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INVESTMENT POLICY REVIEW

The former Yugoslav Republic of MACEDONIA

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Investment Policy Review The former Yugoslav Republic of Macedonia

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A hyphen (-) indicates that the item is equal to zero or its value is negligible.

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PREFACE

The UNCTAD *Investment Policy Reviews* (IPRs) are intended to help countries improve their investment policies and to familiarize Governments and the international private sector with an individual country's investment environment. The reviews are considered by UNCTAD's Investment, Enterprise and Development Commission. The IPR recommendations are then implemented with the technical assistance of UNCTAD. The support to beneficiary countries is delivered through a series of activities which can span over several years (more information about the IPR programme in annex 1).

The *Investment Policy Review of the former Yugoslav Republic of Macedonia*, initiated at the request of the Government of the former Yugoslav Republic of Macedonia, was carried out through a fact-finding mission in February and March 2010. The mission received the full cooperation of the relevant ministries and agencies, in particular the Ministry of Economy and its Department for Stimulating Investments and Social Responsibility. The mission also had the benefit of the views of the private sector, foreign and domestic, and the resident international community, particularly bilateral donors and development agencies. A preliminary version of this report was discussed with government officials in Skopje in December 2010. Comments were also gathered during a workshop organized by the Ministry of Economy. The final report reflects written comments from various Ministries of the Government of the former Yugoslav Republic of Macedonia, as collected by the Ministry of Economy. The report also benefited from discussions with the UNDP Office in the former Yugoslav Republic of Macedonia and the Delegation of the European Union to the former Yugoslav Republic of Macedonia.

The relevance and effectiveness of the regulatory regime are assessed against several related criteria: (a) whether regulations adequately promote and protect the public interest; (b) whether regulations adequately promote investment and sustainable socio-economic development; and (c) whether the methods employed are effective and well-administered, given their public interest and development objectives and the legitimate concerns of investors that rules and procedures do not unduly burden their competitiveness. International benchmarks and best policy practices are taken into account in making the assessment and recommendations in this report.

The strategic focus of this review is on the elaboration of an investment policy programme, namely the "*Programme for Stimulating Investment in the Republic of Macedonia 2011–2014*". The choice of focus follows a specific request from the Government of the former Yugoslav Republic of Macedonia, showing its commitment to the creation of a sound investment climate, thereby contributing to creating an improved business climate, a more competitive economy and, ultimately, generating greater wealth and employment. The Government's commitment has already been demonstrated by the creation and implementation of three programmes of far-reaching reforms, the latest of which being the "*Programme for Stimulating Investment in the Republic of Macedonia 2007–2010*".

This report was prepared by the Investment Policy Review team, under the supervision of Chantal Dupasquier. James Zhan, Director of the Investment and Enterprise Division, provided overall guidance. The report was written by Kalman Kalotay, Isabel Maria Marcin, Massimo Meloni, Ricardo Pinto and Matija Rojec. Substantive contributions from Alexandre de Crombrugghe, Hamed El-Kady, Astrit Sulstarova and Lorenzo Tosini are also acknowledged. The report benefited from comments and suggestions from UNCTAD colleagues, including Kiyoshi Adachi, Yoseph Asmelash, Hans Baumgarten, Richard Bolwijn, Quentin Dupriez, Anna Joubin-Bret, Joachim Karl, Natalia Guerra and Elisabeth Tuerk, as well as from Stephen Young, under a peer review process. Irina Stanyukova and Juan José Maqueda provided research and statistical assistance. This report was funded by the Government of Sweden.

It is hoped that the analysis and recommendations of this review will help the former Yugoslav Republic of Macedonia achieve its development goals, contribute to improved policies, promote dialogue among stakeholders and catalyze investment and the beneficial impact of foreign direct investment.

Geneva, June 2011

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ABBREVIATIONS

BIT	bilateral investment treaty
CBIP	Coordinative Body for Intellectual Property Rights
CEA	Center for Economic Analyses
CEFTA	Central European Free Trade Agreement
CIS	Commonwealth of Independent States
CPC	Commission for Protection of Competition
CR	Central Registry
CSR	corporate social responsibility
DTIDZ	Directorate of the Technological Industrial Development Zones
DTT	double taxation treaty
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EFTA	European Free Trade Association
Empretec	Emprendedores (entrepreneurs) – tecnología (technology)
EU	European Union
EVN	Energie Versorgung Niederösterreich (company)
FATS	Foreign AffiliaTes Statistics
FDI	foreign direct investment
GATS	General Agreement on Trade in Services
GDP	gross domestic product
GFCF	gross fixed capital formation
IBFD	International Bureau of Fiscal Documentation
ICC	International Chamber of Commerce
ICSID	International Centre for Settlement of Investment Disputes
ICT	information and communication technology
IFRS	International Financial Reporting Standard
IMF	International Monetary Fund
IOM	International Organization for Migration
IP	intellectual property
IPA	investment promotion agency
IPPC	Integrated Pollution Prevention and Control
IPR	Investment Policy Review
ISO	International Organization for Standardization
IT	information technology
kWh	kilowatt hour
M&A	merger and acquisition
MCC	Ministerial Committee on Competitiveness
MIGA	Multilateral Investment Guarantee Agency

MoE	Ministry of Economy
NATO	North Atlantic Treaty Organization
NBRM	National Bank of the Republic of Macedonia
NECC	National Entrepreneurship and Competitiveness Council
NGO	non-governmental organization
OECD	Organization for Economic Cooperation and Development
OGRM	Official Gazette of the Republic of Macedonia
PP	public procurement
PPB	Public Procurement Bureau
PPD	public-private dialogue
PPP	public-private partnership
PRO	Public Revenue Office
PV	present value
R&D	research and development
RECA	Real Estate Cadastre
RIA	Regulatory Impact Assessment
SAA	Stabilisation and Association Agreement
SAC	State Appeals Commission
SEE	South-East Europe (Albania, Bosnia and Herzegovina, Croatia, the United Nations Interim Administration Mission of Kosovo, Montenegro, Serbia, and the former Yugoslav Republic of Macedonia)
SME	small and medium-sized enterprise
SOIP	State Office of Industrial Property
SSO	State Statistical Office
TIDZ	Technological Industrial Development Zone
TNC	transnational corporation
TRIMs	Agreement on Trade-Related Investment Measures
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
UNCITRAL	United Nations Commission on International Trade Law
UNERR	Unique National Electronic Registry of Regulations
UNIDO	United Nations Industrial Development Organization
UNMIK	United Nations Interim Administration Mission in Kosovo
USAID	United States Agency for International Development
VAT	value added tax
WIPO	World Intellectual Property Organization
WTO	World Trade Organization
XBRL	eXtensible Business Reporting Language

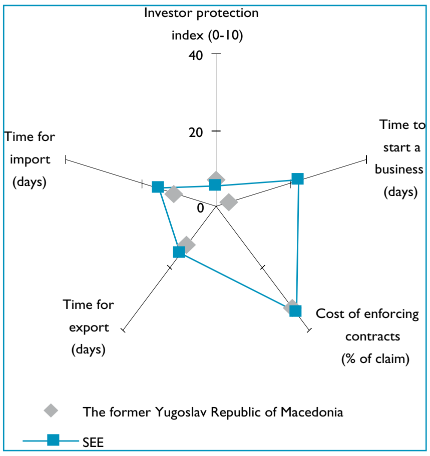
THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

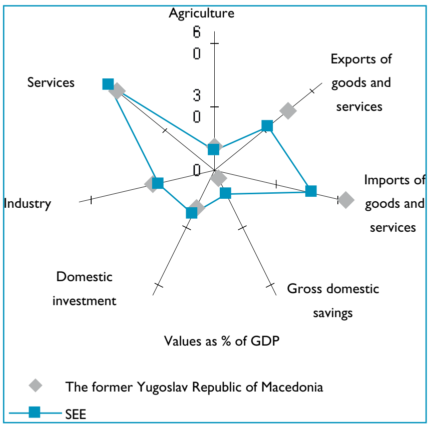
Key investment climate indicators

	The former Yugoslav Republic of Macedonia	Albania	Bulgaria	SEE average
Ease of Doing Business Rank	38.0	82.0	51.0	n.a.
Time to start a business (days)	3.0	5.0	18.0	21.6
Cost of registering property (% of property value)	3.2	3.4	3.0	3.4
Investor protection index (0–10)	6.7	7.3	6.0	5.3
Time to pay taxes (hours per year)	119.0	360.0	616.0	273.0
Time to enforce contracts (days)	370.0	390.0	564.0	502.3
Cost of enforcing contracts (% of claim)	33.1	38.7	23.8	34.5
Time for export (days)	12.0	19.0	23.0	15.7
Time for import (days)	11.0	18.0	21.0	15.0

Key economic and social indicators

Indicator	1992–1999 average	2000–2008 average	2009	SEE total or average 2009
Population (millions)	2.0	2.0	2.0	23.9
GDP at market prices ($ billions)	3.6	5.5	9.5	152.8
GDP per capita ($)	1818.3	2728.5	4662.3	6405.6
Real GDP growth (%)	0.7	3.2	-0.8	-2.5
Gross domestic savings (% GDP)	9.4	3.4	3.5	12.4
Domestic investment (% GDP)	16.8	17.9	19.5	23.5
GDP by sector (%):[1]				
Agriculture	12.6	12.0	11.4	9.7
Industry	32.0	30.2	29.8	27.0
Services	55.4	57.7	58.8	63.4
Inflation, CPI (%)	24.3	3.4	-0.3	1.6
Trade ($ billions):				
Merchandise exports	1.2	2.0	2.7	27.0
Services exports	0.1	0.5	0.9	21.1
Merchandise imports	1.6	3.3	5.0	57.4
Services imports	0.3	0.5	0.8	11.6
Exports to GDP ratio	38.8	45.9	43.4	32.5
Imports to GDP ratio	48.2	63.5	63.2	46.3
Capital flows ($ billions):				
Net FDI flows	0.0	0.3	0.2	6.1
Net flows from private creditors	0.0	0.1	0.5	1.2[2]
Net flows from official creditors	0.0	0.0	0.0	1.0[2]
Grants[3]	0.0	0.2	0.2	1.9[2]
FDI to GDP ratio	1.6	6.0	2.9	5.2
Life expectancy at birth (years)[3]	72.2	73.6	74.2	74.1
Unemployment (% of total labour force)[3]	..	34.5	33.8	..
Literacy rate, adult (%)[3]	94.0	96.6	97.0	98.0





Sources: UNCTAD; World Bank, Global Development Finance and World Development Indicators; United Nations Statistical Division, National Accounts Main Aggregates;

Notes: [1] Agriculture includes agriculture, hunting, forestry and fishing. Industry includes mining and quarrying, manufacturing, electricity, gas and water supply, and construction. Services include all other economic activities.

[2] *Excluding Croatia.*

[3] *Most recent data for 2008.*

Averages refer to unweighted averages.

n.a.: not applicable.

INTRODUCTION

The former Yugoslav Republic of Macedonia is a relatively new destination for foreign direct investment (FDI). Before independence gained in 1991, the former Yugoslavia (of which Macedonia was a constituent republic) had attracted some FDI, but on a small scale. It was overshadowed by the more developed republics of the federation, while less developed regions such as the Socialist Republic of Macedonia attracted almost none.

During the 1990s, FDI inflows remained very small, reflecting the small size of the country (2 million inhabitants), and unfavourable external circumstances such as the civil war in former Yugoslavia, a trade embargo imposed by Greece as a result of a conflict about the name of the country, as well as domestic political problems such as civil unrest in the former Yugoslav Republic of Macedonia proper.

Since 2001, the political situation has stabilized, bringing about economic growth and higher FDI inflows, mostly through privatizations. This period of stability has also made it possible to accelerate reforms and transform the country into a market economy, and prepare it for its integration into the European Union (EU). Over the past years, the business environment has improved significantly, and investment promotion has become very active, using a variety of methods to draw the attention of potential investors. The impact of FDI has been so far small although not insignificant in a few sectors such as banking and telecommunications where foreign investors have attained a critical mass.

The Government has ambitious plans to modernize the country, increase welfare and advance EU integration. It is also aware of the role that FDI can play in reaching its goals in the field of economic development. The financial and economic crisis which started in 2007 has further highlighted the importance of FDI in stabilizing small and vulnerable economies such as the former Yugoslav Republic of Macedonia. The Government has recently embarked on a wide-ranging reform programme that has already increased the ease of doing business. To reap more benefits, it has embarked on an investment programme for 2011–2014, for which the Investment Policy Review (IPR) provides various recommendations.

The recommendations of the IPR (chapter II on regulatory issues and chapter III overall) are based on an analysis of FDI trends and impact (chapter I), and on a thorough assessment of the regulatory framework for FDI and business in general (chapter II). The main aim of chapter I is therefore to analyse the opportunities that the country offers and the challenges it faces. It brings to light the facts that FDI inflows have been relatively small in comparison with neighbouring countries, and have targeted mostly large privatized companies in electricity, manufacturing and telecommunications. Western European countries are the leading investors and the main trading partners, followed by South-East European partner countries. Economic integration in South-East Europe (SEE) and the adoption of national regulations in line with EU standards have deepened the country's participation in the global economy, and can create new opportunities for FDI.

Chapter II builds on the analysis provided in chapter I and lays the ground for the investment programme through an evaluation of the legal and regulatory framework for investment, and provides concrete recommendations to improve it. It highlights that foreign investors have been put on equal footing with domestic companies, and that the country has adopted a transparent and effective taxation system. Furthermore, the ease of doing business has improved through a process called regulatory guillotine. The challenge of moving forward is to consolidate the reform process by way of ensuring the implementation of the new regulations, and strengthening institutions and their capacity to fulfil their tasks. The proposed measures aim at further improving the FDI attractiveness of the former Yugoslav Republic of Macedonia, and enlarging the scope of its competitive advantages to excellence in the investment climate and well-functioning infrastructure, in addition to relatively low-cost labour and favourable taxation.

By bringing together the analysis and recommendations of previous chapters, and complementing them with a review of the institutional framework for investment, chapter III presents an overall strategy to attract investment that will feed into the programme for stimulating investment covering the period 2011 to 2014 that is being developed by the Government. The review of the institutional framework for investment leads to detailed proposals for measures to ensure the consistency of policies and operations, and the development of the relevant institutional capacities.

Chapter IV highlights the main findings and recommendations of the review.

I. FDI TRENDS AND PERFORMANCE

The former Yugoslav Republic of Macedonia (box I.1) is a small landlocked country in the Balkan Peninsula, surrounded by Greece, Bulgaria, Albania and Serbia, including the territory of Kosovo.[1] The country gained independence from the Socialist Federal Republic of Yugoslavia in 1991. Since then, the country has undergone a major transformation, from a socialist model of economic organization to a market economy. In the 1990s and the early 2000s, it underwent a radical privatization process, moving away from a mix of large publicly owned firms called socially owned enterprises and some small privately owned firms to an economy dominated by the private sector. This process is now largely completed. The share of the private sector in the production of the gross domestic product (GDP) increased from 42 per cent in 1992 to 86 per cent in 2002 (Macedonian Privatization Agency, 2002).

Box I.1. What is in a name?

The country admitted to international organizations such as the United Nations under the temporary denomination of the former Yugoslav Republic of Macedonia, calls itself the Republic of Macedonia, a name that Greece contests. After the break-up of Yugoslavia in 1991, when the name of the newly independent republic was chosen, a dispute between Greece and the former Yugoslav Republic of Macedonia arose. Greece did not acknowledge the constitutional name "Republic of Macedonia" claiming that its name, symbol and constitution imply territorial claims to the neighbouring Greek province of Macedonia.

The conflict escalated in 1993 when the former Yugoslav Republic of Macedonia incorporated the Vergina Sun into its flag, which is a symbol of the ancient Kingdom of Macedon. As a result, Greece decided to impose a trade embargo on the former Yugoslav Republic of Macedonia. An interim accord resolved this aspect of the dispute in 1995 by changing the flag. However, the various mediation efforts, which have been undertaken to find a compromise and to give a mutually acceptable name to the country, remain unsuccessful as of the writing of this report. Failure of compromise between Greece and the former Yugoslav Republic Macedonia is the main reason why the latter could not join North Atlantic Treaty Organization (NATO) in 2009, and could not start negotiations about EU accession, despite a positive opinion in the 2009 progress report of the European Commission (EC).

Source: UNCTAD, based on various reports, and EC (2009).

Parallel with the transformation of the economy, the country has also reoriented its international economic relations through accession to international organizations (box I.2). The former Yugoslav Republic of Macedonia has become a member of the United Nations, the International Monetary Fund (IMF), the World Bank and the World Trade Organization (WTO). The country has been particularly active in promoting its Euro-Atlantic integration, notably with respect to its potential accession to the EU and the NATO. It has concluded a Stabilisation and Association Agreement (SAA) with the EU and in 2005 it acquired an EU candidate status (figure I.1).

[1] Kosovo (United Nations Administrative Region, Security Council resolution 1244 (1999)), a province of Serbia, was separated *de facto* from the latter in 1999, when it was occupied by international forces. The majority population declared Kosovo independent in 2008, which has been recognized by 73 of the 192 member countries of the United Nations (as of January 2011), including the former Yugoslav Republic of Macedonia. Kosovo is, however, not a member country of the United Nations, and Security Council Resolution 1244 of 1999 recalling the sovereignty and territorial integrity of the Federal Republic of Yugoslavia (the predecessor of Serbia) alongside a call for self-administration for Kosovo, still remains in force. The treatment of data referring to Serbia and Kosovo in this report does not imply the expression of any opinion whatsoever on the part of the UNCTAD secretariat concerning their legal status or their authorities, or concerning the delimitations of their frontiers or boundaries.

Box I.2. Membership of the former Yugoslav Republic of Macedonia in selected international economic agreements

Stabilisation and Association Agreement

In 1999, the EU offered a stabilization and association process to five South-East European countries, including the former Yugoslav Republic of Macedonia. Within its framework, a *Stabilization and Association Agreement* (SAA) was signed with the country in 2001, which entered into force in 2004 thanks to an Interim Agreement concerning trade and trade-related matters immediately enabling the former Yugoslav Republic of Macedonia to benefit from trade preferences from the EU. The SAA set up two stages to reach full association, which should be realized in a maximum of 10 years. The former Yugoslav Republic of Macedonia has to progress on eight key priority areas, including dialogue between political parties, implementation of the law on police and anticorruption legislation, reform of the judiciary and public administration, as well as measures in employment policy and for enhancing the business environment.

Phase I was scheduled from 2004 to 2008 and concerned primarily the implementation of internal market-related EU laws, as well as other trade-related areas. In 2009, the EC and the Council of the EU recommended to pass to the Phase II of the SAA. Simultaneously, the EC recommended the opening of negotiation for accession, responding to the country's aspiration for full EU membership.[a] In the Phase II, the former Yugoslav Republic of Macedonia needs to take action on the following matters to:

- Extend the right to acquire ownership over real property to branches of EU companies;
- Take steps for the progressive implementation of the supply of services by EU companies;
- Ensure liberalization of portfolio investment, financial loans and credits with a maturity shorter than a year;[b] and
- Discuss the issue of opening and holding of bank accounts abroad by the residents of the former Yugoslav Republic of Macedonia.

Central European Free Trade Agreement

The Central European Free Trade Agreement (CEFTA) was established in 1992 by Czechoslovakia, Hungary and Poland, joined later by Slovenia, Romania, Bulgaria, Croatia and the former Yugoslav Republic of Macedonia, Albania, Bosnia and Herzegovina, the Republic of Moldova, Montenegro, Serbia and Kosovo/ United Nations Interim Administration Mission in Kosovo (UNMIK) (in that order). When the original member countries, as well as Bulgaria, Romania, Slovenia acceded to the EU in 2004 and 2007, they left CEFTA. On the basis of bilateral free trade agreements signed between members in the framework of the Stability Pact for South East Europe, the CEFTA aims at establishing a free trade zone in the region.

Current criteria for membership are WTO membership or commitment to respect all WTO regulations, Free Trade Agreements with the current CEFTA member States and a European Union Association Agreement.

European Free Trade Association

The European Free Trade Association (EFTA) has 20 free trade agreements with countries and territories outside the EU, one of them signed with the former Yugoslav Republic of Macedonia.

World Trade Organization

The former Yugoslav Republic of Macedonia applied for World Trade Organization (WTO) membership in December 1994. In 2002, WTO decided that the former Yugoslav Republic of Macedonia may accede to the WTO Agreement, and on 4 April 2004 the Agreement entered into force. They agreed on a gradual elimination of tariffs and transitional periods for the most vulnerable economic sectors, e.g. they kept a relatively high average tariff rate on agricultural products and little bit higher tariffs on industrial products for a transitional period of 3–5 years (Mojsovska, 2005).

Source: UNCTAD.

[a] At the moment of closing this report (June 2011), accession negotiations had not yet started.

[b] The latest amendment of the Law on Foreign Exchange Operations (July 2008, Official Gazette of the Republic of Macedonia (OGRM) 81) already stipulates that the current restrictions on portfolio investments in securities by residents will cease once the first stage of the SAA expires.

Peace was re-established in the country in 2001, resulting immediately in better economic conditions and higher growth. The announcement of the EU candidature in 2005 further improved the country's attractiveness. Due to its EU membership candidacy, the country is in the process of harmonizing its legal and regulatory systems with international, primarily EU, standards. The recommendation of the EC to opening negotiation talks in 2009 (box I.2) acknowledges the country's reforms and recognizes its fulfilment of the political criteria set by the Copenhagen European Council in 1993.[2]

A. Economic background

After the turbulent period of the 1990s and a more stable one since 2001, important structural changes took place in the country. However, the economic legacy of the past is still felt. The former Yugoslav Republic of Macedonia is one of the countries of Europe with the lowest income and is plagued by high unemployment (over 30 per cent). As the difficulties mentioned above require a long time to overcome, the GDP per capita of the former Yugoslav Republic of Macedonia is relatively low ($4,407 in 2008). In comparison, it is below the average of the South-East European countries and about the same as those of Bosnia and Herzegovina and Albania, which are among the poorest countries in Europe. Given the current conditions, the former Yugoslav Republic of Macedonia would become the poorest EU member State after accession with a GDP per capita which ranks well below those of the two current poorest EU member countries, Bulgaria ($6,546) and Romania ($9,300).

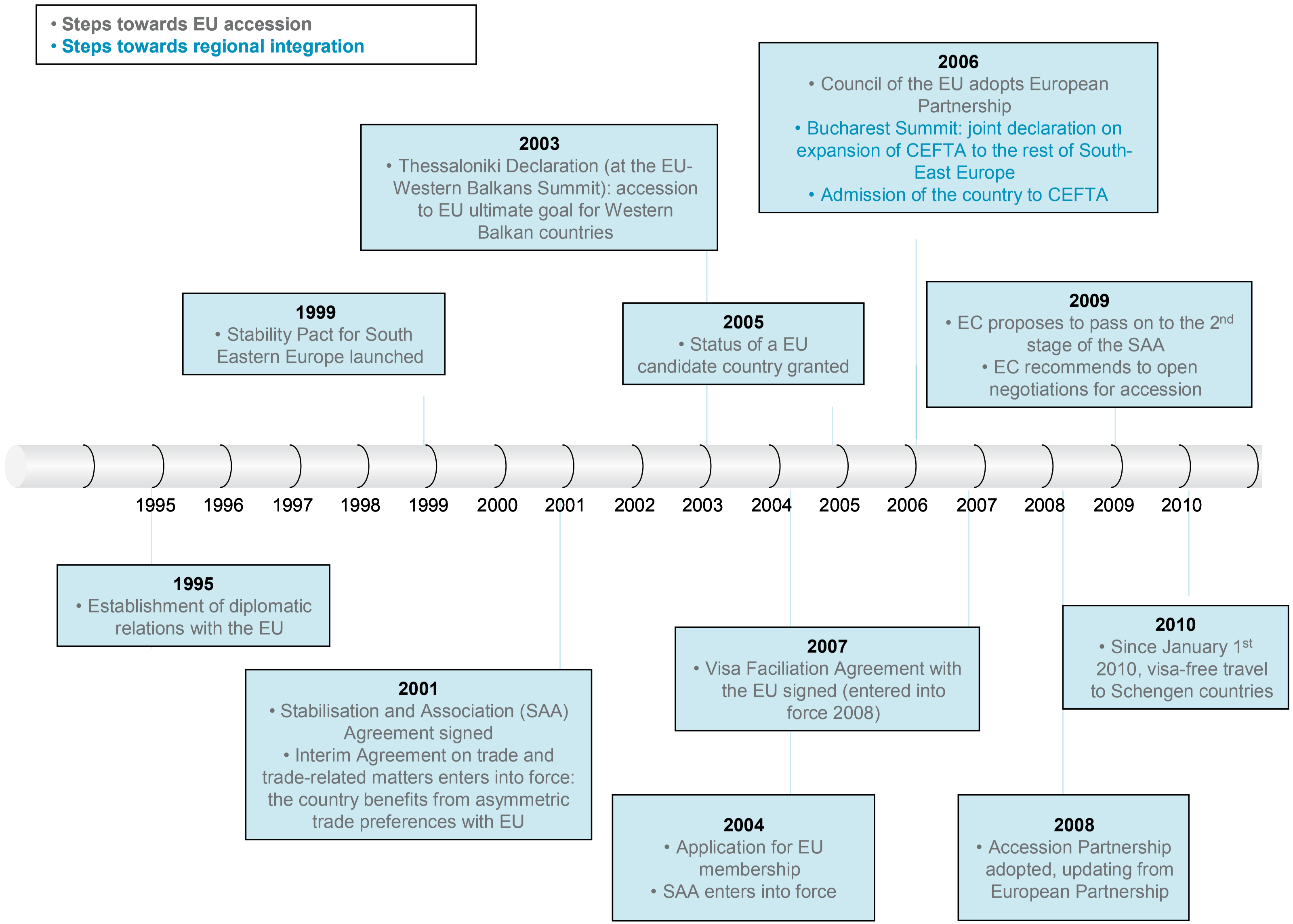
1. Growth and macroeconomic developments

In the wake of the break-up of the former Yugoslavia, the former Yugoslav Republic of Macedonia suffered from output losses for several years (figure I.2). It was followed by a longer period of moderate growth (1996–2008), with the exception of 2001, when the economy contracted due to the Albanian insurgency. The international crisis hit the country again in 2009, and the GDP declined as a result.

After the economic turmoil in the early 1990s, the Government began restoring macroeconomic order and bringing inflation under control by tightening monetary policy, consolidating the fiscal position of the country and retrenching income policies. Today, one of the country's major achievements is its macroeconomic stability. The national currency, the denar, was *de facto* pegged to the Deutsche Mark between October 1995 and 1999 and to the euro since 1999. This peg has also helped to maintain confidence in the stability of the financial system.

[2] The accession criteria are also called Copenhagen Criteria because they were established at the Copenhagen European Council in 1993. The conditions are set out by Article 49 and the principles laid down in Article 6(1) of the Treaty on European Union.

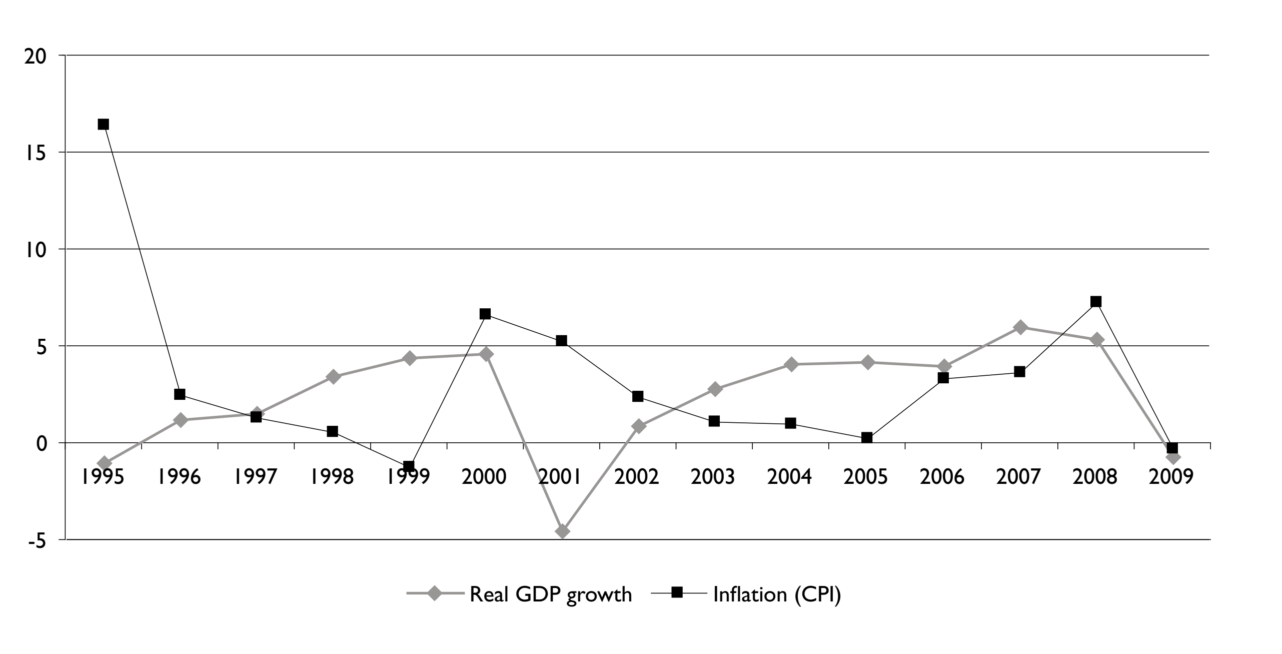
Figure I.1. Chronology of steps of the former Yugoslav Republic of Macedonia towards EU accession and regional integration



Source: UNCTAD.

Figure I.2. Real GDP growth and inflation in the former Yugoslav Republic of Macedonia, 1995–2009

(Annual per cent change)



Source: UNCTAD.

Compared with other transition economies, the financial system of the former Yugoslav Republic of Macedonia was resistant to the economic crisis due to strict liquidity risk management standards and a strong orientation towards traditional banking activities (box I.3). A main concern remains the current account deficit, which reached 12.8 per cent of GDP in 2008, up from 7.6 per cent in 2007 and close to zero in 2006. External balances had improved significantly due to a rebound in exports and low imports. In 2010, the current account deficit narrowed to around 2 per cent of GDP.

2. Labour market

The former Yugoslav Republic Macedonia is suffering from a low activity rate (56.7 per cent in 2009) and a high unemployment rate (32.2 per cent in 2009). The latter may be overstated due to unregistered employment in an extensive informal sector, which is estimated to be the equivalent of 15 per cent of GDP. Nevertheless, long-term unemployment is widespread among youth, the rural population, ethnic minorities and less educated people. One of the main challenges for the former Yugoslav Republic of Macedonia is to create employment and to integrate the youth, women and people employed in the informal sector into the official job market. Many people in the country work in family businesses and more than 10 per cent of the employed population are unpaid family workers. The share of unpaid family workers is especially high in agriculture, accounting for almost 50 per cent of employees (data from the State Statistical Office (SSO) for 2008).

The Government sustained its efforts to provide education to a greater number of students and to improve vocational training for adults. Expenses on education increased, from around 3 per cent of GDP in 2007 to about 4 per cent in 2008 (with a significant share of the additional spending on renovation and construction of school buildings and the purchase of information technology (IT) equipment. Between 2001 and 2007, there was an increase in the number of students who attended first and second stages of tertiary education. Despite these efforts, the overall level of education and training of the labour force is still relatively low and the mismatch persists between the qualification profile of the labour force and the requirements of enterprises. In this regard, a plan for vocational education and training that properly reflects labour market conditions is missing.

Box I.3. The impact of the financial crisis in the former Yugoslav Republic of Macedonia

The financial crisis that started in 2007 as a liquidity crisis in the United States banking system not only put large financial institutions at risk, but led to a worldwide economic downturn. While the banks of the former Yugoslav Republic of Macedonia were affected only moderately by the crisis, the real economy was hit severely at the end of 2008 through a collapse in export demand and loss of external financing. Industrial production and exports declined sharply.

The downturn resulted in lower tax revenues and a forced sell-off of central bank foreign exchange reserves to maintain the exchange rate peg. While the central bank's policy rate was raised from 7 to 9 per cent to attract financial inflows, other measures (10 in total) were undertaken by the Government to fight the crisis. Among them, there were measures like the writing-off of some type of liabilities and tax reductions. In contrast to developed countries, the Government has not given aid to particular firms or sectors (OECD, 2010b).

In a survey undertaken by the German Chamber of Industry and Commerce in Macedonia (2010), 50 per cent of the respondents declared that they experienced decreasing turnovers in 2009. However, 47 per cent believed that they would increase in 2010.

By the second half of 2009, the situation had largely stabilized and confidence had improved. The economic rebound depends on the recovery of the largest trading partners like Germany or Greece and the amount of external financing received in the nation.

Source: IMF (2010a) and CEA (2009).

3. Structure of the economy

The economy is characterized by a large services sector, a middle-sized manufacturing sector and a small agricultural sector. The size of the latter has steadily decreased over time, but still remains significant today. Industry accounted for close to 40 per cent of the total GDP in 1992. Since then, it declined and represents today about 30 per cent of GDP (figure I.3). The manufacturing sector is dominated by iron and steel, textiles, construction, and the exploitation of metals and minerals, some of which could form the basis for clusters development (alongside with niche industries; box I.4). In contrast, the services sector grew from 44 per cent of GDP in 1992 to 58 per cent in 2008.

Structural changes have so far had limited impact on the employment structure of the country. Employment in the services sector grew from 42 to 50 per cent between 2004 and 2009. Employment in the industry sector fluctuated around 32 per cent whereas the share in the agricultural sector declined to 20 per cent. However, the share is still high compared with the average of the Organization for Economic Cooperation and Development (OECD).

Box I.4. Development of clusters in the former Yugoslav Republic of Macedonia

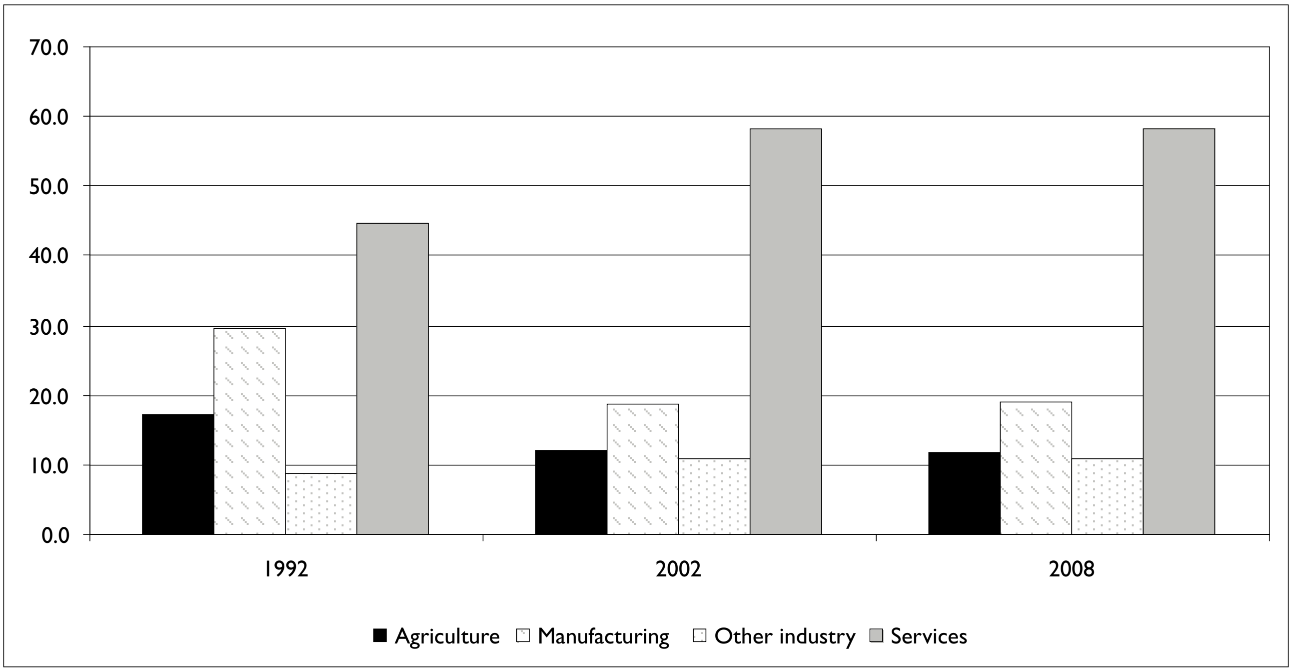
Through its Unit for Industrial Production, Technological Development and Innovations, the Ministry of Economy supports officially the creation and development of clusters comprising both domestic and foreign firms involved in a given value chain. Since small and micro companies prevail in the former Yugoslav Republic of Macedonia, clusters are an important tool to acquire and share information on new products and production processes. In addition, companies in a cluster can embark on a strategy to improve their international competitiveness and their access to international markets.

Clusters are selected by the Ministry on the basis of comparative advantages and traditions of the country, as well as their potential for future development and close cooperation between economic actors. The existing clusters in the country are however at very different levels of development – some of them are fairly advanced in terms of productive capacities, others are rather underdeveloped. In the same vein, some of them operate like real clusters, while producers in others have lower level of awareness about what synergies among producers getting together, supported by educational and training institutions would lead to. At the beginning of 2010, the country had 10 clusters, of which four (information and communication technology (ICT), automotive, textile and wine) are fairly developed, while the six others (fashion and design, wood and furniture, fruits and vegetables, apiculture, confectionary, and snailery) are working at a lower ebb. In some cases, such as the fashion and design cluster, there would be room for further development, for example related to increasing the value added of the related textile cluster. Two clusters (tourism and sheep) have already been abolished officially.

Source: UNCTAD, based on interviews.

Figure I.3. Structure of the economy of the former Yugoslav Republic of Macedonia, 1992, 2002 and 2008

(Per cent)



Source: United Nations Globstat.

Note: Other industries include mining and quarrying, electricity, construction, gas and water supply.

