GOVERNMENT OF THE REPUBLIC OF MACEDONIA
MINISTRY OF ECONOMY

PROGRAMME FOR STIMULATING INVESTMENT IN THE REPUBLIC OF MACEDONIA

The Programme for Simulating Investment
in the Republic of Macedonia has been prepared
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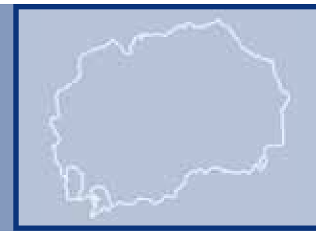

FOREWORD

The Republic of Macedonia has made uneven progress in restructuring its political and economic system since the start of the transition process. Despite the determined efforts of the Government of Macedonia (GoM) for creating a favourable economic environment, the wider regional political instability has affected the image of the country.

The international community and private investors are increasingly aware of the momentum of reform that has built up. Recent activities of the GoM, underpinned by the Ministry of Economy (MoE), include the following:

- Implementation of a strategy for the finalisation of the privatisation process (public auction) through the Macedonian Stock Exchange.

- Transparency in the process of issuing licenses for import and re-export through the introduction of the “first come, first served” principle, an important development in the attempt to reduce corruption.

- Initiation of a programme for the development of small and medium-sized enterprises (SMEs), including a new implementation agency designed to stimulate start-ups and early growth companies.

This is a start, but it is not sufficient. The current economic environment, not least the levels of unemployment, require a rethink of policies with respect to investment, whether domestic or international, in order to accelerate the pace of growth.

Now that the privatisation process is nearing completion, there are no easy options for stimulating investment. At the same time, there is an urgent need to improve the fundamentals of doing business in this country, in order to increase our attractiveness, productivity and competitiveness vis-à-vis our competitors in the South East Europe region and beyond.

In order to meet these needs the *Programme for Stimulating Investment in the Republic of Macedonia* has been created. It is an effort, based on profound previous examination of the existing investment climate in the country, to identify different forms of barriers in the economy, legal system and political environment, that limit and distract investment in general, especially the foreign direct investment (FDI) inflow.

The Programme for Stimulating Investment in the Republic of Macedonia has arisen from a consultation process taking the needs of domestic and international investors as the starting point. The resulting measures for reform amount to a very demanding agenda. The process is to be co-ordinated by the MoE but it will require the active involvement and contribution of various state bodies, the private sector, civil society, as well as the wider international community, in order to make progress. We invite these bodies to continue the partnership for reform.

The GoM recognises that both domestic and international investors are attracted, first and foremost, by a healthy business environment. Consistent with the principles to be outlined in this Programme, and taking into consideration investor's expectations, Government and Parliament are invited to approve the reform priorities that are elaborated more fully in the remainder of this Programme for stimulating domestic as well as foreign direct investment, including:

- Creation of a detailed Action Plan to reduce barriers to investment.
- Creation of the Foreign Investment Agency of the Republic of Macedonia.
- Intensification of the fight against corruption, bribery and favouritism.
- Reform of the tax system and associated investment incentives, etc.

This Programme is a document that will guide the relevant ministries in the process of implementation of the suggested measures, including identified executives and dynamics. At the same time it is a basis for further networking with other development documents of the country. It will serve as the principal guide for the activities of the Ministry of Economy, the future Foreign Investment Agency of the Republic of Macedonia, as well as the relevant ministries, private sector and civil society active in this field.

Ilija Filipovski,

Minister of Economy

1.0. INVESTMENT IN MACEDONIA: Guiding Principles

The Government of the Republic of Macedonia (GoM) is guided by 10 principles that constitute the framework for investment promotion:

1. The GoM is committed to generating a modern, open and competitive economy, in line with the principles of the Stabilisation and Association Agreement signed with the European Union (EU), as well as the framework of the Acquis Communautaire of the EU.
2. The principle of “national treatment” or non-discrimination, is of paramount importance. The same rights and protections afforded to domestic firms apply to international enterprises.
3. The generation of a stable democratic and macroeconomic environment is top priority of GoM, and is of utmost importance to all investors and countries’ citizens equally.
4. Investment promotion aimed at attracting investment will be based on a regional, European-wide and global perspective.
5. The right to free transfers related to investment and protection from arbitrary expropriation, is a prerequisite for stimulating investment.
6. A predictable and transparent regulatory environment, free of administrative impediments, is essential in firms’ investment assessments and location decisions.
7. An impartial, effective and transparent judicial system and other state institutions, law enforcement and dispute resolution is essential to investors’ safeguard.
8. Continuous fight against corruption, bribery and favouritism, which represent a corrosive influence on society and inhibit the conduct of business.
9. Creation of a tax environment that promotes and encourages investment and, at the same time, is capable of raising a fair share on host country profits, and is equitable from the perspective of both business and government.
10. Developing investment incentives consistent with the EU Stabilisation and Association Agreement, as well as World Trade Organisation and other international rules and regulations governing trade relations.

The remainder of the *Programme for Stimulating Investment in the Republic of Macedonia* builds on the framework created by these 10 strategic principles in relation to investment promotion.

INVESTMENT IN THE REPUBLIC OF MACEDONIA

2.0.

This section of the Programme focuses mainly on the issues of Foreign Direct Investment (FDI). The GoM is moving towards eliminating the remaining non-conforming barriers in order to ensure full national treatment. However, in keeping with the principle of non-discrimination discussed in the guiding principles above, the programme also recognises the need to mobilise domestic investment as much as FDI.

2.1 DEFINITIONS

Direct investment is a category of international investment made by a resident entity in one economy (direct investor) with the objective of establishing a lasting interest in an enterprise in an economy other than that of the investor (direct investment enterprise). “Lasting interest” implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the direct investment enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated.

2.2 VALUE OF FDI

The economic benefits of attracting FDI are twofold. Firstly, countries such as Macedonia, where domestic savings are too low to finance economic expansion, can utilise FDI as a source of external finance. Secondly, the presence of foreign corporations tends to be associated with positive “externalities” which countries may benefit from, such as transfers of know-how and technology to assist the development and restructuring of enterprises, for example following privatisation. Other externalities include assisting the process of international trade integration, boosting business competitiveness and assisting human capital formation in the host country. All these externalities, especially the first two, are recognised as being of potential benefit to Macedonia. To the extent that transnational companies (TNCs) are agents affecting a country’s comparative advantages, they are considered to be an important part of the development process. The evidence is that the economic benefits arising from FDI are real (but not automatic), and their magnitude varies from country to country. Without a healthy business-enabling environment that encourages domestic and foreign investment, incentives, competition and improvement in skills and a competitive corporate climate, these benefits may not be realised.

2.3 FDI TRENDS

In the absence of sufficient domestic savings to underpin the acceleration of economic growth (the level of gross investments reached 16% of the GDP in 2002, as compared with a level of 24-25% which would be adequate to embark on a more ambitious process of economic development), the attraction of FDI has been very important to Macedonia. However, an analysis of the FDI inflow over the last ten years demonstrates that the performance has been weak (see Table 1), with net FDI making up about 1% of GDP (FIAS, 2003).

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Total	11.8	2.2	0.8	19.0	8.3	7.2	15.72	117.7	32.1	176.3	443.2	77.5

Table 1. FDI Inflow In Republic of Macedonia in USD mil. (1991-2002)
Sources: State Statistical Bureau (1991-1996); National Bank (1997-2002)

According to the Statistical Bureau and the National Bank of the Republic of Macedonia, the cumulative value of FDI in the Republic of Macedonia at the end of 2002 was equivalent to approximately USD 912 million, the majority being accounted for by privatisation deals transacted through the Macedonian Stock Exchange. In terms of country of origin, the most significant investor to date is Greece, followed by Liechtenstein, Switzerland, Germany, Hungary, Austria and Slovenia.

During the 1990s, the majority of foreign investments were in the manufacturing and construction sectors, but more recent in-flows have focused on the service sector, with headline deals in Stopanska Banka (National Bank of Greece, EBRD and IFC), the insurance company ADOR a.d Skopje (QBE International of the UK), and Macedonian Telecommunications (MATAV of Hungary, which is owned by Deutsche Telekom).

Despite these recent successes and the central role afforded to FDI by the GoM, present levels of FDI lag considerably behind competitor states elsewhere in South East and Central Europe. There are numerous reasons for this, including the small size of the country, limited natural resources and low per capita incomes. In addition, investors continue to be deterred by negative perceptions of the country caused by recent regional conflicts.

The vast majority of FDI has been privatisation-related, with very little “greenfield” investment in the form of new facilities. Privatisation-led injections of investment are no longer an option for the Republic of Macedonia since the only remaining large privatisation deals are likely to be linked to the sale of the Elektrostopanstvo (state electricity company) and Makedonski Posti (state post office). Now that the privatisation process is effectively over and the Privatisation Agency is scheduled to be wound-down at the end of March 2004, the necessity to boost foreign direct as well as domestic investment has become even more urgent.

2.4 FDI DETERMINANTS

A recent study for the Investment Compact for SEE explored the extent to which tax policy design can influence FDI, focusing specifically on the role of tax incentives in the SEE region. Since these countries are Macedonia's main competitors, the analysis is particularly enlightening and leads to the general policy conclusions presented in Box 1 below.

The principal determinants of the location of FDI are the policy framework developed by the host country, the nature of the measures adopted to facilitate and promote investment and the wider economic factors and characteristics of the host country. A SWOT analysis for Macedonia as an FDI location is presented in Box 2. All countries can be the target of FDI if they build on their strengths, take remedial actions to correct their weaknesses, are prepared to take advantage of new opportunities, and protect themselves against developing threats.

Box 1. FDI in SEE[1]: Key Recommendations

- The transition countries have experienced fairly steady growth in inward FDI as they implement market reforms. Taking the four central European countries plus the three Baltic countries, the flow of FDI in the year 2001 was almost four times that of 1993. By contrast, countries such as Belarus and Ukraine, which have been much slower in instituting market reforms, have experienced very little growth in FDI. *This suggests that, providing economic and political conditions are stable and received positively by investors, the SEE countries can expect FDI to increase as they continue to implement reforms.*

- There is a close link in many transition countries between FDI and the privatisation process: that is, a substantial proportion of FDI has taken the form of acquisitions of shares in state-owned enterprises. This accounts in part for the unevenness of FDI in some countries. Progress in privatisation is consequently likely to produce increased FDI. The downside is that once privatisation is completed, investor interest may fall significantly. In Hungary, FDI has declined steadily since 1995 (with a notable reversal in this trend in 2001); in the Czech Republic it peaked in 1999. In Poland, FDI declined in 2001 from its all-time high in 2000: only 6% of FDI was derived from privatisation in 2001, compared to 35% in the previous year. *The indications, therefore, are that FDI in transition countries may decline, perhaps substantially, once the process of privatisation is completed, unless a major effort is made in the right areas to provide an "enabling environment" for "greenfield" investment.*

- Non-transparent policies and administrative practices have contributed considerably to investment costs in SEE countries. The need to allocate significant human resources to understand and comply with non-transparent tax policies and administrative approaches, by increasing project costs, has tended to discourage initial investor interest and scope for continued commitment. Similar cases have been found in other transition economies, where *there is considerable survey evidence that non-transparent and often inconsistent government policies and obstructive or incompetent bureaucracies are major irritants and deterrents to FDI.*

- One of the most important determinants of FDI in SEE countries – and very often the most important – is the risk factor. Investments in SEE countries are typically made on the presumption of an attractive business opportunity, but accompanied by a high perceived-level of risk. In some countries, especially those that have experienced great difficulty attracting substantial FDI, *there are frequent complaints of uncertainty over applicable tax policies and tax administration and thus uncertainty over the implications of tax on profit. A patchwork of changing policies and practices in some countries has heightened uncertainty and perceived levels of project risk, tending to curb investor interest.*

- Closely related to project costs and risks are real and perceived levels of corruption of tax and customs officials. Contending with corruption increases project costs, while uncertainties associated with the frequency, degree and cost of corruption add to project risk. *Corruption, by increasing project costs and risks, operates through these channels to reduce expected risk-adjusted rates of return, discouraging "greenfield" FDI.*

- SEE countries seeking to attract "greenfield" FDI should concentrate their efforts on the implementation of sound economic reforms that focus on providing basic elements of an enabling environment. *Tax and supporting administrative practices should be clarified through budget documents, explanatory notes and public statements. Independent and fair evaluations of major programmes (e.g. tax expenditure programmes) should be undertaken, and audited public accounts should be prepared annually, with unfettered public access to such information.*

Source: OECD, 2003a, pp.187-8, emphasis added

[1] The following countries are referred to: Bulgaria, Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Moldova, Romania and Serbia and Montenegro.

