EUROPEAN BUSINESS ASSOCIATION

DCFTA BUSINESS CLIMATE UPDATES 2023 AND 2024 (Q1)

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)

Chisinau, 2024

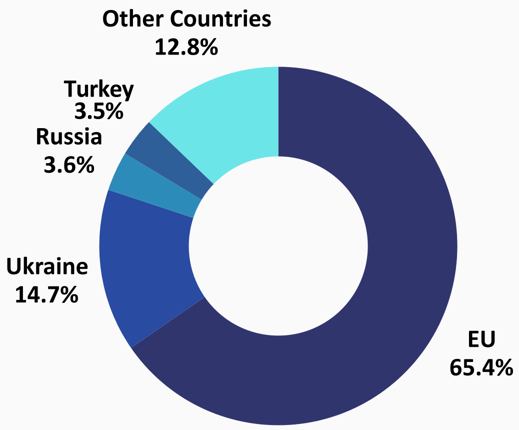
This publication was produced with the financial support of the European Union. Its content is the sole responsibility of the European Business Association Moldova and does not necessarily reflect the views of the European Union.

MACROECONOMICS

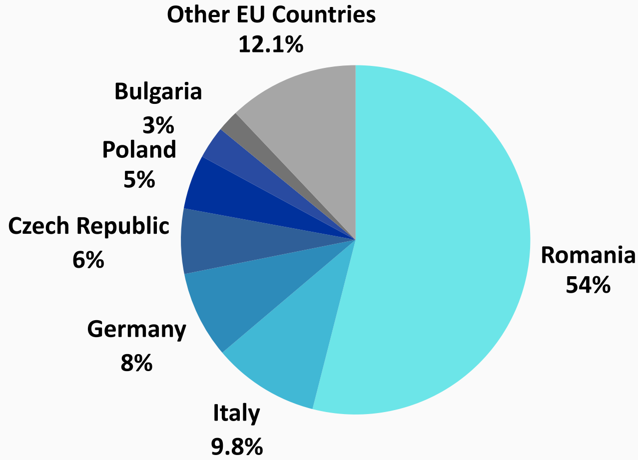
Despite ongoing challenges like crises, war in a neighboring country, severe drought, and high prices, the national economy saw a slight growth. Decreased domestic and external demand, supply chain disruptions, and reduced industrial production were offset by growth in sectors like agriculture, ICT, healthcare, education, and HoReCa. Net exports also contributed positively to the **Gross Domestic Product** due to increased exports and decreased imports.

- In 2023, the **GDP** increased by 0.7%.
- The **annual inflation rate** stood at 4.2% (December 2023 compared to December 2022).
- The **state debt** balance reached 104 bn lei (5.4 bn Euro), up by 9.9% from the same period in 2022. Domestic state debt amounted to 39.7 bn lei (2.06 bn Euro), up by 15%, and external state debt was $3.7 bn (3,4 bn Euro), increasing by 17.7%.
- In 2023, **exports** amounted to $4.04 bn (3.7 bn Euro), down by 6.5% nominally. **Exports to the EU increased by 4.3%** and reached $ 2.6 bn (2.4 bn Euro) holding a share of 65.4% in total exports.
- In 2023, the value of **imports** decreased by 5.9% in 2023, totaling $8.6 bn (8 bn Euro). **Imports from the EU decreased by 4.1%,** holding a share of 48,3% of total imports.
- The average **gross monthly wage** in 2023 was 12,354.7 lei (642.6 Euro), up by 17.3% nominally and 3.5% in real terms from 2022.
- **Industrial production** decreased by 3.6% in 2023, with manufacturing being the most affected branch, declining by 5.3%. Food industry production decreased by 10.7%.
- Global **agricultural production** increased by 23.6% in 2023, with plant production up by 35.1% and animal production down by 1.9%.
- **Foreign direct investments** recorded a net capital inflow of $416.3 M (384,1 M Euro), 23.1% lower than in 2022. Investors from EU countries held the majority share – 86.3%, from other countries – 13%, and from the CIS – 0.7%. Main foreign investors are originate from Cyprus, the Netherlands, Romania, the UK, Bulgaria, France, etc.

