



POLICY COHERENCE FOR INVESTMENT: OBSTACLES TO INVESTING IN BOSNIA AND HERZEGOVINA, POLICY ANALYSIS & RECOMMENDATIONS



2009-2010

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PGlobal Global Advisory and Training Services Ltd

Koza Sok. 37 / 2 – 4 GOP

Ankara 06700 Turkey

Telephone: +90 312 439 3033

Fax: +90 312 439 3029

www.pglobal.com.tr

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ABBREVIATIONS

| | |
|-----------------|---|
| AM | Association of Mediators |
| BiH | Bosnia and Herzegovina |
| CAFAO | Customs and Fiscal Assistance Office |
| CEFTA | Central European Free Trade Agreement |
| EC | PHARE European Commission Poland and Hungary Assistance for Restructuring their Economies |
| EPL | Employment Protection Legislation |
| ETSC | Education Credit Transfer System |
| EU | European Union |
| FBiH | Federation of Bosnia and Herzegovina |
| FDI | Foreign Direct Investment |
| FIAS | Foreign Investment Advisory Service |
| FIPA | Foreign Investment Promotion Agency of Bosnia and Herzegovina |
| FTAs | Free Trade Agreements |
| ICN | International Competition Network |
| IFC | International Finance Corporation |
| IMF | International Monetary Fund |
| IPAs | Investment Promotion Agencies |
| IPR Enforcement | Enforcement of Intellectual Property Rights |
| IRI | Investment Reform Index |
| IDA | International Development Association (World Bank Group) |
| ITA | Indirect Taxation Authority |
| MFN | Most-favoured-Nation Treatment |
| MIGA | Multilateral Investment Guarantee Agency |
| ODA | Official Development Assistance |
| OECD | Organisation for Economic Co-operation and Development |
| OHR | Office of the High Representative |
| RIA | Regulatory Impact Analysis |
| RS | Republika Srpska |
| SAA | Stabilization and Association Agreement |
| SEE Countries | Southern and Eastern Europe Countries |
| SMEs | Small and Medium Sized Enterprises |
| SPIRA | Streamlining Permits and Inspection Regimes Activity |
| TRIPS | Trade-related Aspects of Intellectual Property Rights |
| TVET | Technical and Vocational Education and Training |
| USAID | United States Agency for International Development |
| USD | United States of America dollars |
| VAT | Value-Added Tax |
| VE | Vocational Education |
| VET | Vocational Education and Training |
| WAIPA | World Association of Investment Promotion Agencies |
| WB | World Bank |

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Comments and input were received from Adil Bushnak (Bushnak Group), Rafee Yusoff, Hamza A. Alsaktawi (IDB), Khaled M. Al-Aboodi (IDB), Adzlin Azhar, Oktay Küçükkiremitçi (TKB). Peer reviewers included Alistair Nolan (OECD).

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EXECUTIVE SUMMARY

This Report intends to provide policy makers with recommendations on *policy coherence for investment*; as they could usefully be employed to initiate evidence-based policy dialogue among the government institutions as well as amongst governments in the SEE region. The recommendations are therefore intended to lay the ground for further *complementary* policy studies which would be conducted by government institutions as well as international organizations.

Bosnia and Herzegovina is at the forefront of policy challenges, essentially brought about by globalization since the inception of post conflict transition. To effectively respond to investment related challenges, the Government of Bosnia and Herzegovina, compared to other post conflict states, has triumphantly undertaken numerous policy reforms, aiming at establishing a business enabling environment while setting up a comprehensive strategy and facilitated its implementation so as to attract more FDI to BiH. However, this is not enough and more substantial policy reforms need to be adopted, together with better enforcement.

In this Report, eleven investment related policy dimensions are addressed with a view to identifying the obstacles to investing in Bosnia and Herzegovina and to concurrently examining linkages among the policy dimensions which may undermine or augment their respective impacts. These dimensions are investment, investment promotion & facilitation, trade labor market, tax, aid, corporate governance, Human capital, anti corruption, regulatory reform and competition. Each policy dimension covers a number of identified sub-dimensions.

Policy analysis of this report integrates several tools; examination of the best practices in the South Eastern Europe, survey results, and finally justification of coherence of policy analysis. The writers of this report strongly recommend that the policy findings parts should be read together with policy recommendations as they largely complement or substitute each other.

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Our analysis revealed that lack of essential coordination and the role and responsibilities among the government offices largely undermines the investor confidence. Furthermore, the country's investment environment is negatively affected by the overlapping legislation at a state and entity level, resulting in an overly cumbersome regulatory framework.

Human capital needs to be high on the agenda of the BiH. As Bosnia and Herzegovina is ideally located in the crossroads of the European transportation and trade corridors, it is determinedly seeking to integrate into EU. Attracting FDI is an important milestone in paving the way for its membership as well-educated and skilful labor force will play an important role in accomplishing this endeavor. Needless to say, presence of qualified human resource is one of main criteria investor take into account prior to making investment decision.

The state level government is comprised of many autonomous administrative units where there is no essential coordination on taxation. The resulting inefficiencies in the governance structure and functioning, creating double taxation at times (leading to penalization of businesses operating in different entities) as well as obstacles to enforcement of taxation.

Following the transition period, corruption perception in BiH has been identified as an important obstacle and is highly relevant to investment policies as indicated in our survey. This is highlighted also in the Corruption Perception Index 2009 where Bosnia and Herzegovina is ranked the 99th out of 180 countries. Comparing to its neighbors in SEE, it has the highest score.

The challenges in the labour market are various and they are reflected in wages higher compared to productivity in the formal sector; the large and growing share of informal employment where employees are not covered by social insurance; and persistent unemployment.

In sum, Policy challenges in BiH are various and effective policy reforms are needed to respond to global economic shocks world experience nowadays.

Introduction

Globalization refers to the increasing integration of economies around the world, particularly through the movement of goods, services, and capital across borders. Owing to globalization, foreign direct investment increased from 6.5 percent of world GDP in 1980 to 31.8 percent in 2006 while the stock of bank loans, as a percentage of world GDP, increased from approximately 10 percent in 1980 to 48 percent in 2006 (IMF Staff, 2008).

However, not all world economies have been able to reap the opportunities offered by globalization equally while some has faced challenges in adaptation to the new environment. Many developing countries and transition economies are striving to attract more FDI, as they realized its importance to their development. To this aim, they are heavily involved in eliminating the current obstacles in their domestic investment environment by identifying and removing the policy barriers while providing investors with incentives. Needless to say, however one should acknowledge the existence of counter arguments on globalizations.

Bosnia and Herzegovina is not an exception to this. Following deadly attacks on civil society leading to a full scale civil war, post conflict restructuring efforts have been accelerated, concentrating among others, on creating a business enabling environment so as to attract as much FDI as possible and thereby increasing economic prosperity.

This Report intends to convey policy recommendations, along with underlying reasons, with a view to assisting policy makers overcome the current challenges facing BiH, while the successful policy reforms of BiH are carefully noted. The Report can be instrumental in initiating evidence based policy dialogue among policy makers, as it contains assessment of policy bottlenecks and it develops a holistic tool that can assist policy makers in analyzing the coherence among the policy sets. The recommendations are largely derived from policy findings but others haven't been observed in current policy environment in BiH but included; as their impacts are evidently found to be effective and efficient in OECD countries. While acknowledging the existence of more comprehensive regional approaches and their publications by international organizations such as the OECD IRI or WB Western Balkan Integration, we are confident that the analysis in this Report will put forward a innovative view on strengthening the investment environment through *policy coherence based arguments*.

The analysis as in similar every case is constrained by the availability and reliability of data. while confirmation of collected data with relevant government institutions becomes crucial. This poses notable challenges in achieving thriving outcome on time while the process itself is difficult and over-demanding. In the case of BiH, it is noted that there is incoherence among data sets / time series provided by different government institutions for the same policy areas. Therefore, improving coordination among the government institutions and enhancing statistical capacity of BiH are at the forefront of the policy recommendation chapters of the reports.

Box 1. Overall Methodology and Analytical Tools

This Report largely draws on the analysis¹ of PGlobal experts while considering the views of the BiH government institutions, local experts and perception of the international organizations and most importantly, observations of business circles. In the course of the preparation of the report, we came across various inconsistencies in the data set and contradictory outcomes of analysis conducted by different organizations, academicians, and experts. While trying to re-examine their findings, we revisited the outcome of our survey, indicating responses of the investors whose views have been reflected in this report. Moreover, we justified outcomes of the survey by conducting our own *additional analysis* with a view to exploring underlying reasons for policy obstacles.

While different perceptions of various international organizations and observers co-exist, our analysis revealed that Bosnia and Herzegovina still appears as a very attractive spot for investment in south eastern Europe at large.

Figure 1 briefly explains our methodology for the identification of obstacles to investment and devising policy recommendations for the enhancement of the investment climate in BiH. Our approach integrates several tools; examination of the best practices in the South Eastern Europe, survey results, and finally justifying coherence of policy analysis. It covers eleven most relevant policy dimensions, and sub-dimensions crucial for the investors have been examined.

To this aim, each policy dimension is divided into five main parts. The first part is dedicated to examination of the impact of relevant policy dimensions on the investment while the second one provides readers with a recent snapshot of the relevant BiH policy. The third and the fourth parts are complementary to previous parts and are comprised of different modules on policy sub dimensions, analytical tools, methodology and policy findings. The final part, policy recommendations, is mainly derived from policy findings and presented at the end of each part.

Examination of the best practices in the region provides us with a starting point. It sheds light on where BiH stands comparing to the economies that had similar experiences, and helps us identify BiH's strengths and weaknesses in attracting FDI.

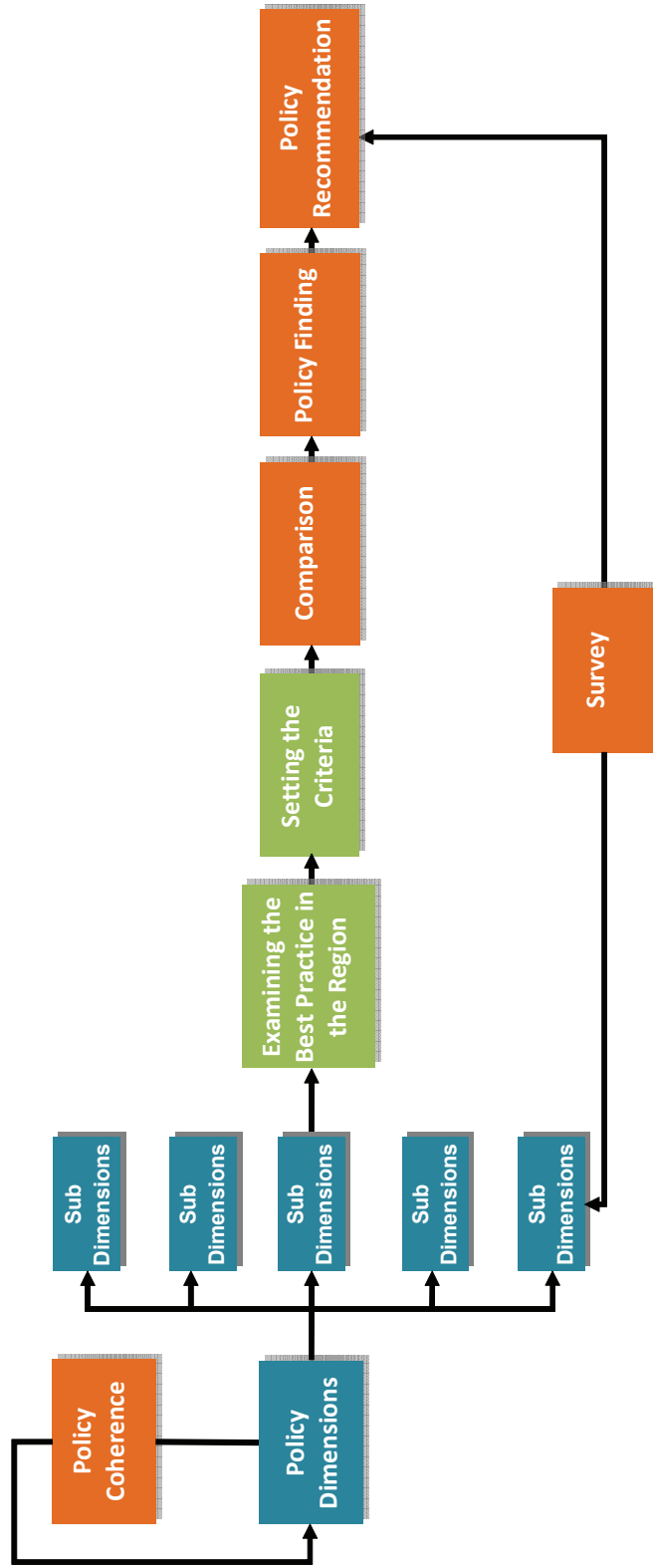
Moreover, our survey, gives us original information about the experiences of the current investors in BiH as well as the perceptions of the potential investors. Our survey results are employed to justify our policy analysis and to propose policy recommendations, as well as to revise our selected policy dimension/sub dimensions whenever necessary.

Once completing the policy analysis, the next step is to make an overall evaluation of the policy dimensions seeking to identify inconsistencies between various dimensions as they will reduce or augment the effect of their respective policy implications on investment. Subsequent to their relevance confirmation, policy recommendations are drawn accordingly.

In the preparation of the report, significant amount of assessment has been carried out in selecting policy dimensions with a view to developing a compact policy report on a timely basis. The Report was not intended to cover every issue related to the investment environment; rather, it focuses on the aspects that might have a substantial effect on the BiH investment climate.

1 PGlobal has conducted several analysis for the report, including a survey (see the annex)

Figure 1. Policy Analysis Methodology



Source: PGlobal Global Advisory and Training Services

Investment Policy

Non- Discrimination
Protection of Property

1. Investment Policy

1.1 FDI and Investment Policy

The overall benefits of FDI for emerging and transition economies are well known. There are many evidences that FDI initiates technology spillovers, assists human capital formation, contributes to international trade integration, helps establish a more competitive business environment and enhances entrepreneurship. As all of these contribute to higher economic growth, it will also help reduce poverty in developing economies. Therefore, there is a growing interest in devising a sound investment policy so as to attract as much FDI as possible.

