

# UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT



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## COMMERCIAL LEGAL REFORM ASSESSMENTS FOR EUROPE AND EURASIA

### **Diagnostic Assessment Report for the Former Yugoslav Republic of Macedonia**

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# Diagnostic Assessment for the Former Yugoslav Republic of Macedonia

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## INTRODUCTION

This diagnostic assessment was carried out in July 2000 by a team of three expatriate lawyers, with assistance from local lawyers and other counterparts. It is the sixth in a series of assessments carried out since 1998 in a program created by USAID in which Booz-Allen & Hamilton was retained to assist in the development of indicators and methodologies for assessing the status of commercial legal and institutional reform in a developing or transition country.

The first four assessments - Kazakhstan, Poland, Romania, and Ukraine -- were used to devise, refine and field test the methodology. The methodology and results were then subjected to peer review by approximately 50 legal development professionals at a

Broad Indicator	Albania	Croatia	Kazakhstan	Macedonia	Poland	Romania	Ukraine
Population (millions) <sup>1</sup>	3.49	4.28	16.73	2.04	38.65	22.41	49.15
Area (km <sup>2</sup> )	28,748	56,538	2,717,300	25,333	312,685	237,500	603,700
1999 GDP Per Capita <sup>2</sup>	\$1,650	\$5,100	\$3,200	\$3,800	\$7,200	\$3,900	\$2,200
% GDP Ave. Annual Growth (1990 – 1999) <sup>3</sup>	2.3	-0.4	-5.9	1.9	4.7	-1.2	-10.8
% GDP - Agriculture	54	9	10	11	4	16	14
% GDP - Industry	25	32	30	28	33	40	34
% GDP - Manufacturing	--	21	23	--	20	30	29
% GDP - Services	21	59	60	60	63	44	51
Foreign Aid Per Capita <sup>4</sup>	\$72.50	\$ 8.70	\$13.30	\$45.80	\$23.30	\$15.80	\$7.60
Corruption Index <sup>5</sup>	N/A	3.7	3.0	N/A	4.1	2.9	1.5
Economic Freedom Index <sup>6</sup>	3.70	3.50	3.70	N/A	2.80	3.30	3.60
Government Effectiveness Rating <sup>7</sup>	-0.653	0.150	-0.824	-0.576	0.674	-0.570	-0.893
Regulatory Framework Rating	-0.700	0.236	-0.405	-0.312	0.565	0.199	-0.721
Rule of Law Rating	-0.918	0.146	-0.590	-0.256	0.538	-0.088	-0.707

<sup>1</sup> CIA World Factbook, July 2000 estimate.

<sup>2</sup> CIA World Factbook; 1999 estimate.

<sup>3</sup> World Development Report 2000/2001, published by The World Bank. Applies to GDP Growth and the agriculture, services, manufacturing, and industry composites of GDP.

<sup>4</sup> The World Bank: <http://devdata.worldbank.org/query>. Figures are from 1998 and are in current US\$. As a point of comparison, foreign aid per capita in all developing countries is \$8.40.

<sup>5</sup> Transparency International 2000. Scale = 1 - 10. Higher scores indicate less corruption.

<sup>6</sup> 2000 Index of Economic Freedom Rankings, *The Heritage Foundation* ([www.heritage.org](http://www.heritage.org)). Scale: 1-1.95, free; 2-2.95, mostly free; 3-3.95, mostly not free; 4-5, repressed.

<sup>7</sup> Worldwide Governance Research Indicators Dataset, The World Bank. Governance indicators reflect the statistical compilation of perceptions of the quality of governance of a large number of survey respondents in industrial and developing countries, as well as non-governmental organizations, commercial risk rating agencies, and think-tanks during 1997 and 1998. Governance indicators are measured in units ranging from about -2.5 to 2.5, with higher values corresponding to better governance outcomes. This footnote applies to the Government Effectiveness Rating, Regulatory Framework Rating, and Rule of Law Rating. Available at <http://www.worldbank.org/wbi/governance/datasets.htm#dataset>.

workshop in Prague during December 1999. On the whole, the participants verified and affirmed both the methodology and results through a "reality check" based on their professional experience in the European and Eurasian regions. Moreover, they provided important input on the indicators used for scoring the countries. Based on this feedback, the indicators were revised during the winter of 2000.

The new indicators (CLIR 2.0) were used to conduct this assessment. The assessment was conducted at the request of the USAID Mission in Skopje, and was the second assessment to be performed with the revised indicators. The first, in Croatia, was used by the USAID Mission in Zagreb to focus programmatic resources on high priority reform needs, and resulted in a program of assistance to the courts, judiciary and legislature. This Macedonia Assessment will likewise be used as a strategic planning document by USAID/Skopje to plan additional legal and institutional reform work in Macedonia.

### **Notes on Scope & Methodology**

The diagnostic assessment was designed to help achieve the following objectives:

1. To provide a factual basis for characterizing the degree of development and the status of commercial law reforms in Macedonia;
2. To provide a methodologically consistent foundation for identifying describing the root causes of the "implementation/enforcement" gap; and,
3. To provide analytical and planning tools and metrics that will help USAID design new approaches to sustainable, cost-effective C-LIR interventions in Macedonia.

For the purposes of most assessments, "commercial law" is defined to include the following substantive legal areas:

- **Bankruptcy** - Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets, and rehabilitation of insolvent debtors.
- **Collateral** - Laws, procedures, and institutions designed to facilitate commerce by promoting transparency, predictability and simplicity in creating, identifying, and extinguishing security interests in assets.
- **Companies** - Legal regime(s) for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.
- **Competition** - Rules, policies and supporting institutions intended to help promote and protect open, fair, and economically efficient competition in the market, and for the market.
- **Contract** - The legal regime and institutional framework for the creation, interpretation, and enforcement of commercial obligations between one or more parties.

- **Foreign Direct Investment** - The laws, procedures and institutions that regulate the treatment of foreign direct investment.
- **Trade** - The laws, procedures, and institutions governing cross-border sale of goods and services.

Within each of these substantive areas, four "dimensions" of C-LIR were examined as a conceptual framework for comparison. These include:

- **Framework Law(s)** - Basic legal documents that define and regulate the substantive rights, duties, and obligations of affected parties and provide the organizational mandate for implementing institutions (e.g., Law on Bankruptcy, Law on Pledge of Moveable Property);



- **Implementing Institution(s)** - Governmental, quasi-governmental or private institutions in which primary legal mandate to implement, administer, interpret, or enforce framework law(s) is vested (e.g., bankruptcy court, collateral registry);

- **Supporting Institution(s)** - Governmental, quasi-governmental or private institutions that either support or facilitate the implementation, administration, interpretation, or enforcement of framework law(s) (e.g., bankruptcy trustees, notaries); and,

- **"Market" For C-LIR** - The interplay of stakeholder interests within a given society, jurisdiction, or group that, in aggregate, exert an influence over the substance, pace, or direction of commercial law reform.

## A. BANKRUPTCY LAW

### *Legal Framework*

Until 1998, the Law on Enforcement, Bankruptcy and Liquidating was the governing law for bankruptcy proceedings in Republic of Macedonia. On May 6, 1998, a new bankruptcy law came into effect.<sup>8</sup> The new law emerged because of structural changes in the country, namely the introduction of a market economy, and the implementation of new laws on the Transformation of Enterprises with Social Capital, and Trading Companies. The 1998 bankruptcy was drafted principally by a Macedonian professor, Professors Dimitar Gelev, with little consultation with the bench or bar.

The 1998 bankruptcy law is modeled, in large part, upon the Croatian law. The Croatian law, in turn, is closely modeled on the 1994 German bankruptcy law. Commentators have noted that the law does not take local conditions into account. The main difference between the Macedonian law and the German/Croatian law, however, is that law contains modifications that bolster workers rights. This is the one area where local conditions (i.e., the need to preserve employment) were incorporated into the legislation.

The 1998 legal framework has been underutilized and thus, never fully implemented by the courts. Although a new law has been in force, very few proceedings have been commenced since 1998. Rather, many insolvent companies continue to be operated rather than liquidated.

The World Bank has indicated that it would like the large state-owned and socially owned enterprises to be sold or closed in an effort to end the privatization initiative. In response, the Macedonian government is taking the lead in addressing the problems in 12 large loss-making enterprises that either remain in majority public ownership or that will revert to public ownership because of non-payment of privatization installments by the current owners. The plan is to restructure and sell the enterprises to strategic investors. Those that cannot be sold will be liquidated.

In Macedonia, reorganization and liquidation of insolvent enterprises tends to be less frequent than desired. In addition, medium and large seized enterprises are rarely liquidated in Macedonia in terms of a wholesale sale of assets and closure of the business. Such an enterprise, however, might be sold as a going concern rather than reorganized under existing management. As discussed below, the sale of Hemteks, a Macedonian textile firm, is an example of such reorganization where the sale is conditioned upon the company being sold as a going concern.

Article 228 contains the "bankruptcy plan" provisions of the law and sets out a whole variety of possible transactions that require a bankruptcy (aka reorganization plan). The

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<sup>8</sup> The law was enacted on October 22, 1997 by the Parliament of the Republic of Macedonia. The law contains 350 article classified into 13 sections. The law on Bankruptcy (Official Gazette of the Republic of Macedonia) published on 29<sup>th</sup> October 1997. The law came into effect 8 days after its official publication and was implemented six month after the effective date.

Article has been described by at least one expert as badly drafted, and includes such things as distributions in kind, merger, and sale of the debtor's property. Proceedings for virtually all the medium and large scale debtors (except Hemteks) have gone the bankruptcy plan route, even though the plan may be little more than a transfer of non productive assets to a new company owned by the creditors, and the productive assets being transferred to the workers in settlement of their claims. It is unknown for facilities to disappear (as steel mills and other heavy industry in North America have disappeared).

These bankruptcy "plans" are typically creditor driven and there is no parallel with, say, chapter 11, which is driven by the management and the shareholders. At present, End Users describe existing bankruptcy plans as usually quite unsophisticated, and as not assessing adequately what it will take (especially in terms of new money and management skills) to make the assets more productive.

As some interviewees noted, the value of the insolvent enterprise, rarely makes it economically efficient to keep the company in operation. "Value" is one of the most difficult concepts with which all participants in the process must deal. In order for reorganization to be a viable option, there needs to be available financing from strategic investors or financial institutions. At present, banks are unwilling to provide credit to insolvent entities for the purpose of reorganization.

The absence of a functioning central financial registry has also been cited by some End Users an impediment for creditors with respect to filing bankruptcy petitions. Creditors are unable to obtain information about debtors with respect to their solvency and ability to pay debts. Annual financial statements, for example, are not available in a centralized registry. Other interviewees noted, however, that creditors should be able to determine when a debtor's account has been blocked at the ZPP – which for bankruptcy purposes should indicate that an entity is insolvent.

As discussed below, the Ministry of Justice responded to some of the perceived inefficiencies in the 1998 bankruptcy law and initiated a working group to amend the legislation. Those amendments were approved by Parliament in early July 2000. Despite there being an ineffective system in place at present, the government and bankruptcy judges have been proactive in promoting reform.

### **The 1998 bankruptcy law**

The principal goal of the Macedonian bankruptcy law is the settlement of claims of creditors against insolvent debtors. Bankruptcy proceedings may be initiated over the property of a debtor – including legal entities, natural persons and banks/financial institutions. There has been consideration of a law on bank insolvency for some time but to date no separate legislation has been enacted. Bankruptcy proceedings may not be initiated over property owned by the Republic of Macedonia or a public legal entity.

