

## **16. Foreign investments and system of incentives for industry**

Based on the defined project assignment, this chapter deals with:

- Analysis and given recommendations on possible ways and type of incentives of industrial production as well as craft and entrepreneurship in the Federation of Bosnia and Herzegovina,
- Economic and legal framework for foreign investments and promotion of export orientation,
- Possible directions of state actions for removal and mitigation of technological backwardness and restrictions in favour of industrial development and faster access to the European Community funds, and creation of conditions and environment for a modern, profitable, export oriented industrial production.

### **Work methodology**

Collecting and processing of data from different sources through:

1. Questioning of economic entities. They were selected on the project-level and this section includes companies from:
  - Metal Processing industry
  - Electro industry
  - Military industry
  - Chemical and pharmaceutical industry
  - Wood processing industry
  - Leather, textile and footwear industry
  - Civil engineering
2. Collecting and processing of data provided by the relevant institutions of counties, Federation of Bosnia and Herzegovina, Bosnia and Herzegovina.
3. Collecting and processing of literature sources and different analyses performed in Bosnia and Herzegovina and in the countries of surrounding region during the past period, as well as certain number of studies to the subject of foreign investments in

transition countries up to now conducted by prominent world and European institutions.

4. Existing condition survey to the question of foreign investments and other forms of incentives for the industry as well as entire legal-economic framework, making certain comparisons to the countries of the European Union as well as transition countries, as Bosnia and Herzegovina is itself.
5. Making proposals and recommendations as possible answers to the given project assignment.

## 16.0 Introduction

It is a general conclusion that according to economic indicators Bosnia and Herzegovina is lagging behind some more developed transition economies. The country needs economic growth that would enable faster economic integration with the European Union (EU) and therewith raise life standard of all of its citizens. Sustainable economic growth critically depends on the amount and quality of investments made by companies. When turning their creative ideas into profitable projects, entrepreneurs need access to the internal and external sources of finance. Retained earnings are often not enough to make more serious investments; therefore companies need external source of finance.

There are three basic possibilities for companies to get external finance:<sup>1</sup>

1. Bank loans,
2. Capital Market and
3. Foreign Direct Investment

Problem with the banks is that they are generally not willing to credit companies as much as needed, especially in the transition economies.

Capital market here definitely does not play the part it does in the developed states, judging by the low level of market capitalisation and transparency.

Foreign direct investment represents a special form of finance. It comprises equity investment in the amount over 10% of common stock or voting right, direct investor's share in reinvested earnings, and other direct invested capital, composed of crediting between direct investor and subsidiary (United Nations, 2001:195). Basically, FDI may be Greenfield investments, or mergers and acquisitions. In the transition economies FDI has proven to be more stable source of finance than any other inflow of foreign capital and it mostly does not create debts in foreign currency. Special importance of FDI for Central and Eastern European Countries (CEEC) lies in the import of know-how of foreign companies, which is especially important in restructuring transition economies towards more concurrent system. Furthermore, foreign investor makes easier access to other

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<sup>1</sup> Cvijanović, V., Kušić, S., Izravna strana ulaganja kao izvori financiranja, *Financijska teorija i praksa (Foreign Direct Investment as sources of finance, Financial Theory and praxis)* 26 (4) p. 879-893, Zagreb, 2002

markets. In general, international risk and country's ranking according to the level of implemented reforms are positively correlated with the capacity of FDI that a country manages to achieve.

When searching for answers to the set project assignment, foreign investments shall take the most of the attention, but other forms of incentives to the companies shall also not be left out.

## 16.1 Possible ways of incentives for the industrial production in the Federation of Bosnia and Herzegovina

As part of the realisation of this part of the subject area, a survey of the existing condition has been conducted based on the common questionnaire containing 8 questions directly related to the foreign investments and system of development incentives. That part of the questionnaire is visible in Appendix V, part L.

In the course of our work we analysed total of 59 companies from different industrial branches. Questionnaires we processed were related to the companies shown in Table 16.1.

**Table 16.1** Companies with questionnaires processed

No.	Name and seat of the company	No.	Name and seat of the company
<b>Metal and Electro industry</b>		<b>Chemical and pharmaceutical industry</b>	
1.	FEAL d.o.o. Široki brijeg	1.	DITA INDUSTRIJA DETERDŽENATA D.D.TUZLA
2.	FE-AL d.o.o. Mostar	2.	SISECAM " SODA D.O.O. LUKAVAC
3.	Livnica Čelika Tuzla	3.	POLIOLCHEM D.O.O. TUZLA
4.	P.D. Igman d.d. Konjic	4.	SOLANA D.D. TUZLA
5.	Elektroremont d.d. Banovići	5.	KOKSARA LUKAVAC
6.	Remontmontaža d.d. Tuzla	<b>Military industry</b>	
7.	ALUMINIJ d.d. MOSTAR	1.	UNIS „GINEX“ d.d. za proizvodnju i promet hemikalija, pripalnih i inicirajućih sredstava Goražde
8.	ENERGOINVEST, d.d. Sarajevo	2.	P.D. Igman d.d. KONJIC
9.	Fabrika autodijelova Jelah-Tešanj	3.	PRETIS d.d.VOGOŠĆA
10.	„Metalno“ Zenica	4.	Dioničarsko društvo za preciznu mehaniku, optiku, optoelektroniku i elektroniku ZRAK d.d. Sarajevo
11.	PETROLINVEST d.d. Sarajevo	<b>Wood processing industry</b>	
12.	UNIS PRETIS ds.o.o Vogošća	1.	DALAS BH d.o.o. Sarajevo- Ilidža
13.	P.D.RUDSTROJ d.d. Kakanj	2.	EKONOMIC d.o.o. Vitez
14.	Strolit d.o.o, Odžak	3.	JADRINA d.o.o Gračanica
15.	TVORNICA ALATA GORAŽDE D.D.	4.	ŠIPAD-EKSPORT IMPORT d.d. za trgovinu i inženjering Sarajevo
16.	„UNIKLIMA“ d. d. Sarajevo	5.	MALAGIĆ d.o.o Živinice
17.	Željezara „Ilijaš“ d.d. Ilijaš	6.	PALAVRA d.o.o. Nova Bila
18.	ŽICA d.d. Sarajevo	7.	KONTINENTAL d.o.o Kiseljak
19.	Arcelor Mittel Zenica	8.	TAMEX d.o.o. Busovača

20.	Elektrokontakt Vareš		<b>Leather, textile and footwear industry</b>
21.	ENKER TEŠANJ	1.	FORTUNA d.d. Gračanica
22.	FAMOS SARAJEVO	2.	IMK KULA d.o.o. Gradačac
23.	HELIOPLAST GRAČANICA	3.	KONFEKCIJA BORAC D.D. TRAVNIK
24.	UNIS KOVINA VISOKO	4.	VIS d.o.o. Gornji Vakuf- Uskoplje
25.	MANN HUMMEL TEŠANJ	5.	BONTEX d.o.o. Maglaj
26.	POBJEDA TEŠANJ		<b>Civil engineering</b>
27.	TMD AI GRAČANICA	1.	GRANIT d.d. Jablanica
28.	UNITAC SARAJEVO	2.	SIPOREX d.d. Tuzla
29.	PREVENT SARAJEVO		
30.	«BIRA» d.d. Bihać		
31.	ELIR «Nikola Tesla» d.d. Tuzla		
32.	«GRAEWE TADIV» d.o.o		
33.	SOKO-Tvornica Transmisija d.o.o		
34.	«TGA»Dioničko društvo, STOLAC		
35.	Jajce Alloy Wheels Jajce		

The collected data were processed based on the questions asked and a thorough analysis has been made<sup>2</sup>. That information contained total of 52 processed questionnaires received by that time. In the meantime, 7 more questionnaires arrived and were processed.

As visible from the form of the questionnaire, analysed were the following possible ways of incentives to the industrial production:

- Incentives by the Government of the Federation or County,
- Incentives based on foreign investments,
- Incentives from different funds,
- Incentives based on investments through transfer of new technologies and
- Other incentives.

Table 16.2 contains data expressed in physical units (KM) of the mentioned incentives. Percentages shown in the table represent ratio between number of business entities that were using some of the incentives and total number of entities from the belonging group of entities. Table clearly shows the following:

- Two groups (wood processing and civil engineering) have not been using any incentives,
- The most used incentive was foreign investment (15 entities out of total of 59, i.e. 25.42 %),
- The second most used incentives (but not second according to value) were incentives provided by the Government of the Federation or Counties)

<sup>2</sup> Overview of the answers to all questions of the questionnaire regarding foreign investments and incentives can be found in Appendix 1

Table 16.2 Amounts of investments according to the type of incentive

Sector (Industry)	Government of the Federation	Foreign investment	Funds	Technology transfer	Other
<b>Metal processing and Electro (35 entities)</b>	1,128,000 5/35 (14.28%)	136,699,305 12/35 (34.28%)	50,000 1/35 (2.8%)	889,972 2/35 (5.7%)	61,150,000 4/35 (11.42%)
<b>Chemical pharmaceutical (5 entities)</b>		47,493,374 2/5 (40%)	65,700 1/5 (20%)	5,000,000 1/5 (20%)	26,000,000 1/5 (20%)
<b>Military (4 entities)</b>	400,000 1/4 (25%)				
<b>Wood processing (8 entities)</b>					
<b>Leather, textile, footwear (5 entities)</b>	450,000 2/5 (40%)	500,000 1/5 (20%)			
<b>Civil engineering (2 entities)</b>					
<b>TOTAL (59 entities)</b>	<b>1,978,000</b> <b>8/59</b> <b>(13.5%)</b>	<b>184,692,679</b> <b>15/59</b> <b>(25.42%)</b>	<b>115,700</b> <b>2/59</b> <b>(3.38%)</b>	<b>5,889,972</b> <b>3/59</b> <b>(5.08%)</b>	<b>87,150,000</b> <b>5/59</b> <b>(8.4%)</b>

Table 16.3 Types of incentives in percents

Sector (Industry)	Government of the Federation	Foreign investment	Funds	Technology transfer	Other	TOTAL
<b>Metal processing and Electro</b>	0.403%	48.851%	0.017%	0.318%	21.852%	<b>71.441%</b>
<b>Chemical pharmaceutical</b>		16.972%	0.024%	1.786%	9.291%	<b>28.073%</b>
<b>Military</b>	0.1429%					<b>0.1429%</b>
<b>Wood processing</b>						
<b>Leather, textile, footwear</b>	0.161%	0.1799%				<b>0.341%</b>
<b>Civil engineering</b>						
<b>TOTAL</b>	<b>0.7069%</b>	<b>66.004%</b>	<b>0.041%</b>	<b>2.104%</b>	<b>31.143%</b>	<b>100%</b>

On the other hand, it is interesting to show percentage of participation of certain types of incentives in total amount of incentives. Those data are shown in Table 16.3. Visible are the following characteristic elements:

1. When focusing on the type of incentives, first place is held by incentives based on foreign investments (66.004%), second are incentives categorised as other (31.143%).
2. Foreign investments are the most represented in all groups that were using that type of incentive.
3. The highest percentage (71.441%) of all incentives was used in metal processing and electro sector, i.e. group.