1.2 Investment policy in Bosnia and Herzegovina

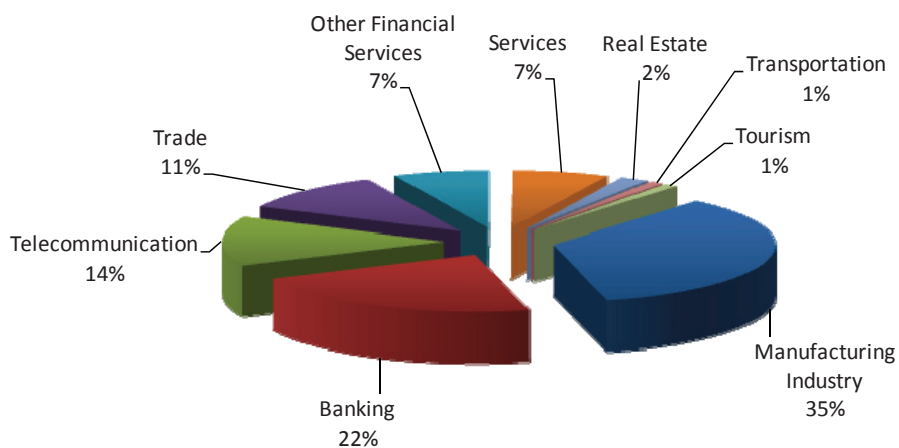
Even though the BiH government strive to open the its economy by attracting more FDI to the country foreign investors still continue facing a number of serious challenges and obstacles, including corruption, a complex legal and regulatory framework, lack of transparency in business procedures, and weak judicial structures etc. Privatization of state-owned enterprises has lagged behind many SEE countries albeit substantial efforts in 2007. Policy reforms to complete the transition to market economy are underway but there is a lot to be done. Foreign investment particularly in greenfield programs are far from being adequate while banking sector successfully attracts notable amount of FDI. Private Public Partnerships (PPP), particularly in the healthcare and transportation sectors, are gradually identified as an effective model to ensure the involvement of the private sector as RS already approved a legal framework on PPP. As there are improvements in every policy dimensions, the impacts of the global turmoil negatively influence the recent reforms and macroeconomic environment.

Box 2. Recent Development in Macroeconomic and Infrastructure Environment

GDP growth in Bosnia Herzegovina has declined continuously since 2006 and the economy as a whole was considerably hit by the global crises in 2009 contracting by -3.1 percent. Bank credits have dried up and a notable shortage in foreign direct investment (FDI) emerged. This was accompanied by lower demand from the European Union for BiH exports and a fall in remittances from workers abroad. Construction activity has suffered and unemployment is on rise.

Bosnia and Herzegovina (BiH) is ideally located at the crossroads between West and East, the Mediterranean and Continent, and its proximity to the main European business hubs makes it an attractive business destiny. Its position can be perceived as a natural gateway to markets with an easy access to 60 million SEE citizens as defined by the SEE Free Trade Agreement. It has a population of 4 million and a significant number of skilled labor force. Moreover, BiH companies have a long standing tradition of successful implementation of international projects particularly during the pre-war period. Political stability has now been largely achieved, resulted in the change of the perception of the investors from post conflict state to business enabled environment.

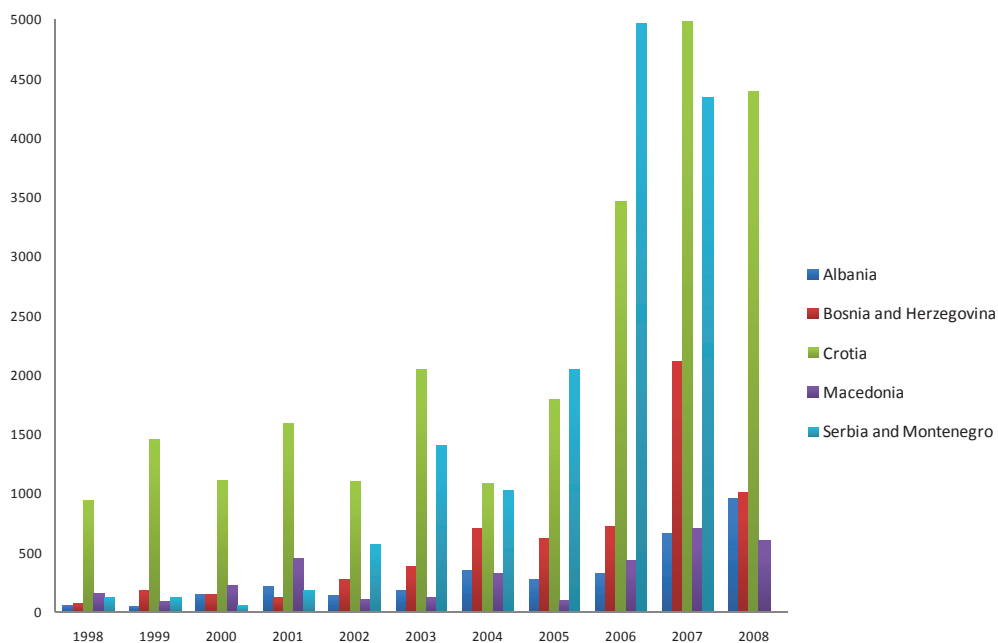
Figure 2. Distribution of the FDI by sectors (1994-2008)



Source: Development Bank of Turkey, 2010

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Figure 3. FDI Flows (in million US\$)



Source: UNCTAD, FDI Statistics 2009

In 2008, foreign direct investment in BiH amounted to USD 1 billion and originated from 26 countries (Slovenia, Austria, Croatia, Serbia, Switzerland, USA, Germany, Netherlands, Poland, Italy, Lithuania, Ireland, Norway, Bulgaria, Turkey, Hungary, Russia, Czech Republic, United Kingdom, Sweden, Denmark, UAE, Montenegro, Spain, Kuwait and Belgium). It declined from a peak of USD 2.1 billion in 2007) when a number of large state-owned enterprise privatizations in the Republika Srpska. However, in comparison to neighboring countries in the SEE, BiH lags behind in attracting FDI.

BiH government has issued vouchers to all of its citizens over 18 years old, aiming at enabling them to purchase state owned properties or shares in SOEs during the privatization process. Subsequently, privatization investment funds were established to convert vouchers into citizens' shareholdings. This central European style voucher type privatization, however, hasn't turned out to be a success story as no incentives to make further investments have been put in place. Therefore, it leaves the privatized businesses as under-performers." In order for better allocation of the resources, radical restructurings or even closures of the loss-making enterprises are necessary in order to eliminate the fiscal burden from BiH government and more importantly to increase productivity and competitiveness in the country.

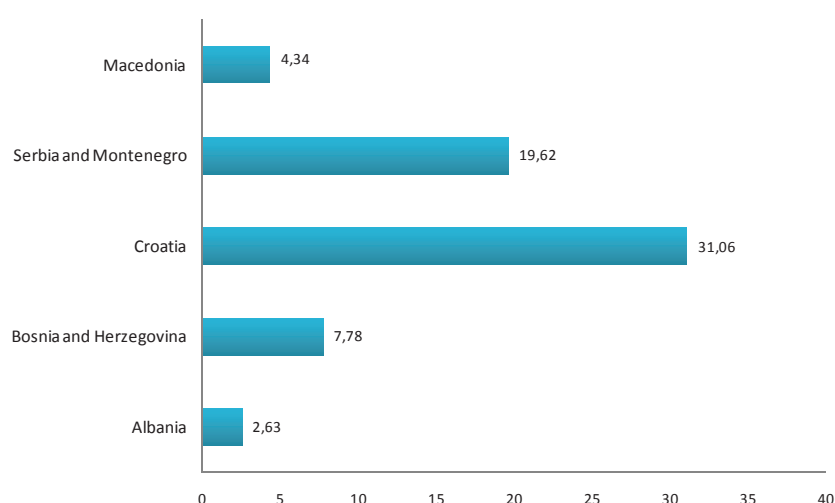
From 1994 to 2008, manufacturing accounts for the largest share in FDI with 35 percent followed by banking, 22 percent. Other than these two; trade and telecommunication constitute 25 percent of the total FDI. In the same period, 56 companies have been successfully privatized to foreign investors in BiH while in RS, shares of the only seventeen companies were sold to overseas investors.

Do You Know This?

According to the Pglobal Survey (see annex); The overall rating for current investment climate in BiH, compared to neighboring countries, is reported to be 5.20 (where respondents were asked to rate the current investment situation out of 10, while 1 represented "least favorite or very poor" and 10 represented "most favorite or very strong").

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Figure 4. FDI Stocks in 2008 (in billion US\$)



Source: UNCTAD, FDI Statistics 2009

Bosnia and Herzegovina attracted FDI of 382 million EUR in the first 9 months of 2009. Because the reinvested earnings¹ are calculated on an annual basis, total FDI figures were not available in the first three quarters' for the year of 2009. Due to the global economic crisis, however, it is estimated that FDI flows to Bosnia and Herzegovina will be negatively affected, as other developing and transition countries.

1.3 Policy Sub-dimensions, analytical tools and framework

Two core policy sub-dimensions are addressed in the investment policy analysis of the BiH: nondiscrimination and protection of property. As they include the main issues related to investment climate, some other relevant topics are also examined in the course of the analysis. Non-discrimination in investment policy requires that all investors, foreign or domestic, be given the same treatment. Core principles of nondiscrimination are as defined by Organization for Economic Cooperation and Development are *National treatment*, *Most-favoured-nation treatment (MFN)*, and *Protecting property and investment*. The policy finding of the analysis is presented below together with the possible causes and recommendations.

1.4 Policy Findings

- Legal framework for investment has been improved recently. The Investment law BiH 17/98 13/03 regarding "the rights and advantage of the foreign investors", indicates that the law has a superiority over subsequently adopted laws and regulations while firms are usefully entitled to choose the most favorable ones among them. While this seems to provide an absolute advantage for firms, misinformation about this particular law and legal system at large are still prevalent among the investors². Uncertainty and lack of information associated with lack of clear legal framework usually leads to misinterpretations.

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This is reflected in the survey of Euro Chambers in 2009 as 56 percent of the survey participants indicated that they were not informed of by significant legal or regulatory changes and these render them surprised

Do You Know This?

Misinformation about investment legal framework in BiH is prevalent among the investors, leading to attenuation of investor confidence.

- Bosnia and Herzegovina still has been prone to weak policy coordination across the different levels of government arising from complex governance structure at state and entity level. Even though the constitution specifies the details of the role and responsibilities of the executive, legislative and judicial institutions of BiH vis à vis the responsibilities of the entity of the FBiH and RS, enforcement needs to be improved.

Moreover, Brčko district has a distinct status in BiH., Each level of government holds responsibility for rule making within its specific competencies. Furthermore, the Office of the High Representative (OHR),

¹ one of the components of FDI

² Interview conducted by a team of PGlobal during the fact finding mission on 2 December 2009.

established under the terms of the Dayton Peace Agreement, has the authority to propose and impose laws in cooperation with the Members of Parliament, Council of Ministers, Presidency and Parliament chambers (Tomas, M., 2007). From investor's point of view; lack of essential coordination and integration among legislative bodies, institutions are the main challenges creating obstacles to investment. Lack of policy coherence between the entities could be readily seen by the launch of two different strategies for the same investment policy dimension³ in FBiH and Republika Srpska, which, in fact, both were aiming to promote economic development & investment as well as to remove the existing obstacles to investment.

- Ownership plays an important role in establishing investors' confidence. Prior to the implementation of joint development cooperation program of GTZ, BMZ and ADA in 2003; the records for property registration were largely unreliable due to the high property transfer taxes and lack of technical infrastructure. In 2006, the program included a cadastre component to lay the ground for linking cadastre and land registry as a reliable and secured basis for property rights.
- Numerous laws and regulations concerning the enforcement of protection of intellectual property rights, such as industrial property law; copyright law on the protection of new plant varieties have already come into effect. Moreover, eleven international agreements have been signed such as Patent Cooperation.

Institute for intellectual property of Bosnia & Herzegovina was established in 2004 having a mandate of protecting intellectual property rights and regulating the market. Even though a comprehensive legal framework for intellectual property rights exists, it needs to be substantially upgraded in order to meet international standards.

Moreover, BiH is not a signatory of the TRIPS agreement and piracy of motion pictures and music and those of software programmes, are pervasive throughout the country. IPR enforcement should be given high government priority through a proactive intellectual property rights protection strategy; proper functioning of the Intellectual Property Institute; increased investigations, concerted efforts by and coordination of police, customs administration, prosecutors and courts; and training on IPR enforcement issues (OECD, 2006).

- The existence of a well-established arbitration mechanism positively influences the investment decisions. Investor confidence is enhanced by enabling the firms to appeal international courts in order to settle disputes. BiH government has already signed and ratified some international agreements.

Moreover, on March 2002 an Association of Mediators (AM) was established, aiming to settle disputes by providing an alternative method. AM consulted the relevant institutions and authorities and proposed a draft law to the legislation authorities. In 2004 the law was adopted, which allows a judge to propose an arbitrator for resolution. Even though, experience revealed that this is an effective method

³ In FBiH, "Policy for Action and Basic Strategies of the Government 2007-2010" whereas in RS, "RS Development Program 2007-2010"

for dispute settlement, sixty one percent of the investors who participated in the Eurochambers⁴ survey consider the dispute settlement in BiH as unreliable. There is no particular law referring to arbitration.

- In BiH, all investors are largely protected against *nationalization and expropriation* (N&E) as N&E are only possible if there is a high public interest. In case it is undertaken, an adequate, effective appropriate compensation is paid. Laws and regulations on expropriation is, to a great extent, are in complying with international requirements.
- The Law on the Policy of Foreign Direct Investments of Bosnia and Herzegovina (Official Gazette of BiH, 17/98, 13/03) ensures national treatment of foreign investors, i.e., foreign investors have the same rights and obligations as those of BiH. The only limitation exists in armament and media sector where foreign control is limited to 49 percent. The same law also guarantees that foreign investors can make transfer payment in convertible currency.
- In FBiH, cantonal governments hold considerable authority over planning, licensing and other areas affecting FDI (D&B Country Report, 2009/10). Stemming from uncoordinated legislative power, it is also observed that transactions between Bosnian and Croat majority cantons become a challenge unless foreign investors establish a business unit in each entity.

Do You Know This?

The only limitation to FDI exists in armament and media sector where foreign control is limited to 49 percent.

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1.5 Recommendations

- Miscommunication is prevalent in BiH between investors and relevant government authorities. There is a strong need to establish better channels of information flows between investors and government offices.
- Lack of essential coordination and details of the role and responsibilities among the government offices largely undermine the investor confidence. Particularly, the country's investment environment is largely hindered by the overlapping legislation at state and entity level, resulting in an overly cumbersome regulatory framework. Present public administration is perceived to be a significant obstacle to investing in BiH. Therefore policies streamlining investment related procedures will help improve business enabling environment.

⁴ Partners For Investment Promotion" Is A Eurochambers Initiative Supported By The European Union Under Cards 2005 Regional Funding

Investment Promotion and Facilitation

Promotion and Facilitation Strategy
Investment Promotion Agency

2. Investment Promotion and Facilitation

2.1 Investment and Investment Promotion and Facilitation Policy

Within the increasingly competitive global environment for attracting FDI, a fundamental challenge for investment promotion agencies (IPAs) in the developing world is to provide investors with the essential information so as to locate their projects. An IPA is often the first government authority welcoming investors, to make a good first impression or to convey them first overall perspective about the country, economy and investment. According to a survey conducted by the Foreign Investment Advisory Services¹, at least half of the surveyed developing-economy IPAs are still not providing services and information that investors are looking for. As a result, many developing-economy IPAs are receiving less attention from investors than they would receive if they performed better. However, the results also reveal that a significant number of developing-economy IPAs are operating at levels close to those of the world's best (MIGA, 2006). The findings also indicate that many IPAs do not have expertise in the industries in which they are seeking to attract investment while not having comprehensive knowledge of economy and sectors.

Box 3. Role of IPA Web Site in Location Decision

A recent survey of executives with direct site-selection responsibilities for large U.S. companies reveals that 65 percent of companies have worked closely with IPAs while working on a location decision; 64 percent of executives indicate a strong likelihood that they would use the IPA Web site in their next location search; Only 8 percent of companies would not contact the IPA during the site-selection process; The percentage of companies that believe the Web site to be an IPA's most effective marketing tool jumped to 56 percent, up from 34 percent in 2002.

