DCFTA BUSINESS CLIMATE UPDATES Semester 1, 2024

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, November 2024

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MACROECONOMIC INDICATORS

The **Gross Domestic Product** amounted to 142.2 bn MDL (7.28 bn Euro), increasing by 2.2% compared to the first semester of 2023.

The **annual inflation rate** (June 2024 compared to June 2023) was 3.8%.

The **state debt** reached the level of 107 bn MDL (5.48 bn Euro) and was up 7.1% compared to the same situation of the previous year. The internal state debt amounts to 43.8 bn MDL (2.24 bn Euro), increasing by 19% and the external state debt – 63.2 bn MDL (3.24 bn Euro), which increased by 2.1%.

Exports amounted to $1780.5M, down by 12.8% reflecting a nominal decrease of 12.8%. Exports to the EU amounted to $1157.8M, down by 7.4%, representing 65% of total exports.

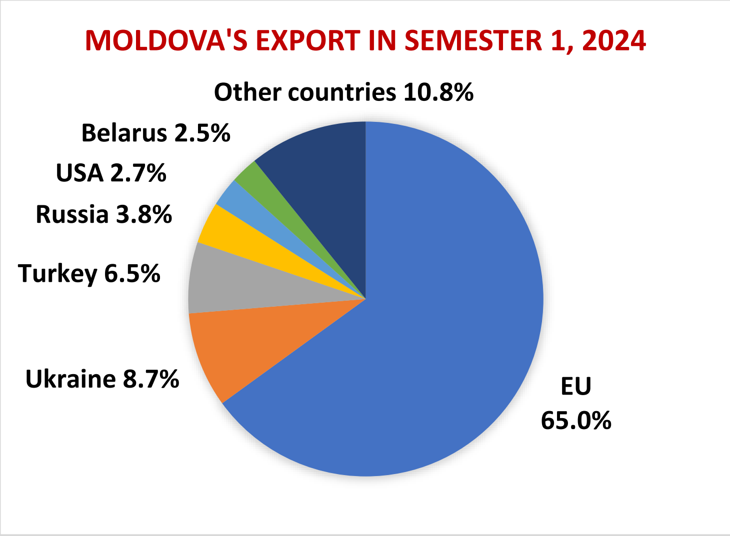
The value of **imports** decreased by 1.3% in the first semester of 2024, totaling $4316.2. Imports from the EU amounted $2111.7M, decreased by 0.1% and holding a share of 48.9% of total imports.

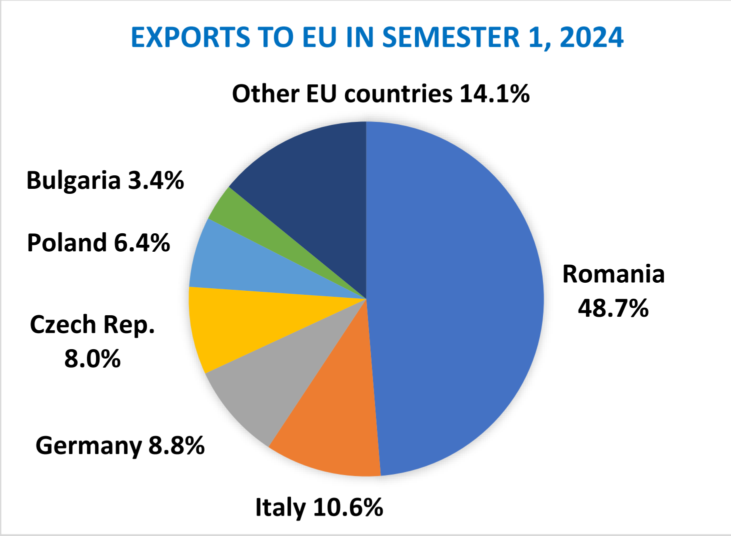
In the first semester of 2024, the **average gross monthly salary** was 13,622.1 MDL (about 709 euros) and increased by 10.8% compared to January-June 2023

