



**EUROPEAN
BUSINESS
ASSOCIATION**

EBA BUSINESS CLIMATE UPDATES 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)

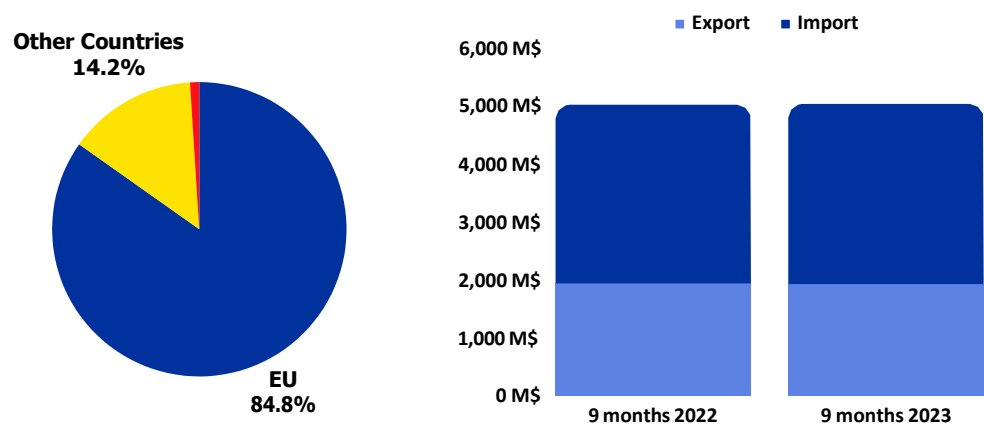
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INTRODUCTION

The ongoing energy crisis, the complex economic situation in the region, and the neighboring country's war continue to impact the economic development of the Republic of Moldova. Consequently, the **Gross Domestic Product** continues its descent, experiencing a 2.3% decline in the first half of the current year.

The **annual inflation rate**, reflecting September 2023 compared to September 2022, stands at 8.6%, maintaining its downward trajectory. **Foreign Direct Investments** have seen a net capital inflow of \$214.9 million, marking a 25.5% decrease from the first half of 2022. In the geographical distribution of accumulated capital, investors from European Union countries hold the majority share at 84.8%, followed by other countries at 14.2%, and the Commonwealth of Independent States at 1%. Cyprus, the Netherlands, Romania, France, Bulgaria, Austria, and the United Kingdom are among the prominent foreign investors in Moldova.

The **bilateral trade** of the Republic of Moldova with the European Union from January to September 2023 reached \$5,035 million, representing a 0.2% increase compared to the same period in the previous year. The **European Union remains Moldova's primary trading partner**, with Moldovan exports to the EU constituting 63.88%, and imports from the EU accounting for 48.5% (January to September 2023).



European integration acts as a driving force for Moldova's private sector development by establishing first of all a predictable, transparent and standardized regulatory framework. Moldova continues its path to European Union integration after receiving the candidate status granted by the European Council in June 2022. In November 2023, the European Commission recommended that the Council open the accession negotiations with Moldova, contingent upon the fulfillment of the nine accession steps. However, significant reforms are still required across various sectors, with a particular focus on aspects influencing the business environment in Moldova, including digital transformation, taxation, customs union, energy, financial services, environmental, and climate change.

Furthermore, the ongoing implementation of the EU-MD Association Agreement and DCFTA remains a priority. A transitional period, where feasible, should be provided to ensure the high-quality implementation of secondary legislation and its effective integration by businesses.

CUSTOMS CODE

The newly approved Moldova Customs Code, aligned with that of the European Union, is set to be enforced from January 1, 2024. Recognizing the complexity and absolute necessity of implementing European legislation, the business environment in the Republic of Moldova reaffirms its support for the harmonization process.

The enforcement of Customs Code 95/2021 on January 1, 2024, brings certain uncertainties regarding the practical operation of the new rules and their impact on the activities of foreign investors operating within the Free Economic Zones (FEZ) and the Free International Port of Giurgiulești (FIPG).

It is essential to emphasize that both FEZs and FIPG were established to accelerate the socio-economic development of the national economy by attracting domestic and foreign investments, fostering export-oriented production, creating essential infrastructure in international transport, ensuring energy security, promoting foreign trade, applying advanced investor experiences in production and management, and generating employment. Notably, residents of FEZ and FIPG contribute approximately 18% to the total national exports, and their investments exceeded USD 526 million in 2022 alone.