Source: Global Investment Promotion Benchmarking 2009: Summary Report May 2009 World Bank

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2.2 Investment Promotion and Facilitation Policy in Bosnia and Herzegovina

As a result of ongoing liberalization efforts –such as a Liberal Foreign Investment Policy Law, a new Value-Added Tax (VAT), and a harmonized trade and customs policy-, Bosnia and Herzegovina experienced significant increase in FDI flow from 2002 to 2005 but there was a sharp 47 percent drop in 2008.

2.3 Policy Sub dimensions, analytical tools and framework

The policy framework for investment and facilitation includes two main components: A pro-active investment promotion and facilitation strategy and an investment promotion agency to implement this strategy. Latter one is analyzed by considering web site and inquiry handling assessments.

2.4 Policy Findings

- Foreign Investment Promotion Agency of Bosnia and Herzegovina (FIPA) has been established in 2004 with a view to attracting and maximizing the flow of foreign direct investment into the country, encouraging existing foreign investors to expand further and develop their businesses in BiH. Moreover, facilitating the linkages between public and private sectors, and having an active role in policy advocacy to contribute to continually improving environment for business investment and economic development are under its scope.

¹ Available at www.fdi.net

- In 2006, the Council of Ministers of BiH adopted the “Investment Promotion Strategy”, with the purpose of developing image building, investment generation and corporate development support programs for FIPA. Even though substantial steps has been taken to strengthen the FIPA, it stills needs to consolidate its activities through some solid measures such as facilitating licensing and administrative procedure for Greenfield projects , according to OECD (OECD, 2006: 62).
- The budget of the FIPA was EUR 742.739 in 2005, the second highest budget in South Eastern Europe, following that of the Bulgarian investment promotion agency. There is no doubt that higher budgets and its effective usage will assist Bosnia in its quest for attracting higher FDI.

Box 4. FIPA: External Evaluations

According to Multilateral Investment Guarantee Agency (MIGA) Evaluation of Investment Promotion Agencies in Europe and Central Asia region, FIPA is ranked *average* with respect to the classification of “good, average, weak, very weak”.

OECD’s comparison among the investment promotion agencies in the SEE region as a demand generator and investment facilitator, reflected FIPA’s overall evaluation below that of the South Eastern Europe average in 2006.

Sources: *The World Bank Group (MIGA, IFC and the WB), 2009. OECD, 2006.*

- Performance of the FIPA is evaluated against the well defined criteria: number of contacts with potential and existing investors, number of presentations made and meetings, as well as quantity of realized investment projects and number of sector analysis and publications. It has a notable HR policy and its employees are well educated and knowledgeable.
- If the FIPA could establish further closer linkages between foreign investors and local firms, it will help facilitate domestic companies’ access to global markets. Moreover, it can also facilitate the integration of domestic SME into global value chain while improving the productivity.
- Effective and targeted investment incentives can play an important role in attracting the FDI. However, recent studies have revealed that the use of investment incentives focusing on foreign firms is not always a successful panacea. Having said this, the BiH Government has established Foreign Investor Support Fund, providing foreign firms with investment incentives in selected sectors thereby creating new jobs. In 2008, the budget of the fund for is one million euros and it aims to promote foreign investment projects in manufacturing, research, development etc. -except trade, banking, leasing and insurance-. Moreover, plenty of soft incentives exist; such as one stop shop for construction permits, working permits, visas, etc., site-visits, consulting services, partnering / matchmaking services and networking etc. Furthermore, FIPA established regular contacts with investors and seek to involve in policy advocacy.
- FIPA and the foreign investment promotion agencies of the Albania, Montenegro, Croatia, Macedonia and Serbia signed a Memorandum of Understanding in order to cooperate in various programs and projects and share their experience and best practices in FDI. FIPA is a member of the World Association of Investment Promotion Agencies (WAIPA).

2.5 Recommendations

- Even though there are substantial improvements in FIPAs functions, the agency stills needs to consolidate its activities through solid measures including facilitation of licensing and administrative procedure for greenfield projects.
- BiH had experienced a civil war and it is always difficult to change investors' perceptions for the post conflict states. Moreover, heavy bureaucracy associated with lack of essential coordination among all levels of public offices lead to uncertainty in the eyes of investors. FIPA, therefore, should be further taking part in the image making efforts and in policy advocacy with the government institutions while streamlining the administrative procedures to the greatest extent possible.
- FIPA needs to hire industrial specialists especially in the priority areas. That will enhance the country's stature as an investment destination by directly targeting high profile investors, increasing the institution's responsiveness to investor needs through better quality and timeliness of responses to queries.
- TVET and VET should be placed at the centre stage of the HR policies at the FIPA. Rising skills and qualification of FIPA employees will help improve quality of services it provides investors with.

Trade Policy

Trade Liberalization
International Trade Agreements
Non-Tariff Barriers

3. Trade Policy

3.1 Investment and Trade Policy

A sound trade policy helps improve investment environment. As it enables specialization and scale economies, trade policy is one of main drivers of productivity, thereby increasing countries' capacity to attract the foreign investors.

3.2 Trade policy in Bosnia and Herzegovina

BiH is running a relatively sizeable trade deficit of 4 million KM in 2008 and its export capacity is still significantly limited. Bosnia and Herzegovina has successfully adopted notable unilateral trade reforms since the end of the civil war. Its *Most Favored Nation* (MFN) applied simple tariff average of 7 percent in 2008 is slightly higher than that of 2001. The use of nontariff barriers, however, is quite restricted and the country has one of the lowest tariff rates on agricultural products among all of the Southern and Eastern Europe (SEE) countries (World Bank, 2008a).

3.3 Policy Sub-dimensions, analytical tools and framework

Under Trade Policy category, policies related to international trade agreement, non trade barriers, tariffs are examined while barriers to export such as lack of a technical standard, certification, branding etc. are addressed.

3.4 Policy Findings

- Easy border crossing is essential in well-functioning international trade. The agreement on the creation of new border crossings has been signed between BiH and Serbia but it has still not been ratified by either party. Even though it is not ratified yet, it is operated quite effectively.
- In case of "serious doubts or concerns concerning the origin of a good", the requirement of making deposits at a bank was; this and other relevant amendments are quite likely to enhance investors confidence.
- Customs administrations of BiH were unified in 2004, aiming at building a system for more coherent implementation of trade policies at the state level. Under the previous arrangement, neither of the entities' customs administrations enforced trade or customs regulation coherently. That resulted not only in inefficient collection of budget revenues but also led to serious distortions in trade flows. The merger of BiH customs administrations into the Indirect Taxation Authority (ITA) substantially improved conditions for foreign trade by reducing the number of customs clearing houses, promoting selection of highly qualified staff, introduction of single standards for imports and exports, etc. Following the establishment of ITA, customs revenues have increased considerably.
- BiH has signed Free Trade Agreements and preferential trade agreements with various trade blocs and countries; such as CEFTA (Central European Free Trade Agreement), FTA with Turkey, prefer-

ential trade agreement with EU, Preferential Export Regimes with USA, Australia, New Zealand, Switzerland, Norway, Russia, Japan, and Canada etc. Though, FTAs are expected to enhance trade between BiH and countries concerned, its full potential has yet to be materialized.

3.5 Recommendations

- Supporting export performance in terms of level and diversification is a crucial policy. Costly and lengthy procedures for obtaining export certificate usually puts heavy burden on exporters as BiH certificate of origin is not always recognized beyond the ex-Yugoslav market such as in Romania and Bulgaria. Therefore, the procedures need to be streamlined. A well defined export promotion policy will boost confidence in BiH products while helping increase productivity and competitiveness and attract FDI.
- There is an urgent need to improve the human capital in government institutions as it will enhance quality of the services and reduce corruption perception.
- Institutional framework related to foreign trade, industry and agriculture needs to be re-defined and integrated as it leads to well-functioning and better coordination among the governmental institutions. This will be particularly useful in state level (Hadiomeragiæ, A., Jakubiak, M., et al, 2007). Moreover, a sound human capital policy should be devised for the trade related governmental bodies. Coordination between state and entity will improve the implementation of the trade related measures.

Labour Market Policy

Informality in Labor Markets
Labor Outcomes
Employment Protection Legislation
Labor Cost
Payroll and Labor Taxes

4. Labour Market Policy

4.1 Investment and Labor Market Policy

Globalization facilitates reallocation of labour across sectors and countries. But the increasing speed and scope of global integration does increase the need for sound labour policies, and also raises potential costs of labour market distortions. Moreover, findings reveal that sound labor market policies help enhance investment environment.

4.2 Labor Market Policy in Bosnia and Herzegovina

Transitory labor markets of Bosnia and Herzegovina are difficult to examine by employing standard data sources and techniques. The registered data on employment through surveys are limited as they obviously do not include the informal economy.

The labour market challenges are various reflected in 1-/high wages compared to productivity in the formal sector as underlined by World Bank (2005), 2-/ large and growing share of informal employment where employees are not covered by social security network, 3-/persistent unemployment.

4.3 Policy Sub dimensions, analytical tools and framework

Even though availability and reliability of the analytical tools to examine grey economy is quite limited, it is certain that informality is a highly relevant topic in the BiH labor market. Furthermore, labor outcomes, employment protection legislation, gross labor costs, and payroll taxes as well as labor taxes are identified as the main sub-dimensions, having significant impact on investment.

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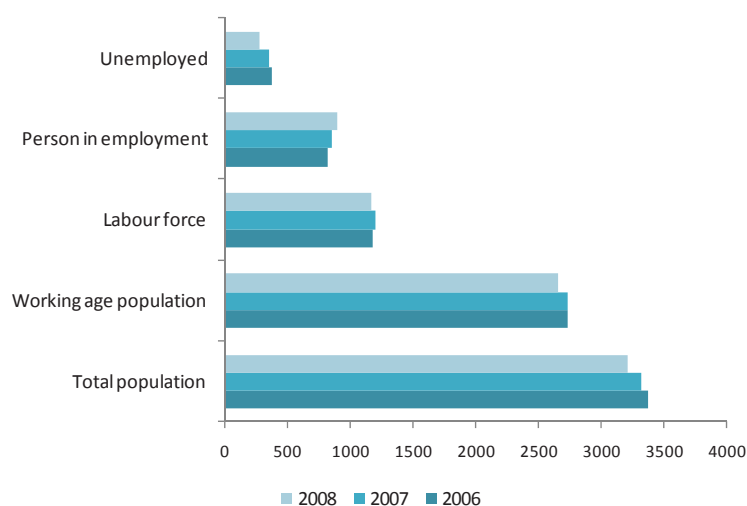
4.4 Policy Findings

- Informality in the labor market is prevalent in BiH; according to World Bank (Krstic, G. and Sanfey P., 2007), informal employment accounts for 47 percent of the total employment. Although its impacts on the investment environment are not well-documented, high informality can result in inefficiencies/low productivities in the longer term.
- High labor taxes have led to high tax wedges in the Western Balkans. The average tax wedge, 35 percent (World Bank, 2008b:58), was found to be higher than that of low-income OECD countries in 2003. The reform process underway in BiH since then, led to a marginal fall on the tax wedge (32.4 percent) by 2007 (World Bank, 2008b: 58). As high tax wedges result in growing economic informality as well as to weaker job creation, it needs to be reduced.
- Employment Protection Legislation (EPL) is an effective tool in protecting workers from the risk of losing their jobs. On the other hand, as EPL reduces the probability of being fired, it may also decrease the probability of hiring the new employees. EPL in Bosnia and Herzegovina is one of the least flexible in South East Europe.

In addition to EPL, the labor movement rigidity is notably high due to the existence of the psychological barriers such as possible unfair treatments in the other regions of the BiH arising from ethnic fragmentation or lack of available housing.

- According to the World Bank (World Bank, 2008b: 87), BiH has one of the highest indexes of hiring difficulty, 67, whereas its neighbors Albania, Montenegro, have relatively lower score of 44 and 33 respectively. On the other hand, in terms of the difficulty of firing index¹ BiH has moderate score of 30, while Macedonia and Croatia hold higher index values of 40 and 50 respectively. Needless to say, difficulty of firing and hiring as well as employment rigidities at large, have direct impact on the investment decision. The combination of relatively high wages and employment rigidities is also reflected in persistent but decreasing unemployment rates in Bosnia and Herzegovina.

Figure 5. Employment, Labour Force in BiH (x1000)

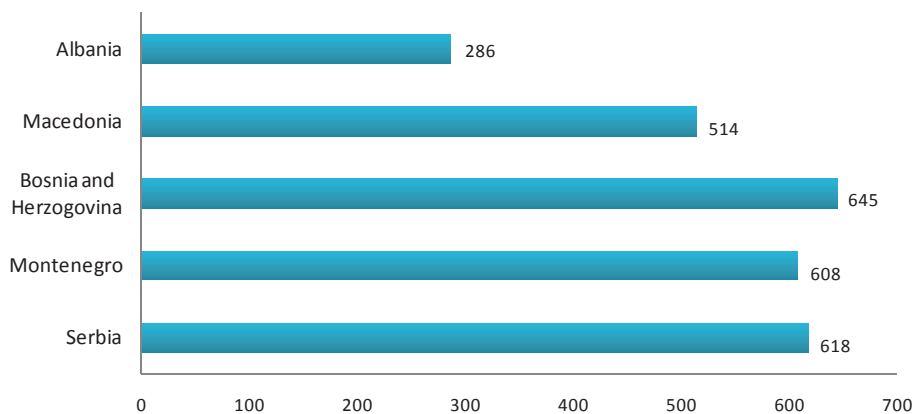


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- Figure 5 gives the total labor costs² for the year 2006 in BiH. It has relatively high gross labor cost figures in the region with USD 645, compared to those of, FYR of Macedonia, Montenegro and Serbia; USD 514, USD 608, USD 618 respectively^[1]. Labour costs are one of the most important issues which investors carefully examine prior to making an investment.

¹ Developed by the World Bank and the IFC.

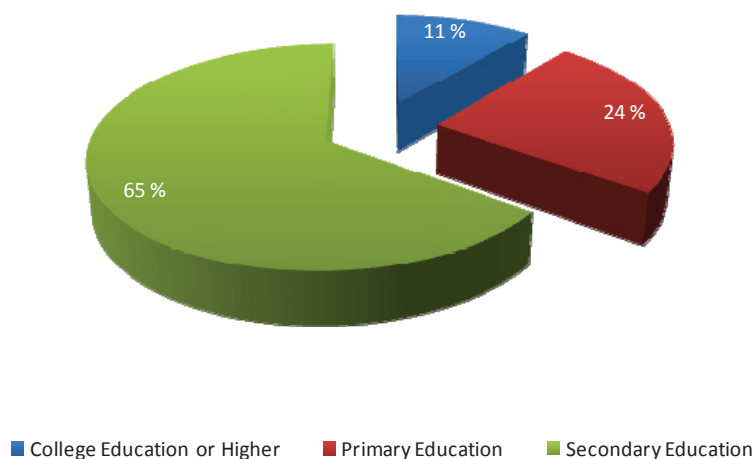
² The statistics concept of labour cost comprises remuneration for work performed, payments in respect of time paid for but not worked, bonuses and gratuities, the cost of food, drink and other payments in kind, cost of workers' housing borne by employers, employers' social security expenditures, cost to the employer for vocational training, welfare services and miscellaneous items, such as transport of workers, work clothes and recruitment, together with taxes regarded as labour cost. (ILO)

Figure 6. Total Labor Costs in 2006 (USD per month)

Source: Site resources, World Bank

- Total labor cost includes gross wages and the social security contributions by the employer.
- According to the World Bank, there is evidence that the effect of education and seniority on earnings was more in line with regulations in the late 1990s than they are today.
- Trade union membership remains heavily concentrated in the state-owned and mass privatized sector, albeit with declining influence.