There are three legal tests for insolvency in the Macedonian law. The tests include:

- a) a debtor's inability to settle monetary obligations within 60 days after they become due;
- b) a debtor as a likely inability to settle its monetary obligations when due;<sup>9</sup> and
- c) the debtor is "over indebted" which is defined as an excess of liabilities over assets (i.e., the value of the debtor as a going concern) if the debtor continues to operate.

The bodies involved in a bankruptcy proceeding include a Bankruptcy Council (a court council composed of three judges – one chairperson, a bankruptcy judge and a judge involved in business disputes), a professional trustee (an individual with a university degree and at least 5 years of work experience who is registered as a sole trader for this purpose), a board of creditors, and an assembly of creditors (consisting of all known creditors). If the Bankruptcy Council appoints a board, it consists of creditors with the larger and smaller claims, representative of the employees and secured creditors. Creditors, however, may reconstitute the board in any manner they see fit.

Bankruptcy proceedings may be initiated at the request of the creditor or the debtor. The party that proposes the bankruptcy proceedings is required to finance the preliminary or investigative hearing in advance. Once a bankruptcy proceeding is initiated, a trustee takes over the debtor's rights to manage and dispose of the bankruptcy estate.

If a debtor challenges a creditor's claim (normally both parties appear in court and a judge holds a hearing), the court appoints a temporary trustee. The primary function of the temporary trustee is to preserve and manage the property of the debtor during the preliminary proceedings. He or she can also be requested to advise the bankruptcy judge on the solvency of the debtor, and in particular, whether there are sufficient assets to pay the costs of administration. Within a period of x days, the judge is responsible for verifying the claim.

As part of a normal procedure, a bankruptcy trustee investigates all claims and decides whether to include them as part of the liquidation plan (or reorganization plan). The trustee keeps money in reserve for questionable claims. The trustee has the authority to invalidate contracts entered into for fraudulent purposes. In practice, however, fraudulent claims are difficult to prove – unless the trustee uses a criminal referral and investigation. The trustee can review and invalidate contracts formed up to 90 days before the filing of a bankruptcy petition. In certain circumstances, however, this period can extend back as far as 10 years. One interviewee noted that a six-month time limit would be preferable.

Within a fixed time after proceedings have been initiated, the bankruptcy trustee must submit a report to the court on the financial situation of the debtor, as well as any options proposals for reorganization. At this hearing, creditors, by a simple majority by value of claim, can reach a decision as to whether the debtor is to be liquidated or placed in

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<sup>9</sup> The debtor is the only one who may file a petition for bankruptcy based on this criterion.

reorganization (whereby the trustee would prepare a so-called “bankruptcy” plan).<sup>10</sup> Debtors can also submit a bankruptcy plan, virtually anytime during the proceeding. A majority of creditors with voting rights (majority in both value and number) must approve a bankruptcy plan, along with the Bankruptcy Council. As part of a bankruptcy plan, the trustee must prepare a social plan. A social plan must detail the procedures for retaining and laying off employees of the insolvent entity.

If liquidation is selected, the assets of the debtor may be sold off by public auction. There are virtually no examples of sale by public auction for medium and large enterprises in Macedonia. Expenses of the bankrupt estate, including post-proposal wages and any borrowings arranged by the trustee are settled before the claims of the pre-proceeding creditors. Liabilities under the social plan are expenses of the bankrupt estate, past due wages are not given any priority.

Secured creditors appear protected under Macedonia’s bankruptcy law. The bankruptcy law states that secured creditors are creditors with a right of separate settlement. A secured creditor may also serve on the board of creditors. Secured creditors have express authorization to proceed with their enforcement proceedings after main bankruptcy proceedings are commenced. During the preliminary proceedings, however, they are stayed. . Separate provisions in the law, however, give the Bankruptcy council the ability to enjoin lien enforcement if such enforcement would threaten or harm a bankruptcy plan that has been submitted.

Some of the problems identified with respect the 1998 bankruptcy law include:

- Requirement that the trustee be a natural person/sole trader rather than a legal entity
- Limitation on the number of cases that a trustee could manage
- Lack of clarity as to how trustees were to be compensated by the court
- Inability of trustees to secure post-insolvency financing
- Lack of professionalism among trustees <sup>11</sup>
- Lack of a quorum requirement for approval of a reorganization plan
- Requirement that creditors finance the cost of preliminary proceedings and deposit an advance with the court.
- Lack of clarity about what rather proof a claim is sufficient for initiating proceeding (this has leads to extended proceedings as disputes concerning claims are reviewed by the courts).<sup>12</sup>.

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<sup>10</sup> The use of the term “bankruptcy” plan in the existing legislation is confusing. The term, in fact, refers to a reorganization plan.

<sup>11</sup> At present, the court in cooperation with the Association of Bankruptcy Trustees, are responsible for selecting a trustee. The Ministry of Economy has not had any input (e.g., certification that the trustee meets the minimum requirements for serving as a trustee) There have been reports of a low level of ethics and professionalism which may lead to potential problems of bribery and corruption as well as delay in procedures (i.e., it earn higher fees . The courts have also failed to coordinate so as to monitor the performance of a trustee in multiple cases. This was identified by a problem by the judiciary – although other End Users noted that the main concern was that trustees with a large caseload might end up making more money than judges.

- Lack of clarity concerning the ability of the Bankruptcy Council to stay enforcement proceedings of a secured creditor

### **Recent Amendments to the Bankruptcy Law**

The Macedonian Parliament approved amendments to the bankruptcy law in early July 2000. Some of the key revisions include the following:

- Trustees may now be legal entities .

The bankruptcy trustee previously was required to be a natural person rather than a legal entity. The law has been changed to allow for the formation of corporate trustees. (e.g., law firms, accounting firms). Such legal entities must employ a licensed trustee, a lawyer, and an auditor).

- Trustee caseload restriction eliminated

The number of cases that a trustee can manage at one time has been removed. The removal of caseload limitations will potentially help to keep trustees with an active workflow.

- Revision to qualifications of trustee.

Trustees will now be required to obtain a professional certification and to pass an examination in order to be accredited. The Ministry of Justice will be responsible for administering the accreditation process and for creating the implementing regulations. The Ministry of Economy will be consulted with respect to the trustee appointment process<sup>13</sup>.

- Trustee able to secure post-insolvency financing

The trustee is now empowered to seek unsecured post-insolvency financing for an insolvent entity.

- Creditor decision-making during the process of reorganization has also been revised.

The amendment introduced the concept of a quorum in terms of the value of claims. Most decisions of the Assembly of creditors are made based on a simple majority in value of

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<sup>12</sup> According to one IFI bankruptcy expert, this was a dispute generated primarily internally by the judges. The law itself is not particularly ambiguous

<sup>13</sup> The Government has noted that it will promote greater coordination among the courts about trustee performance through the use of computerized records. Additionally, the Financial Police (a branch within the Public Revenue Office) will have oversight of an insolvent entity before the appointment of a Trustee to avoid any problems with trustee corruption or collusion with the debtors.

proven claims (i.e. there is no quorum). Reorganization plans historically required a majority in both value and number of creditors eligible to vote. In July, amendments to the law were made to require that this dual majority be subject to a quorum of a minimum of 50% by value participating in the vote. As one interviewee noted, the addition of a quorum is potentially very helpful

- Bankruptcy plan now will be called reorganization plan.

To provide for greater clarity, the term bankruptcy plan will be replaced with reorganization plan.

- Social plan only for reorganization.

A trustee now is required only to provide a social plan in the event of reorganization – previously it was required also for liquidation. This is a major change, and removed an inbuilt bias for non-employee creditors to prefer liquidation to reorganization in certain circumstances.

- Changes in type and nature of documentation required for a settlement offer
- Rules of payment of bankruptcy trustee.

Previously, the court made decision on an ad hoc basis, which lead to inconsistent practice with respect to trustee remuneration. The Ministry of Justice has now been tasked with the responsibility for developing guidelines; this was originally the responsibility of the government.

- Decrease in the contributions to be paid from the debtor's estate during the effectuation of a reorganization plan

The required amount of employer contributions has been decreased by 50%.

- Requirements for commencing a proceeding clarified

It used to be unclear under the 1998 law what was required by creditor to commence proceeding. The proposed amendment states x. The amendment was meant to address situation where reluctant judges were not prepared to accept a previously obtained judgment as proof of a “probable” claim. Some of the lawyers and judges interviewed interpreted the amendment as requiring a creditor to obtain a judgment before a proceeding could be commenced.<sup>14</sup>

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<sup>14</sup> At least one person interviewed feels that this revision does not go far enough. A small creditor can still use a relatively minor judgment as a means of blackmailing the debtor (i.e., 100 DEM debt and take debtor to court saying I will put you in bankruptcy). The interviewee suggested that a court judgment should be required but a dollar limit should be imposed (i.e., only court judgment over “x” DEM will be

However, as one foreign expert noted, there is nothing in the law that indicates “probable claim” means “proven claim”, as indicated by a judgment. The normal commercial sections of the courts are jammed; it takes forever to get a judgment, and an interpretation such as the one suggested by several End Users would effectively shut creditors out of the bankruptcy process.

### *Implementing Institutions*

The Ministry of Justice and the courts are the two main implementing institutions with respect to the bankruptcy law. The Ministry of Economy might also be viewed as an implementing institution with respect to maintaining economic statistics on the number of insolvent enterprises in Macedonia. Additionally, the Ministry of Economy has been mentioned in government documents, as participating in decision-making concerning the appointment of trustees in individual cases.

The Ministry of Economy is technically responsible for monitoring bankruptcy and has some sort of unit – more like a record keeping unit at present. It is unclear what type of records or statistics are retained by the Ministry. The Macedonian Government had established a small fund to help companies reorganize. To date, there has been no criterion established for accessing such a fund. The amount of money allocated to the reorganization fund is reported to be very small. The Ministry of Economy is also supposed to provide input with respect to the appointment of trustees.

The courts, by far, have the largest role with respect to implementation. The bankruptcy statistics (for cases commenced) are extremely varied. For example, one report indicates that during the first six months after the law became implemented, only 10 cases were filed nationwide. Among those interviewed for the assessment, estimates as low as 10 and as high as 100, were provided, for the number of cases that had been filed with the courts since the law had been enacted. Only a handful of these cases have been reorganizations.

According to a trustee, there have been at present only 30 cases filed, with 16 of those being filed in Skopje. A bankruptcy expert from an IFI has estimated that there has been perhaps 50-100 cases for business debtors who are not just individual small traders have been filed. There have been quite a few (approximately 200-300) no-asset cases opened and closed simultaneously. Activity in the bankruptcy area is highly localized, and depends on the capability (and courage) of individual judges

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allowed to commence proceedings against a debtor. There is nothing in the existing law that indicates a minimum size of claim (let alone judgment). In addition, Article 47 quite clearly anticipates that the law can be used as an individual creditor collection mechanism.

Overall, there is a significant decrease in the number of petitions, which had been filed under the previous law (which included the winding down of companies as part of liquidation more generally). In 1997, approximately 17,000 bankruptcy procedures had been commenced under the old law. Under the old law on Financial Operations, the ZPP had a legal obligation to apply to initiate proceedings against any debtor whose account had been blocked for 60 days (a rule more honored in the breach, when it can to medium and large enterprises). Most of these cases related to unpaid filing fees for newly established shell companies. The new bankruptcy law requires creditors to take action themselves (including funding), which accounts for the huge drop in filings.