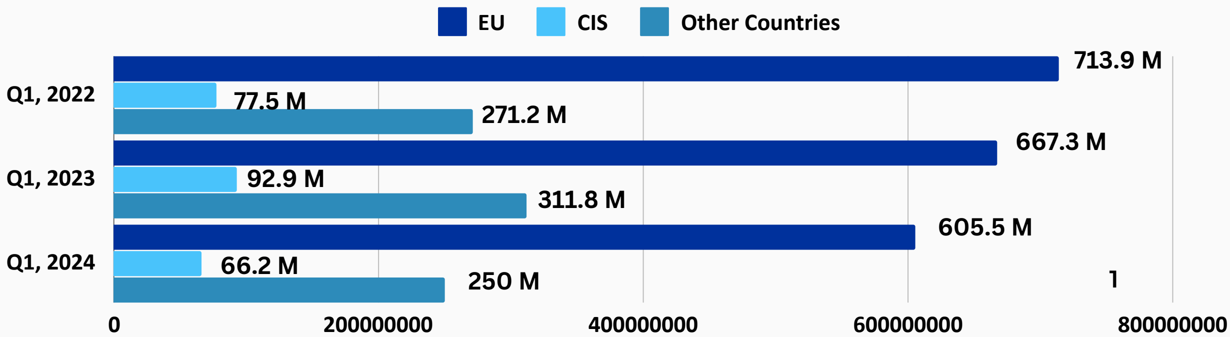
Moldova's Exports in 2023



Export to EU in 2023



Moldova's Exports in Q1, 2022-2024 (US Dollars)



INTRODUCTION

The accession of Moldova to the European Union is a top priority for the current political leadership of the Republic of Moldova (RM) and is on the EU's agenda for future enlargement. Following Moldova's application in March 2022, the EU officially granted Moldova candidate status on 22 June 2022. On 14 December 2023, the European Council decided to open accession negotiations with Moldova.

Currently, Moldova is undergoing a dynamic legislative screening process to ensure its laws comply with the EU Acquis Communautaire. Moldovan authorities aim to join the EU by 2030. During this process, the government has committed to presenting a new legal framework for each chapter swiftly, often without sufficient expertise, calculations, and impact assessments of the immediate transposition of EU directives and regulations, as well as evaluating the readiness of the country, institutions, and the private sector to implement the new legislation.

In this context, the support of the European Union and other donors is crucial in enhancing the capacities of public servants, particularly the Bureau for European Integration, in coordinating and negotiating the development, updating, implementation, and monitoring of the National Action Plan for Moldova's accession to the EU.

Moreover, a significant importance for the private sector is the evaluation of the transposition of several important new directives and regulations from the European Commission that are set to enter into force in 2024-2025, impacting entrepreneurial activity across various sectors. These include ESG Reporting Indicators (such as the Corporate Sustainability Reporting Directive, Sustainable Finance Disclosure Regulation, Directive on Corporate Sustainability Due Diligence), as well as the Digital Markets Act, and the Digital Services Act. The voluntary implementation of these directives will help Moldova's private sector gain competitive advantages, attract investments, improve governance, and align with global best practices, thereby enhancing their market position and ensuring sustainable growth.

JUSTICE SECTOR REFORM

After the 2021 elections, Moldova's authorities announced an ambitious reform of the justice sector. These reforms are built on three main pillars: independence, efficiency, and effective administration of justice. The reform process is ongoing, with its impact set to be evaluated by the end of 2025, the deadline for full implementation.

In 2023, the vetting process for the Supreme Court of Justice (CSJ) resulted in the automatic resignation of 75% of its judges. In 2024, the vetting of the Chișinău Court of Appeal led to the automatic resignation of 50% of its judges.

By May 1, 2024, the Pre-Vetting Commission had evaluated 69 candidates for positions on the Superior Council of Magistracy (CSM) and the Superior Council of Prosecutors (CSP). Of these, 29% passed the evaluation, 51% did not, and 10 candidates are still awaiting reevaluation. Currently, both the CSM and CSP are fully functional, each with a six-year mandate, with one judicial member yet to be appointed to the CSM.

