



**EUROPEAN BUSINESS ASSOCIATION
REPUBLIC OF MOLDOVA**

**DCFTA – BUSINESS CLIMATE UPDATE
-I Semester 2018-**



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Macroeconomic review of the first half of 2018

In the first half of 2018, the economy of the Republic of Moldova attests a positive dynamics in all its sectors. In January-June of 2018 **GDP increased by 4.5%** and amounted 81,8 bil. MDL. The most significant influence on GDP growth had the gross added value created in the wholesale and retail trade, transport and storage, hotels and restaurants; industry; IT and communications, as well as real estate and construction transactions. Domestic trade in goods and services register a positive dynamics, which shows the continued intensification of consumption.

The **average gross monthly earnings per employee** of the national economy for semester I 2018 constituted 6141.2 MDL and increased in nominal terms by 13.1% compared to the first quarter of 2017. In first 6 months of 2018, **industrial production increased** by 8.1% and **agricultural production** by 7.2% compared to the same period of 2017.

The **automotive industry**, in particular the production of electric wires and cables and the production of parts for motor vehicles and engines, are the most progressive industrial branches that led to the growth of industry in the first 6 months of 2018. Most of the production produced in this sector is achieved on foreign markets (about 90%), accounting for about 18% of total exports.

Although the investment climate in the Republic of Moldova is fragile due to the lack of confidence in the government and the banking sector, linked to political uncertainties, in January-June 2018 **the volume of investments increased** by 7.4% compared to the same period of the previous year and constitute 6,8 bil. MDL.

Between January and June 2018, the trade flow was characterized by a significant improvement of the relations between the Republic of Moldova and the EU, which remained the main trade partner of Moldova. According to the statistical data provided by the National Bureau of Statistics, the **Moldovan trade** with the European Union continues to register an increase in the first half of the year. Thus, it amounted to 2, 297.03 million USD, which represents **an increase of 33.16%** compared to the same period of the previous year. In the first 6 months of the year, **Moldovan exports** to the European market represents **68.48% of total exports** (an increase by 38.11%). The main destinations of exports remains Romania, Italy, Germany, Poland and United Kingdom. At the same time **imports** from the EU stand at **51.05% of total imports (an increase by 30.16%)** the main European partners of the Republic of Moldova are Romania, Germany, Italy, Poland, France and Hungary.

The **inflation rate** in June 2018 was 0.8% compared to December 2017, registering a decrease of 4 p.p. compared to the inflation rate in the same period of 2017. The change of the price in I semester of this year was influenced by monetary factors (monetary growth) as well as non-monetary (exchange rate developments, electricity and gas tariffs reduced to consumers as a result of ANRE decisions, etc.).

The public debt (internal and external) has slowed its growth, its total amount amounted about 50.9 million MDL by 30 June 2018 (an increase of 0.5% compared to the same date of 2017). The external public debt increased by 4.1%.

SUMMARY

The development trends of the country over 2017 as well as the DCFTA implementation process have been challenged by a series of economic, social and demographic constraints. Many of the reforms signaled by the private sector as imperative have been launched, nevertheless drafting of the secondary legislation underpinning their implementation is still pending. From the economic point of view, growth proved to be slow and unsustainable, however registering an increase due to a more intensified foreign trade, mainly with EU.

A significant number of reforms such as labor code, permissive acts, labor migration legislation and the associated documentation process for foreigners, public sector, control and inspection, etc. have been launched with pertinent laws amended and approved in 2017, nevertheless, in certain cases, the implementation process and the effect of the reform is undermined due to lack of necessary mechanisms provided in the upcoming secondary legislation.

Following the inputs provided by the private sector, most of the issues identified over the first semester of 2018 were related to the lack of qualitative workforce, significant gap between the labor market needs and the professional knowledge of the graduates, as well as need to improve the cooperation system between educational institutions/ vocational schools and private sector; inconveniences in the waste management legislation that affect the business activity in the field of waste management and creates additional financial burdens to the economic agents by imposing them to implement the extended producer responsibility principles; weaknesses of the state control reform, deficiencies of the banking sector reform that affect the access to financing, especially through considerable limitation of the activity of the banks by the National Bank of Moldova; foreign trade related barriers like import of meat, export of processed agricultural products and walnuts, energy market regulation, data protection etc.