In terms of reorganization, of the judges and the trustee interviewed, about four cases of reorganization in Skopje were discussed – one of a milk factory, another of a lighting manufacturer. A third case involved an employee takeover of the ailing firm and in a fourth instance, the debtor itself filed a petition for bankruptcy and sought reorganization. There are several more in Prilep and Bitola.

Macedonia is currently engaged in its first public international sale of assets. The sale has been publicized in newspapers internationally in both English and Macedonian and involves a bidding procedure. The sale is of the assets of the company Hemteks, which is an insolvent textile company. When speaking with the trustee involved with the sale, he noted that the creditors were presented initially with three options: (1) finding a strategic partner, (2) acquiring proper financing for reorganization, and (3) liquidation. The creditors chose liquidation, and sale of the company as a going concern.

For Hemteks, liquidation rather than reorganization was the only feasible option. Previously, Hemteks had been restructured and offered for sale to strategic investors often over the past 5 years. Although the creditors voted for liquidation, the trustee advertised for people whose bids included commitments to restart the factory, re-employ the workers, and invest significant sums of money. Not a normal liquidation, in the western sense, but entirely consistent with the Macedonian law, which contemplates (among other options), the sale of the assets as part of a going concern.

The example of Hemteks is a perfect illustration of the disfavor of complete liquidation and closure of a company; the creditors (mainly the government) directed the trustee to "liquidate" Hemteks, which he has done by seeking bids from purchasers conditioned on the purchasers agreement to restart the facility (a large chemical factory) and make substantial additional investment.

In July 2000, a tender announcement was published and posted to a government website. If an interested party pays \$500, they get the following in a tender package:

- a) List of assets and intangible property and assessed value (note: at present assessors are apparently government employees);
- b) List of rights and privileges/licenses that the purchaser will acquire

- c) Sample purchase agreement; and
- d) Bid bond requirements and also guarantee with respect to what purchaser will do in respect to continuation of the business; and

A few younger judges are active in the bankruptcy area and are well informed. One estimate is that about 60-65 judges out of 216 have heard bankruptcy cases to date. As noted above, two bankruptcy judges were involved in the recent amendment process.

The judiciary has been quite active with respect to education and outreach to judges, lawyers and creditors with respect to the new bankruptcy law. In cooperation with donor agencies such as the World Bank, and nonprofit organizations such as the American Bar Association, several bankruptcy judges have been active in education and outreach projects. For example, under World Bank sponsorship, a bankruptcy manual was prepared for judges and lawyers, which includes commentary on the individual provisions of the law, as well as detailed practice notes. A similar manual was prepared for creditors.

The creditor manual was a private effort by World Bank staff and some Macedonian colleagues. In addition to the manuals, training sessions have been held for various bankruptcy constituents. In general, the publication of the bankruptcy and creditor's manuals has been viewed as a useful implementation tool. The manuals represent a collaboration between the implementing institution and supporting institutions.

The judiciary has been cited as needing to improve their coordination and oversight of trustees. This can be achieved through greater communication between bankruptcy courts and the computerization of records. The main implementation problem, however, is the failure of debtors and creditors to commence proceedings. The absence of a robust caseload means that judges do not have the opportunity to develop expertise.

It is hoped that the new amendments and increased training for various parties will increase the court's caseload. The problem is complex. Another problem identified by interviewees and End Users is that there are many judges who actively frustrate the attempts of creditors to use the bankruptcy process. Judges may, for example, set unrealistic advances, demanding ever escalating levels of documentation and proof (up to requiring judgments, and generally shuffle difficult bankruptcy applications to the bottom of the pile, for any number of reasons.

Valuation of property, and the enforcement of foreign judgments or the disposal of foreign property in a Macedonian bankruptcy proceeding are all problems cited by judges with respect to their implementation of the 1998 law. The concept of "value", combined with the lack of buyers, is a serious problem.

### *Supporting Institutions*

There are various supporting institutions in Macedonia. The Macedonian Bankruptcy Association, is a recently created professional association, comprises of lawyers, bankruptcy judges trustees accountants and professional appraisers. The MBA held its first conference on the use of reorganization as an alternative liquidation, in June 2000 in Lake Ohrid. MBA conducted this conference in cooperation with ABA-CEELI.

In addition to the MBA, there is a lawyer's organization, the Macedonian Business Lawyer's Association, MBLA also promotes training and continuing legal education on commercial and business law topics for members of the legal profession. There is also a National Information Center for Commercial Law, housed at the University. This Center publishes a legal periodical, which highlights major legal developments and court decisions. NICCL is also a repository for commercial laws and has a website with translations of relevant legislation

Donor organizations and nonprofits have been active in the area of bankruptcy law reform. The World Bank has been active in the area of trustee education and training. This project eventually included judicial education and training as well. The World Bank developed a two day seminar for judges which concentrated on commercial aspects of an insolvency situation; assessment of a business, different concepts of value, etc. About 25 judges came to this first effort. During the same period the World Bank developed and presented a 10 part bankruptcy "basics" training course for potential trustees, for about 160 people in Skopje, Stip and Prilep.

Because there was not competency test for trustees, however, many of the persons who attended the trustee training sessions were, in the view of some interviewees, unqualified to act as professional trustees. Due to their lack of qualifications, the World Bank focuses its additional efforts on judicial training. The World Bank also conducted several residential seminars for the judges in the second segment of the project.

The last segment was to include a "living classroom" working on the liquidation / reorganization of a large enterprise, but there was not example from which to lead such a session. Instead, combined judge-trustee workshops were offered in each of the court districts for trustees and any judges who wanted to attend, and the World Bank acted as "friend of the court" to individual judges and trustees, and tried to develop fora where the judges would exchange information and talk amongst themselves (something that hopefully would survive my departure). The World Bank also provided all the material and support to set up the precursor of the Macedonia Bankruptcy Association.

The American Bar Association's CEELI program has been involved with judges in the preparation and translation of model bankruptcy forms. The forms will become part of regulations adopted by the Supreme Court, thereby providing for standardization in bankruptcy practice.

Bankruptcy trustees have adequate powers under the bankruptcy law. However, there is, at present, a lack of qualified trustees. It is hoped that the amendment process will rectify this. When the law was initially adopted, more than 200 persons expressed interest in role of trustee. The law, however, limits a trustee's caseload to one medium size and two small companies. For individual trustees (i.e., natural persons) this may eventually have been a disincentive as it provided a limit on their remuneration. At present, however, there has not been such a volume of cases as to keep even the most competent of trustees active. Legal entities may now serve as trustees and will be afforded a larger caseload. It is hoped that the credentialing of trustees coupled with the removal of caseload restriction will help to create a group of experienced professional trustees.

As one interviewee noted, it is very important for the development of a true profession of trustees that there be fewer not more, trustees, and that these trustees can work full time as specialized bankruptcy practitioners. By one interviewee's estimate, Macedonia needs somewhere between 50 - 75 competent trustees in the near future.

Interviewees noted that creditors, at present, often do not properly understand the law – especially smaller ones that do not have legal counsel. Therefore, education and outreach for creditors would be a useful step in terms of encouraging a more active bankruptcy culture and tradition. Creditor education was identified by several lawyers and judges as an essential next step. Additionally, creditors need to have access to viable financial information about companies in order to make informed decisions about whether to commence bankruptcy proceedings. Some End Users noted that a centralized financial registry would create a greater degree of transparency in this regard. Others noted that the ZPP already provided a good source of information because of its ability to block a debtor's account.

Theoretically, debtors may face [criminal] sanctions if they fail to commence insolvency proceedings once learning that they are unable to pay their obligations. Debtors, however, are rarely prosecuted and this leads to an ineffective bankruptcy process. Hence, the role of the law enforcement authorities and the Financial Police within the Public Revenue Office could be strengthened to provide incentives for debtors to voluntarily commence proceedings in a timely fashion. Neither debtors, nor trustees, (nor creditors for that matter) face any type of effective sanction for inappropriate conduct.

The creation of centralized collateral registry under the auspices of the Macedonian ZPP (Payments Bureau) may have subsidiary benefits for the bankruptcy system.

### ***The Market for Legislative Reform***

There appears to be a robust market for legislative reform in the bankruptcy area. The legal profession and judges, as the main implementers of bankruptcy law, both advocated for amendments to existing law and participated actively in the amendment process. In

addition, the MBA has been an active professional associating which has provided education and outreach about reorganization as an alternative to liquidation.

The Government has been responsive to the demand for reform. First, the Ministry of Justice initiated the amendment process and formed a working group that provided for a more open and transparent process. Second, the government realizes that there needs to be increased training, education and professionalisation of trustees and will seek donor funds for such a program. The Government is also in the process of enacting a Law on Mortgages to protect the level of security interests in real property.

The Government is also undertaking plans for the settlement of a central registry that will provide for an annual fiscal accounting of all legal entities. This project is being undertaken by the National Bank, the Ministry of Finance, the ZPP and the Public Revenue Office. Finally, efforts are underway to computerize the court record system, which should enhance the record keeping in the bankruptcy area.

### *Possible Next Steps*

In terms of implementation, the amendments to the bankruptcy law will require an increased role for the Ministry of Justice in terms of licensee accreditation and training. This is one area where assistance from donor organizations and nonprofit organizations could be invaluable.

The creation of useful practice manuals and the commentary provided on the bankruptcy law are also innovative tools which take the enactment phase of law reform one step further – and provides tools for implementation of the law that is more long lasting than conferences or training sessions.

Another area where reform is underway that merits further attention is the establishment of a central registry where annual financial accounts are filed by legal entities.

## B. COLLATERAL LAW

### *Overview*

Macedonia's achievements in Collateral Law are the most impressive of any country included in the five country diagnostic survey. Both the law and implementing regulations were adopted only fairly recently (in 1998), and the pledge registry was launched the same year as a nationwide (32 offices) computerized system. Since then, DM 780 million (approximately \$350 million) worth of property are already under pledge. All kinds of property (except real estate) may be pledged, including machinery, vehicles, securities, crops in the field etc. In our interviews the cost and convenience of the system was praised, and 27 out of 30 banks and financial institutions are participating. As a result, the central bank is moving more money through the commercial banks. This is starting to deliver on the major goal of a collateral registry system – i.e., to increase the availability of credit to the private sector on better terms and interest rates.

The analysis and comments below relate to this new system of pledges on movable property. Mortgages on real estate are not covered by the Collateral Law, but rather are subject to a different legal framework and are registered with the State Administration for Geodetic Works, not the Collateral Registry.

### *Legal Framework*

Macedonia's collateral law is the *Law on Pledges of Movable Property and Rights* (the "Law") which was enacted on April 28, 1998 and took effect on May 16, 1998.<sup>15</sup> The Law introduces the non-possessory pledge to Macedonia and governs the manner, terms, conditions and procedures to pledge movable property. Previously, movable property subject to a pledge had to be transferred to the pledgee to be legally protected. The Law was amended in 1999<sup>16</sup> to make the Collateral Registry legally a part of the new Central Registry system. Implementing regulations for the Law were promulgated in November 1998. They are straightforward and contemplate the creation and operation of a user friendly Registry.