The successful completion of justice reform is of paramount importance for Moldova. Establishing an effective judicial system—one that is independent, high-quality, and efficient—remains a top priority for state institutions as Moldova progresses towards EU membership.

PUBLIC PROCUREMENT

Currently, the public procurement is marred by various challenges that impede transparency, efficiency, and fairness. From prioritizing lowest price over quality to issues of corruption and lack of transparency, the sector faces significant hurdles.

The private sector expresses its concerns on the critical issues plaguing public procurement practices in Moldova. These encompass concerns ranging from the quality of work delivered, modifications to contract clauses, and deficiencies in expertise to instances of corruption and inadequate transparency.

- Public procurement often prioritizes the lowest price over quality, resulting in poorly executed works due to non-competitive offers with realistic prices for quality services/goods/works.
- Some contracting authorities (such as the I.S. State Road Administration) at the stage of signing the contracts modify the clauses originally provided in the model contract published in the procurement documents. Such new clauses sometimes are essential to the performance of the contract and have considerable economic impact.
- Working groups lack expertise in public procurement, and certification procedures for specialists are not implemented.
- Contracting authorities exploit permissive regulations to cancel procurements when they can't award contracts to preferred bidders.

- Incompetence and corruption at an alarming level within the Public Procurement Agency, which claim bribes for not blacklisting and for publishing reports in the Public Procurement Magazine (Buletinul Achizitiilor Publice).
- Procurements under the Law no. 74/2020 still remain not sufficiently public and transparent. Not all contracting entities conduct them through the e-procurement system (SIA RSAP MTender), which prevents many economic operators from learning about these procedures. The economic operators do not monitor every possible site every day in order to find out in time about the new procurements of utilities, while MTender connected platforms notify in real time about the new procurements according to CPV.
- Many procurements are exempt from Law no. 131/2015 on public procurement and Law no. 74/2020 on procurement in the energy, water, transportation, and postal services sectors, which limits participation, reduces competition and transparency in the procurement procedures. In particular, it is a problem with procurements organized according to the rules of international organizations.
- Contracting authorities lack the ability to assign contracts to the next bidder if the initial winner fails to execute, leading to unnecessary delays in new procurement procedures.

EBA Moldova reiterates the importance of addressing these challenges as it is essential for fostering a procurement environment that promotes accountability, fairness, and optimal utilization of resources.

RENEWABLE ENERGY

Government Decision No. 690/2018 from its adoption date established clear eligibility criteria for investors and projects seeking large eligible producer status in renewable energy. However, the Ministry of Energy altered the bidding strategy, combining two radically different approaches in the final stage, thus excluding the principle of predictability for potential investors.

This change contradicted the predictability principle and disrupted the efforts of investors who had complied with legislation since 2018, investing significantly in renewable energy projects in Moldova. These investments include land selection, technical studies, obtaining permits, and more. The proposed amendments to the GD No 690/2018 by replacing these efforts with a “roadmap” raises disagreement from the investor community in this industry, who have been present in the Republic of Moldova for several years and have complied with and developed projects that meet the requirements of the current legislation throughout this period. Additionally, the assessment of bids during the qualification stage is crucial. Presenting projects solely with a "roadmap" raises concerns about execution feasibility, compliance with regulations, and potential risks, posing challenges for project evaluation.

The option to use a "roadmap" or a developer's self-declaration to prepare the bidding package (connection permits, land rights, etc.) only if successfully awarded, simplifies bidding requirements and may attract more bidders, but entails the following risks:

- The evaluation process during the qualification stage becomes subjective, as technical assessments rely on incomplete information. Lack of clarity on project execution feasibility, geological/archaeological restrictions, landowner agreements, and technical design compliance undermines the evaluation process.

