

INVESTMENTS IN ENERGY – the Macedonian case



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Since independence at the beginning of 1990s and especially in the last several years, the most important issue to the development of the energy sector in Macedonia has been the lack of a substantial and sustainable investment model. This in turn has been reflected in the modest number of new energy capacities in the country. Most of Macedonia's existing energy infrastructure was developed during the second half of the last century. The consequence of this investment stagnation, especially after the breakout from Yugoslavia, is a weak energy sector, overwhelmingly dependent on imports and uncompetitive in the regional energy market. Foreign investors come and go from the country. Facing different legal and administrative barriers few decide to invest, leaving many strategically important energy projects for Macedonia to wait for 'better days'. In addition, both wholesale and individual consumers have experienced hardships in their businesses and everyday life, faced with poor energy supply, low quality transmission and distribution systems, combined with energy shortages and inefficient energy management. New capacities have been developed in the last two decades, but they are not enough to satisfy the increase in energy demand, or strengthen the energy position of Macedonia within Southeast European region.

In theory, investment in the energy sector is an integral part of the general investment policy of a country. Since energy is the driving force of industry, development of the energy sector and a liberal energy market are areas that guarantee both the stability and profitability of new investments. Moreover, the social stability of a country rests partly on a quality energy supply at an affordable price for the consumers.

In order to achieve the above, the role of the state in the formulation of investment policies, as well as the effectiveness of the state apparatus in their implementation plays a crucial role. The success of energy projects and the attraction of investments in the respective sector rest on: a consistent legal framework, consensus on comprehensive procedures and functional institutions on national and local level, as well as on promotional activities and lobbying. A final aim of this policy is to ensure faster economic development, sustainable development of the energy sector, competitive economy, and no less important - distribution of well-being to all citizens.¹

When looking from a wider perspective at South East Europe (SEE), in the last two decades the transition of socialist economies and opening of their markets has led to a revitalization of industry and has increased the energy consumption in the countries of this region. Therefore, a bold and long-term investment strategy in the SEE countries is an indispensable policy that will put their energy sectors on a solid base and will facilitate sustainable development and economic growth.

Could Macedonia become an attractive investment destination in the years to come? In an attempt to answer this question we will analyze the institutional setting and legal framework that regulate investment activities and make a comparative analysis of the state of doing-business in Macedonia and the countries of the immediate region. Moreover, an overview of the current and planned energy projects in Macedonia and the SEE region will be presented. The final findings of this research are recommendations for: enhancing investment policy, strengthening the investment climate in the country, and prioritization of investment projects in concrete energy sectors.

In this report, Analytica analyzes the current state of investment in energy capacities in Macedonia and the reality of the investment climate, at the same time offering effective policy measures for prioritization, attraction and management of new investments in energy, which will secure the future of Macedonia's energy supply.

¹ These are also the premises of the EU Energy Policy. "An energy policy for Europe", available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2007:0001:FIN:EN:PDF>;

The investment climate in Macedonia

According to the 2006 Investment Reform Index of OECD², investment policy has been one of the most advanced dimensions of policy reform in South East Europe. Every country has created a liberal regime to attract foreign investments, providing: equal treatment of foreign and domestic investors, guarantees against expropriation and free transfer of funds.

The investment climate in the energy sector in Macedonia is influenced by several factors: the legal framework; the policy and institutions for promotion of investment opportunities; the wider economic situation in the country; the pace of development of the regional energy market, as well as regional security and political stability.

In Macedonia, investments in the energy sector are a two-folded issue. On one side there is the government's world-wide investment campaign for attracting new businesses in the country, and on the other side we have old energy capacities, undeveloped infrastructure, weak institutions and an uncoordinated approach to energy investments. The lack of general investment strategy has left Macedonia at the bottom of investments in the SEE; bypassed by the major strategic gas pipelines (like Nabucco, South Stream, TGI), while neighbouring countries are witnessing a boost through investments in their respective energy sectors.³

Legislative Framework

New investments in the energy sector in Macedonia have been supported by an extensive legislative framework. This framework has laid down the basis for liberalization and opening of the energy market towards foreign investors. Besides the Law on Energy, which regulates the energy market, other fundamental laws include:

<i>Company Law</i> ⁴	This Law sets out the conditions for registration of domestic and foreign companies, the types of companies that can be established in Macedonia, and guarantees their rights and obligations. It allows foreign companies in Macedonia to be established under the same conditions as domestic ones. Foreign investors receive the same treatment as local companies and therefore do not need any special approvals.
<i>Law of the One-Stop-Shop system</i> ⁵	Facilitates the registering procedure of a company and shortens the administrative and bureaucratic procedures for registration of a business from 48 to only 4 days, also providing that all types of trade companies are registered within 4 hours of submission.
<i>Competition Law</i> ⁶	Prevents practices and business activities in the market that some undertakings could use to achieve an unjustified advantage over other undertakings and jeopardize free competition.
<i>Macedonian Constitution</i> ⁷	Guarantees the right to property for investors, making no distinction between foreigners and Macedonian citizens. According to Article. 30 "no person may be deprived of his/her property or the rights deriving from it, unless the use of that property affects the general welfare of the public". According to this, foreign investors may also acquire property rights for buildings or any other immovable assets for their business activities, as well as full ownership rights over construction land through a locally registered company. If the foreign company registers a

² This September OECD will hand over the newest report for the business environment in the country to the Macedonian government, and the same study will be internationally published by the end of 2009.

³ "Ekonomiska Analiza-Regionot trcha napred, Makedonija tone", *Kapital*, No. 508, 23 July 2009, pg. 20-28;

⁴ Company Law, *Official Gazette of RM*, No. 28/2004, 84/2005, 25/2007,87/08;

⁵ Law on One-Stop-Shop System, *Official Gazette of RM*, No.84/05,

⁶ Law against Limiting Competition, *Official Gazette of Republic of Macedonia* No.80/99;

⁷ Ustav na Republika Makedonija, available at:

<http://www.sobranie.mk/default.asp?ItemID=2E7B3DD8C5FBCA47A7DC6593841EBDD7>;

	local company according to Macedonian law, it can acquire land with full ownership rights similar to a domestic company. In the event of the property being expropriated or restricted, rightful compensation of its market value is guaranteed.
<i>Law on Construction Land</i> ⁸	Makes a distinction between residential and non-residential investors, simultaneously stating that while non-residents are given the right to acquire ownership over real estate for the purpose of business, foreign companies and citizens can directly own construction land in Macedonia (Art. 6 and 20). This law provides that the construction land is alienated through a public tender procedure. Domestic and foreign private individuals and legal entities can acquire long-term lease of construction land for a maximum period of 99 years through a public bidding process.
<i>Law on Concession and other forms of private-public partnership</i> ⁹	This law regulates the procedure and the general conditions for issuance of concessions for goods of public interest. Its aim was to create a legal framework that would allow for the entry of private capital in the construction of infrastructure and in the public sector for providing quality public services.