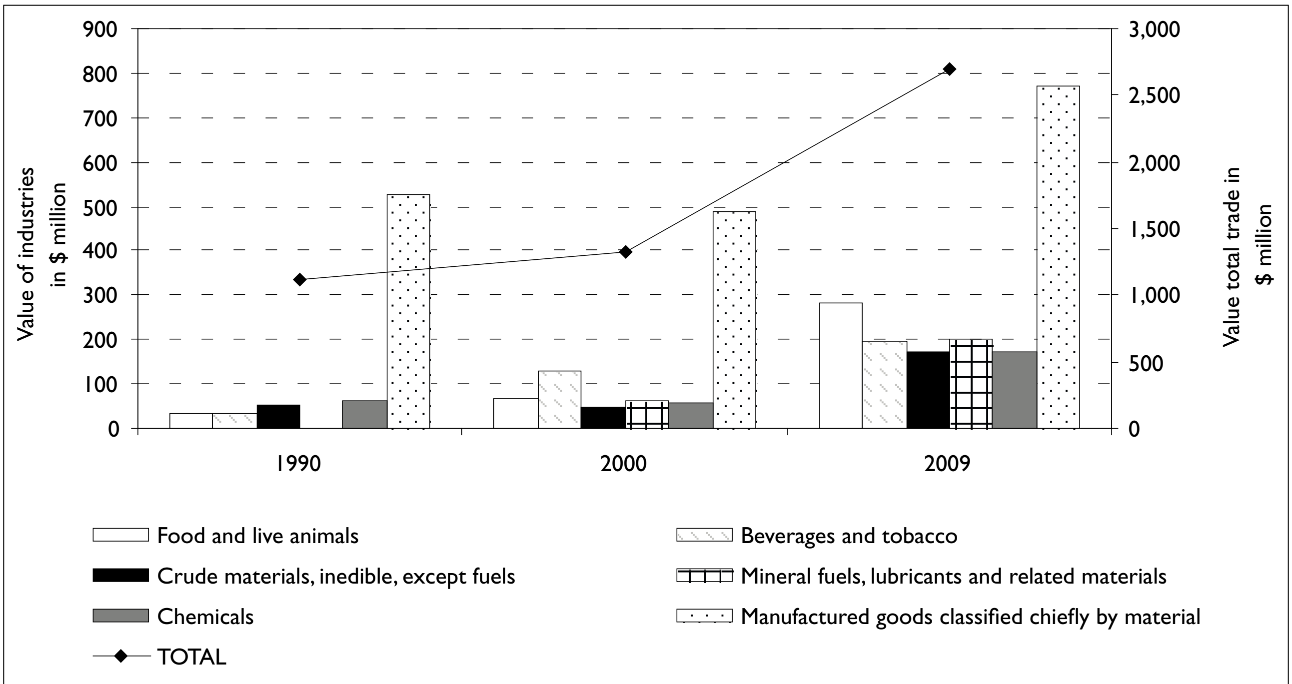
In the business sector, small and medium-sized enterprises (SMEs) accounted nearly 99 per cent of the 70,000 entities of the country in 2009. They represented 79 per cent of total private sector employment and 61 per cent of private sector value added. The majority of them were engaged in services, especially wholesale and retail trade (47 per cent), transportation, storage and communications. On the side of large companies, 200 of them realized about 48 per cent of total revenues and 63 per cent of total profits before taxation of all enterprises in 2008 (Euro Business Centre-Skopje, 2009). The former Yugoslav Republic of Macedonia is therefore characterized by a duality in the business sector. SMEs are a key source of employment but produce rather limited value added. Large companies[3] often operate in an environment delinked from SMEs and create relatively few jobs but are important sources of value creation. This situation, partly inherited from the former Yugoslav system under which a small-scale private sector engaged mostly in trading coexisted with publicly owned large firms, holds back the development of SMEs and limits the scope for potential business linkages between SMEs and large firms (see also section B2. on the linkages between foreign affiliates and SMEs).

4. International trade

As a small country, the former Yugoslav Republic of Macedonia is relatively open to trade (exports and imports) in goods and services (accounting for 133 per cent of GDP in 2008). Thus, the country is highly dependent on the international economy and susceptible to external shocks, such as the recent global economic crisis (box I.3). Both imports and exports were very dynamic in the 2000s, and imports tended to exceed exports. Between 2000 and 2009, imports rose from $2.1 to $5.0 billion, while exports grew from $1.3 to $2.7 billion (figure I.4). The trade deficit can be partly explained by the importation of five large items which are essential for the expansion of the economy, namely petroleum, iron and steel, textile yarn, road vehicles and electric energy. European countries, including South-East European ones, are the main trading partners. The Russian Federation is the country's second largest import partner due to its large oil deliveries (table I.1).

Figure I.4. Trade structure by product group in the former Yugoslav Republic of Macedonia, 1990, 2000 and 2009

(Total export value and export value of important industries according to SITC in $ millions)



Source: SSO.

[3] Including many foreign affiliates.

Table I.1. Main trading partners of the former Yugoslav Republic of Macedonia, 2009

Main export partners	% of total	Main import partners	% of total
Germany	16.7	Germany	10.3
Serbia	12.5	Russian Federation	9.8
Kosovo/United Nations Interim Mission in Kosovo	11.7	Greece	8.7
Greece	10.8	Serbia	7.9
Italy	8.1	Italy	7.2

Source: SSO, preliminary data.

5. Infrastructure

In general, the infrastructure of the former Yugoslav Republic of Macedonia has undergone modernization in recent years; nevertheless further improvements are necessary if the country wishes to grow faster and attract more FDI. In one survey carried out in 2005 (World Bank, 2009), 22 per cent of firms in the country felt that insufficient infrastructure was a constraint to operations. Among export-oriented firms, 57 per cent had a problem with electricity, and 52 per cent with telecommunications.

In *land transport*, Pan-European Corridor VIII runs from Albania in the West to Bulgaria in the East, crossing the former Yugoslav Republic of Macedonia, and Corridor X connects Austria with Greece via Slovenia, Croatia, Serbia and the former Yugoslav Republic of Macedonia. The Macedonian section of Corridor X is almost fully covered by highways and railways, although effective access to sea remains a problem. Business people complain that on the Greek end of Corridor X, strikes too often disturb transportation, and the fees charged by the port of Thessaloniki are too high. The highway links of Corridor VIII are not yet complete,[4] and rail connections are to be built. However, that corridor offers an alternative access to the sea, via the Albanian port of Durrës, which charges are estimated to be 20 per cent lower than those of Thessaloniki.[5] The EU supports the improvement of the Pan-European corridors; in addition the European Bank for Reconstruction and Development (EBRD) lent in 2009 €50 million to the upgrading of more than 400 kilometres of regional and local roads. The World Bank carries out a number of programmes in land transport, including a Regional and Local Roads Programme Support Project (RLRSP) for an amount of $105 million.[6]

In *air transport*, business people see certain bottlenecks constraining the efficient management of operations (e.g. there is no direct connection to major cities in Europe such as Paris or London). The country has two airports (Skopje and Ohrid). In 2008, the Turkish company Tepe Akfen Ventures (TAV) signed a concession agreement to manage both, and started the modernization of the Skopje Airport, and the construction of a new terminal building.

The *telecommunications infrastructure* is generally acceptable for investors. In fixed-line services, Makedonski Telekom enjoys a quasi monopoly. Makedonski Telekom was privatized in 2000 to the Hungarian affiliate of Deutsche Telekom called Magyar Telekom. The mobile telephone segment is more oligopolistic, dominated by three main players: Makedonski Telekom's T-Mobile (with a market share of over 60 per cent in 2009), ONE (Telekom Slovenije, 23 per cent) and VIP (Mobilkom Austria, 12 per cent). After liberalization in 2008, the prices for fixed-line telephone calls went up (table I.2), although they still remained competitive compared with Germany, Croatia and Hungary. In the mobile segment in 2006 (the most recent year for which international comparison was available), the former Yugoslav Republic of Macedonia was less competitive, with a price for one three-minute call ($1.41), being higher than Croatia or Hungary.[7] These differences might have

[4] Tenders for concessions for around €1 billion are under way.

[5] According to the Corridor VIII: Pre-Feasibility Study on the Development of the Railway Axis (Pan-European Corridor VIII Secretariat, 2007), estimations predict that half the imports and exports of the former Yugoslav Republic of Macedonia by container that presently use Thessaloniki port could move to Durrës.

[6] http://web.worldbank.org/external/projects/main?pagePK=64283627&piPK=73230&theSitePK=40941&menuPK=228424&Projectid=P107840. There are two other projects for an approximate cost of $20 million each: the Second Trade and Transportation Facilitation project and the Railways Reform project.

[7] Data from International Telecommunication Union.

been reduced since then as in 2009 significant reductions in retail mobile prices were reported in the former Yugoslav Republic of Macedonia.[8]

Table I.2. Infrastructure indicators of the former Yugoslav Republic of Macedonia, 2003–2009

Item	2003	2004	2005	2006	2007	2008	2009
Fixed telephone, price of a 3-minute local call (peak rate, $)	..	0.061	0.061	0.061	0.067	0.085	..
Mobile cellular, price of 3-minute local call (peak, $)	1.988	1.396	1.400	1.414	..	..	..
Fixed-line penetration rate (per 100 inhabitants)	25.9	26.4	26.2	24.1	22.7	22.4	..
Mobile penetration rate (per 100 inhabitants)	38.3	48.5	62.0	69.5	95.4	122.6	..
Internet users (per 100 inhabitants)	19.1	21.0	23.0	25.0	27.3	42.9	..
Railway labour productivity (1989=100)	67.2	76.2	112.9	132.0	161.0	162.4	..
Residential electricity tariffs (USc kWh)	4.7	5.1	4.4	5.1	5.7	6.1	6.9
Average collection rate, electricity (in %)	77	82	88	85	86	87	91

Source: EBRD and data from International Telecommunication Union data.

In *energy infrastructure* a major challenge for the former Yugoslav Republic Macedonia is to increase and to diversify its electricity supply in order to satisfy increasing domestic demand. Domestic generation capacity is sufficient to match normal demand but already fails to meet peak demand. Electricity imports accounted for 20 per cent of consumption between 2000 and 2009 but peaked at 38 per cent in 2008 (Tieman, 2011). In energy generation and wholesale electricity distribution, still dominated by the State-owned ELEM, there is a lack of competition. Since the electricity industry suffers from a history of under-investment and low standards of maintenance, the introduction of competition is a key priority. In principle, the country has a potential in both the traditional ways of producing energy and in renewable ones, especially solar and hydropower. However, if the Government wants to exploit this potential, especially through attracting foreign investors possessing necessary technologies, it has to aim for a stable and improved regulatory framework. This is particularly true for renewable energies, where a stable regulatory environment guaranteeing good returns on the heavy investments would be essential.

6. Demographic structure and human resources

The former Yugoslav Republic of Macedonia is a small country, with a population of 2 million. Population growth is 0.2 per cent per annum. In the 2009 Human Development Report, the country was ranked 72nd among the 182 countries surveyed, behind Bulgaria (61st), Romania (63rd), Serbia (67th) and Albania (70th).[9] It is characterized by ethnic diversity,[10] and the level of human development varies largely between different ethnic groups. According to data from the SSO, 29 per cent of the total population lived below the national poverty threshold in 2008. Among the most vulnerable ethnic group, the Roma, the same ratio reached 64 per cent (EBRD, 2010).[11]

The former Yugoslav Republic of Macedonia is a net emigration country. Around 370,000 citizens of the country are living abroad (IOM, 2007), mostly in Australia, Germany, Italy, Switzerland, Turkey and the United States. The Diaspora is important from a financial point of view: remittances accounted for around 15–17 per cent of GDP in the 2000s, although the global crisis led to a decrease in those transfers (EBRD, 2010). The Diaspora could play an active role in economic development, for example it could stimulate a partial return of skilled people (Janeska, 2003), who could also bring in foreign business partners. Some returnees already play

[8] Enlargement Countries Monitoring Report III – March 2010. Supply of services in monitoring regulatory and market developments for electronic communications and information society services in Enlargement Countries.

[9] "The Human Development Index (HDI) provides a composite measure of three dimensions of human development: living a long and healthy life (measured by life expectancy), being educated (measured by adult literacy and gross enrolment in education) and having a decent standard of living (measured by purchasing power parity, PPP, income)." (http://hdrstats.undp.org/en/countries/country_fact_sheets/cty_fs_MKD.html).

[10] Ethnic Macedonians are 64.2 per cent, ethnic Albanians 25.2 per cent ethnic Turks 3.9 per cent, ethnic Roma 2.7 per cent, ethnic Serbs 1.8 per cent, ethnic Bosnians 0.8 per cent, and Vlachs 0.5 per cent (EBRD, 2010).

[11] Roma children also have the lowest literacy rate and still a very low rate of enrolment, attendance and completion of both primary (61 per cent) and secondary education (17 per cent) (EC, 2009).

an important role in investment promotion. In this regard, four members of the Diaspora were appointed in key cabinet positions after the 2006 elections, partly with the aim to stimulate foreign investment.[12]

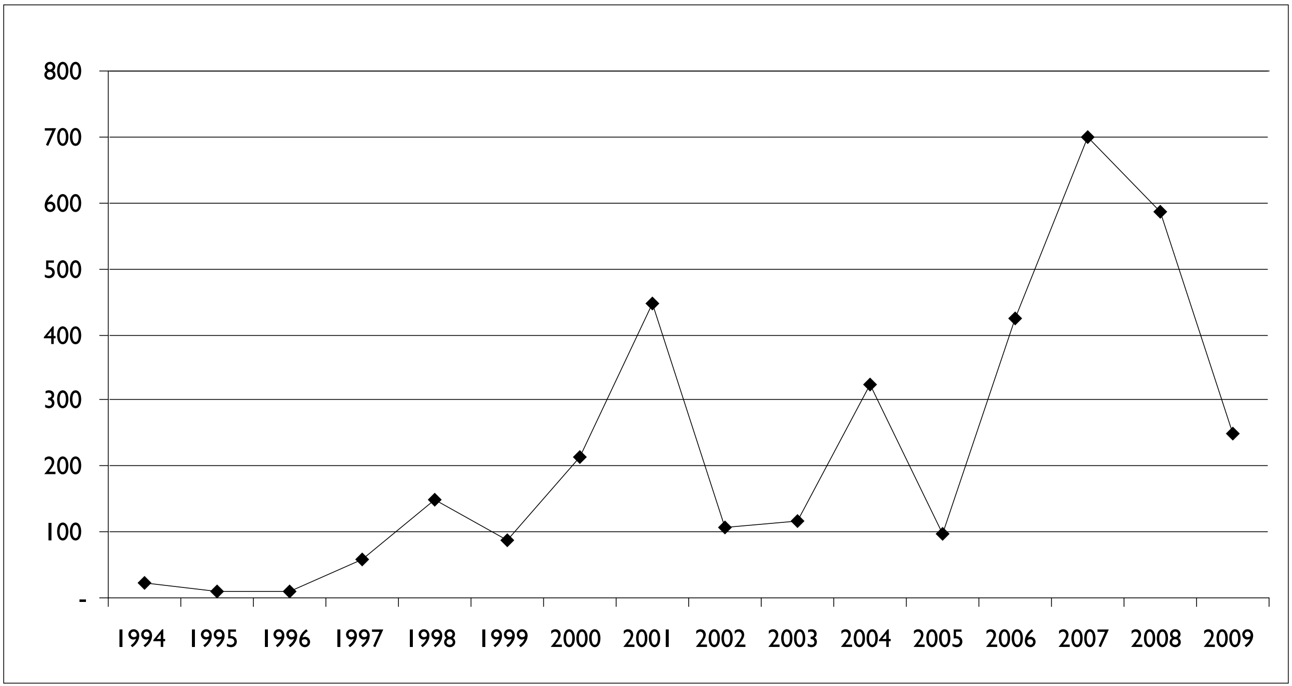
B. FDI trends

1. General FDI trends

FDI inflows were very small until 1998 (box I.5 for the methodology for data collection). Between 1998 and 2007, FDI flows were larger due mostly to the privatization of State-owned firms, and acquisitions of major companies and banks by foreign investors (figure I.5).[13] The sale of the national telecommunications operator to Magyar Telekom, the Hungarian affiliate of Deutsche Telekom in 2001, has so far been the largest FDI transaction (table I.3), explaining the peak of $450 million in inflows in 2001. After a lull, a second peak was observed in 2007, leading to a record of $700 million of inflows. In 2008 and 2009, FDI dropped again, largely due to a deteriorating international environment. Until 2008, 38 per cent of the total FDI (equity capital) was attracted in greenfield projects (including projects in the free economic zones).

Figure I.5. FDI inflows to the former Yugoslav Republic Macedonia, 1994–2009

(Millions of dollars)



Source: UNCTAD, FDI/TNC database.

[12] www.migrationinformation.org/Profiles/display.cfm?ID=608.

[13] Most of these privatizations turned out to be "brownfield" investment in the sense that the acquired companies were reorganized and recapitalized by the new owners (*cf.* Meyer and Estrin, 2001, and Estrin and Meyer, forthcoming).

Table I.3. Top foreign investment projects in the former Yugoslav Republic of Macedonia, 2001–2008

Investor	Home country	Target company	Amount of investment ($ millions)
Magyar Telekom (Deutsche Telekom)	Hungary (Germany)	Makedonski Telekom	346.5
EVN	Austria	ESM Distribution	270.2
National Bank	Greece	Stopanska Banka	46.4
Balkanbrew Holding	Greece	Skopje Brewery	34.0
Hellenic Petroleum	Greece	OKTA refinery	32.0
Société Générale	France	Ohridska Banka	30.4
Titan, Holderbank	Greece/Switzerland	Usje Cement Factory	30.0
Balkan Steel	Liechtenstein	Ladna Valalnica	21.0
QBE Insurance	United Kingdom	ADOR Makedonija	14.8
Duferco	Switzerland	Makstil	11.5
East West Trade	Austria	Centro	11.0
Milestone	Iceland	KIB Kumanovo	6.4
KuppBall Transthandel	Germany	FZC Kumanovo	3.4
SCMM	France	Feni Kavadarci	2.3

Source: UNCTAD, based on United States Department of State (2008).

In global comparison, the former Yugoslav Republic of Macedonia has attracted a fair amount of FDI for the size and the level of development of its economy. It has, however, been outperformed by its peers from SEE and the European part of the Commonwealth of Independent States (CIS) (table I.4). In terms of FDI inflows, the former Yugoslav Republic of Macedonia has lagged behind all comparator countries except for the Republic of Moldova. Its FDI stock of $4,510 in 2009 placed it ahead of the Republic of Moldova and Albania only; nevertheless, since 2001 the latter has attracted more FDI.

A comparison with other regions of the world shows a different picture of the country. According to UNCTAD's performance and potential indices,[14] the former Yugoslav Republic of Macedonia performs above its potential. In 2008, it was ranked 44th (of the 141 economies covered) in terms of FDI performance, and only 100th in terms of FDI potential. In other words, the main reason for limited FDI inflows so far is the weak FDI potential of the country. Indeed, in terms of FDI potential, it ranks lower than any of the comparator countries from SEE or the CIS, including Albania and the Republic of Moldova, while in terms of FDI performance, it fares better than Greece and mostly on par with Ukraine.

[14] The UNCTAD Inward FDI Performance Index is a measure of the extent to which a host country receives inward FDI relative to its economic size. It is calculated as the ratio of a country's share in global FDI inflows to its share in global GDP. The UNCTAD Inward FDI Potential Index is based on 12 economic and structural variables measured by their respective scores on a range of 0–1. For the methodology for building the index, see UNCTAD (2008), pp. 34–36.

Box I.5. Data on FDI and foreign affiliates in the former Yugoslav Republic of Macedonia

In the former Yugoslav Republic of Macedonia, until the end of 2010, three institutions collected information on FDI and foreign affiliates. First, the Central Registry kept a special FDI register (chapter II), as well as a number of other registers which contained various data on foreign affiliates (e.g. trade register, Register of Annual Accounts, etc., see chapter II, section C). As for FDI data collection on a balance-of-payments basis, the National Bank of the Republic of Macedonia (NBRM) collected statistics on FDI flows and stocks according to international standards. In parallel, the State Statistical Office (SSO) produced regular annual FDI surveys, the last one dated 2008.

There were obvious duplications of statistical monitoring of FDI between the NBRM and the SSO. Also, the Central Registry's database contained similar information to that of the two databases (of the NBRM and the SSO). A Memorandum of Understanding (MoU) was signed by the NBRM, the SSO and the Ministry of Finance to create a Working Group on FDI and FATS (Foreign AffiliaTes Statistics), in order to propose solutions and avoid these duplications. The NBRM would be the main institution on statistics of inward and outward FDI flows and stocks, while the SSO would be able to monitor operational characteristics of foreign investment enterprises.

The amendments to the country's programme on statistical research 2008–2012, published in the Official Gazette 141/2010, terminated the research of the SSO entitled "Annual report on FDI and other forms of international economic cooperation". Currently, the NBRM is the only authorized institution for the FDI data according to the balance-of-payments method, although not necessarily statistics on the operations of transnational corporations and their foreign affiliates. According to the definition used in the former Yugoslav Republic of Macedonia, FDI is investment by legal and natural persons from abroad in business entities of the former Yugoslav Republic of Macedonia, resulting in a long-term interest, and an ownership of at least 10 per cent. However, the NBRM takes into account the subsequent investment between the foreign parent company and its local affiliate after the initial equity investment, too. This methodology follows the recommendations of the IMF and the OECD. According to this classification, FDI includes: own capital and reinvested earnings, receivables from related parties from abroad and obligations towards related parties abroad. The weakness of the current system is that, while it is advanced on overall FDI data, it is not complete regarding operational data on foreign affiliates, which would permit a more detailed analysis of the development impact. Moreover, the current system does not optimize the potential synergies between different data collections (e.g. through joint surveys or shared mailing lists).

Source: UNCTAD, based on Methodological Explanations, NBRM.

Table I.4. The former Yugoslav Republic of Macedonia: comparative FDI flows with selected countries, 1996–2009

(Dollars and per cent)

Country	Absolute performance				Relative performance										
	Average FDI inflows per year			FDI Stock	Average FDI inflows per year									FDI Stock	
	Millions of dollars				Per capita (Dollars)			Per $ 1000 GDP			As % of GFCF			Per capita ($)	% GDP
	1996–2000	2001–2005	2006–2009	2009	1996–2000	2001–2005	2006–2009	1996–2000	2001–2005	2006–2009	1996–2000	2001–2005	2006–2009	2009	2009
The former Yugoslav Republic of Macedonia	104.6	218.1	489.5	4 509.7	52.3	107.8	239.9	28.8	52.0	62.2	17.2	32.6	30.3	2,206.1	51.9
Albania	73.6	225.9	738.8	3 537.0	23.9	72.9	232.5	23.2	38.4	62.9	9.7	10.1	17.3	1 106.3	28.7
Bulgaria	597.2	2,226.8	8,613.5	50,727	74.0	285.8	1133.8	49.2	101.0	212.7	35.6	49.2	74.3	6,761.0	107.7
Croatia	895.5	1,475.6	4,309.2	36,602	196.5	326.1	946.8	38.7	45.3	71.6	19.9	20.1	27.2	8 058.9	58.1
Greece	756.6	1,128.0	3,829.9	44,927	69.7	101.9	343.0	5.7	6.1	12.5	2.5	2.8	6.3	4,014.0	13.6
Moldova, Republic of	68.7	119.6	391.6	2,604	16.0	28.3	93.6	46.1	55.5	81.0	25.9	30.0	26.4	624.7	48.2
Montenegro	..	133.0	941.5	4,579	..	264.2	1514.1	..	82.1	249.3	..	49.1	103.0	7,357.9	109.8
Romania	1,118.6	3,482.7	10,381.5	73,983	50.2	159.8	482.6	29.4	48.2	64.5	15.5	21.9	23.0	3,461.8	45.9
Serbia	203.4	913.0	3,181.6	20,584	..	..	..	..	51.1	85.4	..	30.4	39.0	..	49.3
Ukraine	595.6	2,486.4	7,806.0	52,021	11.9	53.0	172.4	15.3	36.5	55.7	7.7	17.2	23.0	1 166.8	44.3
South-East Europe	1,355.1	3,381.9	10,762.7	77,628	86.9	172.2	485.1	32.8	48.7	78.8	16.3	22.0	30.8	3,824.8	52.8
Transition economies	7,949.0	20,441.7	84,543.4	497,404	26.2	66.4	277.5	18.1	27.6	45.0	9.8	13.9	20.3	1,633.4	27.5
European Union 27	351,066.5	333,822.2	602,372.9	7,447,904	728.5	686.1	1228.1	39.8	30.7	36.5	19.5	15.5	17.6	15,155.5	45.5

Source: UNCTAD, FDI/TNC database; World Bank, World Development Indicators 2010.

Notes: Transition economies: SEE and the CIS. Including investment flows between member States of the group.

2. Composition of FDI

2.1. FDI by components

Since 1996, when such detailed data are available, equity capital has been the largest component of FDI inflows, accounting for more than 60 per cent of the cumulative flows over the period 1996–June 2010 (table I.5). Other capital (intra-company loans) and reinvested earnings however played an important role in FDI in individual years (other capital in 2004, 2007 and 2008, reinvested earnings in 2005 and 2007). With the exception of 2005, inbound FDI has exceeded income on inward FDI. However, the latter remained relatively high also in the period 2007–2009. Profit repatriation (the difference between income on inward FDI as registered in the current account and reinvested earnings as registered in the capital account) remained low in the period 1996–2006 but increased afterwards. In the global crisis year of 2009, repatriated profits exceeded total FDI inflows.

Table I.5. FDI inflows by component and income on inward FDI in the former Yugoslav Republic of Macedonia, 1996–June 2010

(Millions of dollars)

Year	Equity capital	Reinvested earnings	Other capital (intra-company loans)	Total FDI inflows	Income on inward FDI	Profit repatriation
	1	2	3	4=1+2+3	5	6=5-2
1996	6.8	..	4.4	11.2	..	..
1997	39.8	-1.7	19.9	58.1	0.3	2
1998	130	7.7	12.8	150.5	9.2	1.5
1999	38	24.9	25.5	88.4	31.4	6.4
2000	182.2	23.7	9.1	215.1	31.3	7.6
2001	447.5	-14.1	13.8	447.1	-0.8	13.3
2002	78.9	14.9	11.7	105.6	39.5	24.5
2003	97.7	30	-9.9	117.8	64.3	34.4
2004	152.9	0.9	169.2	323	67.5	66.5
2005	98.9	55.9	-57.7	97	141.8	86
2006	353.9	19.5	50.8	424.2	58.6	39.2
2007	259.3	251.1	188.7	699.1	469.5	218.5
2008	299.7	24.4	262.9	587	253.4	229.1
2009	214.9	-158	140.2	197.1	138.4	296.4
2010 H1	43.6	59.6	50.6	153.8	103.8	44.2

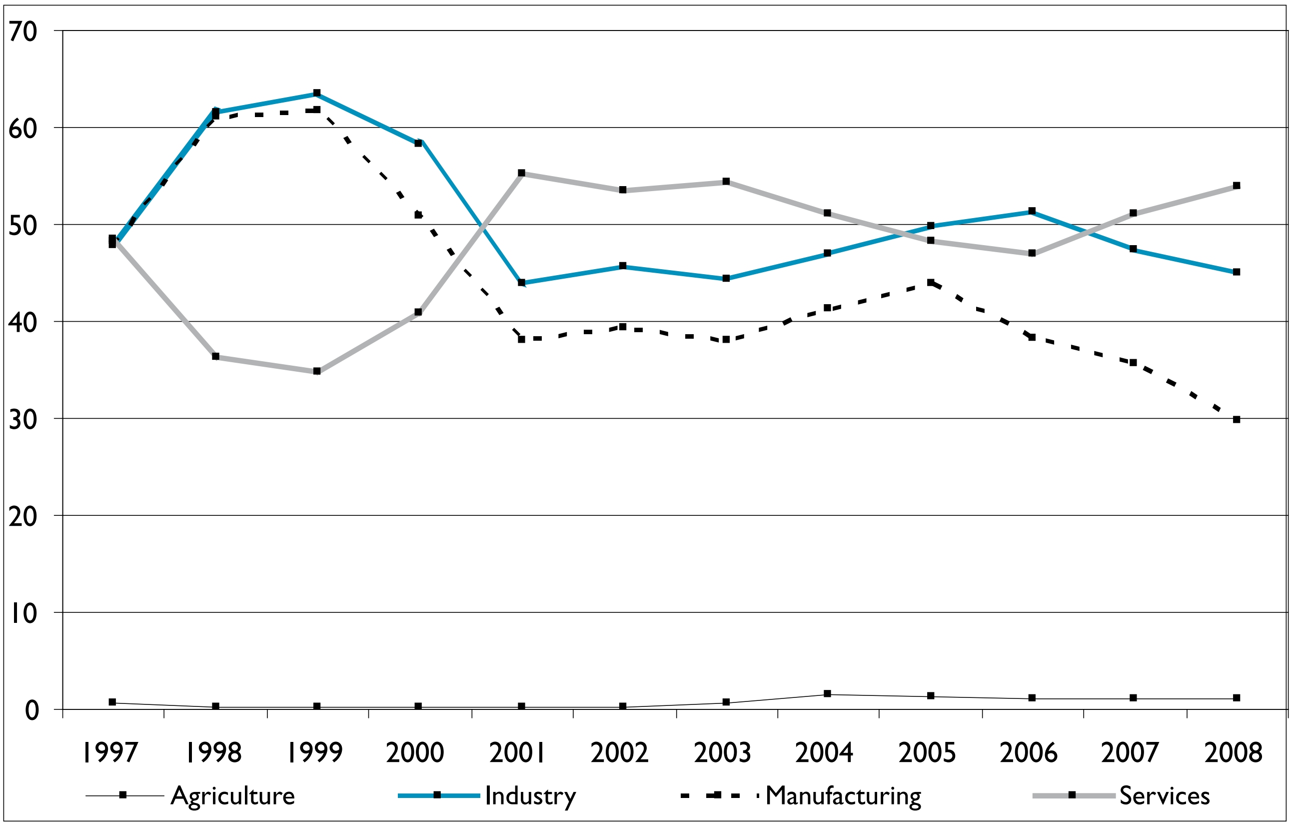
Source: UNCTAD, FDI/TNC database, and NBRM.
Note: 2009 data were revised in November 2010 by including data from the annual FDI Survey and due to improved coverage of credit indebtedness data.

2.2. Sectoral composition

In the 2000s, FDI inflows were concentrated in the services sector, in particular in financial intermediation, as well as in electricity, gas and water supply and manufacturing (figure I.6). Also, as seen above (table I.3), the five largest investors come from these fields, as well as from telecommunications, where large projects had also taken place. The country has a potential of attracting new investors not only in these industries, but also in others where FDI has been so far more limited.

Figure I.6. Sectoral composition of the inward FDI stock of the former Yugoslav Republic of Macedonia, 1997–2008

(Per cent)



Source: Based on NBRM data.

Notes: Percentages add up to less than 100 per cent due to non-allocated stocks. Industry includes mining and quarrying, manufacturing, electricity, gas and water supply, and construction, of which manufacturing is show separately.

Agriculture, food and beverages

Climatic conditions, a longstanding accumulation of skills and traditions make agriculture a particularly important sector for the economy of the former Yugoslav Republic of Macedonia. This does not mean, however, that it would be automatically a major target for inward FDI. In general, FDI in agricultural production is very limited in all parts of the world. Additionally, access to agricultural land is constrained (see chapter II.B).

In principle, possibilities for FDI could take place at other points on the food value chain, especially in downstream activities, such as warehousing, retail and food manufacturing. In the food and beverages industry, there are a few examples of foreign investment, such as the joint purchase by Heineken's Greek affiliate Athenian Brewery S.A. and the Greek soft drinks company Hellenic Bottling of a 51 per cent stake in the Pivara Skopje brewery, the largest one in the former Yugoslav Republic of Macedonia. Another example is Dairy Ideal-Sipka, which was founded in 1997 as a joint venture with Bulgarian investors. The company has 95 employees and is the second largest dairy in the country. In 2007, the Croatian firm Dukat, a company already active in the market of the former Yugoslav Republic of Macedonia, took over Ideal-Sipka, and in so doing enabled the company succeed not only in the country but also on foreign markets.[15] In 2007, Dukat was acquired by the French company Lactalis, and Dukat was made responsible for Lactalis' expansion to SEE. Examples of foreign investment in the wholesale distribution of food and beverages include the Croatian

[15] Outside of the former Yugoslav Republic of Macedonia, the company markets its products in economies such as Albania, Australia, Croatia and Kosovo, UNMIK.

company Agrokor Group (production and distribution of food and beverages), and the Slovenian supermarket chain Tuš. Agrokor plans to construct a $30.9 million distribution centre in the South of the country, while Tuš plans to open 20 supermarkets throughout the former Yugoslav Republic of Macedonia in the next five years. In tobacco production, Imperial Tobacco (United Kingdom) owns 99 per cent of Tutunski Kombinat AD, which manufactures, distributes and sells tobacco products. There are also investment potentials in the wine value chain (box I.6).

Box I.6. Potential for FDI in the wine value chain

Wine production has a long tradition and a good skills base in the former Yugoslav Republic of Macedonia. This industry, together with related input industries (barrels, cork, glass bottles, etc.), its distribution network and related activities (hotels and other tourist services related to wine tourism), has a potential to become a dynamic cluster, fuelling broader growth of the country's economy (box I.4).

The role of foreign investors is relatively limited in wine production but important at other points of the value chain. They are minority shareholders in some of the local wine–producing companies (e.g. Popova Kula) but are important partners in the international distribution of wine. In this area, interests may diverge as foreign buyers tend to insist on buying cheap bulk wine, a demand that leading firms of the former Yugoslav Republic of Macedonia, such as Tikveš (largest winery, accounting for 30 per cent of total wine production capacities of the country) are increasingly turning down. Foreigners are also important partners in supplying inputs to the wine industry. Bottles are imported from Croatia and, to a lesser extent, Bulgaria, cork from Greece, and barrels from France, Hungary and the United States. Foreign investors are interested in investing locally in key input industries.

The potential in this industry is recognized by the fact that the Government has created a wine cluster. To become fully effective, this cluster needs more support from the Government, for example in the form of facilitating regular participation in international fairs, and/or promoting investment in supply industries where local capacities are low or non-existent. A positive example is the attraction of the Turkish glass firm Şişecam to bottle production, which in the longer term could resolve the problem of bottle imports. Similar imports of foreign capital could help for example barrel production. Finally, the Government has a major role in image–building, for example through the registration of the appellations of origin for wine of the former Yugoslav Republic of Macedonia. In this respect, it would be important to register and protect not only the name of the country but also to protect the name of individual wine regions within the country.

Source: UNCTAD.

Manufacturing

Steel. The former Yugoslav Republic of Macedonia possesses both metal ores and water resources, making it an attractive destination for steel production. Duferco (Switzerland) entered the country in 1997 upon privatization and reconstruction of the former Mines and Iron & Steelworks Skopje. Duferco started an intensive modernization programme, with an initial investment of €15 million in 1999, and a subsequent investment of €22 million in 2007. Additionally, they have spent €20 million on projects related to environmental protection. In 2004, another strategic investor, the Netherlands-based company Mittal Steel (now ArcelorMittal), entered the market of the former Yugoslav Republic of Macedonia, which led to a sharp rise in base metal production in 2005. The company obtained a €25 million loan from the EBRD to improve energy efficiency, to provide the company with working capital, and to further promote regional integration of the steel industry.

Zinc, lead and cement. The United Kingdom-based affiliate of the Mumbai-listed Binani Industries Ltd. bought the Zletovo and Toranica lead and zinc mines, and restarted production, yielding over 2,000 tons of lead and just less than 1,000 tons of zinc since December 2006. The German company Knauf has been producing building systems such as gypsum plaster boards in Debar since 1998. The affiliate in the former Yugoslav Republic of Macedonia is a subsidiary of Knauf GmbH, Austria. Knauf acquired an existing company in the former Yugoslav Republic of Macedonia and upgraded the production and started to export most of its output to SEE.

Automotive components industry. There are three important transnational corporations (TNCs) operating in the Technological Industrial Development Zone (TIDZ) of Skopje 1 (table I.6), two of which are already established – Johnson Matthey (United Kingdom) and Johnson Controls (United States) – and one, TeknoHose (Italy), which is being established. The chemical company Johnson Matthey built a new emission control catalyst plant to serve rapidly growing demand for its products in Europe and North America. The first project is a state-of-the-art manufacturing facility. The initial investment in the plant in the former Yugoslav Republic of Macedonia was £34 million (€48 million), and the operation began by the end of 2009. The new plant created 128 new jobs. Johnson Controls has carried out a multi-phase investment in the former Yugoslav Republic of Macedonia for the production of electronic interiors. The first phase of the investment is planned to generate 500 new jobs by 2014. Investment in the infrastructure leading to the zone will amount to about €6 million. TeknoHose will invest €10 million in a factory producing armoured high-pressure rubber hoses for the automobile industry, thereby creating employment for 150 people. The production is expected to start in 2011. The company will export most of its products to Eastern Europe and the Russian Federation.

FDI in the Technological Industrial Development Zones. Although TIDZs do not represent a separate industry, they can be treated apart from the other industries as the zones provide particular services and focus on the attraction of companies in high technology. The former Yugoslav Republic of Macedonia introduced the model of the TIDZs in 2007, providing favourable conditions for the development of business activities by offering prepared industrial sites and pre-built factories with investor-ready physical and legal infrastructure, support services and tax, customs and other additional incentives (see chapter II on tax advantages in TIDZs). The Government tries to attract manufacturing, IT (software development, hardware assembling, digital recording, computer chips and the like), research and development (R&D) and environmental-friendly companies.[16] So far, there are four zones with one of them being operational for investment Skopje 1 (Bunardžik) (table I.6). The Law on Technological Industrial Development Zones formally opens the TIDZs to foreign as well as to domestic natural and legal persons. However, in reality TIDZs focus mostly on foreign investors.

Table I.6. TIDZs in the former Yugoslav Republic of Macedonia, 2010

Feature	Skopje 1	Skopje 2	Štip	Tetovo
Size	140 ha	100 ha	208 ha	97 ha
Ownership	State	State	State	State
Utilized capacity	20%	0	0	0
Key investors	Johnson Controls, Johnson Matthey	None	None	None
Infrastructure	Investment ready	Construction of main infrastructure started 2010 (central boulevard, water, gas and sewage mains)	Construction of main infrastructure started 2010 (central boulevard, water and sewage mains)	Construction of main infrastructure started 2010 (central boulevard, water and sewage mains)

Source: UNCTAD, based on the Invest Macedonia website.

[16] According to our interviews.

The Government of the former Yugoslav Republic of Macedonia is currently in the process of expanding the TIDZs in the country. A further seven sites are being considered for designation and investment. However, given the cost of the investment in necessary infrastructure and the fact that only one of the current four designated TIDZs is investment ready (and 20 per cent utilized), this issue will need to be addressed carefully.

Contracts with TNCs in the textile industry. The textile industry was declining in the 1990s in terms of output and employment. A privatization programme completed in 2001, the entry in force of the SAA with the EU in the same year, and entry in the WTO in 2004, helped the industry recover in recent years. Employment rose from about 4,000 in 2002 to 7,000 in 2006 in Štip, the country's number one centre of textile production (Kathuria, 2008: 127). All the domestic companies in Štip collaborate closely with international firms through contract manufacturing. Firms in the former Yugoslav Republic of Macedonia work mostly for European and United States companies, such as C&A (Belgium), Boss (Germany), Mexx (Netherlands), Bonita (Germany), Mango (Spain), Liz Clairborne (United States) and Kenneth Cole (United States). Due to proximity to the Western European market, the former Yugoslav Republic of Macedonia-based firms can react quickly to changes in orders. However, producers in the former Yugoslav Republic of Macedonia need to move up to more value added processes, including design capacities. The country's first designers' association was established in 2005, which set up a Fashion Centre with offices and work rooms in Skopje (USAID, 2009b: 56). Nevertheless, it is still in an early stage of development.

Services

In the services sector, FDI mainly went to energy distribution, banking and telecommunications-related activities.

Energy. In 1999, Hellenic Petroleum, the Greek State-owned oil company, bought the OKTA refinery. In 2005, the former State-owned utility, ESM, was unbundled into four major companies: AD ESM (distribution), AD MEPSO (transmission system operator), AD ELEM (generation including hydropower) and AD TEC Negotino (generation). The new power distribution company, AD ESM, was sold in 2006 to EVN, an Austrian investor. However, a few years later, relations between the Government and EVN deteriorated, and the latter started an arbitration process against the former Yugoslav Republic of Macedonia (chapter II, section B). In another deal, the Austrian company Energie Zotter Bau acquired 16 sites for construction of small hydro-power plants in 2007, and its plants are expected to be operational by 2012. Another large TNC in the former Yugoslav Republic of Macedonia is the Russian oil company Lukoil, which has been engaged in wholesale and retail trade of oil derivates since 2005. It further plans to build 40 new gas stations estimated to cost more than $50 million.