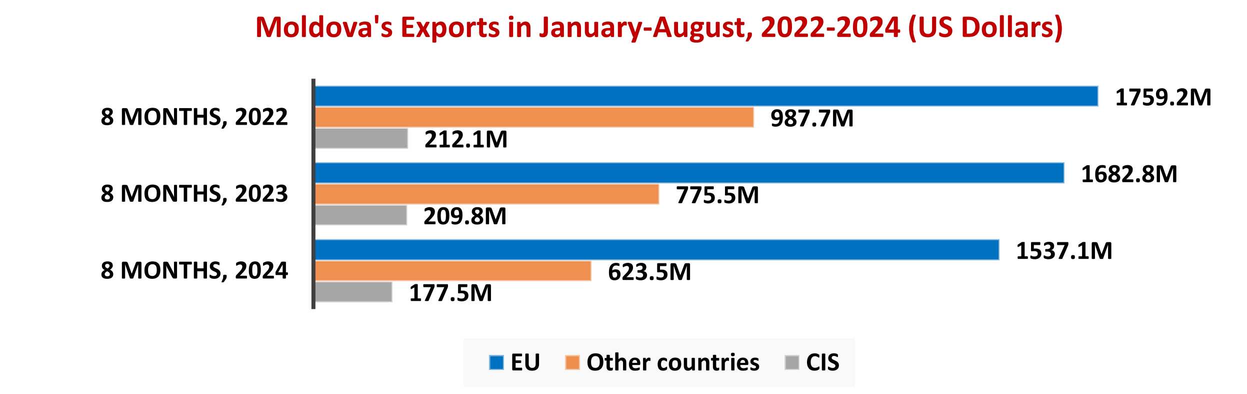
The volume of **industrial production** increased by 0.7% compared to the January-June 2023.

In the first semester of 2024, **agricultural production** increased by 5.5%, reaching a value of about 6.4 bn MDL. Animal production increased by 4.4%; Plant production increased by 13%.

Foreign direct investment (FDI) recorded net capital inflows of $105.4M (1.8 times decrease compared to January-June 2023). Investors from EU countries accounted for the majority (86%) of accumulated capital, followed by other countries (14.9%). Main foreign investors originate from Cyprus, the Netherlands, Romania, France, Bulgaria, Austria, the UK, etc.







JUSTICE

Since 2019, Moldova has pursued major justice sector reforms focused on independence, efficiency, and sound administration was launched, gaining international recognition. Moldova's World Justice Project Rule of Law Index ranking improved from 82nd in 2020 to 64th in 2024, marking a global high of 10.6% progress over five years.

A core element of reform is the vetting of judges and prosecutors to ensure ethical and financial integrity, with the first phase—pre-vetting—98% complete as of November 2024, restructuring key judicial oversight bodies (Superior Council of Magistracy, Superior Council of Prosecutors). The remaining two stages (supreme Court vetting and full vetting) are just commencing.

Achievements

- ✓ In the pre-vetting phase, 49 candidates for the Superior Council of Magistracy were evaluated, with an overall 29% pass rate (18% for judges, 43% for non-judges, and 45% for prosecutors).
- ✓ Vetting revealed significant financial issues, including undeclared assets and large income-expenditure gaps, sometimes in the millions of MDL.
- ✓ Judges and prosecutors who pass vetting have received up to 60% salary increases, and legislative reforms have strengthened anticorruption efforts, including stricter penalties and suspension of statutes of limitations for corruption.

Challenges

- **Systemic strain:** The Supreme Court lost 90% of its judges due to vetting, and 50% of judges at the Chisinau Court of Appeal also resigned, leading to temporary appointments and increased pressure on the system.
- **Slow evaluation:** Each vetting process takes around six months, slowed by staffing shortages, complex case reviews, translation needs, and slow external responses.
- **Low public trust:** Trust in the justice system remains under 20%, highlighting a need for greater transparency and public communication.

EBA Members meet the Prime Minister of the Republic of Moldova to discuss business climate updates and priorities.

Corruption remains a top concern for Moldovans, alongside issues such as high prices and low wages. Since 2023, legislative measures have clarified roles between the National Anticorruption Center (NAC) and the Anticorruption Prosecutor's Office (APO) through three rounds of amendments.

Achievements

- ✓ **Specialized anticorruption panels:** The Superior Council of Magistracy assigned nine specialized judges to handle approximately 120 criminal cases from the APO, leading to faster case processing and more efficient hearings.
- ✓ **Strengthened legal framework:** Legal amendments expanded bribery offense definitions, introduced stricter sanctions on political party financing, and enhanced whistleblower protections, partially aligning with EU directives.

