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### FT REPORT - REPUBLIC OF MACEDONIA: Hopes pinned on foreign investors

By Eric Jansson, Financial Times  
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Facing a global attention deficit, many a small country at some stage plumps for a 30-second spot on CNN or BBC World, hoping that a flicker of local scenery and music might yield a bounce in tourism revenue or charm the odd potential investor.

Not the Republic of Macedonia. When the southernmost former Yugoslav republic launched its own promotional blitz last year, its target was global finance.

Arriving at the World Economic Forum annual meeting in Davos, Switzerland, in January, invitees received complimentary copies of The Economist magazine tucked into glossy wrappers describing Macedonia as "a new business heaven in Europe".

Months later, the country's advertising bonanza carries on, scoring repeated hits in 59 top-flight business publications in 39 countries.

Questioned by taxpayers, government officials refuse to disclose how much the state-funded campaign costs. Yet, even without a figure, the effort by its nature reveals how sure officials in Skopje are that any significant economic breakthrough to be expected in the coming years will be powered by foreign investment.

No one disputes the need for a breakthrough. Real economic growth was steady through 2006 with a 3.2 per cent rise in gross domestic product. The government reports a GDP growth spike of 7 per cent in the first quarter of 2007, year on year. But the country's potential remains woefully underexploited. Rising growth, low inflation and shrinking external debts leave almost untouched a staggering official unemployment figure of 36 per cent.

Two questions arise. First, is it true that foreign investment will provide the fundamental boost needed to speed growth and create jobs? The answer depends on the nature of investment. If the majority of companies pulled in build factories - as a growing number are doing - jobs will come.

Second, is the government's promise of a "heavenly" business climate to be believed? Foreign investors on the ground give positive answers, with contextual reservations.

Since entering office less than 11 months ago, ministers have launched "really positive" reform efforts, says Aristides Vlachos, president of the International Council of Investors in Skopje. He heaps praise on Skopje's "regulatory guillotine" project to cut red tape, but adds that "it is too early to see results".

Reformist ministers find it difficult to make good on promises, dependent as they are on the post-socialist country's anaemic civil service. "We have the impression that the government is trying hard to bring change, but state administration does not follow. They have to get rid of the old bureaucrats," Mr Vlachos says.

Examples abound. A prime achievement is the creation of a "one-stop shop", a system designed to simplify the process by which new companies are registered, cutting the time needed from five days 12 months ago to three days now.

By September, this should be reduced to just 24 hours, says Vera Rafajlovska, the economy minister.

In fact, says Mr Vlachos, the one-stop shop is "a positive idea but still not real". The time for registering new companies remains "variable" and still requires visits to multiple state offices.

The "Invest in Macedonia" campaign also promises exceptionally low tax rates - 12 per cent on corporate and personal income and zero on reinvested profit - lowered further still for investors in free economic zones.

The rates described are technically accurate. But critics note that other important taxes go unmentioned. With certain wage-related contributions counted separately from income tax, aggregate wage taxes actually exceed 75 per cent, says Sam Vaknin, an economic adviser to past governments.

"Yes, corporate profit tax is the lowest in Europe - although Albania is now matching it - but if you calculate the total tax burden on businesses it is either the second or the first, competing with Sweden," Mr Vaknin says.

By launching its campaign before pro-business reforms really work, the government risks fostering "disillusionment and disenchantment" among new arrivals conducting due diligence, he adds.

But the critique may be too sharp. Even sceptics such as Mr Vaknin say they believe that government ministers are trying sincerely to liberate economic potential by cutting taxes, opening the economy and attacking corruption.

According to Trajko Slaveski, finance minister, critics were proved wrong when they predicted that lower personal income and profit tax rates would threaten the state budget - already the region's smallest as a proportion of overall economic activity. "Lower taxes did not just yield higher revenue - they yielded 20 per cent more than we projected," he says.

Partly this reflects the immense amount of business done off the books in an country where many people's flair for entrepreneurial profit-making far exceeds their respect for the tax authority. Some economists estimate that the "grey

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economy" accounts for 50 per cent of GDP.

Many workers take jobs secretly while keeping their unemployed status - the only way to qualify for free state health insurance, says Burt van Selm, resident representative for the International Monetary Fund. "Funny quirks like this need to be worked out," he says.

Mrs Rafajlovska, head of a private consultancy before becoming a minister, says the practical opportunities for meaningful reform have exceeded her expectations. When she first entered her government office, she found "a huge pile of papers on the desk". She was told they were companies' requests for ministerial approval "on all sorts of issues".

"I told them to tell companies they do not need a minister's approval to work legally. Now, look, there is no pile," says Mrs Rafajlovska.

It is a start.

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