Banking. The banking sector comprises 18 banks and 8 savings houses. Its total assets account for about 39 per cent of GDP. Foreign shareholders hold a majority in 13 financial institutions, and control 93 per cent of total banking assets (data at the end of 2008). Two of the three largest banks are owned by foreign shareholders, Stopanska Banka by the National Bank of Greece and NLB Tutunska Banka AD Skopje by Nova Ljubljanska Banka (Slovenia). Other investors are Société Générale (France), Milestone EHF Island (Iceland), Alpha Bank (Greece), T.Z. Ziraat Bankasi (Turkey), Demir-Halk Bank (Netherlands), CKB Bank (Bulgaria), Alfa Finance Holding (Bulgaria), Steiermärkische Bank (Austria), and ProCredit Holding (Germany), a micro-finance bank.

Insurance. The insurance industry is small and growing slowly. In 2000, QBE (Australia) entered the market and became a major stockholder of Makedonija Insurance. In 2008–2009, domestic shareholders were replaced by insurance companies from Slovenia, Austria and Croatia, providing more capital and bringing in expertise in building capacity of institutions.

Business process outsourcing. In this area, FDI inflows have focused mainly on telecommunications-related services. One example is the establishment in 2007 of a multilingual call centre in Skopje by the United Kingdom outsourcing company Euroanswers. Other companies developing software products in the country are Seavus (Sweden) and Netcetera (Switzerland). The Government promotes the ICT industry and created an ICT cluster in 2000, and covering 80 companies today. It fosters regional and international cooperation, for example through collaborations with other ICT associations in SEE and membership in international and regional bodies.

Real estate and tourism. Foreign investment in tourism has been small so far (1 per cent of total FDI stock in 2007). The Turkish company Princess operates under the Sheraton brand. In the real estate industry, foreign investors focus on shopping and business centres. In real estate, Balfin (Albania) is one of the key investors in recent times. Its Skopje City Mall, with a planned retail space of 38 000 m2, located only 3 km from the city centre of Skopje, is expected to be completed in 2012. The Israeli real estate firm Gazit-Globe also plans the construction of a commercial centre in Skopje. The newly constructed Ramstore shopping mall in Skopje is an investment by Koç Holding from Turkey. Slovenia's Merkur Group also owns a new business and technical retail centre. Cevahir Holding (Turkey) in turn has bought land in the municipality of Aerdorom to build three skyscrapers. The Israeli company Industrial Buildings Corporation invested in Sun City, a high-class residential area at the outskirts of Skopje. This track record is good despite the fact that rules on land acquisition still need further improvements (chapter II, section C).

2.3. Origin of FDI

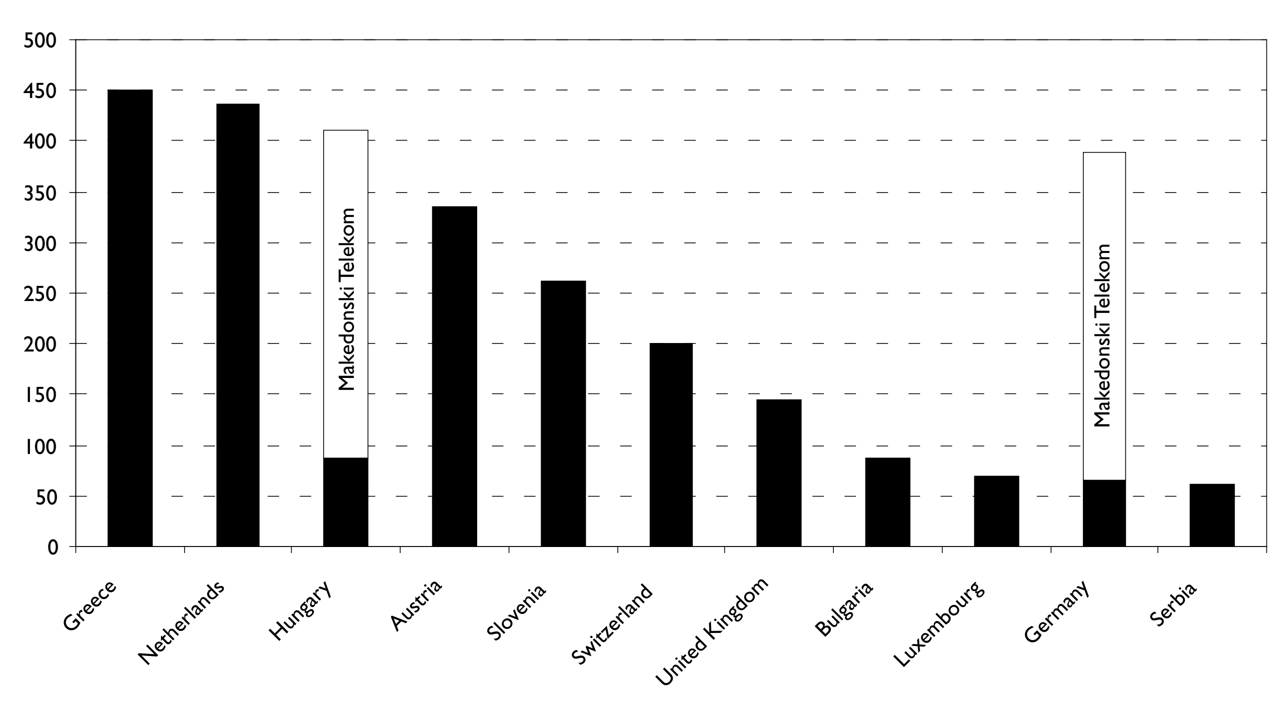
Comprehensive data on FDI inflows by country of origin since 1997 are available. Since then, the largest foreign investors in the former Yugoslav Republic of Macedonia have been Greece, the Netherlands and Hungary, in that order (figure I.7). Statistics on the origin of FDI need to be treated with caution however, because in some cases the nationality of the immediate and final investor may differ. The State-owned telecommunication company of the former Yugoslav Republic of Macedonia, for example, was acquired by the Hungarian-owned company Magyar Telekom; however, this company itself belongs to the German Deutsche Telekom group.[17]

Greek investors target various industries, in particular banking (Kreditna Banka by Alpha Bank, Stopanska Banka by the National Bank of Greece), oil refining (OKTA refinery) and food processing (Skopje Brewery). The largest project from the Netherlands – the second largest investor – has been Mittal Steel's investment project. There are also several investments in agriculture, with European Plants in conifers production, SBW International in vitro technology and Romero in the production of roses. As for Austria's investment, the largest part of inflows comes from the power distribution company EVN. Slovenian investors are active in various areas, including banking (Nova Ljubljanska Banka), telecommunications (ONE) and real estate (Merkur, ERA). Swiss investments consist mainly of Duferco's project; others are in the areas of construction material and software services.

[17] In statistics, this investment is ascribed to Hungary. In figure I.7, the investment in Makedonski Telekom is singled out. Without this investment, Hungary would only hold position in the middle field. In contrast, Germany would be one of the top three investors in the former Yugoslav Republic of Macedonia.

Figure I.7. Inward FDI flows of the former Yugoslav Republic of Macedonia by country of origin, 1997–2008

(Millions of euros)



Source: UNCTAD estimates, based on data from the NBRM (investor countries only) and company reports.
Note: The investment in Makedonski Telekom can be attributed to either Hungary (immediate investor) or Germany (ultimate owner), although official data register it under Hungary only.

C. Impact of FDI

The impact of FDI on a country's economic and social development is measured in terms of its positive contribution to output, employment, export diversification, technology and skills transfer, supplier linkages, as well as fiscal revenues and infrastructure development. However, FDI can also have negative effects on the development of domestic enterprises and the performance of an economy, particularly through crowding out, monopolization or negative environmental impact.

The former Yugoslav Republic of Macedonia has a relatively recent history of FDI attraction and the moderate volume of FDI inflows so far implies that the impact on its economy is limited. Also, there is insufficient data for a systematic impact assessment. Nevertheless, in those industries with significant FDI presence, such as telecommunications and banking, it is possible to observe effects in terms of considerable improvement in services delivery and a reduction in costs. The following section presents some impact assessment that is drawn from available data and anecdotal or ancillary information.

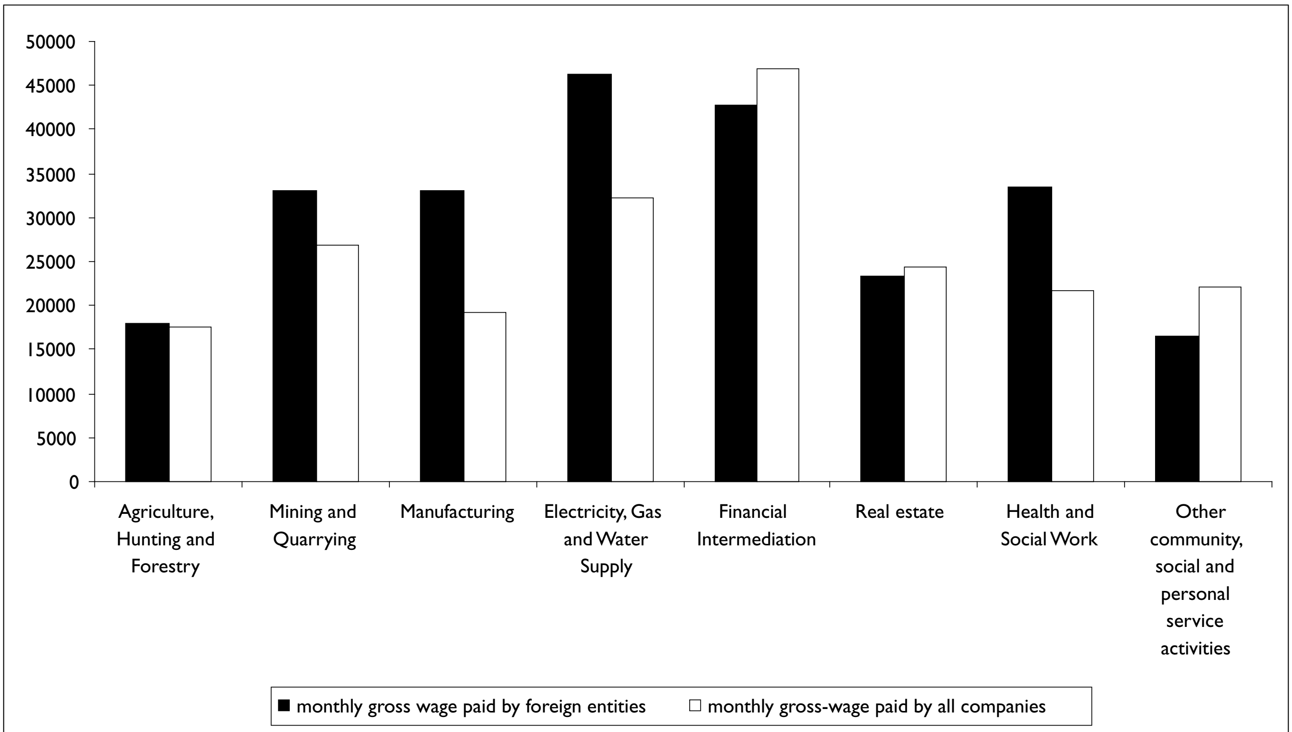
1. Employment and output

With an unemployment rate above 30 per cent in 2009, the former Yugoslav Republic of Macedonia urgently needs job creation. It is thus a crucial question to what extent FDI can generate jobs. In 2009, mergers and acquisitions (M&A) companies had 51,236 employees while greenfield investments provided work for 17,850 employees in the former Yugoslav Republic of Macedonia. This is related to the fact that, so far, the bulk of FDI has taken the form of cross-border M&As (including brownfield projects). In addition, the share of employees per equity capital is twice higher in M&A projects than in greenfield investments, due to differences in the industry composition of the two groups (in M&A projects, one can identify certain labour intensive activities such as telecommunications services).

In the former Yugoslav Republic of Macedonia, foreign investment projects generate relatively well paid and high-productivity jobs. According to data from the SSO for 2007, foreign investors tend to pay higher wages in most industries, except financial intermediation, real estate and other community, social and personal service activities (figure I.8). In the area of training employees, again, foreign affiliates offer certain positive examples. Knauf Radika AD for instance has an International Organization for Standardization (ISO) 9001:2000 Quality Management Certificate and is also a long-term co-operator of the local branch of the International Association for the Exchange of Students for Technical Experience (IAESTE), one of the largest student organizations providing internships in companies and institutions. ArcelorMittal also reported on-the-job training of employees in our interviews.

Figure I.8. Monthly gross wage paid by foreign and domestic companies in the former Yugoslav Republitc of Macedonia, 2007

(Denars)



Source: SSO.

Foreign affiliates are among the largest companies in the former Yugoslav Republic of Macedonia, therefore their economic output is sizeable. Of the 10 largest companies of the country, 7 are foreign affiliates.[18] In general, the acquisition of companies in the former Yugoslav Republic of Macedonia by foreign entities led to an increased output. The previous examples of foreign acquisitions showcased examples of production extensions.

[18] OKTA AD Skopje, EVN Macedonia AD, Makedonski Telekom AD, Feni Industries AD, T-Mobile Macedonia AD, ArcelorMittal Skopje (HRM) AD, ArcelorMittal Skopje (CRM) AD.

2. Linkages and technology transfer

According to our interviews, linkages are weak in the majority of cases. They are particularly low for greenfield investments because these companies are focused on exports, and they import most of their production inputs. Linkages are more developed in companies acquired by foreign investors, in which the new owners not only maintain the existing linkages with domestic suppliers but also aim at upgrading them. For example, in Knauf 60 per cent of their supplies come from companies of the former Yugoslav Republic of Macedonia, and this share is on the rise. Knauf also supports domestic companies to meet the standards of the ISO certificates. According to Knauf, the quality of supplies in the country improved in the last 10 years and the companies are very eager to upgrade their production.

In the area of technology transfer, some affiliates of TNCs import top technology from their mother companies and introduce it into the market of the former Yugoslav Republic of Macedonia. Technology transfer encompasses both physical transfer of machinery and technology, as well as the intangible transfer of knowledge and skills. In general, technology transfer can be enhanced through institutions such as collaborations between university and industry, inter-firm technology collaboration (horizontal and vertical networks of collaborating companies) or creation of high-technology zones. Some clusters collaborate with universities, such as the automotive cluster. Due to the missing linkages, the technology transfer remains within the mother company-affiliate framework and does not benefit domestic suppliers.

3. Trade

Foreign ownership is usually helpful to build an export base. In the former Yugoslav Republic of Macedonia, foreign affiliates trade on average more than domestically-owned companies. They export close to 60 per cent of their output, while the domestic ones export about 40 per cent. That is why FDI had an impact on the trade structure both in terms of trade diversification and destination, and contributes to an increase in national exports. For example, exports of the country are highly concentrated in iron and steel, textiles, and food, beverages and tobacco, and some of these industries (including iron and steel) are dominated by foreign affiliates. All in all, trade flows correlate highly with FDI flows meaning that FDI is complementary to trade.

4. Impact by types of investors

4.1. FDI in selected services

The role of FDI in the development of services has been limited to telecommunications and finance, as FDI other infrastructure services such as power generation has yet to materialize. As noted earlier in the report, foreign telecommunication firms have installed modern technology with approximately 95 per cent coverage of the country in mobile telephony. Through the intensified competition, retail prices dropped recently. Next to Croatia and Turkey, the former Yugoslav Republic of Macedonia is the only country in the West Balkans where mobile subscribers have access to number portability.

In financial services, the entry of foreign investors had two effects. On the one hand, it led to a consolidation of the industry. While in 2003 there were 21 banks (among them 8 owned by foreign investors), there were 18 in 2008, among them 14 foreign-owned. Within this process, three banks, Komercijalna banka, NLB Tutunska banka and Stopanska banka, became larger, controlling two thirds of total banking assets. On the other hand, the entry increased competition because more experienced and productive banks came into the market. Consequently, it led to the steady increase in domestic credit, the decrease in the day-to-day interest rates and lending rates, and the reduction of non-performing loans.

Stopanska Banka AD is one of the examples of restructuring through FDI. After privatization in 2000, the bank had a new IT system and standardized procedures for decision-making; risk management and procurement were introduced, and the new owners cleaned up the loan portfolio. In 2001, the Training and Development Department was established and in 2008 the bank received special recognition from the magazines Euromoney and Finance Central Europe.

The high concentration of foreign-owned banks can potentially lead to an increase in systemic risk when their parent banks suffer financial distress, as has been the situation in Greece starting in early 2010. The four largest Greek banks – the National Bank of Greece (NBG), Alpha, Eurobank EFG and Piraeus – have an estimated market share of 40 per cent in the former Yugoslav Republic of Macedonia. Therefore, the risk for contagion could potentially be high. However, Greek-owned banks in the former Yugoslav Republic of Macedonia do not hold Greek Government debt and have very limited dependence on their parent banks for financing (IMF, 2010b). Thus, it is rather probable that contagion will occur on a smaller scale through reduced funding and credit contraction. The growth rate of domestic credit to the private sector has gone down since 2008, though it is still positive (2.4 per cent in February 2010).[19] In case of bankruptcy of one of the Greek banks or scaling down of their businesses, other banks such as Raiffeisen International have declared that they could step in.[20]

Another problem of the financial market of the former Yugoslav Republic of Macedonia is the limited lending to micro enterprises and SMEs. Often these companies do not meet the rigid collateral requirements and, thus, need to pay higher interest rates. Nevertheless, in recent years, foreign-owned banks, such as the Export & Credit Bank and ProCredit Bank, have been increasingly involved in the micro loans segment, some of them with the support of international development banks.[21] Higher spillover effects can thus be generated if foreign investors collaborate with international financial institutions. The positive impact of the financial industry could be further enhanced if the enforcement of financial collateral and court procedures were strengthened.

4.2. Efficiency-seeking FDI

Efficiency-seeking FDI is commonly described as investing in foreign markets to take advantage of a lower cost structure, in particular through labour costs. The companies in the TIDZ are prime examples of efficiency-seeking TNCs. So far, the benefits have been small because there is little technology transfer to domestic companies. According to our interview, for example, Johnson Controls imports all industrial inputs and exports 100 per cent of its production. The company has no domestic suppliers for inputs aside from the infrastructure suppliers (cleaning companies, electricity, telecommunication, etc.). Yet, they employ nationals of the former Yugoslav Republic of Macedonia and pay a salary higher than the average domestic wage.

According to our interview with Johnson Matthey, the company uses local inputs for consumables of small value and for construction (e.g. mechanical and electrical services). Most of their raw materials are, however, not available in the former Yugoslav Republic of Macedonia. They do not give training to suppliers but guidance to help them meet the international quality standards. For the employees, generic quality training and environmental and health and safety (EHS) training are provided to all employees, whereas job-specific training is only given to some divisions.

As the companies in the TIDZ opened up very recently, it is still too early to make conclusions about the impact achieved.

[19] According to NBRM data.
[20] www.iii.co.uk/news/?type=afxnews&articleid=7895215&subject=companies&action=article.
[21] EBRD (2010).

4.3. FDI in natural resources

Resource-seeking FDI is based on the availability of natural endowments, such as iron or zinc. These are mostly capital-intensive and high-technology industries, where technological spillovers are less probable to occur because new and sophisticated technologies are more difficult to imitate. Often, local firms lack the capacity to catch up with foreign firms in this segment. Capital-intensive industries also generate less employment. For instance, Makstil (owned by Duferco) increased production heavily, but decreased the number of employees from 905 in 1993 to 820 in 2007.[22]

FDI in resources needs to be observed carefully regarding its environmental impact. Recently, non-governmental organizations (NGOs) raised concerns regarding environmental impact of some plants from ArcelorMittal. However, in the former Yugoslav Republic of Macedonia, this is not a concrete concern. ArcelorMittal is currently improving environmental standards; though a new wastewater treatment plant was delayed due to the financial crisis, it is expected to be completed by the end of 2011.[23] According to ArcelorMittal, its local affiliate has introduced various innovations in the area of better environmental management, such as the replacement of heavy fuel oil with natural gas in the hot strip mill in 2008/2009, the introduction of indirect heating in acid tanks, and ISO 14001 certification.

D. Assessment

Since independence, the former Yugoslav Republic of Macedonia has successfully transformed itself into a market economy. This transformation was not an easy process, and during the 1990s the country struggled with a steep fall of GDP, high inflation, and almost no foreign investment for several years. Political instability due to the dispute with Greece and the Albanian insurgency hampered recovery at the end of the 1990s. Since 2001, stability has increased and economic growth strengthened, as the macroeconomic situation has improved. The country has made inroads in its international economic integration, resulting in WTO membership, and in an EU candidate status. Relatively larger flows of FDI entered the country, mostly in the form of acquisitions (including privatizations). However, the financial crisis disrupted the economic revival through decreasing exports and declining financial inflows.

So far, FDI by TNCs has impacted the economy through different channels: (a) an important source of financing as evidenced by its high share in GFCF; (b) foreign companies enhanced services, such as in telecommunications and banking; (c) introduction of new technologies of production and new machineries as well as the establishment of ISO standards; (d) improved export capacities, especially in TIDZs, and through contract manufacturing (for example, in the textile industry); and (e) payment of higher wages than domestic investors.

For potential investors, the country has various attractive features, including political and macroeconomic stability, an open market economy, relatively skilled and motivated workforce, competitive labour costs, and a reasonably developed infrastructure (which nevertheless will require more investments in the near future). As will be highlighted in chapter II, all this is coupled with an EU integration process and a generally good business environment, thanks to a strong commitment of the Government and an ambitious reform agenda.

However, there are important challenges to be addressed if the country wants to fully tap its potential as the world economy will be recovering from the economic and financial crisis. They key in this process will be for the country to better position itself in the international division of labour based on an accelerated search by companies for cost efficiency and higher value added. This is not an easy task as the former Yugoslav Republic of Macedonia is a small and landlocked country, endowed with relatively few natural resources. There are nevertheless other features which can be changed with the right policy mix. These include the low income

[22] www.makstil.com/en/02-Local/profile.aspx.
[23] EBRD website, Bankwatch website.

situation of a majority of the population and the ongoing conflict over the country's name. Also, while the country's image has markedly improved in recent times, further could be done to portray the former Yugoslav Republic of Macedonia as a destination for investors. Furthermore, as it will be shown in chapter II, there are some outstanding issues in the business environment that the Government can continue to improve.

The country should aim to attract more FDI and to derive more benefits from it. To increase these benefits, it has to develop linkages between FDI and the domestic economy. Furthermore, the former Yugoslav Republic of Macedonia could use FDI to improve its infrastructure (e.g. through private-public partnerships). An efficient and high-quality infrastructure with good international transport connections would upgrade the country as an investment destination in the heart of the West Balkans and would also benefit domestic companies. Especially when investment plans are scaled down or postponed, the Government needs to convince foreign investors of the local economy's strength. It has to bundle its forces to create a dynamic and appropriate business environment together with a stable legal framework. Suggestions on how to do so are elaborated upon in the subsequent chapters.

II. THE INVESTMENT FRAMEWORK

A. Introduction

In the course of its transition to a market economy, the former Yugoslav Republic of Macedonia has opened itself to foreign investment and embarked on an ambitious programme of reforms. The changes have been largely determined by the country's aspiration to become a member of the EU and thus the need to progress with the development of a domestic legal framework that takes into account the *acquis communautaire* (thereafter the *acquis*) and will make it possible to accommodate it without jeopardizing basic legal stability The *acquis* is the total body of EU regulations accumulated so far, and its full adoption is an important requirement for candidate countries. The *acquis* is not static and keeps evolving; therefore applicant countries, such as the former Yugoslav Republic of Macedonia, also need the capacity to deal with future additions to their existing body of laws.

The WTO accession and the EU integration processes (box I.2) have opened up new possibilities for the economy of the former Yugoslav Republic of Macedonia. Companies, originally located in a small market of 2 million people, have gained easier access to larger markets. In the case of the EU market of 500 million people, access has indeed become almost completely free (with only a few remaining exceptions, e.g. sensitive agricultural products). However, the access to foreign markets will eventually be accompanied by the opening up of the market of the former Yugoslav Republic of Macedonia to foreign competition. While the SAA allows an asymmetrical opening to foreign markets, preparing for increased competition remains a challenge. Moreover, the uncertainty surrounding the exact date of entry into the EU (chapter I, box I.2) may be interpreted as a risk by investors, which needs to be counterbalanced by an investment environment characterized by increasing stability.

Along with its commitment to EU accession, the Government has engaged, since 2001, in major efforts to improve the ease of doing business and enhance the legal framework and the economic environment for investors. The former Yugoslav Republic of Macedonia offers various attractive features to foreign investors, including a favourable and simple tax system and a smoothly functioning customs administration. These efforts have been recognized internationally, as is reflected in the country's improved international rankings.

Thanks to fast reforms, the economy has improved significantly in recent years. Changes have, however, brought about new problems. One of them is legal stability. In a rapidly changing environment, economic actors and public administration do not always benefit from sufficient information on new laws and regulations in force. The other problem is the capacity of public administration to understand and apply the new laws effectively, issue the right type of by-laws and apply them. A third problem is a multiplication of laws and institutions in a country of only 2 million people. While enacting new laws or creating institutions is probably unavoidable on the road to EU membership, the former Yugoslav Republic of Macedonia needs to pursue its efforts to rationalize them or merge and integrate institutions with similar or overlapping mandates. There are also regulatory areas such as business registration, protection of intellectual property or employment of foreigners where there is room for further simplification.

Against this background, this chapter reviews the regulatory and policy framework of the former Yugoslav Republic of Macedonia for all business, including FDI, and proposes concrete recommendations to further improve the investment climate with a view to derive more developmental benefits from foreign investment.

B. Specific FDI measures

The former Yugoslav Republic of Macedonia is open to foreign investors. In the absence of a specific law regulating foreign investment, the key provisions on the treatment, protection and operation of foreign investment are provided by a body of laws, including the Constitution, the company law (called Law on Trading

Companies), a number of sectoral laws and international treaties signed by the country. This is in line with the practice of EU member States.

1. FDI entry and establishment

The investment regime of the former Yugoslav Republic of Macedonia is open to FDI and contains very few restrictions on the entry or establishment of foreign companies. There are only a few sectors – radio broadcasting, insurance and gaming – where restrictions expressed in terms of foreign shareholding apply. These are not infrequent in other countries, too, and do not prevent the participation of foreign capital in these sectors.

- *Radio Broadcasting*. According to the Law on Radio Broadcasting, a foreign national or legal entity may hold an equity stake in a broadcasting company of up to 25 per cent. Combined foreign shareholding may not exceed 49 per cent.[24]
- *Insurance*. The Insurance Supervision Law[25] stipulates that the individual share of a legal entity or natural person in an insurance company can go up to 25 per cent of the equity, a rule which applies to both foreign and domestic investors (article 16). In the case of a foreign-controlled insurance company, an individual shareholding may go up to 65 per cent, and with a special approval of the Minister of Finance, up to 80 per cent (article 89).
- *Gaming*. Foreign investors may only organize games of chance in conjunction with domestic legal or natural persons in their own hotel, if foreign equity share is higher than 50 per cent. Foreign legal entity or natural person cannot organize entertainment games, neither independently nor through forms of investment in domestic legal entities and other forms of cooperation and joint venture.[26]

While there are no restrictions on the participation of foreign capital in banking (Banking Law),[27] specific requirements apply to foreign banks (or foreign entities with a participation in a foreign bank), related to the acquisition of a licence for founding and operating a bank. According to Article 17 of the Banking Law, these include providing (a) a certificate from the registry of the head office of the foreign bank and/or foreign person who has a participation in a foreign bank; (b) a proof that the foreign bank is authorized to collect deposits and other repayable sources of funds in the country of registration of the bank's head office; (c) an opinion from the competent authorities in the country where the head office of the foreign bank is registered related to the acquiring control in the bank; and (d) evidence that the competent authority of the foreign bank exercises adequate supervision on consolidated basis, at least according to the method and volume specified by the law.

The establishment procedures for all other sectors are the same for domestic and foreign investors (see section C.1.3 for details), with two additional procedures for foreign ones. In addition to reporting to the Trade Register, a mandatory step for all foreign firms and non-residents (see section C.1) is to report (a) their direct investments in the former Yugoslav Republic of Macedonia to the Register of Direct Investments, and (b) their purchases of real estate to the Register of Investments in Immovable Property of Non-Residents in Macedonia and Residents in Macedonia. These two registers are maintained by the Central Registry of the country. These procedures do not serve as screening mechanisms and are used to collect data and statistics on foreign investment. The Central Registry can refuse registration only if the legally required documentation is not sent to the Registry, or if the legal deadlines are not met. According to the Law on Foreign Exchange Operations, foreign companies failing to register (or failing to register within the deadlines) face penalties: for example, they can not transfer dividends or repatriate profit abroad.

[24] See Article 10. Non-official English translation is available at: www.mlrc.org.mk/law/l021.htm.
[25] "Official Gazette of the Republic of Macedonia" (OGRM) 27/2002, 84/2002, 98/2002, 33/2004, 88/2005, 79/2007, 88/2008, 56/2009, 67/2010.
[26] Article 44, Article 54 and Article 60 of the Law on Games of Chance and Entertainment Games, OGRM 10/1997, 54/1997, 13/2001, 2/2002, 54/2007.
[27] OGRM 67/2007, 90/2009.

Once a company is registered with the Register of Direct Investments, it directly acquires national legal status, irrespective of its form and ownership (types of ownership in section C.2.1). However, if the FDI project takes the form of a branch or representative office (section C.2.2), it remains considered as a foreign entity under the law of the former Yugoslav Republic of Macedonia. This differentiation has implications on the acquisition of land and other property by the foreign affiliate (section C.8.1). The categorization of local vs. foreign is picked up as a differentiation between "residents" and "non-residents" in the Law on Foreign Exchange Operations (section B.2). It is, however, treated differently in the Profit Tax Law (section C.3.1), which applies a territorial principle and treats branch and representative offices as local taxpayers.

According to the Law on Foreign Exchange Operations,[28] direct investments and all subsequent modifications shall be reported to the Register of Direct Investments within 60 days from the date of conclusion of the capital transactions. This register contains general information on foreign investors, the type of investment (greenfield vs. acquisition), the amount of investment and method of financing (cash vs. non-financial deposits). The Register of Direct Investments also automatically takes over data from the Trade Register. Regarding the amount and type of invested resources, foreign investors are obliged to submit a bank statement for their investment specifying the amount.

According to Article 12 of the Law on Foreign Exchange Operations, non-residents and affiliates of foreign trade companies in the former Yugoslav Republic of Macedonia that acquire real estate in the country shall report their investment and all subsequent modifications to the Central Registry within 60 days from the transaction, unlike citizens of the former Yugoslav Republic of Macedonia.

The registration procedures of the former Yugoslav Republic of Macedonia work fast in international comparison (section C.2). There are, however, certain problems related to the registration of real estate, and to the reliability of information contained in the national land registry (called cadastre; section C.8). It is also possible to raise a more fundamental question if there is a need for a separate registry for FDI. As the cases of Croatia and Slovenia show, the lack of a separate FDI registry is not necessarily an obstacle to proper registration and monitoring of FDI.

2. Treatment and protection of FDI

2.1. Treatment

The Constitution guarantees "equal position of all entities in the market" (Article 55). The Law on Trading Companies,[29] which regulates the main aspects of the operations of all companies in the country, provides post-establishment national treatment of foreign subsidiaries, branches and representative offices of foreign firms (art. 30 and art. 581). The principle of national treatment is also invoked by the bilateral investment agreements signed by the country (section B.3.1).

Moreover, in the context of privatizations, according to the Law on Privatization of State-owned Capital,[30] foreign investors are guaranteed equal rights with domestic investors when bidding on tenders for company share packages owned by the Government.

2.2. Transfer of funds

The Constitution guarantees foreign investors' right to free transfer and repatriation of investment capital and profits (Article 59). This right is only guaranteed to those who have fulfilled all legal obligations relating to taxes and social insurance contributions. Moreover, according to the Law on Foreign Exchange

[28] OGRM 34/2001, 49/2001, 103/2001, 32/2003, Article 8.
[29] OGRM 28/2004, 84/2005, 25/2007, 87/2008.
[30] OGRM 37/1996.

Operations,[31] the registration of investments at the Central Registry is a precondition for the free transfer of funds (Article 8). The law specifically provides for the free transfer of profits, of proceeds from the alienation or sale of ownership in direct investments, of the remainder of a liquidation estate, as well as for the right to indemnity if damage or lost occurred to the invested capital from expropriation or due to other measures of the Government. There is, however, a difference between "residents" and "non-residents" in the Law on Foreign Exchange Operations.

Current account liberalization (IMF Article VIII) was introduced in 1998. The existing Law on Foreign Exchange Operations is based on the SAA and was adopted in 2001 and later amended. The foreign exchange regime is going through two phases of liberalization, following the requirements of the SAA.

(a) In the first phase, all the transactions were liberalized for non-residents, i.e. their payments related to FDI, portfolio investments, real estate transactions, commercial transactions, credits (with the exception of cash transfers in which higher amounts require prior registration; see below). For residents of the country, everything was liberalized, except that they are not authorized to open deposits abroad,[32] buy real estate abroad, or buy securities abroad (and they also need to register higher amounts of cash transfers). Securities abroad can be bought only by banks and other institutional players at the securities market. In October 2009, the EC proposed to move from the first to the second stage of the SAA;[33] however, this entry to the second stage has not materialized yet.

(b) In the second stage, all the remaining restrictions mentioned above will be abolished. Dealings with securities and residents' investments in real estate abroad will be fully liberalized, and the liberalization of deposit activities of residents abroad will be started. When this happens, the NBRM will have to prepare the necessary by-laws. It is however difficult to predict with precision the exact date of entry into this phase.

The national currency of the former Yugoslav Republic of Macedonia, the denar, is fully convertible within the domestic market, although is not necessarily traded on foreign markets. Payments to or from foreign countries are performed by banks authorized for foreign transactions by the NBRM. Credit transactions between residents and non-residents can be freely arranged. The only requirement is that such loans must be registered with the NBRM. Certain legal entities conducting business activities abroad can hold deposits in foreign banks but only with the permission from the NBRM. Non-residents can freely open non-resident accounts in banks of the former Yugoslav Republic of Macedonia. Residents can hold foreign currency accounts in banks of the country.

Though only a few restrictions remain in the area of transfer of funds, the current foreign exchange regime still compares unfavourably with neighbouring countries which are already in their second phase of liberalization. These include those which have already entered the EU (e.g. Bulgaria and Romania) or are negotiating their entry (e.g. Croatia and Turkey). However, countries such as Albania, Bosnia and Herzegovina, Montenegro, and Serbia, are in the same phase of the SAA as they signed their agreements very recently (between 2008 and 2010). For the former Yugoslav Republic of Macedonia, it is recommended to move to Phase II as quickly as possible as the restrictions of Phase I for residents may potentially hold back or complicate the plans of successful companies in the former Yugoslav Republic of Macedonia or foreign affiliates to expand abroad (e.g. in neighbouring countries).

[31] OGRM 34/2001, 49/2001, 103/2001, 54/2002, 51/2003, 81/2008.

[32] In turn, current accounts abroad are authorized for banks; government representatives; citizens of the former Yugoslav Republic of Macedonia who have an emigration visa or work permit valid for more than six months during the period of their stay abroad; foreign natural persons who temporarily stay in the former Yugoslav Republic of Macedonia on an immigration visa or work permit valid for more than six months; legal persons performing services in the international transportation of goods or passengers; investment companies; scientific institutions; legal persons with a representative office or business unit abroad; residents who have a claim to collect based on a court decision issued by a court abroad; and residents who have claims based on sale of real estate abroad, if the regulations of the country where the real estate is located require the resident to open an account with a foreign bank (IMF Annual Report on Exchange Arrangements and Exchange Restrictions 2009).

[33] http://ec.europa.eu/enlargement/candidate-countries/the_former_yugoslav_republic_of_macedonia/relation/.

2.3. Expropriation

The Constitution guarantees the right to property. No person may be deprived of his/her property or the rights deriving from it, except in cases concerning the public interest as determined by law (Article 30 of the Constitution). According to the Law on Expropriation,[34] expropriation is possible during instances of war or natural disaster, or for reasons of public interest. Public interest, as defined by this Law, includes the following:

- Construction of infrastructure;
- Construction of power stations, waterworks, water supply systems, postal and communication systems and all accompanying and supporting infrastructure;
- Construction of buildings for defence and civil protection and regulation of border crossings; and
- Buildings and equipment for research of natural resources, education, science, health, culture, social security, athletics or activities; and
- Building settlements following extreme natural disasters and relocation settlements.

Under the Constitution and the Law on Expropriation, the State is obliged to pay rightful compensation, not lower than the market value of the expropriated property, plus interests due, since the date of expropriation if the payment is not made within 15 days of the decision on expropriation. The last amendments on the Law on Expropriation (2008) have shortened the period for appeal from 15 to 8 days. The efficiency of the current law is not easy to assess, as there have been no cases of expropriation of foreign investors since the 1950s, nor is there any major reason to think of the probability of such actions in the near future.[35]

The issue of regulatory takings is governed by the bilateral investment treaties (BITs) ratified by the former Yugoslav Republic of Macedonia.

2.4. Other issues related to treatment and protection

In principle, all firms established in the country nominally enjoy the same treatment. However, *de facto*, the quality of treatment can depend on who the investor is (USAID, 2009a: 10). High-profile international investors and larger local investors report few problems with the implementation of the law. Despite problems with the functioning of courts (section C.11.1), the Government has been successful in keeping these larger investors satisfied with their level of treatment; this appears to be achieved largely through informal channels. At the same time, smaller investors and minority shareholders still experience significant barriers to implementation and enforcement of national laws. These smaller firms, as well as other local investors, sometimes feel that a preferential treatment is provided to foreign investors, both in terms of incentives and the enforcement of laws (box II.1).

The *arbitration law* of the former Yugoslav Republic of Macedonia is based on the Constitution, the Litigation Procedure Law,[36] the Law on Disputes Settlement,[37] the Law on International Trade Arbitration[38] and the Law on Trading Companies, and follows the Model Law on International Commercial Arbitration (adopted in 1985, amended in 2006) of the United Nations Commission on International Trade Law (UNCITRAL). Arbitration between companies has been undertaken within the Economic Chamber of Commerce since 1993 through a Permanent Court of Arbitration.

[34] OGRM 33/1995, 20/1998, 40/1999.
[35] www.eubusiness.com/europe/macedonia/invest.
[36] OGRM 4/1977.
[37] "Official Gazette of the Socialist Federal Republic of Yugoslavia" 43/1982.
[38] OGRM 39/2006.

Box II.1. Are local firms discriminated against?

While foreign investors generally feel that their treatment is good, local firms often feel *de facto* disadvantaged relative to foreign investors. The feeling of discrimination stems partly from the fact that most of the foreign companies are larger, and partly from the perception that, consequently, they can talk to the Government more easily. Throughout the interviews conducted for this assessment, three main points have been raised by local firms:

1. Local investors do not feel that their rights are protected adequately (and as much as the rights of foreign investors) by the Government.