Challenges

- ➢ **Separation of NAC and APO roles:** Despite progress, resource and staffing constraints limit the APO's investigative capacity.
- ➢ **Electoral corruption:** The 2024 presidential elections and EU referendum exposed significant electoral corruption, with over $39 million in illegal fund transfers aimed at manipulating the vote. Allegations of internal obstruction by prosecutors and police complicate efforts to address the issue.
- ➢ **Case trends:** Criminal investigations dropped from 723 in 2022 to 396 in 2023, while cases sent to court decreased. However, prosecutions of high-ranking officials rose from 13 to 18.

GREEN DEAL

Energy Renewable

Renewable Energy Tenders. In August 2024, the authorities launched a tender for renewable energy capacity, with a submission deadline of March 31, 2025. According to the Ministry of Energy's timetable, the Tender Commission will announce the winners by August 2025, allowing a five-month evaluation period. **This prolonged timeline raises concerns about the transparency of both the evaluation and award processes.**

In addition, certain concerns related to fair competition and equal conditions to all applicants raise the decision of the authorities to carry out last minute changes to the application procedure and tender specifications.

The changes were made in order to allow any company to participate in the auction even without certain mandatory permissive acts, which have been initially required as mandatory. In this sense, the authorities excluded the obligation to have the connection permit, land entitlement, legal authorizations, technical solution, and any other requirements.

EBA Moldova participates in public consultations regarding the tender documentation for granting the status of large eligible producer for renewable energy projects, including wind and solar energy.

All these documents were replaced by a self-declaration committing to comply with all

requirements of the tender if they won the bid. Such a measure creates space of concerns especially for those applicants who have already invested significant time and resources in obtaining the required documents by the initially published tender specifications.

MGRES's dominant position in Moldova. In coordination with Chisinau authorities, MGRES power plant, owned by Russian Inter-Rao, has historically covered more than 80% of Moldova's power demand on both the right and the left banks of Nistru River. The fact that MGRES does not pay Gazprom for the gas consumed, allows it to offer preferential prices below the regional benchmark. The lower prices offered by MGRES plus the lack of domestic generation capacity and insufficient interconnections with ENTSO-E, result in dependence on MGRES, which creates conditions for geopolitical pressure and blackmail of Moldova. Furthermore, it is not possible to liberalize the electricity market as long as MGRES exercises a dominant position in the wholesale supply of electricity in Moldova. While a strategic plan should be prepared to phase out MGRES, the government, on the contrary, has recently adopted a decision granting state-owned Energocom the exclusive right to purchase electricity from MGRES until the end of 2025. This status quo might affect Moldova's capacity to ensure the security of electricity supply already this winter, especially if MGRES will stop receiving free gas from Russian Federation. This is likely to happen on 1 January 2025.

A dedicated panel on renewables and sustainable economy featured at the EU-Moldova Investment Forum, organized by EBA Moldova with the support of the European Union in the Republic of Moldova, as part of Moldova Business Week 2024.

Development of the electricity generation capacities by Private Sector. Moldova's sustainable growth cannot rely solely on international funding or support from IFIs. Creating favorable business conditions is essential to attract and retain private and European investors. Government institutions must adopt a more business-friendly approach to enable private sector-led development in the energy sector. Currently, the electricity sector is predominantly composed of state-owned enterprises, such as Termoelectrica, CHP CET Balti, Red Nord, Furnizare Nord, Moldelectrica, and Energocom.

In the case of Energocom, it was used in previous administrations as an instrument for schemes and vested interest. Today, Energocom has grown in a unprecedented way, reaching a dominant position in the energy sector: regulated suppliers and network operators must buy from Energocom to cover their power needs Energocom, is the sole buyer of the electricity produced by MGRES, as mentioned before, and also the CHPs, on an exclusivity basis and for the whole of Moldova.

As an example of the facto weak support for the international investors, since 2021, Premier Energy has been working on a project to develop a balancing power plant. The site has been selected, technology has been chosen, technical studies have been prepared, authorizations have been obtained, and so on. However, it has not been possible to start construction due to legal & regulatory constraints and limited institutional commitment. For 2 years, Premier Energy has been discussing with the energy authorities how to develop a market for the provision of balancing service market through open mechanisms, such as a pricing methodology or an international tender for building balancing capacity. Unfortunately, due to insufficient involvement of the authorities, the project has not yet materialized.

Waste Management

In the context of implementing the Extended Producer Responsibility (EPR), in July 2024, Parliament approved the draft amendment to Law 1540/1998 on payment for environmental pollution in its first reading.