The Collateral Registry was developed with assistance from experts familiar with the American Uniform Commercial Code Article 9 and the Texas and Norway registry systems. Many of the usual provisions of a secured transaction law are incorporated in the Law. Pledges of future property are permitted, as are pledges of intangibles. However, there are some features unfamiliar to American eyes. There is no provision for a purchase money lien under Macedonian law. Nor is self-help repossession of the collateral allowed under Macedonian law. Also, unlike American law, Article 14 of the Law gives registered pledges priority over pledges secured only by possession, regardless of the date of attachment or perfection of interest.

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<sup>15</sup> The Law was published in the Official Gazette no. 21/1998, with implementing regulations promulgated in June 1998.

<sup>16</sup> The amendment appears in Official Gazette no.48/99.

The major unfinished business with Collateral Law is the judicial and non-judicial enforcement of pledges. The Law permits the security agreement to become an executive title (Articles 8, 24 and 28) with special enforcement rights if properly notarized. Also under Article 45, in the event of default, the pledgee is entitled to a court order for possession within eight days. However, in practice this process takes months, if not years. Pending before Parliament and expected to pass are amendments to the Law on Execution of Judgments which should help speed up the process of foreclosure on collateral pledges.

Macedonia's scores for Collateral Law Legal Framework are 222 points out of a total possible score of 280. Under this rubric the highest scores are for establishment and registration of the pledge and the definition of the Implementing Institution. Somewhat lower are the scores for the form of collateral and enforcement procedures.

### ***Implementing Institutions***

Under Article 36 of the Law, "the form and content of the Collateral Registry as well as the procedure for recording and the way in which the Registry shall be administered shall be regulated by the Minister of Justice." The Government decided that the quickest and most efficient way to get the registry operational was to utilize the facilities and staff of the Macedonian Payment Bureau (ZPP). This pragmatic decision led to the Collateral Registry becoming operational within ZPP on October 5, 1998. ZPP has a network of 32 offices throughout the country, and its economists, computer experts and engineers were mobilized to launch the new system. No other body in Macedonia possessed the staff, facilities and expertise to launch the registry in such a short time. In March 1999 the Collateral Registry web site was posted on the internet ([www.collateralregistry.com.mk](http://www.collateralregistry.com.mk)).

The Registry quickly developed good relations with the principal customers of the system and is currently cooperating with 27 of the country's 30 banks and financial institutions. The Registry also established good relations with notaries, lawyers and their governing bodies.

Since 1998 the scope of the pledge registry has increased seven times. Currently, approximately \$350 million worth of property is under pledge. All kinds of property (except real estate) are being pledged, including machinery, vehicles, securities, crops in the field etc. As of May 31, 2000, 1078 pledges have been registered in Macedonia. In addition, 28 modifications and 1299 informational filings have been registered. The latter category of filing is necessary for the dial-up service of pledges which becomes operational nationwide in September 2000. This will allow a creditor to determine through a simple click of the mouse whether any other pledges are outstanding in the debtor's name.

The registration process is quite simple. Pledge documents are scanned into the system and the originals are then returned to the parties. Fees have been set very low, about \$5 even for a large pledge, to encourage usage. The ZPP statistics department issues regular reports covering each of the 32 offices in the country on the total number and monetary

value of pledges, and the types of property being secured. Pledgors and pledgees are identified by type of business organization.

On the basis of the foregoing, it should come as no surprise that Macedonia's scores for Implementing Institutions in Collateral Law are extremely high. Macedonia scored 204 out of a total possible score of 235 points. The markdowns occurred mainly in the area of judicial enforcement.

### *Supporting Institutions*

The user -friendly Collateral Registry is doing much to build up a support system that can produce positive spin-offs in this and other reform areas. The business community, bankers, notaries, and lawyers are giving positive ratings to the Collateral Registry. Enforcement complexities are a drawback, but the client base realizes that this is more a problem with the courts and one that requires action by Parliament. For this reason the team gave a perfect 10 to Macedonia on the following Supporting Institutions indicator:

Professional associations are generally satisfied with operations of the Collateral Register and have a collaborative working relationship with the officials of the Registrar.

This favorable evaluation should be sustained with further system improvements such as the dial-up service by debtor's name and the expected amendments to the Law on Execution of Judgments.

In the West, universities, foundations, think tanks, business associations, etc. are key participants in the public policy dialogue that leads to improved commercial laws. Macedonia has a ways to go on this, but a start has been made. The media generally and the Macedonian Press Center specifically have reported on collateral law issues.

One hears of old-line professors who have a lock on the law reform process - i.e., they are paid a lot and stretch out the process to supplement their miserly professorial salaries. This perception may not hold up when tested against the present day reality. The Ministry of Justice claims that it selects working groups to draft laws composed of lawyers, judges, law professors and other substantive experts such as bankers who worked on the Law on Obligations.

In the case of Collateral Law, the working group was composed of four experts, two judges and two law professors. The four worked as a team, with no single individual in charge. They were not paid for their work, the MOJ claiming that their trips to Norway and the United States were compensation enough. The team interviewed one judge and one professor, and was impressed with the practical, sensible, non-ivory towerish approach that each of them displayed to the task.

The expanded use of focus groups and aggressive contractor implementation definitely paid off well in the Collateral Law area. It is interesting that the MOJ is now espousing

an approach to law drafting similar to that tested in drafting the Collateral Law. This may suggest successful behavior modification due to a good technical assistance program.

An interesting byproduct of the Macedonian approach to law drafting is the fact that once a law is produced by the working group and approved by the Government, there is a good likelihood that it will easily pass Parliament. Parliamentary approval has not been a major delaying factor in the enactment of reform legislation, unlike the situation in some countries.

### *The Market for Collateral Law Reform*

In discussing the Market for reform, a “virtuous cycle” of reform is the desired state of affairs. This is where each reform makes the next one easier. The success in Collateral Law may be acting as a catalyst in other reform areas, thereby setting off this “virtuous cycle” of reform.

**Land Law** is the prime example. What has been achieved with movable property highlights the shortcomings of the system for titling and mortgaging of real estate. The absence of a uniform system for registering mortgage rights is increasingly recognized as a key constraint. A Law on Contractual Mortgage, which was before the Parliament at the time of this assessment, was enacted in July 2000 and amended in October 2000.

A second area is the **Law on Administration of Central Registries**. This law was passed in 1998 but is not yet effective, the implementing regulations not having been promulgated. Success with the Collateral Registry has now bolstered interest in making the Central Registry a reality. The Law on Organisation and Work of Administrative Bodies (passed in July 2000 Official Gazette 59/2000) now clearly defines the State Administration for Geodetic Works as an entity in charge for registration of rights over immovables. The drafting committee has been appointed to prepare changes and amendments to the Law on Administering of National Registries.

The team encountered some criticism of the Collateral Law reform for not having solved these problems. This hardly seems reasonable. A more considered conclusion is that success in Collateral Law reform is now producing positive impact in related areas not directly covered by the reform.

An exciting development for Macedonia is the statistic that DM 780 million (approximately \$350 million) worth of property is already under pledge. As a result, the central bank is moving more money through the commercial banks. This is starting to deliver on the major goal of a collateral registry system – to increase the availability of credit to the private sector on better terms and interest rates. In many other transition countries this goal seems like a distant hope but in Macedonia it is well within reach.

The Macedonian experience with Collateral Law is a success story in the making, and could be the theme for a conference or workshop involving other countries in the region.

## C. COMPANY LAW

### *Legal Framework*

Macedonia's company law is the *Law on Trading Companies* (the "Law") which was enacted on May 30, 1996 and took effect on July 6, 1996. The Law has been modified at least once annually since its enactment.<sup>17</sup> Macedonia recognizes five business organizations: the joint stock company, limited liability company, general partnership, limited partnership, and limited partnership by shares. The Law sets forth the rules for organizing, structuring, managing, operating, converting and terminating such companies. The limited liability company ("LLC") is the most popular form of business organization in Macedonia followed by the joint stock company ("JSC"). The formation of a LLC is similar to that of a JSC except (i) the minimum share capital is only DM 5000 (recently reduced from DM10,000), (ii) the company cannot be formed by public invitation, (iii) the number of shareholders may not exceed fifty, and (iv) there are limitations and conditions on the right to transfer deposits ("shares"), which are not securities.

Although the Law created a framework for private sector companies that is familiar to Western (particularly European) businessmen and lawyers, it has been much criticized because of its length (728 articles), and its inflexibility and lack of clarity. The Law protects shareholder rights (i) to participate in a company's affairs through attendance at shareholder meetings and voting rights, and (ii) to participate in profits in the form of dividend payments and claims upon liquidation of the company. Yet there are instances where shareholder rights are unduly restricted. One of the most notorious - conditioning transfer of shares on the company's management consent - was eliminated when the offending articles were deleted in the April 1998 amendments to the Law.

The inflexibility in the Law also extends to company managers and directors. There are too many arbitrary lines which cannot be crossed - even though it may be in the best interests of the company to do so. There is no *de minimus* rule. This stifles creativity. The "business judgment rule" which protects management in the United States when actions reasonably taken in the best interests of a company result in loss does not exist in Macedonia.

There are several governmental initiatives under way to simplify the company registration process (discussed in the next section) and to improve conditions for business operation in Macedonia. At this writing, it is unclear whether this will be accomplished by scrapping the existing law and starting over or by continuing with the current piecemeal changes.

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<sup>17</sup> The Law was published in the Official Gazette no. 28/96-921. Amendments are found at Official Gazette nos. 7/97-423; 21/98-1215; 37/98-2001; 63/98; 39/99; 89/99; and 37/2000.

During the past few years there have been a number of liberalizing amendments to the Law. As mentioned above, these include reducing the minimum capital requirements for a limited liability company<sup>18</sup>, and eliminating the requirement for management consent on the transfer of shares in a joint stock company. In another change, an article preventing a foreign-owned company from acquiring majority participation in another company was deleted. Also in the latest amendment adopted this year, the requirement for Macedonian representation on the managing board of a joint stock company was eliminated.

All in all, Macedonia's scores for Company Law Legal Framework are somewhat higher (a total of 292 points out of a possible 350) than one might imagine based on the fairly constant criticism of the law that one encountered in interviews during the assessment. Part of the explanation lies in the recent nature of beneficial amendments which may have escaped public notice and the fact that deficiencies in the company registration system are reflected in the scores for Implementing Institutions (see next section).

### ***Implementing Institutions***

Much of the negative feeling about the Law is due to the almost universal criticism of the company registration process in Macedonia. The simple act of officially registering a business has grown into a complicated multi-stage procedure requiring extensive time and money. This may be an annoying nuisance for rich, established firms, but for some entrepreneurs struggling to begin operation it is a serious constraint.

In conformity with Article 480 of the Law on Trading Companies, the Minister of Justice adopted a *Trade Registry and Entry In the Trade Registry Rules*, effective February 13, 1997.<sup>19</sup> A key feature of the Law was the re-registration of companies formed under the earlier Law on Enterprises. Re-registration was to be accomplished by the end of 1998 but the deadline was extended a further year. A key reason for re-registration was to eliminate a large number of defunct businesses that were still on the public registry. Failure to re-register results in dissolution of the legal entity. Because of the large number of applications received before the December 31, 1999 deadline, re-registrations were still being processed at the time of our visit.