Box 2. SWOT Analysis: Republic of Macedonia as an FDI Location

Opportunities

Regional economic integration
EU Stabilisation and Association Agreement signed in 2001
Bilateral and multilateral agreements
Large diaspora and remittances
Commitment to unemployment and poverty reduction
Commitment to implement the Ohrid Framework Agreement signed in August 2001, including a process of decentralisation

Weaknesses

Perception of instability and conflicts in the region
Small domestic market
Low per capita income
Highly centralised state and weak institutional capacity
Outdated industrial technology
Rigid labour market
Judicial bottlenecks

Strengths

Stable macro-economic environment
Most democratic and economic structural reforms undertaken
Relatively low-cost, skilled labour
Natural and tourist attractions
Financial and tax incentives for investors
Geographical proximity to major regional and European markets.
Crossroads of European corridors 8 & 10
Proximity to Adriatic and Mediterranean seas
Relatively good infrastructure

Threats

Continued potential for ethnic tension and destabilisation of the country
Increased competition from neighbouring countries
Continued over-reliance on the State

The weakness of the SWOT approach is that it does not take into account TNCs' decision-making process and, in particular, the factors that cause companies to prefer one location above another (UNCTAD, 1998). The basic tenet of such an approach is that an investor targeting strategy can focus on a particular stage of the investment decision process, and thus directly affect the outcome.

There are three basic motivations underlying a TNCs' decision to undertake FDI. An analysis of the situation in Macedonia indicates that the potential lies in market-seeking and/or efficiency-seeking strategies. The *market-seeking* portion of FDI may be interested in entering Macedonia's nascent consumer market and establishing a presence capable of accessing the regional market. In this category, strategic sectors (telecommunications, energy, banking, transport, and water), as well as private investment in infrastructure could be important. With a small domestic market and low per capita income, most FDI outside the strategic or infrastructure sectors is initially likely to be *efficiency-seeking* or cost reducing investment seeking more favourable cost bases for operations, such as export and re-export oriented light manufacturing and services. Efficiency-seeking FDI tends to be attracted to locations with skilled workforces and with good technological and physical infrastructure. Both forms of FDI may enter the market as Macedonia secures greater economic integration, through various trade agreements and removal of non-tariff barriers, thereby increasing the regional market size and income levels, and infrastructure and transport are enhanced.

It must be stressed, however, that significant FDI in Macedonia's "non-strategic" sectors cannot be anticipated without significant progress in improving the country's general business climate. Both focused GoM commitment and support from the international community are required to improve the image of Macedonia as an investment destination. Whilst significant efforts have been made to address some of these problems, serious obstacles to FDI remain to be tackled. It is the aim of this Programme to ensure that progress is made in relation to the key remaining impediments to investment inflows.

2.5 POTENTIAL FOR INVESTMENT

There is a lack of detailed information on the relevant sectors and sub-sectors where Macedonia's comparative advantages lie. Although sectoral studies have been undertaken (MBRC, various), the underlying economic analysis and the link to potential investors need to be further developed. Comparative work is currently being undertaken on key competitors in the SEE region in order to develop a better understanding of where the potential lies, as far as Macedonia is concerned.

Upon the creation of the Foreign Investment Agency of the Republic of Macedonia (FIARM, see below), one of its priority actions will be to lead an urgent and through review of the key sectors and sub-sectors offering potential, including matching the sectors offering investment potential with interested countries / companies, as well as developing the associated investment promotion strategies to ensure proactive marketing (see annex 1).

This will involve using the material that will be available by then, as well as involving the private sector associations/forums in the process to:

- Convene discussions with leaders of principal sectors.
- Request sector leaders to specify an “investment agenda”, based on the investment needs of the sector and the reasons why foreign investors might find the investment opportunities attractive.
- Prioritise opportunities based on the of investment agenda.
- Organise a government-private sector team to market opportunities pro-actively.

2.6 POLICY CONCLUSIONS

The above leads to a number of conclusions in terms of the necessity for Macedonia to attract more domestic and international investment

- To be viewed positively by investors, it is essential for the Macedonian economic and political conditions to be perceived as being stable.
- The attraction of additional investment, whether foreign or local, is essential in order to boost economic growth and development of the country. Further employment, social benefits, improvements in quality of life and standards of living are partly dependent on this happening.
- FDI is not a panacea for achieving the above objectives. However, when harnessed successfully, it can be an engine for a number of positive “spillovers” that would raise the productivity and competitiveness of Macedonian enterprises.
- Macedonia’s relatively generous tax incentives have not succeeded in attracting much FDI. This point reinforces the widely recognised fact that tax incentives are a secondary consideration to investors. A sound business environment is a prerequisite for both domestic and international investment.
- An analysis of the situation in Macedonia indicates that there is potential for attracting market-seeking (regional market and beyond) or efficiency-seeking FDI.
- With the privatisation process coming to an end, reforms in the business environment are urgently required in order to encourage domestic firms and entrepreneurs to undertake new investment as well as encourage foreign enterprises to perceive Macedonia in a more positive light, rather than maintain their risk-averse nature.

- With respect to improving the general business environment, the overall framework of law, regulations and policy is broadly in place. However, reforms are needed to ensure that these can be implemented effectively.

3.0. INVESTMENT PROMOTION

3.1 Context

Investment promotion activity in the Republic of Macedonia remains fragmented, with several organisations dealing with this issue. In order to address this situation, the Ministry of Economy has undertaken a process of rationalizing and strengthening current FDI institutional and policy efforts. This work, supported by the wider FDI stakeholders, has concluded with the widespread consensus about the necessity to establish an independent Foreign Investment Agency of the Republic of Macedonia to co-ordinate the investment promotion activity focused on attracting FDI to the Republic of Macedonia.

3.2 Measures

3.2.1 Foreign Investment Agency of the Republic of Macedonia

Following extensive consultation, the GoM has decided to establish an independent Foreign Investment Agency of the Republic of Macedonia (FIARM), for which the Parliament has been presented an appropriate draft law.

FIARM will focus on:

- Image building and promotion of Macedonia as an attractive site for investment
- Investment generation
- Proposing measures for improvement the investment policy and amendments to the respective legislative
- Servicing investors

FIARM will operate according to the following principles:

- Expertise and professionalism (staff selected according to competence and experience)
- Independence of operation (director appointed by Management Board)

- Transparency of operation (reporting to GoM)
- Neutrality, without any political influences (representative and experienced Management Board)
- Active representation of the private sector, experts and donors in the management
- Financing through state budget, with additional support from donors
- Responsibility for the work and the achieved results

3.2.2 Interim FDI Task Force

Until such a point as FIARM is up and running, it is important that investors are assisted effectively with the problems that they are faced with on a day-to-day basis. Therefore, the GoM will create a dedicated Interim FDI Task Force consisting of civil servants from the following institutions:

- Ministry of Economy
- Ministry of Finance (Customs Administration, Public Revenue Office and Property Rights Administration)
- Ministry of Transport and Communications
- Ministry of Justice
- State Cadastre Bureau

Investors will contact the Ministry of Economy in the first instance and the Ministry will convene and co-ordinate the Interim FDI Task Force. Its aim will be to assist existing investors with:

- Specific problems and impediments faced by them
- Assessing the regulations and identifying solutions

The Interim FDI Task Force will co-ordinate closely with the National Entrepreneurship and Competitiveness Council, where relevant.

3.2.3 Proactive Marketing Initiative

It is important that the momentum in stimulating FDI is maintained, especially at a time when the signs throughout the SEE region, as illustrated by the projections for FDI inflows in 2003, are that the investment climate is going through a significant improvement (OECD, 2003b, p.44). Therefore, the Ministry of Economy will initiate a number of proactive marketing activities, based on input from the private sector, as well as other stakeholders, consisting of the following:

- Identification of 10-15 companies that could respond to the “investment agenda” of prioritised sectors (see 2.5 above)

- Development of targeted communication campaign based on assessment of investment criteria of priority companies
- Provision of information on potential investment projects
- Hosting of business-to-business events
- Investment support services

As in the case of the Interim FDI Task Force, these activities are designed to take place in the absence of the FIARM. The Ministry of Economy will coordinate this initiative with the support of interested donors and investors, including the National Entrepreneurship and Competitiveness Council. It is anticipated that upon its creation, FIARM will take over and intensify the activities of the interim Proactive Marketing Initiative in a targeted manner.

3.2.4 Integration into the International Economic System

The investors typically consider opportunities from the perspective of the wider SEE region, rather than from a Macedonia-specific view. A market of 2 million consumers is attractive for some investors, however, a wider regional market of 60 million consumers in the SEE region, is of interest to most investors. For this reason, the GoM will continue to pursue the following measures, designed to continue the process of integration into the regional and wider international economic system.

SEE Investment Promotion

The Regional Roundtable for Investment Promotion in SEE is a partnership of national organisations active in the field of investment promotion including investment promotion agencies, ministries, private sector and NGOs undertaking two main activities:

- Policy development and institutional capacity building for investment promotion agencies (which will be of particular importance to FIARM, once it is established).
- Raising awareness of the SEE region as an environment offering business opportunities for strategic investors in a coherent manner.

The Republic of Macedonia will contribute to participate in this initiative, in order to reap the benefits of best practice in investment promotion, as well as regional orientation.

Trade, Investment and Tax Agreements

More generally, the Republic of Macedonia will continue its activities with the following initiatives:

- *Free Trade Agreements* have been concluded with 11 countries. Nine are bilateral in nature and two are multilateral (EFTA and SAA with EU). Macedonia has completed six agreements with the countries of the Stability Pact for SEE. The remaining agreement (with Moldova) is expected to be ratified by the end of 2003. The other three countries are Turkey, Ukraine and Slovenia.

- *Memorandum of Understanding on Trade Liberalisation and Facilitation* has been signed with the other SEE countries.
- The Republic of Macedonia became a member of the *World Trade Organisation* (WTO) in April 2003. More significant obligations undertaken by WTO access include: a) abolition of the "LB8" licensing system in the trade regime by the end of 2003; b) the "promotional fee" of 0.1% on all imports and exports applied for the support of Macedonian export will be withdrawn by the end of 2005; c) the current customs duties (averaging 14.8%) will be liberalised (to an average of 8%) by the end of the relevant transitional period (which varies from product to product but lasts until 2012 in the case of "sensitive" products).
- Aside from the candidate countries (Romania and Bulgaria) only Croatia and the Republic of Macedonia have signed the EU *Stabilisation and Association Agreement* (SAA) in the SEE region.
- The Republic of Macedonia has signed *Agreements on the Mutual Protection and Promotion of Foreign Investment* with numerous countries, including most SEE and EU countries.
- *Agreements for Avoidance of Double Taxation* have been signed with 24 countries, including Germany, but this agreement still has to be ratified by the parliaments of both countries.