Through insight into data provided in the filled out questionnaires, the following conclusion is derived:

- Out of total of 59 companies, 33 were using incentives funds (various sources) as follows:
  1. 8 companies were using incentives provided by the Government of the Federation or Counties,
  2. 15 companies were using incentives categorised as foreign investment,
  3. 2 companies were using incentives from the funds,
  4. 3 companies incentives based on investment through transfer of new technologies
  5. 5 companies incentives categorised as other sources.
- The least incentives, i.e. none were used in wood processing industry and civil engineering.
- Viewed from the aspect of value, foreign investments amount to 184,692,679 KM or 66.004% out of total amount of incentives funds of all bases
- Foreign investments were in most cases carried out through agreement signed with a foreign company, but there were also the following cases:
  1. Investments occurred during privatisation of the company,
  2. Investments provided by the government of another state,
  3. Foreign investment was provided by a private person.
- Opinion on the system of incentive measures of the Government of the Federation has a very wide range, from those who believe that the measures are catastrophic to those who believe they are good, but need improving. Here are some of the most frequent answers:
  1. There are no incentive measures whatsoever (Government's activities boil down to collecting information; we never received any sort of incentives, but we asked for it number of times; without evident and concrete

measures; almost as if there were none, poor promotion, nonexistence of cooperation with the employers),

2. Not coordinated with the competence of authorities of Bosnia and Herzegovina,
  3. There is no systematic approach; Organised and systematic incentive measures hardly exist,
  4. Due to the lack of development strategy we can hardly speak of a system of incentive measures,
  5. The system is non efficient and unjust. Incentives to existing companies are neglected,
  6. Information do not arrive in time, neither when they appear, nor during realisation,
  7. The Government needs to recognise priorities in development economic strategy and define measures for their realisation. Incentives need to be in function of strategic development,
  8. "The worst"; few and poor; bad, catastrophic.
- The most frequent problems that occurred during realisation of finance incentives viewed from the aspect of foreign investment are: long waiting period, mistrust of foreign investors, customs problems, high tax rates, long process of registration of foreign investment etc.

Information from the report Doing Business 2008 also speaks in favour of the aforementioned. This report ranked Bosnia and Herzegovina 105 out of 178 economies in terms of overall ease of doing business. When seen in the context of a proximate European market, this ranking seems like a missed opportunity. A closer look into Doing Business rankings indicates much worse performance in a number of areas: starting a business (rank 150), dealing with construction permits (rank 150), registering property (rank 144), paying taxes (rank 142), enforcing contracts (rank 126), employing workers (rank 114). On the other hand, areas in which Bosnia and Herzegovina has seemingly done well such as getting credit (rank 13) and closing business (rank 61) remain of practical concern to businesses in BiH.

More detailed information on the aforementioned is shown in Table 16.4.

**Table 16.4** Doing business in Bosnia and Herzegovina

Doing Business theme	Rank for 2007	Rank for 2008	Change*
Ease of doing business	105	105	0
Starting a business	147	150	-3
Dealing with construction permits	150	150	0
Employing workers	115	114	+1

Registering property	143	144	-1
Getting credit	12	13	-1
Protecting investors	81	83	-2
Paying taxes	143	142	+1
Trading across borders	67	53	+14
Enforcing contracts	125	126	-1
Closing a business	69	61	+8

Especially interesting is the information regarding business registration and commencement. The same source reports that a standard small or medium-sized enterprise needs to complete around 12 procedures over more than 54 days in order to commence operations legally. The number of procedures and duration has remained at the same level for three straight years. This data would suggest that the implementation of the reform programme has not yet caught up with the reality of what businesses face in Bosnia and Herzegovina. Although it is true that Bosnia and Herzegovina has made progress regarding business registration, cutting the number of steps and days needed, it still needs businesses a long time to *commence* operations.

It is important to point out that the differences under aforementioned elements exist between different counties and different towns, which is illustrated in the Table 16.5.

**Table 16.5** Subnational Doing Business Indicators

	BiH	Sarajevo	Banja Luka	Mostar
<b>Starting a business</b>				
Time (in days)	54	54	51	51
Price (% GNI per capita)	30	30	33	40
Procedures	12	12	11	11
<b>Licensing</b>				
Time (in days)	467	467	306	541
Price (% GNI per capita)	790	790	129	254
Procedures	16	16	16	16
<b>Registering property</b>				
Time (in days)	331	331	145	157
Price (% GNI per capita)	5	5	3	5.5
Procedures	7	7	11	8
<b>Enforcing contracts</b>				
Time (in days)	595	595	1.480	1.390
Price (% GNI per capita)	38	38	41	34
Procedures	38	38	38	38



- When speaking about existence of clear rights, obligations and privileges for foreign investment, it is a general opinion that they do exist, but with small suggestions for amendments to the law in order to attract investors. In this context, we quote an answer: "The law is clear, but it needs certain amendments in order to attract qualified investors, a clear and predictable legal and regulative framework is needed in order to eliminate insecurity that investors wish to avoid and to prevent monopoly".
- The procedure of approving and registering of foreign investment was found very slow and uncertain by great majority of examinees who answered,

It is interesting to show a few tables (16.6, 16.7, 16.8) comparing indicators for starting a business in Bosnia and Herzegovina, Armenia and Mauritius (Doing Business 2008).

**Table 16.6** Comparing procedures for Registering and Starting a Business

<i>Time to complete procedure noted in parentheses</i>		
<b>Bosnia and Herzegovina (Rank in starting a business = 150)</b>	<b>Armenia (Rank in starting a business = 47)</b>	<b>Mauritius (Rank in starting a business = 8)</b>
<b>1. Stipulate a founding act and have it notarized in the municipality office (1 day)</b>	1. Register the name of the company at the State Patent Department (2 days)	<b>1. Search for company name and reserve the proposed name (1 day)</b>
<b>2. Obtain a statement from commercial bank that full amount of the capital has been paid in; pay the registration fee to the budget account of the cantonal court (1 day)</b>	2. Procure a written statement of deposited charter capital at a bank (1 day)	<b>2. Incorporate and register the business (2 days)</b>
<b>3. Obtain the statement of tax authorities that the founders have no tax debts (1 day)</b>	3. Procure a registration card from the State Registry office and fill it out (1 day)	<b>3. Receive inspection by local authorities (around 4 days)</b>
<b>4. Court registration with the Cantonal court (15 days)</b>	4. Pay the registration fee at any bank (1 day)	<b>4.* Pay license fees (1 day, simultaneously with procedure 3)</b>
<b>5. Buy a company stamp (1 day)</b>	5. Register with the State Registrar (7 days)	<b>5.* Register with the Social Security Office (1 day, simultaneously with procedure 3)</b>
<b>6. Application for resolution on intended activities to the competent municipality (1 day)</b>	6. Register with tax authorities and obtain a tax identification number (TIN) (2 days)	<b>6.* Make a company seal (1 day, simultaneously with procedure 3)</b>
<b>7. Application for utilization permit to the Canton Ministry of Commerce (15 days)</b>	7. Obtain a right at National Police Department to order a seal for all official company transactions (1 day)	
<b>8. Apply for company identification number with the competent tax office (15 days)</b>	8. Order a seal (2 days)	
<b>9. Open a company account with commercial bank (1 day)</b>	9. Register with statistical office (1 day)	
<b>10. Enroll the employees in pension insurance with Pension Insurance Institute (Zavod za penziono osiguranje) (1 day)</b>		
<b>11. Enroll the employees in health insurance with Health Insurance Institute (Zavod za zdravstveno osiguranje) (1 day)</b>		

12. Adopt and publish a rule book on matters of salary, work organization, discipline, and other employee regulations.(1 day)		
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Table 16.7 Dealing with licences

<i>Time to complete procedure noted in parentheses</i>		
Bosnia and Herzegovina (Rank in dealing with licences = 150)	Georgia (Rank in dealing with licences = 11)	Denmark (Rank in dealing with licences = 6)
1. Obtain excerpt from the cadastre plan showing status of the land plot (7 days)	1. Request and obtain excerpt from the National Public Registry (1 day)	1. Request and obtain building permit with the municipality (40 days)
2.* Obtain excerpt from the land registry book showing proper registration (1 day)	2. Request and obtain terms of construction from Tbilisi Urban Planning Service (30 days)	2. Receive on-site inspection from the competent authority (1 day)
3. Obtain urban planning consent from the municipality (urban planning department) (30 days)	3. Request and obtain an engineering-geology study from a certified geology and engineering company (10 days)	3. Request and obtain electricity connection (5 days)
4. Obtain preliminary verification of the heating and electricity installations (29 days)	4. Request and obtain approval of Architectural - Construction design from Tbilisi Urban Planning Service (20 days)	4.* Request and obtain water supply and sewage connection (5 days)
5.* Obtain preliminary verification of the water supply and sewage system projects (28 days)	5. Request and obtain building permit from Tbilisi Urban Planning Service (10 days)	5.* Request and obtain telephone connection (5 days)
6.* Obtain preliminary verification of study on fire and explosion prevention (4 days)	6. Request and receive inspection for confirmation of connection to water/sewage service (2 days)	6.* Receive final on-site inspection and obtain exploitation permit (5 days)
7. Obtain validation of the technical audit of the main project (5 days)	7. Request and receive inspection for confirmation of connection to electricity service (2 days)	
8. Apply for the building permit with the municipality (30 days)	8 Request and obtain connection to telephone services (5 days)	
9. Request marking out of the land plot (7 days)	9. Request and obtain layout survey and protocol from Architectural Inspection Agency (1 day)	
10. Notify the municipality about the commencement of works (1 day)	10. Request and obtain protocol of completion of major building structure from Architectural Inspection Agency (1 day)	
11. Request telephone line connection (13 days)	11. Request and obtain exploitation of building – construction from the Special Commission (30 days)	
12.* Request water and sewage connection (10 days)	12. Register the building with the National Public Registry (1 day)	
13.* Request electricity connection (5 days)		
14. Request issuance of the building permit usage (30 days)		
15.* Receive technical inspection (1 day)		
16. Register the building in the cadastre book (315 days)		

**Table 16.8** Administrative burden of Paying Taxes

Bosnia and Herzegovina (Rank in paying taxes = 142)			Estonia (Rank in paying taxes = 31)			Mauritius (Rank in paying taxes = 11)		
Tax or mandatory contribution	Payments (number)	Time (hours)	Tax or mandatory contribution	Payments (number)	Time (hours)	Tax or mandatory contribution	Payments (number)	Time (hours)
Social security contributions	12	96	Social security contributions	0	34	Social security contributions	1	100
Corporate income tax	12	80	23/77 Income tax on actual and deemed distributions (dividends tax)	1	20	Corporate income tax	1	13
Payroll tax	0		Fringe benefit tax	0				
Fuel tax	1		Fuel tax	1				
Property tax	12		Land tax	1		Property Transfer tax	1	
Local property tax	1		Unemployment insurance contributions	0		Council tax	1	
			Heavy vehicle tax	4		Road tax	1	
Municipal fee	1		Advertising tax	1		Stamp duty	1	
Accident insurance contribution	0		Stamp duty	1				
Value Added Tax (VAT)	12	192	Value Added Tax (VAT)	1	27	Value Added Tax (VAT)	1	48
Total	51	368	Total	10	81	Total	7	161

- Following the answers concerning export plans, all plan to increase export, some from 10% up, others up to 100%.
- The question “What needs to be changed in the legislation?” had a wide range of answers, but they can all be summarised to necessity of thorough analysis of the legislation and its adjustment to EU legislation. After all, that is the aim of the Federation, and of course, of Bosnia and Herzegovina.

