing the mechanism / internal regulations. The successful completion of this reform will have a significant positive impact on the business environment and must continue focusing on:



- ◆ Eliminating duplications with other acts, mechanisms or procedures;
- ◆ Reducing the unjustified number of submitted documents to obtain the permissive acts;
- ◆ Enhance exchanges of information within and between the authorities without involving the applicant.

Legislation on State Inspections - During 2016 the legal framework regulating the state inspections applied to business activity has been reformed through amendments to the Law 131/2012 on state inspections of the business activity aiming to bring more transparency and predictability to the control procedures and focus more on prevention rather than punishment. Still, ensuring the reform's successful application requires additional measures:

- ◆ Implement institutional reforms at inspection authorities as well as the clarification of the control functions assigned to each of them;
- ◆ Development of checklists of documents for each inspection;
- ◆ Amendments to the Contravention Code and to the Code of Criminal Procedure;
- ◆ Development of necessary IT infrastructure in order to ensure the functioning of the electronic State Register of Inspections.

Law on Data Protection - Recent proposed amendments to the data protection legislation would have a substantial impact on Moldovan companies. Even though the proposed draft law has been withdrawn from the examination in the Parliament due to various concerns and deficiencies, it is important that new draft law will reconsider the previously proposed measures like:

- ◆ The unreasonably large penalties of up to MDL 5 million that can be imposed by the National Centre for Personal Data Protection (NCPDP);
- ◆ Clarify ambiguous regulations and popularise the need to register as operator of personal data as well as provide reasonable time limits for the registration;
- ◆ Justify the proportionality of increasing the control functions of National Centre for Personal Data Protection.

Waste Management Legislation - Recent amendments to Law 1540/1998 on payments for environmental pollution raise the following serious concerns:

- ◆ There is no clear mechanism on the application and for the calculation of the pollution taxes;
- ◆ Despite recent adjustments to the legislation the administration of the pollution tax by the State Ecological Inspectorate and Tax Service is still not clear and as a result the sanctions mechanism is not transparent;
- ◆ The implementation of the extended producer responsibility principle is being delayed as the collective waste management system is not yet operational; and
- ◆ The use of pollution taxes for general budget expenditures instead of using these funds for the development and operation/maintenance of the collective waste management systems.

Law on Electronic Communication - Several initiatives to amend Law 241/2007 on electronic communications have raised serious concerns over the further development of the electronic communication services sector. In particular companies operating in this sector are concerned about the plan to empower the regulatory agency ANRCETI to:

- ◆ cancel licences without court decision,
- ◆ unilaterally change conditions on the use of license,
- ◆ set special licensing conditions besides those provide in the Law 241/200 which is in contradiction with the regulatory regime on licensing set out in the Law 451/2001 that regulates the licensing of the business activity,
- ◆ set quality requirements for the services provide by the supplier on an individual basis,
- ◆ establish reporting and audit requirements at the cost of operators,
- ◆ set any unspecified measures aiming at securing the networks, and to
- ◆ impose exceptions to the authorization regime and certain control functions assigned to the policy-making authority, i.e. the Ministry of Information Technology and Communications.

Furthermore private operators are concerned about a proposed draft amendment that intends to eliminate the possibility of advance payments for the use of electronic communication services in contradiction to relevant provision of the civil code and international practice.

Reform of Domestic Trade Law - The new Law on domestic trade was adopted without consultation and without regulatory impact assessment and as a result has serious flaws. In accordance with the new law:

- ◆ Vendors cannot charge suppliers for marketing expenses and similar services,
- ◆ Vendors cannot return goods to the supplier this amendments being related to all types of goods;
- ◆ The regulations do not differentiate between different types of products, and
- ◆ The regulation about waste disposal in relation to expired perishable goods is unclear.

4. TAX & CUSTOMS FRAMEWORK

Tax Framework - The Ministry of Finance is in the process of developing a new Tax Code in order to revise tax rates, to clarify ambiguous regulations as well as to introduce amendments required in accordance with the Association Agreement. At the same time a new law on accounting and law on audit are being developed based on EU Directives. In order to foster additional private sector investments the authorities should consider:



- ◆ Retaining the overall favourable tax rates while taking measures to boost tax revenues by increasing the number of taxable entities through the attraction of private sector investments and the elimination of Moldova's considerable "grey economy";
- ◆ Improving the fiscal administration by measures such as the introduction of electronic fiscal invoicing systems and streamlined tax reporting obligations;
- ◆ Clarifying tax audit procedures and the procedures for the exemption of VAT payments on goods imported for introduction into the statutory capital of companies.