2. The Government's strategy is not particularly encouraging local investors to start their own businesses in certain locations – it is particularly evident in the TIDZs, where access to locals remains constrained in practice.

3. The authorities have made considerable efforts to liberalize the legislative and administrative regimes according to SAA and WTO rules, but with little limited effort to creating an environment that protects domestic industry to the extent permissible under the same rules (e.g. effective antidumping actions or countervailing duties in case of unfair competition).

The Government may need to pay more attention to ensuring the equality of local firms and foreign investors. One area where a revision of policies could yield results is incentives, especially in TIDZs.

Source: UNCTAD, based on interviews.

According to the Law on International Trade Arbitration, in disputes with other business operators and State agencies acting in their commercial capacity, foreign investors have recourse to international commercial arbitration. The parties involved in an international dispute may agree to settle their dispute through domestic litigation, mediation, or a foreign arbitration tribunal. The Government has 42 arbitrators accredited for domestic arbitration and 30 internationally-accredited arbitrators on the country's arbitration list.[39]

International agreements signed and ratified by the country or inherited from former Yugoslavia on the basis of succession provide for international arbitration of disputes between the foreign investor and the State. The former Yugoslav Republic of Macedonia is a party to the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards, the Geneva Convention on Execution of Foreign Arbitral Awards, the Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID), and the European Convention on International Commercial Arbitration. The former Yugoslav Republic of Macedonia also signed the Convention Establishing the Multilateral Investment Guarantee Agency (MIGA). Ratified international agreements take precedence over domestic legislation.

The number of cases of investor–State disputes brought before international arbitration is not large, although they emanate from major investors in the country, which may be a reason for concern. Until now, there have been three cases of disputes with foreign investors. The first was the case of the Greek investor Hellenic Petroleum regarding the OKTA oil refinery in Skopje. The Greek side claimed and won in 2007 at the International Chamber of Commerce (ICC) compensation from the State due to violation of a sales contract.[40] The second is a case currently before ICSID, filed in 2009 for the power distributor EVN Macedonia. Invoking the Energy Charter Treaty, the Austrian parent company EVN presented claims for unpaid electricity supply

[39] According to information provided by the Permanent Court of Arbitration attached to the Economic Chamber of Macedonia.
[40] ICC Case No. 13176/FM.

during the time prior to the privatization (1995–2004) in the amount of up to €93 million plus interest.[41] The third case, which is also pending, was also filed at ICSID in 2009 and concerns the Swiss confectionary affiliate Swisslion.[42]

3. International framework for FDI

3.1. Bilateral investment treaties

By November 2010, the country had 33 BITs: 30 in force (table II.1) and 3 (Belarus, Egypt and the Islamic Republic of Iran) in the process of ratification. Negotiations with Greece, Northern Ireland and Oman have been completed, and the agreements are to be signed and ratified as soon as possible. BITs are under negotiation with Croatia, Kazakhstan, Qatar and Uzbekistan. The former Yugoslav Republic of Macedonia has not yet concluded BITs with the EU member countries Cyprus, Denmark, Estonia, Ireland, Latvia, Lithuania, Malta, Portugal and the United Kingdom, and the non-EU important trading partners of Australia, Canada, Iceland, Japan, Kosovo/UNMIK,[43] Mexico, the Republic of Moldova, Montenegro, New Zealand, Norway and the United States. The BIT with Montenegro is in the process of signing. The Government started negotiating a BIT with Israel in December 2010, and planned to open negotiations with Canada, Kosovo/UNMIK, the Republic of Moldova and Qatar in 2011. The BITs concluded by the former Yugoslav Republic of Macedonia contain the standard BIT provisions (e.g. protection against expropriation, judicial review in cases of unfair compensation for expropriation, fair and equitable treatment, free transfer of funds and recourse to international arbitration for investor-State dispute settlement,[44] etc.).

While the network of BITs is fairly extensive, it is not yet complete. To further increase legal stability and predictability for FDI, the former Yugoslav Republic of Macedonia would need to initiate and conclude BITs with some of the countries which are important investors in the country or important business partners. In doing so, the country would need to set priorities, given its limited resources and the complexities of potential negotiations. For this reason, it should pursue the completion of BITs with EU member countries as a matter of priority. At the same time, it needs to acknowledge that, as a consequence of the entry into force of the Treaty of Lisbon on 1 December 2009, competences on negotiating international investment agreements have shifted from member countries to the EC. Although uncertainties remain about the exact extent of the competencies that in line with Article 207(1) of the Treaty will be transferred, the Commission will eventually evolve into the entity negotiating BITs for the EU member countries (UNCTAD, 2010: 84). These changes may have implications for the ongoing and future negotiations of BITs by the former Yugoslav Republic of Macedonia with EU member countries.

[41] ICSID Case No. ARB/09/10.
[42] ICSID Case No. ARB/09/16.
[43] The United Nations considers Kosovo to be an internationally administered territory under the name of United Nations Interim Administration Mission in Kosovo (UNMIK) (Security Council resolution 1244 (1999)).
[44] Exceptions always exist. For example, the BIT with Croatia does not have explicit reference to national treatment.

Table II.1. BITs and DTTs of the former Yugoslav Republic of Macedonia as of November 2010

Economy	BITs Year of signature (year of entry into force)	DTTs Year of signature	Economy	BITs Year of signature (year of entry into force)	DTTs Year of signature
Albania	1997 (1998)	1998	Lithuania		2008
Austria	2001 (2002)	2007	Luxembourg	1999 (2002)[a]	
Belarus	2001 (--)	2005	Malaysia	1997 (1999)	
Belgium	1999 (2002)[a]	1991	Moldova, Rep. of		2006
Bosnia and Herzegovina	2001 (2004)		Montenegro		1996b
Bulgaria	1999 (1999)	1999	Morocco	2010 (--)[e]	2010
China	1997 (1997)	1997	Netherlands	1998 (1999)	1998
Croatia	1996 (2002)	1994	Poland	1996 (1997)	1996
Czech Republic	2009 (--)[c]	2001	Qatar		2008
Denmark		2000	Romania	2000 (2002)	2000
Egypt	1999 (--)	1999	Russian Federation	1997 (1998)	1997
Estonia		2008	Serbia	1996 (1996)	1996b
Finland	2001 (2002)	2001	Slovakia	2009 (--)[d]	2009
France	1998 (2000)	1999	Slovenia	1996 (1999)	1998
Germany	1996 (2000)	2006	Spain	2005 (2007)	2005
Hungary	2001 (2002)	2001	Sweden	1998 (1998)	1998
India	2008 (2008)		Switzerland	1996 (1997)	2000
Iran, Islamic Rep. of	2000 (--)	2000	Taiwan Province of China	1999 (1999)	1999
Ireland		2008	Turkey	1995 (1997)	1995
Italy	1997 (1999)	1996	Ukraine	1998 (2000)	1998
Korea, Rep of.	1997 (1998)		United Kingdom		2006
Latvia		2006			

Source: UNCTAD, based on data provided by the Government.
[a] Agreement signed jointly with Belgium and Luxembourg.
[b] The agreement signed with Yugoslavia applies to both Montenegro and Serbia.
[c] The BIT with Czech Republic was ratified by the Parliament of the former Yugoslav Republic of Macedonia on 28 September 2010 (OGRM 123/2010).
[d] The BIT with Slovakia was ratified by the Parliament of the former Yugoslav Republic of Macedonia on 25 December 2009 (OGRM 150/2009).
[e] The BIT with Morocco was ratified by Parliament of the former Yugoslav Republic of Macedonia on 6 November 2010 (OGRM 143/2010).

3.2. Double taxation treaties

The former Yugoslav Republic of Macedonia has signed agreements for avoidance of double taxation (double taxation treaties (DTTs)) with 38 countries,[45] and has taken over and applies one agreement (with Belgium) concluded by the Socialist Federal Republic of Yugoslavia[46] (table II.1). Agreements with 33 countries are in force; the ones concluded with Germany, Egypt and the Islamic Republic of Iran and Morocco are not yet in force. DTTs with Azerbaijan, Bosnia and Herzegovina, and Luxemburg, are yet to be signed by both parties. Negotiations with Israel started in November 2010.

Among the main investing economies in the former Yugoslav Republic of Macedonia, the Government has not yet concluded DTTs with the EU countries of Cyprus, Greece, Malta and Portugal, and some large FDI source countries such as Canada, Japan and the United States. The former Yugoslav Republic of Macedonia would need to initiate, finish and conclude DTTs with some of those countries, again giving preference first to remaining EU countries.

[45] This counting includes Montenegro and Serbia as two countries, although the same agreement signed in 1996 with Yugoslavia is in force with respect to both.
[46] If and when the agreement signed between the former Yugoslav Republic of Macedonia and Belgium enters into force, it will supersede the agreement between the Socialist Federal Republic of Yugoslavia and Belgium. Until that date, the latter will remain into force.

3.3. International agreements containing investment provisions

The former Yugoslav Republic of Macedonia is member of WTO (and hence signatory to the General Agreement on Trade in Services (GATS), the Agreement on Trade Related Investment Measures (TRIMs) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs)), and also a signatory of three multilateral free trade agreements containing investment-related provisions (chapter I, box I.2):

- SAA with the EU member States;
- European Free Trade Association (EFTA) with Iceland, Liechtenstein, Norway and Switzerland; and
- Central European Free Trade Association (CEFTA) with Albania, Bosnia and Herzegovina, Croatia, the Republic of Moldova, Montenegro, Serbia and Kosovo/UNMIK.

CEFTA has an investment chapter where national treatment is applied to the pre-establishment phase of investment (OECD, 2010a: 48). In the framework of the SAA (Article 48), foreign investors from EU countries receive additional guarantees about national treatment in the pre-establishment phase, a standstill on new regulations, and on the free transfer of funds (box II.2). The free trade agreement between EFTA and the former Yugoslav Republic of Macedonia contains explicit provisions for the protection of payments and transfers related to investment (Article 14), and provisions on the promotion of investment in services (Article 27). At the multilateral level, the former Yugoslav Republic of Macedonia is party to MIGA, which is an important investment insurance provider in the country against certain non-commercial risks, i.e. risks of currency transfer restrictions, expropriation, breach of contract, and war or civil disturbance.

Box II.2. Investment-related provisions in the SAA

The SAA between the EU and the former Yugoslav Republic of Macedonia was signed on 9 April 2001 and entered into force on 1 April 2004 (box I.2). The agreement includes investment-related provisions in Title V relating to the right of establishment of companies and the free transfer of capital. The SAA stipulates in Article 48 that, with regards to the establishment of companies, the parties shall grant companies of the other party national or most favoured nation treatment, whichever is more favourable. The agreement also includes a stabilization clause obliging the former Yugoslav Republic of Macedonia not to adopt any new regulations or measures which introduce discrimination as regards the establishment of EU companies.

Concerning capital movement, Article 59 ensures the free movement of capital relating to direct investments made by companies formed in accordance with the laws of the host country. The free movement of capital, however, is subject to exceptions relating to balance of payments crisis and exchange rate policy difficulties. Under these circumstances the parties may take measures to restrict the free movement of capital for a period not exceeding six months.

More general investment promotion provisions are included in Article 84 which encourages the former Yugoslav Republic of Macedonia to improve its legal framework for investment, particularly in connection with the implementation of arrangements for the transfer of capital, and conclude BITs with EU member States.

Source: EU, *Official Journal*, 2004.

4. Assessment of FDI-specific measures

The former Yugoslav Republic of Macedonia is open to foreign investors. Entry, establishment, treatment and protection are up to standards,[47] although in some areas, such as registration, there could be further simplification. In the area of transfer of funds, it would be desirable to move to Phase II of the SAA so as to eliminate the remaining restrictions. With respect to dispute settlement, the quality of the judiciary system needs to be improved (this issue will be analysed in section C.11.1). The former Yugoslav Republic of Macedonia has a fairly extensive network of international agreements dealing with FDI. Most of the texts of bilateral treaties are up to date. The country, however, needs to extend its network of treaties. Given the existing limited resources to deal with these issues, there is a need to set priorities for such negotiations. The country also needs to monitor closely developments related to the transfer of competencies from EU member countries to the EC in the area of investment treaties, and adjust its approach to BITs accordingly.

C. General measures regulating business

In order to eliminate duplication and inconsistency between old and new legislation, the Government of the former Yugoslav Republic of Macedonia has reviewed laws and by-laws with the intent of eliminating all unnecessary, inefficient, complicated and outdated regulations. This process, launched at the end of 2006, is called the "*regulatory guillotine*" (OGRM 129/06) (annex 2 provides more details about this process). Its efficiency hinges on a qualitative assessment of regulations and regulatory changes called the Regulatory Impact Assessment (RIA), in which the Government and the private sector closely cooperate. As a result, the Sector for Regulatory Reforms (which reports to the Cabinet of the Deputy Prime Minister for Economic Affairs) has proposed changes to many laws and by-laws, which resulted in a significant streamlining of the legislation regulating business activity and in the introduction of new measures aimed at improving the country's competitiveness. The key measures are discussed in chapter III of this report, section C.

As a result of the ongoing reform process, the business environment has significantly improved. Since 2007, for domestic and foreign firms alike, the country's international ranking (World Bank, 2009 and 2010, and the OECD's Investment Reform Index) has improved significantly, reflecting these changes (box II.3).

The following sections deal with general measures regulating business in the former Yugoslav Republic of Macedonia and the challenges that the country faces if it wishes to improve further the business environment. This includes continued needs for simplification or elimination of unnecessary regulations, rationalization of the institutional setting, additional reforms and new regulations deriving notably from the EU accession process, and the improvement of the predictability of the regulatory environment, to mention a few.

[47] According to the World Bank's Doing Business Ranking, the former Yugoslav Republic of Macedonia ranked 20th among 183 countries in 2010 regarding investors' protection, compared to only 88th place in 2009. In all the indicators of investors' protection, the former Yugoslav Republic of Macedonia fared better than the Eastern European or OECD average. The only exception was shareholders' ability to sue officers and directors for misconduct.

Box II.3. The former Yugoslav Republic of Macedonia in international business rankings

The Government of the former Yugoslav Republic of Macedonia monitors closely its international ranking in key competitiveness reports, such as the World Economic Forum's Global Competitiveness Index, the EBRD's Transition Indicators, the World Bank's Doing Business Rankings, the World Bank's Worldwide Governance indicators, and the Investment Reform Index of the OECD. In most of these evaluations, the country's position has improved recently, and in some cases it is ahead of its South-East European peers. Most notably, in 2010, the country was the world's 3rd top reformer in the World Bank's Doing Business Report, and 1st in SEE. From the 69th place among 183 economies of the world in 2009, the former Yugoslav Republic of Macedonia progressed as high as to the 36th place in 2010, although it slipped back to the 38th place in 2011. Over the past years, the most significant improvements have been reported in the areas of starting business, where it became by 2011 5th in global ranking, and paying taxes, where the country advanced to the 33rd position. The country is also strong in the area of protecting investors (20th). Still, the Doing Business Report pointed weaknesses, especially in relation to dealing with construction permits (136th) and closing business (116th).

In a different international comparison, on a scale of 1 (meaning minimal policy development) to 5 (representing equivalent to best practice in the OECD area), the Investment Reform Index of 2010 gave an overall score of 3.7 to the country's investment policy and promotion. This is almost the same level as the scores for Bulgaria, Croatia, Montenegro, Romania and Serbia (3.8 each). The former Yugoslav Republic of Macedonia has been found well advanced in most elements of FDI policy, transparency and privatization, and also in some segments of promotion and facilitation, like strategy and institutional support. The country still lags behind others in titling, cadastering and restitution, intellectual property, FDI-SME linkages, one-stop shop and policy advocacy, to mention only a few areas.

These international rankings provide certain useful insights into the external evaluation of the business environment. At the same time, they need to be treated with caution, as they sometimes provide a relatively reduced view of complexities, and they are often stronger on benchmarking formal laws than on measuring of their implementation.

Source: OECD (2010a), World Bank (2010).

1. Adjusting national regulations to the *acquis*

The key challenge for the economy of the former Yugoslav Republic of Macedonia in the coming years is its accession to the EU for which the adoption of the *acquis* is the main prerequisite. The *acquis* is a full set of EU criteria and laws with which the former Yugoslav Republic of Macedonia has to comply. It includes political and economic criteria as well as several legislative areas (called "chapters") with which the country has to align. Most of the 33 chapters of the *acquis* have a direct impact on key aspects of the investment climate, including, among others, trade policy (free movement of goods), work permits (freedom of movement for workers), regulation of services industries (right of establishment and freedom to provide services), treatment of investors (free movement of capital), public procurement, company law, intellectual property (IP) protection, competition policy, sectoral regulations (financial services, IT, agriculture, food, fisheries, transport, energy) and taxation.

Given the scope of the *acquis* and the time frame required for adjusting to it, the Government needs to think strategically about the process. The *acquis* itself is non-negotiable; however, it leaves, beyond minimum requirements, policy space for member and candidate States which can be exploited to pursue their specific development objectives. This policy space is available, at differing levels, in respect to most social and economic policies and the related administrative and institutional infrastructure. In the fiscal domain, for instance, member States have the flexibility to adopt corporate tax rates above the minimum rate set at 10 per cent. The EU accepts a reduced value added tax (VAT) rate for a maximum list of goods and services and each country is then free to apply it to a given basket of goods and services. Starting a business, where the procedures and time necessary for company incorporation clearly differ greatly across EU member States, is another area which is illustrative of the degree of country specificity in adopting the *acquis*.

Some flexibility is also available with respect to the sequencing and timing of relevant regulatory changes necessary to adjust national regulations to the *acquis*. In addition, the subsidiarity principle is one of the pillars of the EU which gives member States and candidates competence over a full range of policies that should be determined locally. In these respects, the alignment of the former Yugoslav Republic of Macedonia to the *acquis* should be anchored to a strategic vision which is consistent with the national development objectives, including in areas related to attracting and benefiting from FDI. Consequently, the country needs to decide, within the policy space at its disposal, how to best align to the *acquis*, at a pace which is suitable to its development priorities, and consistent with the accession requirements.

In 2007, the Government of the former Yugoslav Republic of Macedonia has adopted a framework – the National Programme for Adoption of the Acquis Communautaire (NPAA) – which is updated and upgraded annually. The National Programme determines the short- and long-term priorities of the Government in the area of adjusting to the *acquis*. In most areas, progress is being achieved, although at varying speed. For the time being, however, this difference in the speed of adjustment is not so much the result of a strategic decision but is the reflection of differences in the institutional capacities of the country in different areas. According to the EC 2009 progress report (EC, 2009), good progress has been made in the areas of company law, transport policy, taxation, industrial policy and customs union, but less in some other areas such as competition (where human and financial resources are still inadequate), energy, and justice, freedom and security. In addition, in each field, the implementation capacity of the country needs to be strengthened.

Adjusting national laws to the *acquis* will have a major influence on the business environment. The task of the Government is a complicated one as it needs to ensure that this adjustment is done in a way that does not unnecessarily increase the regulatory burden. To avoid a proliferation of laws, the adoption of the *acquis* is accompanied by a regulatory guillotine to eliminate older, no longer necessary regulation. Effective implementation and use of the RIA, which monitors all new laws, will also help avoiding increased regulatory burden. This strategy is in line with the recommendations of the EC (EC, 2009), which also suggest more regulatory stability and more follow-up of new laws.

Another crucial element when adjusting national regulations to the *acquis* is the risk of capacity overload in public institutions (OECD, 2010a). Adjustment to the *acquis* requires indeed a strengthening of the administrative capacities of the country at all levels, but in particular in the area of implementation of laws. Also, given the importance of the task, efficient coordination of legislation is required. In the field of economic legislation, coordination is carried out by the European Integration Department of the Ministry of Economy, which also regularly monitors progress in this area. The experience of the new EU member countries in their accession process draws lessons for the former Yugoslav Republic of Macedonia on institutional capacities and coordination.

The key is thus to find the right balance between adopting a simplified regulatory approach, conforming to EU norms and keeping track of progress made towards the country's development objectives. The Government of the former Yugoslav Republic of Macedonia needs to follow a step-by-step approach, make best use of the "policy space" offered beyond the non-negotiable part of the *acquis*, and by setting the sequence and the timing to adopt the different elements of the *acquis*.

Another key challenge for the Government in the process of the adoption of the *acquis* is a need for good coordination between different parts of the public administration. The experience of other accession countries such as Croatia, which put in place a high-level Coordinating Committee on the Accession to the European Union (supported by 35 Working Groups on individual chapters of EU accession)[48] shows the need for a high-level coordination. This is a mechanism that could be used to ensure the effective integration of the strategic vision of the country into the accession process. Finally, as it has been highlighted, accession is closely related to capacity building at various levels of public administration as the adjustment to the *acquis* requires skills, especially in terms of interpreting and applying new laws, which are not available at the current stage in the country.

In analysing the different elements of the general business environment, the sections below refer to the progress achieved by the Government of the former Yugoslav Republic of Macedonia in adjusting to the *acquis*, whenever relevant, in order to identify possible changes in the investment environment in the near future.

2. Business registration, documentation, conditions and procedures

Business registration in the former Yugoslav Republic of Macedonia is governed by the Law on Trading Companies, the Law on the One-Stop Shop System and the Administration of the Trade Register and the Register of Other Legal Entities,[49] and Law on Central Registry.[50] The country has introduced a simplified system for the registration of companies, where, in the words of Invest Macedonia, one can register a company at the Trade Register "by visiting one office, obtaining the information from a single place, and addressing one employee". This significantly reduces administrative barriers and start-up costs.

In 2009, the second phase of establishing a one-stop shop for business start-ups was launched, focusing on facilitating the internal exchange of information between various data-collecting institutions, such as the Central Registry, the Employment Agency and the health insurance funds, the SSO and the NBRM. The updating of the legal framework for electronic registration and reporting has been another important step, which has further reduced the costs of registration (EC, 2009).

2.1. Legal forms a business can take

Foreign investors enjoy the same general freedom in choosing the most appropriate legal forms for their activities as local investors. They can create a fully-owned company or affiliate, a joint venture with a local partner, or engage in a concession. The principal law regulating these legal forms is the Law on Trading Companies.[51] The law defines a company as a legal person carrying out profitable operations, established by its founder(s). The two main corporate legal forms are the limited liability company and the joint-stock company.

The *limited liability* company *(DOO or DOOEL)* is a commercial entity that is easy to incorporate. It has no more than 50 natural or legal persons as founders, and its minimum capital is €5,000. Owners are not liable for the company's liabilities.

The *joint-stock* company *(AD)* is a commercial entity in which shareholders participate with contributions in the basic capital, defined by the company charter. A minimum of two legal or natural persons may incorporate a joint-stock company. Shareholders' liabilities are secured with the entire capital of the company. The lowest nominal value of basic capital required for founding a joint-stock company is €50,000 if the shares are issued through public offer, or €25,000 without public offer. Unlike most EU member countries, there is no differentiation between open and closed joint-stock companies in the law of the former Yugoslav Republic

[48] www.eu-pregovori.hr/default.asp?ru=444&sid=&akcija=&jezik=2.
[49] OGRM 84/2005, 150/2007, 140/2008.
[50] OGRM 50/2001, 49/2003, 109/2005, 88/2008.
[51] OGRM 28/2004, 84/2005, 25/2007, 87/2008.

of Macedonia. For the moment, this lack of differentiation does not pose a problem for investors; however in the future, the country may wish to introduce this distinction.

Other types of companies include: the *general partnership,* an association of two or more legal entities or individuals who are jointly liable without limits to the creditors; and the *limited partnership,* which includes two or more legal entities or individuals. In this case, at least one of the partners is liable without limits and the other ones for the obligations of the company up to their recorded contribution in the company.

In addition, foreign companies can open branches and representative offices in the former Yugoslav Republic of Macedonia. These business forms do not constitute separate local legal entities under the law of the former Yugoslav Republic of Macedonia.

Branch Office. A foreign company can establish a branch office in the former Yugoslav Republic of Macedonia if it is legally registered in its home country. The branch works on behalf of its parent foreign-domiciled company, which incurs full liability with its entire assets over the branch operations. If a foreign-domiciled company establishes several branches in the country, it must designate a main branch.

Representative Office. A representative office can be opened by foreign companies to carry out non-income generating activities, such as *advertising* or market research on behalf of their parent company.

The main legal forms of company incorporation follow international standards, and are generally compatible with the *acquis*. However, there are areas where the possibilities of the law of the former Yugoslav Republic of Macedonia are more restrictive than that of other countries. For example, at the moment, the law of the former Yugoslav Republic of Macedonia does not provide the possibility of cross-border mergers of limited-liability companies.

2.2. Registration

All companies have to be registered at the Central Registry (section B.1). The Central Registry manages 10 Regional Registration Offices in large towns of the former Yugoslav Republic of Macedonia. The 10 offices work with 17 smaller regional offices. The Central Registry keeps the following seven registers: (a) Trade Register and register of other legal entities; (b) Register of Annual Accounts; (c) Register of Pledges; (d) Register of Leasing; (e) Register of Rights on Immovable Property; (f) Register of Investments in Immovable Property of Non-Residents in Macedonia and Residents in Macedonia; and (g) Register of Direct Investments. The first five deal with all business entities and natural persons on the former Yugoslav Republic of Macedonia, while the remaining two specializes on foreign investors and/or foreign legal and natural persons.

As any other legal entity in the former Yugoslav Republic of Macedonia, foreign affiliates should register in the Trade Register of the Central Registry. The whole procedure is the same for domestic and foreign-owned companies. The Trade Register does not control for the identity of foreign founders. Company registration is a simple and swift operation. Also, Invest Macedonia is keen to help foreign investors at any stage of the registration.

All forms are available on the web page of the Central Registry. At present, the forms are in Macedonian, but are planned to be available in English. However, the completed forms will have to be submitted in Macedonian. Once submitted, the registration is in principle finished in four hours. In practice, until the end of 2010 it took one or two days. With the operationalization of a system of electronic signature on 1 January 2011, it became possible to reduce the waiting time close to the theoretical four hours.

The Macedonian Central Registry has undergone a major upgrading in recent years, and has improved its functioning. As a result, regarding Starting a Business, the former Yugoslav Republic of Macedonia ranks fifth in the World Bank's Doing Business 2011 report (World Bank, 2010): it takes only three days to register a company. Nevertheless, there is room for further rationalization. The fact that the Macedonian Central Registry also keeps the Trade Register, which is the register of all legal persons in the former Yugoslav Republic of Macedonia, makes the existence of a specific FDI Register partly redundant. All the necessary data on foreign investors and foreign investment companies could be inscribed and kept in the Trade Register, although at the moment, the FDI Register contains some data which are not contained in the Trade Register. Still, the use of modern information technology should allow the Trade Register to be easily modified to include all the data requested from FDI.

In order to start operations legally, in addition to business registration, companies need to register for the VAT if necessary (see section C.3) and provide basic information such as the address of their legal headquarters.

3. Taxation

3.1. Tax rates

Taxation is an attractive feature of the investment climate in the former Yugoslav Republic of Macedonia. The country offers a competitive fiscal regime for business, whereby profits are tax-exempt unless they are distributed, and a flat personal income tax of 10 per cent applies.[52] In addition, a generous VAT system and several incentives to attract foreign investors and innovation-oriented companies contribute to making the fiscal regime a pillar of the official investment attraction strategy.

Corporate tax regime: companies are subject to a tax on distributed profits ("profit tax") of 10 per cent (one of the lowest rates among comparative countries, as per table II.2). Accordingly, any profit distribution is subject to the profit tax in the year of payment. Resident companies are taxed on their worldwide income, but credit for foreign tax is available. Non-resident companies are taxed on their source income from the former Yugoslav Republic of Macedonia. Since 7 July 2010, profits distributed to resident companies are also exempted from taxation, effectively restricting the application of the profit tax to dividends distributed to individuals and non-resident companies.

Table II.2. Nominal corporate tax rates in selected economies in 2010

(Per cent)

Economy	Rate	Economy	Rate
Albania	10.0	Romania	16.0
Belarus	24.0	Serbia	10.0
Bosnia and Herzegovina	10.0	Slovakia	19.0
Bulgaria	10.0	Slovenia	21.0
Croatia	20.0	The former Yugoslav Republic of Macedonia	10.0
Czech Republic	19.0	Turkey	20.0
Estonia	21.0	Ukraine	25.0
Montenegro	9.0	OECD average	25.9
Poland	19.0	EU-27 average	23.1

Source: UNCTAD calculations, based on the EC Taxes in Europe database, International Bureau of Fiscal Documentation (IBFD) data, and the OECD Tax database.
Note: The above rates only provide a partial comparison and do not reflect the effective tax burden on business.

[52] Taxation is regulated by the Profit Tax Law (OGRM 27/2006, 160/2007), the Personal Income Tax Law (OGRM 139/2006), the Law on Value Added Tax (OGRM 44/1999, 114/2007, 103/2008), the Law on Property Taxes (OGRM 54/2000, 102/2008), the Law on Utility Fees (OGRM 61/2004), the Law on Public Revenue Office (OGRM 81/2005), the Law on Technological Industrial Development Zones (OGRM 14/2007, 103/2008, 130/2008), and DTTs.

A list of standard deductible expenses (e.g. capital expenses, wages, etc.), as well as partially deductible expenses are recognized by the tax authorities and reduce the tax base. Capital gains and losses are regarded as ordinary business income, and are included in the taxable base of the company. The law also provides for a special tax regime called "profit tax on non-deductible expenses". These include (a) entertainment expenses; (b) public fines; (c) interest on loans used for the acquisition of items, such as cars, furniture, carpets, works of art; (d) scholarships; (e) insurance premiums related to non-business property; and (f) interest expenses under "thin capitalization" rules. This tax, also 10 per cent, is paid annually.

Depreciable assets include a standard range of tangible and intangible assets as provided for in most tax codes; companies are generally free to choose the method of depreciation. Buildings are depreciated at a rate of 2.5 to 10 per cent, cars at 25 per cent, furniture at 20 per cent, computers at 25 per cent, and machinery and production equipment at 5 to 10 per cent. Land and forests are not depreciable.

With the reform of the fiscal regime in 2009, which reduced the profit tax rate and exempted dividend payments to resident companies from the profit tax, the former Yugoslav Republic of Macedonia abolished loss carry forward provisions.

Withholding tax: the country applies a withholding tax of 10 per cent, unless a DTT prescribes differently. The withholding tax is calculated, retained and paid for, on the basis of the following incomes of non-resident companies: (a) dividends; (b) interests; (c) copyrights; (d) entertainment or sporting activities; (e) management, consulting and financial services, from services related to research and development; (f) telecommunications services; (g) insurance and re-insurance premiums; and (h) lease of real estate located in the former Yugoslav Republic of Macedonia (see section B.3.2 on the DTTs signed by the former Yugoslav Republic of Macedonia).

Value added tax (VAT): the VAT system generally follows the EU VAT system; taxable transactions include the supply and import of goods and services. Since 1 January 2011, the threshold for VAT registration has been denar 2 million (about $46,000).[53] The tax period depends on the value of the taxpayer's total turnover in the last year.[54]

The general VAT rate is 18 per cent. A preferential rate of 5 per cent applies to an extensive list of goods and services, including, among others, food for human consumption, agricultural inputs, pharmaceuticals, computers and software and publications. The list clearly exceeds essential goods that would typically qualify for preferential VAT treatments. Indeed, many of these items are not allowed preferential rates under the EU *acquis*. This is the case, for instance, for agricultural machinery, computers and thermal solar systems.

Exported goods as well as services connected with exports are zero rated for VAT. Exporters can claim a refund of the VAT they have paid on their inputs. Upon a request by the taxpayer, the difference should be refunded within 30 days from the day the tax return was submitted. Tax authorities say they attempt to refund VAT in the legally defined time frame; if the refund is delayed, they are obliged to pay interests. In practice, the business community tends to complain about delays in refunds. Large taxpayers however tend to get faster VAT refunding.

Excise duties: these are levied on a limited number of goods including petroleum products, tobacco products, alcohol and alcoholic beverages, and passenger vehicles.[55] They vary from 5 to 62 per cent. Duties applied on certain goods are still lower than the minimum required by the *acquis* (EC, 2010). Until the end of 2009, excise duties were administered by the Public Revenue Office (PRO). On 1 January 2010, this responsibility was transferred to Customs Administration and falls under customs jurisdiction.

[53] According to the International Bureau of Fiscal Documentation (IBFD) database.

[54] The tax period is (a) one calendar month, if the total turnover of the firm over the last year exceeded denar 25 million (about $560,000); (b) one calendar quarter, if its total turnover over the last year did not exceed denar 25 million; and (c) one calendar year if the taxpayers has voluntarily registered for VAT.

[55] Excise duties are regulated by the Law on Excise (OGRM 32/2001, 50/2001, 52/2001, 45/2002, 98/2002, 24/2003, 96/2004, 38/2005, 88/2008, 105/2009, 34/2010), which follow mostly the EU Directive on Excises no. 92/12/EEC.

Property tax and other indirect taxes: a property tax is paid against the ownership of real estate, such as land and buildings. The tax is levied either on the owners, or on the users (in the case of a usufructuary arrangement). The rate of the property tax is determined by the municipalities and it ranges from 0.1 to 0.2 per cent. The rate for agricultural land not used for agricultural production is significantly higher. A *transfer tax on real estate* shall be paid by the seller of the real estate. A *transfer tax on securities* also applies when securities are exchanged as counterbalance payment. Tax rates for both transfer taxes are 2 to 4 per cent of the market value of the property or the securities, as determined by the municipal councils. Since July 2005, local taxes have been administered by the municipalities.

3.2. Incentives and special regimes

Simplified taxation for small business (micro-enterprises): companies whose economic activity is not in banking, finance, insurance, gaming or entertainment and whose overall revenues over the past three years from all sources have not exceeded denar 3 million per annum (about $70,000), pay a 1 per cent tax on their total income, in replacement of the profit tax and of the tax on non-deductible expenses. Prior approval from the tax administration is needed to adhere to this regime.

Technological Industrial Development Zones (TIDZs). Investors in innovatory activities within the TIDZs are exempt from profit taxes for a period of 10 years; they also qualify for other incentives (box II.4).

Box II.4. Advantages of TIDZs

The Government's objective is to attract enterprises into TIDZs whose main activities lie in the domain of manufacturing, IT (software development, hardware assembling, digital recording, computer chips and the like), scientific research, and new technologies with high environmental standards. To this end, the following benefits are provided:

- No corporate income tax for the first 10 years of operation in the zone;
- No personal income tax for the first 10 years of operation in the zone;
- No VAT and customs duties on imported inputs for re-exported production and on services provided in the zone that are directly related with these imported inputs;
- Land lease for up to 99 years at attractive concessionary rates;
- No municipal fee for preparation of construction land;
- Subsidies of up to €500,000 for building costs, depending on the number of new employees and the volume of investment;
- Subsidies of up to €250,000 for general and customized training programmes for the employees of companies operating in a TIDZ;
- State aid grants in the form of regional aid, e.g. for initial productive investment in capital as well as in immaterial assets (patents, licences, know-how or unpatented technical knowledge);[a]
- Exemption from utility taxes on natural gas, water, sewage and electricity;
- Free connection to utilities; and
- Establishment of a "Green Customs Channel" to facilitate customs clearance.

Source: Invest Macedonia website and "*Programme for Stimulating Investment in the Republic of Macedonia 2007–2010*".

[a] More information on the requirements of State aids grants can be found in the Law on Technological Industrial Development Zones, Art. 4a.

3.3. Tax administration

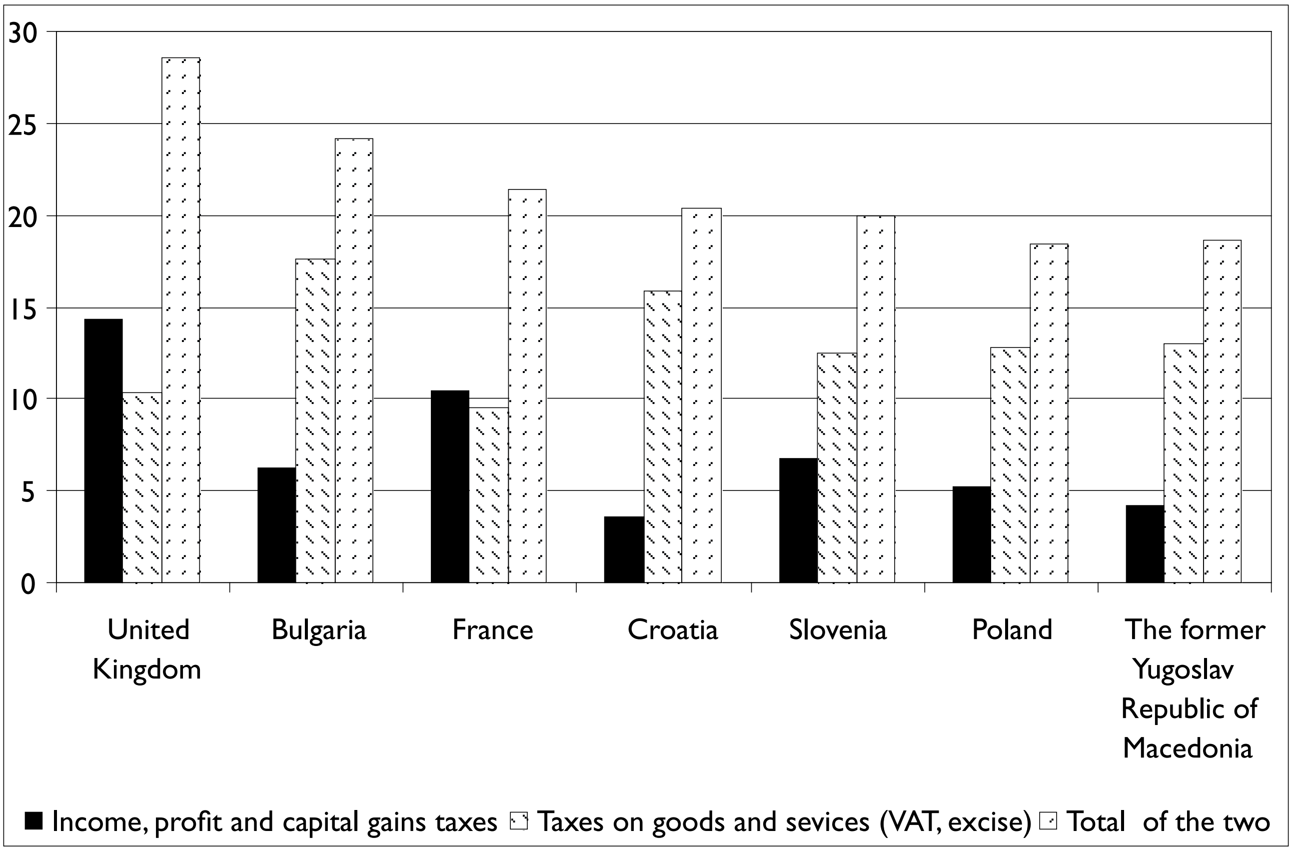
Taxes are administered by the PRO. One of its subsidiary bodies, the “Large Taxpayers Office”, handles taxpayers considered particularly important. As of January 2011, there were 257 such large taxpayers with a special status and a “golden card” granting them a number of advantages, including faster VAT refunding (see above). While a customized service can prove a useful aftercare tool, a problem with this system appears to be the lack of precise criteria for qualification. Since 2007, special offices dealing with SMEs have also been operational within the PRO. They aim at reducing the administrative burden on SMEs. An innovation currently under implementation is an electronic tax system for natural persons. In 2011, the tender for this project was in process.