3.3 Policy Conclusions

- The investment promotion measures highlighted above are a response to the urgent necessity to establish a single body to focus the FDI promotion activity in the Republic of Macedonia.
- There is also a need to maintain the momentum in generating FDI, in the form of an FDI Task Force and a Proactive Marketing Initiative, during the interim period until FIARM is established.
- The measures also reflect a necessity to continue to work in a regional SEE context, through such mechanisms as the bi-lateral trade agreements and the Investment Compact's Regional Roundtable for Investment Promotion.

4.0. REDUCING ADMINISTRATIVE BARRIERS TO INVESTMENT

4.1 Context

The Government of Republic of Macedonia (GoM) recognises that a predictable and transparent regulatory environment, free from unnecessary administrative impediments, is of the utmost importance to investors. This is more important to potential foreign and domestic investors than generous fiscal or financial incentives (see Chapter 5).

The reduction of barriers to domestic and foreign investment must be seen as a process, rather than a one-off event. In 1998, the GoM invited the Foreign Investment Advisory Service (FIAS) of the World Bank to examine the barriers to FDI in the Republic of Macedonia. Following the publication of the report (FIAS, 1998), the *Programme for Stimulating Investments with a Special Emphasis on Foreign Direct Investments* was developed and approved in 1999.

In 2001, the GoM invited the World Bank to undertake a further analysis of the administrative barriers faced by investors, the main conclusion of which was that the reforms are largely satisfactory "on paper", but that there remains a gap between theory and practice (FIAS, 2003). Other bodies such as the Investment Compact of the Stability Pact for South East Europe have also noted the legal and administrative barriers to investment.

Following the presentation of the FIAS recommendations, the Ministry of Economy created a *Steering Committee on Removal of Administrative Barriers to Investment*, thus initiating a structured dialog with the business community. The Steering Committee consisting of key stakeholder institutions, such as state bodies and private sector representatives, has been invited to identify the most urgent reforms required, resulting in the following list:

- Company registration
- Labour legislation (work permits and visas)
- Access to land
- Construction permits
- Customs administration

In accordance with the good practice principles established by FIAS elsewhere in SEE, technical *Working Groups* have been established to draft concrete, detailed proposals for reform. The technical Working Groups include representatives of the relevant state administration, as well as knowledgeable business representatives in order to discuss and agree: the precise measures to be proposed to Government; who will be responsible for implementing the reforms; and when the reforms should be completed.

In the sections that follow, the Programme highlights both the *five identified priorities* arising from the FIAS process as well as a number of *other priorities which will need to be tackled in parallel* in order to help make Macedonia a more attractive investment location.

The resulting Action Plan amounts to an ambitious agenda for reform. Many items included in the Action Plan require a high degree of technical competence in order to underpin the reform efforts in areas such as legal reform, good governance, reform of the land registry, etc. The deference and persistent implementation of the Action Plan by the relevant institutions and ministries, responsible for the specified activities, are key factors in the effectiveness of the reforms. Such support will be delivered by a *Team of Experts*, consisting mainly of lawyers, who will draft the relevant legislation or amendments to regulations. The GoM is conferring with the World Bank, FIAS, MIGA, UNDP, USAID, GTZ/DEG and other national and international donors in order to obtain the required *technical assistance* to support these activities. There is a danger that the Action Plan may not be implemented without a strong degree of technical support.

The Steering Committee will assess progress on a monthly basis and up-date the Action Plan to reflect new priorities, taking into account available data. The Ministry of Economy recognises that it is not in a position to implement all the reforms that appear in the Action Plan on its own. Therefore, it will co-ordinate with all the State Secretaries from the relevant ministries in order to ensure that progress is achieved and that the achievements relating to the Action Plan are monitored on a monthly basis. This will allow new measures to be introduced on a rolling basis, in accordance with the newly aroused needs.

The GoM acknowledges the existence of barriers to investment identified by local and international businesses and organizations. In order to support the process of improving the business environment, the GoM will submit for approval of the Parliament the Action Plan for Removing Administrative Barriers to Investment, which includes the priorities defined after the structured dialogue with the business community, state bodies and other relevant stakeholders.

4.2 Measures

The GoM recognises that the five priorities that have arisen out of the FIAS process do not necessarily constitute the only or indeed the main barriers to unleashing further investment. The analysis below presents the measures, timetables, and responsibilities that the GoM commits itself to, in relation to both the priorities arising from the FIAS process as well as the wider barriers to investment.

4.2.1 Priority Measures

Following the FIAS process, the recommendations for inclusion in the Action Plan for Removing Administrative Barriers have been prioritised by both the Working Groups and the Steering Committee. The state administration and private sector representatives have identified the following aspects as being of particular significance and the GoM will undertake the following reforms on the basis set out below.

1. COMPANY REGISTRATION

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Complex procedures and lack of adequate documentation and information. There is a need to simplify and shorten the procedures necessary for court registration of companies.	Amendment of the Law on Trade Companies. Changes to the rulebook for registration in the trade registry.	
Avoid the necessity for businesses to visit various institutions during the company registration process.	Amendment of the Law on Trade Companies. Amendment of the Law on central register. Other sectoral laws (State Statistical Office, Customs and Tax administration)	Unification of the system of registration into one institution ("one-stop shop"). Introducing unique reference number for the entities in the Central Register.
Plurality of ministries and institutions issuing licenses and permits.	Amalgamation of institutions issuing licenses and permits into one institution.	
Simplification of the procedure and provision of documentation required for company registration in the State Statistics Bureau.	Amendment of the Law on national classification of activities	
The reporting of the lowest salary in the State Statistics Bureau (when salaries are reported which are lower then the foreseen salary for that activity, the individual is obliged to pay contributions for the foreseen amount).		
Lack of guidelines for companies on the registration process with Public Revenues Administration. Lack of up-to-date Register of Taxpayers.	Amendment of the Law on Determining and Collection of Public Revenues (Official Gazette, 13/2001)	
Lack of sufficient information regarding the registration process.		

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.)	Responsibility	Deadline
Acceleration of computerization of the courts Registration via a single form	Ministry of Economy Ministry of Justice Registration courts (Skopje, Bitola & Stip)	December 2003
Training and workshops for Central Register personnel. Asses the fees' level of the Central Register.	Ministry of Justice (registration courts) Ministry of Economy State Statistics Bureau Central Register	June 2004
Computerization and networking of all institutions involved in issuing licenses and permits. Training of staff.	All Ministries that issue licenses and permits	June 2004
Simplification of the documentation for company registration by the organs such as courts, ministries, etc.	State Statistics Bureau	December 2003
Strict registration of minimum salary with the State Statistics Bureau, regardless of the minimum salary declared by applicant.	State Statistics Bureau	December 2003
Adoption of internal guidelines for registration procedure and their publication. Determining and implementing forms for regular upgrading of Register data. Training provision for the direct executors. Better co-operation and exchange of information with Ministry of Interior the update of the data for physical entities. Increase the services offered by Central Register.	Ministry of Finance (Public Revenues Administration) Ministry of Interior	December 2003
Publish the registration procedures on the web sites of the key institutions involved in this procedure. Wide dissemination via the printed media.	Registration Courts, State Statistics Bureau, Central Register, Ministry of Economy (other ministries and institutions depending on the type of the activity)	December 2003

2. LABOR LEGISLATION (WORK PERMITS AND VISAS)

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutions
Incompatibility of existing legislation for establishing of working relations with foreign citizens and for temporary stay of foreign citizens, with existing business conditions.	Adoption of new law for work permits and visas for foreign citizens. Termination of the existing law. Adoption of new law for movement and stay of foreigners (termination of the existing law)	
Lack of grounds for applicants to file appeals against rejections of applications for work permits and visas.	Provisions in the relevant law requiring applicants to be provided with written information on the reasons for rejection and procedure for appeal against the decision.	
Expatriate employment and residency (investors or experts)	Increase duration of employment visa, based on length of employment contract so that it does not have to be renewed annually (3-5 years).	
Lack of coordination between the Ministry of Interior and the Employment Bureau	Introducing one-stop-shop for acquiring of all permits for movement and stay of investors.	

3. ACCESS TO LAND

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Inadequate finance for equipment and staff at the State Geodesy Department. Inefficient processing of the cadastre work.		With the transformation of the State Geodesy Department, the cadastre operations will be decentralized.
Incomplete procedure for determining of boundaries of land plots. Incomplete procedure for registering property rights for the real estate.	Amendment of the law on measurement, cadastre and registration of the real estate rights.	Establishment of a single Land Register, including data on mortgages. Enabling private organizations to deal with this procedure to accelerate the process.
Unsatisfactory administrative procedure for submitting appeals (procedure and deadline)	Amendments to the administrative procedure for submitting appeals	
Improvement of the procedure for privatization of the right to long-term use of land (into right to property ownership).	Determine the timeframe in the relevant laws (Law on privatization of urban land).	
Lack of procedure for leasing state-owned agricultural land (lack of deadlines).	Determine deadlines in the Law and adoption of bylaws. Law on agricultural land, Law on property and other real rights, Law on concessions	

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.)	Responsibility	Deadline
Publication of the law and procedures for work permits on the web sites. Dissemination of brochures.	Ministry of Labor and Social Policy, Ministry of Interior, in cooperation with the Ministry of Foreign Affairs	December 2003
	Ministry of Labor and Social Policy, Ministry of Interior, in cooperation with the Ministry of Foreign Affairs	December 2003
	Ministry of Labor and Social Policy in cooperation with the Ministry of Interior and the Ministry of Foreign Affairs	December 2003
	Ministry of Foreign Affairs Ministry of Interior Employment Bureau	December 2004

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.)	Responsibility	Deadline
Provision of financial and technical assistance for realization of the transformation of the State Geodesy Department from donors (e.g. computers, cars, and training).	State Geodesy Department, in cooperation with international institutions and donors.	December 2005
Networking of the State Geodesy Department with the City Geodesy Departments and the Courts keeping data on mortgages. Enhancement of staff skills and equipment. Enhancement of the procedure for determining of the boundaries of land plots and registration of property rights.	State Geodesy Department and the Courts	December 2006
	State Geodesy Department	December 2004
Improved information to clients about the procedures through printed and electronic publications).	Ministry of Finance (Property Rights Administration)	March 2004
	Ministry of Justice Ministry of Agriculture and Forestry	June 2003

4. CONSTRUCTION PERMITS

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Lack of communication between the Ministry of Transport and Communications and Municipalities regarding the urban plans resulting in variations in implementation and interpretations	Amendments to Law on Urban Planning, Law on Construction of Investment Buildings, Law on Construction Land, Law on Property and Other Real Rights, Law on Local Self-Government.	
Complex and long procedure, involving several institutions for obtaining construction approval.	Amendments to Law on Urban Planning, Law on Construction of Investment Buildings, Law on Construction Land, Law on Property and Other Real Rights, Law on Local Self-Government.	The local government changes will allow the amalgamation of the branch offices of the Ministry of Transport and Communications with Municipalities under the authority of the Ministry for Local Self-government. This will lead to reduction of the procedure for construction approval, the number of institutions involved and the scope for corruption.
Lack of transparency of the international tenders for real estate (bidding for construction land).		
Excessive communal taxes for construction land (especially in Skopje)	Changes to the Law on Construction Land.	