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Figure 7. Labor Force by Highest Education Attained in 2008

Source: Labor Force Survey, 2008

4.5 Recommendations

- Informality needs to be reduced in the long run albeit its positive impact on employment and investment at the early stage of development.
- Labor taxes need to be further lowered in order for attracting Foreign Direct Investment in line with the development objectives of BiH.
- EPL is one of the highest in the SEE, and it is recommended that the government relax the strong grips on the labor market therefore this will increase the employment opportunities.
- Enforceable set of labor regulations should be created and youth minimum wage needs to be introduced. Furthermore, coefficients used in calculation of the wage require simplification and rationalization. Reducing the duration of maternity leave will have a positive impact on employment of women.
- Tripartism is gradually becoming a norm but the industrial relations is still in the state of a flux, and the social partners are still underrepresented.
- Social security contributions of the RS and of the FBiH as well as that of the Brčko entity differ from each other significantly. In FBiH, employer share accounts for 11.50 percent on gross wage (7 percent for pension insurance, 4 percent for health insurance, 0,50 percent for unemployment insurance) In Brčko District: 7 percent on gross wage for pension insurance whereas in RS, there is no contributions. Harmonization is required as the state level in order to create single economic space.

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Box 5. Social Security Policies in BiH

Harmonization of social security policies is required at the state level

In FBiH, employer share of social security accounts for 11,50 percent on gross wage (7 percent for pension insurance, 4 percent for health insurance, 0,50 percent for unemployment insurance) In Brčko District: 7 percent on gross wage for pension insurance whereas in RS, there is no contributions.

Also employee's share of social contribution differs greatly amid entities; in FBiH, it is 5.5 percent on net wage whereas in RS, it varies in the range of 42–57 percent of net wage.

- Enterprise restructuring should be promoted, freeing up unproductive labor currently employed in inefficient firms or organizations in order for reallocating the resources.
- Moreover, Public Employment Centre as well as other active labor market policies need to be launched in order to boost the employment.

Tax Policy

Tax Legislation
Tax Administration
Compliance Costs

5. Tax Policy

5.1 Investment and Tax Policy

Concerning the impact of taxation on investment, ongoing debate concentrates on the appropriate level of a host country's corporate tax burden so as to boost inward FDI. It is also essential for determining cost of tax relief granted to such investments and for estimating the impact on tax revenues of corporate tax policy reform.

Studies examining international flows revealed that on average, FDI decreases by 3.7 percent following a 1 percentage point increase in the tax rate on FDI (OECD, 2008). Other estimates indicate that decreases up to 5 percent triggered by a 1 percentage point increase in the tax rate depending on the industry as well as impact of other factors.

Other studies indicate that that FDI is becoming increasingly sensitive to taxation, emphasizing the increasing mobility of capital as non-tax barriers to FDI are largely removed.

Do You Know This?

A recent analysis revealed that FDI decreases by 3.7 percent following a 1 percentage point increase in the tax rate on FDI.

5.2 Tax Policy in Bosnia and Herzegovina

The state level government is comprised of many autonomous administrative units with almost no essential coordination on taxation. Disorganized government structure, therefore, creates obstacles to enforcement of taxation. According to a research study conducted by *Open Society Fund*, policy reform on direct tax reform has not received adequate attention whereas relevant policies on indirect taxes are rather harmonized at the state level and in place. The same study also argues that the current direct taxation system is highly burdensome with inconsistencies, and is difficult to enforce. This is likely to be one of the main reasons of increasing informality in the BiH economy.

A complexity and lack of coordination among the government institution creates cumbersome tax environment. For instance; legislation is made at cantonal level, the policies are enforced at entity level while tax revenues is used by municipalities as there is no central authority ensuring the coordination among them.

5.3 Policy Sub-dimensions, analytical tools and framework

Under taxation, corporate income taxes, personal income taxes, transparency, taxation of wages, dual taxation are addressed.

5.4 Policy Findings

- At 10 Percent throughout the BiH, corporate income tax rate is very attractive for investors, domestic and international. However, tax bases are defined differently in FBiH and RS. Moreover, there is a need for consistency between the entities and Brcko District, enabling firms to submit only one tax return in its location.
- In BiH, personal income tax (PIT) is levied on the following items: wages, farm earning, property income, and property rights, capital gains and others. In FBiH personal income tax is dealt with at cantonal level, whereas in RS it is regulated at entity level. On the other hand, Brcko district has its own legislation for PIT. In order to restore investor confidence and to create single economic space, state policies are highly needed.
- In BiH, wages are being taxed at 10 percent of the gross salary while the taxation rate of other PIT items varies in the range of 10 percent to 30 percent, depending on the type of the income. On the other hand in RS tax base for wages is net salary while changing from 0 to 15 percent.

Box 6. Tax Incentive for Foreign Investors

The Corporate Income Tax legislation of the FBiH enables firms to deduct the amount of tax equal to the percentage of foreign capital invested in the assets of the company for a period of 5 years, provided that the foreign capital is greater than 20 percent of capital invested. The incentive is valid for companies with 100 percent foreign capital investment.

In FBiH, companies investing their taxable profits (earnings before tax) in their own production activities or in buildings are given a tax relief of 100 percent of the invested value or in the amount of 75 percent if they invest in other activities of their company. Investment capital is exempt from paying import customs and customs duties (with the exception of passenger cars, slot and gambling machines).

Source: FIPA (<http://www.fipa.gov.ba>)

- Transparency, availability of tax relevant information, simple and comprehensible tax law and regulations as well as fewer compliance cost are essential constituents for a sound and fair tax policy. In BiH, taxation procedures need to be streamlined and published in local language as well as in foreign language, ensuring the highest possibility of transparency and dissemination.
- As it is widely observed in many dimensions, existence of different tax policies between FBiH and RS could lead to negative perception regarding the investment environment in BiH from the investor point of view. Therefore, the harmonization and enforcement of nation-wide policies will increase the investor confidence. This is particularly hold true for the taxation of dividends and capital gain. They are taxed at the rate of 5 percent in FBiH, whereas in RS and in BD, on the other hand, they are not taxable.

Do You Know This?

Dividends and capital gains are taxed at the rate of 5 percent in FBiH, whereas in RS and BD, they are not taxable.

- In FBiH, withholding tax on Interest to a non-resident is at 10 percent as it excludes interest paid for procurement of equipment and goods, as well as deposit interest, while in RS the interest paid to a non-resident is not taxable (Foreign Investors Council, 2009).
- In RS, The Corporate Income Tax Law entails the payment of 10 percent withholding tax for capital gain realized by non-resident legal person through sale of stock or share held in a resident company in RS. On the other hand, in FBiH tax is not levied on capital gain, regardless of by non-resident company or domestic company through shares or immovable property in FBiH.
- According to the current legislation in RS, a taxpayer with the principal place of business in FBiH or BD need to pay tax for the profit made only in RS as it is deductible under the new Corporate Income Tax Law in FBiH.

Nevertheless, a taxpayer, whose principal place of business is located in RS, while conducting commercial operations in BD and FBiH, should, under RS laws, pay the tax in RS on total profit of the company, even though taxpayer needs to pay the tax in BD too on profit realized from operations in BD.

Do You Know This?

Double Taxation needs to be avoided as a company operating in different entities shouldn't be penalized for its nation-wide activities.

5.5 Recommendations

- The FBiH Corporate Income Tax Law allows tax payer investing worth not less than KM 20 million, to be exempted from the corporate tax obligation for a period of five years, since beginning the first year of investment provided that four million KM is already invested in this year. In order to be entitled to benefit from the tax relief, investors are required to submit a plan elaborating the time schedule of the investment. In the law, no specific submission date of the plan is indicated thus leading to disagreement between tax authorities and investors over the commencement and realization of the tax relief. Essential modifications of the law should be done to enable the investor enjoy tax relief.
- Transparency plays an important role in enticing investors into making an investment. Timely dissemination of information concerning tax would help promote invest in BiH. To this aim, publishing bilateral agreements on a website of the relevant ministry will be instrumental in disclosure of the recent developments.
- Lack of coordination among two entities lead to different and destabilizing policy implications at the state level. Establishing coordination concerning tax policy are strongly required to establish a single economic space.
- Dual taxation among the entities is an important challenge, breeding limited local business, rather than nation-wide operations and hindering the free flow of FDI within the country. The state policies preventing dual taxation need to be adopted immediately.
- Transparency should be embedded at the core of every tax policy program or activities as it is a crucial tool against corruption.

Aid Policy

Donor Programs
Coordination

6. Aid Policy

6.1 Investment and Aid Policy

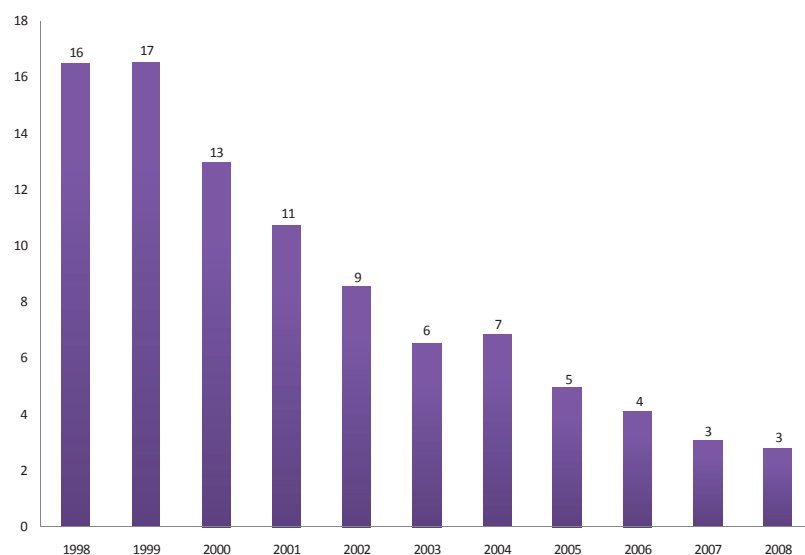
Financial flows to developing countries take three forms—FDI and portfolio investments (private flows), remittances from migrant workers, and Official Development Assistance (ODA) from foreign governments (World Bank, 2004a).

Most lower income countries are unable to attract private investors at satisfactory levels. While in such countries, ODA remains the most important source of foreign financial flows supply constraints limit ODA to play significant roles; ODA accounts for less than 3 percent of the GDP in low-income countries and only 0.5 percent of GDP in middle-income countries in average.

In development circles, there is a growing interest in a particular ODA type, “aid for trade”, aiming to take advantage of trade opportunities and to strengthen partner’s ability to assess and represent their interests in trade negotiations. ODA also covers measures such as trade negotiation capacity building, infrastructure and marketing development, as well as capacity building in meeting sanitary and phyto-sanitary standards.

6.2 Aid Policy in Bosnia and Herzegovina

There is a dramatic decline in the *ratio of the aid to GDP in recent years*. It begun with 7 percent in 2004 and was reduced to only 3 percent in 2008. Even though BiH receives one of the highest ODA in its region with respect to its population and the size of the country; development cooperation programs have yet to yield the long-awaited outcomes. For only investment projects, OECD DAC members provided BiH with 162 million USD in 2007 while it rose to 189.1 Million USD in 2008. Multilateral donors on the other hand increased the provision of ODA by 40 percent from 2006 to 2007, whereas there was no rise over 2007-2008.

Figure 8. Aid/GDP (in percent)

Source: OECD Stats & IMF WEO

The aids include total amount of grants, loans, and expenditures on technical cooperation.

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6.3 Policy Sub dimensions, analytical tools and framework

Even though the availability of reliable data and publication is quite limited, PGlobal's survey and the interviews reveal that aid policy of international community has direct impact on the investment environment in BiH. On the other hand, lack of systematic evaluation and harmonization of the aid programs has made it difficult to assess their outcomes.

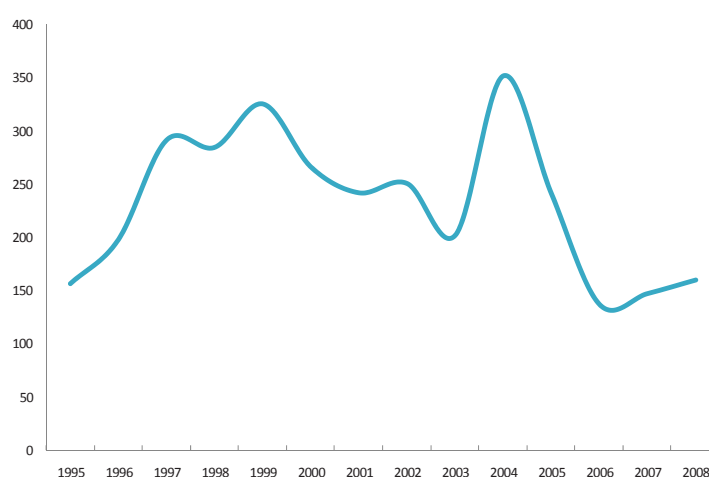
6.4 Policy Findings

- While the provision of official development assistance (ODA) to BiH is in continuous decline (see Figure 8),¹ there is still strong need for collaboration of government institutions and donor agencies in order to maximize the impact of decreasing aid.
- BiH Government has taken some steps to strengthen the system of foreign aid coordination over the last years (BiH Ministry of Finance and Treasury Sector for the Coordination of International Economic Aid, 2009), including reforming the aid coordination architecture, improving public expenditure planning process, programming and managing external funds in line with BiH development priorities, as well as actively taking part in the programs aiming at improving the effectiveness of external assistance flows to Bosnia and Herzegovina. However, these efforts yet to produce the expected policy outcomes.

¹ The main reason is that the country received ODA primarily due to its status as a post-conflict country. Relatively high per income makes it difficult for the country to receive high levels of ODA. The World Bank has announced that the country will, by 2012 cease to receive IDA funding.

- BiH Government still has a rather limited capacity in performing effective aid coordination. Existence of a large number of donors with differing practices, acting almost independently aggravates the situation by reducing the effectiveness and impact of the funds and leading to duplications of activities and effort.
- Preparation of a new memorandum of understanding related to implementation of Paris Declaration² in BiH is underway and expected to be signed shortly between BiH Council of Ministers and donors. The signing of the agreement may be instrumental in increasing aid effectiveness (harmonization, alignment and aid management with a set of monitorable actions and indicators).

