



EUROPEAN BUSINESS ASSOCIATION

REPUBLIC OF MOLDOVA

DCFTA – BUSINESS CLIMATE UPDATE

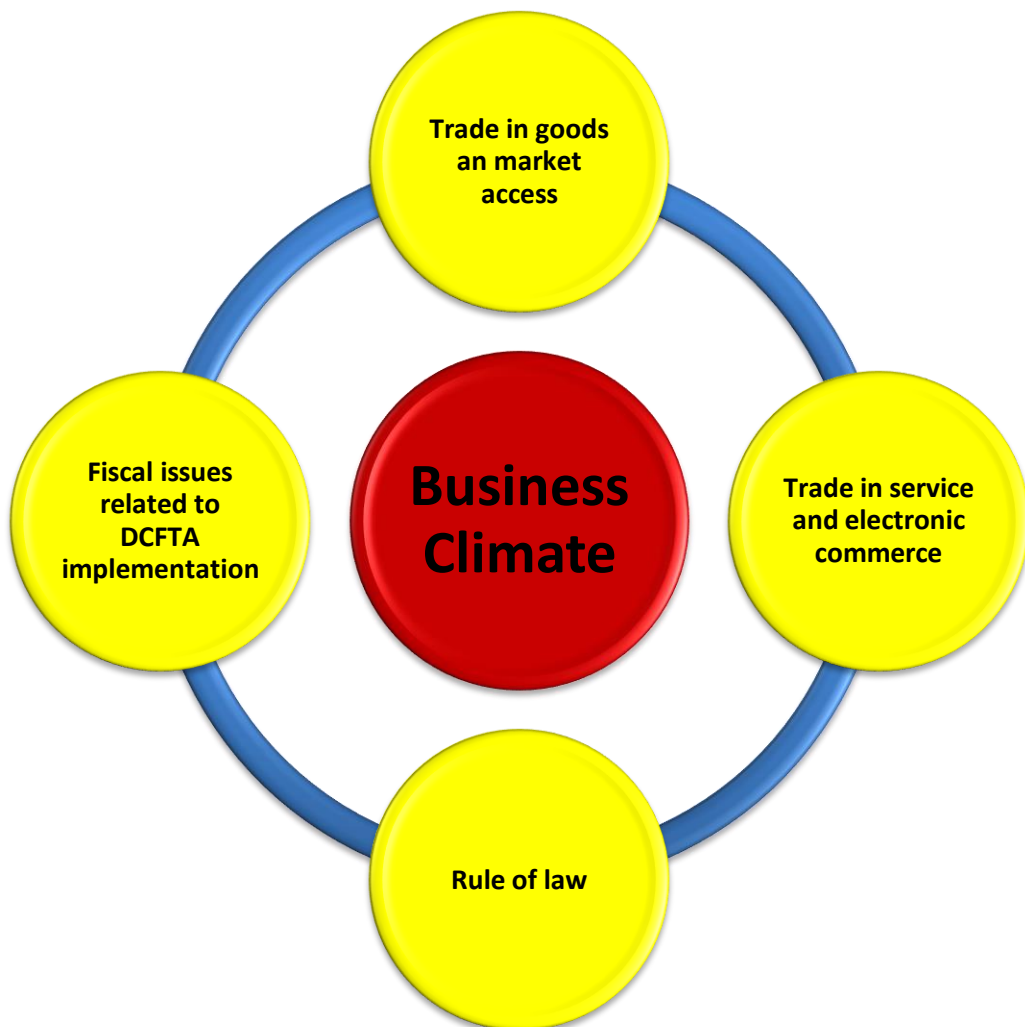


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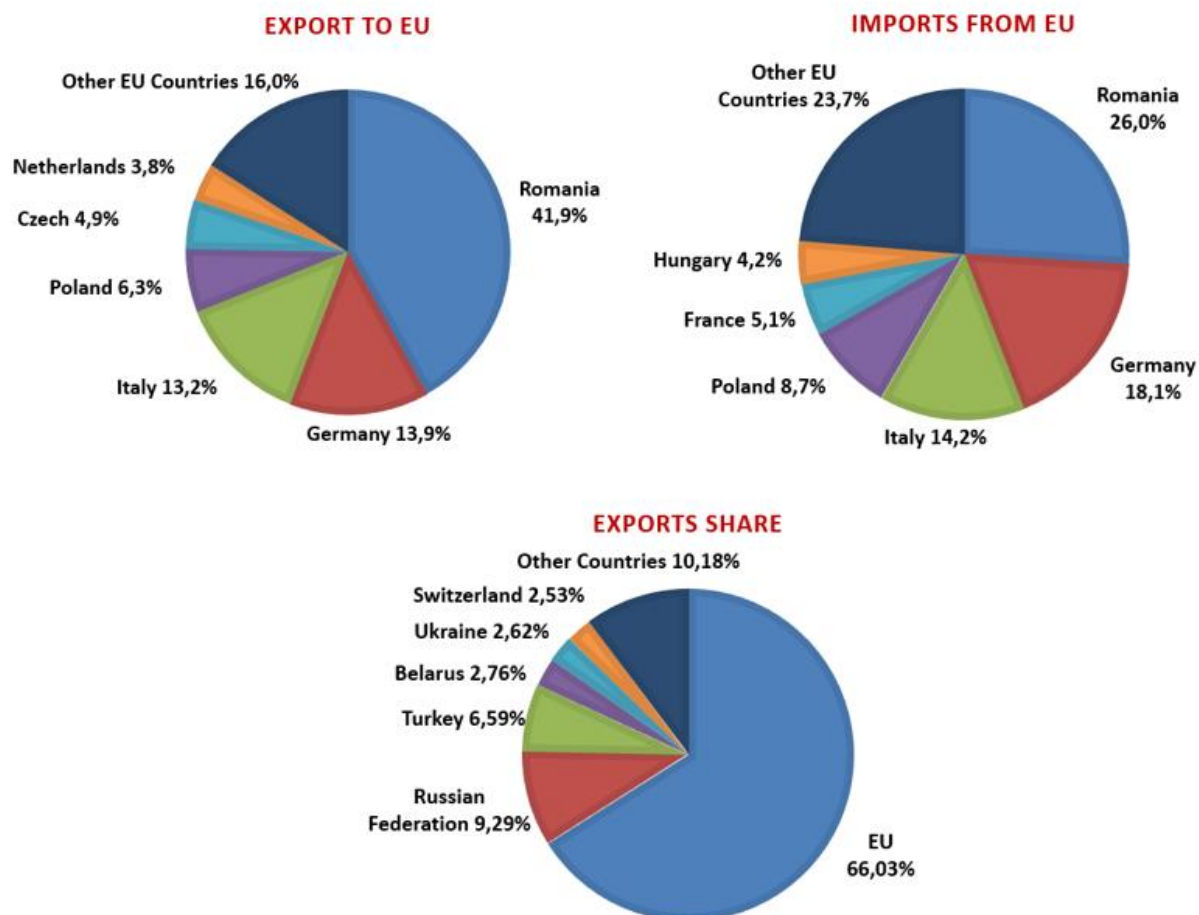
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Macroeconomic outlook and pandemic impact on economic activity

Review for January-September 2020

Source: Ministry of economy and infrastructure of the Republic of Moldova

- **In first Quarter of 2020, GDP** amounted to 43.7 bn MDL (around 2.08 bn Euro) and **increased by 0.9%** compared to the same period of 2019;
- **In first Quarter of 2020, Foreign Direct Investments decreased by 1.5%** compared to Q1 of 2019 and reached 3.24 bn MDL (around 1.54 bn Euro);
- **The Trade flow decreased by 11.29%** and amounted 5.8 bn USD (around 4.6 bn Euro);
- **Exports of the Republic of Moldova decreased by 13.3%** and reached 1.75 bn USD (around 1.45 bn Euro). **Export to the EU** has reached 66,03% of total exports;
- **Imports decreased by 10.3%** and reached 3.83 bn USD (around 3.18 bn Euro). **Imports from the EU** stand at 45.71 % of total imports;
- **Average monthly salary per employee constituted 7850.9 MDL** (around 402 Euro) and increased by 9 % compared to same period of 2019;
- In September 2020, **the inflation rate** was 0.9% compared to December 2019, recording a **decrease of 4.5 p.p.** compared to the inflation rate in the same period of 2019;
- **Public Debt** amounted to 62.2 bn MDL (around 2.9 bn Euro) and registered an increase by 18.8% compared to January-September 2019;
- **Main Sectors:**
 - **Industry** decreased with 6.8%
 - **Agriculture** - decrease by 25.3 %