Laws that should improve the flaws of the existing legal framework and improve conditions for investing in the energy sector are being drafted. The most important are:

<i>Law on Public-Private Partnership (PPP)</i> ¹⁰	The aim of the new law, in draft version, is to set the legal basis for bigger private initiative in the financing of energy projects through a public-private partnership and concession scheme, respecting the principles of equality, transparency, non-discrimination, proportionality, recognition, environmental protection and efficiency. In the same time with this law the authorities want to harmonize Macedonian legislation to the one of EU in the sphere of PPP accepting the provisions of the Directive 2004/18/EC. ¹¹ Since the PPP is one of the most advanced models for development of the business structure in a country and for attracting private investments, the final aim of this law is to improve and legally strengthen the legal ground in Macedonia, as a precondition for new investments and more dynamic economic development.
<i>Draft Law on amendments and annexes of the Law on Technological-Industrial Development Zones (TIDZ)</i> ¹²	The draft law regulates certain provisions in line with European legislation, first, harmonization of the terminology, precision of the procedure for granting state aid and its scope, as well as precision of the provisions that refer to acquiring the status of the user of technological-industrial development zones. The new Law will also regulate the period for which the user is eligible for tax exemption and facilitation. The provisions in the new Law are aligned to attract more foreign investors by giving them more rights and benefits when investing in Macedonia. A new addition is the introduction of 0% personal income tax for period of 10 years, instead 50% for 5 years. The state aid to foreign companies will be 100% for the justified expenses in value to 50 million euro, and up to 50% of the total justified expenses in value of 50 to 100 million euro. ¹³

⁸ Law on Construction Land, *Official Gazette of RM*, No. 82/08;

⁹ Law on Concession and other forms of public-private partnership, *Official Gazette of RM*, No. 07/08;

¹⁰ The draft law was proposed in August 2008. Ministry of Economy, <http://www.economy.gov.mk/WBStorage/Files/Predlog%20zakon%20za%20PPP.pdf>;

¹¹ The Directive on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts can be accessed at: <http://www.dkom.si/util/bin.php?id=2004121408020465>;

¹² The current Law on TIDZ is available at <http://www.fe.z.gov.mk/Law%20on%20TIDZs.pdf>;

¹³ "Minister Besimi on a press conference about the amendments and annexes of the Law on technological-industrial development zones", Skopje, 05.09.2009, available at: <http://economy.gov.mk/default-en.asp?ItemID=168948BA219A5A4BA52896B6605FB03C>;

Doing Business in Macedonia

In the last couple of years there have been many positive changes in the promotion of Macedonia as a good business destination with a favourable investment climate. The last Doing Business Report of the World Bank for 2010¹⁴ has assessed Macedonia as a favourable country for business and as the best consecutive reformer over the past two years in South Eastern Europe. According to this report Macedonia is ranked 32nd in the world, 37 places higher since the last year's rank of 69th. In support of this, foreign companies have also positively assessed the business climate in Macedonia, especially the legal protection of investments, tax benefits, free trade agreements within CEFTA and EU, stable currency and the central position of Macedonia in the Balkans.¹⁵

In our study we refer only to several indicators of the World Bank Doing Business Report, which are prevailing factors when it comes to investments in Macedonia's energy sector.

o Starting a business

With the introduction of the new One-stop-shop system at the beginning of 2006, the conditions for doing business in Macedonia have significantly improved. The one-stop-shop system is designed to be simple, fast and less expensive. It operates within the Central Register via 32 electronically integrated offices located throughout the country. The system offers business registration in four hours, in a single office and gathering all information in one place. This system has decreased the time for registering a company from 48, 15 and 9 days in previous years to only 4 days in 2008. The same is true with the downsizing of the number of necessary procedures that the investor has to go through to four: Notarization of the company deeds and other documents, Registration with the Central Registry, Making a company seal, Registration with the Social Security Office.

o Registering property

In Macedonia the time needed to register property has been reduced to 58 days, almost half of the 2008 level. The current procedures for registering a property in the country include: obtaining a non-encumbrance certificate on the property (this certificate can now be obtained from the real estate registry instead of through the court); preparation of the sale contract by a lawyer; assessment and payment of sale tax on real estate; approving of the contract by a public notary; and applying for registration into the Cadastral Office. The final decision upon the issuance of the permit is made in the Cadastral office i.e. the State Authority for Geodetic Works (SAGW), which nowadays is a modernized electronic real estate cadastre.¹⁶ This institution has introduced internet access to the cadastre data and internet application forms for registration. They offer 24 hours free of charge internet access to data for the property certificate, with an additional option to check the content of the encumbrance (i.e. mortgage). Also, there is a possibility to review topographic maps and aerial photographs on the web page of the SAGW, where geospatial data can be searched, previewed and downloaded.

o Dealing with construction permits

The assessment of the regulatory burden and compliance of issuance of construction permits in Macedonia places the country on a much lower level being ranked 137th globally. On average it requires 21 procedures to be collected and 146 days to acquire a construction permit. In neighbouring countries the process often either lasts longer, in Croatia 420, in Montenegro 230 days, or the number of procedures is higher, e.g. 24 procedures in Bulgaria. However, the fees in Macedonia remain the highest among SEE countries, when viewed as a percentage of income per capita.

¹⁴The Doing Business Report presents quantitative indicators on business regulations and the protection of property rights that can be compared across 183 economies worldwide, and is the most reliable report of the investment climate in a country. Doing Business 2010, FYR Macedonia, World Bank Report is available at:

<http://www.doingbusiness.org/Documents/CountryProfiles/MKD.pdf>;

¹⁵ From an interview with Andrej Kuku, director of Lukoil Macedonia, *Dnevnik*, 20 July 2009, available at:

<http://dnevnik.com.mk/?ItemID=7238A197206B044A9AA195D0137C05A5>;

¹⁶ SAGW official website: <http://www.katastar.gov.mk>;

o Paying taxes

In Macedonia the tax system has undergone reforms aiming to put in place more sound tax legislation and more competent administration that will work in the most transparent, predictable and consistent way. With this reformed tax policy, companies can pay all taxes through the Electronic Tax Payment system. In order to save the taxpayers' time and money, the Public Revenue Office website contains a link by which companies can pay their taxes without having to visit Public Revenue Office personally.¹⁷

However, the tax reforms include not only technical aspects, but also important substantive changes in the amount and type of taxes that domestic and foreign investors pay. First, in order to stimulate additional foreign and domestic investments, there is a 0% corporate tax on retained earnings. Second, as of 2009, with the new amendments to the Profit Tax Law¹⁸ only the distributed part of profit is taxed. The main principle of the law remained unchanged thus keeping corporate and personal income taxes to a flat rate of 10%. Third, the flat tax system has enabled transparent and efficient administrative procedures, allowing for simple calculation and straightforward completion of tax forms. Table 1, is a comparison between corporate and personal income tax in Macedonian and other countries of the wider region.