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.)	Responsibility	Deadline
Co-operation between the Ministry of Transport and Communications and Municipalities in the adoption, implementation and enforcement of the urban plans.	Ministry of Transport and Communications, Ministry of Local Self-Government.	June 2004
Education of local government employees regarding new legal solutions in the procedure for acquiring construction permits and equal implementation and interpretation.	Ministry of Transport and Communications, Ministry of Local Self-Government.	June 2004
Transparency of the tenders respecting: - legally cleared property rights - quality of infrastructure	Ministry of Transport and Communications	Continuously
Analysis of fee structure.	Ministry of Transport and Communications, Ministry of Local Self-Government, Council of Skopje City, Public Enterprise for Living and Business Premises.	December 2003

5. CUSTOMS ADMINISTRATION

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
High tariff rate on imports of new equipment, raw-materials and intermediate goods, particularly from countries with which there are no bilateral trade agreements	Amendments to the Law on Customs Tariff towards economically grounded corrections of the tariff rates (according to WTO, EU and free trade agreements)	
Problems in the payment of customs duties on imports of goods	Introducing reporting period – possibility for compensation of import customs duties with the returns of export duties.	
Lack of coordination and harmonization of custom duties on imports of goods	Introducing of unified customs duties on imports, payable by one-stop-shop system	
Long procedure and incompetence on granting export permits for Macedonian products	IAmendments to the Foreign Trade Law (Official Gazette No. 20/2003) in the section “Decision on the export/import forms”	
Long customs procedure and long period for duty payments		Specialized border crossings for certain goods
Lack of coordination in the working time between the Customs Administration and the Border Inspection Services.		
Lack of statistical information on the daily work of the customs administration.		
Inconsistent application of the customs tariff due to variations in interpretation of the customs tariff book, resulting in scope for corruption.	Prepare Comment to the Harmonized System in line with the WCO Comment to the Harmonized System and the EU Comment to the Combined Nomenclature	

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.)	Responsibility	Deadline
	Ministry of Finance, Customs Administration, Ministry of Economy	March 2004
	Ministry of Finance, Customs Administration	December 2004
	Ministry of Finance, Customs Administration	December 2004
	Ministry of Economy and all ministries where the minister is signatory of the export license	March 2004
	Customs Administration in cooperation with the business community	March 2004
Coordination of working time between the Customs Administration and the Border Inspection Services from the relevant ministries.	Customs Administration, Ministry of Health, Ministry of Agriculture and Forestry, Ministry of Economy and all other relevant ministries that have border inspection services.	December 2003
Further computerization and improvement of the network connecting customs offices.	Ministry of Finance (Customs Administration)	December 2003
Training and education of customs officials on the novelties in the Customs Tariff and origin of goods. - Workshops for the customs duty payers and improved dissemination of information on the amendments of the Customs Tariff	Ministry of Finance (Customs Administration)	September 2003 and continuously

4.2.2 Other Priorities to be Tackled in Parallel

The priorities identified above through the FIAS process are the "tip of the iceberg". Over and above these issues, the MoE's own research, as well as other bodies such as the Investment Compact for SEE and business representative organisations, have identified a range of other issues which require urgent attention. This is not to suggest that the measures listed below represent the full range of issues that need to be addressed. Other issues will be identified and prioritised on a rolling basis, such as effective implementation of international accounting standards, auditing, ineffective court system, etc. The Ministry of Economy, in co-operation with the relevant state bodies and private sector representatives, is committed to implementing the priorities listed below:

- Reduce Corruption, Bribery and the Informal Economy (see also State Commission on Corruption Prevention, 2003)
- Increase Transparency and Consistency of State Administration
- Improve Communications with the Private Sector
- Improve the Court System
- Improve the Banking/Financial System
- Improve Corporate Governance
- Reduce Labour Market Rigidities
- Improve Tax Administration
- Improve the Inspectorate Service

1. REDUCE CORRUPTION, BRIBERY AND THE INFORMAL

The State Programme for Prevention and Repression of Corruption (2003) is the GoM's main vehicle for tackling the levels of corruption in the Republic of Macedonia. A detailed Action Plan - Matrix sets out the measures to be introduced. The Commission notes: "…According to the surveys … the most corrupt sectors have been pointed out to be the customs, tax administration and ministries which issue different approvals, licenses, permits, etc." (2003, p.17). This Action Plan sets out a range of measures designed to address those priority sectors, however, two other priorities are worth highlighting below.

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Lack of awareness of the disadvantages of operating in the informal economy.		
Lack of body examining the scope for reducing the levels of informal activity.		Establishment of an Interministerial Working Group on the Reduction of the Informal Economy to regularly propose and initiate activities.

- Improve Competition and Regulation

The short-term measures below have been identified and prepared with the involvement of the main responsible organisations. The MoE will co-ordinate the process of achieving change, though it must be stressed that progress in implementing these measures depends on the commitment and resources devoted to these tasks by the competent bodies.

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.)	Responsibility	Deadline
Public campaign to raise awareness regarding: Efforts to make it easier to register. Tax reductions and incentives that firms in the formal economy are eligible for, including access to credit. Provisions of Branko’s law, etc.	Ministry of Finance	June 2004
	Ministry of Finance, in cooperation with the private sector and various Ministries.	June 2004

2. INCREASE TRANSPARENCY AND CONSISTENCY OF STATE ADMINISTRATION

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Discretionary decision-making in relation to licenses and permit to enterprises. This may happen when only a single individual has authority for the relevant procedure		
Practice of issuing oral approvals or rejections denies businesses a written justification for a decision, as well as opportunities for appeal.		
Necessity to improve appeals systems.	Review the possibility to amend the Constitution required for allowing the establishment of Administrative Courts.	
Necessity to improve the operation of Second Instance Administrative Commissions.		
Lack of regular information collection and dissemination of information on the number of approvals and rejections issued, as well as number of appeals and their outcome.		
Weak local government capacity to deal with business-related administrative procedures, especially in view of the imminent increase of competencies.		

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.)	Responsibility	Deadline
Remove undue discretion from Government officials by ensuring that: Standard rules, fees and decision-making procedures exist for each type of application (licenses, permits etc.). Information on the standard procedures is widely available. More than one person is responsible for such procedures. Employ objective criteria in decision-making. Ensure the right of appeal	Ministry of Economy Ministry of Finance Customs Office Ministry of Transport and Communication Ministry of Labor and Social Policy State Cadastre Local authorities	December 2003
Ensure that all decisions issued by a government officials are: In writing Providing an objective reason if it is a refusal. Identify the individual making the decision.	Ministry of Economy, Ministry of Finance, Customs Office, Ministry of Transport and Communication, Ministry of Labor and Social Policy, State Cadastre, Local authorities	December 2003
Establish Working Group to determine the amendments required. Training for the staff.	Ministry of Justice	December 2003
Invite external experts to participate in the decision-making process of the commissions. Introduce enforcement measures to ensure implementation of decision. Regular sessions to ensure complaints can be decided within the legal deadlines.	Relevant ministries	December 2003
Keep track of and make publicly available quantifiable data about interactions with citizens.	Ministry of Economy Ministry of Finance Customs Office Ministry of Transport and Communication Ministry of Labor and Social Policy State Cadastre Local authorities	December 2003
Review the administrative procedures at the municipal level. Develop a system for standard application of procedures. Train municipal officials in the following areas - construction procedures - land zoning - tax administration - licenses and permits	Ministry of Local Self Government and Municipalities in cooperation with other line Ministries and State institutions	December 2004

3. IMPROVE COMMUNICATIONS WITH THE PRIVATE SECTOR

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Low level of -communication between business and Government. Instability of changes in laws and regulations, lack of input from businesses as draft laws are being considered, not enough time to respond.		Institutionalise a structured dialogue with the business community on existing legislations, procedures and drafting of laws, including giving the business community enough time to respond (for example, no less than one month). Chamber of Commerce has to be actively involved into the dialogue, through its associations.
Government to depersonalise its interactions with businesspersons by speaking to associations that represent a broader constituency.		

4. IMPROVE THE COURT SYSTEM

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Alternative dispute resolution to avoid lengthy and costly court cases by settling disputes that arise from trade relations with foreign enterprises (international arbitration)	Enactment of Arbitration Law with support from the European Reconstruction Agency.	
Lack of judges specializing in commercial cases and disputes within the court system, including cases related to bankruptcy and industrial property rights.	Asses and amend the Law on Enforcement Procedures	
Lack of specialist commercial courts to deal with commercial cases.		

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.)	Responsibility	Deadline
Establish and maintain Government-Business feedback mechanisms: National Council for Entrepreneurship and Competitiveness. FIAS project Steering Committee and Working Groups. National Council of Investors (FDI focus).	Ministry of Economy	July 2003
Revise the current legislation to introduce voluntary membership of Chamber of Commerce. Strengthen the capacities of the business associations to articulate the interests of their members.	Ministry of Economy	June 2004

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.)	Responsibility	Deadline
Training of arbitrators. Training of judges. Awareness-raising among the business community.	Ministry of Justice, Ministry of Economy, Association of Lawyers and Bar association	June 2004
Continuous training on commercial and company law, bankruptcy law, industrial property rights, etc.	Ministry of Justice and courts.	December 2004
Review of the possibility of reestablishing specialized Commercial Courts.	Ministry of Justice	December 2003

5. IMPROVE THE BANKING/FINANCIAL SYSTEM

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Lack of diversification of the financial market and institutions.	Create a special law on Savings Houses, including regulation, operations and supervisory standers.	
Not a single investment fund has been created since the introduction of the Law on Investment Funds in January 2000.	Review and amend the Law on Investment Funds to liberalise establishment and operation: Decrease funding capital required. Allow part of founding capital to be invested in foreign securities.	
Further stimulation of Macedonian exports and SMEs required.		Review of the operations of the Macedonian Bank for Development Promotion (MBDP): Delivery of a wider range of services, including export guarantees and insurance. Stimulation of export by developing relevant financial instruments. Assist development of enterprises.
To further strengthen the supervision to ensure more efficient, adequate and timely measures for prevention of unlawful operations of Banks and Saving houses	Adoption of bylaws to allow for consolidated supervision, including IT supervision and e-banking	
	Further approximation with EU directives in the banking sector	Establishment of Banking Association
There is need to shorten the procedure for collection of claims; the law not efficiently enforced resulting in bad portfolios and increased costs to the Banks	Asses and amend the Law on Enforcement Procedures	
Need for further improvement of the implementation of the supervision of the insurance companies aimed at providing more efficient, more adequate, and timely measures for preventing illegal operations.	Passing of bylaws related to the Law on Insurance Supervision[1], aimed at approximation and harmonization of the national legislative with the EU Directives.	
Need for significant improvement of the system for compulsory insurance in transport	Adoption of new Law on Compulsory Insurance in Transport[2], aimed at approximation and harmonization of the national legislative, regulating compulsory insurance, with the EU Directives.	

1 With adoption of the Law on Insurance Supervision (Official Gazette No. 27/2002, 84/2002 and 98/2002) the Law on Insurance was abolished (Official Gazette No. 49/97, 79/99 and 13/01), except the Section 5 that regulates the compulsory insurance.

2 With adoption of the Law on Compulsory Insurance in Transport, the Section 5 (Compulsory Insurance) of the Law on Insurance will be terminated.