Pandemic impact on economic activity

The COVID-19 pandemic heavily influenced big part of life, society and the economy, including trade and business. The pandemic brought about significant challenges on the one hand, and opportunities and lessons, on the other hand. In this respect a study was conducted by European Business Association from Georgia, Moldova and Ukraine, aiming to explore the role of the DCFTA as a tool for the private sector from all three Countries to deal with disruptions in their entrepreneurial activity, caused by Covid-19, as well as to identify opportunities, deficiencies and possible quick solutions, policy improvements for businesses under the implementation of the DCFTA provisions.

Thus according to the "Role of DCFTA in tackling Covid-19" study¹, due to the Covid-19 context companies have focused their efforts on implementing and modernizing digital solutions to overcome the crisis caused by the pandemic. Thus, electronic commerce via online sales systems as well as digitisation of public services became a priority. Additionally, companies adjusted to the remote work reality especially for employees in administrative and sales positions. Online payment and online reporting immediately increased.

Moreover, remote communication and online meetings are another step in the use of digital solutions during the Covid-19 period, which are relatively easy to access due to existing solutions at the international level. Moldova, having the advantage of good internet coverage both through fibre optics, as well as 4G internet at reasonable prices, has not encountered difficulties in this respect compared to countries with poor coverage or high costs of internet services.

Unfortunately, Moldova faced the pandemic with significant drawbacks and delays related to the implementation of the key reforms provided by AA/DCFTA which under the current Covi-19 impact have produced a multiple effect thus seriously affecting the business climate. A serious focus on an integrated DCFTA implementation embraced with a political will and Government actions would offer opportunities and advantages for business development as well as provide practical tools to ensure a stronger economic growth and an increased social welfare, especially in the Post-Covid-19 context.

I. TRADE IN GOODS AND MARKET ACCESS

A. Internal Trade Law

During last three years (2018-2020), discussions on amendments to the internal trade law, which so far remains the main dissent between traders and producers in terms of limitations on the marketing and advertising discount, the period for marketing activities, and the obligation to offer at least 50% of market shelf for local products continued without reaching a consensus between all stakeholders.

From the last technical discussions with the Parliament Committee on Economy, Budget and Finance and relevant stakeholders impacted by the proposed amendments (retails, producers, consumers) it was decided by the Parliament to leave only the limitation related to obligation to offer at least 50% of market shelf for local products. As a result, on December 4 the draft law was approved in the second reading of the Parliament.

In this respect, it is important to mention the following shortcomings and risks that will arise with the promulgation of this law:

- Infringement of the international commitments under AA/DCFTA;
- Infringement, both of the principle of freedom of trade, guaranteed by the Constitution of the Republic of Moldova (art. 9 and 126), and of the principle of contractual freedom of the parties, established in the Civil Code;
- Generation of the change in business conduct and establishment of the unfair business practices;
- Establishment of an unfair environment in relation to producers of non-food products, for which no limitations are set;
- Establishment of the unfair conditions for the activity of small and medium-sized enterprises, which are in a more vulnerable position than their larger counterparts and thus will not be able to ensure the implementation of legal provisions;
- Risk of application of the similar measures by the European Union. With the signing of the AA / DCFTA, exports of domestic products to the EU market increased by over 35%. Thus, at present, imports from the

¹[http://eba.md/uploaded/Documente%20de%20pozitie%202020/Covid%2019%20\(partial\)/1.%20EBA%20Moldova%20position%20document%20on%20Role%20of%20DCFTA%20in%20tackling%20Covid-19-merged.pdf](http://eba.md/uploaded/Documente%20de%20pozitie%202020/Covid%2019%20(partial)/1.%20EBA%20Moldova%20position%20document%20on%20Role%20of%20DCFTA%20in%20tackling%20Covid-19-merged.pdf)

Republic of Moldova are not limited by the EU. A similar restriction could be imposed by EU, in response to the restrictions imposed by the Government of the Republic of Moldova;

- Lack of applicability and control rules, difficulty in establishing them in practice.

