



EBA BUSINESS CLIMATE UPDATES

June 2023

An overview and an assessment of implementation of reforms from the prospective of the European business representatives (investors) based on provisions of the EU-Republic of Moldova Association Agreement including the Deep and Comprehensive Free Trade Area (AA/DCFTA).

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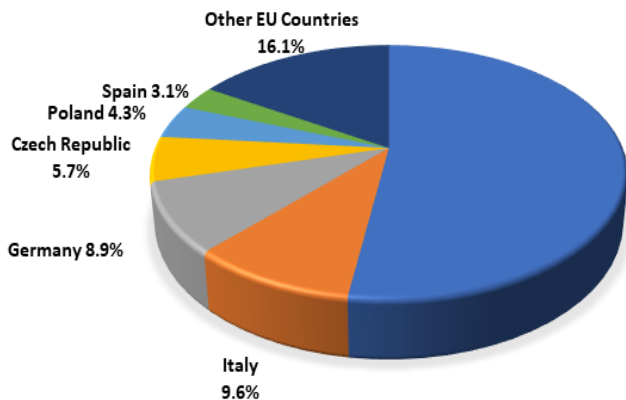
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Macroeconomic outlook

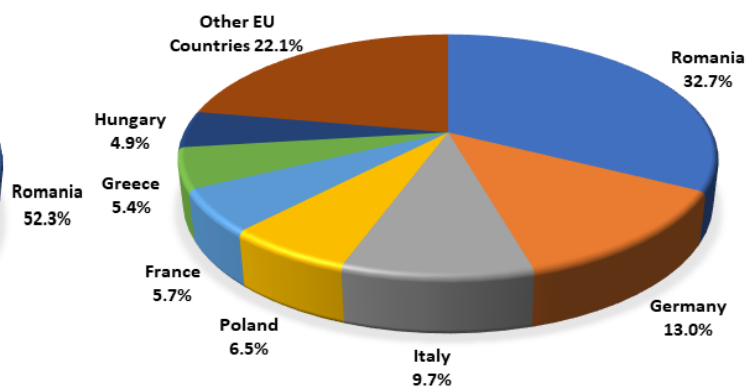
Review for Q1, 2023

- In 2022 **GDP amounted to 272.6 bn MDL** (around 13.7 bn Euro) and decreased by 5.9% compared with 2021;
- The total stock of liabilities in the form of **Foreign Direct Investments** accumulated on 31.12.2022 was valued at 4.9 bn USD (around 4.4 bn Euro). Share of European Union countries investments was 87.1%;
- **In Q1 2023, trade flow** increased by 9% compared to Q1 2022 and amounted 3.38 bn USD (around 3.15 bn Euro);
- **In Q1 2023, exports of the Republic of Moldova increased by 1.2%** and reached 1.07 bn USD (around 1 bn Euro). **Export to the EU** has reached 62.4% of total exports;
- **Imports increased by 13.1%** compared to Q1, 2022 and reached 2.3 bn USD (around 2.14 bn Euro). **Imports from the EU** stand at 48.3% of total imports;
- **In Q1, 2023 average monthly salary per employee** constituted 11 486 MDL (around 597.8 Euro), and increased by 20.1% compared to Q1 2022;
- **The annual inflation rate** in Q1 2023 was 25.1%, a decrease by 7% compared to December 2022;
- **In 2022 public debt** amounted to 94.7 bn MDL (around 3.63 bn Euro) and registered an increase by 21.7% compared to 2021;
- **Main Sectors (Q1 2023 compared to Q1 2022):**
 - **Industry** – decrease by 5.1% (the manufacture -4%, energy supply -7.4%, extractive industry -12%)
 - **Agriculture** – decrease by 5.2% (vegetable production -32.1%, livestock production - 4.9%)