Table 1:

Country	Corporate Income Tax	Personal Income Tax
Macedonia	10%	10%
Croatia	20%	15-45%
Romania	16%	16%
Slovakia	19%	19%
Hungary	16%+4%	1%-36%
Czech Republic	20%	15%
Poland	19%	18%-32%

Source: *Taxes at a Glance 2009*, PricewaterhouseCoopers, Taken from the Macedonian Investment Agency official web site¹⁹

Other tax incentives include the double taxation agreements that Macedonia has signed with many countries and that allow foreign companies operating in Macedonia to avoid double taxation.²⁰ Also special tax incentives are offered for companies operating in the technological-industrial development zones (TIDZs).²¹ The aim of all these reforms was to create tax incentives²² for future investors, and to promote the country as a tax reform leader in the region and an 'investment paradise' when it comes to tax benefits.

o Enforcing contracts and Protecting Investors

According to the Doing Business report, in countries where contract enforcement is efficient, businesses are more likely to engage with new borrowers or customers. Also, enforcement of contracts is closely connected to the protection of investors, particularly the protection of foreign businesses. In Macedonia the number of procedures enforcing contracts is 37 over a period of 370 days. Here Macedonia ranks 20th on a world level, with the strength of investor protection index of 6.7 on a scale of 0-10 (10 being the best mark). All other countries of the wider region have a lower rating.²³

¹⁷ The Public Revenue Office of Republic of Macedonia web page: <http://www.ujp.gov.mk/en>;

¹⁸ Profit Tax Law, *Official Gazette of RM*, No. 80/93, 33/95, 43/95, 71/96, with last changes 159/2008;

¹⁹ Source: <http://www.investinmacedonia.com/page.aspx?language=EN&page=B/TCINKqtiMN7p9bxvlNPg==>;

²⁰ For a complete list of the countries see at the Investment Agency web site:

<http://www.investinmacedonia.com/Page.aspx?language=EN&page=WFBPfkRsgK37My1Stfp7g==>

²¹ For more information on the TIDZ please see the second section of this report *Legislative Framework*, pg. 4.

²² Bulgaria, Croatia, FYR Macedonia and Romania have committed to the EU Code of Conduct on Business Taxation, which is required of all Member States to eliminate tax incentives which could create harmful tax competition within the EU.

²³ The lowest number of procedures is 20 – in Ireland, and the shortest period to obtain a permit is 150 days – in Singapore. Doing Business 2010, FYR Macedonia, World Bank Report, pg. 43;

○ **Functioning and result-driven Investment Promotion Agency**

In order to acquaint foreign investors with the opportunities of the Macedonian energy market and in the last instance to grasp their interest for investments, it is very important that all of the above-mentioned reform steps are well advertised and broadly promoted within the business community. The latter mandates the development of an efficient and sustainable promotional strategy and the establishment of a strong Investment Promotion Agency.

An effective promotion strategy consists of: a clear strategic vision for the country; a precise definition of 'where to compete', including sector and geographic focus customer-type; and a roadmap specifying 'how to compete' with the right skills, sector-specific removal of barriers, linkage programmes and marketing campaigns.²⁴ Macedonia's investment strategy scored below average in 2006's OECD Investment Reform Index (IRI).²⁵ From SEE only Bulgaria and Serbia have succeeded in defining effective investment promotion strategies. Bulgaria has adopted a National Strategy for Investment Promotion for the period 2005-2010, developed in line with the major priorities of its National Development Plan for 2007-2013. Similarly, in 2006 Serbia passed a Strategy for Encouraging and Developing Foreign Investment.

For implementation of an investment strategy, the Investment Promotion Agency (IPA) plays a crucial role. Investment agencies are a reality in every post-transitioning country of the SEE region nowadays and all strive to be the best in attracting investors to their country.²⁶ Thus, when assessing the work and the success of the investment agencies in the region, Bulgaria and Serbia have the most advanced IPAs: customer driven, with strong set of skills for both demand generation and investment facilitation, which act as a one-stop-shop for investors, while playing a strong advocacy role at the same time. In the case of Macedonia the Investment Agency is the primary government institution for supporting foreign investments in the country. Its objective is to assist potential investors in evaluating the business environment in Macedonia, with the goal of winning new investment projects and promoting Macedonia as a top reformer and good investment location to the international community. Even though in Macedonia the role of the Investment Agency has been strengthened within the past couple of years, the Agency did not succeed in attracting many FDI.²⁷ Its major weaknesses are its small operational budget, understaffing and weak relations with the domestic business sector and private sector organizations, as well as lack of good promotional campaigns for the export activities of domestic companies.²⁸

Two decades of independence: how far has Macedonia's energy sector developed?

In the 1990s the energy sector was left without any capital investments that would guarantee the country's energy security and stability. Several major projects in the oil and gas sector were put into operation, but they did not bring stability to the domestic energy supply and Macedonia has remained a country highly dependent on energy imports.²⁹ The following section makes an overview of the current energy infrastructure in Macedonia and recent energy investments, at the same time discussing the major investment challenges of the energy sector.

²⁴ *Progress in Policy Reforms - to improve the Investment Climate in South East Europe*, Investment Reform Index: Policy Findings, OECD 2006, pg. 58;

²⁵ Macedonia was ranked 2nd on a scale from 1 to 4, where one being the weakest and 4 being the highest score. Ibid, pg. 61, Table 4.1;

²⁶ The business community interested to invest in the energy sector in the SEE region is rather the same group of foreign companies, therefore it is of high importance for the individual Investment Promotion Agencies to promote their country in the best way for attracting foreign investors;

²⁷ Out of the total amount of the FDI in Macedonia in the period between 1997-2007 only 6.4% were in the electricity, gas and water sector. Investment Agency, <http://www.investinmacedonia.com/page.aspx?language=EN&page=/ZAIYp2MUuSktqYb2Che6g==>;

²⁸ *Progress in Policy Reforms - to improve the Investment Climate in South East Europe*, OECD 2006, pg. 62, Table 4.2;

²⁹ For more recent data on the energy balance of Macedonia see "Odluka za donesuvanje na energetskiot balans na Republika Makedonija" in Official Gazette, No. 165/2008, No.158/2007, No. 63/06;

Previous energy investment projects

Since electricity is used as primary energy source in Macedonia, it is of high importance to have developed capacities for electricity generation as well as an efficient transmission and distribution network. **Electricity generation** capacities in Macedonia date from the middle of the 20th century. Many of them are in a poor condition, due to lack of funds for their revitalization and upgrading to more efficient electricity generation. The energy capacities built at that time include big hydro power plants like HPP Globochica, Shpilje, Vrben, Raven, Vrutok and Tikvesh. Other major energy investments in the last 30 years were made in the '70s and '80s with opening of coal mines – Suvodol, Oslomej, construction of the thermal power plants TPP Bitola and Oslomej and the TPP Negotino, which uses heavy oil.³⁰

The HPP Sveta Petka with an installed capacity of 36.4MW and annual production of 66 GWh of electricity is expected to be put in operation in 2009. This hydro power plant is ELEM's investment of 44.6 million euro, provided by a loan of 54.7 million euro from Cyprus Defa bank, with the Macedonian government providing state guarantees for the loan.

Both hydro and thermal power plants built in the last century provide the skeleton of the electricity production system in the country and are the backbone of the Macedonian energy stability. However, in the last twenty years the level of new investments in the energy production has seriously declined. The last major investment in this sector was the construction of the HPP Kozjak, put in operation in 2004, which took 10 years to be built. Since 2004 there have been no new investments to construct neither hydro nor thermal power plants.

