

## FOREIGN DIRECT INVESTMENT IN MACEDONIA – IS THERE DISCRIMINATION IN PRACTICE?

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**Abstract:** *The subject of research of this paper presents the foreign direct investment in the Republic of Macedonia. The purpose of the research of this paper is to show whether there is discrimination between domestic investment in the Republic of Macedonia and foreign investments in the country. The first part is an introduction which explains the topic of the research, while the second part focuses on the legal and institutional framework for foreign direct investment in the Republic of Macedonia. The third part of the paper explains the conditions for attracting foreign direct investment in the Republic of Macedonia. The fourth part of the paper analyzes and gives answers for the discrimination between foreign and domestic investment in the practice of the country. Finally, the fifth part of the paper is the conclusion.*

**Key words:** *investment, domestic investment, foreign direct investment, portfolio investment, discrimination.*

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### 1. INTRODUCTION

Investments directly affect the increase of competitiveness and employment in any economy, which simultaneously contributes to the creation of income or gross domestic product (GDP) which will satisfy the needs of present generations of citizens, but also it provides a steady development and improves living conditions for future generations.

In this sense, an important instrument of economic policy of any country that is most suitable for employment growth is the increase in total investment in the economy, and in this framework and foreign direct investment. However, in doing so, interference of objectives with instruments politics is the case when the instrument attracting foreign direct investment is a victim of politics. That is, the policy objective becomes an instrument to attract foreign direct investment, no matter how much it will cost. Then, politicians spend huge resources to attract foreign investors (for example, they build special zones for foreign investment with their complete infrastructure equipment), they change the legislation (e.g. in labor law they reduce workers' rights, because this measure foreign investors often look for), they are introducing subsidies (for example, salaries of foreign investment), they reduce minimum wages (because foreign direct investors are looking for that measure), they are providing tax exemptions for foreign investment etc. Therefore, if we make a calculation, it appears that the domestic economy has lost more than it gained. On the other hand, the same goal of increasing employment could be achieved with the expenditure of considerably less resources. However, politicians in this case indicate that they realized "objective" (and not the policy instrument) which they promised to the citizens before the elections in the country.

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The subject of research of this paper represent foreign direct investment in the Republic of Macedonia. The purpose of the research of this paper is to show whether there is discrimination between domestic investment in the Republic of Macedonia and foreign investments in the country. The methodological approach of this paper covers the method of case study, induction and deduction, the concretization method, the method of classification, the method of description, method of compilation and qualitative method.

## **2. LEGAL AND INSTITUTIONAL FRAMEWORK FOR FOREIGN DIRECT INVESTMENT IN THE REPUBLIC OF MACEDONIA**

### **2.1. LEGAL FRAMEWORK FOR FOREIGN DIRECT INVESTMENT IN THE REPUBLIC OF MACEDONIA**

The main legislation today in the Republic of Macedonia that is regulating business and is attracting foreign direct investment are: *the Law for Foreign Exchange and the Company Law*. In addition, investment conditions for foreign legal and natural persons are defined and dealt with a number of other laws and regulations, such as: *the Law on Securities, the Law on Protection of Competition, the Law against Unfair Competition, the Law on Technological Industrial Development Zones, the Law on State Aid Control, the Law on Income Tax, the Banking Law, the Law of Obligations Act, the Investment buildings Law, the Law on Construction Land, the Law on Ownership and Other Real Rights, etc.* However, *Laws that are passed today in the Republic of Macedonia are recognizable and should remain stable and they should not change often.* In fact, the legal framework which determines the conditions for foreign direct investment - FDI, general rules and norms are regulated by the Law for Foreign Exchange and the Company Law, and the specific conditions in certain activities are regulated by the laws that regulate these activities. [1]

Apart from laws and bylaws, the Republic of Macedonia on a bilateral basis concludes *agreements on promotion and mutual protection of investments, stating the basic principles of "fair and equitable treatment" and "full protection and security" of foreign direct investments by the host country.* [2] Also, the legal framework for foreign direct investments in the Republic of Macedonia was determined by provisions of the Stabilization and Association Agreement with the European Union. [3]