Macedonia seems strongly committed to the judicial registration of companies. This is not a wise use of scarce judicial time, nor do judges particularly add value to the registration process. But it is a practice followed in many continental European countries. Under the *Law On Courts*, all companies throughout the country are registered in one of three courts. These are Basic Court Skopje I, Basic Court Bitola, and Basic Court Stip. There are not enough registration judges – only four for Skopje- and the process is cumbersome. Registration courts do not have enough supporting staff or sufficient budget, nor are they computerized.

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<sup>18</sup> This reduction was based on the recommendations of the EU/Phare Legal Approximation Project during work on Phase I.

<sup>19</sup> This is the date of publication of the Rules in the Official Gazette No. 6/97.

Often judges when unsure of their ground or faced with a novel situation will sit on an application, leading to substantial delays in processing a registration, often more than one year. Registration courts may refuse registration, claiming that submitted documents are not in conformity with Macedonian law even though similar filings have been accepted by other registration judges. Corporate charters and foundation agreements may have to be redrafted several times even though the matter has no effect on the public interest and simply regulates the parties' private relationship.

After the Registration Court has approved the company's registration, then the company must go through a whole new application process before it can start doing business. First, it submits an application to the Statistics Bureau of the Republic of Macedonia for a notification on the classification of business activities of the company. Secondly, companies registered to perform foreign business activities are required to submit an application for entry into the Uniform Customs Registry acquiring a Unique Customs Number. Thirdly, the company must open a giro-account at the Macedonian Payment Bureau (ZPP). All applications require multiple submissions of documents. The fees are substantial and a burden on small business.

In response to mounting complaints from domestic and international business groups, a number of efforts are underway to reform the company registration process. The EU/Phare Public Administration Reform Project (which includes a component on Court and Judicial Administration Reform) supported a pilot project to streamline registration by using a simplified form.<sup>20</sup> This pilot project is well underway in the registration courts in Bitola and Stip. The project has also provided IT equipment for the three registration courts.

The American Bar Association's Central & East European Law Initiative (CEELI) office in Skopje has been a major sponsor of activities to review and reform Macedonia's company law and corporate governance. CEELI has held more than 30 one- and two-day workshops with the MBA, MBLA and MJA on these and related subjects.<sup>21</sup> In October 2000, CEELI and the MBLA will co-sponsor and organize a major international conference with more than 130 participants from 15 countries on corporate governance.

A Government commission for the simplification of formalities (KOPOFO)<sup>22</sup> has also proposed a number of steps to speed up the company registration process. Also the foreign investment promotion office is recommending a one-stop registration process which would combine the several steps in a single application. A further reform avenue is

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<sup>20</sup> Note: The revised registration form served only to simplify the cover page for registrations. The reform itself did not alter the requirement to attach numerous and perhaps extraneous documents to the simplified registration form. In the view of many outside observers, these required attachments are the heart of the problem.

<sup>21</sup> One of CEELI's primary goals is to boost and assure involvement of indigenous Macedonian private voluntary organizations in the legal reform process.

<sup>22</sup> KOPOFO was founded in line with recommendations of the EU/Phare Legal Approximation Project Phase I. In April 1999, the Prime Minister appointed the Minister of Development to chair KOPOFO, who in turn appointed the members. KOPOFO is now guided by Minister of Economy.

the new Central Registry Law (described further in the Collateral Law section) which will include a Registry of Legal Entities as one of its covered registries. Although a reform effort on company registration is definitely underway, it is still too early to claim success. As of this writing, it is not clear how the registration problems will be fixed. The same holds true for other enforcement issues on company law and corporate governance. These await future resolution by a blend of court decision, regulatory interpretation and amendatory legislation.

On the basis of the foregoing, it should come as no surprise that Macedonia's scores for Implementing Institutions in Company Law are low. Macedonia's scores for the 11 items under this heading are 85, out of a total possible score of 190 points.

### *Supporting Institutions*

In other diagnostic countries, scores for Implementing Institutions tended to be somewhat higher than for Supporting Institutions. Macedonia goes against this trend. It scored better in the Supporting Institutions area than it did in Implementing Institutions. Macedonia's score was 120, out of a total possible 230 points.

This score is a reflection of the fact that a support structure for company law is starting to take shape in Macedonia. Organizations such as the Macedonian Business Lawyers Association (MBLA) are using their semi-annual meetings attended by 500-600 lawyers to showcase Company Law enforcement issues. In October 2000, MBLA and ABA/CEELI will sponsor an international conference on company law and corporate governance with the support of the Council of Europe, Macedonian Judges Association, and the Macedonian Bar Association. MBLA was instrumental in developing the National Information Center for Commercial Law (NICCL). MBLA filled a vacuum at a time when the Macedonian Bar Association was inactive but in recent years the Bar has started to assert itself in the Company Law area.

The Macedonian Press Center, as well as other members of the media, report on company law issues. Involvement of a wider array of interests -- business associations, universities, foundations, and think tanks -- is underway, but is still insufficient.

Legislative drafting has been influenced by recent experience in Collateral Law, in which a working group of professors and lawyers drafted the law. This represents a significant shift away from the years in which a few professors were said to control the process unnecessarily. A more inclusive drafting process is underway (a view supported by several attendees at the legal roundtable at MBRC attended by the team), and is evidence of progress in the Supporting Institutions area.

### *The Market for Company Law Reform*

Recent years have seen an improvement in the Market for Company Law reform.

One by-product of the Macedonian approach to law drafting is the fact that once a law is produced by the working group for the MOJ, it receives government approval and is likely to pass Parliament quite easily. Parliamentary approval has not been a major delaying factor in the enactment of reform legislation that it has been in some countries. This affects positively the "Supply" of laws.

Also in the Supply area, it is noteworthy that new laws on the securities markets and the registration of securities were enacted in 1997. The status and functions of the Securities and Exchange Commission were defined in this legislation.

The EU continues to assist with supply side efforts. Under Component 4 (Court and Judicial Administration) of the EU/Phare Public Administration Reform Project, a

working group has been active in preparing changes in the By-law for Entry into the Trade Registry. This group cooperates closely with KOPOFO.

An interesting issue involving the “Market for Company Law Reform” is the interplay between the supporters of a new law and those who favor continuing with piecemeal changes. A new law has the advantage of comprehensiveness, but there is the risk that political infighting and backbiting may undercut the effectiveness of the effort. The five Ministers named to spearhead the effort include a principal author of the earlier, flawed law. Time will tell which is the preferred method for Supply of Laws in the Macedonian context.

As to the Demand for Company Law reform, there is no doubt that the reform constituency is starting to grow. This is clear from the Supporting Institutions section. Yet many Macedonians, having developed their own individual survival strategies, are reconciled to the *status quo* and are not agitating for change.

Once the ball starts rolling on the Demand side, will the private sector and civil society pick it up and keep the momentum going? The answer may have useful applications for other areas of reform.

## D. COMPETITION

### *Overview*

Macedonia enacted the "Law Against Limiting Competition" (hereinafter, the "Law") on December 15, 1999 (Official Gazette 80/99).<sup>23</sup> The Law creates two bodies: a Monopoly Commission and a Cartel Administration (sometimes referred to as an "antimonopoly authority"<sup>24</sup>) that at the time of our interviews were still in the preliminary stages of creation. The Director of the Cartel Administration, Ms. Jasmina Galevska, was appointed to the position on May 23, 2000. Ms Galevska is in the process of building up from scratch a bureaucratic team in order to establish a functioning system of competition policy in the Republic of Macedonia.

At the time of the diagnostic, the Cartel Administration resided within the Ministry of Trade. With the GOM's reorganization and consolidation of ministries in July, the Administration is presumed to have migrated to the Ministry of Economy.

### *Legal Framework*

It is pretty safe to say that Macedonia's statutory framework for establishing a regime of competition policy has not yet been perfected. Issues remain with both the conceptual foundation for competition and with the organization of, and assignment of responsibilities to, the various regulatory and implementing bodies.

Several conceptual provisions of Macedonia's antimonopoly laws have been criticized as being deficient by EU and US observers<sup>25</sup>. For example:

- The language used by the "Law Against Limiting Competition" is not sufficiently emphatic in treating cartel behavior like price-fixing, bid rigging, and customer allocation in a sufficiently serious way.
- The law provides for exemptions from general prohibitions of cartel-like behavior with respect to discounts. U.S. experience indicates that an agreement among firms concerning discounts could easily become a harmful agreement not to compete.
- The law provides no guidance regarding how product or geographic markets are to be determined. Macedonia, a small country with a small population, most certainly will find that a geographic market for some products will extend beyond its borders.
- The Law requires that the Cartel Administration seek permission from a judge in order to embark on an investigation.

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<sup>23</sup> Parliament simultaneously adopted a confusingly named "Law Against Unfair Competition" (Official Gazette 80/99), which is a consumer protection law.

<sup>24</sup> The author, for sake of consistency, will apply the term Cartel Administration, as that is the term most often used in the translation of the Law provided to USAID/Skopje in June 2000.

<sup>25</sup> The Team would like to thank Mr. Russell Pittman of the U.S. Department of Justice's Antitrust Division for a very helpful analysis of the Law.

Macedonia's legislation establishing the bureaucratic organization of the antimonopoly administration also raises many questions. For example:

- How can the Cartel Administration be an independent organ while simultaneously being established within the Ministry of Trade? The Law gives the Trade Minister powers of appointment and removal over the Director and Deputy Director of the Cartel Administration.
- How can the decision-making process of the Cartel Administration's Department for Enactment of Decisions remain free from political interference and bribery, when it only has three voting members who must vote unanimously (or "by consensus")?
- The Law appears to place major overly restrictive barriers on employment by the Cartel Administration and the Monopoly Commission. By law, the only individuals who could fill the position descriptions for the Commission are either university law professors<sup>26</sup> or very wealthy and unemployed intellectuals.

### *Implementing Institutions*

The Law Against Limiting Competition provides for two related bodies:

1. a Monopoly Commission (quasi-judicial and independent of the government in nature), pursuant to Article 30; and
2. a Cartel Administration, an "independent organ" established pursuant to Articles 50-52 of the Law. The Cartel Administration consists of three departments:
  - The Register, where notifications must be filed and recorded;
  - Department for Enactment of Decisions; and
  - Department of Analysis & Research.

A Director and a Deputy Director manage the Cartel Administration's three departments. The Register's function is to accept filings of complaints and to maintain a library and archives. The Department for Enactment of Decisions is to have a staff of three members, who will actually vote on cases. The Director and Deputy Director are not voting members of the Decision-making office. The Department of Analysis & Research, envisioned as having a staff of as many as five, would conduct investigations. It is thought that the staff would consist of three economists and two lawyers.

The Cartel Administration was not yet fully staffed. The law requires a minimum staffing of 13 individuals, but as of the time of the interview only nine people were employed. The Administration, on visual inspection, only occupied two offices within the Trade Ministry's space--clearly insufficient for its projected needs.

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<sup>26</sup> The author finds it curious that a Professor of Law in Skopje drafted the Law.

Salaries of the staff (including decision-makers) are prescribed at a very low rate, between \$100 and \$150 per month. It is unclear whether the Administration can attract a sufficient group of talented employees.

When asked, the Director stated that she was not a member of a political party. She stated she was most likely selected by the then-Trade Minister owing to her work on a closed-out EU sponsored project to draft a competition policy law.