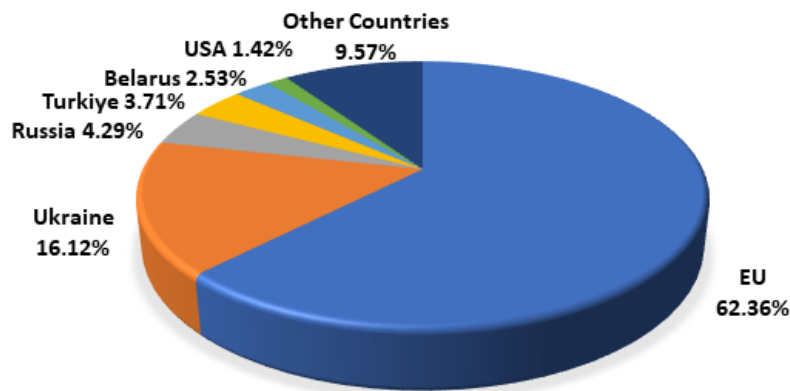
EXPORTS TO EU IN Q1,2023



IMPORTS FROM EU IN Q1, 2023



SHARE OF MOLDOVA'S EXPORTS IN Q1, 2023



Introduction

The year 2022 was a challenging year for the Republic of Moldova since the overall progress on reforms has been affected by a series of crises: the pandemic, the energy crisis, refugee inflows, and the negative impact of Russia's invasion of Ukraine on Moldova's security, trade and economic environment in general. On June 17, 2022 Moldova received the EU candidate status, which led to the boosting of the AA/DCFTA implementation. In this respect, important achievements were accomplished such as synchronization of the Continental European Power System with the power systems of Ukraine and Moldova, mutual recognition of the AEO Program, abolishment of the provision on the limitation related to obligation to offer at least 50% of market shelf for local products (Internal Trade Law), approval by EU of the first unit in the Republic of Moldova with the right to export dairy products (ice cream) and authorization by the European Commission of the export of the processed poultry meat and eggs of category A to the European market.

Still, the Republic of Moldova needs to take significant actions to fulfill its obligations as candidate country for EU membership, and in this sense to ensure proper implementation of the Association Agreement and the DCFTA. According to the European Commission Analytical Report on the Republic of Moldova's application for membership of the European Union, published on February 2, 2023, the following recommendations were provided:

- improvement of the AML system, harmonisation of the legislation and build more capacity for effective implementation;
- harmonisation of the competition policy, build a solid track record of enforced decisions in the area of antitrust, merger control and state aid, and increase the administrative capacities of the Competition Council;
- alignment with the EU's financial services sector legislation, improvements are necessary in the prudential, supervisory, resolution and recovery framework of banks and investment firms;
- harmonisation of the taxation legislation with the EU acquis on VAT and excise duties and international best practices;
- Improvement of Moldova's administrative and operational capacity and increase resources for the customs service. It also needs to bring its IT systems in line with EU standards;
- Implementation of the third energy package in electricity and gas and put in place auction schemes for renewables to exploit its renewable power capacity in a cost-efficient and transparent manner, in full alignment with the EU acquis;

- Substantial work remains to be done in terms of approximation of legislation and implementing rules in the sanitary and phytosanitary area. It is necessary to strengthen administrative capacity and the ANSA.

I. TRADE IN GOODS AND MARKET ACCESS

1. Price regulation for socially important products

Currently there are regulations that contradict the national treatment principle commitments made under the Association Agreement between the European Union and the Republic of Moldova (as stated in article 152). This is particularly evident in the State's involvement in regulating prices for socially important products. According to the Government Decision No.774/2016, producers are allowed to include all expenses related to producing, storing, and servicing social goods (such as loan payments and salaries) in their pricing documents. They can then add a 20% commercial markup. However, for importers, the markup can only be based on the amount of import duties and transport costs paid when delivering goods to the Republic of Moldova. This creates unfair competition between domestic producers and importers, as importers are unable to cover their operational expenses, thus distorting the competitive environment.

In this respect, EBA Moldova reiterated the need to abolish the GD No.774/2016 on the sale prices of socially important products, or at least adjustment and clear description of the mechanism by which prices for domestic market trading are established.

2. Food safety aspects affecting trade facilitation

A. Export of animal origin food products

Over 2021-2022, the Republic of Moldova made significant progress related to the export to the European Union market of animal origin food products from the Republic of Moldova. Thus, the European Commission has authorized:

- the import of raw milk and dairy products intended for human consumption from Moldova (December 2021). The EU approved the first unit in the Moldova with the right to export dairy products (ice cream);
- the extensive list of Moldovan producers for the export of aquaculture products (December 2021);
- the export of processed poultry meat and eggs of category A (March 2023).

These achievements create new prospects for Moldova to increase its export potential for animal-origin food products and entice foreign investors to participate in the growth of the livestock sector in the Republic of Moldova. In this respect, the national authorities should improve and promote the legal amendments and proper animal traceability and pest control.

