



American Chamber of Commerce in BiH

WHITE PAPER

FOR OVERCOMING THE PROBLEMS OF BUSINESS COMMUNITY IN BiH
AND
OBSTACLES TO THE USA INVESTMENT IN BIH

June 2018, Sarajevo, BiH

AmCham BiH White Paper is based on the barriers to foreign investment and business operations for companies operating in BiH, stressed by the US Investors and participants of the U.S. Business Promotion and Networking Forum held in Banja Luka on 22 September 2018.

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FOREWORD

American Chamber of Commerce in BiH (AmCham BiH) has been founded by the Decision on Foundation, dated 6 February 2002 as a voluntary, non-partisan and non-profitable association, pursuant to the Law on Associations and Foundations of Bosnia and Herzegovina.

AmCham BiH is nongovernmental association, guided by American economy in Bosnia and Herzegovina. The association is a leader in promotion of business and regulatory environment through active dialogue and open partnership with Government, economy and other key target groups.

Some of the most important AmCham's objectives and activities are: to promote economic cooperation between the USA and BiH; to serve as a forum for exchange of ideas and establishment of dialogue among the companies operating with BiH; to support and enhance greater scope of investments in BiH and to carry out professional activities and advocate, on behalf of the members handling the issues that impede or have influence on the capacity of the members to conduct their operations in fair and efficient way. AmCham BiH is aimed at contributing to continuous improvement of investment climate in Bosnia and Herzegovina.

AmCham BiH currently has 70 members and it grows in membership every year. AmCham members are mostly the U.S. companies registered in BiH, but also the other international businesses based in BiH, as well as the local BH companies.

AmCham BiH White Paper is the publication of the American Chamber of Commerce in BiH and its purpose is to address BiH authorities with key obstacles to the foreign investment, particular to the USA investors expressed during the U.S. Business Promotion and Networking Forum held on 22 September 2017 in Banja Luka.

AmCham BiH would like to thank the U.S Ambassador to BiH, and employees of the Economic Department of the U.S. Embassy for the continuous support of AmCham activities in BiH.

We welcome comments from all quarters and are looking forward to productive collaboration over the coming year for the growth of investment, business and jobs in Bosnia and Herzegovina.

BUSINESS CLIMATE IN BIH – RECENT ECONOMIC DEVELOPMENTS

Bosnia and Herzegovina is an upper middle-income country which has accomplished a great deal since the mid-1990s and at the same time is a potential EU candidate country.

The country's complicated government structure and political environment has stalled many key economic reforms. BiH's poor investment climate, lingering effects of the global economic downturn, and the country's strong connection to still slow growing Europe has resulted in stagnant foreign direct investment inflow over the past five years. ¹

According to the World Bank's Ease of Doing Business Report, BiH is the least competitive economy in Southeast Europe and is currently ranked 81 out of 190 global economies.² Also the World Bank economic outlook indicates that the "political uncertainties that could hold back the reform agenda are the highest risk for the medium-term outlook".³

In July 2015, the Council of Ministers of BiH, Government of Republika Srpska (RS), and Government of the Federation of Bosnia and Herzegovina (FBiH) adopted a joint program of structural reforms known as the Reform Agenda. This Reform Agenda presents a rare window of opportunity for structural reforms in BiH, underpinned by a broad national consensus on the country's critical challenges and priorities and the sustained support of key development partners.

As poverty is strongly associated with unemployment and inactivity in BiH, for economic growth to translate into poverty reduction, improvements in labor market participation and employment will remain the key. The implementation of new labor laws in both FBiH and RS, as well as the introduction of support schemes for first-time job seekers, is expected to support improved employment outcomes in 2018. However, as unemployment remains high and real wages are expected to remain largely flat due to the substantial persistent slack in the labor market, poverty is projected to decline at a slow pace over the next couple of years.

Overall, in the medium term both fiscal and external deficits will persist until 2019 when a balanced budget is expected to be helped by progress with ongoing structural reform agenda and an ambitious fiscal adjustment. Fiscal consolidation will not be effective if structural rigidities on the expenditure side are not addressed, especially the large public wage bill and sizeable and poorly targeted social assistance.