- The diminished relevance of technical criteria hampers fair comparisons between detailed proposals and roadmaps.
- Potential participants can join without upfront costs, potentially enticing speculators and fostering a secondary market for reselling fixed-price PPAs This could lead to speculation extending beyond connection permits to encompass PPAs for significant renewable energy endeavors. Moreover, the proportion of awarded but unconstructed and failed projects will increase.
- Replacing explicit documentation with declarative commitments poses viability risks, even with specified bank guarantees.
- Allocation of connection permits to projects awarded based on roadmaps is uncertain, raising questions about rights for developers on waiting lists and potential disputes.
- Investors who have invested upfront in permits, wind statistics, land acquisition, etc., may feel disadvantaged by the sudden change in bidding requirements, allowing others to participate without incurring similar costs.
- Ultimately, this approach increases uncertainty for Moldova, setting a negative precedent for investors who have previously committed to investing in the country.

Therefore, EBA Moldova considers that the introduction of a last-minute amendment seemingly favoring opportunistic investors is perplexing and may undermine genuine investment efforts.

WASTE MANAGEMENT

On 1st of October 2023, new legislative amendments entered into force to enhance the functioning of the Extended Producer Responsibility (EPR) principle in Republic of Moldova. Among other, Law 1540/1998 on payment for environmental pollution changed the method of computation of the pollution tax for packaging waste from volume to kg, expanded the type of packaging waste subject to tax, as well as introduced the exemption mechanism for producers that meet specific annual recycling targets.

Furthermore, recent amendments introduced in Law 209/2016 on waste restricted the import of packaged goods on the Moldovan market sole to those registered in the local Waste Management information system. Failure to register, also results in the inability to market products on the Moldovan market.

Despite the progress, several key areas require immediate intervention, including:

- As currently worded, the legislation leaves room for interpretation as to whether the EPR responsibility for packaging waste should be undertaken by entities that place for the first on the Market (i) packaged goods or (ii) packaging without goods; which
- Resulted in diverging opinions between the Ministry of Environment and the Ministry of Finance/State Tax Service, which in turn led to high level of uncertainty at the level of the business community and exposure to potential taxes and penalties.
- The provisions included in Government Decision no. 561/2020 on packaging and packaging waste should be revised and updated in line with the provision of Law 1540/1998. Among other, this should ensure that the producers are not penalized twice for the failure to ensure recycling requirements.
- Furthermore, it remains crucial to ensure the availability of an adequate recycling infrastructure, which is currently lacking despite the environmental tax collected. Additionally, a partnership between the business sector and local public authorities is necessary, as there is currently no commitment or cooperation between collective systems, recyclers, and local public authorities.

CUSTOMS CODE

The new Customs Code, aligned with that of the European Union, entered into force on January 1, 2024.

Currently, both the Customs Service of the Republic of Moldova and businesses are adjusting their internal procedures and systems to align with the new Customs Code and the recently developed secondary and tertiary legislation.

One of the serious concerns generated by the new Code was the application of Guarantee System provided in the Code. Following an active consultation between the Customs Service, Ministry of Finance and business community, in January 2024, the Guarantee System was postponed for a period of 6 months. However, by the end of May 2024, a legal initiative was proposed to further delay the Guarantee System by an additional 2.5 years. This extended transition period will allow the Customs Service, Ministry of Finance, National Bank of Moldova, and the business community to devise and implement the necessary measures to make the Guarantee System feasible and operational.

Another challenge faced in the context of the new Customs Code implementation is related to the application of 10 years guarantee system since the signing of the Association Agreement and DCFTA in 2014 and which is contradicting with entering into force of the new Customs Code. Still, the responsible authorities, Ministry of Digitalization and Economic Development jointly with Ministry of Finance and Customs Service have to clarify in what conditions the new Customs Code shall be applied, so as to ensure the necessary medium term financial and operational perspective for the residents of the Free Economic Zone.

It is imperative to mention that the new Code also provides several benefits for the business community, such as e-customs decisions. However, the necessary information systems are still under development, causing a slight delay in the practical implementation of the new Code.

Once the necessary legislation and IT systems are developed, it will be crucial to ensure that all stakeholders, including officials of executive authorities and economic operators, are aware of and understand the regulatory framework and technological components involved.