According to data published by FIPA BIH (Foreign Investment Promotion Agency of Bosnia and Herzegovina) in 2004, there are 13 laws in Bosnia and Herzegovina that refer to foreign direct investments:

1. Law on the Policy of Foreign Direct Investment
2. Law on Foreign Trade Policy
3. Customs Policy Law

4. Competition Law
5. Law on Free Zones
6. Industrial Property Law
7. Copyright Law
8. Law on Privatisation of Companies and Banks
9. Central Bank Law
10. Communications Law
11. Law on Associations and Foundations
12. Law on Concessions
13. Law on Indirect Taxation

## **16.2 Economic and Legal Framework for Foreign Investments and Promotion of Export Orientation**

### **16.2.1 Introduction**

Capital is an essential factor for the economic development of any country as well as for the social development based upon it. However, for many developing countries especially countries in transition, their own accumulated capital is insufficient in order to generate accelerated and balanced development. On the other hand, such countries do not have enough time on disposition today for long term process of concentration and centralisation of capital in a kind that it took place in Western countries at the beginning of the last century. The only remaining internal source for the financing of development is a deficit financing (expansive monetary and fiscal politics) which is very difficult to control and which is a potential threat to the stability of economy whereas foreign sources (usually conditioned character) are donor's aid, loans and foreign investments.

In the last decade the global economy development was characterised by positively significant lack of funds for financing the development, as much due to accentuated restrictive politics aiming to moderate inflation as for the declining trends of official development aid and deterioration of access to the global financial markets. Therefore, foreign direct investments (FDI) developed into very important potential source of capital for many countries. The domination of neoclassical economic doctrine has changed the negative attitude of less developed countries towards FDI, characteristic for 60ies and 70ies of the twentieth century, promoting FDI into the initiator of significant effects in production, knowledge and technology transfer, economic growth and development of the countries receiving investments. Nowadays, FDI is especially recommended for economies in transition characterised by chronic lack of funds for financing economic development – accelerated reforms require large amounts of financial assets and at the

same time economic activities are temporarily slowed down which even more extends the problem of scarcity of capital. For Bosnia and Herzegovina as a country that simultaneously endeavoured to make reconstruction after several years of war, accelerate economic development and perform the transition (political, legal, economic and social), the key question was also how to ensure the financing of these processes. Own funds were insufficient, access to foreign loans and international financial markets was limited due to political instability and inherited external debt and the possibility of reliance on expansive macroeconomic policies was withheld due to currency board arrangements and fiscal discipline suggested by international financial institutions. Therefore, in the first years after the war, foreign capital poured into BIH mainly in the forms of multilateral and bilateral aid. Nevertheless several years later donor's help was sensibly decreasing while economic activity was still mainly based on that external stimulus. At that time, many perceived attracting FDI as new stimulus for dynamisation of BIH economy. Attracting foreign investors became one of the top priorities. However, for that purpose it was essential to create suitable conditions: political, legal, institutional and economic.

By analysing volume, structure and dynamics of FDI inflow in the period from 1994 to 2007, the aim of this research was to enable insight in the presence of FDI in BIH and to identify main characteristics of investment climate in the country with special reference to advantages and incentives for attracting foreign investors. For this purpose analysis methods were used, notably descriptive and comparative, as well as descriptive statistics method. Research was conducted on the basis of secondary data sources, national and international.

## **16.2.2 Analysis of Foreign Direct Investments in BiH**

### **16.2.2.1 Volume and Movement of FDI in BiH**

In the period from 1995 to 2001 the annual inflows of FDI in BIH were very low so the total registered amount of FDI in BIH was negligible both in absolute terms and comparing to the neighbouring countries. For illustrative purpose, total accumulated amount of FDI in BIH in the abovementioned period was lower than the inflow of FDI in Croatia only in 2001. Major part of the capital inflow in BIH refers to small companies i.e. scattered investment (usually only minimum participation regulated by law) directed mostly to market surveys, without serious intention of investor to perform business in BIH in near future. However, in 2002 there was a trend reversal and sharp rise in FDI inflows no less than 120% comparing to the previous year.<sup>3</sup> From that time till today FDI inflow in BiH records a continuous growth. In 2007 foreign investors invested three times more in BiH than previous year and ten times more than seven years earlier. Total amount of FDI has reached 4.6 billion EUR. Volume and movement of FDI in BiH in time period from 2000 to 2007 is shown in Table 16.10 and figure 16.1 shows FDI inflow for the time period from 1999 to 2007.

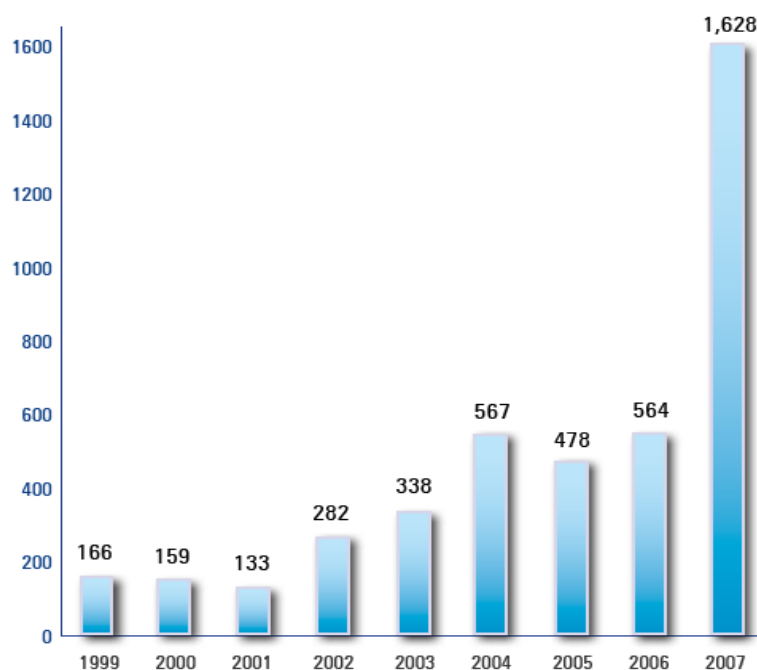
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<sup>3</sup>Ministry of Foreign Trade and Economic Relations of BiH, Report on FDI in BiH, Working documents, Sarajevo, 2003

**Table 16.10** Volume and movement of FDI in BiH (2000-2007)

Indicators	2000	2001	2002	2003	2004	2005	2006	2007*
Annual inflow of FDI (mill EUR)	159	133	282	338	567	478	564	1.628
FDI contribution to GDP (%)	2.9	2.2	4.3	4.6	7.0	5.5	5.8	14.0

\*estimation (Source: FIPA, Investment Opportunities 2008, Sarajevo, 2007)

**Figure 16.1** FDI inflow in BiH (1999-2007) in mill EUR

Source: FIPA, Investment Opportunities 2008, Sarajevo, 2007.

It is evident that certain progress was achieved in attracting FDI. However, if we take into consideration needs for investments in BiH economy or if we compare data on volume and movement of FDI in BiH with data of the same type in other countries of South-eastern Europe, the fact is that progress is insufficient for substantial change in economic situation in the country. According to EBRD data, by the annual FDI inflow BiH is slightly ahead of Albania, Macedonia and Montenegro but considerably behind Romania, Bulgaria, Croatia and Serbia (Table 16.11). Annual FDI inflow in Croatia in 2007 is even now, just like several years ago, larger than total amount that foreign investors brought into BiH in ten years period (1997-2007).

**Table 16.11** FDI in Southeast European countries (2007)

mill

USD

Country	FDI inflow		Total amount of FDI
	2006	2007*	
Romania	11,430	9,659	32,087
Bulgaria	7,333	8,154	21,507
Croatia	3,170	3,845	12,661
Serbia	4,264	2,195	8,895
Bosnia and Herzegovina	423	1,600	3,111
Albania	325	623	2,235
Macedonia	424	321	1,795
Montenegro	650	1,000	1,333

\*estimation (Source: [www.ebrd.com](http://www.ebrd.com) <http://www.ebrd.com/country/sector/econo/stats/mptfdi.xls> )

### 16.2.2.2 Structure of FDI in BiH

Foreign investments could be in different forms and different structure (proprietary, sectoral, geographical etc.). Investment can be performed in the form of cash, assets or rights. This may involve merger or acquisition of existing companies, which is usually related to privatisation projects or a completely new investment so-called Greenfield investment. In terms of ownership of the investment, there are wholly foreign-owned investments and so-called joint ventures i.e. joint investments of foreign and domestic partners. Foreign investments could be structured differently regarding sector – depending on how much is invested in manufacturing and service sectors of economy.

When speaking about the need for attracting foreign investments, one should have in mind that it is not enough only to increase its annual inflows but it is necessary to attract foreign investments of a certain quality respectively structure. All forms of FDI do not have the same developing potential. In terms of countries in transition the biggest contribution to dynamization of the economies is expected from Greenfield investments in manufacturing sector. Nevertheless, the greatest part of FDI in most of countries in transition as well as in BiH is directly connected to the process of privatisation; there are much less Greenfield investments. In 2007 Greenfield investments in BiH contributed with 40% in total FDI. Sectoral structure of FDI in BiH is also unfavourable whereas the major amount of foreign capital is invested in industries with low added value. Sectoral structure of FDI in BiH shows that foreign capital was invested with 48.4% in manufacturing (namely in manufacturing of semi-finished products) whilst 45.7% was invested in service industry. Considering annual FDI inflows in certain sectors in the period from 2004 to 2007, the figure is somewhat more favourable because it is evident that in the last years FDI grow in manufacturing, while FDI in particular types of services mostly stagnate or fall. The abovementioned is shown in Table 16.12.

