

# FDI Incentives and Unequal Treatment of Domestic Investors in Macedonia: Arguments and Consequences

## Public Policy Framework Proposal



### Vision

FDI policy optimized to the strategic economic interests of the Republic of Macedonia and based on significant support by relevant stakeholders, including but not limited to the business community, social partners, and political parties.

### Goals and Results

- New evidence from relevant literature and comparative practice contributed to the policy debate on FDI in the Republic of Macedonia, and shared with relevant stakeholders.
- The debate on FDI incentives expanded to take into consideration the political economy analyses of the reality of the international FDI competition between countries.
- The causes and the context for the unequal treatment (discrimination) of domestic investors properly understood.
- The possible consequences of the unequal treatment of domestic investors considered.
- Effective demonstration of real equality between domestic and foreign investors as a key instrument for countering the feeling of discrimination in the local business community.
- Expanding the debate on equality to include broader aspects of social justice, in particular the balance between the fiscal capacity of the government to provide services to the citizens vs. support to multinational companies.
- Regional policy discussion on the challenges and consequences of the national FDI promotion policies commenced.

### Summary

The location incentives provided to foreign investors are the key issue of interest in the public debate. It is clear that if there would be no program of incentives for the foreign investors, the FDI policy would be of lesser interest to the public (as it has been in the period prior to 2006-2007), even though the issue of the other related cost (international advertisement, etc.) would remain. The central interest of this analysis was to answer the question of why the Macedonian

government has embarked on an obviously costly policy of provision of generous state aid to foreign investors. The conclusion which has emerged from the review of the comparative practice is that the government was in a sense compelled to this by the rules of the international FDI race. A fact which is not discussed in the Macedonian public debate is that the country has joined a fierce international race for FDI. This race is particularly intense in the field of export-oriented FDI that Macedonia is competing for. There is significant evidence from the review of comparative practice presented in the literature that countries which decide to promote inward FDI, and especially countries with small markets and fewer resources, have no choice but to accept the rules of the locational tournament. A country can choose to pursue or not to pursue a desirable type of FDI (greenfield, export-oriented). But if the decision is to actively pursue FDI, then it has to accept the rules of the FDI race. It is quite clear that for a country such as Macedonia, the FDI incentives are a critical part of the investors' decisions to come and invest. If the country decides to suspend the incentives, it has to accept the fact that the flow of inward FDI, which is anyways small, will further decrease. This is the key policy choice to be considered. It should be noted that this argument about the imperative of FDI incentives is not noticeable in the public debate where the dominant view appears to be that of the good business environment as the foremost factor for FDI promotion. Bringing this argument into the policy debate (which is the aim this paper hopes to contribute to) is thus relevant for considering the policy options. A key related policy consideration is whether the small and fiscally-constrained Macedonia can effectively compete in this race with larger countries with more resources. This consideration needs to be weighed based on rigorous additional analysis. (Overall there has to date been rather little analysis on the government's FDI policy beyond the one produced by journalists. More such analysis is needed). In relation to this there is the following consideration: is it worth it ending the campaign after almost a decade of investment in it? Is for example a downsizing a better option? It is obvious that there are risks to the policy decision to enter the FDI race. The obvious negative effect of this race includes the reduced fiscal capacity for delivery of public services. The question is whether the effects of the inward FDI exceed the costs caused by such reduced fiscal capacity. Again, this needs to be decided based on robust measurements of benefits vs. costs. Such measurement should be longitudinal. The issue of discrimination of domestic investors remains a critical point of contention and a polarizing political issue. The review of the evidence indicates that this issue is not typical to Macedonia, but that it is a phenomenon that can be observed across countries.

The evidence suggests that this issue has the potential to polarize the national political agenda and to require political actors to position themselves on it. The Macedonian case follows this pattern.

The survey of the business community has shown a strong feeling of unequal treatment. The consequences of the feeling of unequal treatment in the business community include discouragement of domestic investment, capital flights, and the so-called round-tripping (domestic capital returning disguised as foreign capital in order to qualify for incentives. The threats of discouraged domestic investments and the flight of domestic capital (potentially to neighboring countries which offer incentives) are real.