Figure 9. Multilateral Aid (million US\$)



Source: OECD Stats

- *The multilateral aid figures include the grants, loans, and expenditures on technical cooperation.*
- Among the multilateral agencies, European Union (EU) provides BiH with the largest amount of ODA (see Figure 9). The second largest source of aid is the World Bank whose funds stand at one-third of those of the EU as it is three times more than that of World Bank. While there are many donors and multilateral development finance institutions present in the country, the visibility of many is quite limited (such as for the Islamic Development Bank).
- *Business Enabling Environment Adjustment Credit* project, implemented by the WB aimed at improving the investment climate and support private sector development by reducing administrative and regulatory barriers. Under the project, Electronic Business Registration system has been launched leading to a reduction of the overall number of days required to start business operations from *80 days* in 2002 to *29 days* in 2007. Moreover, the entity inspections were streamlined so as to reduce the average number of inspection days per business to 9.94 in the FBiH and 7.46 in the RS (World Bank, 2008c).

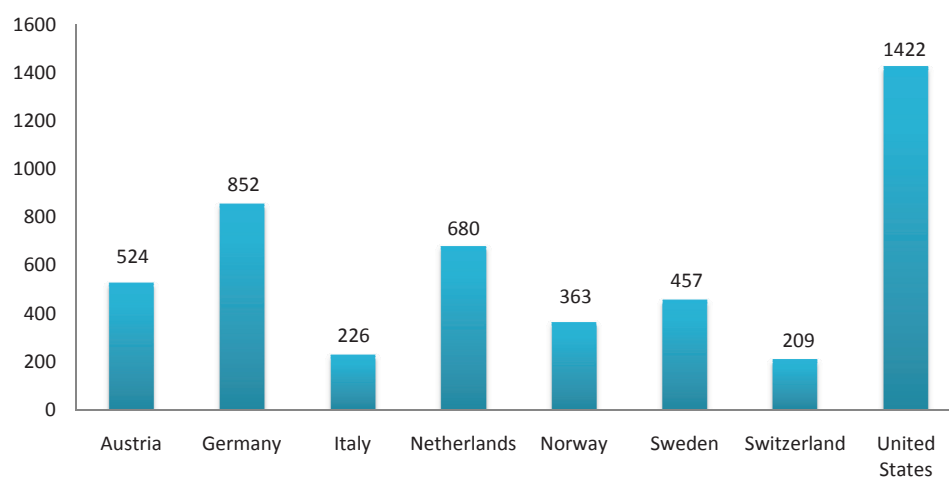
² The Paris Declaration, endorsed on 2 March 2005, is an international agreement to which over one hundred Ministers, Heads of Agencies and other Senior Officials adhered and committed their countries and organizations to continue to increase efforts in harmonization, alignment and managing aid for results with a set of monitorable actions and indicators.

Do You Know This?

As an outcome of the world bank project, *business enabling environment adjustment credit* in BiH, overall number of days required to start business operations reduced from 80 days in 2002 to 29 days in 2007.

In addition to *Electronic Business Registration* system, several other substantial programs have been undertaken to improve the country's business enabling environment including changes and amendments to the bankruptcy and liquidation laws, strengthening of FIPA and abolishment of obligatory membership in the chambers of commerce.

Figure 10. Bilateral Aid: 1995-2008 (million US\$)



Source: OECD Stats

- The bilateral aid figures include the cumulative amounts for grants, loans and expenditures on technical cooperation for 1995-2008 period.

6.5 Recommendations

- There is a strong need to coordinate the ODA activities as there is a large number of donors with differing practices seemingly with little coordination, a lot of overlaps and duplication of effort all leading to ineffectiveness.
- There is a strong need to improve the communication channels between the government and donor agencies and to continue improving the government's coordination and monitoring capacity.
- There is also a strong need to enhance the statistical capacity of the government institutions in the aid accounting in order for avoiding the duplication and making the essential coordination.
- Impact assessment is critically important in the success of the aid programs. While it has become a norm in multilateral aid organizations, bilateral agencies still need to improve evaluation techniques and the outcomes should be shared with policy makers and governmental institutions.

Human Capital

Education Policy
Labor Market Conditions
and Regulations

7. Human Capital

7.1. Investment and Human Capital

Human capital refers to the stock of competencies, knowledge and personality attributes embodied in the ability to perform labor so as to produce economic value. It is gained by a worker through education and experience and is one of the essential ingredients of economic growth. Moreover, highly qualified workforce with flexibility to adjust themselves to changing market conditions and to adopt advancing technology is critically important in attracting foreign investment.

In a globalized world, investors direct the economic and financial resources to economies where the cost of production is relatively lower than their home country with a view to achieving higher the return of investment. However, achieving cost advantage alone is not the only determinant to attract investors and very often the productivity concerns takes precedence in making investment related decisions. As it is relatively easy to conclude that there is high correlation between productivity and stock of human capital, the quality of workforce has obviously a direct impact on the *attractiveness of a country to FDI*.

Human capital cannot be developed or improved in the short run. Building the stock of human capital thus requires sound and sustainable policies with strong government commitment and general public awareness.

7.2 Human Capital in Bosnia and Herzegovina

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Prior to the civil war that broke in 1992, Bosnia and Herzegovina was one of the industrial hubs of the Former Yugoslavia with a relatively well educated and skilled labor force. At the beginning of the 1990s, its production industry employed approximately half a million workers, largely in manufacturing industries, including textiles, armament, machines, metals and wood processing. Subsequent to the disintegration of the Former Yugoslavia, job opportunities in these industries became scarce making it a challenge for the workers to find other positions in other industries due to lack of adjustment programs, particularly VET. Therefore, strong labor market segmentation exists.

BiH had a highly educated skillful labor force of which at least with 70 percent had a high school degree while the ones with university degree accounts for 14 percent according to the 1986 census. On the other hand, due to significant amount of human loss and migration of educated population during the civil war and ethnic clashes, the human capital stock of the country has been negatively affected. Furthermore, the war devastated the educational infrastructure of the country and disrupted the education at all levels and hasn't recovered for a decade. During the turbulent times, approximately sixty percent of the school buildings were destroyed or heavily damaged. Following the Dayton Peace Agreement in 1995, with the help of international community, the schools and the universities have been reconstructed or rehabilitated.

Assessments reveal that the education system and infrastructure of Bosnia and Herzegovina require a major restructuring and reform. Of the secondary school system, in total; the share of vocational education (VE) inherited from the centralized education system of the Former Yugoslavia is very high. Even though the promotion of VE becomes universally accepted as a remedy for unemployment as its graduates are easily employed, most of these occupations of VE programs of the BiH are no longer demanded in the markets.

Moreover, for the transformation of education system according to needs of market economy and establishment of contemporary child-centered teaching, majority of the teachers need in-service teacher training. Higher education system is still fragmented and needs coordination in order to increase the efficiency of the system.

7.3 Policy Sub-dimensions, analytical tools and framework

Education as a sub-policy dimension is found to be highly relevant in policy analysis of the human capital policy in BiH and divided into the following sub-dimensions: education quality, vocational education and training (VET), life-long learning and continuous education for adults, workforce skills development, civil servant training and transparency in education.

The policy findings of the analysis are presented below, followed by a separate section on recommendations.

7.4 Policy Findings

- Recently, Bologna process and the Lisbon Strategy were adopted in BiH. Moreover, Education Credit Transfer System (ETSC) was approved in higher education and the implementation of Erasmus Exchange Program has been put into effect.

Recent policy reforms are likely to improve the quality of education both in secondary and in higher education while helping Bosnia and Herzegovina pursue its path to full membership of European Union.

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- Two new education agencies were established in 2009: *Quality Assurance in Higher Education*, for accreditation, and *Agency on Pre-Primary, Primary and Secondary Education*, for preparing and overseeing curriculum development, setting the evaluation criteria, and assuring quality in-service teacher training & provision of teacher certification and recognition.
- Educational institutions' mandates and directives –the relevant legislation at large-, are still unclear and they do not assign the well defined tasks to each institution. Currently, twelve institutions are active but their field of operations and responsibilities are largely overlapping.
- New policy dimensions aiming to enhance and measurability in education are urgently needed. Currently, there is no standard data collection system available in BiH, which is compatible with that of the EUROSTAT.
- Emigration during and following the civil war caused substantial declines in the population of the BiH and recovery from negative demographical shocks seems being kept high on the agenda of the BiH government for the coming decades. Incentive systems should be launched to attract the country talents abroad to the BiH and policies making reverse immigration possible are strongly needed.

7.5 Recommendations

- The recent policy reforms are likely to improve the quality of education both in secondary and in higher education. But the process needs continuous monitoring and a sound enforcement.
- There is no coordination between public administrative structure of the FBiH and RS. Furthermore new policy dimensions aiming to enhance and measurability in education urgently need to be adopted.

Corporate Governance

Separation of Ownership and Control
Compilation with
International Standards

8. Corporate Governance

8.1 Investment and Corporate Governance

Corporate governance defines (OECD, 2004) a set of relationships between a company's management, its board, its shareholders and other stakeholders. It also provides the structure through which the objectives of the company are identified, and the means of achieving those goals and monitoring performance are determined.

It is well-documented that well governed firms invested more than poorly governed ones. A study conducted in the US manufacturing industry revealed that increased governance quality leads to higher levels of investment and greater responsiveness of investment to growth opportunities (Øyvind, B. et al, 2007). Sound governance also mitigates the underinvestment problem that arises from incentive problems between managers and shareholders while improving the efficiency of capital allocation among firms. It is also observed that better governed companies achieve higher market valuations, increasing the inflow of capital from both domestic and foreign sources in the form of debt and equity.

8.2 Corporate Governance in Bosnia and Herzegovina

Both the FBiH and RS have achieved a notable progress in establishing basic legal and institutional framework for sound functioning capital markets. The improvements include privatization¹, laws improving the governance of the SOE, establishment of the new state commission for accounting and auditing, the development of a common electronic platform for local business registers etc. As the recent policy reforms are impressive, however, many challenges still exist: relevant information about companies is quite limited and most of data is far from being reliable and responsibilities and duties of the board of directors are not well defined. Moreover, security commissions of both entities don't have sufficient control over the securities and their issuers as their resources and authority are limited.

According to the World Bank report on Corporate Governance (World Bank, 2006), corporate governance code is not clear and the companies' awareness of corporate governance is limited. Also significant differences between the corporate governance regimes of each entity are noted.

8.3 Policy Sub-dimensions, analytical tools and framework

Even though corporate governance topics are highly relevant to investment, such as shareholders rights and equitable treatment, the role of stakeholders, transparency and disclosure, the responsibilities of the board, implementation and enforcement separation of ownership and control, decisions on environmental issues etc, main focus of interest in this report is limited to compilation of BiH accounting system to international standard and norms. This is because transparency and reliability of financial statements is a crucial prerequisite that will enhance business quality in the country as well as investor confidence.

¹ According to many international organization, Privatization is not considered succesful.

Even though the focus of this part is on the accounting standards, the PGlobal's survey and interviews revealed that code of business conduct and corporate governance associated with a sound organizational structure and culture needs to be improved in line with international accepted standards and norms.

8.4 Policy Findings

- Firms in both entities are liable for maintaining accounting records, preparing and submitting accounting statements according to the provisions of the Law on Accounting, the International Accounting Rules and International Accounting Standards (FIPA).
- Even though the required legal framework is in place, compliance with accounting requirements is not effectively and consistently enforced throughout BiH due to obstacles in enforcement regime, including management, statutory auditors and regulators.
- While the banking regulatory agencies actively seek to enforce accounting standards in credit institutions, their mandate implies a focus on prudential requirements rather than compliance with accounting standards in general-purpose financial statement (World Bank, 2004)
- The stock market and insurance regulators intend to enforce the accounting standards, but implementation is limited to general-purpose financial statements. Moreover, in most of the firms or of SOEs, enforcement, to a great extent, rest on the corporate managers and directors.
- According to a World Bank study (World Bank, 2004b), inconsistent compilation of accounting and auditing requirements has negative impact on the economy of the BiH. Therefore, there is a strong need for improving firms' organizational structures and cultures to promote coherent implementation of compilation and ensuring transparency in enterprises financial conditions and performances.
- In BiH, The skills required for the audit profession need to be improved through continuous professional education and auditors should be encouraged for lifelong learning.

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8.5 Recommendations

- Improvement in the enforcement of international accounting standards will help attract foreign investors while making foreign resources available to domestic companies.
- Enforcement of compilation need to be improved while there is a high need for raising the awareness of the sound corporate governance amid the managers or CEO's.
- Conducting audit related TVETs for government officials as well as private sector employees will help enforce the legal framework, corporate competitiveness and corporate performance.

Anti-Corruption

Legal framework
International Conventions
Governance and Public Administration
Policy Transparency

9. Anti Corruption

9.1 Investment and Anti-Corruption Policy

Corruption weakens governance and it has a significant adverse impact on legal and administrative structure: It jeopardizes sustainable development process, democratic process, as well as fair business practices. Given the fact that it is a multi-faceted challenge, it is necessary to take a multidisciplinary approach to combat corruption in business. Furthermore, it is critically important to adopt anti-corruption strategies to all policy dimensions as no country can afford the social, political or economic costs incurred.

Corruption also erodes public and investor confidence in political institutions and democracy, undermines rule of law. It profoundly distorts the allocation of resources and destabilizes competition, particularly in transition economies. Recent studies have revealed that together with the impacts above, corruption has a devastating effect on investment, economic growth and development. Therefore, governments seek to alleviate it and pay utmost attention to the relevant polices.

Some effective tools exist to combat with corruption as transparency is identified as one of the most important one in its eradication. It plays a significant role to enhance government's procedures and decision-making processes and it raises the awareness of accountability and obliges the government officials to justify their decisions. In order to integrate transparency into every policy dimensions, the first step is to adopt the laws, entitling public to learn governments operations and decisions.

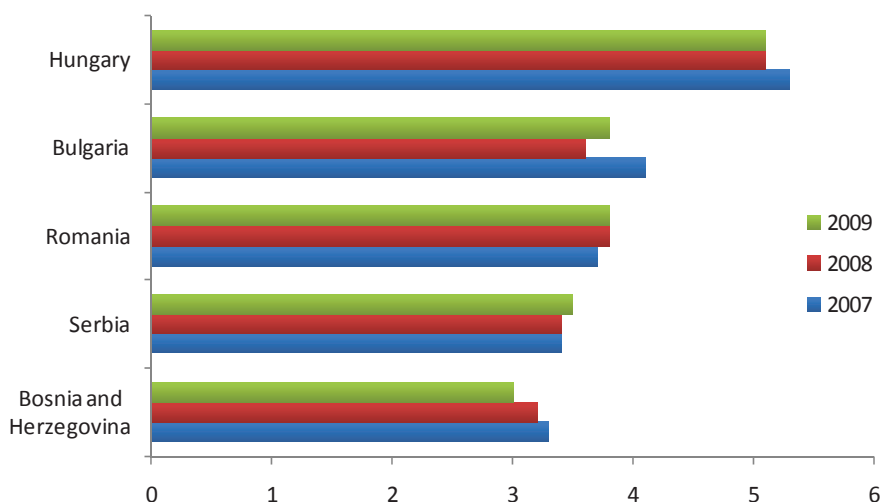
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Entire eradication of the bribery is a highly challenging target and very often, it is not possible to achieve. However, reducing it to marginal amount is the target of the many transition countries. It usually requires several consecutive steps such as training the government officers, forming effective control mechanism between citizens and officials etc.

Policy makers give a high priority to launch anti-corruption policies and enhance the enforcement of the laws through existing organizations in order to successfully combat corruption.