**Table 16.12** FDI inflow in BiH by sectors of economy

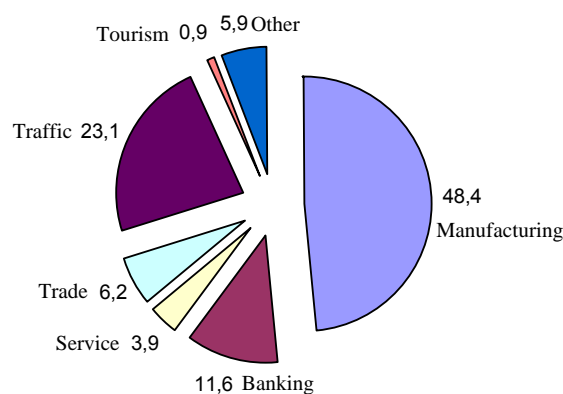
mill EUR

Sectors	2004	2005	2006	2007*
Manufacturing	216	102	153	600
Banking	151	214	241	69
Trade	60	31	37	130
Service	25	28	29	5
Other financial service	73	92	91	31
Tourism	24	-2	-	6
Transport	9	3	2	11
Telecommunication	2	4	4	683
Real estate	7	6	7	93
Total:	567	478	564	1,628

\*estimation (Source: FIPA, Investment Opportunities 2008, Sarajevo, 2007)

Sectoral structure of foreign investments (Figure 16.2) that is not adequate to developing requirements of the country is among all a consequence of certain imperfections in laws on foreign investments. No differentiation has been made in the law between foreign investors regarding tax reliefs – tax reliefs are given linearly and therefore investors who would invest in export oriented production projects are not additionally stimulated.<sup>4</sup>

With respect to form of investment, major part of FDI in BiH makes the money i.e. cash – 80.5%, items (equipment and construction buildings) 18.7% and rights 0.8%<sup>5</sup>.

**Figure 16.2** Sectoral structure of FDI in BiH

Source: Ministry of Foreign Trade and Economic Relations of BiH, Data on direct foreign investments from May 1994 to 31/12/2007, Sarajevo, February 2008

(Manufacturing 48.4, Banking 11.6, Service 3.9, Trade 6.2, Traffic 23.1, Tourism 0.9, Other 5.9, note by the translator)

<sup>4</sup> Dr Fikret Čaušević, PhD »Konkurentnost ekonomije i upravljanje državama kroz međunarodna pravila« (*Competitiveness of Economy and State Governance through International Regulations*), in: Academy of Sciences and Arts of BiH, Centre for Management and Information Technologies EFSA and World Economic Forum, »BiH Competitiveness Report 2004-2005«, Sarajevo, 2005, page 48

<sup>5</sup> Ministry of Foreign Trade and Economic Relations of BiH, »Data on direct foreign investments from May 1994 to 31/12/2007«, Sarajevo, February 2008, page 2



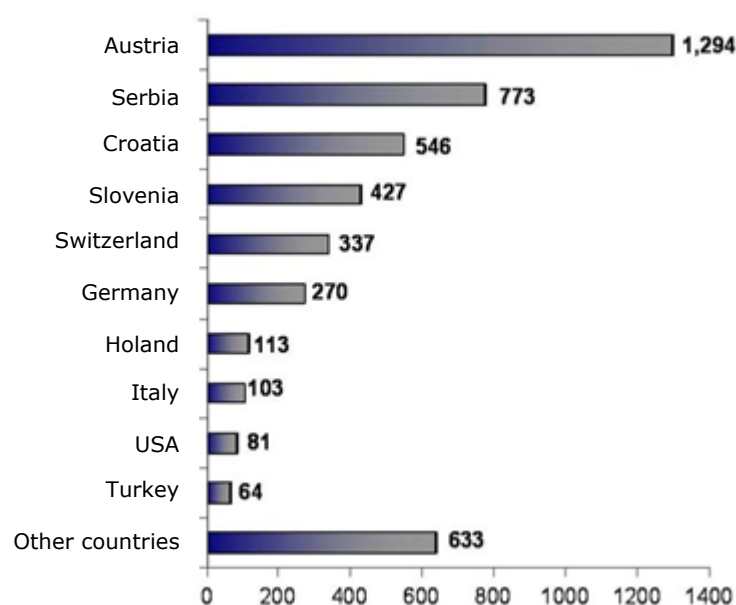
Monitored by the countries of origin, FDI in BiH originate from 89 world countries. However, almost 90% of FDI come from ten countries out of which five are European Union members, as shown in Table 16.13 and following Figure 16.3. Most of FDI come from investors from Austria followed by Serbia, Croatia and Slovenia.<sup>6</sup>

**Table 16.13** Total FDI in BiH by the countries of origin (May 1994 - December 2007) mill EUR

	December 2005	December 2006	December* 2007
Austria	929	1,190	1,294
Serbia	51	65	773
Croatia	357	423	546
Slovenia	278	365	427
Switzerland	51	203	337
Germany	221	255	270
Netherlands	77	95	113
Italy	52	75	103
USA	31	27	81
Turkey	29	53	64
Other countries	387	262	633
Total:	2,463	3,013	4,641

\* estimation; Note: FDI does not include plow back profits

FDI by the countries of origin,  
May 1994 - December 2007



**Figure 16. 3** Total FDI in BiH by the countries of origin

<sup>6</sup> Ministry of Foreign Trade and Economic Relations of BiH, Ibidem, page 2

### 16.2.2.3. Volume and structure of FDI in Federation BiH<sup>7</sup>

According to the data of the Ministry of Foreign Trade and Economic Relations of BiH as from 1 January 2008 to 31 December 2008 (Table 16.14, overview of registered foreign investments in F BiH), total amount of investments in Federation BiH was 436,096,000 KM or 59.1% out of total investment of foreign capital in BiH. In 2008 total investment of foreign capital in BiH was 737,838,000 KM.

**Table 16.14** Foreign investments in FBiH for period from 01/01/2007 to 31/12/2007 and period from 01/01/2008 to 31/12/2008 (in 000 KM)

PERIOD FROM 01/01 TO 31/12	2007	2008	INDEX
Foreign invested funds	443,929	436,096	98.23

Source: Ministry of Foreign Trade and Economic Relations of BiH (MVTEO BiH)

Comparative data on foreign investments for 2007 and 2008 is given in Table 16.14. From the abovementioned table one can perceive that the amount of 443,929,000 KM of foreign capital was invested in Federation BiH in 2007, while 436,096,000 KM was invested in the same period of 2008. In conclusion, with regards to the same time period in 2007, 7.8 million KM or 1.8% less foreign investments were realised in 2008. Overview of the investments by industries is given in the following Table 16.15.

**Table 16.15** Comparative overview of foreign investments in FBiH by industries of investment for the time period from January to December of 2007 and 2008

(in 000 KM)

No.	INDUSTRY	Amount of foreign investments for time period 2007	% share	Amount of foreign investments for time period 2008	% share	Index 2008 2007
1	MANUFACTURING	229,039	51.60	247,497	56.75	108.05
2	TELECOMMUNICATION	75,374	16.98	1,685	0.38	2.23
3	TRADE	67,001	15.10	94,910	21.76	141.65
4	OTHER SERVICES	66,382	14.95	-	-	-
5	Other companies up to 100,000 KM	3,103	0.70	5,087	1.16	163.93
6	FINANCE	1,385	0.31	1,362	0.31	0.98
7	TOURISM	1,366	0.30	6,358	1.50	465.44
8	SERVICE	279	0.06	13,931	3.19	4993.18
9	BANKING	-	-	48,352	11.08	-
10	INSURANCE	-	-	12,942	2.96	-

<sup>7</sup> Taken and review of Ivica Cvjetković, MSc

11	TRAFFIC	-	-	3,972	0.91	-
	<b>TOTAL</b>	<b>443,929</b>	<b>100</b>	<b>436,096</b>	<b>100</b>	<b>98.23</b>

Source: Ministry of Foreign Trade and Economic Relations of BiH (MVTEO BiH)

Comparative overview of foreign investments in Federation BiH by industries of investment for years 2007 and 2008 is given in previous table 16.15. It is visible from the abovementioned table that the greatest part of foreign investments in years 2007 and 2008 was invested in manufacturing, 8% more than in the year 2007. In 2008 247.5 million KM or 56.75 % of total invested funds was invested in manufacturing segment.

It is visible from abovementioned table that the significant investment is accomplished also in the trade segment and it amounts up to 94.9 million KM or 21.7% of total foreign investments in 2008. It is necessary to point out that trade segment scores considerable increase of investment in 2008 with 41.6% compared to 2007. Third largest investment sorted by industry refers to investment in banking and total investment amounts up to 48.3 million KM or 11% of total investment in 2008. Overview by the countries of investment is given in the following Table 16.16.

**Table 16.16** Comparative overview of foreign investments in FBiH by countries of investment (significant investors) for the time period from January to December of 2007 and 2008 (in 000 KM)

No.	COUNTRY	Amount of foreign investments for time period January-December 2007	% share	Amount of foreign investments for time period January-December 2008	% share	Index 2008 2007
1	AUSTRIA	131,279	29.57	96,407	22.12	73.44
2	CROATIA	123,346	27.80	53,471	12.26	43.35
3	SLOVENIA	30,822	6.96	154,581	35.46	501.52
4	HUNGARY	23,002	5.18	2,934	0.67	13.75
5	NETHERLANDS	22,254	5.01	110	0.02	0.49
6	SAUDI ARABIA	21,531	4.85	8,258	1.89	38.35
7	ITALY	18,658	4.20	3,653	0.84	19.57
8	UAE	18,374	4.13	-	-	-
9	LIECHTENSTEIN	9,818	2.21	-	-	-
10	SERBIA	7,471	1.68	6,092	1.41	81.54
11	SWEDEN	6,907	1.55	860	0.20	12.45
12	GERMANY	6,247	1.40	8,676	1.98	138.88
13	SWITZERLAND	4,638	1.04	49,290	11.30	1,062.74

14	USA	4,278	0.96	6,917	1.58	161.68
15	Other countries (up to 100,000 KM)	3,103	0.70	5,087	1.18	163.93
16	POLAND	2,738	0.62	-	-	-
17	UNITED KINGDOM	2,527	0.57	842	0.19	33.32
18	TURKEY	2,202	0.50	9,919	2.28	450.45
19	DENMARK	1,255	0.28	-	-	-
20	SPAIN	1,173	0.26	-	-	-
21	MONTENEGRO	774	0.17	1,600	0.37	206.71
22	SLOVAKIA	558	0.13	-	-	-
23	ICELAND	360	0.08	205	0.06	56.94
24	CZECH REPUBLIC	293	0.07	1,893	0.43	646.07
25	FRANCE	205	0.05	16,6	0.03	80.97
26	LUXEMBOURG	116	0.03	9,876	2.26	8,513.70
27	KUWAIT	-	-	4,500	1.04	-
28	HONG KONG	-	-	4,325	0.99	-
29	NORWAY	-	-	4,067	0.93	-
30	BULGARIA	-	-	1,941	0.45	-
31	BAHRAIN	-	-	300	0.07	-
32	BELGIUM	-	-	126	-	-
	<b>TOTAL</b>	<b>443,929</b>	<b>100</b>	<b>436,096</b>	<b>100</b>	<b>98.23</b>

Source: Ministry of Foreign Trade and Economic Relations of BiH (MVTEO BiH)

Table 16.16 shows comparative overview of foreign investments in Federation BiH by the countries of investment in 2007 and 2008. It is visible from the mentioned table that the largest foreign investment in 2007 refers to Austria and in 2008 to Slovenia. Therefore, in 2007 the largest foreign investment inflow was realised from Austria and it amounts up to 131.2 million KM or 29.6%, followed by Croatia in the amount of 123.3 million KM or 27.8% and Slovenia was at the third place by the amount of invested funds in F BiH with the share of 30.8 million KM or 6.9%.