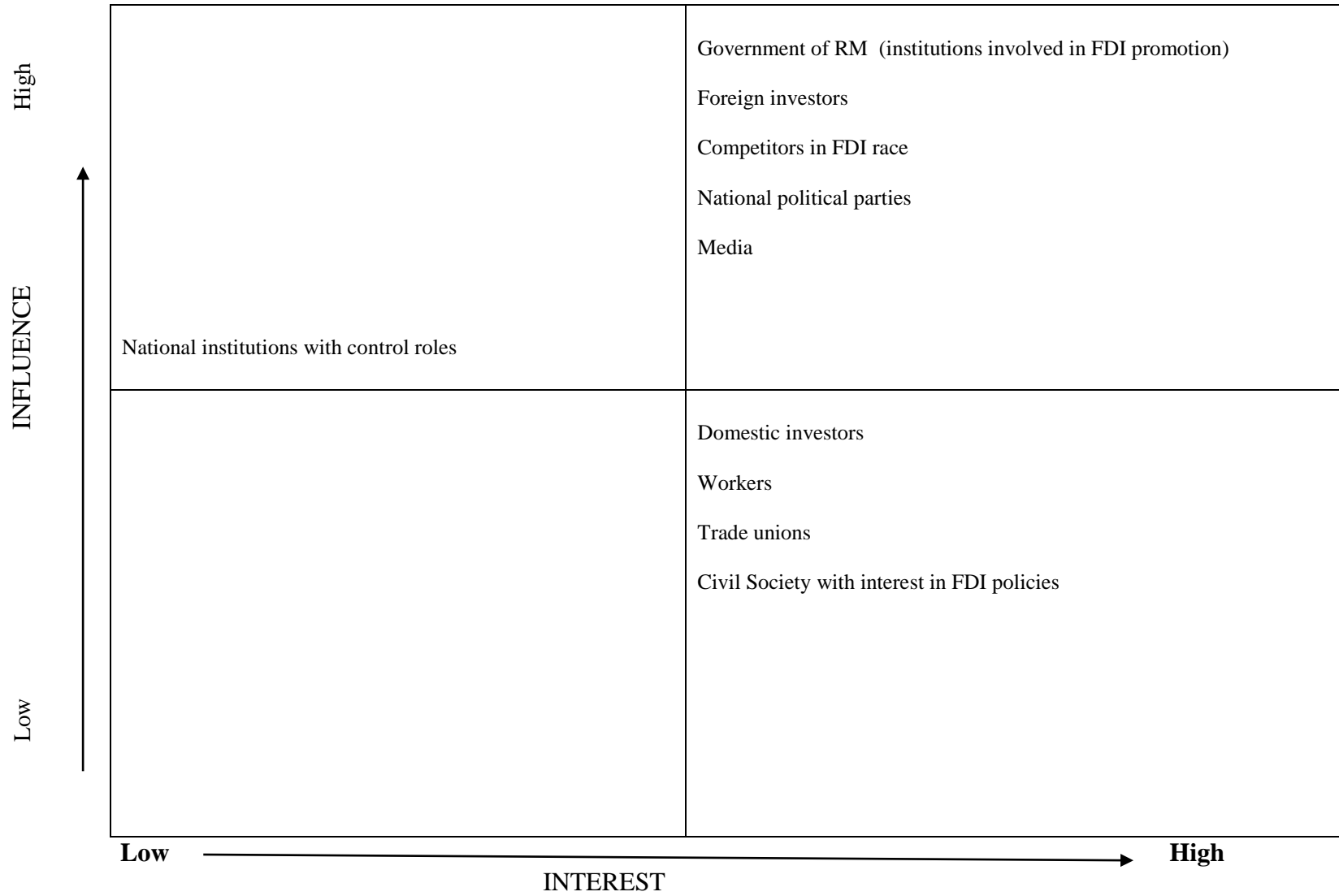
Nonetheless, the business community also displays an attitude of understanding of the necessity of FDI incentives and a feeling that the government's FDI promotion policy has started to show results.