9.2 Anti-corruption policy in Bosnia and Herzegovina

Bosnia Herzegovina has completed a successful post-conflict state transition converting from a centrally planned economy to a market economy. During this transition, corruption has become an important obstacle to overcome. This is indicated in the Corruption Perception Index 2009 as Bosnia and Herzegovina is ranked the 99th out of 180 countries while 1st is the least corrupted whereas 180th is the highest. Comparing to its neighbors in SEE, the country has the highest score.

Figure 11. Corruption Perceptions Index 2007-2009¹

Source: Transparency International

9.3 Policy sub-dimensions, analytical tools and framework

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In BiH, anti-corruption is found to be highly relevant dimension on foreign direct investment and is divided into four sub dimensions: legal framework, adoption of international conventions, good governance & public administration, and transparency.

In BiH, the development and adoption of new civil and criminal laws and regulations –better legal framework—are indispensable to deter corruption as they help establish a business enabling environment. The policy reform areas accordingly are identified as: judicial independence and professionalism; court monitoring; criminal code revision; enhancement of the prosecutor; restructuring and training of security forces; and the Judicial Training Center.

Do You Know This

During the interviews with investors, a striking anecdote is told that firm representatives, individuals who are planning to start a new business in BiH, agree to bribe in order to expedite the application process, assuming that the cost of delays would be much more expensive than the bribe itself.

9.4 Policy Findings

- According to the criminal legislation of Bosnia and Herzegovina, corruption is criminalized. It includes the enforcement of several legislations such as Criminal Codes of Bosnia and Herzegovina, Criminal Code of the Federation of BiH, Brcko District Criminal Code, Law on Conflict of Interest, Law

¹ Higher score indicates lower corruption

on Witness Protection, Law on Financing Political Parties, Law on State Investigation and Protection Agency and Law on Public Procurement.

- Efficient tax collection and custom revenues are essentially required for the economic development of BiH, ensuring free and fair trade while combating corruption.

Box 6. Treatment of CAFAO to Custom and Tax Services

The European Commission's CAFAO (Customs and Fiscal Assistance Office) program has identified several areas of improvement for reliable custom and tax services, including legislation and procedures; organization and infrastructure; training; compliance and enforcement; computerization; mutual assistance agreements with other customs and tax authorities; access to customs related international conventions; internal audit and management assurance.

Source: http://www.ohr.int/ohr-dept/afd/ac-cor-strat/default.asp?content_id=5240

- Various authorities and institutions are currently involved in combating with corruption in BiH. While their activities differ in size and in fields, they are not in collaboration with each other and therefore their overall impact is fairly limited.

9.5 Recommendations

- Multilateral Agreements, particularly those adopted by EC, such as “20 Guiding Principals Against Corruption”, should be integrated into legal structure of the BiH in order for better combating against corruption. Furthermore, policy coherence among the different policy dimensions of the anti corruption has to be established to achieve tangible results.
- Training plays an important role in combating corruption in both the public and the private sectors. Not only police, prosecutors and judges and government officials receive training on the newly adopted laws and procedures, but also the private sector representatives need to be informed of them. This will help ensure the enforcement and enhance investors confidence. As there are numerous training topics available on anti corruption, particular attention should be paid for supervision of banking and money laundering. Universities can adopt the ethic and anti-corruption courses into their curriculum. This helps train younger generation about the negative impacts of the corruption on development.
- Raising public awareness is an important measure in curbing corruption. Especially, it will be helpful if media is widely informed of the bribery incidences and recent improvements in legislation. Also citizens should be encouraged to complain about the corrupt officials and corruption in government institutes they are informed of or they witness.
- Current laws and regulations should continuously be updated by considering best practices in the world, particularly at the OECD countries, so as to improve the anti corruption legislation and to adopt them into ongoing reform process.
- Harmonization of the anti corruption policies and legislations of both FBiH and Republika Srpska are required to improve combating with corruption as it also helps to create a single economic space. Particular attention needs to be paid for tax relevant policies where tax evasion is extremely high.

- In order for the better control of the public revenues, IT structured “Integrated Revenue System”, which oversee revenues obtained through tax, customs, social security collections, can be created, allowing better combat with the corruption. Furthermore, streamlining the tax and custom regulations reduce the level of the corruption and help raise transparency.
- BiH has taken part in numerous international conventions, aiming to alleviate corruption. Even though they have been put into effect for a long time, they haven’t generated anticipated reduction in corruption, mainly due to weak enforcement.
- Establishing sound communication channels with investors and notifying them the recent developments about anti corruption policy sphere are as imperative as the policy reform itself. This is particularly important to enhance investor confidence while improving the transparency.
- Current public administrative structure which is highly complex and divided into many independent units involves challenges in decision making. Restructuring associated with better policy coordination facilitates rising efficiency and effectiveness. Particularly, investment related procedures contain too many burdensome steps and therefore it is very often resulted in corrupted actions.
- In 2007, Ombudsman offices of both BiH entities were merged in order to fight the corruption more effectively in the country. As current administrative structure of the newly established office is principally designed to deal with corruption in public sector, political interference should be prevented and essential policy measures should be taken against it accordingly.
- Substantial amount of literature and studies address correlation among corruption, poverty and inequality. Particularly, lower income is identified as one of the main drivers of corruption, explaining the rationale behind the low level of corruption in highly developed countries.

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The salaries of the government officials in BiH lower than the salaries of the ones occupying the same positions in the OECD countries. By taking budgetary limitations into considerations, the salaries can be raised to adequate level, allowing the recruitment of high caliber professionals in the public sector and help reduce corruption as they would be satisfied with their income.

- In 2003, the Office of the Prosecutors was established in FBiH in order to combat with crimes, terrorism, trafficking and corruption. The mandate of the office contains ambitious objectives but due to resources limitations, such as lack of finance and human capital and heavy workload etc., it has not functioned efficiently.

RS also established a prosecutor’s office with a view to fight against corruption and it would be useful to merge two offices under umbrella organization so as to achieve optimum result.

Regulatory Reform

Legal Framework
Institutional Framework
Regulatory Impact
Regulatory Transparency

10. Regulatory Reform

10.1. Investment and Regulatory Reform

An effective regulatory framework is central to appropriate business climate for economic agents, affecting private investment and the economic performance. Thus, the causality relations between regulatory quality and economic growth is of utmost important since it is generally agreed that ‘sound regulation addresses market failures that inhibit productive investment’ (World Bank, 2004c).

Sound regulation is also conceived as a factor, helping establish competitive markets and business activity at large. (Tomas, M., 2007). In this context, an effective regulatory framework is one that improves regulatory quality by enhancing the performance, cost-effectiveness, quality and implementation of regulations (OECD, 1997). A favorable regulatory framework is one that is conducive to investment by providing high quality, modern, market oriented laws along with an adequate institutional infrastructure, which is necessary for implementation of laws.

Regulatory reform involves actions on several fronts, namely legislative, institutional and organizational. It is important to develop a coherent regulatory strategy to synchronize these activities covering a wide range of simplifications, administrative burden reductions and quality control of new legislation. A sound regulation lowers regulatory burdens and provides instruments to realize social goals. Moreover, regulatory policies enhance competition and reduce regulatory costs, thereby bring about efficiency. Furthermore, regulation framework that reduces business burdens and increases the transparency of regulatory regimes supports entrepreneurship, market entry and economic growth, which in turn attract foreign and domestic investors (OECD, 2006).

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10.2. Regulatory reforms in Bosnia and Herzegovina

Despite complex constitutional framework of the BiH, and the challenges of transition period, the Council of Ministers of Bosnia and Herzegovina, entity governments and Brčko District have initiated a number of regulatory reforms in cooperation with the Peace Implementation Council, Office of the High Representative, the European Commission, and resident missions of the World Bank and IMF.

Under the regulatory policy reform in BiH, process of simplification of existing regulations in a sectoral manner, mainly having focused on the reduction of administrative burdens in the area of licensing and inspections in BiH has been undertaken. (Penev, S. and A. Marušić, 2009). In the context of promoting administrative simplification through two complementary approaches, ‘in designing and implementing regulatory reform, securing ownership and credibility among stakeholders, and marshalling resources to support implementation,’ the focus centres on the importance of engaging the appropriate levels of government (Tomas, M., 2007).

On the one hand, diagnostic analyses, such as the *Review of the Legal Framework and Administrative Barriers to Investment* (FIAS, 2000), have been carried out at three levels of government. These analyses addressed the issues relevant at each level of government and made recommendations for harmonizing entity-level laws and regulations, where appropriate (Tomas, M., 2007). With the support of the international donors such as the World Bank’s comprehensive *Business Environment Adjustment Credit*

project; USAID's programs on taxation reform, bankruptcy and liquidation, inspections and permits; and, UK-DFID's project on business registration streamlining, comprehensive reforms were designed, implemented and institutionalized. The actual implementation of the reforms was undertaken at the entity and cantonal levels through various working groups. In effect, the outcomes and impact of these reforms varies for a number of reasons including lack of capacity and resistance to change (Tomas, M., 2007).

On the other hand, a so called 'bulldozer' committee consisting of representatives of the Council of Ministers, High Representative, entity governments, private sector together with representatives of leading international organizations, was established in 2002. The 'bulldozer' initiative is a bottom-up approach through which wide consultations were conducted to target specific aspects of business related regulations for amendment (World, 2004). In this context, several iterations of the bulldozer have been conducted and efforts have been made to institutionalize this mechanism (Tomas, M., 2007).

10.3. Policy sub-dimensions, analytical tools and framework

10.4. Policy Findings

- Bosnia and Herzegovina has not launched an overall regulatory reform strategy at the state level, even though the entities have adopted some components of a regulatory strategy mainly on a sectoral basis, efforts of which concentrated on the reduction of administrative burdens in the area of licensing and inspections (OECD, 2006).
- RS is in the process of simplification of existing regulations, initiated through the regulatory guillotine programme, focusing on the inspections system. The program dealt with the removal of unnecessary and inefficient regulations and formalities that were unfavourable and increase the costs of business in the RS. The Government established an Economic System Regulatory Reform Council, chaired by the Prime Minister as it has various responsibilities, including (Penev, S. and A. Marušić, 2009) initiating and monitoring the economic system reform, presenting initiatives and proposals for amendments to the existing laws and pass new laws, other regulations and by-laws, and express preliminary opinions on draft laws and other draft regulations, as they are considered important for business environment improvement.
- A Registry of Procedures and Approvals and Inspection Procedures and Control was established in RS, including a database of all procedures and approvals, as well as inspection procedures and control procedures.
- A program entitled 'Streamlining Permits and Inspection Regimes Activity' (SPIRA) funded by USAID was launched in BiH aiming to improve the market access of the Small and Medium Enterprises (SMEs) by reducing administrative barriers during their start up and operations. This was achieved by reforming the regulatory framework in BiH. (Lee Daniel K., 2006).
- RIA implementation in BiH lags behind with respect to the activities related to the simplification of existing legislation. In fact, RIA implementation is in the early phase in the BiH Underlying reason can be explained by the fact that RIA implementation requires not only political support, but also

resource allocation for training, performing adequate RIAs and the establishment of effective and efficient institutional capacity (Penev, S. and A. Marušić, 2009):

- In RS, , the Regulatory Reform Council is entrusted to coordinate and assist Ministries in performing RIA. The first pilot project of RIA of the Law on Spas was finalized in October 2007. The realization of two additional RIA pilot projects has been initiated to be finalized by the end of 2009.
- In 2008, the World Bank/FIAS signed a Memorandum of Understanding with the Ministry of Foreign Trade in order to implement the first RIA pilot project in Bosnia and Herzegovina. However, it hasn't been realized yet in FBiH.

10.5. Recommendations

A comprehensive regulatory and legal framework for start up, survival and code of conduct needs to be adopted. To this aim, several measures can be taken such as;

a/ All kinds of registration formalities should be centralized on the Internet and a central company register system should be introduced. b/Ex ante licenses and permits, should be shifted to ex post controls and monitoring of compliance after the firm begins its activities. c/ old regulations should be reviewed and those no longer needed need to be eliminated. d/ An autonomous oversight body should be established, aiming to prepare draft legislations. It should be independent ensuring an arm's length principle with the entities.

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- Transparency is a critical precondition, supporting legal business environment. Early and meaningful consultation is important prior to conclusion of a regulatory decision.
- Regulations on all levels should be simple practical and understandable while they need to be cost effective in the implementation.

Competition Policy

Competition
Legal Framework
Institutional Framework
Implementation
Policy Advocacy

11. Competition Policy

11.1. Competition policy and Investment

Competition promotes investment and economic development; while increasing consumer welfare and economic efficiency; and encouraging innovation at the national level. Liberalization of markets and privatization, opening the borders for trade and investment can only be the initial steps necessary to achieve free markets where competition is the driving force. But then free markets should be protected against the intended or unintended anticompetitive acts of private agents and the government. Anticompetitive acts create barriers for market access and therefore reduce the incentives for domestic investment, and the flow of trade and cross border investment (World Bank, 2008).

11.2. Competition Policy in Bosnia and Herzegovina

Until 2001, BiH did not have a dedicated law dealing with the anticompetitive acts. Issues concerning the prohibition of cartels and the abuse of dominant position were handled within the Trade Law of BiH and the Trade Law of RS (Vuletic, 2005). The first act on competition was enacted in 2001, prior to the establishment of a competition authority. It included basic competitive principles concerning the prohibition of cartels and restrictive practices, and provided for the establishment of an independent competition authority. Following the establishment of the Competition Council of BiH in May 2004, a completely new act was passed in July 2005. This new act models the EU legislation in the field and it provides the legal framework for the Council in the prohibition of cartels, abuse of dominant position and merger control, and it applies both to public and private undertakings; and provides the Council with investigative and sanctioning powers.

The Competition Council of BiH is the independent authority on the enforcement of the Competition Law in the whole territory of BiH. Competition Council's role is to protect markets from the anticompetitive acts of the private and public undertakers, and to foster competition through policy advocacy. The decisions of the Council are final and open to judicial appeal before the Court of BiH.

11.3. Policy Sub dimensions, analytical tools and framework

Competition policy refers to the set of strategies that create, foster and protect competition. An effective competition policy identifies and removes the impediments to competition, and provides for the establishment of free markets (OECD Competition Division, 2003). Main components of competition policy that will be addressed include competition strategy; legal and institutional frameworks; enforcement and implementation; and policy advocacy and some other related issues.

The legislation on competition establishes the *legal framework* for the implementation and enforcement of competition protection and also provides for the establishment of a competition authority.

Generally, an *independent regulatory body* is established for the enforcement of the competition law. Independence is a main feature for any regulatory authority as it lay the ground for stable and consistent regulatory policies; and protects consumers, firms, as well as investors from the unpredictability of the changing political climate and more importantly from arbitrary government interventions.

As an independent institution, the competition authority needs to establish its legitimacy. Transparency in the implementation and enforcement of the competition legislation, the possibility of judicial review and performance assessment done by a parliamentary committee ensures fair enforcement of the competition act, and establishes competition authority's credibility.

For the effective *implementation and enforcement* of the competition law, competition authority should have sufficient resources and skills to apply the law, and investigative and sanctioning powers. Sanctions are aimed to prevent the anticompetitive behavior resulting in establishing barriers to market access. In order to have the intended deterrence effect, sanctions should be severe enough.