Nevertheless, both national and European companies raise concerns about certain deficiencies in the implementation of the new Customs Code:

- Ongoing development of Secondary legislation to enable the implementation of the provisions of the new Code;
- Application of Guarantees provided by the customs Code – no clarity on how the mechanisms shall be applied;
- The need to corroborate the provisions of the new legislation on State Aid, which is not yet developed with the Free Economic Zone Law (Nr 440) and the new Customs Zone, especially in the context of all taxes and payments paid by the residents of Free economic zones;
- The need for the development, implementation, and testing of an electronic system that ensures the functioning of the regulatory framework established by the new Customs Code;
- Ensuring awareness and understanding of the regulatory framework and technological components by the involved stakeholders, including both the officials of executive authorities and economic operators;
- Imposing significant costs on FIPG residents who must release foreign goods into free circulation, subject to import duties (including fuels, VAT, and excise duties);
- Lack of transitional rules to determine the status of fixed assets and goods existing in FEZ and FIPG after the new Customs Code comes into effect.

Within this context, a phased implementation of the new Customs Code is deemed necessary, synchronized with the finalization of the secondary legislative framework and the punctual testing of information systems (software/applications, etc.) for each customs regime.

Moreover, these measures would facilitate a seamless transition to the new customs regimes after the comprehensive clarification and testing of all issues related to the implementation of changes introduced by the new Code and will establish a complete, coherent, legally sound, well-known, and understood regulatory framework by all parties involved.

AEO PROGRAM PROPER IMPLEMENTATION

The EU-Moldova Authorized Economic Operator (AEO) Mutual Recognition Program, which came into effect on November 1, 2022, plays a pivotal role in enhancing the security, safety, and efficiency of the supply chain between the Republic of Moldova (RM) and the European Union (EU). By coordinating customs activities and fostering collaboration among government authorities, this program aims to streamline trade processes.

Due to the escalation of the war in Ukraine the flow of trucks crossing the Ukrainian Moldovan and consecutively Moldovan EU/Romanian border has dramatically increased. The dramatic flow increase generated and imperative need for urgent investments in infrastructure upgrade on the EU/Romanian side, by adding additional lanes for the AEO Transportation units, but also to reconsider certain border crossing points from the logistics points of view so as to ensure a higher inflow of trucks.

Currently extensive queues, exceeding 10 kilometers, have formed at the Ukrainian border and within the RM at crossings with Romania. The primary challenge stems from the absence of dedicated platforms for AEO holders, resulting in prolonged waits for trucks at the singular border crossing point in Albița (RM).

As a result, international and European investors exporting to the EU based on Just On Time contracts, particularly companies in the automotive industry (as well as other industries), face real risks related to high probability of cancellation of contracts with their EU partners and the payment of penalties due to delays caused by contractual violations and non-compliance with delivery conditions. The loss of these partnerships is a significant problem not only for these companies but also for the overall economy of the Republic of Moldova, which is already seriously affected by the consequences of the war in Ukraine.

In light of these challenges, the private sector welcomes the efforts of the Moldovan Government in managing the critical situation at the Ukraine-Republic of Moldova-Romania border crossing points. and emphasizes the need for the operational cooperation between Romanian and Moldovan authorities and urges for facilitating trade by simplifying border crossing controls.

The investors community has provided a list of proposals in order to facilitate and enable a more efficient border crossing process by:

- Allocating the necessary funds to invest in railway infrastructure in the Republic of Moldova, with the aim of aligning it with EU technical standards and facilitating the export of goods through railways, thereby alleviating truck traffic congestion;
- Additional investments in the village of Giugiuiești, directly at the border crossing on the Romanian side, where the infrastructure already allows for truck parking - creating additional lanes and ensuring the customs process specifically on the Romanian side;

Ensuring the necessary investments on the Romanian side at the Lipcani-Rădăuți border crossing point, which is currently non-functional due to the lack of necessary infrastructure on the Romanian side. It is important to underline that on the Moldovan side, there is access road and partial necessary infrastructure. Providing an additional border crossing point will significantly decongest truck traffic, especially those bound for the EU;

Facilitating data exchange between the Republic of Moldova and Romania, thus streamlining the truck border crossing process (especially relevant for AEO holders) and other economic operators.

ENERGY AND RENEWABLES

It should be noted that in the energy sector, significant progress has been made in the year 2023. Possibly the greatest achievement is related to the energy security of the country, as independence from Russian natural gas for consumption on the right bank, has been achieved. In addition, amendments to Law 10 on the promotion of renewable energy have been passed, implementing the EU's Clean Energy Package. Moreover, the government has announced that tenders for renewable energy large capacity tenders will be launched in Q1 2024. In terms of improvements in the governance of the sector, we would like to mention the openness to dialogue of the energy authorities and the progress of the renovation of the boards of entities such as ANRE (energy regulator) and the Energy Efficiency Agency, aiming to break with the legacy of previous regimes.