B. Food safety aspects affecting trade facilitation

Export of animal origin food products

The constraints faced by businesses in terms of not being possible to export animal origin food products onto the EU Market is a concrete example of a lost opportunity for Moldova under a Covid-19 crisis. With a dramatic fall of sales of meat products (by cca 40%) due to the HORECA downsizing, export of meat products and animal origin products (composite products, national cuisine products etc.) having a demand in the neighbour EU Country, Romania, would have been a solution for export increase, saving jobs in the regions and maintain a certain level of revenues to the budget higher compared to the current situation.

It is important for the Government of the Republic of Moldova to launch discussions with the European Commission on obtaining the right to export dairy and processed meat products based on raw materials imported from the EU. In this respect, priority remains to be given to legislation adjustments and issues related to food safety, in particular to the implementation of the necessary animal traceability systems, animal pest control, unit surveillance, CRDV laboratory management and appropriate accreditation etc.

Import requirements for food products, subject to food safety control

In order to implement the Annex XXII of the Moldova-EU Association Agreement, which provide that import checks shall be based on the level of the risk associated, a draft Government Decision on the 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 developed.

Thus, ANSA with the support of the business environment developed a **risk assessment mechanism for the import of goods** to be included in the GD 938/2018 which provides the performance of identity and physical control over 10% of non-animal food products, based on the known risk. However it was not approved yet.

II. TRADE IN SERVICE AND ELECTRONIC COMMERCE

A. Electronic commerce

Due to the Covid-19 context, companies have focused their efforts on implementing and modernizing digital solutions to overcome the crisis caused by the pandemic. Thus, electronic commerce via online sales systems became a priority. Moreover, in 2020 the Ministry of Economy and Infrastructure approved the Road Map for e-commerce containing the key areas that need to be addressed in order to remove existing obstacles for business to operate and develop e-commerce in Moldova and facilitate e-commerce with other countries. Additionally it is important to ensure the improvement of the legislation in the field of electronic commerce to current situation, as well as to offer the financial support (national program/funds) to SMEs for developing ecommerce module on their web pages.

However, currently the biggest shortcoming in the development of e-commerce is the application of the local taxes, which creates a major financial burden, especially taking into account the financial vulnerability of companies, as well as the inequity of these taxes in different districts of the Republic of Moldova, a confirmatory example being the share of the local tax for online stores, which varies from 0 lei to 10,000 lei depending on the city / district of the Republic.

B. Digitization

Covid-19 Pandemic and the declaration of the state of emergency forced the private sector to use digital signatures or signed documents by other electronic means. However, the main issues faced by the private sector was related to the no acceptance of some public authorities of the documents with digital signature. Additionally, Moldovan legislation is regulating the use of digital signatures and digital documents only within the country.

In order to faster the digitization process in Moldova, the Ministry of Economy and Infrastructure approved a Roadmap on the digitization of the national economy and ecommerce development. Also, an ad-hoc working group on Economy Digitization was established by the Prime Minister Economic Council. As a result, the following important measures were identified by the private sector, to be implemented within the Roadmap:

- Unilateral recognition of electronic signatures from the EU as they are recognized in the EU among member countries according to the EU eIDAS Regulation; Aiming to facilitate and secure the process of signing contracts between parties located in various countries, it is imperative to have a mechanism in place to be applied by a party from abroad for the use of digital signature on a document/contract which would be recognized as valid within the Republic of Moldova;
- To ensure the access by the private sector of its customers and partners through the new distribution networks, through Internet, online stores and dedicated online platforms. In this respect, the role of banking sector is very important, as electronic payments with the use of bankcards, among other positive effects, directly contribute to reducing the share of the informal economy and reducing the risk of spreading the infection;
- Remote interaction in relations with banks (remote identification of customers, remote opening and operation of bank accounts, etc.). Ensure necessary actions and legal provisions are considered on the Financial Market and the Regulator in terms of electronic procedure of KYC.