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.)	Responsibility	Deadline
	Ministry of Finance	December 2003
	Ministry of Finance	December 2003
Facilitate access of SMEs to bank loans.	Ministry of Finance Ministry of Economy Agency for Support of Entrepreneurship and MBDP	December 2003/2004
Increased regional cooperation and exchange of information with supervision units from other countries	National Bank Ministry of Finance	December 2003
Training of the banking personnel, including training on New Capital Accord	National Bank Ministry of Finance in cooperation with EAR Commercial Banks	December 2004
	Ministry of Finance Ministry of Justice	December 2004
Increased regional cooperation and information exchange with authorized institutions for supervision of insurance companies.	Ministry of Finance	December 2003/2004
	Ministry of Finance	December 2003

6. IMPROVE CORPORATE GOVERNANCE

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Undue pressure on minority shareholders to transfer their voting rights.	Amendment to Company Law: Managers and managing board members will no longer be able to exert pressure on minority shareholders to have voting rights at company meetings.	
Conflict of interest by managers of companies.	Amendment to Company Law: Clear definition of conflict of interest situations when managers sign contracts involving companies that they have a commercial interest in.	
Protection of minority shareholders	Amendment to Company Law: Provision defining ‘qualified majority voting’ (three quarters majority of all shareholders) for certain changes in the status of the company, such as mergers and acquisitions, sale of high value company assets etc.	
New company law requirement of only one model of management inconsistent with EU Directives regarding corporate governance.	Amendment to Company Law: Re-establishment of the option of either a “one tier” (board of directors) or a “two tier” (supervisory board and board of directors) model of corporate governance.	
Increasing transparency and harmonization.	New company law: Improvement of law to ensure that inconsistent interpretation is eliminated. Improvement of law to ensure that it is harmonized with relevant EU Directives.	

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.)	Responsibility	Deadline
	Ministry of Economy Ministry of Justice	July 2003
	Ministry of Economy Ministry of Justice	January 2004
	Ministry of Economy Ministry of Justice	December 2003
	Ministry of Economy Ministry of Justice	January 2004
	Ministry of Economy Ministry of Justice	January 2004

7. REDUCE LABOUR MARKET RIGIDITIES

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Relatively poor statistics of the labor market makes it difficult to develop appropriate measures.	Amend Labor Law: introduce obligation for the unemployed to register at Employment Bureau.	
		Improve the monitoring of registered unemployed. Strengthen capacities of the Employment Bureau through creation of Unit for monitoring of the unem-ployed.
	Separate the right to health insurance from the right to unemployment benefits.	
Active Labor Market Policies		
High levels of unemployment among the 25-54 age group.		
Low employment rate of the young population aged between 15-24 years (18%)		
Legal basis for agencies exists, but is constrained by the operation of the Youth Organisation (Mladinska Zadruga), leading to incentives for the legal economy.	Abolish the existing law on Youth Organisations, or transform these into Agencies.	
Collective bargaining agreements introduce complexi-ties and rigidities due to nine different coefficients for		
Improve effectiveness of the Social and Economic Council.		

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.)	Responsibility	Deadline
	Ministry of Labor and Social Policy, Employment Bureau	December 2004
Improve the monitoring of the work status by: Regular controls and inspections. Develop penalties for employers who do not pay social contributions.	Ministry of Labor and Social Policy, Ministry of Justice	December 2003
	Ministry of Labor and Social Policy Employment Bureau Statistical Bureau	December 2004
	Ministry of Labor and Social Policy Ministry of Health Ministry of Finance	December 2003
Introduce practical modules in the education curricula in cooperation with the Chamber of Commerce.	Ministry of Education Ministry of Labor and Social Policy Chamber of Commerce and others	December 2004
Strengthen local Job Clubs to provide different types of services for the unemployed (IT and other types of training, information on employment opportunities and needs, etc.)	Ministry of Labor and Social Policy Employment Bureau Local Job Clubs	December 2004
Update the database of the economically active population to monitor the changes in age, structure, labor force supply and demand, etc.	Statistical Bureau Ministry of Labor and Social Policy	December 2004
Develop self-employment programs, to increase access to credit, strengthen organizational and management skills, as well as entrepreneurial initiative. Establish Business Incubators and Zones.	Employment Bureau Job Clubs Agency for Support of Entrepreneurship Ministry of Economy	December 2004
Introduce the possibility for receiving a lump sum (of the unemployment benefit) for the establishment of businesses	Ministry of Labor and Social Policy Employment Bureau, Ministry of Finance	June 2004
Create electronic database of students and make it accessible for the private sector and other interested. Stimulate linkages between the University and the employers.	Ministry of Education Chamber of Commerce Universities Statistical Bureau Ministry of EconomyAgency for Support of	June 2004
Ensure labor intensive components within the public works to be offered to those with low qualification/education level	All relevant Ministries	December 2004
Promote opportunities of using the short-term employment contracts.	Ministry of Labor and Social Policy Employment Bureau	June 2004
Assess need for a minimum wage and whether the system needs to be so complex.	Ministry of Labor and Social Policy	December 2003
The main tripartite mechanism for social and economic dialogue is in need of reform. Introduce secretariat to run its operations.	Ministry of Labor and Social Policy	December 2004

8. IMPROVE TAX ADMINISTRATION

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Frequent changes in the legislation and late information on changes to enterprises.		
Major problems are experienced in obtaining VAT refunds.		
Enterprises experience difficulties in estimating their likely profit tax.	Legislative regulation of the responsibility of the profession “authorised auditor”	
Insufficient co-operation and exchange of information between the Health and Pension Funds, the Employment Bureau and the Public Revenues Administration on the tax payers, and monitoring of payments.		
The appeals mechanism is not considered to be an effective part of the tax administration system.	Review possibilities for creation of special Law on Tax Procedures.	
The appeals mechanisms and penalties are considered as the most difficult aspects of tax administration.		

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.)	Responsibility	Deadline
Timely incorporation of tax changes. Timely dissemination of information to tax payers. Introduction of a system of obtaining feedback from business in order to improve implementation.	Ministry of Finance (Public Revenues Administration)	1,5 month before introduction of tax changes.
Speeded procedures for VAT refund. Ensure that refund deadline of a maximum of 30 days processing time are met.	Ministry of Finance	December 2003
In consultation with representatives of the business community and accounting/audit firms: Simplify and clarify the definition of the base for profit tax Publish all relevant guidelines, including definitions, calculations and examples.	Ministry of Finance (Public Revenues Administration)	June 2004
Installation of a computerised network for the Funds, the Employment Bureau, Customs Office, Central Registry, Cadastre and the Public revenues administration. Criterion for monitoring of the payment of taxes.	Ministry of Finance (Public revenues administration), the Funds, the Employment Bureau, the Customs Office, the Central Registry, the Cadastre, Statistical Bureau	Continuous
In consultation with the business community, create a credible appeals system.	Ministry of Finance (Public Revenues Administration) Ministry of Justice	June 2004
In consultation with the business community, introduce a penalty system that is adequate to the nature of the violations.	Ministry of Finance (Public Revenues Administration) Ministry of Justice	December 2004

9. IMPROVE THE INSPECTORATE SERVICE

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Representatives of many businesses find the availability of information on changes and updates of existing procedures and regulations to be an obstacle.		
The legislation governing the inspection procedures is vague, resulting in uncertainty.	Amendments to existing procedures.	
Lack of coordination and excessive numbers of inspections, imposing a burden to firms.		
Excessive number of fines (50-80% of all inspections) suggests that either the inspectorates are very strict or firms do not follow any rules.		
Lack of adequate technical equipment as well as training in the inspectorates.		
Too many inspectorates resulting in higher adaptation costs and inefficiencies for enterprises.	Amendments to various laws to create a single state inspectorate.	Single State Inspectorate

10. IMPROVE COMPETITION AND REGULATION

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Decrease the deadline for prior information of mergers and acquisitions to the anti-monopoly authority.	Amendments to articles 26-29 of the Competition Law for planned mergers.	
Establish a regulatory agency for the energy sector, in view of the anticipated privatisations in this sector.		Energy Regulatory Agency
Lack of regulatory body(ies) in other areas where monopolies may arise (e.g. telecommunications, transport, water supply, etc.)		
Lack of effective investigation and sanctioning of anti-competitive behaviour (cartels).	Amendments to the Competition Law.	Institutional strengthening of the Monopolies Authority.

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.)	Responsibility	Deadline
Preparation of brochures with the procedures. Publish mandates of all inspectorate services. Information campaigns on each newly introduced legal provision related to wages (e.g. health and safety).	The relevant ministries and inspectorates	December 2004
Work with inspectors and businesses to identify specific amendments to legislation that determine the inspectorate services.	The relevant ministries and inspectorates	December 2004
Better exchange of information to coordinate inspections.	Relevant ministries and the inspection services, including Bureau for Protection of Industrial Property	December 2003
Examining options for tackling this problem and to make recommendations for reform.	Ministry of Finance and Ministry of Economy in cooperation with the inspectorates	June 2004
Improvement of the technical equipment (computerization, vehicles). Targeted education and training of the personnel.	Relevant ministries and the inspectorates	December 2005
Establish Working Group involving all relevant ministries to determine how to proceed. Establishment of Single State Inspectorate.	Ministry of Justice, Ministry of Economy, all other relevant ministries	June 2004

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.).	Responsibility	Deadline
	Ministry of Economy (Monopolies Authority)	December 2003
	Ministry of Economy	June 2004
Review of necessity for regulatory body(ies) in these areas.	Ministry of Economy, Ministry of Transport and Communications.	December 2004
	Ministry of Economy (Monopolies Authority), Ministry of Justice.	December 2003

11. INDUSTRIAL PROPERTY RIGHTS PROTECTION

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Domestic legal entities and individuals lack awareness for the implications regarding intellectual property rights. Inefficient protection of intellectual property rights within the judicial system	Amendments to respective laws in view to increasing punishments for violation of intellectual property rights, as well as possibility for creation of specialized units within the courts. Amendments to the Code of Criminal Proceedings, Law on Litigation Proceedings. Preparation and submitting of draft law on customs measures for prevention of violation of intellectual property rights, by determining penalties for import/export, re-export and entrance of pirate and forged goods.	Creation of special units within the courts for intellectual property dispute settlement. Institutional strengthening of the Bureau for Protection of Industrial Property, pursuant to the amendments to the Law on Protection of Industrial Property Rights. Institutional strengthening of the Ministry of Culture pursuant to the Conclusions adopted by the Government, after adopting the Information on the Realization and protection of the Copyright.
Lack of network linking among the institutions with the database of the Bureau for Protection of Industrial Property		

12. QUALITY CONTROL

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Lack of adequate capacities of the institutions working on quality assurance		Strengthening of the Institute for Standardization, Institute for Accreditation and Bureau for Meteorology

ACCESS TO INFORMATION FOR BUSINESS ENTITIES

Barrier/Recognition	TYPE OF MEASURES Legislative	TYPE OF MEASURES Institutional
Need for complete and accurate information related to companies' status		

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.).	Responsibility	Deadline
Permanent training of the Courts, private sector and associations on collective realization of copyrights. Public campaigns for increasing awareness on the intellectual property and the services provided by the Center for Technological Monitoring.	Ministry of Economy Ministry of Culture Ministry of Justice Ministry of Finance – Customs Administration Judges Association Bureau for Protection of Industrial Property Chamber of Commerce Center for Technological Monitoring Customers associations	December 2005
Use of funds of international institutions. Larger use of the database of the Center for Technological Monitoring, within the Bureau for Protection of Industrial Property, which is unique of the kind in the region.	Ministry of Economy Bureau for Protection of Industrial Property Customs Administration State Market Inspectorate Drug Registration Bureau and others	December 2004

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.).	Responsibility	Deadline
Specialization and training of the personnel. Financial assistance for equipment of the noted institutions, in order to provide quality services according to European standards.	Ministry of Economy Institute for Standardization Institute for Accreditation Bureau for Meteorology	December 2005

TYPE OF MEASURES Other (finance, programs, training, implementation, etc.).	Responsibility	Deadline
Increase the services offered by the Central Register. Improved accuracy of the Central Securities Registry data Review possibilities for creation of institution for company rating.	Ministry of Economy Central Register Central Securities Registry Statistical Bureau	June 2004

5.0. INVESTMENT INCENTIVES

5.1 Context

The employment of FDI investment incentives is no substitute for pursuing appropriate general policy measures and generating an enabling business environment. This is the rationale for the focus on the creation of a Foreign Investment Agency of the Republic of Macedonia (chapter 3), as well as a detailed programme for the further removal of legal and administrative barriers to investment (chapter 4).