Unlike for the generation system, in the last few years, large investments were made in the electricity **transmission** system. These investments are part of a wider investment scheme for regional integration of the electricity systems of countries in SEE. The investments include development of the transmission network, upgrading the domestic grid and building high voltage inter-state transmission connections between Macedonia, Serbia and Greece. Currently the high-voltage system is connected by 400kV lines with Greece and Serbia. The power system is also connected to Greece by one 150kV transmission line. There are two 220 kV lines connecting the Skopje region and Kosovo but they have been out of operation since 1999. Being left without major investments in the last 30 years, this year MEPSO invested in 400kV high-voltage grid towards Bulgaria and a transformer station in Shtip, which was MEPSO's biggest investment in the national transmission grid. The investment has helped to set up an energy hub in eastern Macedonia. The power transformer station has enabled the establishment of a direct corridor with the places in the region that have big thermal and hydro energy potential, and it is the first high voltage power transformer station in the Balkans to use latest generation technology.³¹ Currently MEPSO is also using the credit lines of the EBRD and World Bank to invest in the modernization and expansion of the transmission infrastructure in Macedonia. With a loan from EBRD this year MEPSO has investment projects amounting to circa 6 million euro for the revitalization of five transformation stations. The World Bank on the other side will finance 25 million USD of the total 39.7 million USD for projects in the period between 2006 and 2011.

The tendering procedure for construction of the HPP Chebren and Galishte has come to a dead-end. After the cancellation of the tender in December 2008, the Ministry of Economy in mid-December has published a second international bid for construction of these two large energy capacities. Several well-known foreign companies, like Enel, RWE, Verbund, have shown interest in this project and have submitted their proposals for the tender, but the final outcome is still unknown.

³⁰ The electricity generated in these six (seven together with HPP Kozjak) state owned hydro power plants, with total installed capacity of 530MW, varies depending on the hydrological conditions from 600GWh to more than 1200GWh per year. TPP Negotino is a reserve generation capacity, with installed capacity of 200 MW. Source: <http://www.elem.com.mk>;

³¹ "Mepso vgradi novi tehnoloski noviteti vo trafostanicata kaj Shtip", *Kanal 5*, 24.03.2009, available at: <http://www.kanal5.com.mk/default.aspx?mId=44&egId=14&eventId=468>;

In the **distribution sector** with the unbundling of the electricity production, the “deal of the decade” was concluded when in early 2006 the government sold the state owned distribution company ESM to a foreign buyer – the Austrian energy company EVN AG.³² This contract brought a quarter of a million euro in the Macedonian budget. The Austrian company is currently one of the biggest investors in the energy sector in Macedonia investing 108.9 million euro in the distribution system, more specifically in building 1000km of new distributive network, over 600 new transformer stations and 11 revitalized hydro power plants.³³

When it comes to other sectors of the Macedonian energy system, like **oil and natural gas** new investments are missing. The one and only investment in the gas sector has been the construction of a transmission pipeline from Deve Bair, at the Bulgarian border to Skopje, carrying Russian natural gas in the Macedonian market. The pipeline was put in operation in 1997. It was a jointly financed project by the Macedonian government and the now private venture “Makpetrol AD”, with “Gazprom” as the strategic partner from Russia.³⁴

For a long time the oil sector in Macedonia has been seen as very attractive, with great potential for investments, mostly because of the expected implementation of the decade old AMBO project, the oil pipeline that should run from the Bulgarian coast of the Black Sea through Macedonia and finish at the Adriatic coast in Albania, as a part of the East-West corridor. AMBO will probably not see the light of the day, mainly because of issues of its economic sustainability – the increasing cost of the project over the years, and the lack of political commitment on the side of governments. Therefore the only investment in oil pipelines in Macedonia remains the construction of the oil pipeline Thessaloniki - Skopje, a 110 million USD investment by the Greek company Hellenic Petroleum. In 1999 the only oil refinery in Skopje (operating since 1982) was sold to the same company. The budget inflows from the purchasing agreement were estimated at up to 32 million USD.³⁵ Lately, the Macedonian oil market has been also attractive for Russian energy companies. Lukoil, one of the Russian energy giants in the oil business, entered the Macedonian market in 2005, after the Memorandum for Collaboration was signed between the Macedonian government and the oil company. Its primary activities are wholesale and retail trade of oil derivatives. Until now, LUKOIL Macedonia had opened 10 of a planned 40 new modern petrol stations.³⁶

New investment opportunities

Besides in traditional energy sources, in recent years EU countries have experienced a trend toward investments in other areas, like green investments in renewable energy and energy efficiency. This trend in Macedonia is modest and characterized by investments in pilot-projects coming from international donors like the World Bank, EBRD, USAID, etc. The sustainability of these projects is their biggest shortcoming, due to a lack of governmental support, both legal and financial. Therefore, the percentage of green investments in Macedonia is very low and variable.

In the **electricity sector**, investments in the construction of large hydro power plants have been ‘in the works’ for several years. Few HPP are planned to be included in the electricity system and to contribute to the stabilization of the electricity supply. However, until now all of

³² At the time of the selling of ESM, the generation company ELEM was considered to be privatized after the parliamentary elections in 2006. However, until nowadays ELEM has remained a state owned generation company.

³³ EVN Macedonia has also a role of a job creator, contributing to the development of the labour market by employing 3000 people and supplying the Macedonian households with quality electricity. From EVN Macedonia web site: <http://www.evn.com.mk/mk/>;

³⁴ More about the natural gas market in Macedonia can be found in: *Natural gas – an energy necessity for Macedonia: Overview of the Macedonian energy potential*, Analytica, July 2008, available at: <http://analyticamk.org/files/ReportNo15.pdf>

³⁵ A deal that was widely condemned as one of the most corrupt in Macedonia’s recent history.

³⁶ Out of ten gas stations four are in Skopje, one in Stip, Prilep, Bitola, Veles, Strumica and also on the place Straza, on the road between Gostivar and Kicevo.

government's efforts for new vital investments are at the stage of feasibility studies, and their implementation has been postponed because of technical, legal and political issues.

These projects include construction of two pumped storage hydro power plants on the River Crna, the HPPs Chebren and Galishte, the pumped storage HPP Boshkov Most and the Vardar Valley system of run-of HPP. HPPs Chebren and Galishte are seen as 'the cure' for the Macedonian energy system. The two plants together will produce up to 1050GWh electricity. The construction of the HPP Chebren will cost 319 million euro and the construction of Galishte is estimated at 200 million euro. The experience with other smaller generation projects, like the HPP Boshkov Most and the plants of the Vardar Valley has not been positive either. After only two companies had shown interest in the hydro power plants of the Vardar Valley in the 2009 tender (the criteria for a successful tender is a minimum three candidates), an investment worth 1.2 billion euro failed. For the HPP Boshkov estimated to 70 million euro, there is still an active international call for concessions that the Ministry of Economy has published in June 2009.³⁷

Since **natural gas** is considered as a clean, environmentally friendly and cheap energy source, the gas sector is very attractive for investment.