However, in 2008 there was a shift so the greatest foreign investment inflow was realised from Slovenia and it amounts up to 154.5 million KM or 35.4% of total realised investment in 2008, followed by Austria with 96.4 million KM invested or 22.1% and Croatia with 53.4 million KM invested or 12.26%. The following Table 16.17 shows the overview of investment by the towns of investment in Federation BiH.

**Table 16.17** Comparative overview of foreign investments in FBiH by towns of investment for the time period from January to December of 2007 and 2008

(in 000 KM)

No.	TOWN	Amount of foreign investment for time period from January to December 2007	% share	Amount of foreign investment for time period from January to December 2008	% share	Index 2008 2007
1	SARAJEVO	166,856	37.58	150,820	34.58	90.38
2	LUKAVAC	114,485	25.78	1,919	0.44	1.67
3	MOSTAR	78,538	17.70	64,942	14.89	82.64
4	ZENICA	11,535	2.59	69,122	15.85	599.23
5	TRAVNIK	11,062	2.49	2,563	0.58	23.16
6	BIHAĆ	7,204	1.54	28,131	6.45	390.49
7	TOMISLAV GRAD	4,947	1.11	6,345	1.45	128.25
8	JAJCE	2,932	0.66	11,450	2.62	390.51
9	ČITLUK	2,053	0.46	7,098	1.62	345.73
10	VISOKO	1,409	0.31	2,060	0.47	146.20
11	ŠIROKI BRIJEG	1,223	0.27	2,033	0.46	166.23
12	TEŠANJ	898	0.20	1,389	0.31	154.67
13	GRADAČAC	869	0.19	14,819	3.39	1705.29
14	LJUBUŠKI	-	-	-	-	736.2
15	TUZLA	418	0.09	7,222	1.65	1727.75
16	DRVAR	391	0.08	293	0.06	74.93
17	ČAPLJINA	312	0.07	1,699	0.38	544.55
18	VITEZ	180	0.04	3,878	0.88	2154.44
19	Other	31,746	8.51	30,296	6.93	95.43
	<b>TOTAL</b>	<b>443,929</b>	<b>100</b>	<b>436,096</b>	<b>100</b>	<b>98.23</b>

Source: MVTEO BiH

It is visible from the abovementioned table that the largest investment in 2008 was realised in Sarajevo with 150.8 million KM or 34.5% of total investments in F BiH. The second largest place takes Zenica with invested 69.1 million KM or 15.8% followed by Mostar with 64.9 million KM or 14.9%.

### **16.2.3 Investment Climate in BiH**

“It would be incorrect to say that Bosnia and Herzegovina deteriorated in the last five years. It would be unrealistic to say that it significantly moved forward. The truth is as usual somewhere between these two opposites. If we take into consideration situation where BiH started its development after the war then the progress, although slow, is certainly evident and very important. On the other hand, if we consider the development of the countries in the region (even without the burden of the war unlike BiH, certainly go through very difficult and turbulent processes of transition) and take our expectations into consideration then we can really say that Bosnia and Herzegovina is in the phase of stagnation.”

Bosnia and Herzegovina is a country that experienced three types of transition in the last fifteen years:

1. transition from war to sustainable peace;
2. transition from the politically controlled economy to market economy;
3. transition from economy moved by international aid to self sustainable economy.

The last two transition processes are still in progress. In spite of the fact that certain positive results are achieved, structural reforms did not develop at a planned rate due to the impact of various external and internal, political and economic factors. Slow rate of the reform processes especially of the privatisation process unfavourably reflected the economic activity within the country. All of that inevitably influenced investment climate in BiH namely political, legal, institutional and macroeconomic conditions that create an environment for foreign investments.

#### **16.2.3.1 Political Stability**

The security of investment as one of the key factors for decision making on investment substantially depends on political stability of the country receiving investment and its environment. When the political situation in BiH is in issue, it is evident that there is a noticeable non-commercial investment risk for many years now. Political system in BiH cannot ensure adequate stability due to its complexity and exposure to constant changes. Numerous factors cause this system state but the most influential ones are the transition from one political system to another, to which the population has not conformed yet, and the conflict of ethnic interests that obstructs the function of government institutions.

Public opinion surveys show that there is a dominant sense of political and institutional instability and citizen distrust of the work of domestic and foreign institutions. The reasons for this are first of all in a weak government structures due to the ethnic division, the complexity of the system of government based upon the domination of particular and ethnic interests over the state and common interest, followed by inability of existing institutions to ensure evident and continuous progress, inability of decision making by internal consensus and high dependence on international factors in the process of political decision making.<sup>8</sup>

According to the trends of political and interethnic stability of BiH, mostly characterised by declining trend in 2007 and first part of 2008, it is evident that it came to the significant aggravation of the political and institutional situation in the country compared to the period between 2000 and 2006.<sup>9</sup> "Last year (2007) was the year of general political conflicts..., and increasing concerns and involvement of international community. All the aforementioned was also followed by ubiquitous sense of paralysed institutions, namely at the government level, and almost complete lack of progress regarding reforms or membership in the EU. Circumstances were additionally aggravated by the impairment of economic climate... Tensions were mounting gradually and constantly (1) between entities, (2) between and within various ethnic groups, and (3) between home politicians and their European or other international interlocutors."<sup>10</sup>

Social stability index reflecting problems that BiH as a society is facing, recorded decline through 2007 and 2008. Different political events and economic pressure generating constantly high unemployment rate, low income, growth of prices of fuel and essential groceries, lack of appropriate government social programmes and so on, led to appreciable growth of pessimism within population and growth of social tensions, which increases the possibility of occurrence of public disturbances.<sup>11</sup>

Political situation in BiH is additionally complicated by the belonging to the region that is exposed to constant political turbulences, even armed conflicts, from ex Yugoslavia collapse over turmoil in Macedonia, separation of Serbia and Montenegro to always actual issue of Kosovo independence. All these events have negative influence to the investor's perception of the region as a whole as well as of the individual belonging countries.

### **16.2.3.2 Legal and Institutional Framework**

#### **16.2.3.2.1 Legal framework**

Legal framework for the foreign investments in BiH is created from the sources of international and national law directly or indirectly related to this area. The first group consists of multilateral conventions that BiH signed, accepted or approved and bilateral

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<sup>8</sup> Ibidem, page 37

<sup>9</sup> UNDP, Early Alert System, »Annual Report 2007«, Sarajevo, 2007, page 78

<sup>10</sup> Ibidem, pages 7-9

<sup>11</sup> Ibidem, pages 13-14.

agreements signed, while the second group consists of Constitution, legal and sub-legal acts. Special importance is given to these international legal acts by the fact that they represent hierarchically higher type of legal sources in relation to domestic legal acts: "In case of conflict, the provisions of international agreements and contracts where Bosnia and Herzegovina is one of the parties have stronger legal strength than the provisions of this law" (Law on the Policy of Foreign Direct Investments in BiH, Article 24).

### **International Legal Acts:**

In the period between 1993 and 1997 BiH became a party to several multilateral conventions, among which we point out the following: "Convention on the Settlement of Investment Disputes between States and Nationals of Other States as of 1965" (ICSID), "The Convention Establishing the Multilateral Investment Guarantee Agency as of 1987" (MIGA Convention), and „Energy Charter Treaty" as of 1994 (ECT).

Bilateral agreements affecting the area of foreign investments are the agreements on improvement and protection of investments and the avoidance of double taxation. The purpose of the agreement on investments is providing legal security, protection, adequate treatment and even privileged status for foreign investors, at the same time protecting the interest of a host country. In most cases their contents are standardized, which provides an equal legal treatment for all foreign investors. The most important provisions refer to non-discriminatory treatment of foreign investors and their investments (national treatment or treatment of the most favourable nation), protection from non-commercial risk (risk of war, other armed conflicts or riots, risk of nationalisation or expropriation) and guaranty of free transfer of funds originating from the investment.

From the end of the war until today BiH has signed/ratified 36 agreements on fostering and protection of foreign investments, namely with the following countries and organisations: Austria, Belgium, Luxembourg, Belarus, Czech Republic, Denmark, Egypt, France, Finland, Greece, Netherlands, Croatia, India, Iran, Italy, Jordan, Qatar, China, Kuwait, Hungary, Macedonia, Malaysia, Moldova, Germany, Pakistan, Portugal, Romania, United States of America, Slovenia, Serbia and Montenegro, Spain, Switzerland, Sweden, Turkey, United Kingdom, Ukraine, OPEC Fund for International Development. Certain number of agreements is also initiated or it is in the process of negotiations namely with the following countries: Albania, Algeria, Bulgaria, Libya, Poland, Republic of Ireland, Russian Federation etc.<sup>12</sup>

Agreements on avoidance of double taxation are also important for foreign investors. By now, BiH has signed 27 such agreements with the following countries: Belgium, Czech Republic, Denmark, Egypt, France, Finland, Greece, Netherlands, Croatia, Iran, Italy, Jordan, Cyprus, Hungary, Moldova, Norway, Germany, Pakistan, Poland, Romania, Slovakia, Slovenia, Serbia, Sweden, Turkey, United Kingdom, United Arab Emirates. With the following countries, the agreements on avoidance of double taxation have been

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<sup>12</sup>[http://www.komorabih.ba/UserFiles/Image/Sprazumi\\_web\\_novembar\\_07.pdf](http://www.komorabih.ba/UserFiles/Image/Sprazumi_web_novembar_07.pdf); <http://www.fipa.gov.ba/#>



initiated but not signed yet: Albania, Austria, Belarus, Qatar, Kuwait, Latvia, Macedonia, Malaysia, Malta, Russia, Syria and Spain.<sup>13</sup>

### **Domestic legislation:**

One of the first steps that BiH did in order to create favourable environment for foreign investments was making adequate legal framework providing not only legal security but also number of privileges for foreign investors. In the post-war period numerous legal acts were adopted directly or indirectly affecting investment and business climate in BiH: laws referring to foreign investments (Law on the Policy of Foreign Direct Investment, Law on Foreign Investment of the Federation BiH, Law on Foreign Investment of Republika Srpska), laws on free zones, concessions, privatisation, enterprises, work and employment, transfer of ownership etc.