At the same time, it is recognized that investment location decisions are usually taken by TNCs in two stages. In the first, investors compile a list of acceptable countries/sites according to the economic and political "fundamentals", more or less irrespective of incentives. It is only in the second stage that investors examine incentives, often seeking them out and sometimes even playing one government against another in order to maximise the generosity of the incentives. Thus, although the business fundamentals are of overriding importance, incentives can play a decisive role in investors' location decisions. In this context, the GoM believes that investment incentives can reasonably be used in situations where they can supplement an increasingly enabling environment, where market imperfections exist which cannot be otherwise addressed and where strong incentives-based competition exists, as in the case of the SEE region.

There are three main types of investment incentive. *Regulatory incentives* seek to attract investment by offering firms derogations from national or sub-national rules and regulations, such as easing environmental, social and labour market requirements. The GoM does not support the use of such incentives. *Financial incentives* tend to focus on areas that are perceived to be disadvantaged compared to other locations to compensate firms for relocating or establishing new branches and to correct market imperfections or overcome transaction costs. The GoM supports the use of such incentives, in a targeted manner. Finally, the most commonly used type of inducement used in the SEE region, where our most important competitors are located, is *tax incentives*. Likewise, the GoM supports the use of such incentives.

5.2 Measures

The main types of such tax and financial incentives available in the Republic of Macedonia are set out below. First, we present the current tax incentives, followed by the reforms that are expected to apply from January 2004.

5.2.1 Tax Incentives

The main features of the tax incentives available in the Republic of Macedonia are highlighted below.

Basic Tax Features

- Corporate Income Tax: 15%
- Income Tax: 15% and 18%
- Social Contributions: 32% of salaries (21.2% - pension and disability insurance, 9.2% - health insurance, 1.6% - employment)
- VAT: 18% and reduced rate of 5%

Investment and Tax Incentives

- To the taxpayer that has **funds invested by foreign persons,** the estimated tax is reduced proportionally to the participation of the foreign capital, on the condition that the participation of the foreign capital is at least 20% in the total invested permanent common capital. As deposited funds by foreign persons is considered the purchase of shares by a foreign person. The tax exemption applies to the taxpayers that are founded completely with foreign capital as well. The tax exemption applies only for the period of the first three years, starting from the year in which profit is realized, under condition that the taxpayer who has used this exemption is operating at least three subsequent years after the end of the ultimate year in which he has used the right of tax exemption.

- To the taxpayer the tax base is reduced for the amount of the ***investments in movable and immovable assets, up to 100,000 Euros*** in denar counter value, in the current year, excluding cars, furniture, carpets, works of art and other decorations for equipping administrative offices.

  In case when the taxpayer does not use the tax exemption till the end of the current year, he has the right to transfer it to the next period till its complete use.

  To the taxpayer, for the amount of the investments in movable and immovable assets exceeding 100,000 Euros, in denar counter value, in the current year, excluding cars, furniture, carpets, works of art and other decorations for equipping administrative offices, the tax base is reduced by up to 30%, but not more than the remaining unused part of the investment.

- The taxpayer who makes technological modernization, or purchases assets for protection of the environment and the nature, has a right to ***accelerated depreciation*** of the fixed assets, but maximum to the value that exceeds by 25% the depreciation calculated by one of the methods of depreciation calculations.

- To the taxpayer that placed an ***investment in economically underdeveloped regions*** and in specific areas (hill-mountain regions, border regions and compact undeveloped regions), the tax base is reduced for the value of the invested funds, but maximum at 50% of the base.

- The taxpayer who is ***beneficiary of a free economic zone*** is exempted from profit tax for a period of 10 years counting from the date of starting operation in the free economic zone, under conditions and procedure stipulated by the Law for Free Economic Zones.

- To the taxpayer the tax base is reduced up to the value of the ***funds invested for protection of the environment and the nature*** (the amount invested for this purpose is acknowledged 100%).

- To the taxpayer who ***starts business activity for the first time***, in the first year of earning profit the estimated tax is reduced by 50%, under condition of continued operation at least for three additional years from the day of implementing the reduction. Otherwise, he is due for the unpaid tax in amount revaluated by the retail price growth rate.

  A taxpayer who has made status changes (merger, acquisition, division, ownership transformation or similar) is not considered as a taxpayer who starts a business activity for the first time.

- In function of the development of the stock exchange in the Republic of Macedonia, the estimated profit tax is reduced by 50% for the ***taxpayer who is listed on the official markets of stock exchange***, three years after the start of the listing. This tax reduction will be implemented until 31 December, 2005.

- To the taxpayer who, pursuant to the Law on Registration of Cash Payments is obliged to introduce and use approved system of ***equipment for registration of cash payments***, the estimated tax is reduced for the value of the maximum ten fiscal machines.

  If the taxpayer does not use the tax exemption till the end of the current year, he has a right to transfer it for the next period.

- The ***losses due to financial, business and non-business transactions*** may be compensated with the profit in the future reporting periods, but maximum in 3 years following the year in which they have been registered.

  This right may not be used in the case of status changes of the taxpayer related to merger, acquisition, division, ownership transformation or similar.

- The ***capital gains*** from the sale of securities, equipment and immovables are included to the tax base in amount of 70%.

  The capital gains from securities will not be subject to taxation until 1 January, 2006, in order to contribute to the development of the securities market in the Republic of Macedonia.

- The ***dividends*** from participation in the capital of another company are exempted from taxation under condition that they have been taxed by the taxpayer who makes payment, according to the general rate of the Profit Tax Law.

- For the ***transfer*** of the part of the ***profit*** earned by a foreign entity, profit tax is not paid for the amount that is transferred.

Expected Reforms

The conclusions to be derived from the recent experience with the above tax incentives is that although the existing incentives are very attractive by the standards of the SEE region (OECD, 2003a), they have not proved to be effective in attracting FDI, except via the privatisation process which has its own set of dynamics and incentives. Given this track record, it is incumbent on the GoM to undertake a through review of the financial and tax incentives, including exploring the possibility of creating of a Macedonian Investment Law. The necessity for such a review arises from the logic of a recent OECD study exploring the extent to which tax policy design can influence FDI, focusing specifically on the role of tax incentives in the SEE region. Since these countries are Macedonia's main competitors, the analysis is particularly enlightening and results in the important policy conclusions presented in Box 3 below. These findings reinforce both the urgent necessity to improve business environment, as well as to improve the tax system and the associated incentives.

The focus of the GoM's Programme is, therefore, not on increasing the generosity of its investment incentives in a situation where they are already generally considered to be highly competitive, but on improving the basic operation of the system. This is consistent with the guiding principle that creating a tax environment that is enabling to investment and at the same time capable of raising a fair share on the host country's profits, is equitable to both business and government.

BOX 3. FDI AND TAX IN SEE

There is a general lack of correlation between a country's ability to attract FDI and its overall tax level or corporate tax burden. The tax system, particularly the corporate income tax, is taken into consideration once a country is "shortlisted" for possible investment. To this extent, countries in SEE should seek to ensure that its tax system and burden do not act as barriers to foreign investment. The following tax impediments to FDI in SEE tend to apply:

- Non-transparent and unstable tax policies combined with sometimes corrupt administrative practice contribute to project costs and increases perceptions of project risk, tending to discourage investment. Tax incentives may add to this risk, for example if administered in a non-transparent fashion. Therefore, a priority is to review tax systems (policies and administration) to improve transparency and minimise the scope for corruption.

- The "enabling environment" should include a simple and easy-to-administer tax system that offers competitive host country tax treatment, with basic corporate tax rules that do not deviate significantly from international norms. Host country tax burdens should not exceed those of competing jurisdictions offering comparable enabling conditions, given the goal of attracting FDI.

- Tax relief can be delivered through the design of basic features of the tax system, such as the setting of the statutory corporate income tax (CIT) rate, the design of the depreciation system, and loss treatment. The adoption of measures that remove impediments may reduce levels of risk and thus encourage FDI.

- Statutory CIT rates in the SEE countries, in the range of 15% to 25%, are moderate or low by international standards. The competitiveness of tax systems can be enhanced by focusing on improving basic aspects of tax systems with the aim of improving transparency, predictability, and collecting a reasonable share of host country tax from foreign investors.

- Progressive and regressive corporate tax rate systems should be reconsidered, in favour of a flat corporate tax rate structure.

- The classical tax system, which most of the SEE countries have opted for, with a final flat-rate withholding tax on dividends to resident individuals, is appropriate, offering the advantage of simplicity and relative ease of administration.

- Systems differ in terms of their treatment of intercorporate dividends. Multiple taxation of distributed profit paid along a chain of related corporations should be avoided, possibly by providing dividend exemptions on intercorporate dividends between related companies, with final withholding on the first payment outside a corporate group. Dividend gross-up and credit provisions at the corporate shareholder level should be avoided if found to add significantly to complexity.

- Where tax treaties do not exist with major capital exporting nations, and the conclusion of such treaties if a number of years off, countries should consider reducing statutory non-treaty rates to levels closer to treaty norms.

- Countries without thin-capitalisation rules or with variants that have been found to be weak, should consider introducing those rules. At the same time, countries should examine their rules and administrative practice covering the enforcement of arm's length prices in international transactions.

- Countries with relatively high

employer social security contribution rates should consider lowering those rates to international norms as soon as possible. Where such reductions are not possible currently due to budgetary pressures, labour market conditions should be examined to determine if institutional changes (e.g. elimination of minimum wages) might be possible to enable at least a partial shifting such contributions onto employees.

- Where special customs duty exemptions are currently provided on imports of machinery and equipment for certain investors, consideration might be given to a general reduction or elimination of import duties still in effect on most types of machinery and equipment. Where revenue requirements make this a difficult option to implement immediately, consideration might be given to an announced gradual reduction.

Source: OECD, 2003b, pp.194-5

Changes to Corporate Income Tax

Following a process of consultation with the business sector, and taking on-board the necessity to ensure that the fundamentals of the tax system are appropriate (as discussed in box 3), a new CIT Law is being finalised with a view to improving the general investment climate. The first outcome of this review is an amendment to the existing CIT Law, resulting in the following tax incentive:

- A tax holiday on all investments on movable and immovable assets up to Euro 100,000. For investments above Euro 100,000, the profit tax exemption will increase to 30%. This amendment applies retroactively to investments made from the 1st of January 2003.

In addition, the GoM is examining the current CIT law with a view to fundamentally revising it. This process is being co-ordinated by the Ministry of Finance, with the close involvement of the business community. The new CIT Law is expected to be approved by Parliament in 2003 and implemented in January 2004 and the changes being considered include the following (see Annex 2 for further information):

- Incentives for new businesses in economically underdeveloped areas.
- Incentives for investment in Free Enterprise Zones.
- Extension of the loss-carry-forward rules, etc.