Growth reached 3.1% in 2016, 0.1 percentage points lower than envisaged by official estimates (BiH Global Fiscal Framework 2017–2019). Consumption remains the main driver of growth. On

¹ Bosnia and Herzegovina Investment Climate Statement 2017, US Department of State

² <http://www.doingbusiness.org/rankings?region=europe-and-central-asia>

³ <http://www.worldbank.org/en/country/bosniaandherzegovina/overview#4>

the production side, agriculture and manufacturing contributed about 80%, together offsetting a contraction in services.

BiH's key economic challenge is the imbalance of its economic model: public policies and incentives are skewed toward the public rather than the private sector, consumption rather than investment, and imports rather than exports.

The country needs to shift to a business environment conducive to private investment that supports both vibrant small and medium-sized enterprises and the growth of larger companies, facilitates export performance and productivity improvements, and generates much-needed private sector employment.

At the same time as addressing these imbalances in the economic model, the country must also ensure the sustainability and inclusiveness of future growth.

AMCHAM BIH ACTIVITIES

- ✓ To promote economic cooperation between the United States of America and Bosnia and Herzegovina through promotion of friendly relations among the companies and financial institutions from BiH and the USA, and particularly, but not exclusively, through encouraging trade, investments, and development of bilateral economic relations;
- ✓ To serve as a forum for exchange of ideas and establishment of dialogue among the companies operating with BiH. Therefore, the Association's objective is to create such environmental relations among its members which are characterized by culture and values, such as: trust, integrity, conscientiousness, and honesty in which mutual business and social interests would be satisfied.
- ✓ To build up throughout territory of BiH, in compliance with international standards, a unified economic space by establishing full freedom of movement of people, goods, capital, and services, without discrimination on any basis whatsoever.
- ✓ To contribute to continuous improvement of investment climate in BiH;
- ✓ To identify constructive solutions of trade and economic problems regarding business relation of the USA and BiH;
- ✓ To carry out professional activities and aggressively advocate, on behalf of the members, handling the issues that impede or have influence on the capacity of the members to conduct their operations in a fair and efficient way.

- ✓ To advocate getting acquainted with and establishing legislation pursuant to international standards on each market based on constitutional provisions which guarantee freedom of movement of people, goods, services, and capital.
- ✓ To advocate integration and development of economy in BiH and globally, in accordance with international standards;
- ✓ To arrange regular meetings of the members in order to discuss issues that are of immediate importance and interest to the members of the Association;
- ✓ To organize conferences, educational programs, seminars, and lectures suggested by the members.
- ✓ To issue publications and publish papers regarding objectives of the Association;
- ✓ To gather and distribute information related to mutual economic and investment possibilities;
- ✓ To provide consulting and assistance to persons considering possibilities to operate in BiH, or who are engaged in economic activities in BiH;
- ✓ To maintain partnership relations and companionship with all institutions to the BiH Government, with the “U.S. Chamber of Commerce” and other commercial/chambers of commerce, and similar business associations in BiH and the USA, as well as other countries;
- ✓ To support and enhance greater scope of investments in BiH.

INTRODUCTION / BACKGROUND

American Chamber of Commerce in BiH, together with the U.S. Embassy in BiH held the “U.S. Business Promotion and Networking Forum” on 22 September 2017. Forum was organized in order to increase investments in BiH, and to increase the partnership opportunities for the U.S. companies and those companies that widely represented American products and services in their sales portfolio. There was also the possibility for the Forum attendees to learn more about the programs offered by USAID and other U.S. Agencies through the U.S. Embassy in BiH for increasing investment and improving the business environment in BiH.