3.4. Assessment and recommendations

There is no doubt that the former Yugoslav Republic of Macedonia offers a competitive fiscal regime for foreign investors and the reforms adopted in recent years to improve the tax administration point to an overall simplification effort which is certainly welcomed by the investors community. However, the combination of a low and flat personal income tax with a low corporate income tax and a generous VAT system risk generating insufficient public revenues to ensure the appropriate functioning of the public administration and the adequate provision of the essential public services. In this regard, figure II.1 shows that the former Yugoslav Republic of Macedonia has one of the lowest shares of fiscal revenue to GDP from direct taxes and the lowest fiscal revenue to GDP in the sample when considering both direct taxes and taxes on good and services.

Figure II.1. Central government tax revenues as a percentage of GDP in selected economies, 2008

(Per cent)



Source: UNCTAD’s calculations, based on data from International Monetary Fund, Government Finance Statistics Yearbook 2009.

Figure II.2. Taxation of investment in the former Yugoslav Republic of Macedonia and in comparator countries, 2010

(Present value of tax as a percentage of investors' cash flow)

Source: UNCTAD.

Note: "I" refers to investment incentives in the country used for the comparison. Annex 3 provides more details about the simulation.

Figure II.2 compares the effective tax burden in the former Yugoslav Republic of Macedonia with other countries for three sectors (consumer electronics, ICT and tourism).[56] The comparison is based on the tax system and incentives (in countries where information about incentives are available and applicable) in place in 2010 using the UNCTAD's comparative tax methodology (annex 3). The discounted present value of tax (PV Tax) is measured as a percentage of investors' cash flow (present value of tax in per cent). The higher the PV tax, the greater the tax burden on an investment.

In the three selected sectors, the burden of the standard tax regime in the former Yugoslav Republic of Macedonia is similar to that in the comparator countries. In consumer electronics, its rate is lower than that of Croatia and Serbia, and only slightly higher than that of the other South-East European countries. It is, however, more competitive than Costa Rica and Viet Nam, two other countries selected for comparison. Once the tax incentives of the TIDZs (box II.4) are also taken into consideration, the tax burden of the former Yugoslav Republic of Macedonia is greatly reduced and much lower than that of other countries, with the exception of Costa Rica. In ICT, the situation is similar, and once TIDZ incentives are considered, the tax burden of the former Yugoslav Republic of Macedonia is the lowest among these countries in comparison. In tourism, where the former Yugoslav Republic of Macedonia does not offer incentives, its tax burden (about 20 per 0cent) is very similar to that of other countries (with the exception of Bulgaria).

This analysis confirms that the tax incentives of the former Yugoslav Republic of Macedonia are very generous and raises the question of rebalancing the tax regime to ensure that the Government improves its capacity to generate sufficient public revenues.

The experience of several developing and transition countries has shown that the effectiveness of fiscal measures in attracting and retaining FDI is limited. Moreover, studies and investor surveys on the subject have consistently concluded that investors value the quality of the investment climate, including the transparency and clarity of the regulations and the effectiveness in their implementation more than any special fiscal treatment in determining their investment decisions.

The analysis of this chapter highlights how, in various key areas such as competition or SME policy, government institutions lack financial and human resources to adequately carry out their mandate. Therefore, it is recommended that the effectiveness of the regime in attracting investors and its repercussions on the capacity of the Government to generate public revenue be monitored on a regular basis. Also, if the former Yugoslav Republic of Macedonia wishes to ensure full compliance with the *acquis*, it would eventually need to reform the VAT regime. Finally, as the reforms to the overall investment climate progress and the country's attractiveness to investors increase, it might be necessary to consider increasing other sources of fiscal revenues, including reviewing both the corporate and personal income tax regimes.

4. Accounting and auditing

In the former Yugoslav Republic of Macedonia, the Law on Trading Companies requires all legal entities to prepare accounts at the end of each calendar year in accordance with national accounting rules. As part of the approximation with both the EU and other international benchmarks, international financial reporting standards (IFRSs) have been in use in the country since the beginning of 1998, although some compliance issues persist.

The Audit Law requires audit activities to be performed pursuant to international standards on auditing. Audit is statutory for all companies with more than 50 employees, and/or turnover and total assets exceeding €2 million. Audit may be performed by an audit company registered with the Central Registry or by a certified

[56] The selection of comparison countries takes into consideration regional competitors and relevant economic features of other countries that have successfully developed certain sectors and attracted FDI into those activities.

auditor operating as a sole proprietor. The licence for a certified auditor is issued by the Institute of Authorized Auditors. Audit activities are coordinated at the national level by the State Audit Office.

In 2009, a rulebook on the requirements for submitting annual accounts in electronic form was adopted, and the Department for Financial Systems in the Ministry of Finance is now sufficiently staffed to prepare instructions and properly enforce accounting and financial reporting requirements (EC, 2009). The IFRS are to be applied fully by large and medium-sized firms, banks, insurers and companies listed on the stock exchange. Other commercial entities have to keep their records in compliance with a simplified version of the IFRS adopted for SMEs. As mentioned, however, delays in translating and transposing international accounting standards including the IFRS and the accounting *acquis* have persisted. With regards to auditing, the provisions of the Directive on Statutory Audit regarding the public oversight system and the EU Transparency Directive (2004/109/EC) remain to be adopted. The transparency directive requires periodic reporting for listed companies, thereby improving the dissemination of information and enhancing investors' confidence.

While accounting and auditing standards in the former Yugoslav Republic of Macedonia are generally moving towards international compatibility and comparability benchmarks, interviews with representatives of the business sector have highlighted that local firms, especially SMEs, have difficulties with understanding and applying the new rules of accounting. For these reasons, there is a need to increase the knowledge and awareness of those companies about accounting rules and their proper application. In this respect, there is a need for a broad-based promotion of the accounting and auditing rules of the country (cf. International Council of Investors (2007): 76–77).

UNCTAD could provide technical assistance to strengthen an association of professional accountants. Once fully operational, the association could also benefit from the assistance of associations of accountants from other countries, including through mentoring arrangements. Through its capacity-building activities, UNCTAD could also support a better and more effective implementation of accounting and auditing standards, including by SMEs.

5. Customs administration

The trade policy and customs administration of the former Yugoslav Republic of Macedonia are guided by the country's membership to WTO and its EU candidate status. The SAA with the EU has had important implications for the country's international trade, and for its customs regime. The terms of the SAAs differ across signatory countries. In the case of the former Yugoslav Republic of Macedonia, its products already enjoy free access to the EU (exceptions remain for sensitive products such as wine, baby beef, sugar, fisheries and fish products, for which tariff quotas have been agreed), but the country has yet to fully open its market to the EU imports, at which time a free trade area should be in place, except for certain agricultural goods, on which quotas or duties still apply.

The former Yugoslav Republic of Macedonia is one of the Balkan countries that have signed SAAs with the EU and are members of CEFTA (box I.2).[57] CEFTA membership has resulted in the completion of a network of bilateral free trade agreements with participant countries. These agreements provide for free trade in at least 90 per cent of mutual trade. Moreover, a diagonal accumulation of origin is possible between the former Yugoslav Republic of Macedonia, the EU and Turkey, and between the former Yugoslav Republic of Macedonia, some CEFTA countries and the EU. The trade liberalization schedules with the EU and CEFTA partners on the one hand, and the maintenance of separate customs systems vis-à-vis third partners on the other, have created significant differences in the structure and level of custom duties and non-tariff barriers

[57] Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Montenegro, Romania and Serbia are also signatories of SAAs and members of CEFTA. The territory of Kosovo/UNMIK, which started the Stabilisation and Association Process Dialogue with the EU in January 2010, and the Republic of Moldova, whose links with the EU, similar to other CIS countries, are governed by the European Neighbourhood and Partnership Instrument (ENPI), are also members of CEFTA.

within each country. Integration in the form of a customs union that would provide for identical foreign trade regime towards the rest of the world is not expected to take place in the near future.

Nonetheless, since 2005, the former Yugoslav Republic of Macedonia has been a candidate for EU accession. As such, it is expected to fully prepare for EU membership. In this respect, the Customs Administration has embarked on an ambitious and demanding reform programme. A need for further assistance in the field of border controls has been identified in relation to certain aspects, one of which is the area of border control administration. For instance, the Law on Customs Tariff was harmonized with Harmonized System of the World Customs Organization and with the EU Combined Nomenclature. Customs procedures are harmonized with the *acquis,* except in the case of transit. Full harmonization with the *acquis* would require the adoption of the Convention on a Common Transit Procedure of the EU and EFTA,[58] which sets the common rules of the two organizations in this domain. This process has started with the installation of the EU's New Computerised Transit System (NCTS), a project financed by the EU.

The former Yugoslav Republic of Macedonia has also ratified the protocol amending the Kyoto International Convention on the Simplification and Harmonization of Customs Procedures,[59] which is the main source of international standardization in the area of customs procedures, and abolished a number of customs-related fees (EC, 2009). Some restrictions still exist in the form of (a) export licences for products related to the protection of environment, human health, animals and plants, historical heritage, and military equipment; and (b) measures for the protection of domestic production in case of significant increases of imported goods, dumping prices and subsidized import prices.[60] Regulations adopted by the Government on protective trade measures are in accordance with WTO rules.[61] Following the ratification of its protocol, there is also a need to implement fully the Action Plan of the Revised Kyoto Convention on the Simplification and Harmonization of Customs Procedures.

A centralized Single Window System has been introduced for the issuing of licences required for customs procedures that links 16 State agencies and allows companies to submit electronically a single request for the documents required for import, export and transit (EC, 2009: 31–32, 73). Still, further improvements are needed to ease customs procedures, e.g. by advancing computerized and paperless systems. In the World Bank's *Doing Business 2011* report (World Bank, 2010), the former Yugoslav Republic of Macedonia ranks 66th in terms of trading across borders. However, it fares better in various aspects of cross-border trade than neighbouring countries. For example, import and export procedures are shorter (11 and 12 days) than in any other country in the region, except for export procedures in Serbia (they also require 12 days). The number of documents required is also among the lowest (6). In terms of costs, it is in the middle range. As a tool for non-intrusive examination of goods, four mobile X-ray scanners of containers and large vehicles have been installed.

The customs administration also needs to foster cross-border cooperation and develop risk analysis to effectively fight illicit trade and organized crime, as these are major problems in the region (Stojarova, 2007). A more systematic analysis of risks and the exchange of experience with, and assistance from customs organizations of EU member countries could also increase the capacities of Customs Administration to detect illicit trade.

Most of the above problems need to be dealt with in the context of the new Customs Strategy of the country, to be adopted for the period 2012–2015. This strategy also needs to improve cooperation with

[58] Official Journal L 226, 13/08/1987 P. 0002 - 0117.
[59] The original convention was signed in 1973; its amendment dates 1993.
[60] According to the Law on Trade, and the following by-laws: 1) Decision on procedure and method of determining safeguard measures against increased imports (OGRM 28/2008); 2) Decision on procedure and method of determination of countervailing duty (OGRM 28/2005) and 3) Decision on procedure and method of determining anti-dumping duty (OGRM 09/2007).
[61] According to communication received from the Ministry of Economy.

the Business Advisory Body of Customs Administration, and in general strengthen its capacities. One of the administrative tasks is the full integration and management of excise duties in Customs Administration.

6. Labour

In the former Yugoslav Republic of Macedonia, the Labour Law and collective agreements are the main sources of regulation of the labour market. The country has a fairly liberal labour regime in comparison to other countries in the region – in terms of flexibility of employment (especially flexibility of hours, rules on redundancy; according to World Bank, 2009). At the same time, this legislation is mostly adjusted to the requirements of the *acquis* in terms of assuring basic labour rights.

The *Labour Law*[62] regulates the rights, obligations and responsibilities of the employee *and* employer. Their relations are generally guided by an individual employment contract, which contains description of the employee's duties, duration of the contract (finite or indefinite), effective and termination date, location of the work place, hours of work, rest and vacation periods, qualifications and training, salary and pay schedule. A new Labour Law was introduced in January 2009 which, in general, promotes a more flexible labour market by offering (a) adaptable employment contracts; (b) variable working time; (c) time limit of five years for fixed-term labour contracts; and (d) no restrictions for seasonal jobs. The changes to this law reduced minimum social contributions and introduced measures to ease the hiring of workers.

Collective agreements are the second pillar of labour market regulations. General collective agreements regulate employment rights and are concluded at the national level. Collective agreements are negotiated between the representative labour unions and the Government (the Ministry of Labour and Social Policy) for the general collective agreements for the public sector, and between the representative labour unions and representative employers association for the general collective agreements for the commercial sector. Based on these two collective agreements, industry branch and employer level collective agreements can be negotiated and signed.

The two principal trade union associations are the Council of Trade Unions of Macedonia and the Union of Independent and Autonomous Syndicates of Macedonia. Each association has independent branch unions from the public and the private sector. Membership in trade unions is voluntary and activities are financed by membership dues. Almost 75 per cent of legally employed workers are dues-paying union members. Still, the capacities of trade unions in defending workers' rights are relatively weak, and social, bipartite and tripartite dialogues work at low ebb (EC, 2009). Strikes and other trade union actions are rare. This is not necessarily due to good industrial relations but to the fact that in practice there are limits to trade union action: they have to specify the length of the strike in advance, and participants can be dismissed if a court declares the strike illegal.[63] There are also provisions of the Labour Relations Law which could be potentially misused: for example, employers can suspend strikers declared to be "violent" or showing "non-democratic" behaviour.[64]

The main rules on employment are as follows:

(a) *Working hours*. The law established that working hours are eight hours per day, five days per week;

(b) *Salaries*. As of February 2010, the average monthly gross salary was denar 29,751 (equivalent to €489). Collective agreements define a minimum salary for each professional branch, but there is no general statutory minimum wage for the private sector;

(c) *Social insurance and pensions*. At the beginning of 2009, the Law on Compulsory Social Contributions[65] introduced a unified system of gross salaries (Government of the former Yugoslav Republic of

[62] OGRM 62/2005, 106/2008, 161/2008.
[63] ITUC 2010 Annual Survey of Violations of Trade Union Rights.
[64] ITUC 2010 Annual Survey of Violations of Trade Union Rights.
[65] OGRM 142/2008.

Macedonia, 2009). Employers are obliged to calculate, withhold from employees' gross salary and pay into the accounts of respective funds the compulsory social contributions through a single window created at the PRO for this purpose. In January 2011, social contributions will be reduced by roughly one third;[66]

(d) *Other benefits*. Employees are entitled to rest and leave periods (e.g. a rest of at least 12 hours during two consecutive working days, and an annual leave between 20 and 26 working days), sick leave (21 days of sick leave paid by the employer, after which the Health Insurance Fund takes over the payment of indemnities),[67] maternity leave (nine months of continuous leave during pregnancy, birth and maternity),[68] and severance payments (due to termination of employment).[69]

No major changes are required in laws regulating employment and labour relations, as they are compatible with the *acquis* as well as the current economic situation and goals of the country. There are, however, problems with the application of existing laws and regulations, and a full respect of labour rights in practice. Trade unions need to become more efficient in defending workers' rights, and social, bipartite and tripartite dialogue on labour issues needs to be strengthened.

7. Employment and residence of foreigners

The current regime for the employment of foreign workers is restrictive. It does not allow for the attraction and diffusion of new or missing skills. Moreover, unless gradual reforms are undertaken, the level of labour market openness that will be required by the accession to the EU risks producing a shock for the local labour market.

The entry, employment and residence of foreigners are regulated by the Law on Foreigners and the Law on Employment and Work of Foreigners.[70] Foreigners willing to enter the former Yugoslav Republic of Macedonia for a short period (up to 90 days) for either tourism or business purposes need to apply for a short-stay visa (visa C) at the diplomatic outposts of the former Yugoslav Republic of Macedonia abroad. The requirements for a short-stay visa are fairly standard, with the exception of a requirement of a letter of invitation or guarantee from a Macedonian physical or legal person certified by a notary. The citizens of the EU member States and Schengen States do not require this visa, and can enter and stay up to 90 days with a valid ID card.

All foreigners who wish to work in Macedonia for a period beyond this limit – either as investors, self-employed persons or employees – need to apply for a long-stay visa (visa D) and for a temporary residence permit at the diplomatic outposts of the former Yugoslav Republic of Macedonia abroad. In parallel, foreigners must apply for a work permit either directly, if they are investors or self-employed persons, or through their prospective employers if they are employees. Three categories of work permits exist:

(a) *Personal work permits*. These are reserved for investors and self-employed persons, and are valid for one year. Their application must be accompanied by a business plan detailing the economic benefits for the former Yugoslav Republic of Macedonia, including the number of new jobs to be created. The permit is renewable year by year (or every three years under special conditions), provided that the Ministry of Economy is satisfied with the realization of the business plan;

(b) *Employment permits*. Foreign employees in the country need an employment permit. These permits are subject to a number of restrictive criteria. According to the legislation, upon applications by the employer, the authorities first verify that the foreign employment quota (5 per cent of the

[66] Pension and disability insurance from 19 to 15 per cent, the health insurance from 7.5 to 6 per cent, the unemployment insurance from 1.4 to 1 per cent. Only the additional health insurance rate with remain the same (0.5 per cent).
[67] According to the Health Insurance Law, which requires mandatory health insurance.
[68] To be financed from the Health Insurance Fund.
[69] Severance has to be paid to the employee based on his or her length of employment (one month's salary for each two years spent in work, but not exceeding twelve months' salary; see Article 130 of the Labour Law).
[70] OGRM 70/2007, 5/2009.

legally employed population) is not surpassed,[71] then apply a labour market search to make sure that there are no Macedonian workers interested in the vacant position (the law does not spell out explicitly whether qualifications of the person of the former Yugoslav Republic of Macedonia for the position should be the same as the qualifications of the foreign applicant).

The permit is granted only upon meeting these conditions and provided that the foreigner's employment does not affect negatively the economy and the employment rate (Art. 7 and 13.2). The permits are valid for a maximum of one year, and the employer willing to retain the foreign worker after the first year will need to repeat the entire application procedure without any guarantee regarding the outcome;

(c) *Work permits*. These are temporary permits with pre-determined duration for seasonal workers or other *ad hoc* categories such as trainings and work by foreign representatives. These permits follow general international standards.

Although it is mostly in line with the requirements of the *acquis*, the regime described above is not best suited for the former Yugoslav Republic of Macedonia for a number of reasons. First, while it is liberal on the entry of foreign investors and self-employed entrepreneurs, it does not make any distinction between employees in managerial posts or possessing special technical and professional skills on the one hand, and low-skilled workers on the other. This lack of differentiation may have negative implications for the attraction of skills and skilled persons required for specific FDI projects, and hence may harm the country's attractiveness to foreign investors. Second, the current conditions for the issuance and renewal of employment permits are too restrictive, discouraging employers from seeking foreign skills and leaving the employees in uncertainty about the stability of their permits. Finally, the current system does not prepare the country for its accession to the EU, which will result eventually in a full opening of the local labour market to all EU citizens. The risk is that a sharp transition from the current system might generate too much pressure on the labour market, unless transitional measures are granted to counterbalance it.

Our interviews with representatives of the business community have also highlighted problems with the procedures applicants have to follow. Investors think that these procedures are unnecessarily heavy. One of the complaints is that the requirement that applications have to be submitted by the foreigners personally to the diplomatic or consular mission of the former Yugoslav Republic of Macedonia in their home country may be too restrictive for the personnel of large TNCs that are often redeployed in different countries of the world. It also seems that there are considerable delays in the processing of applications (OECD, 2010a: 41), specifically at the Ministry of Interior, which does the security checking.

It is recommended that the regime be reformed so that skills attraction becomes an explicit objective of the country's FDI policy. At the same time, the EU accession should be an opportunity to attract talents that can contribute to the country's development. In these respect, the following reforms should be considered:

- The quota system and the labour market test could be replaced, at least for highly skilled workers, with a "scarce skills" approach. The Government would set up a predetermined list of skills where shortages exist. Local and foreign investors seeking employees with those skills would be exempted of the labour market test and of the quotas;
- An active skills attraction and diffusion programme targeting EU countries could be developed and marketed. This would build on the scarce skills list to offer EU professionals and high-skills employees in priority sectors (and their families) fast-track entry and residence permits, along with assistance in lodging and local integration;
- A number of expatriate positions could be automatically assigned to those companies that have a proven track record of local staff training and which adopt understudy schemes;
- The validity of the work and residence permit should be extended to five years and renewable

[71] The rule does not apply to persons exempted of the quota.

for the founders and directors of the foreign company, and to three years for others;

- The application and verification procedures should be reviewed to ensure efficiency and timeliness in responding to the applicants, according to the terms currently established in the law. Also, the possibility of submitting applications at missions of the former Yugoslav Republic of Macedonia in the current country of residence of the applicant should be considered.

8. Land and construction permits

Land acquisition and construction permits are regulated by the Law on Ownerships and Other Related Rights and the Law on Construction Land.[72] In the last years, this area has undergone many changes and is mostly in line with the a*cquis*, according to the EC (EC, 2009). There remain however a few areas where further improvements are desirable.

8.1. Cadastral records

The registration of real estate rights in the Real Estate Cadastre (RECA) is compulsory and is done either *ex officio* or at the request of the client. The Agency for Real Estate Cadastre registers all real estate rights.[73] The Agency is responsible for establishing, operating and maintaining the RECA, and managing the geodetic-cadastral information system. In the past few years, significant progress has been made in the area of property registration. By the end of 2010, the coverage of the RECA reached 99.5 per cent of the construction and agricultural land in the entire territory of the former Yugoslav Republic of Macedonia.[74] The electronic database of the RECA is continuously updated and available online (USAID, 2009b: 17). The time required for property registration is eight days, down from 66 days in 2008 (OECD, 2010a: 45, 302). As for foreign investors, they need to register their property purchase both in the Cadastre and the Central Registry (the Register of Investments in Immovable Property of Non-Residents in Macedonia and Residents in Macedonia; *cf.* sections B.1 and C.2.2).

While the coverage is now very high, the cadastral records and tradable titles still need to be updated in order to properly reflect the current ownership. Buyers still need to be assured that current cadastral records reflect all restitutions undertaken during denationalizations properly.

8.2. Land acquisition

Access to construction land is unrestricted to affiliates of foreign companies, which are registered in the country (i.e. subsidiaries and associate companies), and thus are considered to be nationals of the former Yugoslav Republic of Macedonia before the law. Some limitations, however, apply to "foreigners" not registered in the country (e.g. branch and representative offices) depending if they are from EU and OECD member countries or other countries. According to recent amendments to the Law on Ownership and Other Real Rights,[75] natural persons and legal entities of EU and OECD member countries enjoy equal rights with the citizens of the former Yugoslav Republic of Macedonia regarding ownership of real estate, apartments, buildings and business premises, including construction land, long-term lease of construction land, and long-term lease of agricultural land and forests. Non-EU and non-OECD residents can enjoy the same treatment under terms of reciprocity (if their country applies the same treatment to nationals of the former Yugoslav Republic of Macedonia). The application of reciprocity rights is determined by the Minister of Justice.

[72] OGRM 82/2008.
[73] OGRM 48/08 and 158/10.
[74] The World Bank is supporting the programme of reforming the RECA (World Bank, 2009, Status of Projects in Execution - FY09 SOPE, Europe and Central Asia Region, Country: Former Yugoslav Republic of Macedonia).
[75] Article 245 of the Law on Changes and Amendments to the Law on Property and Other Real Rights, OGRM 92/2008.

Foreign physical and legal persons are not allowed to own agricultural land.[76] They can sign a long-term lease for agricultural land under conditions of reciprocity, on the basis of consent by the Minister of Justice and a prior opinion of the Minister of Agriculture, Forestry and Water Economy as well as the Minister of Finance.

While there is limited discrimination of foreign investors concerning land ownership, in fact tradability of land is limited and the land market functions poorly. A modern land use policy needs to be developed so that land rights are secured and land can be used for investment within the framework of a transparent policy (World Bank, 2008: 73). The main reasons for the current weaknesses of lands ownership are small and fragmented land holdings, imperfect management of the State land and problems with construction permits (see below).

Privately-owned sites for construction are sold through direct negotiation between the buyer and the land owner. Around 80 per cent of arable land is owned by private farmers. If in State ownership, construction land is sold or leased through a public tender procedure. Minimum bidding prices are set by the Ministry of Transport and Communications in compliance with the Construction Land Price Determination Methodology.

State land is managed at the central level by the Ministry of Transport and Communications for construction land and by the Ministry of Agriculture, Forestry and Water Economy for agriculture land and forests. Municipalities are expected to obtain the responsibility for the management of State land in 2011 because decisions are expected to be taken more quickly at that level. At the same time, the capacities of municipalities in land management and zoning need to be improved significantly, so that they are able to cope with their new mandate of managing State-owned land. According to our interviews, investors are afraid that municipalities might not be able to manage these resources correctly and would re-sell them too quickly to reap short-term gains.

8.3. Construction permits

The procedure for obtaining a construction permit goes through the following steps: (a) obtaining a copy of the detailed urban plan, (b) a decision on site conditions, and (c) applying for a construction permit. The construction permit is to be issued within seven days from the date of completion of the stated documentation. In practice, however, obtaining a construction permit remains one of the most challenging aspects of the business environment in the former Yugoslav Republic of Macedonia: it takes 146 days and 21 procedures, according to the *Doing Business 2011* report (World Bank, 2010). This places the former Yugoslav Republic of Macedonia 136th in global comparison. Although the other countries of the region, with the exception of Bulgaria, are even more bureaucratic than the former Yugoslav Republic of Macedonia in this respect, the latter has to take into consideration that the current situation is still insufficient in light of the plans of becoming a globally attractive location for investors.

The creation of a single window system for land management and construction permits could be a solution (for details, see USAID, 2009b: 20). Proposals from our interviews also go in the direction of a less costly system of construction permits. Compared with the Eastern European countries' average, the former Yugoslav Republic of Macedonia has approximately the same number of procedures to get a permit, fewer days are needed, but the costs of getting the construction permit are three times as high as Eastern European countries' average, and almost 30 times higher than the OECD countries' average. The entire construction permit process involves too many institutions (including municipal authorities, the State Inspectorate for Construction and Urban Works and other organizational units in larger municipalities, and RECA) with only limited exchange of information between them (USAID, 2009b: 17–19). The applicants suffer from the lack of advice, public information and professional help.

[76] Article 246 of the same Law.

At the moment of writing this report, the Ministry of Transport and Communications and the International Finance Corporation were considering a programme for simplifying the procedures for issuing construction permits in the country. The construction permit approval process and the underlying legislation were analysed in September 2010. The review suggested ways to streamline the construction permitting process in the country to make it more efficient, transparent and business-friendly. Priority recommendations included improvement of the procedures for the acquisition of land, revision of the categorization of construction structures towards a balanced risk-based system, introduction of a modern building, reform of the communal tax (see section C.8.4), and a review of the involvement of authorities in the procedure for construction permits. The Government expects a major improvement of the construction permitting system form the adoption of these measures.

8.4. Land-related fees

Communal fees (and construction fees) are high while property taxes are low. These communal fees are charged by municipalities and in principle should cover the costs of road, water, sewage and other connections. The fees are paid by investors prior to the issuance of construction permits. In this way, the costs for these connections are borne by the new investors only, rather than being spread across the entire population, which makes them very expensive to the investors. Furthermore, in a number of cases, especially in areas which are not fully urban, investors complain about a lack of connections or too long a waiting period before being connected.[77] Finally, once the area is fully constructed, the funds received from property tax are not enough to properly maintain and upgrade the existing infrastructure (World Bank, 2006).

By keeping property tax rates low a lot of land remains idle. Also, variations in the land tax cause additional problems. Its rate can be between 2 and 4 per cent; the actual rate is determined by municipalities within this range. The variation of the rate is too high and should be reduced; the same goes for the discretionary right of municipalities to define the rate. In the neighbourhood of the former Yugoslav Republic of Macedonia, all countries but Bulgaria apply fix rates,[78] which are more transparent and easier to calculate.

9. Environment

Environmental regulation follows largely the EU *acquis*. Relevant environment-related legislation includes the Law on Environment,[79] Law on Nature Protection,[80] Law on Waste Management[81] and Law on Ambient Air Quality.[82] The Law on Environment has introduced three principles: the polluter pays (Art. 9), the user (of natural resources) pays (Art. 10) and cleaner production (Art. 15). The goal of the law is the prevention and remediation of the entire damage caused to environment, its restoration, and the introduction of measures and practices for the minimization of risks. The polluter must cover all the expenses related to prevention and remediation. Article 27 of the law also requests labelling of products and packaging for their possible negative environmental impact. According to the Law, charges paid by legal entities and natural persons that have caused environmental pollution, damaged the environment through the use of products and substances, use natural resources, load the environment with wastes, import used products in the former Yugoslav Republic of Macedonia, and produce or import products and goods that are harmful (Art. 162), have to contribute funds for the implementation of measures aimed at environmental protection and safeguarding of nature.

77 According to UNCTAD's interviews.
78 Albania: 2 per cent, Bosnia and Herzegovina: 5 per cent (with the exception of Zenica), Croatia: 5 per cent, Montenegro: 3 per cent, Serbia: 2.5 per cent, Slovenia: 2 per cent. In Bulgaria, the rate varies between 0.1 and 3 per cent.
79 OGRM 53/2005, 81/2005, 24/2007, 159/2008.
80 OGRM 67/2004, 84/2007.
81 OGRM 68/2004, 107/2007, 102/2008, 143/2009.
82 OGRM 67/2004.

In compliance with the Law on Environment, operations can be restricted by the authorities in the following cases:

- construction without licence and determined standards for protection of the environment;
- production and import of machinery and equipment that do not comply with the conditions stipulated for the emission of the mobile sources of pollution and noise; and
- release of polluting materials and substances in the environment.

In line with the EU Directives 96/61/EC and 2008/1/EC on Integrated Pollution Prevention and Control (IPPC), the Chapter XII of the Law on Environment introduces integrated environmental permits for industrial facilities considered to be significant polluters. The Chapter XIII on General Environmental Audit sets obligations for operators to carry out a general environmental audit in case of termination of activities at an installation and in case of transfer of the integrated environmental permit. The control of the installation's operations and emissions must be followed by self-monitoring and yearly inspections of State environmental inspectors.

In the field of the environment, in particular for horizontal legislation and waste management, the Government of the former Yugoslav Republic of Macedonia progressed on adjustment to the *acquis*. However, some areas, like water quality or IPPC, are still lagging behind (EC, 2009: 69–71). Implementation of the legislation also remains a considerable challenge. Administrative capacity is weak at both national and local levels. This is particularly true of the inspectorates. Environmental protection requirements are still not well integrated into policymaking and implementation in other areas. The precautionary principle, the principle of preventive action and the polluter-pays principle are only partially applied.

10. Competition policy

The former Yugoslav Republic of Macedonia has a relatively well developed competition law but an understaffed competition authority to implement it. Overall, the Law for Protection of Competition[83] provides a good basis for implementing measures to protect competition. It is aligned with the EU regulatory framework, and offers a framework for effective functioning of the Commission for Protection of Competition as the main regulatory and implementation body (USAID, 2009a). Compared with its predecessor, drafted on the basis of the German Act on Unfair Competition, the current law is better adapted to both the needs of the country and the requirements of the *acquis*. However, its by-laws need to be amended in order to follow new developments in EU competition law, for example, in the area of block exemptions.

The Commission for Protection of Competition is responsible for enforcing the Law on Protection of Competition. Despite its resource constraints, the Commission functions reasonably well in carrying out its prescribed duties in compliance with the law.[84] A credible enforcement record has been built up, in particular in the field of concentrations. However, the fight against cartels should be strengthened. It also needs to deal with an increasing number of *ex ante* State aid decisions (EC, 2009: 39).

The human and financial resources of the competition authority remain inadequate to tackle all relevant cases in an efficient manner (EC, 2009: 39). Although the Commission for the Protection of Competition has been fully established, it still has only a limited power to implement and enforce the law. The Commission should be given the power to directly enforce the law, having full political[85] and financial independence (currently being financed through the State budget), higher budget (at present only approximately €350,000) and more staff (currently only 16) (World Bank, 2008: 73). The capacity of staff should be further strengthened, particularly in their knowledge of inspection and enforcement procedures (USAID, 2009a). A capacity-building

[83] OGRM 4/2005, 70/2006, 22/2007.

[84] In 2007, the Commission reviewed 16 cases of mergers; in 2008, 29; and in 2009, 17. The number of cases related to cartels and abuse fluctuated between 2 to 3 per year.

[85] The freshly appointed Commissioners often have limited experience in competition issues. One report claims that appointments are made on political considerations and therefore the Commission is highly politicized (USAID, 2009a).

provision should be established in the budget of the Commission – according to our interviews, right now all training of staff is carried out from external (donor) resources.

11. Governance and institutional capacities

In the former Yugoslav Republic of Macedonia, as in many other countries, the quality of governance of public institutions in terms of delivering justice and enforcing contracts, ensuring proper functioning and efficiency of the public administration (e.g. through transparent processes), and the effective participation to decision making through democratic means have a major impact on investors' decisions. At the same time, investors also need to manage their business in accordance with international standards (through corporate governance, including corporate social responsibility). This section analyses these selected aspects of governance.

11.1. Commercial justice

In recent years, the former Yugoslav Republic of Macedonia has made significant progress in the area of commercial justice (EC, 2009: 58f; and USAID, 2009a: 10). However, despite these improvements, commercial justice remains weak aspects of the country's governance. In 2011, enforcing contracts was one of the rare aspects where the former Yugoslav Republic of Macedonia ranked lower (65th) than its general ranking (38th) and also lost two ranks vis-à-vis 2010 in the World Bank's *Doing Business* reports (World Bank, 2009 and 2010). This relative weakness is shared with other countries in the region, with the exception of the cost of justice where the other countries fare better. The average number of procedures required in the former Yugoslav Republic of Macedonia was 37, more or less the same as in other South-East European countries.[86] It, however, takes about 370 days to enforce contracts, a period shorter than in other countries of the subregion.[87] In turn, the cost of justice amounts to 33.1 per cent of the claim, which compares unfavourably with other countries of the subregion, except Albania and Bosnia and Herzegovina.

The judiciary still suffers from a perceived lack of independence (political pressures) and low efficiency (International Council of Investors, 2007, and the 2011 *Index of Economic Freedom* of the Heritage Foundation). The limited efficiency of courts reflects long delays, slow and long procedures, insufficient impartiality of the judiciary, and poor performing courts within Skopje compared with those outside its jurisdiction. They are the most frequently mentioned problems by investors and experts (USAID, 2009a; EC, 2009). This is so despite recent improvements, especially related to new cases filed with courts. According to the data of the Ministry of Justice, 24,577 cases were filed in 2010 in the 12 courts with extended jurisdiction, of which 9,678 (31 per cent) remained pending at the end of the year. This was an improvement from 2009, when 42 per cent remained pending at the end of the year, which was also an improvement from 46 per cent in 2008.

The Pre-Accession Economic Programme 2009–2011 (Government of the former Yugoslav Republic of Macedonia, 2009: 99–100, 108) presented a number of initiatives aiming at strengthening the independence and the capacity of the judicial system. These include: improving the court infrastructure, establishing IT systems in the judicial institutions, improving the enforcement of court cases, and establishing an efficient system to deliver court summons. These initiatives need to be implemented as soon as possible. In addition, to improve the efficiency of commercial justice, it is recommended that specialized commercial judges be trained in the country.[88]

[86] In Albania 39, 38 in Bosnia and Herzegovina, 39 in Bulgaria, 38 in Croatia, 36 in Serbia. Montenegro is an outlier with 49 procedures.
[87] In other South-East European countries, it is over 500 days, with the exception of Albania, where it is 390.
[88] They can work either in specialized commercial departments of basic courts with extended jurisdiction, or at commercial courts, depending on the decision of the Government.

11.2. Transparency

Corruption is still a significant problem in the former Yugoslav Republic of Macedonia, despite progress in the institutional setting and adoption of most of the necessary laws for combating it. In 2010, Transparency International ranked the former Yugoslav Republic of Macedonia 62nd among 180 countries compared to 103rd among 159 countries in 2005. UNCTAD's interviews with the business community also confirmed that corruption is a major problem and that the fight against it needs to be reinforced.

The former Yugoslav Republic of Macedonia has signed the OECD Convention on Combating Bribery, ratified the United Nations Convention against Corruption in early 2007, and the United Nations Convention against Transnational Organized Crime. The OECD Convention on Combating Bribery of Foreign Officials (entered into force on 15 February 1999) remains to be signed. A series of laws has also been adopted or amended to control crimes. In addition to the criminal code, other major anti-corruption legislation includes the Law on Money Laundering Prevention and the Law on Corruption Prevention. In 2002, an independent State Commission for Prevention of Corruption was established, which adopts and monitors the implementation of the State Programme for Prevention and Repression of Corruption and the State Programme for Prevention and Reduction of Conflict of Interests. This commission is accountable to the Parliament.

In practice, progress has been made in the fight against corruption through prosecution of high-level cases, strengthening of the legal framework, notably through the adoption of the amended Law on Financing Political Parties, and enhancing the capacity of anti-corruption institutions. Although most of the necessary laws are in place, enforcement is to be strengthened, and the Government needs to show more forcefully its commitment to prosecute corrupt officials. In general, the number of cases brought to prosecution remains low and the process is slow. A very important step undertaken was the establishment of a specialized anti-corruption unit operating within the main office of the Public Prosecutor (Basic Prosecutor's office for organized crime and corruption). However, the unit needs to be strengthened and the Public Prosecutor's offices need more staff (EC, 2009).

A more transparent functioning of public administration in areas where it interacts with the private sector is also desirable. In this regard, the Government has amended the Law on Public Procurement and established new institutions to deal with these issues, including the Public Procurement Bureau and the State Appeals Commission. While the general principles of public procurement are well regulated, problems remain. For example, the Law on Public Procurement could make better use of the flexibility permitted under the *acquis* for the arrangements on utilities. Also, there are no statistics on corruption cases related to public procurement handled by the courts, and the general level of awareness as regards conflicts of interest remains too low. The fact that several major tenders have been cancelled or failed is a reflection of these problems.

11.3. Government policies conducive to corporate social responsibility

In recent years, the Government has taken some steps to improve the level of corporate social responsibility (CSR). However, investors still lack information and relevant practical tools to implement CSR in business strategy and day-to-day operations. To remedy this situation and to ensure the approximation of practices of the former Yugoslav Republic of Macedonia with the EU, the Ministry of Economy established in 2007 a National Coordinating Body on CSR that became operational soon afterwards. By adopting the National CSR policy document for the period 2008–2012, the former Yugoslav Republic of Macedonia is the third country in Europe, after Denmark and Lithuania, that has adopted such a document.

The CSR policy document builds on the principles of the United Nations Global Compact, the United Nations Principles for Responsible Investment and the OECD Guidelines for Multinational Enterprises. It has three main aims: raising awareness, developing capacities and competences to mainstream CSR in business, and creating an enabling environment for CSR. The implementation of the national agenda in this field is very challenging. While foreign investors may have more international experience with CSR and thus for them the implementation of its principles may be less difficult, many other businesses, especially SMEs, need significant training in this area. The Government has an ambitious action plan in this field, including the introduction and promotion of environmental and social labelling, and the creation of the obligation of CSR reporting for all State-owned entities, including State-owned firms.