Major investment in natural gas is the construction of the first gas-fired Combined Heat and Power plant (CHP) "TE-TO" in Skopje. This is the first private investment in electricity production in Macedonia, and the first private company for electricity production in the Balkans. The international partner of the Macedonian investor "Toplifikacija" is the Russian company Sintez, which will invest 80% of the 137 million euro worth project.³⁸ The implementation of this project started in 2006 and the start of the plant is envisaged for April 2010. The CHP will use natural gas for both electricity generation and the production of thermal energy. The installed capacity is 223MW electricity and 160MW thermal energy. The annual production is estimated to 1850 GWh electricity and 350GWh thermal energy. This is 30% of the total electricity generation in the country and 50-60% of the thermal energy generation by the current heat supplier "Toplifikacija". A second CHP is ELEM's "Zelezara". ELEM (the state-owned electricity generation company) together with a foreign strategic partner will invest 140 million euro in this project. The power plant will have 200MW of installed electricity power and 150MW of installed heat energy, annually producing 1500GWh electricity and 440GWh heating energy. With these two investments the state has secured its electricity supply and encouraged greater exploitation of natural gas, which in turn means a decrease in the energy intensity of the Macedonian energy system.

Aside from electricity generation, other priorities for exploitation of natural gas in Macedonia include gasification of the country by construction of distributive gas infrastructure.³⁹

Besides the new projects in the generation sector, the upcoming period foresees highly needed investments in the **transmission network**. Investments in the transmission network are required in order to ease overloading and to meet security criteria. Increased interconnection with neighbouring countries, like the realization of 400kV among Macedonia and Serbia, Bulgaria and Greece will strengthen the north-south electricity corridor, multiplying the transmission capacities.⁴⁰ In the context of regional power market liberalization this will provide opportunities for increased energy security and reduce the cost of supply. Also, through a new credit from the World Bank, MEPSO will invest in the improvement of the absorption capacity of the transmission network in the country. However, it should be noted that this last project is only in its initial phase.

³⁷ This call will be active until the end of this month – September 2009;

³⁸ This project is the first in Macedonia financed under the UNFCC Clean Development Mechanism (CDM).

³⁹ *Natural gas – an energy necessity for Macedonia: Overview of the Macedonian energy potential*, Analytica report, July 2008, pg. 5, available at: <http://www.analyticamk.org/files/ReportNo15.pdf>;

⁴⁰ These projects include 400kV OHL to Nis (Serbia), together with recently established 400 kV OHL Bitola (Macedonia) – Florina (Greece) and ongoing construction of 400 kV OHL Shtip (Macedonia) –Chervena Mogila (Bulgaria). Energy Community Secretariat, 09 April 2008, <http://www.energy-community.org/pls/portal/docs/36349.PDF>;

In order to sustain the security of supply Macedonian government has developed a framework under which investments in **coal mining** will proceed. Here three major investment projects are included, the coal mine Suvodol, Zivojno and Popovjani.⁴¹ ELEM also foresees the possibility of opening a new coal mine in the region of Mariovo. Based on the estimated coal reserves in this region, a thermal power plant with an installed capacity of 300MW and a generation capacity of 2 000GWh per year is planned for construction. The planned projects should be realized in the period from 2010 to 2013. The total investment including the opening of the new coal mine will cost around 460 million euro.⁴² It is believed that the mining investments will contribute to stabilizing Macedonia's power imports to a close to acceptable critical benchmarks.

Even though, it is generally accepted that the **renewable energy sources** (RES) cannot solve the problem with energy supply, indisputably the RES are an integral part of the system of energy security. Therefore, investing in RES is an important sign for the preparedness and sensitiveness of the government to build a stable energy system and protect the environment. By using the hydro power as RES, with construction of small hydro power plants (SHPP) the country could reach a certain level of electricity production through local production and the need to import electrical energy in Macedonia will diminish. So far out of the three tenders for concessions of SHPP that were published in the past there years only one agreement for the concession of 16 SHPP was signed with the Austrian company Energie Zotter-Bau GmbH & Co KG. This investment worth 15 million euros is expected to provide additional 26.48GWh electricity to the grid every year starting from 2012 when the hydro power plants should become operational.⁴³

This concession is part of a wider governmental project for construction of 400 SHPPs in Macedonia, with a total installed capacity of 250MW and an annual production of 1200GWh. The value of the project is estimated to be 300 million euro and the source for financing will be provided by international public tenders and concession agreements with future investors. The project is ongoing, with 2 tenders already closed and the third one under way. However, the signing of the concession agreements has been constantly delayed starting from the first tender in 2007, thus the outcome of the investment in actual kWh of generated electricity is far from realization.⁴⁴

The projects with SHPP have become very attractive because of its environmental dimension as a non-polluting RES. The SHPPs can qualify under the CDM mechanism of the Kyoto protocol, for mitigation of the GHG emissions.

The Macedonian potential for the exploration of other RES like wind, solar and biomass is unlimited. New investments support schemes are available for the Macedonian market, and with the development of the technology for RE, projects with RE production are becoming more cost-effective and attractive.

In solar energy, the investments include solar thermal panels and the first solar PV power plant for electricity production in the country – “Solar Park Kadino”, built by the Macedonian company SIETO. The station consists of 120 PV panels for electricity generation. The expected annual production of electricity is between 23 and 27MWh. The investment in the solar park is 70,000 euro, investment which in current conditions of beneficial feed-in tariffs for electricity from photovoltaics (46€cents/kWh) is expected to be returned to the investor in six-and-a-half

⁴¹ See at <http://elem.com.mk/en/Elem.asp>;

⁴²With realization of this project, new jobs will be open (1000 to 1200), which is important for the economic and social development of this underdeveloped region in Macedonia. “ELEM ke go istrazuva Mariovskiot basen”, *Utrinski Vesnik*, 24.09.2009, Source: <http://utrinski.com.mk/?ItemID=5A7CC3D832ED6642BDAFFFB164CB598A>;

⁴³ The concessioner should provide all necessary documents according to the legal requirements before starting with the construction. Source: <http://www.economy.gov.mk/?ItemID=E68DF6721ADD854F8BA22E5283762512>;

⁴⁴ “Until now, the Ministry of Economy announced three public tenders for their realisation, of which the first two have closed, and the third one is in the evaluation phase; soon, the forth one will be announced, in which 30 to 40 locations will be offered,” Fatmir Besimi, Minister of Economy, after signing the contract. www.energetika.net;

years. The produced electricity in the plant will be sold to EVN and will go in the distribution grid.⁴⁵

When it comes to biomass as a renewable energy source, the only investment has come from the private company Makpetrol, which invested in a factory for the production of 30,000 tonnes of biodiesel annually. It went in hand with the modernization of their petrol stations in order to provide facilities to sell biodiesel.⁴⁶ Other investments in biomass include projects for the production of energy from agriculture and manure waste. These are investments by foreign private investors under the CDM mechanism of the Kyoto protocol. However, their realization is pending and is uncertain for the moment.