H.E. Maureen E. Cormack, the U.S. ambassador to BiH in her open remarks on the Forum emphasized that there are approximately 30 companies in BiH that are either official representations of the U.S. companies, or are the U.S. Franchise or American-owned, most of which are based in Sarajevo. Although 30 is a small number of companies, U.S. investments in BiH have a positive impact on the overall economy, due to the fact that they invested about \$ 250 million so far in this country. About \$ 200 million were invested by KKR, who is the owner

of Telemach BH, which is based in the United States. KKR has been one of the major investors in BiH in the past three years.

Throughout the Forum, through five different panels, distinguished panelists discussed the following: the experiences of the U.S. Investment funds presented in BiH; commercial and economic support programs of the U.S. government in BiH; the regional perspectives of the U.S. companies; the challenges and opportunities of the ICT sector in BiH, and the strategic perspectives and priorities of the BH chambers and business associations.

Using the emphasized barriers to foreign investment and business operations for companies operating in BiH, stressed by the U.S. Investors and participants of the U.S. Business Promotion and Networking Forum held in Banja Luka, the American Chamber of Commerce in BiH compiled this White Paper to serve as a document for identifying areas of critical industry issues and for proposing solutions to overcome the stated issues.

PROBLEM STATEMENT

Political gridlock in 2017 combined with the BiH's complex constitutional set-up and weak inter-government cooperation have made it difficult to effect policy changes and implement reforms. The RS and FBiH parliaments met sporadically in 2017 due to coalition infighting and ethno-nationalist tensions, slowing the reform momentum. The upcoming general election in late 2018 poses uncertainties.

In order to meet the established EU membership criteria as well as their own interest, Western Balkan countries must undertake comprehensive reforms in key areas. The rule of law, the fundamental rights and rules must be significantly strengthened. Judicial reform, the fight against corruption and organized crime and public administration reform need to deliver real results, and the functioning of democratic institutions needs to be significantly improved. Economic reforms must be firmly implemented and address structural weaknesses, low competitiveness and high unemployment rates. All countries must unambiguously commit, in words and deeds, overcoming the legacy of the past by reconciliation and resolving open issues much before their EU accession, especially with regard to border disputes.

Bosnia and Herzegovina faces a shortage of qualified labor, which is a problem for the U.S. investors who are pointing out many other obstacles that they face here, such as: corruption, non-transparent public procurement procedures, and unpredictable charges that can occur at all levels of government. Private sector in BiH is growing slowly, but foreign investment has dropped sharply since 2007.⁴ Government spending - including transfer payments - remains high, at roughly 40% of GDP, because of redundant government offices at the national, sub-national (state and entity), and municipal level.

⁴ See: https://www.indexmundi.com/bosnia_and_herzegovina/economy_profile.html

Bosnia and Herzegovina's top economic priorities are: acceleration of integration into the EU, strengthening the fiscal system, public administration reform, World Trade Organization membership, and securing economic growth by fostering a dynamic, competitive private sector.⁵

Building on a relatively stable macroeconomic position, the government could convert any fiscal adjustment into public investment or a reduction of the tax burden on workers and businesses. Leveraging its strengths, BiH could become a vibrant economy with dynamic entrepreneurs leading a “catch-up race” with wealthier countries in Europe. That would mean creating conditions for a bigger and internationally competitive private sector, which would encourage youth to stay in BiH and the diaspora to return or invest in export-oriented sectors that can generate sustainable, productive jobs.⁶ One of the main legal challenges facing the country is creating a single economic space in which to do business.

Bosnia and Herzegovina struggles to attract foreign investment because of the complex labor and pension laws, the administrative barriers, the lack of a single economic space, and inadequate judicial and regulatory protections. Establishing a business in BiH can be an extremely burdensome and time-consuming process for investors. The World Bank estimates there are on average 12 procedures (actual number depends on the type of business), taking a total of 65 days, to register a new business in the capital city of Sarajevo. Registration in BiH can sometimes be expedited if companies retain a local lawyer to follow up at each step of the process.⁷

BiH needs international investments in order to solve its economic problems, huge unemployment and enhance economic growth and development. There are many advantages for investing in BiH. In the first place, it is its well-educated and cheap workforce, with language and computer skills. There is an abundance of raw material, water and energy. BiH’s favorable geographic position, many bilateral and multilateral agreements, as well as advancement toward the EU make BiH a desirable destination for foreign direct investments. However, there are also obstacles for foreign direct investments. It is necessary for BiH to improve, in the first place, its legal environment, including ease of company registration, unification of rules at the state level and simplification of administrative procedures. The phenomenon of legal particularism exists in BiH.