Income Tax Law

The GoM will review the current income tax arrangements with a view to adopting a simple, equitable and transparent Income Tax Law by 2004.

5.2.2 Other Inducements

Tax incentives are one of the GoM's principal tools for stimulating greater levels of domestic and foreign investment. In addition the GoM is in the process of placing a number of other measures at the disposal of investors, which add to the attractiveness and competitiveness of Macedonia as an investment location.

Support to Micro Enterprises – Pro Biz Bank

Micro enterprises constitute an important part of the Macedonian economy. However, by virtue of their size and lack of credit history, they are often denied access to finance through the commercial banks. For this reason, the GoM has sought to deal with this barrier to investment by enacting a special law enabling the creation of a Micro Finance Bank with half the normal capitalisation that is required. If, as expected, the experience elsewhere in the SEE region is reproduced in the Republic of Macedonia, the Pro Biz Bank will boost the levels of investment in the micro enterprise sector.

Support to SME Development – Credit Guarantee Fund

A key problem affecting the level of domestic investment in enterprises is the inability of many SMEs to meet commercial banks' requests for collateral, even though they may have a workable business plan for their proposed investment. The GoM is seeking to alleviate this problem through the creation of a Credit Guarantee Fund. The amount of the Credit Guarantee Fund is expected to be 10 mil. Euros for a 3 year period (the envisaged sources of the Fund are: the privatization proceeds, state budget, private companies, donors, etc.) that will be used to support only commercially viable projects that would otherwise be denied access to credit from commercial banks by virtue of its inability to secure loans through the provision of collateral.

Export Promotion Support - Macedonian Bank for Development Promotion

The Macedonian Bank for Development Promotion (MBDP) is a state-owned bank whose mission is to contribute enterprise development through:

- Investment finance for SMEs.
- Support exports via export credit insurance.
- Management and implementation of the foreign credit lines.

The Ministry of Finance is in the process of reviewing the mission and range of services offered by the MBDP to ensure that it is able to further assist the development of enterprises, especially through the stimulation of exports.

Political Risk Guarantee/Insurance

A number of foreign investors may be concerned about political and non-commercial risks. This is not a barrier to investment in Macedonia since a political risk insurance exists and can counteract the risk perception associated with the regional instability. This insurance is operated through the World Bank / Multilateral Investment Guarantee Agency. In addition, different national investment insurance agencies provide insurance for Macedonia (OND, ICO, ECDG, OPIC, SACE, SID).

As in other countries, MIGA's coverage is against the following risks: Transfer Restriction, Expropriation, Breach of Contract, War and Civil Disturbance. The standard application procedure is used, starting with submission of the application to MIGA and is finalized by approval of the Government of Macedonia (based on recommendation of the Ministry of Finance). By now, MIGA has issued guarantees for only 2 investments in Macedonia, but none of which have been used yet. This indicates that there is a room for further promotion of this facility within the investment community. Apart from the regular information available at the MIGA Web site (www.miga.org), there is no public information on the MIGA insurance. Once established, FIARM will intensify the promotion of various insurance opportunities for Macedonia.

Underdeveloped Regions Bureau

For stimulating balanced regional development and development of economically underdeveloped regions a special Bureau is available. It operates under the auspices of the Ministry of Local Self-Government and provides grants to specific investment projects (mostly infrastructure projects). The criteria, amount, conditions and use of the Bureau funds are regulated with a Government decision, as well as the regions defined as underdeveloped. 1,003 settlements (out of a total of 1,602 in the country), 64% of the territory with 19% of the population are classified as underdeveloped regions. However, the budget of the Bureau is mostly provided by the State budget and if compared to the needs is very limited (2003 budget is app. 4.3 mill. EUR).

In order to improve the Bureau’s transparency and overcome the criticisms of being politicised, in 2003 a Committee composed of representatives of several relevant ministries has been introduced to the allocation processes. However, the issue of Bureau’s transparency has still to be addressed, since there is not much information about its operations and allocation processes publicly available.

Free Economic Zones (FEZ)

Free economic zones exist in all SEE countries. Although fiscal incentives exist, the Republic of Macedonia is still to create a functional FEZ. Despite the strong competition and uneven degree of the success of such zones elsewhere, in the countries where these zones have been implemented effectively, they have proved effective in attracting FDI, reducing unemployment rates, promoting exports and generating foreign currency revenues. Therefore, future activities will focus on FEZ Bunardzik, through an investment programme for building infrastructure to the Zone and selection of a developer, who would be in charge of the Zone development and attracting investors.

Employment Stimulation

One of the GoM's strategic objectives is the reduction of unemployment (currently 32%) and the level of poverty. Aside from the creation of a culture of entrepreneurship which helps stimulate start-ups, SME development and the attraction of investment for economic growth, the GoM will foster employment growth through active labour market policies. We recognise that self-employment support programmes can reduce the duration of unemployment, raise incomes and provide a cost-effective alternative to paying unemployment insurance. However, the persons who are most likely to benefit from such schemes are the more motivated individuals and persons possessing work experience and accumulated human and financial assets, as compared to, for example, the long-term unemployment.

- The GoM has recently introduced Branko's Law, designed to stimulate employment by exempting all enterprises that generate new employment (from groups such as the unemployed, those receiving social assistance and companies undergoing economic restructuring) from social contributions for a period of two years. In addition, the employers are eligible for a lump sum of 25% of the average salary per employee for a period of three months. This incentive is expected to help create 45,000 new jobs annually and/or have a strong impact on the reduction of the informal economy.

- The GoM is implementing a National Action Plan on Employment, which is likely to include the following active labour market measures:

  o Support to the unemployed to access employment through such measures as Job Clubs, training and mediation.

  o SME development through measures to assist the unemployed to become self-employed via support, advice, training, etc.

  o Development of a more targeted public works programme for the unemployed.

- The GoM will actively explore the possibility of creating financial incentives, along the lines of other countries such as Slovenia and Croatia, for stimulating new employment in sectors with potential for rapid growth (such as new technologies), as well as high unemployment and underdeveloped regions. Such incentives should be carefully targeted to avoid waste and to be regularly reviewed in order to ensure effectiveness. The Ministry of Economy will bring forward proposals for the establishment of job-creation grants to encourage employers to stimulate investment in new jobs (with a condition that the number of employees cannot be reduced for, say three years). The resources for such grants will come from an Employment Generation Fund and be limited in nature. The implementation will be according to strictly commercial criteria through a transparent tendering process involving commercial banks. The amount will increase if the employment is generated in one of the designated underdeveloped or high unemployment regions of Macedonia.

5.2.2 Evaluation of Investment Incentives

Comparisons of the incentives offered in competing countries in the SEE region conclude that the incentives are "very generous" (OECD, 2003a). Via this comprehensive programme of fiscal and other inducements, the GoM provides sufficient scope for investors to be interested in Macedonia as an investment location.

International best practice suggests the need for an evaluation of tax and financial investment incentives to be undertaken on a regular basis. There are at least two reasons for doing so:

- The relative lack of success in attracting FDI, despite relatively generous incentives, calls for a thorough review of the incentives and the reasons why they have not proved to be more effective.
- The presence and magnitude of the positive "externalities" (discussed in section 2.2 of this Programme) are the key determinants of whether FDI incentives may be "wasteful", taking into account factors such as efficiency, effectiveness, opportunity costs, deadweight loss, etc., or not. Given the competing pressures on state budgets, it is important to assess this issue.

The Ministry of Economy, in collaboration with the Ministry of Finance and the Foreign Investment Agency of the Republic of Macedonia, will commission an independent review recommending changes to the tax (and financial) incentive regimes, including the examination of the scope for an Investment Law. The evaluation will be carried out by January 2005 with a view to enabling the Republic of Macedonia to develop an effective, coherent and transparent system of tax and financial incentives for investment, consistent with international expectations and obligations. In addition, the Ministry of Economy, in collaboration with the Ministry of Finance will invite independent foreign institution to assess the country rating from the perspective of foreign investors.

5.3 Policy Conclusions

- Whilst recognising that tax incentives are not the primary consideration for investors, they can play a decisive role in the second stage of investors' decision-making process. Tax and financial incentives may reasonably be used to supplement an increasingly enabling business environment, to counteract market imperfections and where strong incentives based competition exists, as in the case of the SEE region.

- The Macedonian CIT rate (15%) is one of the lowest in the SEE region. Nevertheless, the GoM will review the CIT system in order to ensure that, once it is "short listed" by potential investors, the tax system does not act as a barrier to investors. The same applies to the income tax system. These measures are designed to ensure that the Republic of Macedonia develops a relatively simple and easy to administer tax system offering competitive host country tax treatment. The anticipated changes will be more consistent with international norms and thus reduce investors' perceived levels of risk. The resulting system will also result in the collection of a reasonable share of host country tax from foreign and domestic investors.
- There is a wide range of tax (and financial) incentives on offer in the Republic of Macedonia that is very competitive by the SEE region standards. The GoM recognises that a multiplicity of tax incentives may be counterproductive and in certain cases may increase perceived levels of risk unless they are well co-ordinated and administered in an effective, coherent and transparent fashion.
- Therefore, following the establishment of FIARM, the framework for investment incentives will be reviewed in order to assess the effectiveness of the existing tax and financial incentives, including the possibility of creating an Investment Law, in order to develop efficient, consistent and transparent tax and financial investment incentives, in accord with international expectations and obligations.

CONCLUSIONS FOR THE PROGRAM

6.0.

With reference to the Programme for Stimulating Investment in the Republic of Macedonia, the Government has adopted the following conclusions:

1. The Government of the Republic of Macedonia adopts the Programme for Stimulating Investment in the Republic of Macedonia and suggests it be delivered to the Parliament of the Republic of Macedonia and be examined in a session together with the Law on Establishing Agency for Foreign Investments of the Republic of Macedonia and the Law for Stimulating Entrepreneurship.
2. The Government of the Republic of Macedonia obliges the Ministry of Finance to include the FIAS 2 project (the Project) in the three-year arrangement with the World Bank in accordance with the dynamics planned in this Programme.
3. The Steering Committee assigned for the preparation of the Project, has to continue with the implementation of the Project and to review its implementation on monthly basis, informing the Ministry of Economy about the progress.
4. The Government of the Republic of Macedonia obliges the Ministry of Economy to coordinate the implementation of the Project, to track the dynamics of its realization and to inform the Government of the Republic of Macedonia on monthly basis about the progress.
5. The Government of the Republic of Macedonia obliges all the Ministries and other State bodies, in coordination with the Ministry of Economy, to fulfill the activities defined in this Programme according to their respective competences within the scheduled time frame.
6. The Ministry of Economy has to constitute an ad hoc expert team (Interim Task Force) which, in cooperation with the responsible ministries, will work on the implementation of the Programme by preparation of the laws and bylaws.
7. The Ministry of Economy has to engage an ad hock expert team for preparation of feasibility study for linking the electronic systems of all relevant institutions, noted in this Programme, into one network, aimed at the realization of the “one-stop shop” principal.
8. The Ministry of Economy is obliged, in cooperation with the Ministry of Finance, to animate the potential donors for financing of the two ad hock expert teams noted in points 6 and 7.

   In the case of insufficient funds collected from the donors, the Ministry of Finance, in accordance with the frames of the budget, will examine the request of the Ministry of Economy for realization of the activities noted in the points 6 and 7.

9. For the purposes of creating a network of electronic systems, the Ministry of Finance has to collect necessary funds in accordance with the feasibility study noted in point 7, for supplying other necessary resources from the three year arrangement with the World Bank.