Customs Framework - Overall the customs administration registered significant improvements in recent years. However, there remain a number of obstacles that should be addressed:

- ◆ Customs infrastructure and procedures in Moldova and Romania remain a major impediment to fast border crossings for increasing exports to the European single market leading to large queues and delays. Apart from expanding existing terminals joint measures with Romania must be undertaken such as introducing a joint weighing system, mutual recognition of AEO status (Authorised Economic Operator); The introduction of electronic declaration of goods in Moldova had the intended
- ◆ positive effect and should be extended to residents in FEZs. To improve the customs procedures further it is recommended to improve the ASYCUDA software, to expand the assigning of AEO status, to ensure the functionality of the procedure of Customs Clearing at Premises and to clarify and if possible reduce the documentation required by customs for import/export procedures.
The implementation of the envisaged reform of the procedure for issuing certificates
- ◆ of origin is important to ensure transparency and to eliminate the abusive practices such as the arbitrary requests for specific documents at defined times.
The customs valuation procedure should be revised in order not to penalise those companies that benefit from price discounts. For example, companies active in the
- ◆ textile and automotive sectors, who manage to buy raw material based on long-term contracts with substantial price discounts are currently evaluated against much higher international spot market prices.

5. RULE OF LAW

The Government is making comprehensive efforts to improve the rule of law such as the reform of the law on state inspections, the on-going reform of the judiciary as well as the envisaged comprehensive reform of public administration. Nevertheless these reforms must be accelerated and completed in order to firmly establish confidence in the rule of law. Therefore the Government should:

- ◆ Vigorously fight corruption in the judicial system, enhance the capacity of judges and streamline judicial processes.
- ◆ Enhance the capacity, regulation, functioning and oversight over the tax and customs authorities as well as over regulatory and certification bodies such as National Food Safety Agency (ANSA), National energy regulator (ANRE), National Commission for Financial Markets (NCFM), Competition Council and National regulator in telecommunications (ANRCETI).

National Food Safety Agency (ANSA) - The overdue reform of ANSA should encompass both, the internal management of the institution and the relation of the Agency with market operators. The following measures should be considered as a priority in the context of trade facilitation and the implementation of the DCFTA:

- ◆ Development of a comprehensive IT infrastructure to ensure the internal electronic circulation of documents and enabling the data exchange with other relevant authorities (e.g. Customs Service);
- ◆ The establishment of internationally accredited laboratories with necessary infrastructure for certification;
- ◆ The implementation of the ONE STOP SHOP system regarding certification of products; The simplification and transparency in issuing import/export related certificates (e.g.: sanitary veterinary certificate at the import of food stuffs);
- ◆ The abolishment of double/additional certification of food stuffs imported to Moldova from EU for those products that were subjected to laboratory certification in the EU and that are processed by TRACES system;
- ◆ Enhancing ANSA staff capacities in the regions, so as to enable the processing of export related procedures at the local level;
- ◆ Ensuring that the control and inspection function is based on risk management approach;
- ◆ Enhancing ANSA involvement in case of non-compliant meat/milk/other food processors operating on the domestic market;
- ◆ Involving ANSA jointly with Ministry of Environment and other relevant public bodies
- ◆ in development of necessary legislation in the area of animal origin wastes treatment and disposal.

National Energy Regulator (ANRE) - The most relevant issues that deteriorate the investment conditions and the business climate in the electricity sector are the lack of transparency of the energy regulator including unilateral and abusive rulings and the disrespect of the prevailing regulatory framework and of the commitments stipulated in agreements with private investors, causing uncertainty and unpredictability. For example, the energy regulatory agency attempts to modify the existing tariff methodology on electricity before its expiration term despite contrary advice of the Energy Community. The regulator has furthermore applied extraordinary and disproportionate penalties on the 2017 electricity tariff to de facto offset the effective recovery of the historical tariff deficit, that had been agreed under the mediation of the Energy Community and which formed part of the conditions for the current IMF Program.

National Commission for Financial Market (NCFM) – As a matter of priority the Parliament should clarify the governance structure of NCFM by finalising the appointment of a new chairman and a new board and should enhance the supervision capacity of the NCFM.

6. INFRASTRUCTURE

Although major public and private investments in Moldova's infrastructure have shown some positive results, substantial additional investments as well as regulatory measures are required.

Roads – A comprehensive road rehabilitation program is being implemented with substantial support of international financial institutions. The implementation of this program suffers, however, from considerable delays and the lack of prioritisation of strategically important projects. Road rehabilitation projects linking Moldova to the European single market should be prioritised in order to facilitate the increasing exports to this region. In this context the Government should in particular accelerate the rehabilitation of the following roads:

- ◆ Chisinau - Ungheni – Iasi in order to improve access to Romania as well as Hungary, Austria and southern Germany;
- ◆ Chisinau – Giurgiulesti in order to improve access to Moldova's only sea–river port as well as to improve access to Romania, Bulgaria, Greece as well as Turkey;
- ◆ Chisinau – Lipcani in order to improve access to Poland and Germany via western Ukraine.

Railway – With the support of the EBRD and EIB overdue investments into the railway infrastructure and rolling stock are resuming and the reform of the state railway has been initiated. Major investments and restructuring efforts (e.g. tariff methodology) are required in order to improve the service and ensure the viability of the state railway. At the same time regulatory measures should be taken in order to attract private railway operators.