Still, priority remains to be given to issues on food traceability and food safety, in particular the implementation of the necessary systems for identification and registration, plant and animal health and welfare, supervision of self-monitoring systems of food units - HACCP, ISO, CRDV laboratory management and appropriate accreditation in accordance with international standards, etc.

B. Import requirements for food products, subject to food control

The draft amendment of the Government Decision No 938/2018 on the Regulation regarding the National Agency for Food Safety (ANSA) border control of the imported goods was discussed on the platform of the Prime Minister Economic Council under the Trade Facilitation committee

chaired by the EBA on October 31, 2022. The main issue related to the approval of the respective normative act is the provision that foresees the exclusion of the ANSA's obligation to perform the border control based on the known risk and infringe the Annex XXII of the EU-Moldova Association Agreement, which provides that border control shall be carried out based on the risk assessment mechanism for the import of goods. The amendments are still in the approval process. The process is led by the Ministry of Economic Development and Digitization. **Business operators still face full control at the border, which implies high costs and longer time to clearance of goods.**

II. CUSTOMS AND TRADE FACILITATION

1. New Customs Code

The Republic of Moldova adopted the new Customs Code in accordance with the European Acquis on 24 August 2021 and will enter into force on January 1, 2024. The new Customs Code is partially aligned with the Union Customs Code, although the implementing regulation has to be adopted. Moldova needs to fully align its law on customs with the Union Customs Code and work on further alignment with EU rules.

With the view to the Free Economic Zones (FEZ), the Law No 440/2001 that regulates the activity of FEZ is being amended, however there is not clear communication among responsible authorities with a view to further operation and the regimes, especially the Tax Regime to be applied to companies upon the territory of FEZ. Especially this relates to the tax administration regime as well as active inward processing and the way it will be applied on the FEZ operators (residents).

2. AEO practical implementation

Following multiple EBA Moldova's position papers and meetings organized on the issue related to the need for the recognition of the Moldovan Authorized Economic Operator (AEO) status by EU countries, the EU-Moldova Authorized Economic Operator Mutual Recognition Program took effect on 1 November 2022. This decision facilitates the deepening of the economic integration between the Republic of Moldova and the European community and the increase of the export capacity of Moldovan products on the EU market. However, it is necessary to advance the Republic of Moldova's accession to the Common Transit Procedure Convention and implementation of the New Computerized Transit System.

Still, issues related to the practical functioning and implementation of the AEO Program remain to be solved. Those are mainly related to the logistic constraints due to inappropriate and uncompiled road conditions and infrastructure at the border, especially on the EU side.

3. Implementation of the extended producer responsibility principle (EPR)

The Ministry of Environment has initiated the process of amending Law no. 1540/1998 regarding the payment for environmental pollution, a draft law that still creates obstacles for the implementation of the Extended Producer Responsibility principle. In the discussions held with representatives of competent authorities, both on the Ministry of Environment's Working Group and on the Environmental Parliamentary Commission platforms, EBA Moldova presented an analysis of good EPR practices that are functioning in six countries, both within and outside the European Union.

In the countries analysed, the economic mechanism related to EPR policy is exemption-based and presents the following key characteristics:

- Waste producers can opt for the individual or collective recycling process.

- Waste producers who achieve recycling targets at the end of the management period and fulfil administrative procedures and other requirements established by law are not subject to environmental pollution payment fees.
- In the case of non-fulfilment of specific targets, the difference between the minimum targets specified in the legislation and the actual amount recycled is calculated and paid. In other cases, waste producers are liable to pay the full fee.

Furthermore, starting with January 1, 2023 companies subject to EPR requirements are obliged to bear the costs related to the recycling process, which must be carried out in accordance with Law 209/2016, combined with the provisions of the Government Decision 561/2020, as well as the costs associated with the payment of the environmental pollution fee in accordance with Law 1540/1998. This financial burden will result in additional expenses for companies and will have an impact on the further development of businesses.

In this context, it is important to ensure a fair and efficient taxation system that would encourage the private sector to invest in more environmentally friendly products and stimulate the business environment to implement the economic mechanism, thereby contributing to waste reduction.