The financial penalties incurred resulting from violation of the law should be higher than the possible gains from the anticompetitive behavior, so that firms benefitting from the anticompetitive acts do not perceive the fines just as another cost of doing business. The competition authority should be able to impose penalties for non-compliance with the law, and also non-compliance with its will / intention.

The role of the competition authority extends well beyond the traditional antitrust enforcement. Especially in transition economies, where free markets and competition are relatively new concepts, the competition authority needs to be involved in economic policy reform process and to establish a competition culture. Even though competition authority do not play policy maker role during the liberalization process, it is the primary advocate of the reform and of the pro-competitive market opening (OECD Competition Division, 2003). The *policy advocacy role* refers to competition authority's role in preventing regulation in other policy fields to impose unnecessary restrictions on competition, and proposing solutions. Other than the anticompetitive acts of private and public enterprises, threats to competition may come from the administrative rules and the way these rules are applied.

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These acts might be unintentional or due to the existence of another objective, but nevertheless creates legal and institutional barriers to entry, and restricts competition. The competition authority's role would be to identify the legal impediments to competition and market access, and propose solutions for the elimination or ease of these restrictions. The *competition advocacy* refers to competition authority's role in the promotion of competition and creation of a competition culture. Competition authority should raise public awareness about the advantages of competitive markets for the businesses and for the consumers.

International cooperation is crucial to deal with cross border competition threats. Information sharing in factual and legal issues between national competition authorities is necessary since domestic resources are generally not enough, and there is no effective way of international law enforcement for the time being. Competition authorities can gain from the experiences and support of other countries' competition authorities. Through Cooperation national competition authorities can share the experiences of other countries in the implementation and enforcement.

Bilateral or regional agreements between national competition authorities and involvement with multilateral institutions is beneficial for the development of the newly established competition authorities that lack the necessary experience, legal tools, financial and human capital resources. Multilateral institutions provide technical and financial support (usually in the form of training, internships for the staff, and workshops), and bring competition authorities together for support and experience sharing

International cooperation, whether in the form of bilateral/multilateral cooperation agreements that standardizing the competition procedures or taking the form of development cooperation, usually resulted in the convergence of the competition policies and makes competition laws and their implementations more predictable for the foreign investors; and therefore promotes investment.

The State Aid Programme is unique to the EU competition law. The intention of the programme is to achieve fairness in competition by preventing discriminatory and exclusionary effects of the government subsidies and ensuring a transparent environment regarding state aids.

11.4. Policy Findings

- The Competition Act of BiH, adopted in 2005, covers provisions on prohibited agreements, abuse of dominant position, and market concentrations. The Act applies both to private and public entities, state and local self-government units, and also to foreign firms if their activities have substantial effect on the market of BiH.
- The new Competition Act models the EU legislation. Harmonization with EU legislation is an important step to avoid the unnecessary cost of compliance of several national competition laws.
- The Council of Competition of BiH, established in May 2004, is an independent, state level authority with the exclusive power to enforce the Competition Act, aiming to protect and promote competition. The Council is composed of six members selected among recognized experts in law and economics; and appointed for a 6 year term with a possibility of extension for one more year only. The Council currently has 25 employees (EC Progress report, 2009), and the offices in the two entities (The Offices for Competition in FBiH and RS).
- Legal independence of the Council is under the guarantee of Competition Act. The Competition Council of BiH has a complete autonomy and its members cannot be dismissed due to disagreement with the political authority but could only be removed due to misconduct or involving into criminal activity.
- The members are also subject to limitations in their professional activities and prohibited from performing any other duties, excluding academic activities or research based scientific organizations. The Council is not financially independent, and its activities are funded from the *Budget of Institutions of the BiH*.
- Appointment of the members ensures that all ethnic groups or entities are equally represented in the Council. Decisions require the presence of at least 5 members, and are given by the majority vote. So the decision should be voted by at least one representative for each constituent.
- The decisions of the Council are open to judicial review. The final decisions of the Council can be appealed to Court of BiH within 30 days of decision announcement.
- The Council disseminates the legislation, the decisions about the cases, and annual reports in its official website in all official languages, while the coverage in English is not full.

- In addition to the possibility of judicial review, regular monitoring of the Council's work is conducted by the Council of Ministers. The Council is subject to performance assessment, and has to prepare annual reports for the approval of the Council of Ministers.
- The Act provides the Council with investigative powers. It is entitled to inquire from the parties or any other third parties, oral or written and including confidential information during the
- Investigation and litigation. Any parties that do not cooperate with the Council's will in the investigation process are subject to financial penalties. The council can demand the search of promises and can issue interim measures if found necessary.
- The Council is equipped with sanctioning powers. These sanctions are administrative in nature and include financial penalties for the violations of the Act, for not cooperating with the investigation and for non-compliance with the Council's decisions. The fines can be imposed on legal persons and on the natural persons who is found to be responsible for the violation. The fines are among the highest ones in the region but still low when compared to their EU counterparts.
- The new Act introduces *leniency policy* (OECD, 2006), defined as a procedure for granting full or partial immunity from fines, arising from the faulty undertakings for cooperating with the competition authority. This provision applies to the fines stemming from the violation of the provision on prohibited agreements, provided that the faulty parties cooperate with the Council throughout the investigation process. Leniency policy is an effective market control mechanism as it encourages the participants to cooperate with the Council. This provision increases the effectiveness of the enforcement of competition law, improves the detection and prosecution of cartels.
- All intended concentrations including mergers, acquisitions and long-term joint ventures above a certain threshold level should be reported to the Competition Council of BiH. There are no specific merger provisions that favor domestic over foreign firms. With the amendment to the Competition Law on September 2009, the threshold levels that necessitate notification of a transaction, the jurisdiction of the Council, the fines and the procedural rules associated with the merger control have been changed.
- The threshold levels that necessitate notification of a transaction to the Council have been raised and the jurisdiction of the Council has been redefined with the Amendment. The notification of a transaction is necessary under following condition (The Competition Act of BiH, Article 14): a/If the combined aggregate's worldwide turnover of all undertakings concerned is more than KM100 (approximately 50 million Euro) and when at least one undertaking is incorporated in BiH, or b/If the turnover of each of at least two undertakings concerned in BiH amounts to or exceeds KM5 million (approximately 2.5 million euro), or if their joint market share is more than 40 percent.
- The increase in the merger control threshold levels is estimated to avoid the unnecessary administrative burden that falls on the economic entities while conducting their businesses and establishing concentrations that does not have a limiting effect on competition. Furthermore, it is anticipated that the council will receive fewer notifications and this will decrease its workload, and hence free some of the limited resources for more efficient uses like policy advocacy or working on cases that are more detrimental to competition.

- The jurisdiction of the Council for the merger control is redefined; and foreign to foreign mergers also falls within the jurisdiction of the Council provided that the threshold levels are met.
- By introducing a new amendment, a penalty for failing to notify the Council, or to proceed with a transaction before obtaining a clearance from the Council is introduced. The Council might impose fines up to 1 percent of the annual turnover of undertakings that fail to meet the notification obligation (Global Legal Group, 2009).
- Fifteen days following a merger notification, the Council declares that either filing is complete or initiates a formal merger proceeding. In the case of formal proceedings, the Council has three months for the investigation and assessment of the transaction. The Council might extend the proceedings for an additional three months if the prior investigation suggests that the transaction raises competition concerns. During the investigation period the Council might inquire about the transaction from the concerned parties. Experience revealed that the Council fulfills its obligations on time, and responds within the 15 day period (Theiss, 2006), and in the case of formal proceedings responds to transactions that do not raise competition concerns within 1.5 months of the notification (Global Legal Group, 2009).
- The provision of the assessment of concentrations provides the Council with a comprehensive view. While reviewing the intended concentrations, the Council evaluates the positive and negative effects of the transaction keeping in mind the interests of the consumers and the possible effects of concentration on the actual or potential competitors. This provision allows the Council to work on a case-by-case basis to distinguish between concentrations that are efficiency enhancing, and the ones leading to anticompetitive results.
- The regulation on the agreements of minor importance (*de minimis* principle) provides exemptions for agreements that do not have substantial effects on competition. These include agreements between the parties that have insignificant common market shares (a total market share of 10 percent for actual competitors, and 15 percent for others), on the condition that the agreements do not prevent, restrict or distort competition.
- The Act also provides for individual and block exemptions for agreements that contribute to the promotion of technical and economic process. Some of the block exemptions include horizontal agreements on research, development and specialization; agreements on transfer of technology and know-how, and vertical agreements on franchising. Individual exemptions are subject to obligation to notify.
- The Act clearly indicates the structural and procedural criteria for triggering action with the aim of decreasing business uncertainty and enhances compliance with the legislation. The procedures for the initiation of the proceedings, investigation process, and adoption of the final decision; and the rights and obligations of the relevant parties in these matters are clearly stated in the Competition Act.
- The burden of proof falls on the party which submits the request for the initiation of the proceedings. An oral hearing open to public is obligatory during the proceedings. The parties to the proceedings are entitled to access to the case files.

- The Council is entrusted with the conducting policy advocacy role by the act. It is entitled to express its opinion and recommendations on any issue related to competition including draft versions of legislations and regulations, and on the enforcement of the legislations.
- The Council together with other regulatory bodies have jurisdiction in respective sectors, and while ensuring the enforcement of pro-competitive regulation in network industries.
- The Competition Council of BiH, is a newly established institution (2004), but has been very active following its inception. The enforcement record including some high profile cases, investigations and prosecutions on the regional governments and private entities has established credibility for the Council, and earned considerable public confidence and support. Furthermore, The policy advocacy role of the Council has been recognized by the public authorities
- It collected around \$500,000 fines from economic entities that were not in comply accordance with the Competition Law (EC Progress Report on BiH, 2009).
- The Council has a substantial enforcement record including some high profile cases, and investigations and prosecutions on regional governments and on private parties (Official website of the Council of Competition of BiH, decisions).

Box 8. Cases on Anti Competition

The Council, acted on a complaint by various private companies, concluded with the followings:

- Government of Sarajevo Canton, as the administrative unit of KJKP Gras Sarajevo, created legal and administrative barriers, hindering access to the public transportation services market by providing subsidy to a specific group of consumers, and not providing the subsidy for other carriers apart from KJKP Gras.
- The Council prosecuted the regional health insurance office of Sarajevo Canton for limiting competition by the changes it made on the list of medicines reimbursed under the insurance, and imposed a KM 50,000 financial penalty on the National Health Insurance Institute of Sarajevo Canton and a KM 15,000 financial penalty on the director of the Institute for their involvement in a prohibited agreement.
- The Council, acted on a complaint by MRM Export-Import, concluded that ASA Auto abused its dominant position in the wholesale market of the Volkswagen products and restricted the competition in the market by applying different conditions to MRM for the similar activities compared to the other dealers; and ASA Auto is given a financial penalty of KM 150,000.

- With regard to the policy advocacy role, The Competition Council has taken the initiative of advocacy role, amending the Competition Law which was adopted by the Council of Ministers on September 2009 (EC Progress Report on BiH, 2009).

Box 9. Opinions of The Competition Council

The Competition Council has initiated 118 procedures and has issued 50 opinions (EC Progress Report on BiH, 2009), including (Official website of the Council of Competition of BiH, conclusions of the weekly sessions):

Electric Regulatory Agency of FBiH concerning the draft regulation on purchase and sale of electricity.

The Regulatory Commission for Electric Power of FBiH and Regulatory Commission for the Electric Power of RS concerning regulations on acquiring a status of the qualified buyer.

Public Procurement Agency of BiH concerning the issue if the market competition terms are met in the relevant market of telecommunication services; in its stated opinion overriding the sector regulator's on the matter on the grounds that the Competition Council has the exclusive competence to determine the presence of competition in the market of BiH.

Federal Ministry of Trade concerning the change and amendments to the Federal Law on Trade.

The Assembly of Sarajevo Canton concerning the draft decision on adoption of network pharmacies.

The State Regulatory Commission for Electricity concerning the draft decision on the size, conditions and time schedule of opening electricity market in BiH.

- The new Act enables the council to be involved in the international cooperation. The cooperation areas cover information sharing (factual and legal issues as well as data) while both recipient and donors attaches importance in protecting the confidentiality of the businesses.

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Do You Know This?

Stabilization and Association Agreements (SAA) is signed in June 2008. Through SAA, BiH is entitled to receive technical and financial support from EC both in antitrust enforcement and policy advocacy areas.

- BiH is a beneficiary country of the OECD Competition Law and Policy Initiative program, aiming to support the national competition authorities in their policy advocacy roles and in the enforcement of the competition law, and to increase cooperation among the SEE countries in the field.
- The Competition Council of BiH has been a member country of the International Competition Network (ICN) since 2005, aiming to establish cooperation between various countries' competition authorities and to exchange information on the antitrust and policy advocacy issues.
- The Council has also established regional cooperation agreements with the competition authorities of Croatia, FYR Macedonia, Bulgaria and Serbia to address the challenges of regional competition and to share their experiences in the transition process.
- In collaboration with EU, a draft law on State Aid legislation has been drawn up, but not adopted yet (EC Progress Report on BiH, 2009). The goal is to establish a state level independent authority for the enforcement of the State Aid Legislation and for the monitoring of the state aid, a separate body from the Competition Council of BiH.

11.5. Recommendations

- Implementation and enforcement of the Competition Act should not be too restrictive, as it needs to allow for efficiency enhancing cooperation, agreements and mergers between the firms. The regulations and provisions concerning the threshold level for mergers, *de minimis principle*, and exemptions provide the Council with flexible tools to implement competition policy on a case-by-case basis, where the objective of the Council should be to establish an “optimal degree of competition as opposed to the maximum competition” (Adhikari & Knight-John, 2004 citing Singh, 2002).
- In order to effectively deter anticompetitive behavior, the severity of the sanctions related to violation should be increased. The financial penalties should be raised above the existing levels, and in addition to the administrative penalties that are in place, civil penalties and right to redress for the affected parties should be introduced. Civil penalties including imprisonment is shown to be an effective deterrence affect (OECD Competition Division, 2003), and redress to the third parties increase the financial penalty relating to the violation and also establish the private enforcement of the competition law (Adhikari & Knight-John, 2004).
- It goes without saying that the ex-post dismantling of the mergers and litigation are costly and adversarial. Therefore, alternative dispute resolution mechanisms and preventive actions should be adopted by the Council.
- 70 • In order to reduce business uncertainty and to enable the Council to earn the confidence of the public, the effective and transparent enforcement of laws, to set out a clear criterion for triggering an investigation, simplification of the procedures and short duration of proceedings becomes necessary.
- Human capital of the Council of Competition of BiH should be strengthened. Implementation of the competition law requires high degree of skills and expertise. To attract the experts having right skills to the Council, the salaries of the competition authorities should be competitive, and the work should be motivating. For this adequate financing must be allocated in the state budget.
- Priority setting in the enforcement is crucial due to resource constraints faced by the Council. The Council should focus on both competition relevant topics, and on its advocacy role rather than dealing with cases that have limited effects on competition.
- Competition advocacy should be of high priority. Promoting competition and establishing a competition culture will establish the support and legitimacy needed. Communicating the benefits of competition to the consumer and business groups and regulators through an accessible web page and through media should be given importance.
- The policy advocacy role of the Council of Competition of BiH should be fully recognized and supported. Coordination and cooperation between the Council, and various governmental departments and independent regulatory agencies should be established in order to remove of the impediments to effective competition and to establish pro-competitive legislation.