### **2.2. INSTITUTIONAL FRAMEWORK FOR FOREIGN DIRECT INVESTMENT IN THE REPUBLIC OF MACEDONIA**

The institutional framework with legislative powers in the field of foreign direct investment - FDI in the Republic of Macedonia covers a lot of entities. Since the framework that is associated with foreign direct investment - FDI is regulated through several laws and regulations, the responsibility for their implementation and control of the implementation is delegated to individual institutions that have authority in a particular area, so here are the following: Ministry of Economy (as creator of the policy to attract foreign direct investment - FDI), the Minister who in charge of attracting foreign investment, the Ministry of Finance, Ministry of Transport and Communications, Ministry of Agricultural, Forestry and Water Management and others, then the Central Bank of the Republic of Macedonia, the Commission for Securities, Geodetic Administration, the Cadaster, etc.

On the other hand, the attraction of foreign direct investment - FDI presumed involvement of multiple jurisdictions or institutions for policy for foreign direct investment - FDI, or for

providing various services and support to foreign investors. Thus is formed a whole group of actors and institutions dealing with attracting foreign direct investment - FDI in the Republic of Macedonia, which includes the Agency for Foreign Investment (Invest-Macedonia), Directorate for Technological Industrial Development Zones, Agency for development and investments, then local authorities, the Council of foreign investors in the Republic of Macedonia, the National Council for entrepreneurship and competitiveness, and numerous NGOs.

However, the practice of various countries who have good success in attracting foreign direct investment - FDI is known that the institutional framework for foreign direct investment - FDI, although on the one hand have to involve a greater number of relevant institutions at the same time it should be concentrated on the least possible number of institutions (institutions for foreign investors are "restore that need to knock"). That opposition usually surmounted by creating a so-called "one-stop-shop-institution" for foreign direct investment - FDI, which should be responsible to guide foreign investors through the maze of national laws, rules and competent institutions. The Republic of Macedonia introduced this legal system that allows investors to register their business after 4 hours of submitting the application (in practice it still takes 1-2 days). [4]

### **3. THE CONDITIONS FOR ATTRACTING FOREIGN DIRECT INVESTMENTS IN THE REPUBLIC OF MACEDONIA**

As in many countries seeking to attract foreign direct investment – FDI, in the Republic of Macedonia the legal framework that is "responsible" for it, is based on four key principles: (a) national treatment to foreign investors (they are treated the same as domestic investors); (b) the maximum effective protection of property rights (both domestic and foreign investors) [5]; (c) building a stable legal and institutional environment; and (d) transparent functioning of the institutions. The last two principles are a process and not a single act, but an integral part of the legal framework that creates conditions for attracting foreign direct investment - FDI. [6]

Foreign direct investment - FDI in the Republic of Macedonia are free, except in some sectors (military equipment, trade in weapons, drugs, historical monuments and cultural heritage). Foreign investors need to register with the Ministry of Economy each investment and its amendments. Foreign investors can invest in existing businesses to establish their own businesses or have joint ventures, under the same conditions as domestic investors. All registered foreign investments are protected against nationalization. The transfer of profits and other offerings is free, after they meet any tax liabilities towards the Republic of Macedonia.

Foreign investors may acquire real estate in the Republic of Macedonia, in accordance with the provisions of a special law or international agreement under the condition of reciprocity. Registration or sale of the property is carried out in the Central Registry. Foreign nationals acquired real estate can sell to domestic citizens if the real estate is registered in the register.

Foreign investors in the Republic of Macedonia, as well as domestic, may write down and trading in securities only through authorized participants (brokers) of the capital market. Also, they can acquire domestic securities that are not traded in the market only initial public offerings, private placements and in cases of non-trade transactions (compensation, inheritance, pledge, repo transactions, and gifts). Foreign investors have equal treatment in concluding insurance contracts with domestic companies for life insurance.