Unlike the sectors of solar energy and biomass that had modest beginnings, wind and geothermal sector are struggling to witness first investments in new generation capacities. There are a few companies that have measured the wind strength in certain parts of the country for several years now, but none have developed and implemented a feasible project for wind farms. The investments are not realized because of many unresolved legal and technical issues, including the real absorption capacity of the transmission network of MEPSO, the lack of an accurate wind map for the territory of Macedonia, and the lack of a sustainable governmental policy towards this sector of electricity production. Currently new investment opportunities have been announced, like the one from the Spanish company Inval that plans to build three wind farms in eastern Macedonia, near the cities of Stip, Sveti Nikole and Kriva Palanka, a total investment of 720 million euro.⁴⁷ Even though these announcements usually end up as media propaganda, if realized these may be the first investments in the wind energy for electricity production in Macedonia.⁴⁸

The last important part of the investment map in Macedonia is the **energy efficiency (EE)**. The projects of EE until now have been implemented by foreign donors due to the lack of specially allocated fund in the state budget that will finance EE projects. Therefore, when it comes to investments in EE, the Global Environment Facility (GEF) project managed by the World Bank is the major fund that finances projects which include implementation of energy efficiency measures nation-wide. The Austrian government through its Development Agency in Macedonia is also financing the institutional development and capacity building in energy efficiency. Its last donation is 1.6 million euro to help the country to improve the environment for energy efficiency in buildings.⁴⁹ EE investments in households are concentrated in the private sector, however with currently no direct state support. Investments in EE measures for the generation capacities don't have well developed support strategy either, and remain delayed and insufficient.

⁴⁵ The monthly income from electricity selling will be 1000 to 1200 euro. This amount of money is far more than the average monthly salary in Macedonia of around 400 euro.

⁴⁶ See: www.makpetrol.com.mk;

⁴⁷ The Spanish company Inval will build three wind farms in eastern Macedonia. The first one will be constructed in the city of Stip. The other two will be in the towns of Sveti Nikole and Kriva Palanka. The entire project is estimated at 720 million euro. "Spanish company will build windmills in eastern Macedonia", 12.06.2009, <http://www.energetika.net/eu/novice/oil-and-oil-derivatives/spanish-company-will-build-windmills-in-eastern-macedonia>;

⁴⁸ As recalled, other companies have also expressed interest in similar projects in Shtip. The Slovenian engineering company Comita has announced, for instance, a wind power project worth EUR 150mn. Source: <http://www.euromoney.com/Article/2053598/ISINewsFeed/17/ChannelPage/8959/Spanish-Si-capital-Inval-to-build-50-wind-power-plants-near-Stip.html>;

⁴⁹ The purpose of the grant, whose direct beneficiary is the Energy Agency of the Republic of Macedonia, is to realize the Programme for Energy Efficiency in the Construction Sector, in the period of August 2009 to September 2012. Source: <http://www.economy.gov.mk/?ItemID=49C4D62C2B59C24D86BBBD2CE6524F88>;

Analysis of potential reasons for lack of investments in energy

The legal and economic reforms are still incompatible with the amount of investments in the Macedonian energy sector. The attraction of foreign direct investments (FDI) has been one of the weakest points of the Macedonian economy during the transition period. Apart from increased activities for promotion of Macedonia as an 'investment paradise', the energy sector has benefited only in few cases. In the period from 1997 to 2007, the share of the investments in the field of electricity and gas (and water) was only 6.5% of the total stock of FDI in the country. Among them, the biggest investment is the one from EVN Austria in 2006, in the value of 225 million euro.⁵⁰

In the time when SEE is becoming highly attractive for investments - starting from the big pan-European gas pipelines, through investments in oil exploitation and oil processing, to increasing number of Greenfield investments in hydro energy or other RES (wind, solar, biomass) – the level of investments in energy in Macedonia is minor. There are many reasons for the vulnerable position in which the energy supply in Macedonia is. This report will focus on few of them that after an extensive analysis were identified as the most influential for the low number of energy investments in the country.

1. Legal barriers

The (non)implementation of laws is one of the major obstacles for doing business in Macedonia and in the same time it is the first barrier that impedes the foreign companies to invest in big projects in the country. After receiving EU candidacy status and signing the Treaty on Energy Community in SEE in 2005, guided by the prospective of EU membership and in order to comply with the EU *Aquis Communautaire* on energy, all consecutive governments have introduced substantial changes in the legislation that regulates the energy market.

The Law on Energy from 2006 is the first legal document that traces the opening of the energy market, and provides a sound legal basis, especially for foreign investors.

However, when it comes to conclusion of bulky business deals, what is on paper is rarely implemented in practice. In this sense the major criticism goes to the Energy Law itself. Couple of month ago, in the summer of 2009, the Secretariat of the Energy Community has criticized the government that it did not succeed to open the wholesale market of electricity starting from January 2008, which was its obligation under the Energy Community Treaty. Also, according to some experts, with the amendments in 2008 the Energy Law does not comply with the EU directives, since the amended law is conflicting to the unbundling of the electricity production and has allowed ELEM to be in the same time electricity producer, supplier and trader with electricity. In this way the position of the TSO MEPSO as the supplier of electricity is disturbed, as well as the principle of liberal energy market.⁵¹

There are also significant flaws in the secondary and tertiary legislation. One example is the lack of clear regulation of the electricity market. According to the existing legal framework households are still exempt from the area of electricity production. At this moment, only firms can be producers and sellers of electricity in Macedonia.

Another problem is the judicial system, whose independence and transparency are under question after the latest dispute between EVN and ELEM over the charge for unpaid debt by EVN that ELEM claimed, according to the contract of sale and purchase.

⁵⁰ The amount of FDI in 2006 was 424.2 millions USD. According to the data of the Macedonian Investment Agency <http://www.investinmacedonia.com/Default.aspx?item=menu&itemid=698&themeid=306>;

⁵¹ In an interview with professor Atanasko Tuneski, in *Vreme*, No. 1433, 29.07.2008, available at: <http://www.vreme.com.mk/DesktopDefault.aspx?tabindex=0&tabid=1&EditionID=1463&ArticleID=95417> (accessed on 02.10.2009);

Land ownership plays an important role in determining the quality of the business environment and it influences the country's attractiveness to foreign investors. The problems with property rights in Macedonia are in outdated land registers (in process of updating and creation of a country-wide cadastre database), nationalised property, and in some cases, the right to purchase land.⁵²

Furthermore, there is no price liberalization and healthy market competition, particularly in the electricity market. The electricity price is still largely subsidized by the government and kept on very low social level. This is a discouraging sign for the investors because they cannot make a reliable cost-benefit analysis of the profitability of their investment well in advance.

2. Administrative barriers

Before registration of any business in Macedonia, as well as during the implementation of energy related projects, the biggest problem is the timely implementation of the legislation and effective functioning of the public administration. This is the case in situations like hiring workers, property rights protection, or in the tender procedure for big energy projects.

Sluggishness in issuance of various permits is a major issue. The procedure for registration of foreign workers and providing them with a working permit is rather complicated and a long one. Three institutions are in charge for issuing permits, the Employment Agency, the Ministry of Interior (MoI), and indirectly the Ministry of Foreign Affairs (MoFA), which through the Macedonian embassies in other countries plays a significant role in the issuance of work and residence permits. Moreover, there is no proper coordination between the ministries i.e. between MoI and MoFA, thus procedures, documents and time are duplicated.