- The Council's promotion of competition policy in the fields of market liberalization, privatization, restructuring, and screening of the legislation needs to be reinforced. Any government policy or regulatory oversight that has potential discriminatory and exclusionary effects for domestic or foreign investors should be corrected by the persistent policy advocacy of the Council. Immediate attention should be given to the prevention and abolishment of the informal markets and corruption, establishment of pro-competitive legislation for public procurement, maintaining pro-competitive regulation for the network industries and the preparation of the State Aid legislation and programs.

The Council should seek for technical assistance. The nature of the assistance should not be intrusive but should aim to increase the technical capacity of the Council in the long-run.

- The administrative capacity of the Courts of BiH in the competition area needs to be enhanced. This will increase in the effectiveness of the appeal mechanism; and thereby improving the credibility of the Council
- Data relating to markets should be made available by the Agency for Statistics of BiH. Availability and reliability of the market data will facilitate the implementation of the law

POLICY COHERENCE AND CONCLUSIONS

Foreign Direct Investment (FDI) flows to emerging economies and developing countries have been the main driver of the global economic growth in last two decades. In their quest of higher returns for their capital accumulation, and cheaper labor as well as further productivity enhancement opportunities; multinational corporations as well as medium size domestic firms, all began to shift their investments to promising destinations particularly in Asia and East Europe.

Emerging economies like China, India, Russian Federation, Czech Republic, Poland, Brazil and Argentina received the highest share of this flow in past decade. Concurrently, more countries began to recognize the significance of FDI for their future economic growth as well as its on their efforts to alleviate poverty and to improve their living standards.¹ Therefore, the developing and transition economies heavily involved in designing new policy dimensions so as to attract more foreign investment to their countries while, as part of new policy dimensions, adopting various strategies to establish business environment. However, for many countries, their implementations still remain a challenge, arising from mostly political social reasons and above all; from absence of policy incoherence.

Policy coherence can be defined: “systematic promotion of mutually reinforcing policy actions across government departments and agencies creating synergies towards achieving the agreed objectives”. As there are various definitions available, policy coherence can be currently examined in several dimension including: internal coherence within development co-operation policies; intra-country coherence: consistency between aid and non-aid policies of a single donor; Inter-donor coherence: consistency of aid and non-aid policies of donors; donor-partner coherence to achieve shared development objectives; consistency of donor and developing-country policies etc (OECD. It calls for the policy decisions and their implementations to be coordinated with each other so as to achieve the maximum efficiency and impact and to avoid potential conflicts among the policies. For instance, reducing the corporate tax burden entices foreign investors into making investment in country, but concurrently public revenues decrease therefore budget allocations for infrastructure projects becomes less. Lack of sound infrastructure is of concern to investor and resulted in decreasing FDI in the long term. Therefore, prior to adopting new tax policies, an integrated policy approach should be developed so as to attenuate the negative impacts on the investment environment.

For BiH, policy recommendations are presented below based on *policy coherence* approach²:

- The analysis revealed that lack of essential coordination and the role and responsibilities among the government offices largely undermines the investor confidence. Moreover, the country’s investment environment is negatively affected by the overlapping legislation at a state and entity level, resulting in an overly cumbersome regulatory framework. Provision of international aid programs can help restructure the public administration through both institution and capacity building with a view to improving the country’s investment environment.

1 Despite of the benefits of the globalization, the current financial crisis has put globalization on hold, with capital flows reversing and global trade shrinking associated with rising protectionism.

2 Policy recommendations presented in each respective policy dimension are given here once again, together with policy coherence advises with a view to providing policy makers with a holistic approach to address the policy bottleneck.

- The state level government is made up of many autonomous administrative units among which coordination, especially on taxation, is quite limited. Disorganized government structure, therefore, creates obstacles to enforcement of taxation and double taxation needs to be avoided as a company operating in different entities should not be penalized for its nation-wide activities.
- Miscommunication is prevalent among investors and relevant government authorities. There is a strong need to establish better channels for information flows between investors and government offices. FIPA could further its role in establishing communication channels and should assume policy advocacy duty.
- FIPA's functions and services have improved substantially. However, the agency stills need to strengthen its roles by taking some solid measures such as assuming licensing and administrative procedure for greenfield projects. This requires close coordination with other government institutions support. Furthermore, it could identify investment opportunities in BiH and inform potential investors through conferences and seminars.
- FIPA needs to hire industrial specialist to respond better to sector specific inquiries. As the Agency plays a role of intermediary between potential investors and institutions, lack of specialists often prolongs response time and reduces response quality.
- TVET and VET should be placed at the centre-stage of the HR policies at the FIPA. It goes without saying that rising skills and qualification of FIPA employees will help improve quality of services it provides investors with.
- Informality is high in BiH and needs to be reduced in the long run albeit its positive impact on employment and investment at the early stage of development. This is controversial policy debate, hence it requires the participation of all stakeholders (unions, government institutions, NGO etc.) in dialogue.
- Labor taxes need to be further lowered in order for attracting Foreign Direct Investment. The reduction, however, should be adapted to the development objectives of BiH while taking macro-economic policies into consideration.
- EPL is one of the highest in the SEE, and it is recommended that the government relax the strong grips on the labor market as it increases the employment opportunities. It is a compromise between social and labor market policies and its influence on the investment environment.
- Enforceable set of labor regulations should be created and youth minimum wage needs to be introduced. Furthermore, coefficients used in calculation of the wage require simplification and rationalization. Reducing the duration of maternity leave will have a positive impact on employment of women.
- Tripartism in BiH is gradually becoming a norm but the industrial relations is still in the state of a flux, and the social partners are still underrepresented.

- Social security contributions of the RS and of the FBiH as well as that of the Brčko entity differ from each other significantly. In FBiH, employer share accounts for 11,50 percent on gross wage (7 percent for pension insurance, 4 percent for health insurance, 0,50 percent for unemployment insurance) In Brčko District: 7 percent on gross wage for pension insurance whereas in RS, there is no contributions. Harmonization is required as the state level in order to create single economic space.
- There is a strong need to coordinate the ODA activities in BiH as there is a large number of donors with differing practices, acting almost independently, while no communication channels exist between government and their agencies. This leads to duplications of the activities in certain fields while concerted efforts are strongly needed. Aid policies of donor countries should be coherent with investment policies of BiH
- Evaluations are critically important in the success of the aid programs. While it has become a norm in multilateral aid organizations, bilateral agencies still need to improve evaluation techniques and outcomes and they should be shared with policy makers and governmental institutions.
- There is a strong need to enhance the statistical capacity of the government institutions for the aid accounting in order for avoiding the duplication and making the essential coordination.
- The recent policy reforms are estimated to improve the quality of education both in secondary and in higher education. But they need continuous monitoring and a sound enforcement.
- Even though data and information are limited on the human capital, it is noted that skillful blue collar labor force can fill the labor demand and supply gap as they will be highly needed by foreign investors.
- The improved enforcement of international accounting standards is highly needed as it will attract foreign investors and promote partnership with domestic companies.
- Enforcement of corporate governance laws, regulations etc. need to be improved while there is a high need for raising the awareness of the sound corporate governance amid the managers or CEO 's.
- Conducting *audit related* TVETs for government officials help enforce the legal framework and resulted in increasing the corporate performance
- Multilateral Agreements, particularly those adopted by EC, such as “20 Guiding Principles Against Corruption”, should be integrated into legal structure of the BiH in order for better combating against corruption. Furthermore, policy coherence among the different policy dimensions of the anti corruption has to be established to achieve tangible results. Anti corruption has been indicated as the most investment related policy dimension in the PGLocal survey (see annex A)
- Training plays an important role in combating corruption in both the public and the private sectors. Not only police, prosecutors and judges and government officials receive training on the newly adopted laws and procedures, but also the private sector representatives need to be informed of

them. This will ensure the enforcement and enhance confidence in investment environment. As there are numerous training topics available on anti corruption, particular attention should be paid for supervision of banking and money laundering.

- Current laws and regulations should continuously be updated by considering best practices in the world, particularly at the OECD countries ,so as to improve the anti corruption legislation and to adopt them into ongoing reform process.
- Harmonization of the anti corruption policies and legislations of both FBiH and Republic Serbska are required to improve combating with corruption as it also helps create a single economic space. Particular attention needs to be paid for tax relevant policies where tax evasion is extremely high.
- In order for the better control of the public revenues, IT structured “Integrated Revenue System”, which oversee revenues obtained through tax, customs, social security collections, can be created, allowing better combat with the corruption. Furthermore, streamlining the tax and custom regulations reduce the level of the corruption and help raise transparency.
- BiH has taken part in numerous international conventions, aiming to alleviate corruption. Even though they have been put into effect for a long time, they haven’t t generated anticipated reduction in corruption, mainly due to weak enforcement.
- Establishing sound communication channels with investors and notifying them the recent development about anti corruption policy sphere are as imperative as the policy reform itself. This is particularly important to enhance investor confidence while improving the transparency.
- Current Public administrative structure which is highly complex and divided into many independent units involves challenges in decision making. Restructuring associated with better policy coordination facilitates rising efficiency and effectiveness. Particularly, investment related procedures contain too many burdensome steps and therefore it is very often resulted in corrupted actions.
- Experience revealed that training has one of the most significant impacts on alleviation of corruption if its contents are well devised; its targets are tangible and participation of both public employee and representatives of private sector is facilitated. In essence, this is required to inform all stakeholders about the recent developments and to enable them to take part in joint actions.
- Universities can adopt the ethic & anti corruption courses into their curriculum. This helps train younger generation about the negative impacts of the corruption on development.
- Raising public awareness is an important measure in curbing corruption. Especially, It will be helpful if media is widely informed of the bribery incidences and recent improvements in legislation. Also citizens should be encouraged to complain about the corrupt officials and corruption in government institutes they are informed of or they witness.
- In 2007, Ombudsman offices of the both entities were merged in order to fight the corruption more effectively in BiH. As current administrative structure of the newly established office is principally

designed to deal with corruption in public sector, political interference should be prevented and essential policy measures should be taken against it accordingly.

- Substantial amount of literature and studies address correlation among corruption, poverty and inequality. Particularly, lower income is identified as one of the main driver of the corruption, explaining the rationale behind the low level of corruption in highly developed countries. The salaries of the government officials in BiH lower than the salaries of the ones occupying the same positions in the OECD countries. By taking budgetary limitations into considerations, the salaries can be raised to adequate level, allowing the recruitment of high caliber professionals in the public sector and help reduce corruption as they would be satisfied with their income.
- In 2003, the Office of the Prosecutors was established in FBiH in order to combat with crimes, terrorism, trafficking and corruption. The mandate of the office contains ambitious objectives but due to resources limitations, such as lack of finance & human capital and heavy workload etc., it hasn't functioned efficiently.
- RS also established a prosecutor's office with a view to fight against corruption and it would be useful to merge two offices under umbrella organization so as to achieve optimum result.
- A comprehensive regulatory and legal framework for start up, survival and code of conduct needs to be adopted. To this aim, several measures can be taken such as; a/ All kinds of registration formalities should be centralized on the Internet and a central company register system should be introduced. b/Ex ante licenses and permits, should be shifted to ex post controls and monitoring of compliance after the firm begin its activities. c/ old regulations should be reviewed and those no longer needed need to be eliminated. d/ An autonomous oversight body should be established, aiming to prepare draft legislations. It should be independent ensuring be arm's length principle with the entities.
- Transparency is a critical precondition, supporting legal business environment. Early and meaningful consultation is important prior to conclusion of a regulatory decision.
- Regulations on all levels should be simple practical and understandable while they need to be cost effective in the implementation.
- Implementation and enforcement of the Competition Act should not be too restrictive, as it needs to allow for efficiency enhancing cooperation, agreements and mergers between the firms. The regulations and provisions concerning the threshold level for mergers, *de minimis principle*, and exemptions provide the Council with flexible tools to implement competition policy on a case-by-case basis, where the objective of the Council should be to establish an "optimal degree of competition as opposed to the maximum competition" (Adhikari & Knight-John, 2004 citing Singh, 2002).
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ANNEX. BOSNIA AND HERZEGOVINA INVESTMENT REPORT: SURVEY RESULTS

Within the context of Policy Coherence For Investment: Obstacles To Investing In Bosnia And Herzegovina, Policy Analysis & Recommendations, an online survey was conducted in order to identify policy obstacles, hindering foreign investment flows into Bosnia and Herzegovina.

Majority of the survey participants (93 percent) are the employees / managers in the companies, those either has invested or plan to invest in Bosnia and Herzegovina in the near future. Survey respondents represent a diverse background in terms of size, region, country of origin while a large number of them work for the companies in agribusiness, financial services, energy and tourism. The reported amount of possible current or possible future foreign investment varies between 150 thousand to 15 million USD annually. As it indicated in the form, some of the survey respondents are small business owners while some others represent multi-national firms.

The overall rating for current investment climate in Bosnia and Herzegovina, compared to neighboring countries, is reported to be 5.20 (where respondents were asked to rate the current investment situation out of 10, while 1 represented “least favorite or very poor” and 10 represented “most favorite or very strong”). The level of coordination among institutions and governmental authorities are reported to be 3.72.

Using a similar scale (where respondents were asked to rate the importance of a policy dimension or an area for the investment climate out of 4, while 1 represented “least important” and 4 represented “most important”), the respondents assigned following ratings and rankings for the selected policy dimensions and areas in terms of their importance in improving the investment climate in Bosnia and Herzegovina:

Figure 1. Importance of a Policy Rating



| | | |
|-----|-------------------------------------|------|
| 1) | Anti-corruption Strategy: | 3.58 |
| 2) | Investment Policy and Promotion: | 3.33 |
| 3) | Infrastructure: | 3.32 |
| 4) | Regulatory Framework: | 3.29 |
| 5) | Tax Policy: | 3.26 |
| 6) | Human Capital: | 3.21 |
| 7) | Efficiency of the Financial System: | 3.11 |
| 8) | Coordination among Institutions: | 3.07 |
| 9) | Trade Policy: | 2.92 |
| 10) | Competition Policy: | 2.89 |
| 11) | Formalities and Red Taping: | 2.79 |

Interestingly, Formalities and Red Taping rank in the end of the list. This could be explained with recent changes and improvements made in the procedures and regulations.

Survey respondents reported the following obstacles and barriers that they have faced in the past before or while they had been investing in Bosnia and Herzegovina:

- Regulatory framework is very complex
- Number of institutions requests same documentation and usually is not well coordinated
- Weak and slow response from state institutions
- Difficulties to find authorized relevant correspondent state institution for the relevant issues
- Complex administrative structure
- High level of corruption
- Weak local financial institutions
- Lack of clear set guidelines and rules that one can follow and adhere to, and that others, mainly governmental institutions, can obey as well
- Disharmony between regulation on regional and national level
- Inconsistent tax and legal framework policy
- Low credit rating of the country
- Complicated and in many areas undefined legal system particularly in tax area
- Generally, very low level or even lack of support in implementation of legal procedures in each stage of investment
- High level of bureaucracy that have no sense of importance of time budget
- There is not protection of unscrupulous “investors” that have no fair investing aims and take advantage of lacking protection mechanism to implement their, obviously, non-investing goals
- Unfair competition
- Slow approval process

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