### ***Supporting Institutions***

The Law provides corollary roles to the Ministers of Trade and of Economy. These Ministers have the power to grant exemptions or approvals for certain actions. This framework is not straightforward and can cause confusion or even conflict. With the absorption of the Trade Ministry into the Ministry of Economy, perhaps this confusion is moot.

Other institutions, like the courts, have received little, if any, training on competition matters. Therefore, it is doubtful that they will be able to make solid decisions on cases arising from disputes between the Administration and the private sector.

The Consumers Organization of Macedonia (COM) is an apparently vibrant NGO that serves as an advocate for consumers. Its Chairman is Marijana Loncar Velkova, another prominent woman lawyer<sup>27</sup> in Skopje.

### ***The Market for Reform in Competition Law***

Some mention must be made of the unusual situation surrounding the promulgation of the enacted competition policy laws in Macedonia. The EU/Phare Legal Approximation Project, started in December 1997, initiated a comprehensive approximation of laws project in Macedonia. A major component of this project was the drafting of laws on competition and consumer protection. As mentioned, the current Director of the Cartel Administration was an employee of the EU-sponsored project.

The Legal Approximation Project concluded in September 1999. Experts from the Project reviewed and commented upon drafts of both of the competition laws and assisted in the first stage of drafting the Consumer Protection Laws, and left behind draft laws for consideration by the Macedonian Government. The GOM, however, appeared to ignore completely the work done by EU experts and contracted with a Macedonian professor of law to draft laws in both these areas. The Competition laws were passed on December 15, 1999, and the Consumer Protection Law on April 1, 2000.

All the more confounding, these laws (purportedly demi-translations of German law) contain serious flaws and do not reflect minimum European Union standards for legislation of countries seeking membership. The rejection of the higher quality

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<sup>27</sup> The MBLA, the Bar Association, and the COM all prominently feature women attorneys in leadership roles.

European draft in favor of the flawed current law suggests that the demand for quality reform in competition law has not yet been adequately focused or captured.

## E. Contract Law

### *Legal Framework*

Contractual relationships in Macedonia are governed by the Law on Obligations (“LO”). The LO was enacted originally in 1978 as the Law on Obligations of Yugoslavia.<sup>28</sup> The LO law was subsequently amended in 1985 and 1989.<sup>29</sup> The LO was adopted formally by the Republic of Macedonia in 1991 pursuant to Article 5 of the Law for the Enforcement of the Constitution.

The LO is, for the most part, a modern market-oriented code that governs both contract and tort (damages) law in Macedonia. It contains 1109 articles and is considered the cornerstone of Macedonian civil law. The LO is the primary source for contract law in Macedonia. It provides a comprehensive legal framework that governs a general contracts as well as more specialized types of agreements.<sup>30</sup>

*The Amendment Process.* Unlike other legislative projects (notably the law on bankruptcy and collateral), the LO has been undergoing revision since 1996 without any legislative enactment of proposed amendments. As of the date of the CLIR assessment, proposed amendments were before Parliament but had yet to be approved.

In 1997, the Ministry of Justice made a decision to revise the LO. There were two primary reasons for such a revision. First, the revision was meant to eliminate any terminology in the law that referred to previous socialist terms or legal concepts. Second, revisions were to be made to provisions related to monetary transactions and interest rates. Professor Galev, in close co-operation with the USAID/Commercial Law Project team, prepared the amendments to the law that were submitted to the Ministry of Justice in 1998.

In March 1999, The Ministry of Justice subsequently convened a working group to review and prepare the final revisions. The working group was chaired by Professor Galev. Other members of the group included at least two other academics and one retired Supreme Court Justice. Additional revisions were proposed by the working group – which included new chapters of the Law on Obligations. The new sections were included to cover types of agreements not initially included within the 1978 law.

The March 1999 amendments included the following new sections:

- partnership agreements;

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<sup>28</sup> SFRJ 29/78.

<sup>29</sup> SFJ 39/85 and SFJ 57/89.

<sup>30</sup> Among others, the LO contains provisions governing the following types of agreements:

loan ; consignment; employment; construction; sale of goods; transport; leases; deposit/banking; warehousing (bailment’s); commercial agency ; brokerage; securities; pledge; forward; inspection; travel; insurance; guarantees; and exchange (barter)

- loan for use contracts;<sup>31</sup>
- gifts/donative transfers
- a provision for the elimination of penalty or default interest (the payment of interest upon interest); and
- contracts for lifetime maintenance and support

The working group also considered adding a new chapter on factoring agreements. However, this idea was not implemented. Other End Users mentioned that franchise agreements might also have been a suitable subject for inclusion in the draft.

The Ministry of Justice recently drafted a Proposal for Amendments to the Law on Obligations that was submitted to Parliament for review during July 2000. At the time of the CLIR assessment, the amendments had been through a first reading in Parliament.

For the most part, End Users felt that the LO was a sound and robust legal framework for contract law. End Users pointed out that, unlike many other former socialist countries, Macedonia did not have an outmoded Civil Code. Rather, the 1978 Yugoslav law had already taken into account many market-based factors. Furthermore, the Yugoslavian Law on Obligations had been drafted by academics that referred extensively to the civil codes of countries such as Germany.

While the legal framework is sufficient, many End Users expressed frustration with the delays and the length of the amendment process. When contrasted with other commercial laws reform (e.g., the enactment of new laws in bankruptcy and collateral), the amendment process for the LO has been much lengthier while the changes themselves have been far less ambitious. Some End Users noted that the bankruptcy law and the collateral law were enacted due, in part, to external pressure from international financial institutions. Without outside impetus, therefore, the LO amendments have not been on a legislative fast track

### ***Implementing Institutions***

The courts are the main implementing institutions for contract law in Macedonia. There has been a great deal of reform -- judicial, institutional and organizational in an attempt to create an effective court system in Macedonia. The process of creating a legal framework commenced in 1991. There have been quite a few laws enacted relating to the court system including the Law on Courts (1995), and the Law on Enforcement Procedures (1998). Despite the wide scale of legislative form, End Users almost uniformly feel that court procedures are time consuming and slow

Part of the problem relates to the overload of cases. The basic courts, responsible for hearing civil disputes, are overloaded. An increase in the level of court administration at the basic court level is perhaps one reason for increased delay. In 1997, the Ministry of

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<sup>31</sup> Loan for use contracts are not lease agreements. Loan for use refers to gratuitous loans of personal property's

Justice released statistics, which revealed that there were over one million cases (unresolved or new) currently before the courts.

Judges are involved with applying the LO and with clarifying practice with respect to the meaning of the law. Judges from the Basic Court and the Court of Appeals who were interviewed were generally satisfied with the LO and felt that the main challenge posed by the law was applying the provisions in the context of a more fully developed market economy.

One judge who was interviewed provided an example where the court played a role in interpreting and clarifying an ambiguous provision from the LO. In the case, three individuals had two separate debt agreements between them. The parties tried to use a cessation/novation procedure to revise both contracts and to substitute the first debtor as the debtor to second creditor. The court wrote an opinion stating that the original agreements were the ones that governs the relationship between each set of the parties. The Supreme Court rejected a request for an appeal so that this is now binding precedent in Macedonia with respect to a party's ability to substitute another person to answer for his or her debts.

Judges noted that published Supreme Court opinions also helped to develop consistent practice and interpretation among courts. The Supreme Court has been active in clarifying the meaning of unclear terms on the Law on Obligations. For example, the Supreme Court has interpreted what the term "larger amount" means in the LO. The Supreme Court thus provides guidance and helps to clarify contradictory decisions between court councils. The Macedonian Business Law Association also publishes a bar journal called *Pravnik*, which helps to publicize important decisions among lawyers.

Interestingly, End Users mentioned that concepts of "custom" and "trade usage" were not used by the Macedonian courts to help aid their decision making in commercial contract disputes. Judges are aware of things such as industry codes of conduct, for example. Such codes or business practices are not permitted as the basis for a judge's decision. Rather, only written law and decisions may be used by the courts.

The LO is perceived as adequate and properly implemented by the courts. The major problem identified by the majority of End Users of the LO is the length of court procedure. Commercial disputes, it was noted, can often take several years to conclude. Parties also mentioned that the manner of proceeding with the enforcement/execution of judgments is also time consuming and cumbersome.

Furthermore, the number of court personnel may not be adequate with respect to this caseload. Judge's salaries remain very low and judges are prohibited from taking on outside work. Hence, it is difficult to attract well-qualified professionals into the judicial branch.

The problems with inefficiency in civil court litigation are exacerbated by the absence of a meaningful system of alternative dispute resolution (ADR) in Macedonia for commercial contract disputes.

Some End Users noted that codification would make it easier for judges to apply the law. Because of the enactment of a wide range of laws, codification, some interviewees noted, would help to create a more accessible framework. The LO, however, is codified and provides a basic framework for contract law. Consequently, in the area of contract law, the legal framework seems more than sufficient.

Other End Users noted that the creation of an effective ADR system and the modernization of the courts (computerization, improvement of infrastructure, increase in court personnel, and increased judicial training) are the key to a more efficient court system. Without improvements in enforcement of judgments and also with the time period for litigation, investors will not be confident of efficient and prompt protection of their rights in the event of a contractual dispute.

The encouragement of standardized forms for certain types of agreements might also be an effective means of ensuring certainty and predictability in the commercial sector -- by encouraging business entities to include specific remedies within contractual provisions and by developing a uniform set of terms and conditions for certain types of transactions. Standardization might be considered in both business-to-business and business-to-consumer agreements.

### *Supporting Institutions*

Arbitration and ADR in Macedonia are still in a dormant phase. There has been some arbitration of international commercial disputes. By contrast, however, domestic arbitration appears to be non-existent. It was not possible to obtain any statistics on the number of cases referred to arbitration or resolved by arbitration/ADR in Macedonia.

ADR and arbitration would offer business entities the opportunity for simple, fast, and cost-effective means for resolving commercial disputes. Furthermore, properly trained arbitrators can lend specific expertise to commercial arbitration that would benefit parties in complex business disputes.

Arbitration in Macedonia is currently handled by an arbitration council under the auspices of the National Economic Chamber (a governmentally run "chamber of commerce"). Some End User attributed the governmental sponsorship/involvement in arbitration as one of the reasons it has not flourished in Macedonia.

In 1993, a permanent elected arbitration court was formed at the National Economic Chamber with a view to resolving contractual disputes between parties. Some End Users noted that to date, the arbitration court has not resolved a single domestic dispute between domestic parties. The President of the Arbitration Council is a professor at the

University in Skopje. Within the National Economic Chamber, there is currently a list of about 54 foreign arbitrators and approximately 25 local arbitrators.

Macedonia is a signatory country to the 1968 New York Convention for the Acceptance and Execution of Foreign Arbitration Decisions (the New York Convention) and the UNCITRAL Rules for Resolving Disputes through Ad Hoc Arbitrations (1976) and the Uniform Law on International Commercial Arbitration (1985). In 1998, Macedonia joined the International Center for Solving Investment Disputes.

For international arbitration matters, the parties have the right to choose foreign law and a foreign language for the proceedings. According to the President of the Arbitration Council, there have been 18 international arbitrations to date – 15 of which have been resolved. These have included disputes with parties from Bulgaria, Turkey and Germany. The arbitral awards have been subsequently carried out by foreign courts.