The time of getting work and residence permit varies, from the shortest period of 3 months until one year, even though since recently (March 2009) a new on-line system of integration of all embassies has been established and the time of the issuing procedure is shortened noticeably up to 2-3 months. Another disadvantageous fact is that even the short-time workers (up to 3 months) have to go through the same administrative labyrinth and spend as much time to receive the work and residence permit, as the rest.

Concerning national treatment of foreign investment in SEE, the administrative barriers (e.g. licensing and approval procedures, permits) continue to be a real issue. For the director of EVN Macedonia, Mr. Waldner, "The procedure for getting work permits in the last years has become very complicated in Macedonia and is taking a lot of time. After two years I finally got a work permit and I don't have to work as a tourist anymore."⁵³ Bureaucracy is also a big issue for the Russian companies that work in Macedonia. Waiting for work permits leaves a vacuum period, in which the company bears the to be fined by the Labour Inspectorate. The state institutions are not internally connected and don't have oversight of their work, thus causing the problems and delays with the working permits.

The issue with the tenders is in the procrastination of the tendering procedure. Many of them are failing due to lack of clear and accurate data, studies and maps for the water flows, and bureaucracy issues. Moreover, there is no institutional support by the Energy Agency for the complex administrative procedures. The typical example for this is the tender for the small hydro power plants from 2006, which was successfully completed, however recently only one

⁵² "We are not completely satisfied from the pace of development of the retail network of 'Lukoil' in Macedonia. [...] the unsolved property rights issues, long and complicated procedure for urbanization of land, were the reasons why today we have only 10 gas stations in operation." "Interview: Andrej Kuku, director of 'Lukoil Macedonia'", *Dnevnik*, 20.07.2009, available at: <http://dnevnik.com.mk/?itemID=7238A197206B044A9AA195D0137C05A5>;

⁵³ Georg Waldner, president of the Board of directors of EVN Macedonia in "Birokratski pekol vo investiciski raj", *Dnevnik*, 26.06.2009, available at: <http://www.dnevnik.com.mk/?itemID=CE2AA0118025D4449B44B736128F867C&arc=1> (accessed 02.10.2009);

company of those selected at the tender, has signed a concession agreement with the Ministry of Economy in July 2009.⁵⁴

3. The characteristics of the energy market and the global economic crisis

Besides having best legal reforms, there are other deciding factors with specific economic features that influence the energy market in Macedonia, such as: small market, weak economy and low rate of economic growth; undeveloped intrastate connections and infrastructure (gas and oil pipelines, electricity transmission lines, highways); issues with crediting of SMEs and of individual energy producers; lack of qualified workforce; and the impact of the global economic crisis on the investors' states and on Macedonia.

For attracting investments there are two important and inseparable conditions or policies that have to be in place in order the country to have a stabile legal and economic basis for future investors. First one is the Investment Policy (which includes the principles of Non-discrimination and international cooperation and Protection of property) and second one is Investment promotion and Facilitation (including Investment Promotion and Facilitation Strategy and functioning Investment Promotion Agency).

Macedonia has a small energy market with two million consumers, including industry, services and households.⁵⁵ This is not an encouraging number to be presented to a foreign company that always seeks larger markets for investing, and thus sees Serbian, Bulgarian and Romanian energy markets of several dozen million consumers as much more attractive and profitable. However, an encouraging fact for investors in the last several years is the effort to promote the SEE as one integrated regional energy market. Nevertheless besides the made progress until now, only after full liberalization and integration of the energy markets of SEE is complete, by investing in one country the investors can reach the large number of consumers of the whole region.

In Macedonia it appears that there is a form but not a substance for investments – meaning that the government is working more on Investment promotion and Facilitation, having developed investment promotion strategy and established a functional Investment Agency, and much less

on the promotion and protection of the legal principles of property rights and fair and transparent market competition. For example, the National treatment and the Most-favoured-nation treatment as one of the core principles of non-discrimination policy are not well respected in Macedonia. There is a clear example of violation of this principle in the case of EVN as foreign investor in Macedonia, which is treated 'less favourably' than the domestic company ELEM when it comes to the electricity market in the country.

Standards of quality of the equipment in operation are real obstacles for the Macedonian firms in particular. At the moment cheap and low-quality equipment that is not certified can be found on the market. Therefore, it is very important to establish institution(s) which will test the equipment and will issue a certificate of quality. In the case of solar panels one test station was established in Skopje, but unfortunately it does not function. Even the Macedonian government, in its campaign for subsidising installation of solar thermal systems in households, does not ask for a certificate for quality of the installed equipment. There must be a regulatory body in the country which will regulate trade of the equipment, as well as authorised distributors and installers.

Getting credit is also a big obstacle for firms, SMEs and individuals. Even though in 2009 the public credit bureau increased its coverage by introducing a better database that includes more information and lowering the minimum loan threshold, still getting credit in Macedonia is not

⁵⁴ "Po rečisi tri godini, deneska i oficijalno se potpisha dogovor za izgradba na mali hidrocentrali". <http://a1.com.mk/vesti/default.aspx?VestiID=111524>, 16.07.2009;

⁵⁵ The total number of customers connected to distribution grid in Macedonia is about 620,000. *In-Depth Review of the Investment Climate and Market Structure in the Energy Sector*. Energy Charter Secretariat, 2006.

an easy task for the SMEs. This is especially the case for the households and natural persons that want to invest in small scale individual energy projects. At the moment, the World Bank, through the GEF project, has revealed a credit line for renewable energy sources in Macedonia, which is managed by the MBDP. Even though the GEF project was promoted already in January 2008, only one Macedonian company has used the money from this grant.⁵⁶

4. Geopolitics

The geography of a country in the ultimate case determines its energy outlook as country energy exporter, transit country, or country dependant on energy import. These three 'axis' define the strategy for development of the energy sector and in the last case have an impact on the type and amount of investments. Not having fossil fuel sources like oil and natural gas, and with limited amounts of lignite coal, Macedonia is defined as – energy import dependant country. Moreover, Macedonia is a land-locked country, with no access to open sea. This in turn means that we are very much dependant on Thessaloniki as the major transit port for oil in Southern Europe. Yet, in the case of the RES, which are indigenous and give good results even when operating in isolated systems, Macedonia is in a very favourable position. The solar energy and the wind can be exploited in a cost-effective way, without direct side effects from the global or regional energy markets.

At present Macedonia does not have well developed interstate infrastructure (gas, oil pipelines, electricity transmission lines, highways), especially throughout the East-West corridor. Even though geographically Macedonia is in the heart of the Balkan Peninsula, the country didn't make use of this advantageous position, in economic and security terms, when it comes to the conventional way of transit of natural gas through underground pipelines. This shows that the geography per se is not as important, but the power of the political bargaining is outweighs the favourable natural conditions.