However, the proposed amendment to Law 1540/1998 does not provide for the exemption principle of the "environmental tax," but rather its compensation, without clarity on the compensation mechanism and guarantees in this regard. Achieving targets comes with costs for the economic operator, and under current economic conditions, imposing the advance payment of a tax that is not certain to be recovered in the near future, is not justified.

In this regard, the following actions are necessary to ensure the proper implementation of EPR:

- Urgent cancellation of the environmental tax for product categories subject to EPR requirements, and establishment of a mechanism for penalty payment for producers who do not implement EPR or fail to achieve recycling targets.
- Implementation of an economic exemption mechanism, through modification of the regulatory framework (Law no. 1540/1998) to stipulate that payment will be made annually rather than monthly, as well as to charge the payment for the quantity corresponding to the difference between the targets prescribed by legislation and the target actually achieved.
- Modification of the targets set out in Government Decision 561/2020, considering the existing capacities in the Republic of Moldova and the gradual manner in which these can be expanded. Otherwise, there is a major risk of stipulating targets that cannot realistically be achieved and as a result, the EPR principle will not function efficiently.
- Modification of the current method of calculating payment for environmental pollution, by applying payment based on quantity (kg) rather than volume, which does not correspond to the way the waste is generated. Calculation of payment for environmental pollution based on the quantity (kg) of polluting packaging, applicable to all types of packaging waste generated, including primary, secondary, and tertiary packaging.

III. TRADE IN SERVICES AND ELECTRONIC COMMERCE

1. Digitization of national economy

EBA Moldova jointly with PWC developed a package of legal proposals aimed to facilitate customs procedures for online exports, enhance postal and courier/delivery services and to ensure necessary fiscal traceability documents. The legal amendments were submitted to the Moldovan Customs Service, State Tax Service and the Ministry of Finance, and finally presented to the Prime Minister Economic Council for consideration and consultancy process.

On May 7, 2023 the Parliament of the Republic of Moldova approved the draft legal act on amending the above-mentioned laws. The vast majority of proposals submitted by EBA Moldova were taken into consideration. However, a new package of normative acts amendment and improvement will be developed during the next stage of the national economy digitalization.

On 26 June 2023, the Parliament approved in the second and final hearing a legislative package generically called “Contactless business”. The draft law on amending a series of laws and regulations provides for the following innovative instruments and tools designed to further digitalize Moldovan economy and integrate foreign investors to Moldovan business environment:

1. Remote and electronic assignment of a Moldovan identification number to foreigners (without a need to visit Moldova) which will allow them to get Moldovan digital signature and, respectively, be fully integrated in digital life
2. E-notary, i.e. legal mechanisms for implementation of electronic notarial services
3. Mandatory translation of public services-related documentation (regulations, instructions, application forms, etc.) in English language together with an obligation for the public services providers to accept them for processing and others

EBA Moldova was actively involved in the process of discussion and promotion of this much needed piece of legislation.

4. Data Protection (GDPR)

The proposed draft laws for transposing European legislation on the protection of personal data (GDPR), which were developed in 2018 on which EBA Moldova presented consistent recommendations (over 100 proposals), were not approved in the last parliamentary reading.

Despite multiple public consultations, including within the Working Group on the platform of the Parliamentary Commission for National Security, Defense, and Public Order, and the Economic Council to the Prime Minister, the draft laws did not address the recommendations of the business community and national and international experts. Consequently, the private sector has requested the withdrawal of the four draft laws from Parliament, which do not align with the provisions of EU Regulation (EU) 2016/679 as of 27 April 2016 on the protection of individuals with regard to the processing of personal data and on the free movement of personal data.

Additionally, at the request of EBA Moldova, the Ministry of Justice has established a Working Group to amend the Law on the protection of personal data. Throughout 2022, the Working Group organized several meetings, with EBA Moldova participating and providing expertise by presenting comments and additional proposals to avoid any potential risks and financial burdens for the business environment.

5. Development of the ITC sector

In the field of Information and Communications Technology (ITC) sector development, it is imperative to ensure that European standards are uniformly transposed for the sustainable development of the communication sector and to attain digitalization objectives. The private sector emphasizes the importance of aligning Law no. 241/2007 on Electronic Communications with the European Electronic Communications Code, particularly the chapter related to the duration of license validity and the provisions concerning administrative costs for frequency usage.