The proposed changes aim to support the implementation of the Extended Producer Responsibility (EPR) concept and improve the accuracy of data related to the traceability of packaging waste. This is crucial for aligning with future EU directives and ensuring compliance with recovery targets set by the Law No. 209/2016 on waste and Government Decision No. 561/2020 on packaging and packaging waste.

However, the private sector highlights several issues in implementing the EPR principle and the need to adjust the regulatory framework to address these deficiencies:

1. **The current legislation creates confusion regarding the application of the environmental tax** for producers who fulfill their EPR obligations through an individual system. Payment obligations disadvantage producers fulfilling requirements individually, as they alone must contribute to the Fund, unlike those in collective systems. Also, individually implementing producers may face triple penalties for failing recycling targets: environmental taxes (Law No. 1540/1998), contributions to the Fund (GD No. 561/2020), and fines under the Contravention Code No. 218/2008, adding substantial financial and administrative burdens.
2. **Lack of a balanced approach to the specifics of the local market in the Deposit Return System** (DRS) for packaging. Launching the DRS before January 2027 may put unnecessary pressure on producers and retailers who are still adapting to EPR requirements. A well-defined rollout will enable a smoother transition and ensure efficient implementation of both systems.

EBA Moldova takes part in discussions within the Economic Council to the Prime Minister, focusing on implementing the Extended Producer Responsibility Principle, in a meeting chaired by the Minister of the Environment.

3. **Obligation to provide required infrastructure (Automated Packaging Collection Equipment)**. According to European practices, purchasing, installing, and maintaining automated machines for consumer packaging collection involves significant investment costs, which the business sector must bear. The draft regulation under consultation offers no compensation mechanism, except for local public administration authorities.
4. **Need of the implementation of the E-Deposit System**. Introducing an E-Deposit system, modeled after Belgium's approach, could effectively complement the DRS. The E-Deposit system offers such benefits as reduced costs (reduces infrastructure needs), increased accessibility (consumers can return packaging through a mobile app, enhancing system accessibility and flexibility), easy integration (the E-Deposit system can be seamlessly integrated with the government's EVO platform, ensuring efficient data centralization and transparent monitoring).

TRADE FACILITATION

Food Safety

Following the European Commission's authorization in March 2023 for Moldova to export processed poultry meat and Category A eggs, the first Moldovan egg producer received approval for export to the EU market in October 2024. This milestone marks the first operator to meet the EU's stringent standards, enabling them to export eggs to the European single market.

To further capitalize on this opportunity and expand Moldova's export potential for animal-origin food products, producers must continue aligning their practices with the EU's regulatory framework. This includes poultry-related activities such as incubation, farming, slaughtering, processing, and storage facilities.

A key challenge, however, is the limited number of national laboratories capable of meeting the sanitary and phytosanitary certification requirements for EU exports. The lack of high-performance equipment and insufficient investments in laboratory infrastructure impacts their operational capacity.

In light of these challenges, Moldova's private sector emphasizes the urgent need for the following actions:

1. Expanding the network of national laboratories and upgrading technical infrastructure to improve certification processes for export-oriented products destined for the EU, with 24/7 laboratory operations at border checkpoints.
2. Strengthening institutional capacities within the Ministry of Agriculture and Food Industry (MAFI) and the National Food Safety Agency (ANSA) to accelerate the alignment of national legislation with EU standards.
3. Providing pre-accession funds to support local producers and the development of municipal public markets.

TAX POLICY UNDER THE EU HARMONIZATION

Transfer Pricing

The transfer pricing mechanism was included in the tax policy in July 2024 and approved by Law 214/2024. As a result, the Ministry of Finance has initiated the drafting of amendments to Order No. 9/2024 regarding the rules for implementing transfer pricing, that aim to approve the Transfer Pricing Regulation.

In the context of ensuring proper enforcement of transfer pricing legislation and regulations, the private sector raises the following concerns:

- The draft Regulation applies solely to legal entities, despite the Fiscal Code defines a taxpayer as any person required to calculate and/or pay taxes and fees to the budget. Therefore, individuals engaged in entrepreneurial activities should also fall under these provisions, and the transfer pricing regulation must apply to them just as it does to legal entities.

- Furthermore, the draft regulation lacks clarity on the procedures for applying transfer pricing methods, with the exception of the price comparison method. It also provides only brief and implicit guidelines on the criteria and rules for selecting the appropriate method for each controlled transaction.