⁵ See: “Bosnia and Herzegovina Doing Business for Everyone Guide”, International Business Publications, USA, page 26

⁶ See: <https://www.brookings.edu/blog/future-development/2015/11/05/three-reasons-why-the-economy-of-bosnia-and-herzegovina-is-off-balance/>

⁷ See: <https://ba.usembassy.gov/wp-content/uploads/sites/270/2017/08/BiH-ICS-FINAL-2017.pdf>

THE OBSTACLES TO USA INVESTMENT IN BIH

1. Permits and Procedures

Simplifying administrative procedures is one of the conditions for creating a positive business climate and attracting investors. The registration process in BiH takes too long. According to the World Bank report on their ease of doing business in 2016, where the process of registering business entities is analyzed and ranked, BiH has been ranked 175th out of 189 countries, indicating the necessity of a comprehensive and complete system audit⁸.

The Government of the Federation BiH has accepted the information on the need to reform the registration process of business entities in the Federation of BiH with the aim of establishing a one-stop shop business system and enabling electronic registration. The Government entered the project of establishing the one-stop shop registration system as a priority in the period 2016 – 2018 in the field of business environment reform. Expected results of the establishment of the one-stop shop registration system and the on-line registration of economic entities in the FBiH are the shortening of the registration process for business entities to three days (excluding VAT registration) for all types of limited liability companies, reduction of the necessary steps for registration of business entities in FBiH by 50% and the registration costs of business entities, an increase in the number of newly registered business entities by 15% in the FBiH for 18 months after the implementation of reforms, compared to the period of two years before the reform.

The establishment of a one-stop shop system until the moment of the publication of the AmCham BiH White Paper has still not been realized in the FBiH, while the establishment in the RS already has its first positive reactions. There is an increase in the number of registered subjects, a reduced number of registration procedures (10 out of 5 procedures), a shorter registration period (from 23 days to a maximum of 5 working days), and a reduction in the number of participants activated in the registration process as well as costs of the establishment itself.

Most licenses and business permits are administered at a subnational level in BiH by more than one level of government, thus creating certain confusion in responsibilities. By-laws governing the issuance of business permits are generally drafted at the entity-level, but their application falls under the responsibility of the municipalities, and they too set fees. Furthermore, the competence of local administrations vary from one municipality to another. Comprehensive reform of the registration process aims to increase the competitiveness of the economy of the BiH and strengthen the efficiency, effectiveness, quality, flexibility and transparency of the

⁸ See: <http://www.doingbusiness.org/rankings>

public sector through the use of innovative solutions and information and communication technologies to stimulate growth and development of the private sector.

In addition, obtaining business permits (building permits, environmental permits) is a painstaking and very demanding job. E-Procedures that precede the issuance of permits are still complicated, both time and financially demanding, and often slow down the process of obtaining permits for several years (especially in cases of unfounded court dispute).

Proposed solution:

Set valid regulations at the state level. It is necessary to work on shortening the procedure for issuing business permits, and to provide electronic means for investor-institution communication. Where there is an easier procedure for obtaining license and permits, simplicity and lower costs, there are also greater investment interests. All possible pre-requisites for obtaining building permits must be resolved in an adequate manner, by introducing the system of electronic permits. Potential investors should obtain their permits within a period of less than 30 days, through a so-called unified procedure and in one place, through the administration bodies, which should be obliged to ensure all the necessary documentation and transparent access to information through an electronic submission system for issuing permits, which will extenuate business in BiH. Upon the statement by the Ministry of Economic Relations and Regional Cooperation, this recommendation has already been submitted in the Economic Reform Program 2017-2020⁹.