Consequently, EBA Moldova has proposed a revision of the methodology for calculating fees for radio frequency allocation, with a 50% reduction, while eliminating double taxation by two separate authorities (SNMFR and ANRCETI). The current process unduly burdens telecom operators in their network development and investment efforts. The application of the article 16 of the European Electronic Communications Code, which was approved by European Directive no. 2018/1972, is of great significance in this regard.

Furthermore, in order to reduce electronic waste and minimize environmental impact, the private sector suggests the need to amend the provisions of the Special License Type Conditions for radio frequency/channel usage, approved by CA ANRCETI on 14.07.2014. Specifically, chapter V, point 19, paragraph (1), which prohibits the installation of second-hand equipment for [800/900/1800 MHz] networks, should be amended to comply with EU regulations on circular economy and principles of the green economy.

Additionally, on the 31st of May, President of the Republic of Moldova Maia Sandu and the President of the EU Commission Ursula von der Leyen announced the reduction of the roaming fees between Moldova and the EU as of 1st of January 2024. In this context it is crucial that the challenges described above are addressed in order to secure financial capacity of Moldovan telecom/mobile telephony operators so as they can afford implementation of the agreement announcement. As such, it is crucial that each of the EU Member state would support domestically the announced action. In parallel Moldovan Government should work on legal approximation in order to ensure and provide a permanent legal solution for roaming liberalisation with the EU.

IV. TRADE - RELATED ENERGY ISSUES

1. Green transition

During the 2022, EBA Moldova, in cooperation with other business associations, advocated for the approval of capacity limits, maximum rates and capacity categories in the field of electricity from renewable sources valid until December 31, 2025. In this regard, the business community maintains its position regarding the imperative need to ensure predictability, transparency, and non-discrimination in the legislative process. Therefore, the allocation of new quotas should be carried out in a separate process of "confirmation of the eligible producer," rather than as part of an ongoing process.

As a result, of the total 410 MW that the Moldova's Government plans to allocate by 2025, the business environment insists that the highest possible proportion should be assigned to tenders for renewable energy production capacities. Additionally, within the tenders, the allocation by technology type should consider the ANRE's approved price per kWh per technology, as well as the investors' interest reflected in the list of connection permits issued by Moldelectrica.

Moreover, in the context of promoting renewable energy production and attracting investments in this field, the private sector considers necessary the organization of tenders to achieve the assumed targets of renewable energy production, in accordance with Law 10/2016. It is important to mention that international investors in countries such as France, Italy, Romania, Spain, Denmark, etc., have expressed their willingness to invest in the renewable energy sector under competitive and transparent conditions. The energy transition requires expertise and specialized international capital, technology transfer, and know-how. However, instead of efforts to organize tender and allocate production capacities at competitive prices, the Moldovan authorities are changing their vision, contrary to the policies and principles of predictability, by assigning significant capacities (additional, 100 MW) in a more expensive scheme. The fixed tariff for solar

installations approved by ANRE for 2022 was 90 euros/MWh, while through tenders for the same solar technology, a price 20-25% lower could be obtained, with a starting price of 79 euros / MWh for wind technologies.

In this respect, EBA Moldova submitted several position documents on the amendment of the GD no. 401/2021 and as a result, the annex to the respective Government Decision was amended and approved by the Government. With respect to the amendment of the Law no. 10/2016, the Ministry of Energy initiated in April 2023 the public consultations on the amendment of the above-mentioned law.

Considering the above mentioned, the following actions should be undertaken:

- Transfer/redistribution towards the "fixed price" scheme for tenders, on cheaper and highly competitive technologies, in order to decrease the tariff for the final consumer;
- Amendment of the Law no. 10/2016 and Law no. 107/2016 as soon as possible, in order to regulate the competitive market and medium- to long-term bilateral contracts;
- Amendment of the Regulation on the conduct of tenders for obtaining the eligible producer status, approved by Government Decision no. 690/2018;
- Organize the tender for renewable energy production capacities no later than the third quarter of 2023.