11.4. Public-private partnerships

Public-private partnerships (PPPs) are at a nascent stage in the country as is the case for several countries in the region. International experience has shown that PPPs can become an effective tool for governments to finance and manage infrastructure and to deliver public services when limited budgetary resources are available (ECE, 2008). In the former Yugoslav Republic of Macedonia, a Law on Concessions and Public-Private Partnerships[89] was adopted in 2007, leading to the creation of a Public-Private Partnership Unit within the Ministry of Economy. The Law mostly follows the procedures suggested by the EC and the Directive 2004/18/EC of the European Parliament and the Council to award public contracts, including work, supply and services. However, it is not yet fully aligned to the *acquis*, as it does not make a clear distinction between the different forms of PPP (Georgievski, 2009: 162),[90] and the country's sector-specific legislation largely takes precedence over it. This poses a problem because in some cases the Law on PPP and the sector-specific ones are inconsistent which lead to ambiguities (Georgievski, 2009: 172). Moreover, there is insufficient progress with the adoption of secondary legislation or guidance on how to prepare and deliver a PPP due to a lack of expertise in the country (Sigma, 2009). A new draft version of the PPP Law, which aims at aligning it to the *acquis* by making the distinction between different forms of PPP and eliminating the inconsistencies with sector-specific laws, is under parliamentary procedure.

To enhance the delivery of public services through an effective functioning of public procurement and the use of public-private partnerships will therefore require to further improve the regulatory framework and the process to award contracts, and to strengthen the administrative capacities through increased human and financial resources as well as training.

12. Protection of intellectual property

The protection of intellectual property (IP) rights has a developed legal framework. These include the Law on Industrial Property,[91] and the Law on Copyright and Related Rights[92]. These two laws are mostly in accordance with relevant EU directives and relevant international conventions.[93] The former Yugoslav Republic of Macedonia is a member of World Intellectual Property Organization (WIPO) and of all the relevant WIPO agreements. It is also signatory to the WTO TRIPS agreement, and in 2009 became a member of the European Patent Organization and ratified the European Patent Convention.

The institutional responsibility for IP rights related issues is divided between the Ministry of Culture and the State Office of Industrial Property (SOIP). The Sector for Copyright and Related Rights within the Ministry of Culture is responsible for the implementation of copyrights and other related rights, including the supervision over the work of the agencies dealing with the management of rights, while the SOIP deals with industrial property rights. IP enforcement institutions include the Customs Administration, the Ministry of Interior and the State Market Inspectorate. In 2007, the Government established the Coordinative Body for Intellectual Property Rights (CBIP) to reduce IP rights infringements, especially counterfeiting and piracy. The CBIP ensures co-ordinated approaches to IP policy development and enforcement.

[89] OGRM19/2004, OGRM 136/2007.

[90] Concessions where authorities grant the concessionaire the right to use particular public goods only (e.g. mineral resources, water, a highway); public works concessions; and public service concessions.

[91] OGRM 21/2009.

[92] OGRM 115/2010.

[93] Paris Convention, Berne Convention, Madrid Agreement, Hague Agreement, Nice Agreement, Lisbon Agreement, Rome Convention, Locarno Agreement, PCT, Vienna Agreement, Budapest Treaty, Brussels Convention, Singapore Treaty, Patent Law Treaty, WIPO Copyright Treaty, WIPO Performances and Phonograms Treaty.

In spite of a sound regulatory framework, various investors – particularly those from the IT industry, broadcasters, TV and movie producers and publishers – complain that their products marketed in the country are often subject to IP rights infringements. Estimated software piracy decreased marginally from 70 in 2005 to 68 per cent in 2008 (OECD, 2010a: 302). To address these issues effectively, there is need to improve the implementation and enforcement of IP laws. In this regard, the Government has taken actions to combat piracy of items such as compact discs, DVDs, and software, with partial results. Between 2005 and 2008, the Ministry of Interior and the Public Prosecutor's Office, as enforcement bodies, initiated criminal cases before courts. Possible measures as pointed out during the interviews include strengthening of implementation institutions, training of inspectors and judges and awareness raising campaigns about IP rights issues.

Furthermore, the need for relevant and consistent data on court proceedings against IP right infringements has led to the adoption of a methodology on collecting and processing statistical data, whose preparation is in progress in 2011. In some cases of infringement of IP rights, no action has been taken. Often this is due to insufficient personnel capacities and/or lack of knowledge on the part of the implementing and enforcing institutions involved. On the other hand, the Customs Administration, and to some extent the Coordinative Body for Protection for Intellectual Property, have struggled – in most cases successfully – to fight against IP rights infringements.

Addressing those issues will be critical to achieving the Government's investment attraction objectives, particularly as regards innovation-oriented investors.

D. Assessment

The business environment of the former Yugoslav Republic of Macedonia has improved significantly since 2007. The country has been seen as one of the fast–reforming countries of the world, quickly approaching the criteria for membership in key organizations it would like to join (EU, NATO). The former Yugoslav Republic of Macedonia has also made progress with adopting the *acquis*, in line with its status of candidate for EU accession and in recent years, modern legislation has been adopted in several domains, including company registration, labour, environment, customs, intellectual property and competition. At this stage, the main aim of the Government should be the consolidation and effective implementation of the recently adopted laws after a long period of fast reforms, and limit in as much as possible the multiplication of new laws.

The specific FDI regulatory framework is in general well advanced and up to the expectations of investors. Nevertheless, this report encourages the country to move to Phase II of the SAA process, and to enlarge its BIT network.

The general regulatory framework of the country has improved significantly in recent times. Only a few regulatory constraints persist, for example in the areas of construction permitting or employment of foreign workers. The key bottlenecks to business development are seldom of regulatory nature but to deficiencies in the implementation of the existing regulations and to the institutional weakness of the responsible government agencies. This situation is detrimental not only in terms of investment attraction but also with respect to the adequate protection of public interest in important areas such as environmental protection, competition or labour rights.

This report argues that, with a well-targeted effort, the country can achieve regulatory excellence and therefore further improve its business framework. To this end, it calls for a strengthening of the institutional capacity of several government agencies. In this respect, while it is recognized that the current tax system is attractive to foreign investors, a reflection is necessary regarding its capacity to generate sufficient revenues to the Government to ensure that the public institutions have the necessary means to carry out their mandate and implement the existing legislation. Worldwide experience has shown that a good overall investment climate is a far better long-term determinant of investment attraction and private sector development than heavily competitive fiscal policies which make up for the inadequacies of the investment climate and risk leading to a "race to the bottom" approach.

The former Yugoslav Republic of Macedonia has also made good progress with the adoption of the *acquis*. This is very important for a small landlocked country in the Balkans whose attraction for potential investors may lie in its access to the large EU market. It is recommended that the former Yugoslav Republic of Macedonia adopt a more strategic approach to the regulatory and institutional reforms called for by its accession process to the EU. The key is to find the right balance in reforming the current environment, adopting a simplified regulatory approach and conforming with EU norms, at a pace and in a manner which are compatible with the country's overall development objectives. In this respect, the process of accession should be considered a strategic opportunity to strengthen institutional capacity with the assistance of the EU partners. This is possible as the success of EU countries with lighter regulations such as the Baltic States proves.

III. DESIGNING A NEW PROGRAMME FOR STIMULATING INVESTMENT

A. Introduction

At the specific request of the Government, this chapter presents strategic inputs for a programme to stimulate investment that the Government of the former Yugoslav Republic of Macedonia will implement during the period 2011–2014. Based on the findings of chapter II on the business climate, combined with a detailed process of consultations with relevant stakeholders, and building on the priorities of the Government, the programme proposes an overall strategic approach to stimulate investment, accompanied by a number of specific actions to be implemented either within the period 2011–2014 or beyond, depending on the priorities of the Government.

The general vision of the Government is to create an environment conducive to sustainable economic growth and development leading to the modernization of the economy. The improvement of the business environment with the aim of promoting investment, both domestic and foreign, is particularly important in that context. Prosperous business is central to creating jobs, developing technology, enhancing skills and reducing poverty. Furthermore, in this modernization process, all actors are important and have a complementary role to play. For example, while SMEs are key to job creation, they often lack technology and skills. In this regard, foreign investors can have significant impact in terms of technology and skills transfer, which may lead, if accompanied by effective linkages to the local economy, to a more dynamic SME sector. The recommendations presented in this chapter for a new programme leverages this complementarity and fosters synergies with other government programmes, including on issues related to industrial policy, competitiveness, trade, transportation and environmental protection, to mention a few.

The proposed inputs to the "*Programme for Stimulating Investment in the Republic of Macedonia 2011–2014*" take into account the fact that the country has, over the past decade and especially during 2007–2010, achieved commendable results in improving the business environment through regulatory reforms and new legislation. Consequently, the Government should seize the opportunity, through the new programme, to consolidate the reforms undertaken in previous periods and strengthen its capacity to effectively implement the newly adopted or modernized laws. Furthermore, the programme should fully take into account the fact that the former Yugoslav Republic of Macedonia is a candidate country to the EU, and also needs to further harmonize its legal framework with that of the EU. Finally, the successful implementation of the programme will require the continued commitment and support of the Government, including the provision of sufficient human and financial resources.

The following sections present a brief overview of the results achieved through the past programmes (Section B) and then elaborate on the possible structure of the new programme for 2011–2014 (Section C). The inputs to the programme proposed by this report highlight the need for an integrated policy approach to competitiveness, investment and industrial development, and identify a number of areas where policy action is required to foster greater impact for FDI, such as linkages, SME development, clusters and institutional framework responsible for investment promotion. Recommendations to guide policy action in these areas is summarized in annex 4, which presents the UNCTAD input to the new programme for stimulating investment, in the form of a detailed matrix comprising the specific short-, medium- and long-term actions to be implemented either during the next programming period (2011–2014) or subsequently, as required.

B. Assessing the implementation of past programmes

The "*Programme for Stimulating Investment in the Republic of Macedonia 2011–2014*" is the fourth in a series of programmes started in 1999. They all aimed at increasing the country's attractiveness for domestic and foreign investments by improving the general business and investment climate.[94]

The preparation of the past programmes was based on widespread consultations. The 2007–2010 programme, for instance, was developed with inputs from over 50 State agencies, international organizations and representatives of the business community. The common objective of all programmes for stimulating investment was the simplification of the investment and business environments. Within that context, the 2007–2010 programme focused in particular on the advancement of the former Yugoslav Republic of Macedonia in international rankings, such as the World Bank's "Doing Business Index", the "Economic Freedom Index" of the Heritage Foundation and the "Competitiveness Index" of the World Economic Forum.

In order to achieve their objectives, each programme identified a matrix of reforms and initiatives, grouped around priority areas. The 2007–2010 programme covered policy areas such as investment, competition, tax, trade as well as anti-corruption and business integrity, among others. If and when another connected government programme existed, such as SME-specific development strategies, these were left outside the programme for stimulating investment in order to avoid duplication. In this regard, investment issues were treated in part separately from broader competitiveness considerations or industrial policymaking.

The programmes have been very successful in introducing a number of significant regulatory and institutional reforms, which have led to an improvement in the country's international rankings, thus achieving this particular objective. The recent reform of the tax regime, the streamlining of business registration and the introduction of the new legislation in the areas of labour, environment and competition are all examples of key achievements of the past programmes, as discussed in chapter II of this report.

However, monitoring and assessing the progress made through the past programmes has proved challenging. The Government has usually reported a good implementation rate. For instance, according to the 2010 Annual Report, the Government estimated that 96 per cent of the measures (159) contained in the 2007–2010 programme have been fully (137) or partially (22) implemented. Nonetheless, progress reports are not always straightforward and implementation statistics are difficult to find or verify. The monitoring role is assigned to the Ministry of Economy, in collaboration with other relevant ministries and State bodies. The Ministry, however, has had limited leverage over other government agencies in convincing them to carry out all recommendations and to provide the information necessary for the monitoring and follow-up of the programmes. As a result, while official reporting is not limited to the actions implemented directly by the Ministry of Economy, it can be difficult to obtain information from some public institutions.

Another difficulty in assessing the past programmes for stimulating investment is related to the fact that the programmes' objectives are not static. They can be reviewed and updated annually, to include or remove measures based on the evolving policy experience, such as to reflect a changing economic environment or the lessons learned through the implementation of other measures. A case in point is the 2007–2010 programme that called for a review of the loss carry forward provision with a view to extending it beyond three years. In 2009, however, this provision was eliminated to compensate for the introduction of a lower corporate tax rate.

Finally, the Government recognizes that the implementation of a large number of the intended measures is only part of the picture. Experience suggests that it takes time for some of the implemented measures to achieve the desired effect. Furthermore, while many new laws and regulations have been adopted, their

[94] . The first "Programme of the Republic of Macedonia for Stimulating Investments with a Special Emphasis on Attracting FDI" covered the period 1999–2002; the second "Programme for Stimulating Investment in the Republic of Macedonia" was adopted for the period 2003–2006, and the third programme, under the same name, for 2007–2010.

full impact will be felt only if and when they are effectively implemented. Many regulatory changes are not complete unless they are accompanied by the by-laws needed for their implementation or by the creation of the relevant institutional setting. In this regard, a number of issues have been raised, notably in chapter II, on the need to further strengthen the capacity of many public institutions, both in terms of financial and human resources.

The need to consolidate the reforms introduced so far can be an opportunity to strengthen and systematize the overall strategy to stimulate investment. Attracting FDI is not a goal *per se* and broader development gains should be taken into account when designing a strategy to stimulate investment. In this regard, the Government should examine carefully the degree to which past reforms have successfully contributed to attracting FDI and benefiting from it for the development of the country. Such an approach should form the basis to assess how areas of slow progress can be improved through a strategic approach which focuses more on the internal development needs of the country than on issues such as international rankings. The exercise involves addressing issues such as determining what types of investors the country would like to attract and in which sectors, and what kind of benefits it would like to extract for the local economy. All these elements form the basis of the proposed new programme for stimulating investment.

C. Developing a new programme for stimulating investment

The "*Programme for Stimulating Investment in the Republic of Macedonia 2011–2014*" starts at a major juncture of the economic development of the former Yugoslav Republic of Macedonia. The country has made significant progress in improving its business environment and in adjusting national regulations to the *acquis communautaire*. As mentioned in the previous section, the time is ripe to strengthen and consolidate those results by ensuring that recent reforms are effectively implemented. This IPR also recommends that, as part of a strategic approach to policymaking in the area of investment, the 2011–2014 Programme presents an integrated approach to the issues related to investment, competitiveness and industrial policy.

It is particularly important that the "*Programme for Stimulating Investment in the Republic of Macedonia 2011–2014*" be well integrated with the other efforts towards improving competitiveness, including the action plans prepared in this area. The Competitiveness Action Plan for 2010 was prepared by the Government, including all relevant ministries, and contained about 330 measures. These measures are currently being implemented by the Government and the chambers of commerce (activities related to the Global Competitiveness Index). The assessment of the implementation of this plan will be done by the Government in cooperation with the National Entrepreneurship and Competitiveness Council (NECC; see also section C.3.1).[95] In addition, the Centre for Economic Analyses (CEA), in collaboration with USAID, is preparing a National Competitiveness Report 2010, which should indicate weaknesses and make recommendations to improve the competitive position of the country. Based on this report and information on progress with the Action Plan for 2010, specific recommendations will be prepared for the five-year period 2011–2015.[96]

Improved overall competitiveness of the national economy leads to increased attractiveness for FDI and the benefits derived from it. Competitiveness also directly impacts on the type of investment that a country can attract (box III.1). In the past 20 years, the nature of cross-border business has changed fundamentally. TNCs in many industries seek competitive advantages by dispersing activities in the supply chains of their products and services around the globe where each activity can be performed cost effectively, and where product quality can be increased. Consequently, successful countries are those that can host efficient segments of global supply chains (UNCTAD, 2009a). Against this background, an effective FDI strategy should have the long-term goal of helping to position the country to participate successfully in the opportunities that this

[95] Established in 2004, the NECC aims at a dialogue between the private, civil and public sectors in various areas to improve economic prosperity in the country, including identifying and eliminating obstacles to the development of the private sector, advocating policy changes crucial to economic growth, raising awareness about the importance of entrepreneurship and competitiveness, developing strategies for the promotion of competitiveness, productivity and entrepreneurship, analysing the country's economic policy against international benchmarks, and helping to build a "culture of competitiveness" in the private and public sectors.

[96] The reactivation of the NECC, and capacity building for its sustainability, will cost denar 6 million ($135 thousand) in 2011.

Box III.1. Policy lessons from Estonia's FDI attractiveness

The former Yugoslav Republic of Macedonia is one of the 67 small developing and transition economies of the world (defined as countries with a population of less than 3 million) which can benefit from the lessons in small developed countries such as Estonia. This case is particularly interesting because Estonia was a country in transition, which became a high-income economy only in the 2000s. Moreover, it joined the EU in 2004, a path the former Yugoslav Republic of Macedonia wishes to follow in the future.

Although Estonia's population (1.3 million) is smaller than that of the former Yugoslav Republic of Macedonia (2 million), its average FDI inflows over the period 2001–2009 were more than four times larger ($1.5 billion, as compared with $339 million in the former Yugoslav Republic of Macedonia). Estonia has been a magnet for FDI, thanks to its EU membership, and also to its open FDI policy and favourable business climate. Nevertheless, and as a majority of countries in the world, its FDI inflows were affected by the 2008–2009 crisis.

After Estonia's separation from the Soviet Union in 1991, FDI attraction became an integral component of a liberal free market approach implemented over a very short period of time. Equal treatment of foreign and domestic investors and unrestricted repatriation of profits have been overarching principles in the Estonian policy since independence. Foreign investors are free to invest in any area of business open to the private sector and take up to 100 per cent ownership. Since 2001, this and other business establishment measures have been dealt with through the Commercial Code (adopted in 1995). Current exceptions to national treatment relate only to real estate.

Estonia's policy efforts are characterized by maintaining a regulatory environment to protect the public interest, while remaining conducive to business. Its key features include (a) observance of private property rights and intellectual property rights; (b) independent judiciary; (c) regulations and penalties to combat corruption; and (d) transparent policies to foster competition. Since 2001, Estonia's competition law has been harmonized with the EU legislation, and a well-staffed Competition Authority oversees regulated industries. A Financial Services Authority was also established under the auspices of the Central Bank to undertake financial supervision on behalf of, but independent of, the Government.

Unlike most other Central and East European countries, Estonia has not offered any incentives specific to foreign investors. In 2000, however, a new tax regime was introduced which applies zero corporate taxation until profits are distributed (either in the form of dividends or as an addition to reserves). Upon distribution, the underlying profits are taxed at 21 per cent. This provision offers a stimulus to investment and capital accumulation, and accounts for the large share of retained earnings in total FDI inflows. There are also four customs-free zones near Estonian ports and inland, with duty-free status for imports and re-exports. Most of these zones will lose their duty-free status beyond March 2011 as a result of EU membership.

Source: UNCTAD (2011).

international landscape presents (especially with its main trading and investment partners from the EU). FDI attraction activities carried out by the Minister without Portfolio and the Agency for Foreign Investments and Export Promotion (commonly called Invest Macedonia) to a large extent take into consideration these opportunities. However, industrial policy should be strengthened in order to maximize the positive impact of FDI on the local economy. A well-structured industrial policy can strengthen local absorptive capacity and enable local economic actors, SMEs in particular, to maximize the benefits derived from the presence of TNCs. For instance, TNCs have an interest in assisting potential and existing local suppliers in enhancing their production processes to benefit from cost efficiency along the supply chains (UNCTAD, 2001; UNCTAD, 2009b). In this respect, a well-designed supplier linkages programme can help SMEs reach the needed level of absorptive capacity and encourage TNCs to source locally.

Given the country's location and its ambition to leverage its opportunities through joining the EU, progress with such accession is key for the success of the "*Programme for Stimulating Investment in the Republic of Macedonia 2011–2014*". It would (a) anchor and operationalize economic reforms; (b) further increase the attractiveness of the country to the business community that, according to our interviews, unequivocally supports EU accession; and (c) consolidate its integration into one of the largest and richest markets of the world. As discussed in other sections of this report, the key issue for the Government, in respect to the EU accession process, is to apply the *acquis* without overstretching its institutional and financial capabilities, and to ensure that the adoption of new laws and regulations does not generate duplication and overlaps with existing laws, at the expenses of legal stability.

Based on the above considerations and in response to a request by the Government, this report proposes a number of strategic inputs to the programme for stimulating investment 2011–2014, structured around five main axes, which are discussed in the following sections:

1. Achieving global excellence in the investment framework;
2. Creating synergies between FDI and industrial policy;
3. Strengthening policymaking in the area of investment and competitiveness;
4. Rationalizing the investment promotion effort;
5. Ensuring effective policy implementation.

1. Achieving global excellence in the investment framework

Chapter II of this report has illustrated that in recent years, modern legislation has been adopted in several domains of the regulatory framework of the former Yugoslav Republic of Macedonia, including company registration, labour, environment, customs, intellectual property and competition. These reforms have a direct bearing on the ease and cost of doing business in the country and its levels of competitiveness. Chapter II, however, also provided various recommendations to address remaining regulatory constraints (such as in the area of construction permitting and entry of foreign labour and further improve the business environment and the competitiveness of the productive sectors of the former Yugoslav Republic of Macedonia). It also stressed the need to consolidate and implement recent reforms by adopting the necessary by-laws and regulations and strengthening the institutions in charge of their implementation in important areas such as environmental protection, competition and labour rights. Chapter II has also stressed the need to continue the task of eliminating the unnecessary duplication of laws, especially through the mechanisms of regulatory guillotine. These and other relevant recommendations are not repeated here, but will be summarized in the matrix at the end of this chapter.

2. Creating synergies between FDI and industrial policy

Aside from measures that enhance the overall investment climate, the Government should also consider, within the programme for stimulating investment, those elements of FDI policy that are in line with industrial policy, whose implementation can create synergies between the two policy areas and help reap the benefits from FDI in terms of employment, innovation and integration of the local productive sector in the international value chains of foreign investors. In this respect, it should consider initiatives aimed at upgrading SMEs, developing clusters and transforming the TIDZ. The success of these initiatives should be measured in terms of increased innovation and export activity by the local SMEs and the successful creation of business linkages with TNCs.

When devising industrial policy, it is important to take into account the lessons learned in both developed and developing countries over the past century. Industrial policy can be a powerful development tool, but it can also have detrimental effects on long-term competitiveness. This is the case, for instance, when the support granted to certain sectors of the economy by the State is not based on their potential to produce competitive market players, but rather on short-sighted political gains or naïve development objectives disconnected from sound economic analysis.

Although there is no one-size-fits-all recipe to ensure the success of industrial policy, a number of factors can help make it effective. In particular, (a) industrial policy should be anchored on a long-term development vision of the country, based on well-researched and achievable targets and effective public-private dialogue, so that the Government fully understands the challenges faced by the private sector and how to address them; (b) it should balance the support provided to certain sectors and economic agents with the need to expose them to competitive pressure, allowing them to fail if they do not perform and providing support if they do perform; and finally (c) it should carefully gauge the need for fiscal and financial incentives against other types of non-monetary support. When resorting to incentives, it is essential to ensure that sound mechanisms are in place to assess and monitor their effectiveness for a transparent and accountable use of public resources.

Judged against the criteria discussed above, the "*Industrial Policy of the Republic of Macedonia 2009–2020*" (Government of the former Yugoslav Republic of Macedonia, Ministry of Economy, 2009) is a balanced document which provides the basic guidelines for the long-term economic development of the country. It was prepared in a participatory process between the public and private sector, and it is based on a thorough analysis of the current competitiveness of the industry of the former Yugoslav Republic of Macedonia, as well as its future challenges. The long-term vision of the industrial policy is the orientation of the industry of the former Yugoslav Republic of Macedonia towards higher value added products and services, based on knowledge, innovation and collaboration. FDI attraction is recognized as one of the five strategic objectives that will contribute to achieving this vision.[97] In particular, the need to stimulate the internationalization of local SMEs through their interaction and supply chain partnership with TNCs is highlighted. The following sections provide a number of recommendations to translate these objectives into concrete policy measures.

Empowering SMEs

SMEs play a fundamental role in economic development. In most developed countries, they account for more than 50 per cent of both GDP and employment. The former Yugoslav Republic of Macedonia is no exception, and although unemployment and poverty levels are high, SMEs make up the vast majority of enterprises and are an important source of employment and output. SMEs are also one of the key channels for extracting development benefits from FDI. A vibrant local SME sector is generally an asset for investors looking to outsource part of their production process. At the same time, the level of competitiveness and sophistication of the local SME sector is one of the key factors that determine the type of supplier linkages that emerge between SMEs and TNCs. When the SME sector is weak, supplier linkages are typically limited to the provision of packaging and other basic inputs. In the presence of a dynamic SME sector, however, FDI can be a critical channel to promote the insertion of local companies in international production networks.

In the former Yugoslav Republic of Macedonia, national policy guiding their development has had disappointing results thus far. While the country has good strategic plans, such as the "*Strategy for SMEs Development 2002–2013*", the "*Programme for Development of Entrepreneurship, Competitiveness and Innovation of SMEs 2007–2010*" and the "*Industrial Policy of the Republic of Macedonia 2009–2020*" (Government of the former Yugoslav Republic of Macedonia, Ministry of Economy, 2009), it is clear that the public entities responsible for the implementation of SME policy, not least the Agency for the Support of Entrepreneurship

[97] The other four are "Applicable research, development and innovations", "Eco-friendly products and services for sustainable development", "Development of SMEs and entrepreneurship", and "Cooperation in clusters and networks".

and the Regional Business Support Centres, do not have the resources to fully carry out their mandates in terms of supporting financially and through technical support.

Microenterprises and SMEs are running their business with high risks and are more susceptible to revenue volatility; they are also more likely to run into debt due to the lack of equity capital. Therefore, the Government should reinforce its effort to promote access to finance, such as microfinance in the country, following the measures set-out in the Industrial Policy and SME Programme. The introduction of new financial instruments designed for SMEs (e.g. start-up capital, guarantees etc.) and public partnership with financial institutions to inject venture capital into enterprises should be considered, including the active involvement of the Macedonian Bank for Development Promotion.

Other important obstacles to SME development include the scarcity of skills, especially in entrepreneurship education and the availability of ready-to-use industrial sites.[98] In order to address the skills shortage, the Government should do more to support vocational education and triangulate with the educational system and the business sector to ensure that the former is aligned to the labour market needs. Furthermore, it should consider supporting small business by providing training in entrepreneurial skills, basic accounting and managing so that they are able to start their own business. In this respect, the establishment of institutions such as UNCTAD's Empretec programme (box III.2) – which supports the development of micro, small and medium-sized enterprises through training and other business development services – should be explored. Finally, the lack of readily available industrial sites appears to be a problem that domestic SMEs encounter as much as foreign investors. The onerous process of leasing industrial and commercial land should be simplified (see chapter II).

Box III.2. UNCTAD's Empretec programme

UNCTAD's Empretec programme (the abbreviation stands for "*emprendedores*" (entrepreneurs) and "*tecnología*" (technology)) aims at inspiring entrepreneurs in developing and transition economies to start, grow and develop their businesses. The main beneficiaries are aspiring entrepreneurs, women entrepreneurs, small businesses, young people and employees of large public or private firms.

The Empretec programme is implemented through its national centres, which are currently operational in 32 countries, mainly in Africa and Latin America, but also in Romania and Jordan. Since its creation in 1988, Empretec has successfully trained over 200,000 people – helping to found or expand businesses, and creating thousands of jobs in the process.

The Empretec programme identifies and reinforces personal opportunities through a process of self-assessment. Participants in the training workshops develop clear ideas about what they want to do with their businesses in the short and the long term. With these goals in focus, Empretec helps entrepreneurs to improve the results of their businesses.

In Romania, the first transition economy to implement such a programme, the Government has incorporated Empretec into its national strategy for the development of SMEs. There are 11 regional centres throughout the country. The number of entrepreneurship development workshops held reached 48 by 2010, while the number of certified participants reached almost 920. Twelve national trainees (assistant trainers) are being trained to become national Empretec trainers.

Source: UNCTAD.

[98] An USAID survey of companies of the former Yugoslav Republic of Macedonia found that, after finance, the top obstacles SMEs faced were availability of industrial locations and the availability of trained personnel (USAID, 2009a).

Developing clusters and supplier linkages

The mixed record of results in clusters (chapter I, box I.4) suggests that, although the Government has a role to play as a facilitator, clusters would form "naturally" through the initiative of the companies involved. In other words, companies participating must see the potential benefit in synergies in order to commit themselves to sharing their technology and know-how.

In the case of the former Yugoslav Republic of Macedonia, the majority of clusters (with the notable exception of the automotive one) have been mainly created to group SMEs so that they have a better position in the market, but more could be done in the area of sharing R&D costs and creating economies of scale (for example, in fashion and design). Moreover, in most cases (box I.4) large companies are rarely involved in clusters and, as a result, these fail to acquire the necessary "critical mass" to thrive; there are no leading companies or TNCs that can secure an external buyer and introduce the clusters in the international value chains. In turn, in the automotive cluster the linkages of local companies with foreign affiliates have remained weak. In this sense, local SMEs have forged limited linkages with FDI already present in the country.

The Government should place emphasis on creating supply chain partnerships between SMEs and TNCs and launch a structured supplier linkages programme. The programme would include targeting foreign investors that are already established in the country through "match-making" events and aiding SMEs to meet the required standards to become suppliers to international firms through training and co-financing. Depending on the success of this strategy, in partnership with the Ministry of Economy, Invest Macedonia could organize regional or international forums to showcase clusters as suppliers of TNCs aiming to expand their network. UNCTAD has developed experience in assisting developing countries to structure linkages programmes and stands ready to assist the Government in this area (box III.3).

Box III.3. UNCTAD's Business Linkages Programme

UNCTAD's Business Linkages Programme is aimed at facilitating the creation of new supplier links, and deepening existing relationships between foreign companies' affiliates and domestic SMEs, thereby making the operations of the latter more sustainable. The Programme improves the performance, productivity and efficiency of local suppliers through training, mentoring, information exchange, quality improvements, innovation and technology transfer. UNCTAD also assists developing countries' Governments and other stakeholders to build the enabling policy environment, and supports networks of business development and other service providers, based on the analysis of international experience and best practices. The Programme is operational in eight countries: Argentina, Brazil, the Dominican Republic, Mozambique, Peru, the United Republic of Tanzania, Uganda, and Zambia.

Source: UNCTAD.

Transforming TIDZs

Thus far, the success of TIDZs has been limited, in spite of the generous tax incentives. One of the reasons could be that the original profile of the TIDZ (focusing on high-technology foreign investors in selected manufacturing, in particular automotive and electronics industries) could be too narrow and insufficiently aligned with the country's comparative advantages. Given the low success rate in attracting FDI, the Government should reconsider the development strategy behind TIDZs, fully turning then into multi-facility zones (box III.4), in which all types of production and services, for both the domestic and international markets, are welcome. That would also require a modification of the regulatory framework, which is currently geared towards export production only.

Box III.4. The multi-facility economic zone concept

A multi-facility economic zone is a policy tool which caters to both export-oriented industries (foreign and locally owned alike) and domestic production, combining their establishment in a single facility. All these producers benefit from the infrastructure (electricity, water, roads) and from the regulatory advantages and best practices provided by the zone, although adapted to the specificities of their activities. For example, export-oriented producers can benefit from duty–free imports while domestic producers have to pay import taxes. However, all of them can benefit from best practices in project approval and administrative procedures. Every investor located within the multi-facility economic zone should receive its privileges and incentives in a written form. The same country can be the host to various multi-facility economic zones located in different regions. While the pilot project of the multi-facility economic zone should ideally be a government effort or a joint effort with the private sector, the additional zones of this type can also be fully privately operated.

Source: UNCTAD.

Although, TIDZs are theoretically open to both foreign and domestic investors, in reality it appears that the Government has only pursued foreign companies. So far, however, their achievements were limited. The Government could gain from greater promotion of domestic firms in the zones, following the examples of other countries such as the Dominican Republic (box III.5) and Ireland. International experience shows that "maximizing the benefits of zones depends on the extent to which they are integrated with their host economies. The static and economic impacts of zone development are suppressed when zones are operated as enclaves. They are multiplied when they are accompanied by countrywide economic policy and structural reforms that enhance the competitiveness of domestic enterprises and facilitate the development of backward and forward linkages" (BearingPoint, 2004: 46). More importantly, the Government could align its cluster development strategy more closely to the TIDZs scheme. For instance, domestic suppliers could be encouraged to settle in the TIDZs alongside TNCs and large domestic companies when possible, in order to foster synergies between companies in related fields. The risk is that TIDZs become "islands" within the former Yugoslav Republic of Macedonia with little linkages to the domestic economy, no technological spillovers and delivering little fiscal revenue to the country.

Box III.5. Local firms in the free zones of the Dominican Republic

In the free zones of the Dominican Republic, close to one third of the companies are domestically owned. The free zones have an extraterritorial customs status. Companies in the zones must export at least 80 per cent of their output. Duty-paid sales of up to 20 per cent of the output to the domestic market are permitted. More local sales can be made if the product is manufactured domestically and if local inputs account for at least 25 per cent of value. Import duty is payable on local sales but excludes the value attributable to local inputs.

Source: UNCTAD (2009c).

In addition to the conceptual changes described above, a serious examination of the fiscal incentives provided by TIDZ should be urgently undertaken. In a country that already enjoys one of the lowest corporate tax rates in the region (chapter II), lowering the fiscal burden even further may not be the appropriate incentive to attract FDI. Indeed, the current fiscal incentives may fail to pass a cost-benefit analysis, if measured against their success. Rather than relying on fiscal incentives, more efforts should be spent in delivering state-of-the-art industrial sites with top-notch infrastructure and services, for which demand is high. As mentioned above, scarcity of investment-ready industrial sites has been identified as a major concern by foreign and local investors alike. In other words, the main potential advantage that TIDZs can offer investors is not necessarily tax incentives, but the fact that the zones enable fast and cost-efficient realization of projects by reducing the cost and time involved with the acquisition of land, construction permits, etc.

In this respect, the announced plan to expand the TIDZs scheme by a further seven zones seems premature. Given the fact that the current four are still far from being completed, let alone utilized, that they still require significant investment and that the global financial and economic situation has altered fundamentally, the Government should postpone the expansion. The Government may wish to prioritize contracting world-class specialist zone operators that will be able to assist the remaining three existing zones to achieve "investment-ready" status. As for the areas originally foreseen for new zones, they can be reclassified and reserved for potential future investment projects, without granting the status of a TIDZ, which would make the development of these areas more costly (in terms of the infrastructure required) and their profile more restricted than if they remain general industrial zones.

3. Strengthening policymaking in the area of investment and competitiveness

The vision of an integrated and coherent approach to the issues related to investment, competitiveness and industrial policy in the 2011–2014 programme recommended in this section of the IPR requires a tightening of the institutional setting of the country dealing with those policy areas. Achieving such an integrated and coherent approach is a challenge that requires significant government efforts in terms of planning, institutional coordination, and consultations with stakeholders both at the public and private levels. This section of the report analyses the current institutional architecture relevant to the planning and execution of investment and competitiveness strategies, and makes recommendations with a view to strengthening it.

3.1. Current institutional setting

Within the current setting, investment policy, competitiveness policy and industrial policy are carried out separately, although most of the agencies and units dealing with policymaking in this area ultimately report to the Deputy Prime Minister for Economic Affairs. Below is a brief description of each institution dealing with investment policy and its main functions.

Deputy Prime Minister for Economic Affairs

The Deputy Prime Minister for Economic Affairs supervises policies, projects and reforms undertaken by the Government which relate to the business environment (e.g. taxation, regulatory framework, land, infrastructure, agriculture and energy) and the promotion of domestic and foreign investment. In this regard, the Cabinet of the Deputy Prime Minister sets Government priorities geared towards improving the international ranking of the former Yugoslav Republic of Macedonia. In recent years, these priorities have been identified based on the Word Bank's Doing Business Index Action Plan, the Heritage Foundation's Economic Freedom Index Action Plan, and the World Economic Forum's Competitiveness Index Action Plan.

Investment Committee

The Investment Committee is a high-level team headed by the Deputy Prime Minister for Economic Affairs and consisting of the FDI Minister(s) without Portfolio, the Ministers of Economy, Finance, and Transport and Communications, the Directors of Invest Macedonia, Directorate of the Technological Industrial Development Zones (DTIDZ) and State Authority for Geodetic Works. Hence, the Committee has both policy planning and executing institutions among its members. It meets every two weeks to review the situation of investors and to ensure that barriers to their investment projects are reduced as much as possible. While the Investment Committee has initiated many key amendments to laws and regulations, over time its work has become less policy-oriented and more focused on operational issues. In this regard, the Committee is often requested to provide services to address specific day-to-day problems faced by investors.

Ministerial Committee on Competitiveness

The Investment Committee has to coordinate with other *ad hoc* governmental bodies which deal with other economic affairs. The most notable one is the Ministerial Committee on Competitiveness (MCC), which has a membership similar to the Investment Committee and focuses on competitiveness and industrial policy issues (Government of the former Yugoslav Republic of Macedonia, Ministry of Economy, 2009: 77). Its members include the Deputy Prime Minister for Economic Affairs (chair), the Ministers of Economy, Finance, Education and Science, Agriculture, Local Self-Government, Environment and Physical Planning, Labour and Social Policy, and Information Society, and the Secretariat for European Affairs. The Committee is assisted by an Inter-Ministerial Expert Group for Industrial Policy. The Committee, together with the Expert Group, prepared the Industrial Policy for 2009–2020.

Ministry of Economy – Department for Stimulating Investments and Social Responsibility

The Department for Stimulating Investments and Social Responsibility (total number of staff 10) is in charge of FDI policy formulation within the Ministry of Economy. The Department was reformed in mid-2010, when the export promotion function was transferred to Invest Macedonia. The Department focuses on investment policy, coordination of investment data collection with other agencies, and CSR. The Department's activities in relation to investment policy include analysis of the investment climate in selected industries, identification and assessment of investment projects, comparative analysis of the investment climate with benchmark countries, review of the legal framework, formulation of recommendations for measures to improving the investment climate, removal of administrative barriers to investment. In particular, the Department has been responsible for preparing and coordinating the implementation of the past and current Programmes for Stimulating Investment in the former Yugoslav Republic of Macedonia. To ensure effective progress with these programmes, the Department produces, together with other government agencies and ministries involved, annual implementation Action Plans. It also has responsibility to prepare annual progress reports, which are presented to the Government.

Representatives of the business sector

The representatives of the business sector include foreign investors, and members of the chambers of commerce. The former Yugoslav Republic of Macedonia has two associations of foreign investors (one of them working mostly with investors from Germany and the other one mostly with investors from Greece), three major chambers of commerce and various regional and sectoral business associations. The NECC, a tri-partite (public sector, private sector, NGOs) consultative body, which aims at fostering the country's competitiveness through enhanced management capabilities and European integration, also has the potential to play a role to promote increased domestic and foreign, both public and private, investment. However, its revival would require serious efforts from the Government and other stakeholders.