Very often obtaining various permits is contingent upon provision of voluminous documentation that also must be issued by the authorities holding competence for the permit issuance. Possible acceleration of the process of documentation issuance (by Land Registry, Cadaster, Court Register, etc.) would directly contribute to faster permit obtaining. Therefore, digitalization of the Land Registry and the Cadaster would ensure a prompt and efficient target permit obtaining. Additionally, once reorganized, said offices would not be overloaded with requests and thus would be capable of accelerating their operations.

2. Legal & Regulatory Framework

The legal environment continues to be complex and challenging. The country's multi-layered constitutional and political structure continues to have a negative impact on the legal reform. The problems of the multi-layered legal structure are in evidence in a number of areas of law. The legal framework in Bosnia and Herzegovina is quite complex due to the combination of different government systems. In addition to the State, the two Entities – Republika Srpska and

⁹ Economic Reform Program 2017-2019 (ERP BiH 2017-2019)

the Federation of Bosnia and Herzegovina – have their own legal systems. Furthermore, the Brčko District has a separate legal framework.

Speaking of the judicial sector, there are two separate legal systems and there is limited coordination at the federal level. Investors often encounter unfounded lawsuits which hinder their investment plans and more than significantly slow down their business and the realization of the planned profit. When a certain administrative dispute is initiated, the investors as the involved party (or the interested party) are not able to continue the activities of the construction until the dispute is over. Due to the collapse of the courts and the slow administration, the waiting for the verdict can be prolonged for years, and so the necessary licenses that have been obtained for construction become obsolete.

Business registration, small claims, enforcement and bankruptcy tend to be the most problematic commercial cases in FBiH. These cases suffer from large backlogs, long processing times, low clearance rates, and unsatisfactory court service. They cause the most frustration for court users. There are particular reasons why each of these case types underperform. In order to improve the effectiveness of solving economic disputes, The World Bank conducted a research (in which AmCham BiH participated) and issued a study entitled “Improving Commercial Case Management in the Federation of Bosnia and Herzegovina”. Unlike the FBiH, the judiciary of Republika Srpska, has formed commercial courts in its structure; The High Commercial Court BL and 6 district economic tribunals, which greatly facilitate the resolution of economic disputes.

Proposed solutions:

Prospects for Bosnia and Herzegovina depend largely on the implementation of practical legal reforms and integration, both internally and regionally.

Conclusions from the U.S. Business and Networking forum held in Banja Luka stressed that the courts must be effective and transparent and so promote new business activities in their work. For doing business in BiH, legal security is very important for the investors. Trust requires a reliable legislation, it is of the utmost importance that the constitution environment is respected by the legislation and by the acting people. Justice system is a generator of overall trust, including trust in other public institutions because it provides some guarantee against possible misconduct.

It is crucial to harmonize the entity and cantonal regulations to underlie uniform market development and business conduct. Harmonization may be achieved in two ways, either by adoption of identical solutions or by approval of a frame solution applicable at the state level and from which the mutually aligned subordinate regulations would be derived at different competence levels. Companies face numerous problems arising from non-aligned regulations

which differently treat a single issue. Operations of foreign investors are impaired by non-alignment or even non-existence of uniform regulations in this business segment: obtaining a concession (there are state, entity but also cantonal laws governing this business segment). Actually, in the Federation of BiH, obtaining the concession is regulated by cantonal laws which are not uniform and have prevalence over the law of the Federation; the state law is quite "outdated" and is usually "disregarded". Hence, a legal framework should be developed from which the subordinate regulations would be derived or the existing subordinate regulations would be aligned with. A similar situation may be observed with lack of uniform legal framework to regulate public-private partnership relations (A law on public-private partnership relations has not been enacted at either the state or the FBiH level).

Furthermore, the companies seated in one entity and operating or willing to operate in the other entity face problems arising from non-harmonized entity regulations or different interpretation of regulations by the competent bodies-supervisors or from different practice (e.g. in the segment of insurance mediation). This problem could be solved by either 1) harmonization of the entity regulations, or 2) development of a frame solution applicable at the state level, or 3) implementation of a state level supervision instead of the entity supervision, or 4) close cooperation of the entity institutions/supervisors and exchange of experience in solving business problems at the entity level.