Attracting foreign direct investment - FDI depends on several aspects, which are formulated as a convenience for foreign investors. In this sense, in the Republic of Macedonia there are rules for avoiding double taxation and exemption of foreign investments from taxation if they are in the free economic zones. But for foreign investors more important is the existence of a predictable and transparent legal environment without administrative obstacles. [7] Thus, in an analysis of the attractiveness of the Republic of Macedonia for foreign direct investment - FDI made by the Advisory Council for Foreign Investments (FIAS) concludes that reforms in the Republic of Macedonia are mostly satisfying "on paper", but there are still large gap between theory and practice. In this sense, often mentioned barriers for foreign investors in the Republic of Macedonia are: assumed high political risk, the lack of infrastructure, underdeveloped financial market, the high degree of corruption, bureaucracy, underdeveloped institutional infrastructure, poor governance and relatively poor quality of workforce (human capital). [8]

#### 4. IS THERE DISCRIMINATION IN PRACTICE BETWEEN THE FOREIGN AND DOMESTIC INVESTMENT IN THE REPUBLIC OF MACEDONIA?

At the beginning of this section the question that arises is: Should the regime applicable to domestic investors be the same for foreign investors or foreign investors should have beneficiary treatment? The answer is very clear: the regime should be the same for domestic and foreign investors, because more favorable treatment of foreign investors versus domestic investors ruins the legal regime in a country, and forced domestic investor to make redistribution or outflow of capital abroad. Also the phenomenon of "traveling with a return ticket (round-tripping), which means that the domestic capital is out of the country and returns "disguised" as a foreign capital in order to

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have access to benefits in the country, is possible. However the most serious possible consequence is *discouraging domestic investment*.

Although domestic and foreign companies in the Republic of Macedonia are formally and legally equal, we still believe that this argument for declarative legal equality of domestic and foreign investors is often used for hiding the real de facto inequality that exists. The incentives for foreign investors are the main tool for attracting investors in the Republic of Macedonia, and they are given for a particular type of investment, typically in: *production, greenfield, export-oriented sectors and based on sophisticated technology*.

*The major policies and measures to attract foreign direct investments in the Republic of Macedonia are the following:* [9]

- Flat tax rate of 10%;
- Tax breaks - there is no income tax on reinvested net profit before tax;
- *Investments again in the technological industrial development zones (TIDZ) offer state aid schemes in the form of regional aid, including:*
  - Exemption from personal and corporate income tax in the first 10 years;
  - Exemption from VAT and customs duties for goods, raw materials, equipment and machinery to 500 thousand euros as a subsidy to encourage spending, depending on the value of investment and number of employees;
  - Lease of land up to 99 years;
  - Free connection to natural gas, water, electricity; as well as Exemption from paying municipal taxes to the local municipality and fees for building permits and green customs channels for good.

All users of the *Technological Industrial Development Zones (TIDZ)* receive the entire package of benefits in opening investment. Some of these companies get additional funds as a cash grant, but the grant amounts remain secret in the Republic of Macedonia. It is only known that Kemet has received 2.05 million euro grant and other benefit package. Given that the company must employ 500 people, it turns out that for one job in the country, the Republic of Macedonia gave 4.100 euros.

Thus giving benefits only to foreign companies, the Government of the Republic of Macedonia discriminates the domestic investors, namely insufficient attention is given to domestic investors (and they cannot get help in solving common, minor problems). Foreign investors are paid with the money on the basis of taxes and duties paid by domestic companies, while foreign companies are then exempt from these charges. Therefore we believe that in the Republic of Macedonia there is discrimination against domestic investors.