The aim of the legislation directly regulating the area of foreign investments is to establish a clear, transparent, predictable and stable policy of foreign investments and organise legal framework to provide rights, privileges and protection of foreign investors<sup>14</sup>. The basis for this legislation represents the Law on the Policy of Foreign Direct Investment adopted on a state level in 1998. It is a framework law, i.e. "umbrella" legislation regulating basic policies and principles of participation of foreign investors in the BiH economy. This law was assessed by the international community as non-discriminative and highly liberal.

Entity-level foreign investment laws were adopted only several years later (Federation BiH 2001, Republika Srpska 2002). The reason for postponement was very poor cooperation between state and entity authorities in the aforementioned period, which disabled creation of the common economic space, i.e. created serious barriers for development of entrepreneurship in general, involving foreign investments as well.<sup>15</sup>

However, with purpose of objectivity and facts, it is necessary to mention that the Law on Foreign Investments (Official Gazette FBiH No. 2/95) had been adopted in the Federation BiH back in 1995. That Law regulated the implementation of the administrative procedure, i.e. registration of the foreign direct investments in the Federation BiH, performed by the Federal Ministry of Trade and Tourism since 1996, i.e. since establishment of the aforementioned Ministry.<sup>16</sup>

Law on the Policy of Foreign Direct Investment in BiH (Official Gazette BiH No. 17/98) was adopted three years later. Article 5 of the aforementioned Law defines under a)

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<sup>13</sup>[http://www.komorabih.ba/UserFiles/Image/Sprazumi\\_web\\_novembar\\_07.pdf](http://www.komorabih.ba/UserFiles/Image/Sprazumi_web_novembar_07.pdf); <http://www.fipa.gov.ba/#>

<sup>14</sup> Law on the Policy of Foreign Direct Investment, »Official Gazette BiH«, No. 17/98 and 13/03, Preamble, p. 303.

<sup>15</sup> Dr Fikret Čaušević, PhD, »Konkurentnost ekonomije i upravljanje državama kroz međunarodna pravila (*Economic competitiveness and governing states through international rules*)«, in: Academy of Sciences and Arts BiH, Center for Management and Information Technologies of School of Economics and Business, University of Sarajevo and World Economic Forum »Report on Competitiveness of BiH 2004-2005«, Sarajevo, November 2005, p.48

<sup>16</sup> Overtaken and review of mr.sc. Ivica Cvjetković

“Foreign investors in BiH need to register their individual investments with the competent State authority and competent authority of the relevant entity”.

Following the aforementioned, Federation BiH adopted new Law on Foreign Investments (Official Gazette FBiH No. 61/2001), completely harmonised with the Law on the Policy of Foreign Direct Investment in BiH (Official Gazette BiH No. 17/98). Under that Law, the following sub-legal acts were adopted and published: Regulations on registration of foreign direct investments (Official Gazette FBiH No. 15/02), Regulation on conditions and procedure for compensation to foreign investor in case of dispossession or other measures with similar consequences (Official Gazette FBiH No. 30/02). Law on the Policy of Foreign Direct Investment in BiH, Article 5 defined that individual investments needed to be registered simultaneously with the competent state authority and competent entity-level authority, but regarding the aspect of time, the aforementioned represented barrier for registration of foreign investments.

In order to reduce the procedure of registration of foreign direct investments, Law on Amendments to the Law on the Policy of Foreign Direct Investment in Bosnia and Herzegovina (Official Gazette BiH No. 13/03) has been adopted. Article 1 under a) of the aforementioned Law defines that “Foreign investors in Bosnia and Herzegovina need to register their individual investments with the competent state authority”. Herewith ceased the obligation to register foreign direct investments on entity-level. At the same time, Federation BiH adopted Law on Amendments to the Law on Foreign Investments (Official Gazette FBiH No. 50/03), which defined that the obligation to register foreign direct investments in the Federation of Bosnia and Herzegovina was to cease.

It is necessary to point out to the following activities undertaken in order to reduce the period of registration of foreign investments and equalise that procedure with the ones in the EU countries:

„Council of Ministers of BiH adopted the report of the Ministry of Foreign Trade and Economic Relations of BiH on assessment of effects of amendments to the Law on the Policy of Foreign Direct Investment in Bosnia and Herzegovina and Instruction for registration....of foreign direct investments.

As the Council of Ministers reported, in December 2007, with help of the World Bank, they had launched a pilot project on assessment of regulations amendments effects, by which an interest had been shown in bringing BiH closer to the world best practices, including new system of adopting regulations established in the EU. This joint project referred to provisions of the Law on the Policy of Foreign Direct Investment and its implementing acts. Four areas of effect assessment of amendments to the Law and its sub-legal acts have been defined: economic area, social impact area, environmental protection and public administration area.

After comprehensive consultations, as best option was evaluated the one anticipating simplification of foreign investment registration procedures and reforms implementation, including preparing and publishing new instructions, i.e. sub-legal acts. In accordance with the accepted option Report, Ministry of Foreign Trade and Economic Relations of BiH

is in charge of implementation of reforms of the Law on the Policy of Foreign Direct Investment in BiH and Instruction on registration of direct foreign investment, with aim to improve regulatory framework for foreign investors in BiH.” (Biznis.ba/onasa, 16 April 2009)

In the end, it needs to be mentioned that numerous legal acts on international, state and entity level regulating foreign investment create certain difficulties in practice. First of all, there is necessity for harmonisation of legal acts indirectly dealing with foreign investment with the principles and solutions given in the umbrella legislation. Further liberalisation of the regulations referring to business, simplification and reduction of administrative procedures is also necessary. Finally, in the process of EU accession, and pursuant to directions from the White book, it is necessary to adopt sequence of new acts referring to this area, but also harmonise the existing ones with the legal regulations of EU. Therefore, we can conclude that creating legal framework for foreign investment in BiH is still an open process.

#### **16.2.3.2.2 Institutions**

According to the Constitution of BiH, the area of foreign investment is under the authority of state institutions. Institution directly responsible for the control of this area is the Ministry of Foreign trade and Economic relations of BiH.

A few years ago, a Foreign Investments Promotion Agency was established with the Council of Ministers of BiH in order to attract FDI to BiH and encourage the existing foreign investors to expand and develop their business in BiH. FIPA provides different free services for foreign investors, such as: providing information on business and investment environment (legal framework, investment incentives, macroeconomic and business trends), identification and presentation of investment opportunities (investment projects in the development-phase or ready for implementation, companies in the process of privatisation, local companies seeking partners), assisting foreign investors develop contacts with the public and private sector, etc.

Following the recommendation of FIPA, the Council of Ministers of BiH established the Foreign Investors Support Fund in September 2007. Its objective is to provide to new and existing investors financial incentive for investment into projects that would open new workplaces, introduce new environmentally friendly technologies, encourage development of underdeveloped areas and export growth. In this way BiH joined other countries of the region that also provide incentives for foreign investors in order to attract foreign investments. Fund’s budget for 2008 amounts to two million KM and is provided from the budget of the BiH institutions.

Foreign Trade Chamber of BiH is also one of the state-level institutions engaged in improvement of business and investment climate in BiH. Besides its regular activities directed to that purpose, in June 2008 Foreign Trade Chamber launched a joint project with chambers from other Western Balkans countries entitled “Partners for Investment Promotion”. The project was launched in cooperation with the Eurochamber and co-

financed by the European Commission, with the purpose of improvement of environment for FDI and attracting foreign investors to the region.

Since 2006 a non-profit business association Foreign Investors Council (FIC) is also active in BiH. Its objectives are also improvement of investment and business climate and promotion of communication and cooperation between foreign investors and state institutions in BiH.

### 16.2.3.3 Macroeconomic Situation

Immediately upon the war, BiH was considered as one of the fastest growing economies in the world, scoring double-digit rates of growth stimulated by inflow of significant amounts from international aid. Several years later, after the international aid began to scale down, while its position of the main source of financing development was not replaced by private investments, domestic and foreign, rate of growth sharply fell – from 2000 till today average rate of growth stood at about 5% annually. Therefore, not until one decade after the war, BiH achieved level of GDP of before the war. Estimated level of GDP in 2007 was 11.6 billion Euros. Sector of services has still got the far highest contribution to the creation of GDP– over 50%, while manufacture and agriculture are significantly lagging. Contribution of private sector in GDP creation is about 55%, which is below average for the Western Balkan countries. Underground economy is growing, estimated between 30 and 40% of GDP, which makes it one of the biggest problems of BiH economy.

Due to the acceleration of the economic activities, although insufficient for some visible progress, unemployment rate began to decline in the last couple of years, fell from 40% to 30%, which is still troublesome high unemployment level. Export rose too and from one year to another it grows faster but trade deficit is still one of the pressing issues of Bosnian and Herzegovinian economy. Trade deficit has risen to the amount of 4.14 billions of EUR i.e. 35.6% of GDP which is considered as enormous trade deficit compared to the size of economy. BiH is therefore still in the “medium development” group of countries with low income. Reduction of international aid, slow implementation of structural reforms, absence of relevant macroeconomic management and insisting on macroeconomic stability regardless of other circumstances are main economic reasons for insufficient economic prosperity of BiH. General economic indicators for BiH are shown in table 16.18.