Electricity – The envisaged construction of electricity converter stations will link Moldova's network to the European network and thereby improve Moldova's energy security and enhance competition among suppliers. Investments in transmission lines will significantly reduce large transportation losses and complement private energy efficiency investments. To increase private investments in the electricity in the sector, however, the transparent and efficient operation of regulatory agency ANRE must be ensured, the electricity procurement process improved, the prevailing regulatory framework respected and the commitments stipulated in agreements with private investors such as tariff adjustment and tariff deviation recovery complied with.

Gas – With the construction of the Iasi – Ungheni – Chisinau gas pipeline Moldova will be able to diversify the supply of gas, improve Moldova's energy security and enhance competition among suppliers. A timely completion of this strategically important project linking Moldova's to the EU's gas network is therefore of great importance.



Water / Waste Water – Considerable investments supported by international financial institutions are gradually improving Moldova's water and wastewater infrastructure. Uninterrupted supply of water from the river Dniester has to be ensured in co-operation with Ukraine. The gradual rehabilitation of Moldova's irrigation systems will significantly increase the production of agricultural goods and therefore increase Moldova's exports. In order to accelerate this process the Government and Parliament should re-consider the current prohibition to use ground water for irrigation purposes.

Telecommunication - Moldova enjoys overall a good telecommunication and IT infrastructure. Nevertheless the Telecommunication sector is still facing challenges that impede the development of the sector as a whole:

- ◆ A major concern of private ICT companies, remains the dominant role of state-owned Moldtelecom in regard to international calls which leads to unfair competition and cross-subsidization of telecom services and of increasing tariffs for the use of Moldtelecom's infrastructure;
- ◆ In this regard, the performance of regulator ANRCETI and of the Competition Council should be reviewed. ANRCETI seems unduly favour large operators in breach of applicable procedures and the Competition Council's treatment of complaints could be substantially improved.
- ◆ Other concerns of private investors in the sector relate to the continuing application of a 2.5% tax for luxury services applied to mobile telephone operators as well as excessive charges for the transfer of phone numbers.

7. ACCESS TO FINANCIAL SERVICES

Having access to financial services at reasonable terms and conditions is critical for any business and key to ensure sustainable economic growth in Moldova. The reform and strengthening of Moldova's financial sector following the large scale fraud in the banking sector is therefore rightfully a key priority of the Government and of international financial institutions operating in Moldova.

Banking Sector - Companies experience difficulties in accessing financing since the large-scale bank fraud that caused the insolvency of three banks and threatened Moldova's entire banking sector. As a result of this fraud the local currency devalued, interest rates temporarily increased significantly and the regulatory framework was considerably tightened. The successful and timely completion of the restructuring of the banking sector and the establishment of a reliable supervision is therefore critical to ensure the safety of deposits and to improve Moldova's small-, medium- and large enterprises access to financing at reasonable terms and conditions. In order to strengthen and re-establish the credibility of the banking sector special attention should be paid to:



- ◆ The transparency of the ownership structure of banks by ensuring the application and functionality of the ultimate beneficial owner verification mechanism;
- ◆ Improving the internal regulatory and supervisory systems of banks based on international standards;
- ◆ Enhancing the capacity of the National Bank of Moldova with a focus on anti fraud, risk management and compliance, anti-money laundering, supervision and oversight functions and ensure the compliance and implementation of internationally recognised standards for the whole banking system


Insurance Sector - Apart from the banking sector also the insurance sector requires restructuring, effective supervision and an improved legal framework. Several major insurance companies are experiencing serious financial difficulties which can affect the entire sector. In order to improve the stability of the insurance sector the following measures should be urgently considered:

- ◆ The overdue appointment of a new chairman and a new board of the National Commission for Financial Market (NCFM) and a comprehensive reform of the regulator;
- ◆ The immediate restoration of the financial stability and security of Moldovan National Bureaux of Car Insurers (BNAA) in order to eliminate the risk of Moldova being suspended from the International Green Card System. Moldova is the longest-monitored country (since 2002) form all 48 members of the Green Card System;
- ◆ The acceleration and finalisation of the fraud investigation related to embezzlement of assets from BNAA and measures to ensure the recovery of these assets;
- ◆ Ensuring the implementation of ultimate beneficial owner verification mechanism in the insurance sector similar to the banking system;
- ◆ Reforming the actuary system in Moldova by enhancing the capacity and increasing its transparency;
- ◆ Increasing the professional requirements of the actuaries (auditors of insurance companies);

8. HUMAN RESOURCES

One of the main challenges of Moldova is to preserve and develop its human resources. Companies are increasingly concerned about the continuing migration of well-educated workforce, about Moldova's general demographic trends as well as the insufficient progress in the reform of Moldova's education system. To address the problems of migration and demographic trends, comprehensive measures have to be taken to:



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- ◆ improve the overall quality of life in Moldova, e.g. investments in the health system, the establishment of a reliable and fair pension system as well as to firmly establish the rule of law.
 - ◆ strengthen the education system in particular in those areas required by strategic growth sectors such as the manufacturing industry (automotive, textiles, etc.), agriculture / agro-processing, ICT and Business Process Outsourcing.
 - ◆ foster vocational training and other forms of education in addition to higher education in collaboration with the private sector.