III. RULE OF LAW

According to the business environment perception, insufficient independence of judges and lack of control of the prosecutor's activity raised the following concerns by the business community:

- selective and politicized justice, where certain court files are examined as a matter of priority while the examination of others lasts for years without sufficient justification;
- judicial bias and favouritism towards certain parties which in most of the cases is done against EU investors; unbiased judicial review is critical for a trustworthy judiciary system;
- hostile take-over attempts facilitated and tolerated by state authorities and Moldovan courts;
- selected interpretation of customs regulations by the customs authorities supported by courts, uncommon in the international trading business;
- failure to comply with commitments made to European investors under bilateral Investment Agreements;
- need to provide consistent and sustained training to judges as well as a proper and improved qualification process for judges in all areas of law that are important for business, as well as in judicial assessment of economic decisions made by business decision-makers, including with respect to the manner of drafting and content of any and all court.

A. Justice Sector Reform

Currently, there are multiple judicial cases affecting several EBA members' examples where European Principles and Standards regarding a proper Judiciary System are being violated, such as the case of Premier Energy with the Court of Appeal of Cahul and the trials affecting Danube Logistics.

Premier Energy case

A lawsuit was filed against Premier Energy after a fire broke out in a commercial space with small scattered shops due to the combustion of highly flammable materials exhibited, allegedly due to an electrical peak. Throughout the judicial proceeding, multiple irregularities were committed in breach of the principles of Rule of Law, Non-discretion, Transparency and Due Process:

- The Court did not admit the testimonies, in favour of Premier Energy, from other clients connected to the same power line as the plaintiff that concur that they did not suffer any overvoltage in their energy supply (note: if there is a power hike in the network, it affects the whole power line, not just a single customer). The Court neither accepted the technical automatic records of Premier Energy that show the non-occurrence of overvoltage events in the network. The Court also rejected the technical expertise proving that the high voltage surge had been caused by an overload in the internal network of the consumer, for which Premier Energy is not responsible.
- The Court did not admit any of the two independent damage assessment reports prepared by independent experts proposed by Premier Energy (one from Moldova and the other from Romania). Inclusively, during the judicial process, it was refused to appoint a certified judicial expert to independently and accurately assess the damage.
- The Court did not accept the request of Premier Energy to verify the evidences, to challenge the judge and to transfer the hearings of the case to another judicial instance, requests promoted by Premier Energy given the existence of personal family relationships and "camaraderie" between the plaintiffs, the judges and influential people in the local judicial system.

- There are solid and well-founded suspicions of falsification of evidence and testimonies, which are in the process of corresponding legal investigation.

Status Quo: At the request of Premier Energy, the case has been transferred to the Court of Appeals of Chisinau, where the proceedings will resume in December 2020.

Danube Logistics case

Since 2014 Danube Logistics SRL, the operator of the strategic important Giurgiulesti International Free Port, is target of a raider attack involving multiple frivolous claims pursued in Moldova's notorious courts against the company, its employees, its Dutch shareholder Danube Logistics Holding BV and one of the company's ultimate beneficiaries. The raider attack is orchestrated by a former investor in the project with the objective to gain control of Danube Logistics SRL and thereby control of Moldova's only port.

Following flawed Moldovan court proceedings the former investor managed to establish a claim against one of Danube Logistics SRL's ultimate beneficiaries. This claim and the conduct of the proceedings are subject to a review by the European Court for Human Rights. Since October 2019 he attempts to enforce this claim against Danube Logistics Holding BV's assets in Moldova, and in particular to seize dividend payments as well as the majority of Danube Logistics SRL's share capital. This measure constitutes an illegal expropriation not only of the property of the Dutch Danube Logistics Holding BV but also of the EBRD, who is entitled to 65% of the dividend and share sales proceeds deriving from Danube Logistics Holding BV's shareholding in Danube Logistics SRL. Despite the objections of Danube Logistics Holding BV and of the EBRD the Chisinau Appeals Court confirmed in contradiction to applicable law on 12 May 2020 the legality of the bailiff's approach.

Status Quo: On 3 November 2020 the Chisinau Appeals Court annulled the claim of Danube Logistics Holding BV against the bailiff's unlawful injunction to seize Danube Logistics SRL's share capital based on supposedly technical breaches. Both rulings constitute severe deteriorations of Moldova's business climate as they demonstrate that Moldova's notorious courts hold limited liability companies and financial institution liable for debts of any of their ultimate beneficiaries.