**Table 16.18** General Economic Indicators of BiH (2000-2007)

Indicators	2000	2001	2002	2003	2004	2005	2006	2007
GDP (billion EUR)	5.5	5.9	6.6	7.4	8.1	8.7	9.8	11.6
GDP per capita (EUR)	1,660	1,786	1,958	2,214	2,388	2,561	2,873	3,412
Real GDP growth rate (%)	5.5	4.5	5.5	3.0	6.3	4.3	6.2	8.0
Industrial production growth rate (%)	8.8	12.2	9.2	4.8	9.0	10.0	11.0	10.0

Average net wages (EUR)	190	209	228	247	258	275	300	322
Annual inflation rate (%)	4.8	3.1	0.4	0.6	0.4	3.7	6.1	4.9
Unemployment rate (%)	39.7	40.3	40.9	42.0	43.2	31.1	30.0	28.0
Foreign currency reserves (mill EUR)	522	1,379	1,270	1,428	1,779	2,160	2,787	3,420
Trade balance (mill EUR)	-3.00	-3.31	-3.52	-3.67	-3.68	-4.01	-3.41	-4.14

Source: Agency for Statistics of Bosnia and Herzegovina, Central Bank of BiH; FIPA

The abovementioned indicators show that it is however possible to realise even certain growth of GDP rate even with today's priority goal, price and exchange stability. However, it is necessary to emphasise that in the case of BiH, GDP was based on the growth of in-house consumption and reconstruction while it did not resolve unemployment. On the contrary, unemployment is not reduced, which means that growth rate is not the only important figure but also its structure. In the structure of the GDP growth, it is of necessity that the primary role is given to the so-called real sector (industry, energetics, construction), and the basic prerequisite for its long-term growth is export. It is necessary to remind that tertiary sector development in developed countries was in progress correspondingly with growth of the so-called real sector<sup>17</sup>.

However if we analyse GDP growth in percentages in 2007, it figured out at 8% of the real growth (inflation influence excluded) and that is a result worth of our attention. On the other hand, there is no place for self-satisfaction if the structure of GDP is considered, not only in 2007 but in all previous years as well.

Investments in production are insufficient if it should give greater effects in GDP structure. Through superficial insight, the conclusion is derived that GDP growth first of all referred to trade and services, while industry performed modest GDP growth rates.

For many years now, economists and politicians, domestic and foreign as well, anticipate and foresee that BiH will finally make a revolutionary move towards establishment of self-sustainable economy – and significantly increase economic activity, reduce unemployment and trade deficit, attract large amounts of FDI and become a member of the World Trade Organisation and EU membership candidate. BiH ends each year with unfulfilled expectations regarding economic progress. According to the indicators from the first half of this year, contained in researches of UNDP Early Alert System, the same thing will probably happen in 2008.

#### 16.2.4 Why (not) invest in Bosnia and Herzegovina: advantages and disadvantages of BiH as investment destination

When deciding on investing, foreign investors primarily consider two factors: safety of future investment and existence of profitable business environment. The first factor

<sup>17</sup> Taken and review of Ivica Cvjetković, MSc

understands legal security and protection against non-commercial (political) risk, and the second regards reduction of commercial risk of investment.

#### **16.2.4.1 Barriers for foreign investment**

In the post-war period, Bosnia and Herzegovina has made some movements towards reducing non-commercial and commercial investment risk, i.e. creating a favourable environment for FDI. However, rather low level of FDI in the country points out that numerous barriers to inflow of foreign capital still exist.

As significant non-economic – political, legal and institutional – barriers to attracting FDI to BiH, numerous studies have identified the following:

- political instability in the country and the region,
- legal insecurity (low level of practice of adopted legal regulations and non-efficient system of justice),
- inadequately developed market institutions (underdevelopment of capital market, lack of mobility in the labour market)
- long and complicated administrative procedures for registration of company and doing business,
- corruption at all levels of state administration and society in general,
- non-existence of common economic space,
- non-existence of industrial and technology development strategy (impossibility to predict future position of certain industries invested in today regarding state aid or incentives),
- slow implementation of structural reforms, mainly privatisation; significant part of the total state capital has still not been privatised,
- slow settlement of matters concerning land titles, restitution of property and reestablishment of property registration system in BiH, which is of essential importance for foreign investors,
- slow political, institutional, legal and economic approach to the European integrations.

Economic characteristics of investment climate in BiH that have negative influence to the stand of foreign investors are:

- macroeconomic situation characterised by rather low level of economic activity, high unemployment rate, high trade deficit etc.,
- non-adequate economic structure,
- small market,
- destimulating tax policy,

- underdeveloped infrastructure,
- lack of adequate macroeconomic management,
- underground economy.

Business community in BiH believes that for years already the most problematic barriers for doing business in BiH are the following non-economic factors: non-efficiency of government administration, instability of government, instability of politics and corruption.<sup>18</sup>

Most of these non-economic and economic barriers, e.g. political instability, legal insecurity, underground economy, corruption, non-adequate tax policy, are not specific for BiH, but are common for the most transition countries. It is evident that the rest of the Western Balkans countries are facing all of these problems too, which made the foreign investors' perception of the region as a whole not specifically favourable. It has been determined that this region is lagging behind the "new" Europe more than the "new" Europe is lagging behind the "old" Europe.<sup>19</sup>

Nevertheless, unlike its neighbours, BiH is facing some additional problems that make it even less attractive to foreign investors. In comparison to the other former Yugoslav republics, it is politically and economically the most affected by the fall of Yugoslavia and years of war. It is politically the most instable country in the region due to the constant presence of ethnic division. The same ethnic division is the reason why BiH has the most complicated state organisation and expensive and bulky state administration. Political and ethnic divisions are also slowing down the processes of structural reforms, causing BiH to lag behind other countries in the region on its way to join the European Union.

According to the Global Competitiveness Index (GCI)<sup>20</sup> determined by the World Economic Forum, in the period from 2007 to 2008 BiH was ranked 106<sup>th</sup>, which represents a fall of 15 positions compared to the period 2006-2007. BiH is the only country of the South East Europe+<sup>21</sup> region enlisted in "Top 10 failures" according to GCI index movement, holding high second position, after Botswana.<sup>22</sup> According to Business Competitiveness Index (BCI) BiH is constantly falling down on a list of 178 countries, opposed to Bulgaria, Croatia, Romania and Turkey that have been continuously improving their ranking over the past three years. If we consider BCI components,

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<sup>18</sup> Zlatko Lagumdžija and group of authors from MIT Centre «Competitiveness of Bosnia and Herzegovina and SEE region 2007-2008», Regional Economic Forum for South East Europe and Centre for Management and Information Technologies of School of Economics and Business, University of Sarajevo, Sarajevo, 2007, p. 110-111.

<sup>19</sup> Zlatko Lagumdžija and others, Ibidem, p. 115.

<sup>20</sup> „GCI (Global Competitiveness Index) gives holistic view of critical factors determining productivity and competitiveness of countries, grouped in 12 pillars of competitiveness: Institutions, Infrastructure, Macro economy, Health and primary education, Higher education and training, Goods Market efficiency, Labour Market efficiency, Sophistication of Financial markets, Technological readiness, Market size, Business sophistication, Innovation („Report on Competitiveness of BiH“)

<sup>21</sup> „SEE+ region“ includes Western Balkans countries, Bulgaria, Greece, Romania, Slovenia and Turkey.

<sup>22</sup> Academy of Sciences and Arts BiH, Center for Management and Information Technologies of School of Economics and Business, University of Sarajevo and World Economic Forum „Report on Competitiveness of BiH 2007-2008“, Sarajevo, November 2007, p.3



according to one of them – quality of business environment – BiH is ranked last of the South East Europe+ region, behind Albania and Moldavia.

#### **16.2.4.2 Incentives for foreign investments**

BiH cannot offer some special facilities to foreign investors, e.g. rich natural resources, but as any other country it has certain potentials that, if used adequately, can be economically developed and in that way make BiH more attractive as investment destination.

Most frequently mentioned advantages of BiH as investment destination include:

1. stable macroeconomic environment

- Due to arrangement of the Currency Board and fiscal discipline, BiH has a stable and convertible currency pegged to Euro. Convertible mark is the most stable currency in the region.
- Inflation has been less than 1% for years; after introducing VAT it somewhat grew (to 6% in 2006), but has been kept under control.

2. reformed banking system

- Banking system is almost entirely privatised, with enormously high participation of foreign capital (over 70% of private capital in the banking sector is of foreign origin). The process of privatisation was performed very quickly, with significant reforms contributing to its stability and efficiency.

3. competent and rather cheap labour force

- This is one of the positive sides of investment environment of BiH, but it is not specific; this characteristic is common for most transition economies.

4. privatisation projects

- Since the so-called strategic enterprises from the field of telecommunications, energetics, mining etc. that were planned for tender privatisation have still not been privatised, numerous possibilities for potential investors are opened.

5. free trade zones

- On 22 November 2007 BiH has entered into Free Trade Agreement (CEFTA) involving eight countries of the region: Albania, BiH, Montenegro, Croatia, Macedonia, Moldova, Serbia and UNMIK/Kosovo. BiH has also signed a free trade agreement with Turkey.

6. preferential export regime to EU and several large non-European countries

- For years already, BiH has been beneficiary of the preferential export regime to EU, which implies possibility to export goods of BiH origin (given that the EU standards have been met) without paying customs duties and quotas. Preferential regime is approved until 2010. In the meantime (17 June 2007), BiH signed a Stabilisation and Association Agreement with EU providing further liberalisation of



trade between BiH and EU. BiH is also using preferential export regime to Canada, USA, Japan, Russia and Turkey, but only for a limited number of products.

7. several profitable sectors of economy

- the following sectors have been identified as potentially attractive for foreign investors by numerous surveys of international and domestic institutions: agriculture and food industry, forestry and wood processing industry, mining and metallurgy, auto industry, energetics, civil engineering, information and communication technologies, banking and financial sector, tourism.

8. foreign investment promotion agency

- FIPA is a state agency with a mission to attract FDI by improving investment climate. With that cause, FIPA helps state institutions identify barriers for foreign investments and find solutions, as well as provide different free assistance to foreign investors.

9. significantly liberalised foreign investment regime, privileges and protection for foreign investors

Privileges for foreign investors determined by the Law on the Policy of Foreign Direct Investment in Bosnia and Herzegovina are the following: exemption from paying import duties to equipment intended for investment (passenger cars and gambling machines excluded); right to open any commercial bank account in domestic or other convertible currency; right to a free and immediate transfer abroad of the investment income; protection against nationalisation, expropriation and other measures with similar effect; right to employ foreign workers in accordance with labour and immigration laws; right to reinvest investment income into any sector (exempt from military industry and public information sectors due to certain restrictions determined by the law); national treatment for foreign investors regarding possession of the real estate; right to establish free zones; right to use free zones with privileges as exemption from VAT and import duties to production equipment, free investment and free transfer of investment income and assets. Rights and privileges, as well as obligations, determined for foreign investors by this law, cannot be altered or cancelled by subsequently adopted laws or regulations. In case those other laws or regulations grant more favourable treatment to a foreign investor, their right is to choose under which regime their investment is to be regulated.