TRANSBORDER MOBILITY

A significant challenge for customs authorities persists in streamlining the flow of goods at the Moldovan-Romanian border amid the ongoing Russia’s war of aggression against Ukraine. Despite efforts by the Moldovan Government to address issues such as long queues and extensive wait times for trucks, the lack of essential infrastructure and limited capacity to manage commercial transport flow at Romanian border points remains an ongoing concern.

Consequently, international and European investors, particularly those in industries like automotive manufacturing, face significant risks due to potential contract cancellations and penalties resulting from delivery delays. This mostly affects companies operating under Just-In-Time contracts, where adherence to precise delivery schedules is critical.

With the aim to reduce delays, minimize disruptions to supply chains, and support the smooth flow of goods between Moldova and the EU, the private sector underlines the urgent need for investment in infrastructure at the Lipcani-Rădăuți border crossing point on the Romanian side, which is currently non-functional due to insufficient infrastructure. Establishing an additional border crossing point would alleviate truck congestion, particularly for vehicles bound for the EU.

Additionally, it is important to enhance the data exchange between the Republic of Moldova and Romania to streamline border crossing procedures, especially for Authorized Economic Operator (AEO) holders and other economic operators. It is important that all MD and RO institutions present at the border treat the business operators holding the AEO status with priority. Functioning of the AEO Mutual Recognition Agreement (MRA) is affected by the fact that not all the institutions present at the border, recognize it.

FOOD SAFETY

The European Commission authorized the export of processed poultry meat and eggs of category A (March 2023) and fresh and frozen poultry meat (April 2024) from the Republic of Moldova, opening new opportunities for the country to expand its export potential for animal-origin food products and attract foreign investors to contribute to the growth of the livestock sector.

In this respect, the poultry producers have been making significant efforts to align their activities with the EU regulatory framework. for poultry meat exports to the European Union.

However, the main challenges in the area of animal origin production is the limited number of national laboratories capable of ensuring compliance with all sanitary and phytosanitary requirements for certifying products intended for the EU market. The lack of high-performance equipment and significant investments in this area affects the operational capacity of national laboratories.

Additionally, amendments to the Government Decision No 938/2018 on the Regulation regarding the National Agency for Food Safety (ANSA) border control of the imported goods were approved. The main issue related to the approval of the respective normative act was the provision that foreseen the exclusion of the ANSA's obligation to perform the border control based on the known risk.

This infringes the Annex XXII of the EU-Moldova Association Agreement, which provide that border control shall be carry out based on the risk assessment mechanism for the import of goods. Despite the fact that the normative act was adjusted according to the AA/DCFTA provisions, the business operators still face full control at the border, which implies high costs and longer time to clearance of goods.

Based on the above, the private sector from Moldova underline the urgent need to implement the following actions:

- Expanding the network of national laboratories and improving technical infrastructure to enhance the certification process for export-oriented products destined for the European market. Ensure the laboratories activity at the border 24/7.
- Strengthening institutional capacities within the Ministry of Agriculture and Food Industry (MAFI) and the National Food Safety Agency (ANSA) to expedite the harmonization of national legislation with EU standards.
- Offering the pre-accession funds for local producers and the development of municipal public markets.

ACCESS TO FINANCE

Robust access to finance is essential for fostering a competitive business environment, stimulating economic growth, and promoting sustainable development. It enables businesses of all sizes—small, medium, and large—to thrive and innovate.

Limited access to finance can significantly hinder the growth and operations of even large companies, which require substantial financial resources for large-scale investments, mergers and acquisitions, research and development, and international expansion.

For SMEs, the main barriers to accessing finance include high interest rates, excessive charges and commissions, and a lack of expertise in preparing loan applications. Additionally, the long processing times and stringent requirements can further complicate their efforts to secure funding. Large companies, despite their scale, also face challenges such as the scarcity of available credit tailored to their needs. Addressing these barriers is crucial for ensuring that businesses at all levels can secure the necessary funds to support their strategic objectives and sustain their expansion plans effectively.