B. Competition

Timbrus case – misuse of competition legal framework

The company has been producing and successfully exporting high quality wines on the EU market using the denomination of the village "Purcari", where the wine yards were located. This fact represented an irritancy for a market competitor which complained to the Competition Council (CC) on alleged infringements and misuse of Purcari name. Unfortunately, the CC has not taken into considerations arguments provided by Timbrus Company and took a biased attitude in the case. Similar actions were undertaken in Romania which led to suspension by the court of sales on the Romanian market of Timbrus wines. Unfortunately, there the authorities proved to be biased as well and neglected the arguments presented by Timbrus and proves of international registration of Timbrus Trademarks at the World's Intellectual Propriety Office (WIPO).

Sofilarex case – export of scrap metal

Following the de-monopolization of the metal scrap export market, through abolishment of the Government Decision no 1284/2002 on the obtaining of the license for trading and export of the ferrous and nonferrous metal scrap, the market was liberalized and companies obtained the right to export metal scrap onto the UE market and other countries. However, there are still abusive measure orchestrated by state bodies like Ministry of Internal affairs, as well as by physical persons of unknown identity, putting pressure on any other companies than "Metal Feros" willing to export onto the EU Market.

Since the liberalization of the scrap metal market export, namely since Sofilarex company started to export, being the second company after Metal Feros, to export – the company (Sofilarex) is facing serious personal and company's attacks aiming to stop the activity of the company:

- The unknown explosive objects were found on trucks carrying scrap metal. So far, the Police Inspectorate has not come up with an answer in this regard;
- Imposing additional conditions for carrying out entrepreneurial activity in this field, which until now were not stipulated;
- The multitude of verifications from the state bodies;
- Filing criminal cases, about which the company finds out from the press;

- Lack of fair competition;
- Intimidating customers.

Additionally, the economic activity of the Sofilarex was partially suspended, especially following the Government meeting on December 5, when the Prime Minister requested to revise the legal framework for the company entrepreneurial activity.

C. Developments affecting banking stability

The banking sector is still recovering after significant damage caused by the 2014 banking fraud and all related it developments. More advantages and opportunities for business would come if the banking sector would be oriented towards the customers in prospective of offering more electronic and digital solutions, which would ease/facilitate access of businesses to financial services offered by banks (such as: electronic granting of loans, facilitation or digitalization with other stakeholders including bailiffs). At the same time, the main issue related to the banking sector is the lack of credibility of the sector at the international level and the consequences associated with these related to low appetite to channel investments on the financial market of the RM, lack of access to low cost funding, increased costs for international transfers because of the country high risk qualified by the corresponding banks etc.

VictoriaBank case

After the fraud of 2014, several important reforms were implemented for the cleaning and modernization of the banking sector in the Republic of Moldova, one of them being the investment made by Banca Transilvania in "Victorianbank" in strategic partnership with EBRD, which can be described as a major milestone and which encouraged other strategic investors to invest later in the other three systemic banks in Moldova (OTP Group in Mobiasbanca, Dovere Group in Moldincombank, International Investment Fund in partnership with EBRD in MAIB). Unfortunately, all these reforms and modernization efforts risk to be erased by the actions taken in 2020 by the Anticorruption Prosecutor's Office, which instead of looking for the real beneficiaries of the billion theft and recovering the damage from them, seeks to transfer responsibilities and the burden of damages on banking institutions now owned by an EU member state.

These actions are accompanied either by various television broadcasts of so-called "banking experts" or "key witnesses" of the Prosecutor's Office or by press releases and conferences of prominent officials of the Anti-Corruption Prosecutor's Office in which statements that violate basic and fundamental principles of the presumption of innocence are made or in which media pressure is exerted on judges who "dare" not to agree with the decisions of the prosecutors investigating the case.

Progress obtained with great efforts in the banking sector must be protected, and this requires the cooperation and understanding of all decision-makers in Moldova and the EU.

IV. FISCAL ISSUES RELATED TO DCFTA IMPLEMENTATION

A. Extended Producer Responsibility Principle

Following multiple discussions and technical meeting organized with the representatives of the private sector, Ministry of Finance and Ministry of Agriculture and Regional Development a new article on subsidizing the packaging waste management process has been introduced in Law 209/2016 on wastes. The amendment, as a part of Fiscal and Tax Policy for 2021, was approved at the Government Meeting on November 30, 2020, following multiple Position Papers developed by EBA Moldova as well as an analytical study developed by EBA under GIZ support which illustrates the practical implementation of EPR in the EU countries and provides concrete proposals on the fiscal solution of the EPR Mechanism in Moldova.