Tax reliefs for investors, both domestic and foreign, are determined by the entity-level laws. Law on the Corporate Income Tax of the Federation of BiH<sup>23</sup> grants the following reliefs: exemption from paying income tax in a year in which 30% of income of a taxpayer is earned through export; exemption from paying tax for a five-year period if a taxpayer uses this period to continuously invest in production on the territory of BiH in the minimal amount of 20 million KM (during first year of that period in the minimal amount of 4 million KM); exemption from paying income tax in a year in which a taxpayer employs 50% of handicapped persons or persons with special needs for a one-

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<sup>23</sup> Official Gazette of the Federation BiH No. 32a/97 and 29/00

year period at least.<sup>24</sup> In the Republic Srpska the law determines reduction of tax base by the amount invested in machines and equipment for performance of production activity for which a taxpayer is registered (provision in effect till 31 December 2008).

The law determines only a few restrictions for foreign investment. Investment into military industry and public information is subject to obligation of obtaining a prior authorisation from competent entity authorities, and foreign equity shares in a company in these sectors cannot be above 49%. Restrictions concerning investments into public politics, health care and environmental protection are the same both for domestic and foreign investors.

Protection of foreign investors and their investments are guaranteed by the laws from the field of foreign investment and bilateral agreements on investments where BiH is a signatory country. However, as the political risk as one of the components of non-commercial risk is very high both for BiH and the region, there are institutions providing guarantees for investments, supported by relevant international organisations: EU Investment Guarantee Trust Fund administered by the member of the World Bank-Multilateral Investment Guarantee Agency, US Overseas Private Investment Corporation (OPIC) and national Investment Guarantee Agency (IGA).

«EU Integration Strategy of Bosnia and Herzegovina» gives certain recommendations on the activities that are to be undertaken in order to approach EU acts and practice in the field of capital movement, at the same time attracting foreign investments<sup>25</sup>:

- simplify bureaucratic procedures for acquiring real estate ownership rights
- establish national incentive instruments for attracting Greenfield foreign investments and participation of foreign capital in development and privatisation programmes of the processing industry;
- create common system of capital transfer from BiH to abroad, but also between residents and non-residents within BiH
- prepare for abolition of restrictions related to investments and acquiring property in certain sectors;
- start public promotion and informing the public on money laundering and direct technical assistance to this field.

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<sup>24</sup> New Law on the Corporate Income Tax of the Federation of BiH has entered into force on 1 January 2008, but provisions of the previous law regulating reduction of tax liability are in force until the period in which they can be used expires.

<sup>25</sup> Council of Ministers of BiH, Directorate for European Integration, "EU Integration Strategy of Bosnia and Herzegovina", Sarajevo, 2005-06.

### **16.3 Possible directions of state actions for removal and mitigation of technological backwardness and restrictions in favour of industrial development and faster access to the European Community funds, and creation of conditions for a modern, profitable, export oriented industrial production**

In the process of revitalisation and development of industrial production, legislative and executive authorities on the level of state, entity and canton, should speed up and undertake activities in the following areas:

- Form an expert team on a state level to analyse documents of the EU industrial development strategy, on which basis industrial development strategy of BiH, and accordingly Federation of BiH, are to be harmonised.
- Form a team of legal experts on a state level to initialise harmonisation of domestic laws with legal regulations in the EU countries regarding industry, eneregtics, traffic etc.
- Through education of personnel in administration authorities of the Federation of BiH (Ministry of Energy, Mining and Industry of the Federation of BiH, cantonal ministries of industry and energy) it is essential to train the structures to adjust domestic legal norms to EU standards in the field of industry, eneregtics etc. It is necessary to simplify the existing procedures in investment implementation in the sector of industrial production.
- Institute for Standards needs strengthening regarding personnel and materially, so that the process of acceptance and implementation of technical standards and technical regulations in form of EU rulebook would find faster implementation in school and industrial system of BiH.
- Strengthen the education system materially regarding equipment, personnel and facilities, in accordance with the EU systems. The education of personnel should be matched with the requirements of the labour market in Bosnia and Herzegovina and occupations in demand in the EU countries.
- At higher education institutions having critical mass of quality personnel initiate establishment of technology development centres, institutes capable to participate in development projects from EU funds.

- Step up international cooperation between Balkans countries through bilateral agreements in the field of education and research development projects for the needs of their industrial complexes, and in common approach towards EU development funds.
- Through bilateral agreements with developed industrial EU countries provide specialist additional education to domestic personnel at the institutions active at development projects in the industry sector.
- Through elements of tax and customs policy stimulate investments into modern means of work and development programmes of industrial complex.
- Through customs and tax policy stimulate usage of own energy resources in the industrial capacities of Bosnia and Herzegovina, especially renewable energy.
- Through tariff policy in energetics stimulate increase of energy efficiency in the industrial capacities of Bosnia and Herzegovina.
- Through privatisation process of metallurgy capacities contractually oblige investors to expand the selection of their products essential for domestic metal and metal processing industry.
- Through inspection activities from the entity level it is essential to improve the control over work of lower state authorities in implementation of privatisation process and new investment activities in the sectors of industry, energetics etc.
- Through system of chambers of commerce and trades and crafts connect business people and technology development centres, aiming at permanent education of personnel and products and technology development. Create quality database with all participants in the industrial and education sector and present them in the business community using electronic media.
- Organise annual classification of production and research companies of Bosnia and Herzegovina by sectors of industrial production and present them in domestic and EU business community.

Due to complicated procedures in the parliaments of BiH and Federation of BiH when adopting new laws and amending the existing ones, some essential standards need to be implemented through decisions of the Government of Federation of BiH. In the process of adopting laws, their detailed harmonisation with the set of corresponding domestic norms is required.

We find it necessary to provide recommendations from the document "Bosnia and Herzegovina - Investment Climate Assessment – ICA), June 2008, summarised in Table 16.19.<sup>26</sup>

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<sup>26</sup> ICA BH Chapter 2 Administrative and regulatory barriers to business in Bosnia and Herzegovina

**Table 16.19** Summary of recommendations in Key areas

Recommended reforms	Short term recommendations	Medium term recommendations
Starting a Business <sup>27</sup>	<p>Eliminate need for statement that company founders have no tax debts</p> <p>Review and possibly eliminate requirement for company seal or stamp.</p> <p>Eliminate requirements for opening a bank account (use as good practice guideline).</p> <p>Eliminate requirements that companies publish a rule book.</p>	<p>Make business registration a fully administrative process; that will help speed up court systems as well.</p> <p>Make available standardised incorporation documents.</p> <p>Move to one-stop shop for obtaining business start-up clearances.</p> <p>Online submission for a single application.</p>
Dealing with Licences	<p>Eliminate preliminary verification of heating and electricity installations, water supply and sewage system projects, and study on fire and explosion prevention.</p> <p>Rationalise requests for information related to land plot use.</p> <p>Afford easy access to information on all licensing requirements.</p>	<p>Set targets for reducing licensing burden; a single agency to monitor.</p> <p>Create single window for project clearances.</p> <p>Significantly speed-up registration of buildings in the cadastre block.</p>
Paying Taxes	<p>Consolidate multiple tax payments.</p> <p>Rationalise property tax payments by cutting number of payments to 1 (or perhaps 1 per quarter).</p> <p>Include local property taxes in overall property tax payment. Transfer share of total property tax revenue to local authorities through inter-governmental transfer.</p>	<p>Offer on-line tax filing services.</p> <p>Consolidate various taxes. Tax authority could earmark tax receipts for different purposes (general government revenue, social security contributions, local tax revenues etc.</p>

Further we find that the work should continue in order to adopt State Aid Law in Bosnia and Herzegovina. That law, i.e. its draft classifies shapes of state aid as follows <sup>28</sup>:

- Export aid
- State aid for small and medium enterprises
- State aid for environmental protection and energy savings
- State aid for recovery or restructuring of business entities
- State aid for new investments and creation of new work places
- State aid for research and development
- State aid for employment
- State aid for training
- State aid for current maintenance of production
- State aid for business entities in specific sectors

<sup>27</sup> The Entities have piloted a business registration system that embodies common procedures and forms and utilizes a single database

<sup>28</sup> Final advisory opinion of the project for working group on draft of the state aid law in Bosnia and Herzegovina

## 16.4 Conclusion

All of the aforementioned leads to a conclusion that there are various means of incentives for the industrial production, but that their usage is insufficient and lacking quality. Reasons for that are numerous and mainly of political, legal, institutional and economic nature.

Conducted research shows practical problems occurring when using different means of incentives and they mostly match the results of other studies conducted in this region over the last few years.

It is a fact that BiH, as other transition countries, tried to stimulate FDI inflow already during the first years of the transition process. However, research shows that FDI level did not correspond the level of stimulating policies. Moreover, regarding annual FDI inflow BiH held one of the last rankings among transition countries, even behind all of the Western Balkans countries. Considering that neither quantity nor quality of FDI reached the expected and required level, i.e. level that could grant more significant positive effect to country's economy, foreign investments still do not represent significant additional source of finance and economy dynamising for BiH.

Positive attitude and stimulating policy towards FDI are required, but they are not the only way of attracting FDI; other factors rising competitiveness of domestic economy are to be improved as well. *Conditio sine qua non* for attracting foreign investors is an organised state and economy. Non-existence of organised state and socio-economic system cannot be compensated by any incentive measures, which is exactly the example of BiH.

Inability of BiH to attract more FDI, especially of better quality, is consequence of insufficiently favourable investment climate compared to many other transition countries competing among themselves to attract foreign investors. A country characterised by still rather high political risk, unfinished privatisation, non-enforcement of law, red tape, corruption, insufficiently stimulating tax system, underdeveloped infrastructure and without perspective of near accession to the European Union, cannot be described as attractive destination for FDI. Political and economic situation in the country need drastic improvement in order to attract foreign investment in desired range.

Besides all the aforementioned, one must keep in mind that the positive effects of FDI are not generated automatically. To some extent, FDI can raise the level of productivity and export growth. On the other hand, they are often directly connected to disproportional import growth, distortion of competition, i.e. creation of foreign monopolies and dependence of the recipient state and its economy on the foreign capital. Basic characteristic of FDI is that they are private, profit-oriented investments, and not

foreign capital inflow intended to encourage country's development.<sup>29</sup> Finally, not all FDI forms have the same development potential. Priority should be given to Greenfield investments over acquisition or merger, investments into manufacturing over service sector, investments into productions with high level of added value, as well as larger spillover effects.

In order to make FDI generate potential positive effects in BiH, it is necessary to increase their inflow, but with active and selective approach in the sense of influence to the investment infrastructure, coordination with other dynamising factors and involvement of FDI into country's development strategy.

Regarding possible state actions, besides the ones discussed in the last chapter, we find it necessary to point out to the importance of education at all levels. In this area state is expected to take a clearer and strategic stand.

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<sup>29</sup> "Foreign capital does not come in to help the host country develop, but to make profit, and those are two completely different things." (Branko Horvat, "Ekonomika brzog razvoja", Forum Bosnae 12/01, International Forum Bosna, Sarajevo, 2001)

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