The DCFTA – Business Climate Update presented below is a snapshot of the main issues signaled by the private sector in 2018, broken down by areas of concern. In certain cases – concrete recommendations have been drafted to address the issue.

Most of the areas described below have been addressed by EBA under its Business Environment - Lobby and Advocacy Agenda within the Position papers developed by the EBA Team in this regard, presented to relevant Public Authorities and tackled upon in various PPD meetings in the Government and Parliament.

I. TRADE AND SUSTAINABLE DEVELOPMENT

A. Labor and Education

The educational system in the Republic of Moldova still remains weak and needs to be adjusted to the current and emerging needs of the labor market as to foster employability and entrepreneurship. Currently, there is a major lack of qualifications obtained in educational institutions. Most often, foreign investors and the business community report on the significant gap between their needs and the professional knowledge of the graduates, as well as the lack of sufficient number of admissions for all specialties with advanced perspectives for the development of the country's economy (electronic specialties, manufacturing and processing technologies, construction and civil engineering, welders, textiles).

Dual Education

After the approval of the Regulation concerning the organization of programs for technical professional training through dual education (Government Decision no 70/2018), the private sector have raised problems in the education system as very theorized and inadequate to the needs of the labor market university curriculum and additional financial cost of the company in the implementation of the dual education.

In this regard, the EBA was involved in the process of the adjustment of secondary legislation related to dual education through amending the Tax Code (art. 24, point (19)) by introducing the definition of "an apprentice in dual education" and introducing the provision regarding the deduction of expenses incurred for transport, food and professional studies related the organization and implementation of technical training programs through dual education.

The biggest deficiency in the implementation of the dual education in Moldova is lack of a functional cooperation system between educational institutions/ vocational schools and private sector. Thus, the following goals were identified: to improve the functional capacities of the management of educational institutions, especially of vocational technical schools, to provide schools with teachers who can deliver the necessary training at the request of companies, decent wages for the teachers, ensure up to date curricula and ongoing accreditation of teachers.

Tertiary Education

Over 2018, in order to signal and prioritize problems in the tertiary education system, EBA Moldova submitted recommendations for the optimization the financial mechanism of the funding the tertiary institutions, as well as to diversify the types of specialties to match the demand of the private sector.

As such, the main reasons of the problems in tertiary education system can be highlighted as following:

- Lack of international evaluation and accreditation of the educational institutions and professional training programs for labor market specialists;
- A very theorized and inadequate to the needs of the labor market university curriculum;
- Insufficient training of teachers and their modest and uncompetitive remuneration;
- A deficient equipment of the of the educational institutions with relevant laboratories, systems, software, which would provide the necessary basis for achieving the professional skills and knowledge for training of a specialist;
- The current funding system of the educational institutions does not allow a budget increase with the aim to acquire the relevant educational infrastructure;
- The admission process for students should be more rigorous and transparent.

B. Waste Management

The waste management legislation in the Republic of Moldova is strongly correlated to the implementation of the extended producer responsibility (EPR) principle, approved in Law on waste (209/2016). Up to now the implementation of the EPR principle is being delayed as the collective waste management system is not yet operational and roles and responsibilities of the various stakeholders are not clearly and transparently defined.

With respect to the environmental pollution taxes, prescribed in Law no 1540/1998, currently there is no a clear mechanism for calculating and applying the respective taxes. Also, one of the private sector's concern is related to the inappropriate 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.

Additionally, there is a reservation from the business community regarding the approval of the Regulation on packaging and packaging waste, due to the risk of double taxation for the environment pollution imposed to the private sector through the Law no. 1540/1998 and the above mentioned Regulation on the one side and on the other side lack of the cooperation between all relevant stakeholders as local authorities, government, business community, population, in collection and recycling of packaging waste. The Government is expected for a more active and transparent functioning system in the area of waste management system.

There is a limited number of waste management facilities designed for products of animal origin and their management capacity is not sufficient compared to the demand on the market. This situation poses a difficult

challenge due to negative effects on the environment protection, considering that most of the animal origin waste is being disposed in the unauthorized land fields at the moment. Moreover, an important issues is related to the concept of incineration and co-incineration that currently is vehemently rejected, but directly related to EPR implementation, whereby the economic agent assumes the responsibility of waste disposal, which obviously involves additional costs and investments.