   If the funds are not supplied from these sources, the Ministry of Finance has to provide them from the Budget of the Republic of Macedonia for the year 2004.

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www.gov.mk

Macedonian Privatisation Agency
www.mpa.org.mk

Ministry of Economy
www.economy.gov.mk

Ministry of finance
www.finance.gov.mk

Ministry of information
www.sinf.gov.mk

Macedonian Stock Exchange
www.mse.com.mk

Statistical Office of the Republic of Macedonia
www.stat.gov.mk

Macedonian National Bank
www.nbrm.gov.mk

Macedonian Economic Chamber
www.mchamber.org.mk

Macedonian Information Agency
www.mia.com.mk

General Information and Links
www.macedonia.org

Business Catalogue
www.unet.com.mk/mbc

Annex 1:

FOREIGN INVESTMENT AGENCY OF THE REPUBLIC OF MACEDONIA

Operational Principles

FIARM will begin its operations no later than the 1st of January 2004. It will be highly professional and closely related to the private sector.

The Government of the Republic of Macedonia, on proposal of the Minister of Economy, will nominate the members of the Management Board. Out of the 7 Management Board members 4 will be representatives of businesses and their associations and 3 will be representatives of the Ministry of Economy, Ministry of Finance and the Agency for Support of Entrepreneurship. The basic criteria for selection of the members of the Management Board should be their expertise, neutrality and experience.

FIARM will start operations with a staff of 15, and it will grow in accordance with the performance and ability to attract additional funds. There will be a process of open competition for all FIARM jobs. The Director should be familiar with international and domestic investment trends, should have a proven track record of engagement with the private sector and international experience. The staff will be experienced professionals, with backgrounds in business management and administration, marketing, economics or related disciplines. All operational staff will need to be fluent in at least one western European language.

The Director of FIARM will report on progress to the Minister of Economy on a regular basis, through the Management Board. The Ministry of Economy will determine national policy with respect to FDI with the active involvement of FIARM. The role of implementation of the policy will be left to FIARM.

FIARM will establish a close and regular working relationship with the relevant ministries, institutions, investors' associations, as well as embassies and other bodies representing Macedonia abroad. This will ensure that its activities are transparent and objective.

All operational costs for FIARM (salaries, office overheads, travel and communications, etc.) will be financed through the State budget. FIARM will have an operational budget of at least Euro 750,000 for the first full year of operation (FIARM, 2003 and MoE estimates). International experience with investment promotion agencies suggest that it not realistic to expect them to become fully self-funding in the initial period. Since the services offered by such agencies are of a public good nature, that would not otherwise be provided by the market and the results of their operation do not enable profit earning, it should be anticipated an on-going state funding.

International donor contributions for the Agency will provide training and capacity building for the management and staff of FIARM. It is envisaged that donor contributions will be front-ended, gearing down over the initial three-year period of operations. FIARM will also be able to attract donations and sponsorship money from other organisations, including private sector, consistent with its remit of promoting Macedonia to the relevant countries and companies.

The performance of FIARM will be judged on its programme outputs and success in attracting FDI. A system for evaluating FIARM's activities and effectiveness needs to be developed (see MIGA, 2000). The system of remuneration will include a performance-related component in order to incentivise the generation of additional funds, over and above those provided by the state budget..

Annex 2

PROPOSAL FOR MACEDONIAN CORPORATE INCOME TAX

The Republic of Macedonia is currently rewriting its Profit Tax Law and expects the new law to be operative by January 1, 2004. However, both the current law and proposed law share common enhancements equally for domestic and foreign businesses.

1. Flat profit Tax Rate of 15%
2. Transparency – incentives are made a part of the law eliminating administrative procedure and project uncertainty.
3. Clarity, simplicity and computation of a tax base corresponding to the market economy standards, thus eliminating unpredictability and the risks of a major capital investment.
4. Incentives through tax rate reductions for new businesses, businesses established in economically undeveloped areas, free-economic zones, major capital investments. The tax reductions vary in amount and term, but all commence in the first year of profit.
5. Proposed – full tax exemption for foreign companies limiting its economic activity to management of its global economic activities.
6. No tax on dividend income both domestically and to foreign investors.
7. Tax free return of profit to foreign parent from branch and subsidiary operations within Macedonia.
8. Enhanced tax base deduction allowance up to 100% of tax base on investments in fixed assets in the amount of 100,000 euros and additional allowance up to 30% of tax base on investment amount exceeding 100,000 euros.
9. Relief from double taxation.
10. Foreign investor withholding rates more favourable than standard treaty guidelines.
11. Foreign tax credit or deduction from tax base permitted.
12. Recognition and allowances for advertising, public relations, marketing, charitable and sponsorship expenditures.

13. Sophisticated reorganisations, merger and liquidation provisions.
14. Consolidated returns and aggregated permanent establishment annual tax returns permitted.
15. Small businesses may elect to pay a flat annual fee in lieu of profit tax.

Annex 3

COMPARATIVE ANALYSIS OF INCENTIVES IN SEE

The Ministry of Economy has undertaken a comparative review of investment incentives in the SEE region, focusing on the principal form of incentives. The analysis is based on a recent OECD study on this issue (OECD, 2003a). This summary highlights a number of important points that has to be considered in the implementation of this Programme for Stimulating Investment in the Republic of Macedonia.

Types of Investment Incentives

There are three main types of investment incentive. Regulatory incentives seek to attract foreign firms by offering them derogations from national or sub-national rules and regulations, such as easing environmental, social and labour market requirements. Most Governments reject the use of such incentives. Financial incentives focus on areas that are perceived to be disadvantaged compared to other locations (e.g. in disadvantaged areas) to compensate firms for relocating or establishing new branches and to correct market imperfections or overcome transaction costs (employment subsidies, credit guarantees, etc.). These are costly and must be used in a targeted manner. By far the most commonly used type of inducement in the SEE region is tax incentives. It is particularly attractive to countries with a limited capacity to offer financial incentives.

Incentive Considerations in SEE countries

- The evidence regarding the possible influence of taxation on Foreign Direct Investment (FDI) decisions is that the effective tax rate:
    - IPlays little or no part in the initial decision of MNEs to invest.
    - IMay play an important role (rarely the key role) in location decisions.
    - IMay be more important to export-oriented investment.
    - IIs growing in importance in the SEE region.
- There is very limited evidence of host country taxation being a relevant factor in attracting investment, given the considerable uncertainties and risks posed by investing in the region.
- Where tax was identified as important, the relevant concerns were transparency and complexity, rather than particular tax relieving (incentives) provisions.

- Investor surveys highlight frustration over unstable and non-transparent elements of the tax system, in areas of both policy and administration, which are impeding investment. There is an important interaction between transparency and lack of certainty, and perceptions of project risk.
- Where investments may lead to high expected rates of return, but are accompanied by high levels of perceived risk, such as in the SEE region, investors are discouraged by tax systems that are non-transparent due to provisions that are overly complex or at odds with international practice.
- Other factors contributing to uncertainty are unstable laws and regulations and unpredictable administrative practice.
- In such a context, incentives cannot be expected to compensate for these deficiencies that add to project risk and discourage investment. Indeed, tax incentive practices may contribute to or be a central element of these factors.

The above analysis, leads to the following policy conclusion, of great relevance to the Republic of Macedonia:

> “This … cautions against the use of special tax incentives, with a focus instead on providing a low, competitive effective host country tax burden by careful and clever design of the basic tax provisions. SEE countries that wish to be “long-listed” as a possible investment location should recognise that MNEs generally do not even consider special tax incentives at this stage of an investment decision... Where tax is taken into account, the focus tends to be on main elements, including the basic corporate income tax rate, the treatment of losses, and the existence of a tax treaty network. Therefore, for countries wishing to make it onto a candidate list of countries, the focus of efforts on attracting FDI should be non-tax policy areas impacting the enabling environment, and as regards taxation, main tax considerations. Indeed, the country work has found that, where enabling conditions are relatively weak, tax incentives may make the situation even worse – and tending to add to investor uncertainty and perceptions of risk, and thus tending to decrease chances of being chosen as a suitable investment location.” (OECD, 2003, p.35, emphasis added)

Macedonia Vs SEE Region

Tables 1 and 2 set out the position of Macedonia relative to its main competitors in relation to incentives. Table 2 also sets out the position of the Czech Republic.

Basic Tax features

Table A1. illustrates the point that, based on the main features of the tax system, be it CIT, maximum rate of income tax, the level of VAT, social contributions etc., the Republic of Macedonia appears to be highly competitive vis-à-vis its main competitors. This is not to suggest that the administration, clarity, stability, simplicity, transparency, etc. of the tax system are competitive. The evidence indicates the necessity to focus on improving the operation of the basic tax system, rather than the need to make it more attractive to investors through the actual rates. This is the reason why the GoM is focusing on creating a new Corporate Income Tax Law, consistent with international standards. The same will apply to the proposed Income Tax Law.

Tax Incentives

The Republic of Macedonia offers the most investment incentives of the countries in SEE (jointly with Romania – Table A2.). However, this only tells part of the story. Although the incentives are among the most generous:

"The low level of FDI in Macedonia demonstrates that even the most generous tax incentives are unlikely to be effective if other conditions are unfavourable to investment. The existing incentives would seem to be difficult to interpret and to apply in practice. There is some overlap between the different provisions and they appear to be cumulative (i.e. a taxpayer can claim a 50% tax reduction under one provision and an investment allowance under another, in the same year)." (OECD, 2003a, p.136, emphasis added)

This is the reason why the Ministry of Finance plans a major review of the tax incentives system; and why the focus remains firmly on the necessity to improve the business environment.

TABLE A1.
BASIC TAX FEATURES IN SEE COUNTRIES

Country	Albania	Bosnia & Herzegovina	Bulgaria	Croatia	FRY Montenegro	FRY Serbia	R. Macedonia	Moldova	Romania
Standard Corporate Income Tax	25%	30% Fed 10% RS	23.5%	20%	15% / 20%	20%	**15%**	25%	25%
Maximum Personal Income Tax	20%	30% Fed 10% RS	29%	45%	40%	20%	**18%**	25%	40%
Social Security Contributions	Employer 34.2%; employee 11.7%	F BiH/RS: Employer 47%/42, Employee 19,2%/19.5%	Employer 32.2%; employee 10.5%	Employer 8.75%; employee 20.60%	Employer 20%, employee 20%	Employer 16.3%, employee 16.3%	**Employer 18%; employee 15%**	Employer 30% Employee 30%	Employer 23.33%. Employee 11.67%
Standard VAT	20%	Sales tax	20%	22%	17%	Danok na promet	**18%**	20%	19%

TABLE A2.
INVESTMENT INCENTIVES IN SEE COUNTRIES

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	Macedonia	Moldova	Romania	Yugoslavia (FR)	Czech Republic
Tax holidays		X		X	**X**	X	X	X	
Partial profit exemption		X					X		
Preferential CIT rate				X					X
Accelerated depreciation			X	X	**X**		X		X
Investment allowance		X				X	X		
Reinvestment allowance					**X**				X
Investment tax credit			X		**X**				
Customs duty exemption		X		X		X	X	X	X
Customs duty deferral	X								
VAT exemption									X
VAT deferral	X					X			
Special zones offering:									
Customs duty exemption	X	X	X	X	**X**	X	X	X	X
VAT exemption			X				X	X	X
Tax holiday (CIT exemption)		X		X			X	X	X
Other tax exemptions		X					X		X

Source: OECD, 2003a