3.2. Enhancing the efficiency of the institutional framework

The former Yugoslav Republic of Macedonia has made sustained efforts to devise an institutional architecture that would allow it to plan, implement and monitor policies aimed at increasing its FDI attractiveness. The existence of many institutional mechanisms geared towards improving the investment climate is indicative of these efforts. The analysis in this report, however, points to a rationalization of the existing structure, notably for institutions that have overlapping mandates or an unclear division of labour. Furthermore, the Ministry of

Economy is assigned a role in both planning and implementation of the programmes for stimulating investment. This goes beyond its strict competence in the area of economic policy and is, in several important areas, greatly dependent on the good cooperation of other line ministries. This has, in the past, challenged the capacity of the Ministry to assess the implementation of the previous programmes for stimulating investment, including that of 2007–2010; these challenges are likely reproduced in 2011–2014. Within the context of a more integrated approach between investment, competitiveness and industrial policy as proposed in this report, it would be very important to ensure that the policymaking capacity of the Government is strengthened. In this regard, the following recommendations are made:

Cabinet of the Deputy Prime Minister for Economic Affairs

The Deputy Prime Minister for Economic Affairs should remain an essential player in investment policymaking and for the operationalization of the programmes for stimulating investment. The Deputy Prime Minister should, in this regard, continue to coordinate the work of the ministries under his responsibility and work closely with Invest Macedonia. His Cabinet should also carry on with activities geared towards improving the country's position in major international rankings. However, its main focus should shift from prioritizing external rankings to setting priorities based on established domestic development needs. The Deputy Prime Minister should also continue to lead the Investment Committee, and should join Team Macedonia (see below) when required. His Cabinet should also have the overall responsibility for supervising the implementation and assessing the results of the future Programmes of Stimulating Investment, mostly through the MCC.

Investment Committee

The Investment Committee should play central role in the creation of an environment conducive for investment and in the design and adoption of the country's overall investment strategy. The Committee also has the potential to become a powerful mechanism for dialogue between the Government and the investor community, providing investors a channel to advocate further reforms of the investment climate at the highest policymaking level. The advocacy role of the Investment Committee should be centred on identifying policy gaps and bottlenecks and addressing them through additional policy reforms. This is a somewhat different function from that of dealing with day-to-day investors' operational problems, which currently constitutes one of the main activities of the Committee. The responsibility for dealing with the operational problems should be transferred to Invest Macedonia, which is ideally positioned to receive investors' complaints and requests for assistance. As part of its advocacy function, Invest Macedonia should, in turn, distil and channel the key issues regarding the investment climate that should be addressed by policy reforms to the Investment Committee.

In shifting the focus to broader and strategic policy issues, the Committee would be expected to meet less frequently – two or three times a year would possibly be sufficient to assess the need for policy reform based on the inputs received from Invest Macedonia, other public agencies dealing with investors, and the representatives of the private sector. The Committee would also be entrusted with the adoption of future Programmes for Stimulating Investment.

In addition to the actual members representing government ministries and agencies (the Deputy Prime Minister for Economic Affairs, the Ministries of Economy, Finance, and Transport and Communications, the Minister without Portfolio, Invest Macedonia, DTIDZ and the State Authority for Geodetic Works), the Committee should consider including representatives of the investment community for a total membership of 20 to 30 persons. The investor community would bring not only their experience in the former Yugoslav Republic of Macedonia, but also the experience gathered in other countries or regions of the world. The private sector members could serve for a mandate of two years with a possibility to renew their mandate so as to ensure continuity. Furthermore, the involvement of the Prime Minister, as chairperson of the regular sessions, is considered essential for the functioning of the Committee and for an effective implementation of its recommendations.

Ministerial Committee on Competitiveness

The Government needs to consider a potential role for the Ministerial Committee on Competitiveness (MCC) in the preparation and monitoring of the programmes for stimulating investment in the country. This report recommends that the MCC be mandated to ensure the integrated treatment of competitiveness, investment and industrial policy at an inter-agency level, under the supervision of the Deputy Prime Minister for Economic Affairs. The MCC would thus oversee the preparation of the future programmes for stimulating investment, which would then be adopted by the Investment Committee. Being positioned at a high policymaking level, the MCC could best ensure that cross-cutting policy changes are proposed and effectively implemented. Furthermore, its involvement would also foster the participation of all relevant ministries in the preparation of the programme and the monitoring of the implementation of its recommended actions. The inter-institutional nature of the MCC is also an asset to maximize coordination and minimize the risk of duplications among the policy plans and programmes of different ministries in the areas of competitiveness, investment and industrial policy. However, since the MCC does not have a permanent secretariat, it may need to delegate the preparation of the programmes for stimulating investment to a body that has the substantive knowledge in that field.

In implementing this new structure, the Government will therefore need to determine if the permanent operational team in charge of drafting the programmes for stimulating investment should remain with the Ministry of Economy, or if an integrated programme covering investment, competitiveness and industrial policy would be necessary. It is important to note here that the personnel in charge of drafting the investment and competitiveness agenda should be formed as a team of technical experts and not as a body to push forward a political agenda on investment. It is up to the Government to identify and select the best operational arrangements for the preparation of future programmes for stimulating investment and on how they will integrate the competitiveness and industrial policy aspects. In any case, the MCC will also be expected to play a more active role in ensuring that transparent and detailed implementation progress reports are being prepared (see below).

Taking into account the fact that all agencies should be given the time and the resources to adjust their human and financial resources to changes in their mandates, etc., a full reorganization of the current institutional setting could go beyond the time frame (2011–2014) of the programme for stimulating investment under preparation.

While the options discussed above have potential implications for the activities carried out by the Ministry of Economy, this ministry should remain a central actor for investment policy. In this connection, this report recommends to strengthen its analytical functions in order to undertake research studies which deal with investment-related issues. A formal agreement with the NBRM for joint analytical activities can be envisaged in this context. FDI inflows raise a number of important questions, such as how these flows impact economic growth, employment, regional disparities and poverty. The answers to these questions are important for future policy decisions affecting investment and should, therefore, be thoroughly analysed by the ministry.

4. Rationalizing the investment promotion effort

4.1. Current structure

In the former Yugoslav Republic of Macedonia, as in most other countries, many organizations in the public and private sectors contribute to the investment promotion effort. The key players include the Minister(s) without Portfolio in charge of FDI, Invest Macedonia, the Directorate for TIDZs and the local governments. The main functions related to investment promotion of these institutions are discussed below.

Team Macedonia

To deliver a clear and strong message about the country's commitment to attracting foreign investment, the Government has constituted the Team Macedonia. It comprises the Prime Minister, the Deputy Prime Minister for Economic Affairs and the Director of Invest Macedonia. Team Macedonia is a high-level marketing initiative involving the preparation and delivery of a series of customized road shows, such as the one carried out in the Czech Republic in early 2010. In these international visits, the Team presents the country's attractive features in the area of FDI to potential investors from targeted sectors and companies.

Minister without Portfolio in charge of FDI

There is currently one Minister without Portfolio[99] with primary responsibilities to attracting greenfield FDI projects by participating in Team Macedonia road shows and events, and establishing high-level relationships between Government officials and foreign company representatives. The typical day-to-day activities include running marketing campaigns, contacting proactively executives of Global 1000 companies and large mid-sized enterprises with a potential to invest in the country. With its permanent staff of six, the Minister's cabinet targets priority industries (manufacturing activities in greenfield sites and outsourcing activities), typically connected to the current four designated TIDZs and other locations in the country. The Minister identifies potential investors, visits them and attempts to persuade them to invest in the country. Once a potential investor shows interest, the FDI Minister is expected to refer them to Invest Macedonia for facilitation and support.

Invest Macedonia

Invest Macedonia was created in January 2005 and works closely with the Deputy Prime Minister for Economic Affairs, who coordinates all the economic institutions of the Government. Invest Macedonia is a primary Government institution supporting foreign investment in the country. Its main functions include general investment promotion, targeting of investors, facilitation of investment projects, and more recently, aftercare services and advocacy. In 2010, the mandate of Invest Macedonia was expanded to include export promotion activities. Consequently, the responsibility for dealing with these issues was transferred from the Ministry of Economy.[100] Invest Macedonia is relatively well endowed in terms of financial resources (its annual funding rose from €100,000 in 2006 to over €6.8 million in 2010) and human resources (the staff complement increased from six in 2006 to 25 in March 2010).

The main agents of Invest Macedonia's activities in attracting foreign investors abroad are its economic promoters located at embassies or consulates of the former Yugoslav Republic of Macedonia. However, they are selected and employed by, and report exclusively to, Invest Macedonia. At the end of 2010, there were 19 economic promoters abroad. In 2011, the number of promoters was expected to rise to a total of 29.

[99] In the past, there were two posts for Minister without Portfolio. At the time of writing this report, one post was filled. It is understood there may be more such posts in the future.
[100] Law on establishing the Agency for Investment and Export Promotion, OGRM 57/2010.

Directorate for TIDZs

The Directorate for TIDZs (DTIDZ) was created by the Law on Free Economic Zones and is responsible for promoting the development and establishment of TIDZs, as well as for monitoring and regulating the users' operations. It issues approvals for the establishment, promotion and termination of the users' operations. The Directorate is also responsible for regulating the rents, tariffs and fees charged to users, and for coordinating the processing of approvals and permits required for the commencement of a company's operations in the zone. In addition, it is in charge of site analysis for the zones, planning and technical documentation, promotion and advertisement of zones, land acquisition, infrastructure building inside the zones, record-keeping of State aid, preparation of annual reports, supervision of infrastructure, 24/7 security, sales of natural gas in the zones. To carry out these functions, the DTIDZ has a staff of 36 and an annual budget of €7,740,000 for capital expenditures (equipment, machines, construction land and buildings), as well as additional resources for salaries and other activities.

Local government

The former Yugoslav Republic of Macedonia also has 85 municipalities, including the city of Skopje. The 2002 Law on Local Government gives extensive responsibilities to municipalities in relation to local economic development, one aspect of which relates to the attraction of foreign and domestic investment. Moreover, from 2011, municipalities will obtain the responsibility for the management and sale of State land.

4.2. Proposed structure

There is scope for rationalizing the current structure of investment promotion. The key challenges for doing this include (a) how to utilize the respective resources and competences in an efficient way, avoid duplications and increase accountability; (b) how to project a coherent and well-branded promotional message to investors; and (c) how to strengthen the investment promotion function and carry out systematic aftercare. In this regard, this report recommends abolition of the post of Minister without Portfolio and a merger of the DTIDZ with Invest Macedonia. The proposed changes would simplify the institutional structure and the reporting lines (figure III.1). As a result, each stakeholder would have clearer responsibilities, reducing functional overlap and improving accountability. Such a change would also save scarce resources, and would go in the same direction, although not as far, as the proposed export promotion strategy of the country (Brown, 2010): the change would apply over a longer time horizon and with a more gradual transfer of responsibilities.

Minister without Portfolio for FDI and Team Macedonia

The creation of two posts of Minister without Portfolio in 2007 was intended to be a transitory arrangement. This arrangement has since been extended for one of the two posts. With its increased staff and its network of promoters (22 from January 2011), Invest Macedonia is now in a much better position to play an active role in targeting potential foreign investors. Consequently, to avoid duplication, the Government should phase out the post of the Minister without Portfolio in charge of FDI in a well-planned manner. As described below, the role of Invest Macedonia in targeting investors could be complemented by the work of the Investment Committee and Team Macedonia.

Under this proposed setting, an important role will continue to be played by Team Macedonia, which will work in close cooperation with the Investment Committee. In this regard, the Team could – in addition to the Prime Minister, the Deputy Prime Minister for Economic Affairs and the Director of Invest Macedonia who are the core members – benefit from the participation of representatives of the business community or other experts on an ad hoc basis, depending on the topic of the mission they are undertaking.

Invest Macedonia

Invest Macedonia should remain the lead agency for investment promotion, but should formally report directly to the Deputy Prime Minister for Economic Affairs. This will ensure a continuous dialogue with the institutions which play a central role in designing and implementing the investment strategy. Also, given its close contact with investors and foreign ones in particular, Invest Macedonia is ideally placed to provide the Deputy Prime Minister for Economic Affairs and the Investment Committee with feedback on their perception of the investment environment and on the challenges they face in their day-to-day operations. These would constitute valuable inputs to further improve the investment strategy and better adapt it to fit the development needs of the country.

To deliver on its mandate effectively, Invest Macedonia requires further capacity-building. The Aftercare and Policy Advocacy Department was officially established in May 2010. The Department is neither fully operational nor staffed and the aftercare function, mainly dedicated for investors in TIDZs, continues to be performed through the Investor Servicing Department. Once adequately staffed, the Aftercare and Policy Advocacy Department will need to segment, target and define its aftercare programme and articulate a meaningful policy advocacy agenda. In terms of aftercare, for instance, it will need to (a) categorize its aftercare services offer; (b) identify the clientele by setting up a database of established companies that are targets for re-investment; and (c) assign account managers specifically to priority sectors, which would assess their customers' needs and receive their concerns, which will feed into the policy advocacy agenda. UNCTAD could provide technical assistance for aftercare services through the provision of its i-Track software.[101]

With respect to promotion, in addition to the sections in charge of marketing and communications, and investor servicing, the economic promoters posted in embassies abroad play an important role. To maximize the impact of their activities, Invest Macedonia should define measurable performance criteria, without sacrificing the quality of FDI to be attracted. Furthermore, the agency could also consider using in certain countries national consultants as so-called "door openers" to support the work done by the promoters. To reward them for success, a portion of their salary could be performance-based.

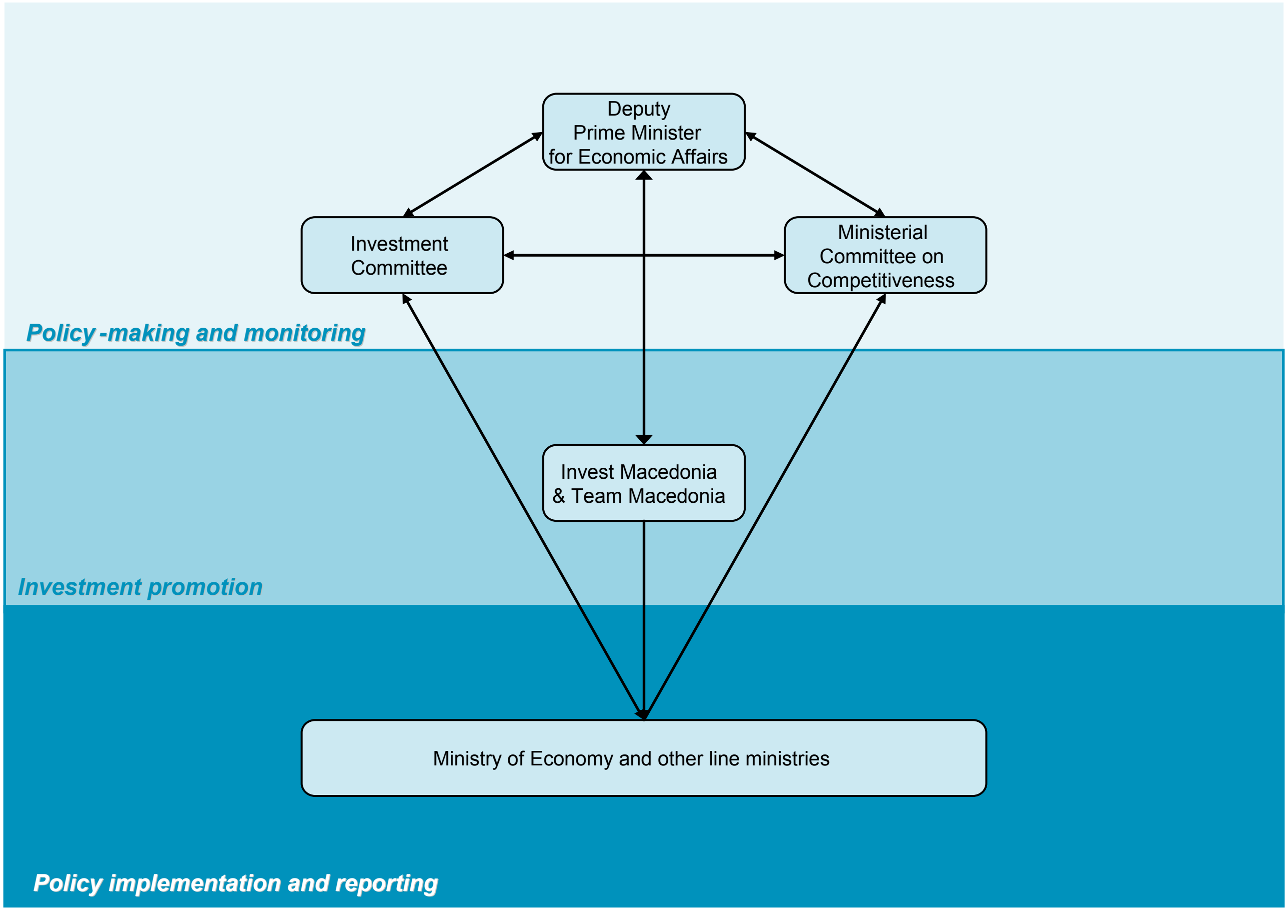
Invest Macedonia also needs to develop its newly acquired export promotion unit as a separately managed but related body. The agency has to develop an export promotion strategy. Once the unit on export promotion has been fully integrated, Invest Macedonia should focus on facilitating the exports of all producers, domestic and foreign-owned ones. Export promotion may be linked to the promotion of linkages between foreign affiliates and local companies as the two groups of firms have joint export opportunities when operating in the same value chain. In this context, a pilot initiative focusing on the discussed linkages programme would be worth exploring in one or two sectors or industries.

As for investment facilitation, current activities should be expanded to include facilitating access to information, including on laws and regulations which affect business. In this regard, Invest Macedonia should become a focal point, through its Marketing and Communications Department, for the online publication in English of the most updated investment-related laws and regulations of the country.

A well-designed and regularly updated Internet site is central to the facilitation efforts of an investment promotion agency (IPA). Invest Macedonia has already made important progress to develop and market its website to investors and provide them with useful information both about the country's investment regime and opportunities. More, however, needs to be done to fully tap the potential of such a powerful tool. For instance, the site should contain all the English version of laws and regulations which affect business. In a world where competition to attract investors is increasingly intense, such information is indispensable.

[101] i-Track is a system that manages investors' online applications for investment licences and enables investment promotion agencies (IPAs) to track investors through their investment cycle – from their initial inquiry at the agency; to following up a lead and assisting them to obtain the necessary ancillary licences, to the actual investment and regularly following up with investors to assess their ongoing needs.

Figure III.1. Possible future national structure for investment and competitiveness



In addition to information on regulatory issues, the site should also include logistical information on visiting the former Yugoslav Republic of Macedonia and the services Invest Macedonia can provide to investors when they visit the country to explore further investment opportunities. For example, details about the procedures to obtain visas, airport pickup services and the organization of meetings. Furthermore, the site should be hub for detailed information on investment projects and opportunities, including promotional materials for selected sectors. In this area, it would be also useful to consider reviving the idea of the capacity-building project for identification and appraisal of suitable investment projects that the Ministry of Economy formulated for the United Nations Industrial Development Organization (UNIDO) in the 1990s.

DTIDZ

Another issue that should be considered is the possibility of merging the DTIDZ into Invest Macedonia, while privatizing the day-to-day management of the zones. The two agencies carry out similar activities (e.g. attracting investors to TIDZs is the responsibility of both); a merger could eliminate overlaps. The integration of the DTIDZ could also provide the opportunity of a more effective promotion of linkages by allowing Invest Macedonia of liaising directly from the premises in the TIDZs. It would also go to the same direction, although not as far, as the proposed export promotion strategy of the country (Brown, 2010), and in a more gradual manner.

The management of the TIDZs would improve through the hiring of specialist zone operators from the private sector which could take the form of a concession agreement. The supervision of the private managers will remain the responsibility of the agency supervising the zones. UNCTAD has assisted many investment promotion agencies around the world to developing their strategies and strengthening their capacities. It stands ready to provide technical assistance to the Government in this area.

Enhancing the role of local actors

To complement the activities undertaken at the national level, there is scope for a more active role of local actors in investment promotion, especially related to the development of underdeveloped or peripheral areas. The country needs to discuss the most appropriate modalities of decentralization, as the current number of municipalities (86) is too high for the effective management of investment promotion in such a small country. Local investment promotion should coordinate both with Invest Macedonia (in order to ensure coherence and consistency) and with the Bureau for Economically Underdeveloped Areas, a body under the Ministry of Local Self-Government. Municipalities need to develop their skills, knowledge and capabilities if they wish to manage their local economic development offices effectively. These offices can play a role in identifying potential locations for investment (greenfield and brownfield), as well as facilitating the process of purchasing land and/or obtaining permits for construction activity. A database of investment opportunities and key local contacts (local economic development offices, mayors, companies, etc.) needs to be developed and updated regularly through Invest Macedonia.

5. Ensuring effective policy implementation

An important precondition of the success of the new programme for stimulating investment is, in addition to adequate resources for its implementation, an effective monitoring and evaluation mechanism of the progress made. In terms of resources, the programme will be implemented with public funds, a signal of the Government's commitment to promote both domestic and foreign investment. The international support from international institutions, including the EC and bilateral partners, should be sought to complement the dedicated national resources.

The Ministry of Economy (through the Department for Stimulating Investments and Social Responsibility) was responsible for the monitoring and evaluation of past programmes. This Department has, in addition to setting up the programme itself, prepared annual progress reports, as well as the overall evaluation reports for these programmes, including that covering the period 2007–2010. As indicated previously, the Ministry of Economy does not have official authority to enforce the implementation of the various elements of the programme; it has to carry out its monitoring and evaluation through informal cooperation with other Government agencies. This causes challenges for adequately monitoring and assessing impact. For example, in the progress report of 2009, several entries do not contain information regarding the status of implementation of the proposed measures. There are also no explanations as to why some specific measures were not implemented and/or replaced by other measures. Furthermore, while the programmes were made widely available to the public, this is not the case for either the progress reports or the evaluation reports.

Against this background, two issues could improve the monitoring and evaluation of the forthcoming programme to stimulate investment: (a) defining the government entity responsible for overseeing the monitoring, including evaluation and obtaining the relevant information from executing entities; and (b) improving transparency by making these reports available to the public.

As for the programme itself, it is recommended that the Cabinet of the Deputy Prime Minister for Economic Affairs has the oversight role for the preparation of the progress and evaluation reports. The Cabinet is more likely to be able to enforce implementation, obtain appropriate information about the implementation process and explanations about challenges from all the executing agencies involved in the various segments of the programme than a single line ministry. To facilitate the preparation of the annual progress report, it is recommended to gather inputs from all the agencies involved on a quarterly basis. Towards the end of the year, once the draft progress report is complete, it should be presented at one of the sessions of the Ministerial

Committee on Competitiveness to brief its members on progress made, receive feedback on how to integrate lessons learned and move forward with the implementation of the programme. Once the progress report is finalized, it should be made available to the public through, for instance, the Deputy Prime Minister's, the Ministry of Economy's and Invest Macedonia's websites.

At the end of the implementation cycle of the programme, usually four years, the Cabinet of the Deputy Prime Minister should prepare – or have prepared – an evaluation report. The report will assess the degree to which the proposed measures in the programme have been implemented and also the results obtained through these measures. The Government could request UNCTAD to evaluate the implementation of the Investment Policy Review and, at the same time, provide an assessment of the impact of the programme for stimulating investment. Specifically, UNCTAD could, at the request of the Government and if resources permit, undertake an independent evaluation and deliver concrete recommendations for a more effective implementation of the Programme and of the other recommendations of the Investment Policy Review. UNCTAD could also assist in the preparation of a future programme to stimulate investment, based on the experience and recommendations connected with the implementation of the current one.

Improving statistical reporting on FDI

As highlighted previously, the objective of the programme should focus not only on attracting investment but on deriving benefits for the economy in terms of output growth, employment, technology transfer and so on. To come up with a good assessment of these impacts, there is need to improve the quality of information that is made available, including statistics about FDI (and eventually about the activities of foreign affiliates in the country). As presented in chapter I (box I.5), statistics on FDI and foreign affiliates suffers form certain bottlenecks. In this regard, the combination of FDI-related information collected by the Central Registry, the National Bank (NBRM) and the State Statistical Office (SSO) would enable a simple, efficient and well-coordinated statistical monitoring of FDI with the following distribution of work: (a) the Central Registry would identify the foreign-owned firms; (b) the NBRM would continue to collect data on FDI flows and stocks; and (c) the SSO would collect data on various operational aspects of foreign affiliates (e.g. number of employees). Each agency will strengthen its data collection in its own area of responsibility. The related surveys of the different agencies should be coordinated: the NBRM and the SSO should merge their mailing lists and carry out a single survey of investors. As the NBRM has a more detailed mailing list, it could take the lead in this area. UNCTAD could provide technical assistance in the area of FDI statistics through a national workshop involving all agencies dealing with FDI/TNC statistics and relevant follow-up activities (box III.6).

Existing data could also be better exploited for policymaking purposes. Here the main responsibility lies with the SSO, which could match the Central Registry and NBRM databases with other relevant databases available at the SSO (e.g. financial statements, foreign trade, etc.) simply by using the registry numbers of firms to distinguish between foreign- and domestic-owned firms. This would enable quality monitoring of all the operational aspects of foreign affiliates in the former Yugoslav Republic of Macedonia without imposing any additional burden on foreign investors and their firms.

In addition, an annual questionnaire survey targeting the foreign investors in the former Yugoslav Republic of Macedonia, the business climate in the country and various other investment-related aspects would be a useful additional tool for FDI policymaking. Invest Macedonia would be the most appropriate institution to perform such a function, in cooperation with the Ministry of Economy and/or the Office of the Deputy Prime Minister for Economic Affairs.

Box III. 6. UNCTAD's technical assistance in collecting and reporting statistics on FDI and activities of TNCs

To alleviate the problems related to the lack of relevant, reliable and timely information on FDI and activities of TNCs, UNCTAD is undertaking capacity-building activities in developing and transition countries aimed at helping the collection, improvement and international harmonization of such statistics. These activities build on UNCTAD's expertise gained in maintaining one of the world's largest FDI/TNC databases, covering information on more than 200 economies over a period of 40 years, and actively participating in the preparation and improvement of international benchmarks such as fourth edition of OECD Benchmark Definition and sixth edition of IMF Balance of Payments and International Investment Position. In addition, in 2010, UNCTAD has published a three-volume Manual on Statistics of FDI and the operations of TNCs.

A large part of UNCTAD's technical assistance takes the form of national or regional workshops, bringing together all relevant stakeholders (central banks, national statistical offices, company registries, investment promotion agencies, etc.) dealing with FDI/TNC statistics. Officials participating in the workshop are encouraged to establish a unified, coherent and effective survey system to collect and disseminate data on FDI and activities of foreign affiliates. The final aim of the workshops in to enable developing and transition economies to make appropriate decisions and formulate development-oriented policies in the area of attracting FDI. Since the inception of this programme in 2004, UNCTAD has carried out around 40 workshops. Albania and Belarus are examples of transition economies that have benefited from the programme so far.

The workshops (a) raise awareness about internationally accepted standards and guidelines regarding the compilation of data on FDI and the activities of foreign affiliates; (b) discuss the UNCTAD common survey on FDI and TNCs; (c) help understanding of definitions and methodologies in the area of FDI/TNC statistics; and (d) provide advice on specific issues and challenges of particular interest to the country/region. In order to ensure adequate follow-up, they also initiate a networking among national authorities involved in FDI data compilation and reporting.

Source: UNCTAD.

D. Conclusion

At the request of the Government, this chapter presents a set of recommendations for consideration for incorporation in the new programme for stimulating investment 2011–2014. The recommendations are summarized in annex 4 and focus on five main policy areas discussed in this chapter.

Each subsection of the matrix in annex 4 begins with a brief description of the issues covered, followed by a series of detailed recommendations which highlight the overall *policy area* being addressed, the specific *objective* of the measure, the actual measure(s) per se and the proposed implementation timeline: short-term (up to two years), medium-term (up to four years) and longer-term (over four years).

The recommendations for the future programme for stimulating investment are based on the analysis presented in chapters I–III which derives from an in-depth analysis of the existing policy framework affecting issues related to investment, discussions with numerous public and private institutions in the country, secondary sources of information and international best practices. The objective is to assist the Government to create an integrated and forward-looking programme of reform designed to stimulate investment. For the recommendations which may require a longer timescale for implementation than the four-year covered by the programme for stimulating investment, the Government may wish to implement them during the following programming cycle.

IV. SUMMARY OF FINDINGS AND RECOMMENDATIONS

During the past decade, the Government of the former Yugoslav Republic of Macedonia has undertaken ambitious reforms to modernize the country, complete the process of transformation into a market economy, and improve the living conditions of the population. These reforms have benefited from a more stable political and economic environment. Effectively, since the Ohrid Framework Agreement in 2001 between ethnic Macedonians and Albanians, democratization and stabilization efforts have gained momentum. Macroeconomic stability and the accession to the WTO (in 2004) have given an impetus to economic modernization and the development of an attractive business climate. In addition, of crucial importance is the country's candidacy for EU membership. The process of accession to the EU, including the adjustment of national laws to the requirements of the *acquis communautaire*, has provided a basis and framework for the economic reforms and policy changes analysed in the Investment Policy Review.

The reform drive has introduced modern legislation in several areas and led to an overall conducive regulatory framework for investment. This is acknowledged by improving international business rankings and has resulted in higher economic growth rates. Nonetheless, the former Yugoslav Republic of Macedonia remains one of the poorest countries in Europe, with a large unemployment problem. The Government is striving to project a new country image, one that dissociates from high political and economic risks. However, FDI inflows, though increasing, have so far been low compared with other South-East European countries. Most of the large FDI transactions have taken place in the form of privatization and, only recently, the country has begun to attract more greenfield projects. Consequently, the impact of FDI on creating jobs and improving overall productivity is felt primarily in sectors where the presence of foreign investors is large, as is the case in banking and telecommunications.

Among the factors holding back investment, the most important are:

- Outstanding issues in the business and investment environment, including in areas such as access to land and construction permits as well as employment of foreigners or implementation of existing legislation;
- A lack of coordination in policymaking and execution and the ensuing proliferation of insufficiently related and consistent development strategies, competitiveness plans, industrial policies and investment strategies;
- Inadequate investment promotion effort resulting from a lack of capacity and overlapping mandates of institutions in charge of investment attraction.

The proposed "*Programme for Stimulating Investment in the Republic of Macedonia 2011–2014*" to which this IPR suggests strategic and practical inputs could have a critical role to play in respect of improving policies and implementation, and to ensure that the country performs better in attracting FDI. Through this proposed Programme, the Government also needs to put more emphasis on the potential development impact of FDI, thus shifting away from the focus on improving the country's international rankings which has characterized the past programmes. Under the right policy and economic conditions, FDI can and should play a more fundamental role in poverty reduction and improvement of the population's welfare, through its contribution to growth, employment, exports, technology, skills and know-how transfer, infrastructure upgrading and supplier linkages with domestic firms.

To meet these goals, the overall strategy proposed in the IPR report builds on five main pillars: (a) achieving global excellence in the investment framework; (b) creating synergies between FDI and industrial policy; (c) strengthening policymaking in the area of investment and competitiveness; (d) rationalizing the investment promotion effort; and (e) ensuring effective policy implementation. The detailed recommendations are described in annex 4. The main threads of the four main pillars of the proposed strategy are discussed in the following pages.

A. Achieving global excellence in the investment framework

This report suggests that global excellence in the investment framework is an achievable goal for the former Yugoslav Republic of Macedonia in the short-to-medium term. The country should strive for global excellence by addressing the remaining bottlenecks in the investment climate and ensuring full implementation of the recent reforms. It should then capitalize on the quality of its investment climate by turning it into a key factor of attractiveness, around which to build its FDI promotion strategy. In this regard, the analysis presented in this report (mainly chapter II) recommends major priority reforms:

- Streamlining the construction permitting process and ensuring equal treatment in the access to land to all investors alike;
- Reorienting the policy on the employment and residence of foreigners to attract skills necessary to the development of the local economy;
- Ensuring a balance between the attractiveness of the fiscal regime for investors and the capacity of the Government to generate sufficient revenues to carry out the mandate of public institutions;
- Strengthening the implementation of existing laws and the capacities of institutions dealing with them, especially in the areas where public interest is to be protected such as environment, competition and labour rights; and
- Strengthening the independence and capacity of the commercial judicial system and adopting a zero tolerance approach to administrative corruption, including via an improved procurement regime.

UNCTAD recognizes the need to translate the *acquis* into the national legislation and recommends the Government to utilize the policy space at its disposal to adopt a step-by-step approach useful to ensuring coherence of the changes with the country's wider development objectives.

B. Creating synergies between FDI and industrial policy

Global excellence in the investment framework aims at both attracting FDI and deriving benefits from its flows for the country. In order to maximize the benefits from existing and future FDI in terms of employment, innovation and integration of the local productive sector in the international value chains, the Government should make sure that it contributes to achieving the goals of the *Industrial Policy of the Republic of Macedonia 2009–2020*. This report suggests three main areas of intervention: (a) empowering SMEs through training and improved access to credit; (b) developing supplier linkages to strengthen potential supply chain partnerships between SMEs and TNCs, and fostering the creation of clusters to generate synergies among SMEs; and (c) revisiting the development strategy of the Technological Industrial Development Zones (TIDZs) with a view to proactively seek new investors, including local firms.

C. Strengthening policymaking in the area of investment and competitiveness

Improving the business environment requires a policymaking and implementation system capable of providing the relevant institutional architecture for the attainment of that ambitious goal. Within the current setting, the issues of investment, competitiveness and industrial policy are addressed and treated largely in a separate manner, although most of the agencies and units responsible for policymaking in these areas ultimately report to the Deputy Prime Minister for Economic Affairs. This report calls for a more integrated, strategic and coherent approach to investment policymaking, one that fully recognizes that competitiveness and industrial policy can greatly influence the type and quality of incoming FDI, and also its contribution to economic development. Likewise, successfully targeting certain type of investors can have direct impact on a country's competitiveness levels.

The integrated treatment of investment, competitiveness and industrial policy in the former Yugoslav Republic of Macedonia would require a rationalization of the existing policymaking structure and a reallocation of responsibilities. In particular, the report makes recommendations for the Government to:

- Transform the Investment Committee into a mechanism for advocacy and dialogue with the investor community. This implies, among other developments, a change in the frequency of its meetings (to two–three per year), a change in its agenda (to identifying policy gaps and bottlenecks, and recommending policy reforms), an increase in its membership (to include representatives of the investor community), and the involvement of the Prime Minister as chairperson in regular sessions;
- Turn the Ministerial Committee on Competitiveness (MCC) into the entity responsible for overseeing the integrated treatment of competitiveness, industrial policy and investment, ensuring that the contents and the implementation of programmes in these areas are well coordinated. The entity in charge of preparing future Programmes for Stimulating Investment and their monitoring should work closely with the MCC and report to it;
- Strengthen the policymaking and analytical capabilities of the Department for Stimulating Investments and Social Responsibility at the Ministry of Economy to carry out research, analysis and reporting on the impact of FDI on the local economy;
- Strengthen the quality of the information used in impact analysis, including statistics about FDI and activities of foreign affiliates, questionnaire surveys targeting foreign investors, and information on potential business opportunities in the country;
- Strengthen the monitoring and evaluation capabilities of the institutions responsible for the creation and follow up of government programmes, and extend their mandate to gather information from government agencies participating in those programmes.

D. Rationalizing the investment promotion effort

Several public and private sector institutions currently contribute to the investment promotion effort. This setting would also benefit from strengthening and/or rationalization. In particular, it is recommended to:

- Phase out the post of the Minister(s) without Portfolio and devise ways for Invest Macedonia to take over client relationship management in investment promotion;
- Strengthen Team Macedonia by co-opting business representatives on an *ad hoc* basis; and
- Absorb the activities related to promotion of the Directorate for Technological Industrial Development Zones under the auspices of Invest Macedonia.

In addition to the institutional reform proposed in the report, there is need to develop comprehensive capacity-building programmes for public servants in various key policy areas, including taxation, incentives, competition, public procurement and social responsibility. That would require increased resources made available for these governmental institutions.

E. Ensuring effective policy implementation

As mentioned, one of the key challenges faced by the Government of the former Yugoslav Republic of Macedonia, and indeed by most countries experiencing a fast reform pace, is to ensure that the resulting laws and stated policies become reality through implementation and capacity building of the institutions with responsibility for investment issues. In this regard, some recommendations are proposed and aim at developing an effective monitoring and evaluation mechanism. UNCTAD also recommends ways to strengthen the methodology for collecting statistics on FDI and TNC activities so as to provide policymakers with relevant information on the impact of their policies on FDI attraction and on the local economy.

ANNEX 1. IPRS – AN INTEGRATED ASSISTANCE APPROACH

The Investment Policy Review (IPR) is a comprehensive, demand-driven and country-specific process of technical assistance which spans over a medium- to long-term horizon. The programme starts with preparation of the IPR report and policy advice, continues with support for putting the recommendations into action and follows on with a formal implementation report with proposed further actions. Below is a schematic presentation of the IPR approach.

Phase 1 Government request	• Government requests support through the IPR programme • Counterpart in Government is identified • Strategic focus of the IPR is jointly defined
Phase 2 The IPR evaluation and advisory report	• UNCTAD conducts fact-finding mission • Consultations are held with relevant Government's agencies and stakeholders • Draft IPR report is prepared • Draft IPR is subject to a series of internal and external technical peer reviews • Draft IPR and its recommendations are discussed with the Government and stakeholders through a national workshop • IPR report is finalized
Phase 3 Intergovernmental peer review and country ownership	• Intergovernmental session is held in Geneva to present the main findings and recommendations for peer review • Best practices are exchanged between Governments • The Government of the country under review endorses selective recommendations and takes ownership of IPR report
Phase 4 Implementation of recommendations and follow-up technical assistance	• Technical assistance (TA) is provided to Government to implement IPR recommendations • UNCTAD is involved in providing follow-up TA • TA can cover wide range of investment-related issues (legal and regulatory, customs, training and institutions building, investment facilitation/promotion, targeting and aftercare, good governance, international agreements) • Government implements part of the recommendations without need for TA • Sister organizations may be called upon to provide follow-up technical assistance as needed
Phase 5 Implementation report and further actions	• Impact is assessed through a formal implementation report 5-6 years after IPR publication • Further actions and technical assistance are proposed as needed

For more information on the IPR process and framework, please visit:
www.unctad.org/ipr

ANNEX 2. REGULATORY REFORMS IN THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

In order to eliminate duplication and inconsistency between the old and the new sets of legislation, the Government of the former Yugoslav Republic of Macedonia initiated, at the end of 2006, a process to review existing laws and by-laws, to streamline bureaucratic procedures, and introduce a Regulatory Impact Assessment (RIA). As a result, and in consultation with the business community, ministries, non-governmental organizations and independent experts, the Sector for Regulatory Reforms (which reports to the Cabinet of the Deputy Prime Minister for Economic Affairs) has proposed changes to many laws and by-laws. This process called the "regulatory guillotine"[102] has been continuously carried out in several stages. Hitherto, in the first phase, 2000 laws and by-laws were reviewed in cooperation with the business community and citizens, and measures were taken and carried out in 545 regulations. The second phase started in April 2009, whereby 54 measures were adopted towards simplification of the cross-border trading procedures. As a third phase, in October 2010 the Government adopted a new package of 47 measures, which are currently under implementation. The measures relate to procedures in several areas, such as agriculture, labour and social policy, health, environment and insurance. Their implementation is scheduled for completion by mid-2011, followed by more consultation with the business community, determining the possibility of formulating a new set of measures for further simplification of the administrative procedures.