II. TRADE IN GOODS

A. Trade Irritancies

Import of meat (as raw materials for meat processing industry)

Over the last years the Moldovan meat processors are facing constraints in their economic activity after consuming of the EU quota for import of pork and poultry. Both in 2017 and 2018, the import quotas from EU was capitalized in August, the situation which directly leads to a significant increase of the prices of raw material (poultry and pork) on the local market. Nevertheless there is a significant number of traders who import meat at the beginning of the year, with the aim to sell it at a much higher price after the EU quota is consumed. Hence the meat processors are forced to buy the raw materials from these traders or to import it by paying customs taxes according to the Law no 172/2014 on Combined Nomenclature of Goods, which are quite significant. In this context, there is a continuous crisis in the meat sector, which leads to higher prices for the final consumer.

Moreover, it is important to note that the lack of sufficient resources to overcome the crisis in the field of meat import produces deficit of the raw material for processors with the following negative effects:

- Lack of chilled pig and poultry raw materials on the local market;
- Increasing of the artificial price on raw materials on the local market;
- In the context of the raw materials deficiency, meat processors record an decreases of the monthly industrial production indices;
- The continuous increase of the price of finished products for the whole range of chilled pork, poultry and other products made from these raw materials.

Thus, the following viable solutions were identified to overcome the created situation:

- To increase the annual import quota by developing a strict mechanism for the distribution of quotas and to examine the possibility of allocating a special quota for meat processors;
- To reduce the customs duties applied for the import of pork and poultry meat by amending the Law no. 172 /2014 on Combined Nomenclature of Goods;
- To conclude a long-term cooperation agreements between processors and producers with the timely fixed purchase price and quantity of local raw material;
- To orient to other pork and poultry import markets other than CIS and EU markets.

Export of the processed agricultural products /ethyl alcohol

Starting with 2016 the quota of 2 500 tone granted by the European Union for the export of the ethyl alcohol (code: 220710) has exceeded in proportions varying between 300%-500%. In the first half-year of 2018, the quota exceeded by 95%, with presume an increase of the volume of ethyl alcohol export by 400% till the end of the year.

Taking into consideration the increase of the existing national ethyl alcohol production capacities and the promotion of exports of domestic products to the European Union, it is important to reiterate the need to increase the volume of quota for processed agricultural products by activating the anti-circumvention mechanism.

Export of walnuts

The main issues identified in the field of walnuts export to the European Union markets are additional verifications carried out by the Customs Service's investigation service with the aim to verify the origin of the exported product.

Currently, the purchase of walnuts and other horticultural products from individuals takes place on the basis of the acquisition act through the collectors based on the established contractual relationships. At the same time, it is regrettable that throughout the whole commercial chain - the collectors do not bear any legal liability and the excessive number of acquisition acts make it impossible for the exporter to verify the veracity / identity of the person from whom the agricultural product was purchased.

As a result the Customs Service after the controls has the legal basis to forward the file to the prosecutor's office, which ultimately leads to the opening of a criminal case.

In the light of the aforementioned, it is important to reiterate the costs associated with these restraints: the stationing of the truck at the terminal, the penalties paid by the exporter for failing to honour the contractual provisions with the partners, all the tax obligations generally associated with the export of the product - 5% to the source of payment, etc. Moreover, like any other agricultural branch, walnut exports have its seasonality when the product can be sold at a higher price and any delay in these circumstances - affects and diminishes the competitiveness of the product, especially considering that the walnut product is a very competitive product on the world market.

Despite the multiples EBA Moldova interventions through the organization of meetings on the central public authorities and the Economic Council to the Prime Minister platforms, the subject remains unsolved.

III. TRADE IN SERVICES

A. Banking sector reform, affecting the access to financing

Creditation of the related party in the financial sector

Within the Supplementary Memorandum of Economic and Financial Policies, signed between the Government of the Republic of Moldova (GRM) and the International Monetary Fund (IMF), the GRM committed to address issue regarding the related party lending in the financial sector.