As noted by End Users, parties may choose arbitration on a voluntary basis and both parties must consent. At that point, an individual arbitration council comprised of three members is appointed. Each party to the arbitration appoints one arbitrator and the president of the arbitration council is selected by the other two arbitrators. If there is a disagreement, the President of the Macedonian Council of Arbitrations makes the final decision. Local disputes are governed solely by the laws of Macedonia. Parties are not free, therefore, to have a local dispute governed by the laws of another jurisdiction. Judgments of an arbitration council are supposed to be final and there are no internal or extra review procedures. There is also a mediation option available to parties before a full fledged arbitration.

The American Bar Association has been active in trying to promote and encourage ADR in Macedonia. An international arbitration expert was resident in Macedonia for approximately one year. In addition, the USAID Commercial Law project has promoted training for lawyers and business people on arbitration. This program will need to overcome what has been reported as a general reluctance by the business community to try this new procedure, as well as questions about the actual enforcement of the awards by the courts. (Although they are enforceable in theory, the practical implementation of the law is still uncertain.)

End Users mentioned as a top priority the drafting of a new Law in Arbitration that will regulate both institutional and ad hoc arbitration. Furthermore, End Users noted that the Government needs to take measures to increase confidence in the arbitration services offered by the Macedonian Economic Chamber. End Users also noted the following needs with respect to encouraging the use of ADR in Macedonia:

- Improvement of domestic arbitration through increased training and outreach efforts to commercial managers, potential arbitrators and lawyers;
- Increased publication of articles and works (both academic and popular) on the benefits of arbitration; and

- Encouragement and use of non-binding mediation as an alternative to litigation

Lawyers have been active in terms of trying to implement reform with respect to the LO. The Macedonian Business Lawyers Association (MBLA) has hosted sessions on the amendment process, at their annual meetings. Drafters and members of the LO working group have been invited to speak to the membership and to answer questions about the amendment process.

The MBLA has also facilitated education in the area of commercial law with the publication of its legal magazine *Pravnik*. The National Information Center for Commercial Law, a sister organization to the MBLA is yet another avenue for legal education and outreach about commercial and contract law.

IFIs, donors and nongovernmental organizations have similarly been active in trying to encourage the adoption of the amendments to the LO. The USAID Commercial Law Project, for example, convened a group of End Users to meet with the drafters of the LO amendments, in order to provide more input into the process. This process, however, has been quite different from the amendment process for the Law on Bankruptcy, where End Users (in addition to the traditional academics) were included by the Ministry of Justice from the beginning of the amendment process. Some End Users felt that it was only external pressure from nongovernmental organizations which lead to greater transparency in the amendment process for the LO.

There is a distinct lack of professional/trade organizations outside of the legal profession that are active in terms of commercial law reform. Several professional associations are convened under the auspices of the National Economic Chamber. However, none of these groups has turned into a robust trade group that advocates for legislative change. Additionally, standardization of contract forms or terms does not appear to have occurred. Some End Users noted, that this may be because lawyers and businesspersons take a proprietary interest in the agreements they procure and thus providing shared forms or common forms is not seen as enhancing trade and commerce.

The Board of Banking and Insurance Association (a group convened by the National Economic Chamber) did submit comments in February 199 concerning the proposed changes to the LO on default interest. This does mark some involvement in the legislative process. Nonetheless, all End Users interviewed, noted that there is room for improvement in terms of the participation of banks and other business entities in the legislative process, and in the development of more standard policies, procedures and agreements in different industries.

### ***The Market for Contract Law Reform***

The demand for contract law reform did not seem as high as in other areas of commercial law reform. In part, this is because practitioners, judges and business entities are relatively comfortable with the existing legislation. To the extent that there was any

criticism, it was with the frustration of the pace of legislative reform. As noted above, through the inattentive of the CFED commercial law project, lawyers and other stakeholders were able to meet with the drafters of the amendments to voice their comments and provide input.

Greater frustration is felt with (a) the ability to enforce court judgments and (b) the lack of viable alternative dispute resolution in Macedonia.

## F. FOREIGN DIRECT INVESTMENT

### *Overview*

Macedonia has done an admirable job in maintaining internal tranquility, both socially and economically, during the last decade's series of cataclysms stemming from the breakup of former Yugoslavia. At the beginning of a new millennium, Macedonia has achieved macroeconomic stabilization and positive economic growth. Nonetheless, heavy foreign direct investment inflows are not materializing.

Macedonia has many factors working in its favor: it is situated at the junction of two major transportation corridors, has an educated and productive workforce, good physical infrastructure, a relatively non-corrupt and comprehensive legal system.

A recent FIAS report<sup>32</sup> noted that changes in GOM policies and laws could only marginally affect foreign investment levels. It noted that foreign investors were staying away because of the perception of the southern Balkan region as being dangerous and because Macedonia lacks a significant, wealthy internal consumer market. Nonetheless, FIAS concluded that there were significant actions that the Government of Macedonia could take in order to make the investment climate more attractive.

Total foreign direct investment is estimated at about U.S. \$205 million<sup>33</sup>, compared to over \$2 billion in Bulgaria. Even in *per capita* terms, Macedonia has among the lowest levels of foreign investment of the former socialist countries of Southeastern Europe.

One very striking positive factor in Macedonia is the sea change in enthusiasm for privatization of major socialist-owned firms. With the election of a new government in 1998, and a new President from the same political party in 1999, several such firms either have been or are being put on the auction block. Already sold are the petroleum refinery and Macedonia's major commercial bank (Stopanska Banka, Skopje). Still to come is the sale of Macedonia's telecommunications company. Even more surprising is that Greek interests are snapping up these companies.

### *Legal Framework*

Macedonia's legal framework is pretty comprehensive but contains inconsistencies. Nonetheless, it has not been a major impediment to attracting foreign investment. Some of the foreign investors we interviewed reported having no serious problems with Macedonia's legal system. There is no separate law on FDI, and this is perceived as advantageous by FIAS.

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<sup>32</sup> Former Yugoslav Republic of Macedonia: Improving the Environment for Foreign Direct Investment, August 1998; Foreign Investment Advisory Service.

<sup>33</sup> Source: Privatization Agency January 2000, as reported in "Investment Promotion in the Republic of Macedonia", MIGA, May 2000.

The Government of Macedonia has made some rather significant attempts to attract foreign investment through diplomatic initiatives. The GOM has entered into free-trade agreements with neighboring Turkey, Bulgaria, Yugoslavia, and Slovenia. More such agreements are envisioned. The country is on course for World Trade Organization accession, and then European Union membership.

The GOM's efforts at attracting investment through direct targeting of major corporations appear to be ineffective thus far.

Domestic legislation has many positive features:

- the Macedonian foreign investment regime is largely open, with investment only regulated or disallowed in certain categories;
- Macedonian legislation guarantees free repatriation of profits and for compensation in the event of expropriation;
- there is no discrimination made between foreign and domestic investors, except that foreign investment is encouraged with a 50% tax holiday on corporate tax for an initial period of the investment;
- foreign investors are granted national treatment, except for purposes of urban land ownership;
- foreign investors can participate in all transactions which are not specifically forbidden by law, including the privatization program; and
- there are no restrictions in the percentages of foreign participation in commercial companies.

The FIAS report and other observers have identified several weaknesses in the legal regime which should be rectified. The most significant among them is the Law on Trading Companies (Official Gazette 28/96, as amended): This law, which essentially lays out the prerequisites for company entrance and operation, is cumbersome and is plagued with numerous ambiguities. The GOM is overseeing an entire overhaul of this law in order to make the registration process routine and automatic. USAID, working with its partner ABA-CEELI, is providing some technical assistance to the GOM on this.

Some gaps exist in the domestic legal framework, notably on mortgages, investment funds, and credit rating agencies. The mortgage area is being addressed, as noted briefly in the Collateral Law discussion.

Macedonia's framework for commercial dispute resolution would benefit from reform. Macedonia recognized the importance of arbitration in the settlement of commercial disputes when it became a signatory to the New York Convention of 1958 regarding the recognition and execution of foreign arbitration awards and of United Nations Commission on International Trade Law (UNCITRAL). Macedonia is a party to the ICSID Convention concluded in Washington in 1965.<sup>34</sup>

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<sup>34</sup> Macedonia's application came into force on November 26, 1998

Macedonia is a member of the Multilateral Investment Guarantee Agency (MIGA), part of the World Bank group. It now has a developed system of bilateral investment treaties (or "BITs") with the following countries: Albania, Belgium & Luxembourg, Bulgaria, Germany, Italy, Yugoslavia, North Korea, Malaysia, Poland, the Russian Federation, Slovenia, Turkey, Ukraine, France, Netherlands, Croatia, Switzerland and Sweden. Special mention should be made of Macedonia's establishment of diplomatic relations with the Government of the Republic of China (Taiwan), apparently with some expectation of significant foreign investment.

### ***Implementing Institutions***

While there is general policy agreement within the GOM that foreign investment is necessary and beneficial, initial impressions by the Diagnostic Team were that the government's approach to attracting foreign investment needs better focus. No fewer than four agencies and one non-governmental firm are actively vying for leadership roles in this area. The most responsive of these entities were the Investment Promotion Unit of the Ministry of Development ("IPU") and the Macedonian Business Resource Center (MBRC).<sup>35</sup> Also claiming a role in this area were the Ministry of Economy, the Agency for Reconstruction (ARD) and Development, and the Privatization Agency, none of which responded to our requests for a meeting.

In any event, the IPU appears to be the *de facto* governmental body in charge of investment coordination and promotion within the government. It is receiving advice and technical assistance from the World Bank (including MIGA and FIAS), and is responsible for coordinating a comprehensive economic reform agenda.<sup>36</sup>

### ***Supporting Institutions***

Macedonian foreign investors have not yet organized, but discussions are taking place for establishing some kind of entity like a U.S.-Macedonia Chamber of Commerce. The existing Economic Chamber has signed bilateral and multilateral agreements with 53 countries. An important part of those agreements is the establishment of associations that would enable mutual cooperation, particularly in the area of investment and SME development.

Macedonia is the first country in southeastern Europe to fully adopt IAS standards. While IAS is well known and understood in Macedonia, they have not been widely adopted by domestic companies. Foreign investors in the past have criticized the poor level of service provided by banks. It is expected that the government's sale of Stopanska

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<sup>35</sup> It should be noted that Diagnostic Team Members interviewed staff at MBRC and the Ministry of Development, but no one at any of other agencies.

<sup>36</sup> Assistant Minister Maja Kurcieva-Filipova of the Ministry of Development, Unit for Investment Promotion, provided the team with a booklet titled "Program Of The Republic Of Macedonia For Stimulating Investments With A Special Emphasis On Attracting Foreign Direct Investments" (Skopje, March 1999), along with a progress report, dated May 2000. This report has a comprehensive and ambitious action plan covering that encompasses many USAID market reform initiatives.

Banka (Skopje) to a foreign led consortium consisting of EBRD and the National Bank of Greece will inject some modernity to the banking system.

Some foreign investors have reported that Macedonian government officials, like tax and labor inspectors, conduct stricter and more frequent inspections of their companies than of indigenously owned companies.

### ***The Market for FDI***

The GOM lacks a consultative mechanism to dialogue with the private sector and investors. This represents an potential obstacle to developing investment legislation adequate to support economic growth and increased foreign investment. Multilateral donors like OECD and FIAS have conducted polls of foreign businessmen. These polls have identified certain issues concerning discriminatory treatment by government functionaries in application of laws and regulations.