Evidence suggests that governments can counter the feeling of discrimination by presenting a relevant demonstration of equality which exceeds the rhetorical and normative exercise of providing a de jure equality. The effective demonstration of real equality appears to be a key instrument for countering the feeling of discrimination by local businesses.

The debate over inequality in Macedonia is directly focused on incentives for foreign investors vs. no incentives for domestic companies. The issue of inequality seen in the broader and anti-globalist terms of support to multinationals at the expense of reduced fiscal capacity to service citizens (with emphasis on the poor) does not seem to be of direct interest to the debate in Macedonia. This argument deserves a stronger voice in the debate.

The reality of the FDI race imposes difficult choices for governments. The literature has noted that due to the nature of the phenomenon, such policy challenges cannot be effectively addressed by national governments alone and that international coordination is needed. At present such a debate is not present in Macedonia (given that the fact of the FDI race is not acknowledged) and the pursuing of such a policy objective from a current standpoint seems rather ambitious. Nonetheless, starting a regional forum of discussion on the issue could be a first step in that direction.

## Stakeholder Analysis



## **PESTLE Analysis**

The external environment for the FDI policy is summarized in the format of a PESTLE analysis, which includes political, economic, social, technological, legal, and ethical factors.

### **Political Environment**

The external environment for the FDI promotion policy in Macedonia is polarized. The issue of unequal treatment of domestic investors is relevant on the political agenda. Political actors position themselves on the issue. The FDI policy is influenced by factors which exceed the national policy framework.

### **Economic Environment**

Macedonia has had modest economic growth since the end of the global economic crisis. The national business community feels discriminated by the government's FDI policy but believes the policy has to date produced effects.

### **Social Environment**

The rate of unemployment is among the highest in Europe. The standard of living is among the lowest in Europe. The country has weak trade unions.

### **Technological Factors**

The import of new technology into the country, in addition to creating jobs, is one of the strongest motives for the government's FDI incentives policy. The issue of spillover and integration of domestic companies in the value chains created by the inward FDI are issue of critical importance, but insufficiently explored.

### **Legal Factors**

The legislative framework for FDI promotion is to a considerable extent harmonized with EU state aid regulation. There oversight role of competent institutions appears weak.

### **Ethical Factors**

There is evidence from the comparative practice that the FDI promotion competition between countries has over the past few decades turned into an intense "locational tournament" where FDI incentives are the major instrument. The competition is also referred to as "race to the bottom" and a "bidding contest".

## **Risk Analysis**

Key risks include:

- decreased fiscal capacity for provision of public services to primarily affect the poor
- increasing of public debt
- overdependence on FDI incentives as mechanism for preventing the leaving of investors and loss of jobs
- discouraged domestic investment
- domestic capital flight
- race to the bottom; ever more costly beggar-thy-neighbor measures

## **The Way Ahead**

- opening up the debate with the political opponents and business representatives on the imperatives of the FDI incentives, based on increased transparency,
- setting in place robust mechanisms for measurement of the effects of the FDI incentives; ensuring room for diversity of views and transparency of measurement results,
- creating the conditions for effective demonstration of real (not just de jure) equality of domestic investors for the investment incentives,
- expanding the inequality debate beyond the direct axis of equality of investors, in order to address broader social justice issues; ensuring stronger civil society involvement in this debate,
- initiating the creation of a regional forum for discussion on FDI incentive policies and the mechanisms for their control,

## **Key Impacts**

- improved political and social dialogue of the imperatives of the FDI incentives policy,
- the feeling of unequal treatment by the national business community reduced

## **Measurement**

- systematic, longitudinal, and transparent measurement of the effects of the country's FDI promotion policy,
- regular surveys of public opinion,
- periodic surveys of the business community,