Other issues affecting the governance of the energy sector are:

- **Balancing Market**
 - Speculative behaviour from certain parties is being tolerated by the regulator, with a negative impact on final consumers, in spite of EBA energy committee alerting about this issue;
 - Decisions regulating the market are taken retroactively e.g. in May 2023 affecting from June 2022;
 - Exaggerated prices, there are no producers who would be able to participate in the balancing market;
 - The issue of VAT for balancing energy is still not solved. Even to this day, the invoices from August 2022 have not been issued. The proposal was a single VAT rate.
- **Strengthening of the state in the energy sector.** With the support of international funding, the state-owned companies in the sector have increase its dominant position in the sector. While the role of the State was crucial during the energy crisis, the situation should not perpetuate leading to abuse of position and crowding out of international investors willing to invests in the energy domain. The Private Sector can actively contribute to increasing Moldova's security of supply, modernizing its infrastructure, making system operation more efficient and developing energy markets in line with the European acquis. However, the conditions for this are not created and state companies are performing activities that private sector could execute more efficiently without requiring resources from the state of the international community.

V. RULE OF LAW

Vetting and pre-vetting procedure

The private sector expressed its concern on the slow implementation of the anti-corruption reform started in 2022 with the vetting of candidates for the self-management bodies of judges and prosecutors. The phenomenon of corruption is perpetuated in the justice sector and negatively impacts the investment climate and the principle of predictability, being reflected by the fact that certain judges, prosecutors and bailiffs act in collusion with some state authorities

and / or private actors, often ignoring the fundamental legal principles, including by infringing the property rights of local and international investors.

In this respect, the private sector and the civil society organizations advocate for the need to continue the launched reform by the vetting of judges of the Supreme Court (SCJ) and subsequent reform of that court (SCJ vetting), as well as by the subsequent vetting of key positions from the court system and prosecution office (full-vetting).

Thus, to overcome the deadlock and the tense situation in the justice sector the following actions should be undertaken by the state institutions:

- To appoint by the Parliament the judicial vetting committee and to promote as soon as possible the package aimed at finalizing the reform of the SCJ (ground and procedure of appeal to the SCJ);
- To ensure proactive communication and inclusive dialogue with all interested parties, judges, prosecutors, and civil society to operationalize the new reforms, guaranteeing the further implementation of the SCJ reform and the extraordinary evaluation of judges and prosecutors in full compliance with the main recommendations of the Venice Commission;

Additionally, the support of the development partners is needed to promote and implement the recently announced reforms (SCM, SCJ, extraordinary evaluation).

VI. FINANCIAL MARKET REGULATION AFFECTING BUSINESS ENVIRONMENT

1. AML

The Parliamentary Commission on national security, defence and public order initiated the process of the amendment of the Law no 308/2017 on preventing and combating money laundering and terrorist financing. In response, EBA Moldova has submitted position papers containing concrete proposals and recommendations to improve the draft law. EBA Moldova has also been actively involved in several technical discussions with the Moldova's Office for Prevention and Fight Against Money Laundering, which were organized on the platform of the Parliament Commission.

As a result of EBA Moldova's efforts, the recommendations they presented have been taken into account, and the draft law has been approved in the second reading of the Parliament on March 30, 2023. The law is set to come into force on July 1, 2023.

2. Tax Policy

As part of the EU-RM Association Agreement providing for a series of important economic and geopolitical benefits, Republic of Moldova committed to harmonize to the EU standards and legislation certain mutually designated areas of interest, including in the tax field. According to the Annex VI of the Agreement, Moldova committed to gradually harmonize its VAT legislative framework with the EU VAT Directive and international best practice.

Additionally, the following amendments related to the tax policy should be implemented to ensure economic development of the country and improvement of the business environment:

- Implementation of the economic exemption mechanism related to the Extended Producer Responsibility principle (REP) and the amendment of Law no 1540/1998 on payment for environmental pollution;
- VAT exemption/deferral for PV panels and inverters with elimination of import duty on inverters. This measure will accelerate the development of the energy sector, namely the renewable industry;

- Exclusion of the limit of 0.5% of the sales income obtained during the previous year, in order to apply VAT to the delivery of goods and services carried out free of charge for the purposes of advertising and/or sales promotion;
- The introduction of VAT taxation on the import of cars with the elimination of excise duties that are currently applied;
- Development of the legal framework necessary to ensure the free circulation of denatured alcohol without payment of excise duties;
- Revision of the taxation of ferrous and non-ferrous metal waste collection activity;
- Standardization of the product categories for which the 8% VAT reduced rate is applied;
- Revision of the expenditure deduction limits as well as personal exemptions in line with forecasted inflation;
- Elimination of the 5-year limit for reporting tax losses.