At the moment, the Law no. 202/2017 on the banks activity grants the right to the National Bank of Moldova (NBM) to presume the persons as affiliates to commercial banks, using the identification characteristics of the persons affiliated to the bank that are stipulated in the NBM Regulation (No. 240/2013).

During 2017 and 2018, as a result of the controls carried out by the NBM representatives, the bank's failure to non-compliance of the prudential limits set by the NBM was found, which caused:

- Restrictions on the transactions with the affiliated persons of the bank, including those presumed as affiliated by the NBM;
- Blocking the activity of granting credits, but also of transactions with the persons affiliated to the bank;
- The lapse of the economic interests of both clients and banks, contrary to economic and business rules;
- Increase of the administrative expenses of the banks that already are to significant.

According to the banking sector opinion, the approach of the NBM is counterproductive and considerably limits the activity of the banks. Moreover, the provisions defining the characteristics used by the NBM to

identify persons having relationships or transactions with the bank and / or its affiliates are extremely large and do not meet the criteria and definitions set out in the NBM Regulation and Law 202/2013.

In this respect, in order to overcome the created problem, EBA Moldova has developed a position paper that contains proposals to amend the NBM Regulation, in particular regarding the clear and exhaustive delimitation of the characteristics used by the NBM, so as to limit the risks of concentration of bank exposures to affiliated persons. At the same time, at the request of EBA Moldova, a meeting was held with the representatives of the IMF mission to Moldova, where the banking sector expressed its concerns about the over-regulation of the NBM and its Regulation non-compliance with the EU legislation.

IV. ENERGY SECTOR

A. Tariff Regulation

Due to the accumulation of a huge tariff deficit derived from the fact that the electricity tariffs had not been adjusted since May 2012 to reflect the real costs of energy, Gas Natural Fenosa (GNF), the largest European private investors in Moldova launched arbitration proceedings against Moldova in ICSID (International Centre for the Settlement of Investments Disputes).

In June 2016, with the mediation of Energy Community Secretariat (ECS), a Settlement Agreement was signed between the Ministry of Economy and GNF, where a debt (the tariff deficit) with GNF of €82 Million was recognized, to be paid in 4 years (2017 -2020) via tariff adjustments.

In February and March 2017, the energy regulator (ANRE), without listening to stake-holders, made several amendments to the distribution tariff methodology, without respecting its period of validity and against the firm recommendation of the ECS. According to ANRE, the changes in the regulatory framework derived from the new electricity law 107/2016, published in July 2016, which implemented the III Energy Package of the European Union. The III Energy Package refers mainly to the liberalization and unbundling of the energy sector, the open access in the network and the independence of the Regulator, being no legal basis in the III Energy Package that justifies these amendments, which affected detailed specific parameters of electricity tariffs.

The modified tariff parameters were the recognized energy losses, the rate of return on assets (WACC) and the cost of extension of lifespan of the assets. In addition, a penalty of €6.2 million was applied to the distribution company, for investing in 2015 below the required threshold. In 2015, the inaction of ANRE to adjust the tariff to energy cost recovery level provoked a lack of resources in the electricity system (the tariff deficit). In this context, to avoid massive power cuts, GNF prioritized the payment to energy suppliers, and thus was not able to fully execute the investment plan.

These measures implied a reduction in 2017 of the revenues of GNF of €20.6 million, equivalent to the annual proceedings from the Settlement Agreement. As a result, though, apparently, the Agreement signed was being fulfilled, the fact is, the tariff arrears were not being effectively recovered.

GNF complaint to the ECS claiming that the ANRE had infringed the Treaty Establishing the Energy Community and its principles of Rule of law, Legal Certainty and proper business climate. In November 2017, the Energy Community opened dispute settlement proceedings against Moldova for breach of the Treaty.

In February 2018 new electricity tariff methodologies were approved by ANRE, after discussions with stakeholders and with the assistance of the ECS, to ensure compliance with European standards.

In June 2018, ANRE set the electricity tariffs for 2018, based in the new methodologies. During the discussions, the discrepancies on the tariff arrears actually recovered were solved, as ANRE agreed to partially withdraw the penalty imposed in 2017 for insufficient investments in 2015, in exchange for further investments by GNF.