3. Corruption

Corruption presents a particular threat to transition countries, in which the democratic, institutional and valuable systems have not yet been sufficiently built. Fighting corruption is a big challenge for most developed countries of the world, therefore it is not surprising that Bosnia and Herzegovina, unfortunately burdened with political problems and poverty, finds it difficult to detect effective mechanisms to fight these very negative phenomena.

Bosnia and Herzegovina became a party to the United Nations Convention against Corruption (UNCAC). The Member States of the Convention have introduced a mechanism for monitoring the implementation of the Convention through an audit process in which the implementation of UNCAC provisions in the signatory countries is assessed. In 2014 The Law on Protection of Persons Reporting Corruption in the Institutions of Bosnia and Herzegovina (namely Whistleblowers) entered into force. Based on it, a total of three people got the whistleblower status, while eight requests were rejected. However, this law applies only to the public sector at the state level.

The high level of corruption in BiH is a symptom of the irregularities in the work of the administration, whereby the costs are transferred to the citizens and the economy. To tackle this problem, in 2015 The Council of Ministers of Bosnia and Herzegovina, adopted the Anti-

Corruption Strategy 2015 – 2019 and the Action Plan for the Implementation of the Anti-Corruption Strategy. Also, some progress has been made in the BiH judicial system. The Justice Sector Reform Strategy in Bosnia and Herzegovina has been adopted for the period 2014-2018. The Group of States against Corruption (GRECO), the Anti-Corruption Monitoring Body of the Council of Europe, in its new report forewarned BiH with their earlier recommendations on preventing corruption among judges and prosecutors that Bosnia and Herzegovina did not carry out satisfactorily, not even one of the 15 recommendations contained in the Fourth Round Report. Eleven recommendations out of fifteen have partially been conducted, while four have not even been implemented.

Due to the fact that The U.S. Department of State has made anti-corruption a national security priority and works across the globe to prevent graft, promote accountability, and empower reformers, AmCham BiH as an association that is guided by American business values of competition, transparency, and liberal entrepreneurship being a voice of American economy in Bosnia and Herzegovina, is actively committed to advocate the fight against corruption in BiH. Thus it will continue its activities in this field (AmCham BiH is co-organizer of the Balkan Compliance and Ethics Forum 2018), and in promoting best practices of business and regulatory environment through active dialogue and open partnership with Government, economy, and other key target groups.

Proposed solutions:

It is necessary to follow the implementation of the Law on Freedom of Access to Information at all levels in BiH, as well as to stimulate and improve proactive transparency of the work of public institutions in BiH in conforming to the standards of Open Government Partnership.

It is known that BiH is a signatory to all significant international agreements relating to the fight against corruption, and that the laws at all levels are continuously aligned with international standards. Nonetheless, such compliance is currently not fully satisfactory, and in that sense the legislators in BiH are faced with several key interventions that are primarily related to GRECO's binding recommendations, but also wider legislative procedures. First and foremost, at the state level it is necessary to incriminate bribery in the private sector, which is a binding recommendation for BiH, which should be considered as the first task that needs to be corrected through all legislative bodies. After that, focus on aligning the legal framework for combating corruption at state level. Harmonize the legal texts but above all equalize the threatened punishments in the context of the proportion of prescribed sanctions with the offense committed. The equality of citizens should be primary, in the sense that the perpetrator of the same offense in the territory of Bosnia and Herzegovina will be punished with the same

punishment regardless of which part of the country he/she lives in, all for the purpose of achieving the legal security that GRECO¹⁰ specifically insists on.

AmCham BiH will form the Ethics and Compliance Committee which will be aimed at discussing topics regarding protection of the member companies' integrity. The mentioned Committee will help member companies operate through the highest ethical business standards and in accordance with applicable laws and regulations.

