Statement by Misha Popovikj

Thank you very much, Chairman Hastings and Co-Chairman Wicker, Distinguished all Members of the Committee, Senate and the House of Representatives,

Since its independence from the socialist Yugoslavia in 1991, the economy of North Macedonia has become more liberalized. Prior to independence, however, domestic companies became accustomed to a centrally planned economy. Therefore, in the 1990s, the difficult transition towards the market economy led to a decline in employment, while the private sector struggled to meet the needs of modern customers and to compete in the globalized economy. The economy eventually reached its pre-independence level in 2006 and after some stagnation during the financial crisis of 2007–2008, maintained slow but steady progress.

Even though unemployment has decreased over the years, it is still high according to the State Statistical Office. In the second quarter of 2019, it was 17.5 percent. It is not surprising that public opinion polls repeatedly single out unemployment as one of the two most pressing issues, along with the state of the economy. According to the polling referenced by CIPE, 46 percent of the respondents cited unemployment and 33 percent the economy as the issues that concerned them the most at the end of 2018. The two issues are, of course, closely linked.

Being a small, open country, North Macedonia relies on foreign direct investment (FDI) to spur economic growth. FDI can play a significant role in strengthening the economy by increasing exports, integrating in the global market, developing workforce proficiency and productivity, and promoting innovation through technology transfer. Most importantly, FDI can help reduce unemployment. That is why the political elite in North Macedonia has been keen on attracting FDI to create new jobs for its voters.

To attract FDI, successive governments of North Macedonia have offered and provided various incentives to prospective investors. Between 2007 and 2016, the estimated amount of the awarded incentives was 225 million EUR. It typically ranged from 7 to 47 percent of the overall investment. Whether any of this public money was spent efficiently and effectively is impossible to assess due to the lack of a public register providing a comprehensive overview of these incentives and corresponding evaluation of their contribution to strengthening the economy of North Macedonia. The introduction of such a registry would be a welcome step towards enhancing transparency and oversight of investment incentives.

In some cases, incentives were awarded to companies without thorough examination of their capacity to carry out the investment, which led to the failure to realize such investment and the loss of public resources. Under the former government, political and economic cycles seemed to be jointly determined and investment became one of the channels through which politics influenced the economy and vice versa. Though any investment creates opportunities for corruption on both sides and leads to an increased risk of corruption, this is especially the case when state incentivizes investment and such investment helps prevent government failures, emboldens politicians, enriches investors, and finances corrupt dealing.

North Macedonia's government has begun 2019 with promises of an economic upturn and a push toward further democratic reform and efforts to ensure good governance, increase standards of living and access to opportunities and entrepreneurship, including to prevent many of Macedonia's population from leaving the country. According to the 2019 study of the Westminster Foundation for Democracy, due to the inability to prevent annual emigration, the potential annual gross added value loss measured around EUR 333 million, which is around 3,1 percent of the 2018 GDP. To put it simply, every work-able person who leaves North Macedonia takes nearly 16 thousand EUR of potential future GDP abroad. A survey among young Macedonian people – Youth Study North Macedonia 2018/2019 – showed that nearly half of young people cited the improvement of their standard of living as the main reason for migration, almost 18 percent cited higher salaries and 11.3 percent better employment possibilities. Brain drain requires a complex set of measures that reflect the specifics of each country and that should connect with a series of socio-economic policies to be effective in the medium term. FDI has, however, been recognized as a key growth factor and a viable solution to the brain drain, or the permanent loss of skilled workers through emigration. If invested wisely, it brings not only economic growth, job opportunities but also increase demand for skilled workers, thus helps stem brain drain.

Since the change in government in 2017, the awarded amount has totaled 40.2 million EUR and is expected to increase as the current government plans to increase the respective budget allocation. It also extended these incentives to domestic companies. While this move can certainly foster competitiveness of local companies, it also causes further concerns as the government does not thoroughly examine the ultimate beneficial ownership of the companies seeking investment incentives and does not screen foreign investment for potential risks either. As foreign investment can arrive through a citizen, shell company or a domestic subsidiary of a foreign company, this may lead to an increased footprint of foreign investment in key sectors of our economy to the detriment of the country's political development.

That is why we decided to focus our efforts on ways to mitigate the negative effects that corrosive capital can have on the governance of investment incentives and subsequently democratic transition of North Macedonia by strengthening the resiliency of the relevant institutional and regulatory frameworks.

To this end, we cooperated with the Directorate for Technological and Industrial Development Zones – one of the key institutions in this regard to ensure that investment incentives benefit the country's economic development generally rather than individual companies while maintaining financial stability, and thus contribute to the development of the world economy.

While the supply of corrosive capital is not restricted to any particular country of origin, in North Macedonia it is typically associated with investment flows backed by Russia and China. Both have recently stepped up their presence in the region, including through investments that lack transparency, accountability, and market orientation. Previous assessments of Russia's economic footprint in North Macedonia showed that the volume of investment originating in Russia was relatively low in comparison to other countries of the Western Balkans. However, it increased from roughly 1 to 4 percent when off-shore companies were included in the calculations. This opacity highlights the need for examination of ultimate beneficial ownership that I mentioned earlier.

The core reason for ultimate beneficial ownership identification is to prevent financial malintent such as laundering of money being hidden behind the closed doors of corporations, which then can be and in fact were used for further questionable transactions in North Macedonia in the past. Our analysis of the applicable regulations to identify the ultimate beneficial ownership of a company requesting investment incentives, showed that the examination is limited to the country of origin of the parent company seeking to invest and the regulations are difficult to implement due to the lack of corresponding expertise by the Directorate staff. For the same reason, it is also easy for public officials to circumvent them without any consequences.

Connected to this issue is the lack of cooperation among various public institutions on prospective beneficiaries' potential connections to criminal activities. While the institutions responsible for investment incentives conduct standard sanctions checks, at no point does any of them conduct a specialized search that would include national and transnational criminal records to identify individuals and companies who may be under investigation for criminal activities, such as money laundering, to mitigate risks associated with awarding incentives to such individuals or companies they are involved with.

Given the recent investigation of money laundering and fake insolvency of one of the major Russian investments in North Macedonia, we would argue that creating conditions to detect suspicious transactions at any point in the significant investment's lifespan is an urgent matter. This is not only because it might have protected the public revenues that the Te-To plant reportedly owned by Russian Senator Leonid Lebedev was expected to generate, along with the energy supply to 50,000 households in Skopje, which is now at stake, but also potential incentives that may have to be spared to prevent Te-To's failure and subsequent loss of jobs and associated economic development. .

Finally, based on what we learned from surveying the employees of the Directorate and its clients as well as the history of investment incentives in North Macedonia, we suggest separating FDI promotion from politics. In other words, let professionals rather that politicians take care of it because potential for corruption is inherent to FDI as even genuine companies want to make a profit and politicians leverage the jobs they bring. After all, the best way to attract investment is to provide investors with an enabling environment instead of favors.