In October of 2018, ANRE approved the Operational Expenses to be transferred to the tariff.

The approval of the new methodologies following European standards, the partial cancelation of the investment penalty, the setting of 2018 tariffs in accordance with the new methodologies and the definition of recognized OPEX following technical criteria have contributed to the clearing of the existing dispute. In this endeavor, the involvement of the international institutions, like ECS and WB, has been fundamental.

B. Distribution of energy

Following the analysis of the individual quality indicators specified in the *Regulation on the quality of transmission and distribution of electricity services*, GNF notes that it is unable to meet these indicators in short terms for the following reasons:

- Considerable investment resources to be attracted to this process;
- The limited capacities to acquire these resources, as well as the very limited time allowed for the relevant investments;
- Lack of the database of assigned consumers, as well as the computerized data processing system. The development of the above-mentioned database, as well as the creation of a system for monitoring, checking and distributing payments effectively requires an important effort and investments estimated at approx. 15 million MDL;
- If this set of measures is not achieved, it will not be possible to ensure that customers truly affected by each interruption will be paid. It is necessary to take into consideration the claims and damages to the company's image for not paying the compensations granted to the really affected customers;
- The need to make unnecessary compensatory payments to consumers that are not affected by energy interruptions;

As a result, it was proposed to:

- ✓ Extend the implementation deadline of point 55 (b) of the Regulation to 0.4 kV consumers **by January 1, 2023**, this being the appropriate deadline for the company to partially perform electrical network rehabilitation works;
- ✓ Amend the point 15 and 16 of the Regulation;
- ✓ Attract the necessary expertise from the Energy Community to ensure the transposal of the best European practices in this field.

V. RULES OF LAW

A. Implementation of the state control reform

The state control reform was launched with the aim to reduce the administrative burdens on the business environment, eliminate the abuse situations, streamline and transparency of state control. Nevertheless, the number of state controls in the first half of 2018 has increased considerably compared to the whole 2017, especially in the regions.

As the common issues identified in the implementation of the state control reform, the following are to be mentioned:

- With respect to the planned controls, the requirement to notify regarding the delegation control is not always met;
- As to the unplanned controls, the motivation statement of the control is not attached to the delegation control act;
- Lack of necessary documents that should be attached to the delegation control;
- Additional requirements of the control bodies that are not fitted to the Law No 131/2012;
- Another important issue is referring to the invalid State Register of Controls. According to the provisions of the Law No 131/2012 on state control of entrepreneurial activity, the state control is

considered to be legal, only if it is fixed in the State Register of Controls. The lack of functionality of the respective Register seriously affects the legality and transparency of the control process;

- Low competencies of the control inspectors;
- As a result of the central public authorities reform, ministries and subordinate agencies were deprived of a qualified staff and institutional memory, the new employees being unprepared for the big volume of work and for the private sector demand.

Agency for Consumer Protection and Market Surveillance (ACPMS)

With respect to the ACPMS, the business environment stated that there is an overlapping of the controls conducted by the respective Agency and National Agency for Energy Regulation. Usually the set of documents for the delegation control presented by representatives of the ACPMS are prepared inappropriate, due to the lack of competencies of the Agency in the field of energy regulation;

National Agency for Public Health (NAPH)

A major issue for tobacco product operators is the arbitrary interpretation by the NAPH of the legislation in force. The legislation provides the sanitary act as the one single permissive act for the placement on of cigarettes the market. However, the activity of market operators is permanently disturbed by ad hoc requests and controls at points of sale, which clearly overcomes the framework established by Law No. 278/2007 on tobacco control and other regulatory acts in this field.

As examples, the following abuses of the Agency's representatives can be listed:

- The request to coordinate both health warnings on packets prior its placing on the market, as well as cigarette package layouts;
- Request to submit additional information about products placed on the market in the context of notification of imported products;
- Checking the location of tobacco products at points of sale, followed by arbitrary and authoritative requests to exclude product-related information (i.e. excluding information on cigarette packet prices or shelf, etc.).