In the Republic of Macedonia there is *lack of transparency, data and information on the costs for subsidizing foreign direct investment, and non-compliance with the European legislation on transparency in state aid*. Namely, the Government of the Republic of Macedonia does not publish the contracts concluded with the companies investing in technological industrial development zones. For example, in Serbia with the publication of any investment, it is published how much the state has given to the investor state aid money and also the tax exemptions and other privileges and amenities. *In the Republic of Macedonia, however, the agreements between the Government and investors are treated as strict confidential*. There is also *lack of timely reporting to investors, lack of criteria for selecting and contracting with, foreign direct investment, incomplete planning of funds in the budget of the Republic of Macedonia, but also a lack of monitoring and evaluation of the outcomes achieved*.

*The gross added value of companies in TIDZ has the delayed effect time, and until now positive effects have only three of the seven companies. Tax exemptions and grants, in absolute terms are amounted to EUR 56.58 million. State aid granted to beneficiaries in the Technological Industrial Development Zone (TIDZ) is a significant financial impact on the decision to invest in the Republic of Macedonia, and the sustainability of investments in the long term after the period of tax exemption is controversial. Departure after a period of receiving subsidies after the tenth year would result in a drain on capital, firing employees, and the need for application to other investors in TIDZ. User companies in TIDZ to finance assets are significant mostly financed through commitments with related parties (mothers companies) and to a lesser extent through the capital increase, with companies in TIDZ pay expenses for interest, reflected in reduced profits, reduced distribution of profits and potentially less income tax on distributed profits. The total average cost determined by subsidies and tax exemptions expressed through employment generated in the period is amounted to EUR 21.454. Average net wages paid to employees of companies are in the average level of the national average, but that is not the case for most companies, so continuous promotion of cheap labor, while at the same time a policy for attracting developed technologies are not reflected in labor costs, which denies the effect of the transfer of knowledge and knowledge spillovers in other companies of the sector. The potential benefits of positive externalities as spillover of knowledge is expected but faced challenges given that the sectors that generate new knowledge and transferring or spillover of knowledge: research and development, marketing, sales, are reserved at maternal companies or regional centers, and thus it is limiting factor for spillover of knowledge as an argument to attract foreign direct investments in the country. [10]*

The functioning of the Technological Industrial Development Zones in the country is a point of separation with the economic development that is typical of the European Union member states. In essence, this is a separation of domestic from foreign investors. In the Macedonian TIDZ, foreign investors are encouraged and stimulated through plenty more options available in a way that is not available to domestic investors. In this context of superiority and discretionary privileges exclusively set by the Government of the Republic of Macedonia, in addition to domestic legal entities, especially subordinates are individuals who are employed in companies TIDZ. [11]

Public money that have been spent on attracting foreign investment will have a much greater impact on economic growth of the country's economy if it were spent on direct domestic investment. [12]

The unequal treatment of domestic and foreign investors or quiet favoring foreign investors over domestic has been also criticized by the European Commission. In addition, the constant interference of the Government of the Republic of Macedonia in the economy through legislation or subsidies is a problem that prevents proper and rapid economic development. The conclusions that are repeated for years, and now receive a new and improved dimension, and it is - corruption is widespread, and the fight against it is extremely selective. Therefore, the European Commission points out that in the Republic of Macedonia there are laws, but there is no application of these laws in practice [13]

## **5. CONCLUSION**

From the overall research in this paper, we can conclude that although the domestic and foreign companies in the Republic of Macedonia are formally and legally equal, we still believe that

this argument for declarative legal equality of domestic and foreign investors are often used for hiding the true de facto inequality that actually exists.

The results showed that despite of all the benefits and advantages for foreign investors on the Macedonian market, the inefficiency of the legal system, including: frequent changes of laws, slow legal procedures, lack of protection of property rights and corruption, resulting in unattractive investment climate, and this is the main problem in further state functioning of the existing and attracting new foreign direct investment. In order to have more investment it is necessary to increase the legal certainty and the rule of law.

Formal legal equalization of domestic and foreign investors is not enough to eliminate the feeling of unequal treatment. It requires effective demonstration of real equality of domestic and foreign investors in terms of access to FDI benefits, or domestic companies to obtain equally, and possibly more benefits from foreign investors under equal conditions. A key prerequisite for this is greater transparency in the management of FDI benefits.

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