In 2024 EBA organized a series of events on Transfer Pricing and IFRS.

Tax exemption for ferrous and non-ferrous metal wastes

The recent amendments to Moldova's tax and customs policy do not fully reflect a comprehensive approach to the EU-RM Association Agreement commitments, promoting a circular economy, protecting vulnerable groups, or strengthening fiscal discipline.

The current tax policy imposes a 12% income tax on earnings from the surrender of ferrous and non-ferrous metal waste. Importantly, this taxation was not consulted with the business community in advance, nor was it supported by a detailed impact analysis that could justify the need for such an intervention.

Law 209/2016 on Waste, which aligns with Moldova's European integration goals, emphasizes efficient waste management, including the recycling of metals. The law requires operators to record information about individuals surrendering metal waste, highlighting their role in the waste management chain. Exempting income from metal waste surrender would encourage public participation, supporting national environmental goals.

Other waste types, like paper, plastic, and used batteries, are exempt from taxation under the Tax Code, reflecting the country's commitment to environmental policies. Thus, taxing income from metal waste surrender is both unclear and unjustified.

Internationally, countries like Romania, Germany, France, and the Nordic states exempt such income to stimulate participation in the circular economy, recognizing citizens' crucial role in environmental protection.

In this respect, the private sector from Moldova, underline the importance of reintroducing tax exemptions for metal waste surrender, that would encourage public involvement in recycling and align Moldova's tax policy with European practices, supporting the transition to a green economy. This would also demonstrate Moldova's commitment to European integration.

FINANCIAL MARKET

AML

In October 2024, the National Bank of Moldova (NBM) initiated a public consultation on the draft Executive Committee Decision "On approval of the regulation on requirements for identifying and verifying client identity through electronic means."

The purpose of the draft is to align with Law 308/2017 on preventing and combating money laundering and terrorism financing, and to ensure regulatory compliance with the Financial Action Task Force (FATF) recommendations (the 40 FATF recommendations).

EBA participates at a meeting with the National Bank of Moldova on e-KYC Regulation.

The private sector supports this initiative by the NBM and presents a set of recommendations to clarify the Regulation's implementation and ensure its consistent application:

- The criteria by which a reporting entity might classify a geographic location as abnormal or unusual are unclear. Given the necessity of clarifying these factors, as they are a minimum requirement for the bank's monitoring mechanisms, it is recommended to specify clear criteria for determining an abnormal geographic position.
- If there are suspicions about a person's identity or the authenticity of presented documents, the eKYC process should be halted, and in-person identification should take place at a bank branch. This recommendation applies specifically to remote business relationships conducted electronically without staff involvement, where an automated solution provides a "true" or "false" verification result. In these cases, it is not feasible to ask additional questions to confirm identity or document authenticity.
- Further clarification is needed in the Regulation regarding the list of six international standards (ISO/IEC and NIST SP) and whether the remote identification solution must be certified to one of these standards or all of them. The private sector suggests that the regulation apply only to the component of the IT system that processes biometric data (collects, processes, and/or stores it), rather than the entire IT system, which also includes components for managing integrations with state population registers and/or the bank's information systems. Additionally, some of the listed standards are recommendations, while others apply to specific components of the systems in use.
- A reasonable compliance period of at least six months from the Regulation's effective date is essential, as adapting existing IT solutions to meet the new requirements may involve time and possibly additional technical development, requiring sufficient time and additional investment.

Insurance and Capital Markets

To align Moldova's insurance sector with international best practices and the EU Acquis, it is essential to implement Solvency II under feasible and predictable terms.

Currently, the private sector faces significant challenges due to the lack of legislative predictability, as impactful legal amendments often come into effect immediately upon publication or with unreasonable implementation timelines.

A key concern is the authorities' transposition of EU legislation, which sometimes exceeds its intended scope, hindering sector development due to insufficient professional expertise and clarity.

Since July 2023, the Republic of Moldova has two supervisory authorities for the insurance sector: the National Bank of Moldova (NBM) and the National Commission for Financial Markets (NCFM). Clear delineation of roles and responsibilities between these entities, alongside improved institutional dialogue involving the Ministry of Finance, is critical for sector stability.