B. Data Protection

With the enforcement of the EU General Data Protection Regulation (GDPR) the business environment is aware that GDPR comes with an increased territorial scope, targeting the local business offering their services and goods for EU consumers, residing in the EU or on the territory of Moldova for the EU data subjects.

Considering these legal changes there is a risk that companies that misuse personal data of their customers or fall victim to security breaches not only risk financial loss, but also reputational damage. The lack of uniform national data protection legal framework that is still aligned to the already repealed EU Directive 95/46/EC on data protection, affects the business by playing double standards in the chaise of being complaint with both legal framework.

Moreover, identity theft (data as name, credit card data, security and ID number) known as serious security breaches leading to serious financial crimes as money laundering, including in services such as e-procurement, e-identification, online banking, e-delivery, e-Health, e-insurance services proved to be an issue in Moldova. Since the personal data processing shall be done by ensuring a high security level, especially in digital economy, digital transformation is shadowed by insufficient preventive measures that require instilling a GDPR & e-Privacy culture that supports customer confidence, enhance personal data security during processing operations, while enabling the company's reputation and competition.

Upon DCFTA further implementation, in view of cross-border trade and cooperation, it is essential to be able to also transmit customers' personal data, under GDPR legitimate restriction. This will enhance the local business capacity on being more competitive, transparent and customer centred.

In this respect, the EBA provided its recommendations on the national legislation related to the data protection, such as the Law on the National Centre for Personal Data Protection, Law on the Protection of Personal Data, Media regulation law and Law on prevention and fight against cybercrime.

VI. UPDATE ON THE PREVIOUSLY IDENTIFIED ISSUES

The issues identified in 2017 still remains to be addressed. In this respect, the EBA Moldova continue to undertake the necessary measures to solve the deficiencies mostly related to sanitary and phytosanitary certification, customs valuation procedures, incremental changes of the Domestic Trade Law, electronic communication networks and services, rules of law, etc.

Thus, regarding the **sanitary and phytosanitary certification** various problems remain to be addressed and specific solutions shall be set in place. These problems refers to double certification procedure for the same products imported from EU, an extensive duration for issuing the certificate of safety, especially for perishable products, homologation of sanitary-veterinary certificates for animal products imported in RM.

With respect to the **customs valuation**, many importers are still uncertain of how to properly declare the value of their goods when importing into Moldova, partly due to the many unclear and non-transparent rules and factors to be considered when determining valuation. In this respect a number of meetings were organized with the public authorities, Customs Service. Also, with the support of IFC, some recommendations were elaborated to increase the transparency of the Custom Service when determining the value of the imported goods. As a result the Customs Service developed proposals to amend the Government Decision no Nr 974/2016, which is currently examined by the business environment.

Another still ongoing problem related to customs procedures is the fact that the Moldovan **Authorized Economic Operator (AEO) status** is not recognized by EU countries, which makes Moldovan trucks queuing at the Romanian border, thus finally generating delays of contracts (just-on-time contracts) implying additional financial costs. One of the solution proposed was to create a pilot Moldova-Romanian project at the one of the customs point in a form of a joint Moldova-Romania customs point. Based on the international experience on similar points between EU and third countries these have managed to facilitate trade saving costs and time.

Following the last amendments to the **Domestic Trade Law** that has included incremental changes in relation to operations conducted by food retailers and wholesalers, multiple meetings were organized in order to amend the respective Law with the aim to protect the rights and interests of businesses and citizens against anti-competitive practices and unfair competition. Nevertheless, the document presented to the Parliament for the approval has contained the provision other than those agreed between all interested stakeholders. As result, a meeting within the Parliament Committee on economy, budget and finance was organized with the participation of the private sector, central public authorities and business associations where it was agreed to amend the draft law according to the consensus reached before the Government approval.

Even if, the Parliament Committee express its openness and support to the business environment the Domestic Trade law have been withdrawn for 2 times from the agenda of the Parliament Committee and it is still frozen at the Parliament.

In the field of **electronic communication networks and services**, the issues related to the application of a 2, 5% tax for luxury services applied to mobile telephone operators remains unsolved. The elimination of the so called 2, 5% „luxury tax” applied to mobile operators is welcomed, and this fiscal measure has to be revised considering that mobile telephony services are no longer considered a luxury service.