On the other hand, the private sector considers that there are certain aspects that need to improve in order to create a stable and attractive business climate for European and international investors.

In 2023, the Ministry of Energy initiated a regulatory process to amend Law 107 on electricity. The primary goals are to ensure the efficient operation of the electricity market, integrate it into regional and European markets, foster competition, and address the imperative need to clarify trends in the electricity market established in 2022 amid the energy crisis. While the proposed amendments pursue noble objectives, the private sector has identified various risks associated with the project's provisions. Notably, the imposition of sanctions for non-compliance or violation of obligations by participants in the electricity market, without specifying a legal maximum but only a minimum, grants authorities a wide margin for discretion and creates conditions for potential abuses in their enforcement.

Furthermore, the private sector expresses its concerns about the potential establishment of a monopoly through government designation or restriction to a single operator in the day-ahead and the intraday electricity markets. Establishing a monopoly at this juncture would curtail competition among energy exchange services without justifying the perpetuation of an already functional system. Moreover, the direct designation of the electricity market operator and limiting it to a single operator contradicts the provisions of Regulation (EU) 2015/1222 on capacity allocation and congestion management, as well as any public procurement rules.

Likewise, in the context of the current emergency situation, the energy authorities are creating development opportunities exclusively for state companies, which lead to state monopolies with dominance of market position, raised with the funds from the international assistance. In the medium term this will lead to inefficiency and corruption. Despite the official messages, the business community does not perceive a firm interest in assigning the private sector a role in the development and modernization of Moldova's energy infrastructure. Despite the necessity to grow the power generation capacity in Moldova, investors willing to install power plants and batteries to provide flexibility to the grid and enable the deployment of renewable energies cannot move forward with their projects for lack of a clear legal and regulatory framework that would provide certainty on the recovery of their investments.

Given these concerns, the EBA business community advocates for regulatory reform in the energy sector to:

- Ensure energy security;
- Provide consumers with electricity under conditions of accessibility, availability, reliability, continuity, quality, and transparency;
- Ensure free access to the electricity market;
- Promote electricity generation;
- Maintain an adequate balance between supply and demand, including an appropriate level of interconnection capacities to facilitate cross-border electricity exchanges;
- Develop the electricity market and integrate it into a competitive electricity markets.

Furthermore, the business community emphasizes the necessity of VAT exemption with the right to deduct for the import of equipment used for generating electricity from renewable sources with a manufacturing lifespan not exceeding 48 months. This VAT exemption aims to support renewable energy producers acquiring new equipment, especially those who may sell electricity under market conditions.

To expedite the development of the energy sector, particularly the renewable energy industry, we reiterate the proposal for VAT exemption/deferral for photovoltaic panels and inverters, along with the elimination of customs duties for imported inverters.

INSURANCE MARKET

The Insurance Sector of the Republic of Moldova expresses concern regarding the amount of fees and charges approved by the National Commission for Financial Markets (NCFM) at a rate of 0.3%, applicable to both general insurance and life insurance. In this regard, the decision of NCFM to impose a similar fee for life insurance as for other types of insurance without considering the specific nature of short-term insurance contracts (up to 1 year) compared to long-term insurance contracts is unjustified and contradicts the European practices.

According to the practices of European countries, no fee is imposed by regulators for long-term life insurance, or if applicable, it is significantly lower than the fee for general insurance, which usually covers short-term insurance. In some countries such as Croatia, Bulgaria, Slovenia, Hungary, Serbia, Montenegro, Bosnia, and Ukraine for all insurance contracts with a term longer than 10 years, the fee is 0%.

Additionally, the modification of NCFM's competencies in July 2023, as outlined in Law 175/2023, entails a shift in responsibilities, with a focus on regulating, supervising, and controlling the protection of consumer rights in financial services, while the supervisory functions are transferred to the National Bank of Moldova (NBM). Concurrently, NBM is anticipated to introduce its own supervisory fee for the insurance market. This raises the concern of potential double taxation on insurance market operators by both regulators, thereby imposing an additional financial burden on the private sector and impeding the growth and development of the insurance sector in Moldova.

In light of these, it is necessary to review the amount of fees and charges, taking into account the duration of insurance contracts and the fact that fees and charges to the National Bank of Moldova as the supervisory authority are yet to be finalized and approved.