The private sector emphasizes the need to adjust the criteria for defining SMEs, stipulated in Law 179/2016 on small and medium-sized enterprises, to align with the European Commission Recommendation of 6 May 2003 concerning the definition of SMEs. This adjustment will enable a greater number of entrepreneurs to be eligible for support under the State Programs for SME development and to receive non-reimbursable financing, preferential loans, and financial guarantees for contracting loans from commercial banks.

GDPR

Following multiple discussions on both the Ministry of Justice Working Group platform and the Working Group platform of the State Commission for the Regulation of Entrepreneurial Activity, on May 8, 2024 the Government approved the Government Decision on the approval of the data protection law.

However, still there is a pressing need to assess the adverse impacts, particularly the economic repercussions, on the private sector and foreign investors resulting from specific provisions of the draft law, particularly:

- The obligation to appoint a representative (individual or legal entity) based in the Republic of Moldova, who will represent the operator or authorized person regarding their obligations under the new law. This provision will impose an additional financial burden on foreign investors.
- The absence of a supervisory authority overseeing the processing operations of judicial authorities in the execution of justice. The draft law designates the National Center for Personal Data Protection with the responsibility of ensuring supervision and monitoring of law enforcement, yet it fails to establish a supervisory authority in the judicial domain.
- Non-compliance with the principle of the unrestricted flow of data in cross-border data transfers and the obligatory authorization requirement for such data transfers.
- Risks regarding potential abuses by state security organs given that the draft law, for unclear reasons, excludes information classified as state secrets from these regulations.

In this context, EBA Moldova reiterates the imperative need to refine the provisions of the draft law. The exclusion or modification of clauses that place additional financial and administrative burdens on the private sector is of utmost importance to ensure a balanced and efficient implementation of the legislation. The draft law, registered in Parliament for approval, is currently under coordination with all relevant Parliament Committees.

ELECTRONIC COMMUNICATION

Sector Development Priorities

- **Lower roaming tariffs with EU countries.** The private sector acknowledges the collaborative efforts of Moldovan and EU authorities towards integrating the Republic of Moldova into the European communication landscape by facilitating the reduction of roaming tariffs. Moldovan regulator has dropped the international MTRs to the level of the EU starting from 1 Jan 2024. Additionally, further participation from EU operators in the voluntary roaming agreement until Moldova would be eligible for a mandatory agreement, is welcomed by the industry's operators.
- **EU Electronic Communication Code.** Moldovan authorities have committed to adopting the EU Electronic Communication Code, and the private sector advocates for expedited implementation. Swift transposition is essential to foster sector growth, provide clarity on licensing processes, frequency usage taxes, and the option for license fee installment payments.
- **Digital Europe Program.** The sector eagerly anticipates engagement in the Digital Europe Program, recognizing the significance of digitalization and cybersecurity for Moldova's industry advancement.

Circular economy in electronic communication industry

Currently the use of redeployed equipment is restricted by the frequency licenses usage provisions. Considering the strategy of the Republic of Moldova regarding the circular and environmentally friendly economy, as well as the recommendations of the GSMA, the use of redeployed mobile network equipment would constitute a major advantage for both network providers and society, as well as for the environment. The development of networks would allow providers to better contribute to the achievement of the state's goals of digitizing society. According to GSMA studies, the usage of refurbished spare parts for repairing existing equipment reduces the demands for manufacturing new products, significantly lowers the carbon emissions associated with the electronic communications industry, as well as fosters more efficient working practices where network failures can be cleared more quickly, which would reduce network downtime and disruption. The regulatory focus in particular within the European Union and its Taxonomy framework is also a key driver for this development.

The benefits of using redeployed equipment may also be passed on to the network customers. Redeployed equipment removes the need for products to be shipped from overseas and this can significantly shorten the lead-times associated with acquiring items. This may mean that network faults can be repaired more quickly, resulting in less downtime for the client and an improved service. Over time the improved service combined with reduced costs will allow the mobile operator to stay competitive and provide affordable mobile services to its customers.