However, when it comes to creation of investment policy, the political stability in the country and the wider region has a direct influence for normal economic and energy development. In the Balkans, in the past two decades issues of political stability and security were one of the major obstacles for the economic prosperity of the countries. With the stabilization of the region and its political integration, in the last several years more and more investments have entered in the energy sectors of these countries. Furthermore, it is strongly believed that NATO membership and the EU membership perspective will bring economic prosperity and stability of the investment climate in SEE. In Macedonia as neither NATO member nor EU member state, it is interesting to see how this theory will develop in future. Even though it is probable and foreseeable, from the experience of other countries from the region – like Croatia or Albania, it is not possible to make the clear-cut connection between the security dimension and the increase of the investments in energy.

Analytica's recommendations

Poor investments in the energy sector in Macedonia have been a common practice in the last two decades. Even though the country possesses big investment potential, nowadays the energy sector is facing many challenges in the realization of energy projects. This is due to the unclear development strategy, non established legal basis and few investors who will take the risk to invest in unstable investment climate. An overall perception is that the general investment conditions are unfavourable for starting new businesses. Foreign companies that are operating on the Macedonian energy market are not entirely satisfied from the general economic situation in the country. Even though attracting investments and economic development have been one of the premises of the Macedonian transition period, there has been little consent over the policy how to achieve that. The principle of sustainability, meaning locally supported economic

⁵⁶ This is the company SIETO that used a credit of 20 000 euro for the construction of the Solar Park "Kadino";

growth, in the last two decades in Macedonia was generally not respected. The latter refers to the development of the energy sector as well.

Since the economic growth is inseparable to the stability of energy supply and diversification of energy sources, functional energy market and investments in this sector are important. In order to comply with the principles of liberal market and the EU standards, all consecutive Macedonian governments have undertaken reform steps towards opening the energy market and attracting new investments. Macedonia has adopted most of the provisions of the EU legislation, developed non-discriminatory, market-oriented laws, and started the privatization process in the energy sector, aspiring full-scale integration in regional and global markets. However, the lack of investments in the energy sector points out major discrepancies between the 'reforms on paper' and their realization. There is inadequate implementation of the adopted energy sector legislation; insufficient protection of investor rights (including the efficiency of the court system); inadequate quality of governance and corporate management; constraints in crediting SME; not enough regulatory supervision and transparency; and most influential the bureaucracy issue, which halts energy projects in all stages of their implementation. Another important issue with the energy investments in Macedonia is the lack of investment strategy that would prioritize the energy areas for investment, by importance, time, and cost. That is closely related to the absence of overall national strategy for development of the energy sector.

How to improve current situation and where to direct future investors to place their assets and money in the energy market in Macedonia will be a real economic and political challenge in the months to follow. The country needs first, a stabilization of its energy market and positive investment climate and second, strengthening of the energy diplomacy.

- *Stable and developed energy market and positive investment climate*

Having undertaken responsibilities for reforms in the energy market, Macedonia has to stay on track of open, low-risk and transparent economy. Therefore, concerning the energy market a good, transparent and EU driven legislative and regulatory framework needs to be functional and implementable. Here institutions' independence is of highest concern. Strengthening the independence of the judiciary and the Energy Regulatory Commission (ERC) has to be in the focus of the relevant authorities. The provisions of the Energy Community Treaty must not be violated; serious approach towards protection of foreign investors needs to be sustained; simplifying of permit granting procedures and real opening of the electricity and gas markets must be obtained. An overall issue is the efficiency of the public administration, which needs to be increased with capacity building, pursuing carrier-based system and competency principle in the hiring procedures, trainings, building of electronic databases and connection of all institutions in one electronic network.

On the side of the economic policies, Macedonia has to pursue strong commitment for continuing the reforms in the pricing system, which means bigger role of the ERC in the liberalization of the electricity price. Introducing market driven electricity price is also a constant recommendation of the World Bank to the government. Moreover, a firm stance in the area of crediting policy needs to be undertaken. Bad conditions for crediting of SMEs and households need to be improved to allow easier and simpler crediting procedure. More attractive credit lines from the commercial banks need to be developed. This will have positive impact on the interest of the domestic investors, especially for medium-scale and individual energy projects. The implementation of these reforms is essential if Macedonia wants to sustain the favourable investment climate and to continue to be among the top reformers in doing business on global level.

The new "Strategy for the Development of the Energy Sector in Macedonia until 2020", currently in draft version, is supposed to have important role in defining the future energy investment priorities, both as state projects and private investments. Here, the focus should be on Macedonia's potential for attracting FDI i.e. Greenfield investments, especially in alternative

energy sources like wind, solar and biomass. For the stability of energy supply particularly important is the construction of the large hydro power plants, among them Chebren and Galishte as pressing projects. In the electricity production sector, we compliment and encourage further construction of gas fired CHP plants, as profitable and environmentally friendly energy capacities. Finally, the connection infrastructure has to come once again in the focus of the priorities. The current projects of construction of interstate electricity connections need to be supplemented with various projects of distributive gas pipelines for secondary gasification of the country, as well as development of connections with the regional gas network. Even though under current conditions coal fired thermal power plants are seen as reasonable energy generators, the environmental requirements for new and old TPP will considerably increase the price of these investments. The nuclear energy is seen as a potential source for Macedonia and the region. However, the scenarios for its exploitation on long-term are exceeding the period of 2020.

- *Strengthening of the energy diplomacy*

As it was discussed in the previous parts of the report, in the creation of the energy policy geography is only one factor. Investments in energy depend also on the political support of the energy projects by domestic government as well as in the international investors' community. Herein, the role of the government institutions involved in political representation and economic promotion of Macedonia in the world is very important. In Macedonia there are several institutions that have responsibilities in regulation of the energy market and promotion of the investment opportunities abroad. They include the Ministry of Economy, the Ministry of Foreign Affairs and the Investment Promotion Agency. In order to strengthen their role in the energy diplomacy, particularly for attracting energy investments several policy measures need to be considered.

In the Ministry of Economy, especially in the Department of Energy, strengthening the capacity of the ministry is seen as a priority. Since the energy sector is top priority of the ruling government, the lack of capacity in the Department of Energy, responsible for tracing the energy outlook of the country should not be neglected.

The Ministry of Foreign Affairs has indirect but indisputable role in the process of attracting foreign investments. On one side through the diplomatic core, the energy potential of Macedonia is internationally promoted. Lobbying and strong negotiation skills are essential for attracting investors. On the other side Macedonian embassies abroad have important role in the process of granting permits to foreign workers, since they are the first stop in the employment procedure. A more efficient procedure and better coordination between embassies and state institutions like Ministry of Interior and the Employment Agency, is necessary for shortening the time of issuance of work and stay permits. This will improve the image of Macedonian legal and administrative system within the foreign investors' community.

With a network of 23 foreign offices, the energy diplomacy of the Investment Promotion Agency of Macedonia did not give best results. Only two major investments in the energy sector, the energy and environmental services company "EVN" from Austria, and the Russian oil company "Lukoil" have fallen under its work. For better results the Agency need to improve its relation with the domestic business sector, as well as to take more active energy diplomacy through its foreign offices in promotion of the energy sector in Macedonia.

Energy and Infrastructure Program

“Investments in Energy – the Macedonian case”

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