The RIA is a complementary tool of the regulatory guillotine, aimed at preventing the generation of additional administrative burdens and barriers in the new legislation. It involves public-private consultations and the use of a unique national electronic registry. Following a pilot project in 2008, all ministries have the obligation, since January 2009, to undertake an RIA when adopting new laws (Government of the former Yugoslav Republic of Macedonia, 2009). The regulatory guillotine will be implemented continuously until a capacity is built for implementation of RIA in by-laws, which actually hold the largest administrative burdens.

The legal framework for the RIA was established through the Rules of Procedure for Amendments and Modifications of the Government of the Republic of Macedonia, the Methodology for Regulatory Impact Assessment and Decision on Format and Contents of the Regulatory Impact Assessment. The RIA is applied to all draft laws from 1 January 2009 (except for the laws adopted in an urgent procedure). As a technical support to the RIA process, a Unique National Electronic Registry of Regulations (UNERR) was established, which enables stakeholders to submit electronic comments and suggestions directly to the government institutions. By the end of October 2010, 1,553 current regulations were included in the UNERR, 224 of which are draft laws that were available for public comments and that have undergone the RIA process.

To build administrative capacity for RIA, the General Secretariat of the Government of the former Yugoslav Republic of Macedonia and the Ministry of Foreign Affairs of the United Kingdom signed a Memorandum of Cooperation in October 2010. The project, titled "Better Business Regulations in Macedonia", implemented from November 2010 to March 2011, includes the following activities:

- Analysis of the RIA process implementation and the UNERR functioning up-to-date;
- Development of an action plan for implementation of better regulatory reform;
- Analysis of the RIA application in specific business regulations; and
- Analysis of the consultation process with the business community as an important part of the RIA process and development of Consultation Code.

Another area of regulatory reform concerns the penalty policy of the country. In March 2010, the Government, in cooperation with the chambers of commerce, associations of enterprises and business entities, identified the problems that the business community is facing from inspection authorities. Following

[102] OGRM 129/06.

the recommendations of the business community, the first package for a better penalty policy was adopted in July 2010. By September 2010, changes and adjustments of 22 laws had been made. By October 2010, a further 37 laws were amended through a second package. According to the Action Plan adopted by the Government, measures affecting penalty policy should affect approximately 160 laws by the end of the first quarter of 2011.

Finally, part of the regulatory reform has been undertaken through the Government's anti-crisis measures. By March 2010, four packages of anti-crisis measures had been adopted. The last round included 25 measures, designed to facilitate the procedures for doing business in the country, improve access of micro-enterprises and SMEs to credit, increase their liquidity, stimulate construction, promote the privatization of land, promote employment in agriculture, improve tourism, promote exports, and reduce unfair competition. This fourth package is to be fully implemented by the end of 2011. The Government continuously monitored the global economic crisis and its effects on the national economy. If need for additional liquidity arises, a new package of anti-crisis measures will be created in cooperation with the business community.

Source: UNCTAD, based on information provided by the Cabinet of the Deputy Prime Minister for Economic Affairs.

ANNEX 3. METHODOLOGY OF INTERNATIONAL TAX COMPARISONS

The *Comparative Taxation Survey* compares taxation on investment in several sectors in the former Yugoslav Republic of Macedonia with taxation in other selected countries – neighbours and countries elsewhere that have succeeded in attracting FDI to specific sectors. These results provide an assessment of the competitiveness of the former Yugoslav Republic of Macedonia in terms of its taxation regime.

Corporate taxation affects the cost of investment and its profitability, and thus the return on investment. This impact is not just a question of looking at the headline rate of tax on profits. The tax burden on the investor depends on a number of factors and their interaction, including allowed expenses, rates of capital allowances (tax depreciation), the availability of tax credits, investment allowances and tax holidays, the loss carry-forward provisions and the taxation of dividends, among other things.

Comparative tax modelling is a method of taking into account the most important of these variables in the fiscal regime in a manner that facilitates comparison between countries. The tax variables included in the analysis are:

- Corporate income tax;
- Tax rates including tax holidays, if any;
- Loss carry-forward provisions;
- Capital allowances, investment allowances and investment credits;
- Tax on dividends; and
- Customs import duties and excise duties on business inputs.

Financial models of project investment and financing, revenues and expenses are utilized for a hypothetical business in each sector. These are based on typical costs and revenues experienced in such businesses in a developing economy. The business models cover a selected business within each sector. The fiscal regime in the former Yugoslav Republic of Macedonia for each sector is applied to the standard business model for each sector over 10 years beginning with the initial investment. The financial models calculate net cash flow to the investor assuming that the company pays out all residual profits after tax (100 per cent dividend pay out) and that the investor gains the residual value of the company, which is sold after 10 years for an amount equal to its balance sheet value.

The impact of the fiscal regime is presented as the present value of tax (PV tax). PV tax is the total of taxes and duties collected by the Government over the 10 years as a percentage of the project cash flow pre-tax and post-finance where both cash flows are discounted to a present value at a rate of 10 per cent per annum. PV tax thus measures how much of investors' potential project return is taken by the government in taxes and duties. The higher the PV tax, the more the fiscal regime burdens investors and reduces the incentive to invest. The simulation prepared for the former Yugoslav Republic of Macedonia considered three sectors that are of major importance for existing and potential FDI in the country: consumer electronics, ICT and tourism. Comparisons were made with other countries of the subregion (Albania, Bulgaria, Croatia, Montenegro and Serbia), as well as with some developing countries where the sectors selected attracted FDI: Costa Rica and Viet Nam in consumer electronics, Malaysia and Singapore in ICT, and China, Malaysia, Sri Lanka and Thailand in tourism. Whenever information was available, the simulation of the tax model took into consideration the incentives programmes of the countries separately.

ANNEX 4. INPUTS FOR THE IMPLEMENTATION OF THE PROGRAMME FOR STIMULATING INVESTMENT

1. Achieving global excellence in the investment framework

In recent years, modern legislation has been adopted in several domains of the regulatory framework of the former Yugoslav Republic of Macedonia, including company registration, labour, environment, customs, intellectual property and competition. These reforms have a direct bearing on the ease and cost of doing business in the country and its levels of competitiveness. There are, however, remaining regulatory constraints, such as in the area of construction permitting and entry of foreign labour. The country also needs to consolidate and implement recent reforms by adopting the necessary by-laws and regulations and strengthening the institutions in charge of their implementation in important areas such as environmental protection, competition or labour rights. The following tables summarize the relevant recommendations in the area of competitiveness of the economy. In the timeline, short term indicates actions to be undertaken in the first year of the programme for stimulating investment, medium term denotes actions to be completed before the end of the 2011–2014 cycle, and long term indicates actions that may require time going beyond 2014.

1.1. International framework for FDI

	Area	Objective	Measure(s)	Timeline
1.1.1.	BITs	Extend the network of BITs	Initiate and conclude BITs with EU member countries as a matter of priority Ensure that three BITs enter into force (Islamic Republic of Iran, Egypt and Belarus) Sign and ratify the agreed BITs with Greece, Northern Ireland and Oman) Sign and ratify BITs with the remaining EU countries (Ireland, Portugal, Luxembourg, Malta, Latvia, Cyprus, Estonia, United Kingdom, Denmark and Lithuania) Extend the network of BITs to other key trading partners such as the United States, Japan, Canada, Australia, New Zealand, Mexico, Norway, Iceland, Montenegro, Kosovo and the Republic of Moldova, including amendments for Croatia, Uzbekistan, Kazakhstan and Qatar	Short Short Short to medium Short to medium Short to medium
1.1.2.	Lisbon Treaty and BITs	Monitor the consequences of the Treaty of Lisbon for BITs	Monitor closely new developments in the area of transfer of competencies in the EU from member countries to the EC due to the entry into force of the Treaty of Lisbon Adjust approach to BITs according to the entry into force of this treaty	Short to medium Short

1.2. Business registration, documentation, conditions and procedures

	Area	Objective	Measure(s)	Timeline
1.2.1.	Registration	Further simplify the registration process Complete electronic registration service	Finalize electronic signature legislation Introduce online business registration (in Macedonian) Introduce online business registration (in English if law allows) Introduce E-bankruptcy system registering in all phases of the bankruptcy and liquidation Introduce E-liquidation system registering all blacklisted directors Move ahead with the E-integration of the Employment Agency, Pension and Disability Fund and Health Fund into one-stop-shop system Create a disaster recovery system for safeguarding the CR databases XBRL strategy on standardizing the e-exchange of financial and business information and data Establish E-leasing/E-pledge for submission of documents to registers	Short Short Short Short Short Short to medium Short Short Short
1.2.2.	Deregistration	To simplify the deregistration process	Introduce online voluntary business de-registration (Macedonian) Introduce online voluntary business de-registration (English) Strengthen the capacity of the Bankruptcy Department (MoE) of Economy to supervise implementation of the bankruptcy law Educate, train and raise awareness of all stakeholders (judges, trustees, creditors (especially SMEs), managers, government agencies) on the scope of the law, the urgency of the procedure and the need for adequate compensation of trustees	Short Short Short Short to medium
1.2.3.		Analyse if there is a need for a separate registry for FDI	Introduce streamlined, one step registration process for foreigners	Short

1.3. Taxation

	Area	Objective	Measure(s)	Timeline
1.3.1.	Tax rates	Optimize fiscal revenues	Consider increasing sources of fiscal revenues, including reviewing both the corporate and personal income tax regimes	Short to long
1.3.2.	Excise duties	Conform excise duties with the acquis	Raise excise duties on certain goods to the minimum required by the acquis	Short to medium
1.3.3.	VAT	Conform VAT with the acquis	Raise VAT on certain goods to the minimum required by the acquis	Short to medium
1.3.4.	DTTs	Extend the DTT network	Ratify DTTs with Belgium, Germany, Egypt and Morocco Extend the network of DTTs with the EU countries of Cyprus, Greece, Malta and Portugal as a matter of priority Initiate DTTs with Canada, Japan and the United States	Short Short Short to medium
1.3.5.	FDI incentives	Increase cost-effectiveness of FDI incentives	Monitor the effectiveness of the FDI incentives regime in attracting investors and its impact on the capacity of the Government to generate public revenue on a regular basis Ensure that Invest Macedonia not only negotiates and signs all agreements on TIDZ incentives comprising State aid, but that it also reports on granted State aid annually to Parliament (instead of DTIDZ)	Short to medium Short
1.3.6.	Build capacity and raise professionalism	Raise knowledge and standards	Train regularly Invest Macedonia staff, such as economic advisers, on tax incentives and investment-related matters	Short

1.4. Accounting and auditing

	Area	Objective	Measure(s)	Timeline
1.4.1.	Accounting and auditing	Increase the knowledge and awareness about accounting and auditing standards and their proper application	Carry out broad-based promotion of the accounting and auditing rules of the country Strengthen an association of professional accountants Seek assistance from associations of accountants from other countries, including through mentoring arrangements and technical assistance provided by UNCTAD	Short Short to medium Short to medium

1.5. Customs administration

	Area	Objective	Measure(s)	Timeline
1.5.1.	Legal requirements of customs administration	Approximate EU requirements	Align legislation with EU requirements (Customs Law) Accede to the convention on Common Transit Procedures Implement the Action Plan for implementation of the standards of the Revised Kyoto Convention Implement the Advanced Economic Operator (AEO) concept	Short Short Medium Medium
1.5.2.	Institutional vision and capacity of customs	Develop a strategic vision and improve operation	Revise and obtain approval for the new Customs Strategy (2012–15) Improve the cooperation with Business Advisory Body Strengthen capacity of customs administration Ensure full integration and management of excise duties in customs	Medium Short to medium Short Short
1.5.3.	Illicit trade and crime	Reduce illicit trade and crime	Develop and improve the risk analysis and selectivity methods in detection of illicit trade and crime Improve capacity to detect different forms of illicit trade Improve cooperation and data exchange with national agencies, other customs administrations and EU institutions in the fight against illicit trade and organized crime	Short to medium Short Short to medium
1.5.4.	Speed and efficiency of customs operations	Further streamline process, reduce time and cost of procedures	Implement the new customs declaration system for processing the (electronic and paper) customs declarations Implement the Integrated Tariff System (TARIC) Implement the Excise Movement Control System Develop further a fully computerized Single Window system for Export/Import/Transit licences on goods and quotas Implement fully computerized and paperless Document Management System for documents delivered to the customs administration Ensure full integration and management of excise duties in customs administration	Short Short to medium Short Medium Short to medium Medium
1.5.5.	Cooperation with business	Strengthen cooperation with business	Improve cooperation between customs administration and the Business Advisory Body of Customs Administration	Short to medium
1.5.6.	Standardization	Approximate EU standards	Fulfil membership conditions in EU bodies Transpose remaining EU standards Raise capacities of the Institute for Accreditation Implement strategy for development of metrology	Medium Medium Medium Short

1.6. Labour

	Area	Objective	Measure(s)	Timeline
1.16.1.	Capacities of IP institutions	Promote capacity building of IP institutions	Strengthen the institutional capacity (staff, budget and capacity building) of Copyright and Related Sector Unit Ministry of Culture	Short
			Establish a Specialized Unit for IP within State Market Inspectorate	
			Implement the current IP rights Strategy focusing on strengthening: the legal framework and its enforcement;	Short
			capacity development and awareness raising	Short
1.16.2.	IP rights protection	Improve IP rights protection	Prepare the integrated IP rights Strategy (2013–2016)	Short
			Ensure that the IRIS (Infrastructure Framework for Intellectual Property) system is fully operational (exchange of information between designated IP rights protection institutions)	Short
			Ensure that the harmonized draft Copyright and Related Rights Law is enforced	Short to medium
			Strengthen capacity of Coordinative Body for IP and implement its programme to fight against piracy and counterfeiting though better coordination of the enforcement agencies	Short to medium
			Review scope for creating a specialized IP rights court (instead of the current 13)	Medium
			Establish mediation and arbitration procedures and mechanisms for settling IP disputes	Short to medium
1.16.3.	Training about IP rights	Promote capacity building of IP experts	Establish, through the Academy for Judges and Prosecutors, regular specialized training programme and retraining for judges/Public Prosecuting Office on effective enforcement of IP rights	Short to medium
			Deliver specialized training for enforcement bodies (Customs Administration, State Market Inspectorate, etc.), on effective enforcement of IP rights	Short to medium
1.16.4.	Awareness raising	Raise awareness about IP rights	Raise awareness of IP rights among the general public: Develop IP rights educational campaigns (video and printed materials); Develop information on the perils of pirated/counterfeited goods;	Short to medium
			Improve access to information on IP rights	Short to medium

1.7. Employment and residence of foreigners

	Area	Objective	Measure(s)	Timeline
1.7.1.	Quotas and labour market test	Use employment of foreigners to fill gaps in skills where shortages exist	Replace the quota system and the labour market test for highly skilled workers with a "scarce skills" approach	Short
			Exempt local and foreign investors seeking employees with scarce skills of the labour market test and of the quotas	Short
1.7.2.	Skills attraction and diffusion	Attract missing skills	Develop and market an active skills attraction and diffusion programme targeting EU countries, based on the scarce skills list to offer EU professionals and high-skills employees in priority sectors (and their families), fast-track entry and residence permits, along with assistance in lodging and local integration	Short to medium
			Assign automatically a number of expatriate positions to those companies that have a proven track record of local staff training	Short
			Extend the validity of the work and residence permit to five years renewable for the founders and directors of the foreign company, and to three years for others	Short
1.7.3.	Procedures of work and employment permit	Simplify the procedures	Review the application and verification procedures for work and residence permits to ensure efficiency and timeliness in responding to the applicants, according to the law	Short
			Consider the possibility of submitting applications at the former Yugoslav Republic of Macedonia missions of the current country of residence of the applicant	Short to medium

1.8. Land and construction permits

	Area	Objective	Measure(s)	Timeline
1.8.1.	Titling and cadastre	Ensure efficiency in the real estate cadastre domain	Update and clarify up to 100 per cent cadastral records and tradable titles Complete the process of digitization of 1:25,000 maps Establish the e-cadastre system and roll out Complete the process of cadastre digitization Complete the e-conveyance system for completion of the property transfer online Complete the system of e-payment for services Prepare the Strategy on National Infrastructure of spatial data Establish National Infrastructure of spatial data Ensure that the Cadastre Agency becomes a self-funding institution	Short Short Short Medium Short Short Short Short Medium
1.8.2.	Land ownership	Foreign legal entities and persons are allowed to acquire land on the same basis as domestic	Ensure that administrative procedures for acquisition of land by foreigners is not more burdensome than those for domestic investors	Short to medium
1.8.3.	Construction permit fees	Reducing fees	Consider reducing the fees of construction permits	Short
1.8.4.	Communal fees and property taxes	Rationalize fees	Consider reducing communal fees and making them more uniform Consider increasing property taxes	Short Short

1.9. Environmental protection

	Area	Objective	Measure(s)	Timeline
1.9.1.	Administration capacities in environmental protection	Improve administrative capacities	Increase national administrative capacities in environmental protection, especially inspectorates	Short to long
1.9.2.	Environmental laws	Strengthen environmental laws	Update national legislation on water quality or IPPC, in order to progress on the acquis Strengthen the full integration of the precautionary principle, the principle of preventive action and the polluter-pays principle into national policymaking and implementation in areas other than environmental protection itself Strengthen implementation of environmental laws	Medium to long Short to long Short to long

1.10. Competition policy and State aid

	Area	Objective	Measure(s)	Timeline
1.10.1.	Competition Agency	Strengthen the Competition Agency	Ensure that resources (staff and funds) are available to implement remit Establish sound implementation of State aid provisions, demonstrated by the record of enforcement	Short Short
1.10.2.	Capacity-building	Strengthen autonomous capacity in skills development	Strengthen the capacity of the staff of the competition authority: establish a capacity-building provision in the budget of the Commission	Short to medium

	Area	Objective	Measure(s)	Timeline
1.10.3.	Implementation of Competition Law and secondary legislation	Implement fully the Competition Law and secondary legislation	Ensure full harmonization with EU requirements by adopting regulation relating to block exemption to certain agreements and concerted practices in air transport Adopt Decree on the conditions and procedure for decreasing and abolishing fines in the misdemeanour procedure (leniency) Adopt necessary guidelines for realization of mergers Adopt guidelines on the concept of the concentration	Short Medium Medium Medium
1.10.4.	CPC capacity	Strengthen the CPC capacity	Increase CPC budget to increase the case handlers (e.g. focusing on cartels and abuse of dominant position) to 18 Develop skills and capacity of the technical staff at CPC	Short Short
1.10.5.	Competition-relates legislation	Strengthen competition-related rules	Amend the Law on Prevention of Corruption: Improve protection for "whistleblowers"	Short
1.10.6.	Control and surveillance of the State aid	Improve Commission's efficiency in surveillance and control of the State aid Improve coordination between State aid providers and businesses	Increase the number and capacity of the State Aid Unit Increase the capacity of State aid providers Adopt new Decree on conditions and procedure for submission of State aid notification to the CPC and assessment of the State aid Adopt Decree on conditions and procedure for granting de minimis State aid Establish and build reliable record for realization of State aid control Establish an comprehensive system for ex ante control of State aid Raise awareness of State aid regulations among government institutions, business and the general public	Short Short to medium Short Short Short Short Short to medium

1.11. Commercial justice

	Area	Objective	Measure(s)	Timeline
1.11.1.	Commercial justice	Build the capacity of staff dealing with commercial justice issues	Strengthen the independence and the capacity of the judicial system through: • Improving the court infrastructure; • Establishing IT systems in the judicial institutions; • Improving the enforcement of court cases, and establishing an efficient system to deliver court summons Train specialized commercial judges to improve the efficiency of commercial justice	Short to long Short to medium

1.12. Transparency

	Area	Objective	Measure(s)	Timeline
1.12.1.	Anti-corruption strategy	Develop a strategic framework for anti corruption activity	Prepare integrated anti-corruption and prevention of conflict of interest strategy/ programme Submit strategy to Parliament for information Review regularly progress with implementation Submit annual progress report to Parliament for information	Short Short Medium Short
1.12.2.	Ratification of international conventions	Combat bribery	Adopt the OECD Convention on Combating Bribery of Foreign Public Officials Review regularly progress with implementation of: • OECD Convention; • UN Convention against Corruption	Medium Medium
1.12.3.	Fight against corruption	Improve the capacity of entities dealing with corruption	Improve enforcement capability in the area of criminalization of corruption Improve implementation of rules on conflict of interest policy for civil servants Strengthen the specialized anti-corruption unit operating within the main office of the Public Prosecutor (Basic Prosecutor's office for organized crime and corruption), and increase the staff of the Public Prosecutor's office Show more forcefully willingness to prosecute corrupt officials by increasing the number of cases brought to prosecution and speeding up the process Strengthen the enforcement of the amended Law on Financing Political Parties	Short to long Short to medium Short to medium Short to medium Short to medium
1.12.6.	Other	Enhance transparency about anti-corruption	Compile statistics on corruption cases related to public procurement handled by the courts	Short to medium

1.13. Public procurement

	Area	Objective	Measure(s)	Timeline
1.13.1.	Public procurement capacities	Increase the capacities of the PPB Develop the legal, institutional and admin. capacity Implement the PP Law	Increase the staff complement of Public Procurement Bureau (PPB) commensurate with responsibilities, continue with training of staff Adopt the Strategy on Development of the Public Procurement System (2010–2015) with associated action plan Monitor, review and update regularly the Strategy implementation Enact the changes and amendments to the Public Procurement (PP) Law Review why several major public tenders have been cancelled or failed Implement recommendations to streamline process Make better use of the flexibility permitted under the acquis for the arrangements on utilities when applying the Law on Public Procurement	Short to medium Short to long Short to medium Short Short Short Short
1.13.2.	Remedies system	Promote institutional and administrative capacity-building Increase the awareness of legal protection	Increase staff and budget of the State Appeals Commission (SAC) Ensure budget for technical advice from external experts Align with amended EC Remedies Directives Implement Document Management System Raise awareness as to the SAC's activities and mandate	Short to medium Short Short Short Short to medium
1.13.3.	Conflict of Interest policy	Reduce conflicts of interest	Raise awareness on conflicts of interest in PP matters Develop statistics on PP corruption cases handled by the courts (software, training, etc.)	Short to medium Short
1.13.4.	Corruption in Public Procurement	Improve coop. between contractors and economic operators	Strengthen administrative capacity and coordination mechanisms of the main stakeholders in the public procurement system Continue to build capacity of both tenderers and public authorities through the Public Procurement Training Centre	Short to medium Short to medium

1.14. Corporate social responsibility (CSR)

	Area	Objective	Measure(s)t	Timeline
1.14.1.	CSR policy	Strengthen CSR policy	Implement the National Agenda on CSR in Macedonia 2008–2012 Introduce and promote environmental and social labelling Create the obligation of CSR reporting for all State-owned entities, including firms	Short to medium Medium Short to medium
1.14.2.	CRS capacity-building	Strengthen institutions	Strengthen the National Coordinating Body on CSR Develop capabilities of the NGOs Train media and carry out capacity building for NCB–CSR (through the National Coordination Body for CSR) Ensure consultancy and expert policy assistance to the working group of State institutions and regulators of the NCB–CSR	Short to medium Short to medium Short to medium Short to medium
1.14.3.	CSR awareness raising campaign	Promote effective implementation of project on behalf of CSR stakeholders	Implement the "Mainstreaming of the National Agenda on CSR – Support to the National CSR Platform" to promote CSR through: Production of CSR promotional materials, CSR Caravan, CSR thematic forums, media coverage and web site and E-bulletin; Organization of National CSR Award; State and private enterprise reporting on CSR measures; Mapping CSR steps in public procurement procedures	Short to medium

1.15. Public-private partnerships (PPP)

	Area	Objective	Measure(s)	Timeline
1.15.1.	PPP – Implementation unit	Establish adequate PPP capability	Strengthen the administrative capacities of the Public-Private Partnership Unit within the Ministry of Economy through increased human and financial resources as well as training	Short to medium
1.15.2.	PPP – Legislation	Develop the necessary PPP laws and regulations	Adopt a new PPP Law aiming at eliminating inconsistencies with sector-specific laws Prepare by-laws connected with the Law on Concessions and PPP Prepare legal guide for implementation of PPP Capacity building and support connected with PPP (Law of Concessions and PPP)	Short Short to medium Short Medium
1.15.3.	PPP – Consultations	Allow for dialogue on PPPs	Establish regular consultations with domestic and foreign investors/firms on PPP matters	Short to medium

1.16. Protection of intellectual property (IP)

	Area	Objective	Measure(s)	Timeline
1.16.1.	Capacities of IP institutions	Promote capacity building of IP institutions	Strengthen the institutional capacity (staff, budget and capacity building) of Copyright and Related Sector Unit Ministry of Culture Establish a Specialized Unit for IP within State Market Inspectorate Implement the current IP rights Strategy focusing on strengthening: • the legal framework and its enforcement; • capacity development and awareness raising	Short Short Short
1.16.2.	IP rights protection	Improve IP rights protection	Prepare the integrated IP rights Strategy (2013–2016) Ensure that the IRIS (Infrastructure Framework for Intellectual Property) system is fully operational (exchange of information between designated IP rights protection institutions) Ensure that the harmonized draft Copyright and Related Rights Law is enforced Strengthen capacity of Coordinative Body for IP and implement its programme to fight against piracy and counterfeiting though better coordination of the enforcement agencies Review scope for creating a specialized IP rights court (instead of the current 13) Establish mediation and arbitration procedures and mechanisms for settling IP disputes	Short Short Short to medium Short to medium Medium Short to medium
1.16.3.	Training about IP rights	Promote capacity building of IP experts	Establish, through the Academy for Judges and Prosecutors, regular specialized training programme and retraining for judges/Public Prosecuting Office on effective enforcement of IP rights Deliver specialized training for enforcement bodies (Customs Administration, State Market Inspectorate, etc.), on effective enforcement of IP rights	Short to medium Short to medium
1.16.4.	Awareness raising	Raise awareness about IP rights	Raise awareness of IP rights among the general public: Develop IP rights educational campaigns (video and printed materials); Develop information on the perils of pirated/counterfeited goods; Improve access to information on IP rights	Short to medium Short to medium

1.17. Simplification and regulatory impact assessment

	Area	Objective	Measure(s)	Timeline
1.17.1.	Guillotine	Reduce admin. barriers Improve regulatory Environment	Complete the streamlining of legislation connected with the third Guillotine process focusing on customs, transport and agriculture Evaluate impact of rounds 1–3 of the Guillotine process Determine focus of round 4 of the Guillotine process, if any Implement all Guillotine recommendations	Short Short Short Medium
1.17.2.	Regulatory impact assessment (RIA)	Reduce administrative Barriers Improve the regulatory Environment	Build capacity for the establishment of RIA within all institutions Ensure that RIA is systematically applied to all draft economic policy normative acts Obtain evidence that the results of RIA are used to change draft laws Develop effective PPD mechanisms for the RIA process Assess quality of IA capability within Ministry of Economy Continue building capacity within all departments at MoE	Short Short to medium Short Short Short Medium
1.17.3.	Public-private dialogue (PPD)	Establish a PPD forum for economic matters	Re-establish the NECC as a key tool for high level PPD Ensure sustainability of NECC by securing funding from State budget Implement regular (monthly or more frequent) meetings of the NECC Develop the capacity of secretarial of the NECC to perform its role	Short Short to medium Short to medium Short

2. Creating synergies between FDI and industrial policy

Aside from measures that must be taken to enhance the overall investment climate, the Government should also consider, within the programme for stimulating investment, those elements of industrial policy that are directly related to the aim of reaping the benefits from FDI in terms of employment, innovation and integration of the local productive sector in the international value chains of foreign investors. In this respect, it should consider initiatives aimed at upgrading SMEs, developing clusters and transforming the TIDZ. The success of these initiatives should be measured in terms of increased innovation and export activity by the local SMEs and the successful creation of business linkages with TNCs.

2.1. Empowering SMEs

	Area	Objective	Measure(s)	Timeline
2.1.1.	Agency for Promotion of Entrepreneurship of the Republic of Macedonia	Strengthen capacities	Increase human and financial resources of SME promotion	Short to medium
2.1.2.	Access to Public Revenue Office (PRO) by SMEs	Improve access and payment methods	Extend number of PRO branch offices in the country from 30 to 70 Introduce new methods of communication with SMEs, e.g. SMS Establish electronic submission of VAT, personal income tax, etc. by natural persons	Short to medium Short to medium Short
2.1.3.	Access to PRO by SMEs	Ensure that SMEs have easier access and payment methods	Extend number of PRO branch offices in the country from 30 to 70 Introduce new methods of communication with SMEs, e.g. SMS Establish electronic submission of VAT, personal income tax, etc. by natural persons	Short to medium Short to medium Short
2.1.4.	Micro finance	Facilitate access to credit for SMEs	Introduce new instruments (start-up capital, guarantees) Introduce venture capital, through involving the Macedonian Bank for Development Promotion	Short to medium Short to medium
2.1.5.	Vocational training, education	Proving training to SMEs	Provide training in entrepreneurial skills, basic accounting and basic management Establish an UNCTAD Empretec Centre to assess impact in the country	Short Short to medium

2.2. Developing clusters and supplier linkages

	Area	Objective	Measure(s)	Timeline
2.2.1.	FDI-SME linkages	Promote transfer technology and know-how, and increase SME competitiveness	Establish and update Joint Ventures database with focus on SMEs Review priority investment sectors Develop SME linkages programme once export promotion has been integrated Work closely with the SME Agency to develop and support SMEs Create match making events, such as international forums to showcase clusters as suppliers of TNCs	Short Short Short to medium Short to medium Short to medium
2.2.2.	Clusters development	Strengthen international visibility of clusters	Organize regional or international forums to showcase clusters as suppliers of TNCs	Short to medium

2.3. Transforming TIDZs

	Area	Objective	Measure(s)	Timeline
2.3.1.	Management of TIDZs	Reconsider the management of TIDZs	Consider opening new TIDZs only if this involves land preparation for private investment Determine model for management of current 4 and future new zones Transfer zone management to private sector (if model is selected)	Short Short Short
2.3.2.	Institutional support to TIDZs	Promote institutional streamlining	Establish one-stop-shop system for all TIDZ matters (including environmental impact assessment, building permits and licenses, resident permits, etc.) Prepare an analysis of the TIDZ Law to assess impact	Short Short
2.3.3.	TIDZs and clusters	Align TIDZs with clusters development	Encourage the establishment of local suppliers in TIDZs Promote TIDZs to domestic firms Consider turning the TIDZs into multi-facility zones	Short to medium Short to medium Medium to long

3. Strengthening policymaking in the area of investment and competitiveness

Achieving an integrated and coherent approach to policymaking in the area of investment and competitiveness is a challenge that requires significant government efforts in terms of planning, institutional coordination and consultations with stakeholders, both at the public and private levels. This dimension of the matrix contains recommendations with a view to strengthening the current institutional architecture relevant to the planning and execution of investment and competitiveness strategies.

3.1. Enhancing the efficiency of the institutional framework in the area of investment and competitiveness

	Area	Objective	Measure(s)	Timeline
3.1.1.	Investment Committee	Transform the Investment Committee into a mechanism for advocacy and dialogue with the investor community	Change schedules of meetings to 2–3 per year Change agenda to identifying policy gaps and bottlenecks, and recommending policy reforms Increase membership of the Investment Committee to include representatives of the investor community Define the mandate of investor community: such as two years, renewable Involve Prime Minister as chairperson of regular sessions Adopt future Programmes for Stimulating Investment	Short Short Short Short Short Medium
3.1.2.	Ministerial Committee on Competitiveness (MCC)	Transform the MCC into the entity responsible for the oversight of the integrated treatment of competitiveness, industrial policy and investment	Strengthen the team designing future Programmes for Stimulating Investment, its links with the MCC, and its mandate; Become focal point for monitoring future Programmes for Stimulating Investment: • Delegate their preparation to the right entity; • Participate in the monitoring of their implementation; • Recommend policy actions to modify them	Long Long
3.1.3.	Ministry of Economy, Department for Stimulating Investments and Social Responsibility	Analyse FDI impact to guide policy action	Strengthen analytical capabilities to carry out research to: • Prepare inputs for Programmes for Stimulating Investment; • Assess the impact of FDI inflows on the economy; • Devise policy options to optimize the impact of FDI inflows on the country's economic and social development	Short to long

4. Rationalizing the investment promotion effort

In the former Yugoslav Republic of Macedonia, as in most other countries, many organizations in the public and private sectors contribute to the investment promotion effort. This dimension of the Programme sums up recommendations on how to rationalize the current setting.

4.1. Rationalization of investment promotion institutions

	Area	Objective	Measure(s)	Timeline
4.1.1.	Minister(s) without Portfolio	Rationalize the system of investment attraction	Consider phasing out the post of Minister(s) without Portfolio Analyse how and when Invest Macedonia's promoters can take over the role of targeting investors	Short Short
4.1.2.	Team Macedonia	Strengthen Team Macedonia	Co-opt business representatives on an ad hoc basis	Short
4.1.3.	TIDZs	Rationalize FDI attraction to TIDZs	Assess scope for merging the investment promotion activities of Invest Macedonia and TIDZ Merge the investment promotion activities of Invest Macedonia and TIDZ	Short Medium

4.2. Invest Macedonia

	Area	Objective	Measure(s)	Timeline
4.2.1.	Investment promotion strategy	Develop a clear strategic vision and improve the image of the former Yugoslav Republic of Macedonia	Revise and update Investment Promotion Strategy (current one up to 2007) Obtain Government approval for new Investment Promotion Strategy (coordinated with the Export Promotion Strategy below)	Short Short
4.2.2.	Institutional support for investment promotion	Implement investment promotion strategy and promote institutional streamlining	Create a new IPA structure to incorporate new Export Promotion remit Ensure adequate budget and staff complement for new activities Revise wage structure to reflect needs of investment / export promotion Establish regular links with key local authorities (land management, permits, etc.) Establish regular links with 8 planning regions/ development agencies (and work with them) Raise wages levels of comparable regional levels (benchmarking) in order to attract and retain qualified staff	Short Short Short Short to medium Short to medium Short to medium
4.2.3.	One-stop shop	Streamline and facilitate delivery of services	Develop strategy for conversion of IPA into one-stop shop Implement strategy for establishment of one-stop shop capability	Short Short to medium
4.2.4.	Client relationship management in investment promotion	Streamline the process of attracting investors	Shift management of CRM database to Invest Macedonia	Medium

	Area	Objective	Measure(s)	Timeline
4.2.5.	Aftercare services	Anchor existing investors in the country	Categorize aftercare services Identify the clientele by setting-up a database of established companies that are targets for re-investment, based on the database of the Ministers Without Portfolio Assign account managers specifically to priority sectors and assess customers' needs Develop a systemized and streamlined aftercare function for: • TIDZ investors; • Non-TIDZ investors Prioritize key aftercare services focusing on: • Work and residency permits; • Construction permits; • VAT and taxation Implement the "10-point checklist for effective aftercare" which forms part of the IPA's strategy Consider adopting UNCTAD's i-Track software	Short Short Short Short Short Short to medium Short
4.2.6.	Policy advocacy	Ensure transparency in the investment environment	Establish and apply mechanism for regular dialogue (quarterly basis) with stakeholders e.g. FIC, ICI, NECC, business associations, etc. Develop capacity of the IPA Advocacy Team Determine policy advocacy approach for existing and new investors Feed investors' concerns into the policy advocacy agenda	Short to medium Short Short Short
4.2.7.	Export promotion	Develop export promotion as a separately managed section within Invest Macedonia	Develop Strategy for Export Promotion (and coordinate it with the investment promotion strategy) Start a pilot programme of linkages between local producers/exporters and foreign firms	Short Short to medium

4.3. Access to key information in investment promotion

	Area	Objective	Measure(s)	Timeline
4.3.1.	Publication avenues and tools	Ensure the widest access possible to IPA information	Translate website into new key languages, in addition to English (German, French, Japanese, Chinese, etc.) Ensure all legislation relevant to investment and export matters is made available on Internet in Macedonian and English free of charge Publish online the most updated investment-related laws and regulations of the country in non-official English translation Post all key information on investment policy laws, regulations, opportunities, etc. on the website, update regularly and make available in English	Short Short to medium Short Short to medium
4.3.2.	Prior notification and stakeholder consultations	Raise investor awareness of laws and regulations	Give prior notification of investment and export laws, regulations, policies, strategies and programmes Implement regular, broad based consultation on the above issues	Short Short to medium
4.3.3.	Procedural transparency	Give investors the possibility of recourse	Establish right to complain and/or appeal denial of investment projects Establish prompt and impartial review of decisions, including judicial review	Short Short

4.4. Local actors

	Area	Objective	Measure(s)	Timeline
4.4.1.	Skills and local municipalities	Improve skills, knowledge and capabilities about attracting investors	Raise awareness of the link between FDI and local economic development Deliver training on FDI issues Work with municipalities to develop database of greenfield and brownfield opportunities Ensure that the local investment opportunities database is regularly updated	Short Short Short Short to medium

5. Ensuring effective policy implementation

An important precondition of the success of the new programme for stimulating investment is, in addition to adequate resources for implementation, to develop an effective monitoring and evaluation mechanism of the programme results. In terms of resources, the Programme will be implemented with public funds, a signal of the Government's commitment to promote both domestic and foreign investment. International support from international institutions, including the EC, and bilateral partners should also be sought to complement the dedicated national resources. The recommendations in this area are:

5.1. Improving the monitoring and evaluation of the programme

	Area	Objective	Measure(s)	Timeline
5.1.1.	Monitoring and evaluation of the investment programme	Improve the monitoring and evaluation of the programme for stimulating investment	Define the Government entity responsible for overseeing the monitoring and evaluation and obtaining the relevant information from executing entities Transfer the oversight of progress and evaluation reports on the programme for stimulating investment to the Cabinet of the Deputy Prime Minister for Economic Affairs Gather inputs on a quarterly basis Present progress reports annually to the MCC Prepare evaluation report at the end of the cycle Involve UNCTAD in evaluation	Medium to long Medium to long Short to medium Short to medium Medium Medium
5.1.2.	Monitoring and evaluation of Invest Macedonia	Improve the assessment of progress and effectiveness	Regularly assess progress and evaluate effectiveness Monitor regularly the implementation of the Programme to Stimulate Investment Develop a mechanism for monitoring progress against Investment Promotion and Export Promotion Strategy(ies) Benchmark progress against IPAs in Western Balkans Report to Management Board and Investment Committee regularly	Short to medium Short to medium Short to medium Short Short to medium
5.1.3.	Transparency of progress reports	Improve transparency by making progress reports available to the public	Make progress report available to public on Ministry of Economy, Deputy Prime Minister for Economic Affairs and Invest Macedonia websites	Short to medium

5.2. Improving statistical reporting

	Area	Objective	Measure(s)	Timeline
5.2.1.	Data collection on FDI and TNC activities	Improve data collection	Simplify data collection of FDI and TNC activities Organize responsibilities for FDI data as follows: • Central Registry identifies foreign-owned firms. • NBRM collects data on FDI. • NBRM and SSO merge mailing lists for TNC survey. • Carry out one TNC survey. • Annual questionnaire on business climate.	Short to medium Short to medium
5.2.2.	Data analysis	Exploit better existing data	Match FDI/TNC data with other data sources (e.g. financial statements, foreign trade)	Short

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