## G. INTERNATIONAL TRADE

### *Overview*

As summarized in the general indicator table at the beginning of this report, Macedonia has a population of 2.04 million, with a GDP per capita of \$3,800. Macedonia's foreign trade is predominantly with the European Union, followed by the countries of Southeastern Europe, and the U.S. Exports in 1998 measured \$1.2 billion, with food, beverages, clothing and textiles, iron, and steel destined for Germany (21%), Serbia and Montenegro (18%), United States (13%), Greece (7%), and Italy (6%). Imports included machinery and equipment, chemicals, fuels, and consumption goods, valued at \$1.56 billion. Import partners include Germany (13%), Serbia and Montenegro (13%), Slovenia (8%), Ukraine (6%), and Italy (6%). Overall trade was severely affected by the Kosovo crisis in the first months of 1999 however, with total exports falling to 75% of 1998 levels and total imports falling to 80% of 1998 levels. Gross official reserves declined by \$14 million.

Multilateral and bilateral trade agreements continue to be the principle means towards achieving greater trade liberalization. In addition to ongoing work aimed at WTO accession, Macedonia has negotiated a number of trade agreements with neighboring countries, such as FRY (1996), Slovenia (1996), Croatia (1997), Turkey (1999), Bulgaria (1999), and United States (1996). Macedonia is currently negotiating similar agreements with Albania, Romania, Bosnia and Herzegovina, and Ukraine. Macedonia continues to work for regional trade agreements, with plans to initiate negotiations for the Stabilization Association agreement with the EU in 2000.

Access to international markets is particularly important for Macedonian businesses and consumers both because of the dramatic shrinkage in its domestic market<sup>37</sup> and because of Macedonia's landlocked situation in the southern Balkans, surrounded by the Federal Republic of Yugoslavia (specifically, Kosovo and Serbia), Bulgaria, Greece, and Albania.

The placing of sanctions on Bosnia and on Serbia and Montenegro by the international community in 1991, and of an economic blockade by Greece in 1994 (both of which have since been lifted), served to seriously isolate Macedonia from international commerce. Both Serbia and Greece connect with Macedonia's principal transportation corridor and also serve as major markets for exports. Linkages with and markets in Bulgaria and Albania are less well developed, although some coordinated international development efforts are underway to improve this situation.

WTO accession is requiring many serious changes in Macedonia's legal regime, and in the ways key ministries, agencies, and the judicial system operate.

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<sup>37</sup>Before the breakup of Yugoslavia, Macedonia's "domestic" market included Kosovo, Bosnia, Slovenia, Serbia-proper, and Montenegro. Presently, these markets can now only be reached after passing through customs checkpoints and passport control.

### ***Legal Framework***

Trade relations between Macedonia and the EU are governed by a Partnership and Cooperation Agreement (PCA). The PCA defines the legal parameters for trade between Macedonia and the EU, and specifies trade concessions such as most-favored-nation (MFN) status and access to the Generalized System of Preferences (GSP). Measures for phased liberalization of trade in services, FDI, capital transfers, and protection of intellectual property rights are also addressed. The PCA also creates a framework for on-going cooperation, primarily in the form of an annual Ministerial Cooperation Council, and a Parliamentary Cooperation Committee.

Trade relations between the U.S. and Macedonia are governed by a bilateral treaty, under which the parties extend mutual Most Favored Nation (MFN) status.

### ***Status of GOM Accession to WTO***

The GOM applied for GATT observer status in October 1993 and for World Trade Organization accession in December 1994 using FYROM as its name. In July 1996, Macedonia submitted to the WTO Secretariat its Memorandum of Foreign Trade Regime, which outlined its trade laws and practices according to a specified format.

Secretariat organized a Working Party to address Macedonia's accession and appointed the Norwegian Ambassador as the Working Party Committee's Chair. Secretariat also translated the Memorandum of Foreign Trade Regime from English into Spanish and French (which are the three WTO working languages).

The GOM's application was frozen at this point because of a disagreement related to the name issue with Greece. Because of Greek objections to Macedonia's insistence on the use by Secretariat of "MK" as country coding for WTO-generated documents, the European Union delegation to the WTO (acting on behalf of Greece) effectively blocked circulation of any documents. This impasse was finally resolved in March 1999 by an agreement to use "007" as Macedonia's country code by Secretariat.

Meanwhile, beginning in June 1998, the GOM decided to revise the two-year old, and out-of-date, Memorandum of Foreign Trade Regime for submission to the WTO. A new memorandum was subsequently submitted in the summer of 1999. USAID, working through its partner Booz·Allen & Hamilton, began a program of technical assistance to the Ministry of Trade in September 1999.

The GOM has been making steady progress in its understanding and incorporation of WTO principles and obligations into its legal framework. A first working party meeting was successfully accomplished in July 2000, with another one expected early 2001.

Macedonia's customs regime substantially conforms with European standards, where customs value is defined as the sum of the sales price, transportation costs, freight, insurance, storage fees, and any other costs not foreseen in the contract price.

### *Implementing Institutions*

For the purpose of this assessment, Macedonia's implementing institution for trade was the Ministry of Trade, which has since been incorporated into the Ministry of Economy. The assessment of its institutional capacity is based on an admittedly narrow sample of meetings with relevant government officials, donor-funded advisors, and private sector participants. It is clear that expert, qualified individuals knowledgeable about trade are few in number. Donor institutions, however, are actively providing training and technical assistance to the staffs of both implementing and supporting institutions, which over time, will rectify this situation.

It is worth noting that corruption is remarkably low in Macedonia, when compared to other countries in the region. A prominent local attorney informed us that charges had been brought against the former Deputy Minister of Trade for accepting a medium-size bribe in return for approving an import license from a foreign businessman. All the more surprising was that it did not appear that official had been singled out as part of a vendetta; rather, it was -- in the attorney's opinion -- an issue of the police doing their job.

### *Supporting Institutions*

The Macedonian customs agency manages facilities at 15 border points and four inland terminals. All goods imported into Macedonia are processed or cleared for entry at the inland terminals. The agency is making changes in order to bring it into compliance with EU standards. A new customs tariff was implemented in August 1996, and a new customs code was adopted in April 1998. Changes were based on practices of EU member states.

Macedonia is exceeding minimum requirements in nomenclature, having introduced a 10-digit system for products. Staffing appears to be adequate. Pilot projects underway for automation; declarations may be submitted by email. Computers are used at all inland terminals (where goods are cleared for entry). A website is being constructed at [www.customs.gov.mk](http://www.customs.gov.mk).

Customs laws and regulations are reportedly interpreted fairly similarly. Corruption, although present, is mitigated by annual rotations of personnel among the 19 facilities. Based on anecdotal evidence, corruption arises in the form of evading high tariffs through miscategorization of product-items, and through intentional misidentifying country-of-origin in order to receive duty-free treatment pursuant to the handful of free-trade agreements Macedonia is a party to.

The customs clearance system still requires 100% inspection of all shipments, although plans are underway to reduce this to 40%. The ASYCUDA system is operational at the four inland terminals. Disputes are resolved through the Ministry of Finance.

Some foreign investors have reported that customs officials typically single out their shipments for scrupulous inspections, leading to the prospect of delays, fines, or perhaps bribes.

Other supporting institutions not interviewed include the Registry for trademarks and patents, the product standards organization, and sanitary/phytosanitary regulatory agency. It is presumed that these organizations require significant resources in order to effectively operate as contemplated pursuant to WTO agreements.

### ***The Market for Trade Liberalization***

The market for trade liberalization is relatively strong in Macedonia. Government officials recognize the importance of trade and investment, and see WTO membership as an important part of the equation. Government officials and politicians have strong connections to major industrial enterprises throughout the country, providing an informal network. This network, however, is heavily slanted in favor of so-called "old economy" bosses, who owe their positions to the former socialist party networks created under the old Yugoslav system. This can be seen quite starkly by the National Economic Chamber's lethargy in reforming itself and taking a more dynamic role in the economic development of the country. The Chamber is also dominated by "old economy" relics, who maintain their positions based through political connections, not merit.

An important step that Macedonia will inevitably make is when the "new economy" entrepreneurs better organize themselves and begin lobbying Parliament and the Ministries in a systematic, focused way.

### **Note on the WTO Accession Process**

By deciding to accede to the WTO, Macedonia is committing itself to three basic principles under GATT that must be followed in any legislation affecting trade:

- Most-favored nation (MFN) treatment, whereby concessions negotiated between two members are applicable and/or available to all other members;
- National Treatment, whereby foreign businesses and persons must have the same rights and privileges of domestic ones; and
- Transparency, whereby laws, regulations, and dispute resolution mechanisms must operate in a predictable and open manner.

The procedural steps to be taken in acceding to the WTO may be grouped into the following five categories: (1) initial notification, (2) organization and convening of a Working Party Group, (3) foreign trade regime examination and review, (4) market access negotiations, and (5) negotiation of a Protocol of Accession.

I. Initial Notification and Application: Country governments as well as customs entities, like Hong Kong and the European Union, may accede to the WTO. Typically, the applicant government would apply for observer status, and at some later time formally apply. Following some statement of intention to apply, the applicant government will submit a "Memorandum of Foreign Trade Regime", which outlines its trade laws and practices according to the format specified by the WTO Secretariat.

II. Organization and Convening of a Working Party Group: Following submission of a Memorandum of Foreign Trade Regime (which must be submitted in either English, French, or Spanish - the three official languages used by the WTO), the WTO Secretariat prepares translations, if necessary. Simultaneously, a Working Party Group will be organized, comprising representatives of WTO members with an expressed interest in the particular applicant government's accession. Each Working Party Group appoints a chairman, who serves as a communications conduit regarding accession procedures (like the convening of Working Party Meetings) and as a shepherd of sorts to guide the accession process.

III. Foreign Trade Regime Examination and Discussion: This is done through the applicant government's thorough preparation of documentation and through answering technical questions posed by WTO member countries. Documentation includes the following:

- Memorandum of Foreign Trade Regime (ACC/1)
- Documentation prescribed by various WTO Secretariat memoranda, including:
  - Questionnaire on technical product standards and certification requirements;
  - ACC/4 - Questionnaire on Agriculture, including Aggregate Measures of Support, subsidies; and
  - ACC/5 - Questionnaire on Services.

- Answers to possibly hundreds of questions (i.e., questions which have been posed by WTO signatories and forwarded by the WTO Secretariat to the applicant). Macedonia's answers would be sent to the WTO Secretariat, and would form part of the agenda of the next Working Party Meeting. This process may be repeated a number of times before progressing to next steps.
- Preparation of a Tariff Schedule in WTO-prescribed format.

IV. Market Access Negotiations: Negotiations take place on a bilateral basis outside the formal workings of the Working Party. It should be expected that negotiations would take place with the applicant's major trading partners. At this point the applicant would prepare the following items to complete this phase of the accession:

- Offer on Tariff Concessions (to be completed once bilateral negotiations with major trading partners are carried out);
- Offer on Services;
- Report of the Working Party on the applicant's accession, which outlines the various commitments to be made by the applicant's government concerning WTO obligations. (To commence once tariff concessions are negotiated.)

V. Protocol of Accession: This is a WTO document which outlines the conditions under which the applicant's accession is to be accomplished; it will outline any special conditions to be applied during any phase-in period following formal accession by the applicant. (To be negotiated and agreed upon once all previous phases are completed.)