The private sector has also identified several deficiencies in the insurance and capital markets:

- Lack of a structured plan with actionable and feasible steps to foster the development of capital markets;
- The insurance sector faces uneven playing conditions and biased regulatory attitudes, disadvantaging market players;
- The market suffers from widespread illegal cashback schemes and hidden discounts, distorting competition;
- The intermediary sector in Moldova's insurance market remains underdeveloped, primarily due to legal provisions that are inconsistent with EU legislation. These include discriminatory requirements for brokerage assistants based on their status as legal or physical persons and the incorrect transposition of EU terminology into national law, which has contributed to an increase in shadow transactions.

EBA participates at a meeting with the National Commission for Financial Markets on developing the potential of the capital market in the Republic of Moldova.

The insurance sector also expresses concerns about the supervision fee of 0.3% introduced by the NCFM, which applies uniformly to both long-term life insurance and short-term non-life insurance contracts. This fails to account for the distinct characteristics of long-term policies, which often span over a decade, compared to short-term policies lasting up to one year.

In European countries, regulators either exempt long-term life insurance contracts from such fees or impose significantly lower rates. For example, Croatia, Bulgaria, Slovenia, Hungary, Serbia, Montenegro, Bosnia, and Ukraine apply a 0% fee for insurance contracts with a term longer than 10 years.

Additionally, the reassignment of regulatory responsibilities under Law 175/2023, which transferred supervisory functions to the NBM while limiting NCFM's role to consumer protection, has raised concerns. The expected introduction of a separate supervisory fee by the NBM could lead to double taxation on insurance operators, further burdening the private sector and constraining the development of the insurance market.

These overlapping regulatory challenges and financial pressures underscore the need to align fees with the nature and duration of insurance contracts, ensure coordination between regulatory authorities, and foster a more transparent and fair regulatory environment to support the growth of Moldova's insurance and capital markets.

GDPR

With the active involvement of the private sector over the past five years, Law No. 195 on personal data protection was approved on 27.07.2024 and is set to take effect on 23.08.2026.

This law aligns with the EU Regulation 2016/679on the protection of natural persons with regard to the processing of personal data and on the free movement of such data.

The law applies both to data processing by operators registered in Moldova and to the data processing of Moldovan individuals by operators based outside the country. To comply, companies will need time to develop and approve internal policies, codes of conduct, and mandatory corporate rules, all of which must be approved by the National Center for Personal Data Protection (CNPDCP). Additionally, each company is required to maintain a registry of data processing activities. However, businesses have noted the lack of a model registry and specific guidance from CNPDCP as a challenge.

Further challenges highlighted by the private sector include:

- Insufficient information provided to small and medium-sized enterprises (SMEs).
- Regulations that could stifle innovation due to strict compliance requirements.
- Significant fines and potential reputational damage, which could create additional pressures for businesses.

EBA organized a series of workshops on "GDPR: from harmonization to implementation."

To address these issues, the private sector has recommended the following:

- Development of guidelines to facilitate alignment with Law No. 195/2024.
- Access to data protection experts for specific guidance on implementing the law.
- Initial warnings and prescriptive guidance from CNPDCP for data operators.
- CNPDCP-led public awareness campaigns to increase understanding of the law.

ELECTRONIC COMMUNICATIONS

Lower roaming tariffs with EU countries. The telecom sector in Moldova commends the efforts of Moldovan and EU authorities to integrate the Republic of Moldova into the European communications space, particularly through initiatives to reduce roaming tariffs. As of 1 January 2024, Moldova's regulator has aligned international mobile termination rates (MTRs) with EU levels. However, only four EU operators have joined the voluntary roaming agreement. Moldovan telecom operators would therefore support adding Moldova to the list of countries in Annex 1 of Commission Delegated Regulation (EU) 2021/654, which supplements Directive (EU) 2018/1972 by establishing a single maximum Union-wide mobile and fixed voice termination rate.

EU Electronic Communication Code. Moldovan authorities are committed to adopting the EU Electronic Communications Code. The private sector would strongly support an accelerated transposition to drive sector growth, strengthen the Regulator's authority, streamline licensing procedures, clarify license and frequency usage fees, and introduce installment options for license payments as state incentives to promote digitalization.

The Digital Europe Program is of great interest to the sector, as digitalization and

cybersecurity are essential for advancing Moldova's telecommunications industry. However, there is a notable lack of incentives and support to enhance private sector capacity and ensure effective implementation of EU digital initiatives. At present, entrepreneurs are expected to achieve these objectives at their own expense and within strict timeframes, which creates substantial challenges for sustainable progress and alignment with EU standards.