Thus, the amendment provides that methods, conditions, procedure and the amount of the subsidy will be determined by the Government, through a dedicated Government Decision. Moreover, the subsidy will be granted from the funds accumulated in the National Ecological Fund.

B. The Tax Policy measures developed by the MoF for 2021 have partially addressed the business community needs especially following the Covid-19 impact on private sector.

In this regard EBA has developed its Position Paper on the proposal of the business community to the 2021 Tax Policy Exercise. Among the priorities the following proposals can be found:

1. Abolishment of the 2,5 % Luxury tax in the telecom industry

Electronic communication networks and services growth still remains affected by obsolete taxation provisions. The 2.5% luxury tax applied to all mobile operators seriously affects development of the sector and limits investments in the area. Currently all the fees imposed or regulated by the state on the communication industry like license fees, MNP (mobile number portability) fees and local interconnection tariffs are denominated in EUR, although the tariffs to customers are in local currency. Beside this, all telecom equipment/software and related support and maintenance network costs are imported and are foreign currency denominated as well. The companies are facing material foreign exposure, which is not being possible to hedge due to underdeveloped banking sector. All these factors stop development of the sector and limits full use of DCFTA's opportunities with regards to trade in services.

One of the EBA key proposals under the 2021 Tax Policy Exercise was to abolish the 2.5% tax as an unjustified and discriminatory measure in the current situation and future context, given the lack of liquidity, which significantly increases the tax burden exclusively on the electronic communications sector, the strategic sector for the national economy. It was proposed to exclude / revise the luxury tax, a process that unfortunately ended with the emergence of a new tax - the portability fee in the amount of 50% of the payment for the operation. In the EU, the trend is to reduce the costs of mobile operators as well as electronic communications operators, thus reducing consumer costs, while in the Republic of Moldova, these costs will increase by 1.5 million Euros, costs to be covered by operators.

Following all the discussions, MoF accepted to reduce the tax down to 1.5 % starting with 2022 still unaccepted by telecom sector.

2. Implementation of Euro 5, Euro 6, Euro7 emissions standards in Moldova

These standards define the acceptable limits for exhaust emissions of new vehicles sold in the European Union and EEA member states. The emission standards are defined in a series of European Union directives staging the progressive introduction of increasingly stringent standards. The final standard is Euro 7, which will be followed by vehicles. Considering that the pollution level of the country increases, implementation of the Euro 5, 6, 7 emission standards becomes critical for Moldova. In this context EBA advocates for the import of the vehicles that correspond to the EUR 5 standard at least, starting with January 1, 2021. Of course the state can allow import of the second hand cars older than 7 years, however with an increased excise if to compare with the excise applied on newly import cars. This excise should consider the engine capacity.

3. Prohibition of import of second hand spare parts for auto services/second car market

EBA is advocating for not accepting the import of second hand spare parts, this affecting the human safety as there is no certification/accreditation body that would certify the quality/safety thereof. Moreover the customs valuation process becomes extremely evasive and obscure, a fact that can boost corruption and grey economy. Such kind of „business” will demotivate the importers of cars as well as technical services providers, including importers of new spare parts to do proper business and will create precondition for underground economy.

4. Reducing the 18 % income tax to 12 % income tax for the legal professionals

It is not reasonable to have such a difference between the 2 types of tax rates, thus demotivating freelancers, lawyers of legal services by taxing their activity with a higher rate of 18 % against the common rate of 12 %. This difference generates the appetite for tax evasion and grey economy on the freelancers market, especially among legal services.

5. Ensuring clear norms regarding taxation of non-residents

Taxation rules with regard to non-residents in Moldova need to be revised, taking into account the current development of the economy, as well as the existing international trends. Specifically, the clear rules of taxation and allocation of profits for the activity of permanent establishments need to be ensured, in order not to discriminate the activity of non-residents in Moldova performed through a permanent establishment. In this regard it is essential as well to review the applicable rules and limits for allowed deductions, so as to provide non-resident with equal treatment as for other businesses in Moldova.

EBA has proposed the related amendments to the tax legislation, and we are glad that as an initial stage the draft fiscal policy contained amendments to the definition of the permanent establishment.