GDPR

In the context of aligning with EU regulations on personal data protection (GDPR), the Ministry of Justice, in collaboration with the private sector, has crafted a new draft law on personal data protection. This document has undergone discussions on both the Ministry's Working Group platform (in October and November) and the Working Group platform of the State Commission for the Regulation of Entrepreneurial Activity.

Given the aspiration to have the draft law approved by the Government by the end of 2023, 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.

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.

WASTE MANAGEMENT AND REPORTING

The private sector acknowledges the government's efforts to promote the circular economy through the enhancement of the legal framework related to waste management and the implementation of the Extended Producer Responsibility (EPR) principle. In July 2023, amendments to Law 1540/1998 on payment for environmental pollution were approved. These changes align with the EPR principle outlined in the EU-RM Association Agreement.

The updated legislation introduces new provisions, including a new basis for packaging waste taxation, a tax mechanism granting exemptions to businesses engaged in packaging recovery and recycling, mandatory tax reporting for products causing environmental pollution, and the introduction of a mandatory tax reporting instruction called POLMED23. However, the implementation of POLMED23, mandatory from January 2024, poses a significant challenge for the private sector due to a lack of clarity on its completion.

Regarding the Ministry of Environment's initiative to amend Law 209/2016 on waste, the private sector raises concerns about practical applicability. Specifically:

- The proposed effective date of January 1, 2025, for the project is operationally unrealistic for preparing and implementing the deposit system in Moldova. Article 44 of EU Regulation 2019/1020 mandates EU member states to ensure that all Deposit-Return Systems (DRS) comply with minimum requirements by January 1, 2029. Currently, only 14 out of 27 EU member states implement deposit systems, each with an individually adapted model, and some apply the deposit system only to PET or glass packaging.
- There is a need for transparency and consultation of the regulation of the deposit system involving all stakeholders: producers, importers, retailers, consumer associations, environmental NGOs, tax experts, waste management experts. The Ministry of Environment should play a leadership and mediating role in this process.
- Alignment of the project's provisions with the objectives of the EU Directive 2008/98/EC on waste management, especially regarding the creation of a non-profit organization for the management of single-use packaging waste, requirements for collection points in commercial spaces, and limitations on the authorization of waste collection and storage activities.
- The mandatory marking of products with a label indicating producers' participation in a collective packaging waste management system, which is a costly and complex measure to implement.
- Ambiguities in the current Extended Producer Responsibility (REP) system with differing interpretations from state authorities (Ministry of Environment, Fiscal Service, Customs Service, etc.), including accounting perspectives.

In this context, EBA Moldova emphasizes the necessity of providing a minimum transition period for implementing the deposit system until 2028 to ensure transparency and clarity in the upcoming system. Additionally, the proposal recommends piloting the deposit system from 2027 alongside the existing REP system and maintaining the dual barcode system until 2028 (current labels + pilot deposit system labels) to gain a practical understanding of the precise model needed for implementation in Moldova.

TAX POLICY UNDER THE EU HARMONISATION

The private sector from Moldova expresses its concern regarding the implementation of the transfer pricing mechanism, as well as the right of the State Tax Service to reclassify transactions.

The legislative proposal to grant the State Tax Service a new mandate regarding the possibility of reclassifying transactions is one that will create major obstacles for the entire business community. Notably, the newly introduced provisions lack a reasonable justification for their necessity and fail to address the potential impact of these proposed changes on businesses. Furthermore, the proposed legislative changes are very general, lacking specific criteria and a clear methodology for their application in the context of tax inspections. In respect to transfer pricing, there are several concerns in respect to how the new legislation will be applied starting in 2024. Most importantly, the new stipulations have not been correlated with other provisions of the Fiscal Code which will result in conflict between the various norms, as well as tax controversy and disputes.

It is essential to consider international practices, particularly those within the European Union (EU), which offer valuable insights into the need for a measured and gradual approach to introducing such provisions.

In light of these concerns, the following recommendations are put forth:

- Postpone the implementation of regulations pertaining to transfer pricing and transaction reclassification until after January 1, 2025, ensuring a smooth and organic transition.
- Harmonise transfer pricing stipulations with other provisions of the fiscal code, provide relevant clarifications to the various definitions used and invest in building the capacity of the civil servants in implementation of the legislation.
- Refrain from imposing fines for at least the initial 2 years following the application of the norms. This grace period will enable the business environment to voluntarily adapt to the requirements, fostering a period of comprehension, adjustment, and refinement where necessary.