AmCham BiH was recently invited to become the Member of the Western Balkans Network for Integrity and Compliance. The mission of the WBNIC will be to address problems of corruption of the business environment, promote best practices of business integrity and compliance and improve the business climate in the Western Balkans region, through proactive collective efforts of the members of the WBNIC. AmCham BiH sees this Institutional membership in WBNIC (reserved for all business associations or other NON-Governmental associations with a business focus) as an opportunity to cooperate with all AmChams in the region on topics related to businesses ethics and moral principles.

4. Taxes

Public services, infrastructure and other services which are necessary for normal functioning of the economy are funded through taxes, so the tax policy and taxes are of crucial importance for one country. There are many disadvantages in BiH tax regulations, which hinder the development of the economy of BiH. Enormous taxes and levies on salaries place a heavy burden on industry and prevent any considerable growth of salaries. Due to tax burdens, professionals with university degrees earn lower salaries, which creates a significant difference in the living standard between BiH and the Western countries, and so results in the desire of young people to leave the country.

To foster inter-entity consistency, the Republika Srpska parliament adopted amendments to the Law on Corporate Income Tax, after the FBiH parliament had done so earlier. The FBiH government had submitted to parliament amendments to the laws on personal income tax and social security contributions, which is expected to more closely align labor tax laws with those in RS and reduce the high tax wedge on labor.¹¹

¹⁰ GRECO - Group of States Against Corruption; www.coe.int/greco - Fourth Interim Compliance Report on Bosnia and Herzegovina "Incriminations (ETS 173 and 191, GPC 2)"

¹¹ BOSNIA AND HERZEGOVINA 2017 ARTICLE IV CONSULTATION, FIRST REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, REQUESTS FOR EXTENSION OF THE ARRANGEMENT, REPHASING OF PURCHASES, AND WAIVER OF NONOBSERVANCE OF PERFORMANCE CRITERION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR BOSNIA AND HERZEGOVINA, IMF Country Report No. 18/39, February 2018, International Monetary Fund, Washington, D.C., page 11

In Bosnia and Herzegovina there are inconsistencies and complexities in the tax systems in different parts of the country that pose major problems for investors (potential and existing) in the economy. What BiH still keeps quite low on the ladder are administrative difficulties in paying taxes. The taxation of the costs of earnings has three main components: the share of employees in social security contributions, the share of employers in social security contributions, and personal income tax. In accordance with the above, the FBiH is ranked very high by the taxation of labor in comparison with other countries.

The World Bank statement on the ease of doing business in 2018 states that companies in BiH need to make 33 payments of taxes during one year, spend 411 hours on submitting a payment order, preparation and payment of taxes and pay tax fees in the amount of 23.7% of the realized profit, leaving BiH in a very bad position for a foreign investment race. Globally speaking, when it comes to paying taxes Bosnia and Herzegovina is 137th out of 190 economies.

¹²

Tax competitiveness is one of the most important determinants of the overall competitiveness determinants of a country. Tax competitiveness is, in fact, a competition among countries to attract foreign direct investment by tax instruments and incentives, which is a crucial influence on the commercial and overall economic growth. Direct taxes that burden the economy are inversely proportional to the competitiveness of the economy. Higher direct taxes cause higher costs of companies resulting in lower competitiveness, and vice versa, lower direct taxes contribute to increasing the competitiveness of the economy.

The most frequently mentioned examples of difficulties faced by investors when it comes to the field of taxation, that were highlighted at the US Business and Promotion Forum, are: unequal tax practice of business entities registered in the other BiH entity and Brčko District; critical review of the procedure of giving opinions to ITA BiH, the application of international agreements on the exclusion of double taxation in BiH, suggesting the adoption of a new VAT law in BiH for approximation with EU regulations.

Proposed Solutions:

Economies around the globe have made it faster and easier to pay tax by unifying the submitting of applications, reducing the frequency of payments, or offering the electronic filing of payment orders.

The direct tax burden relief of the business entities could significantly open new investment and employment opportunities, and it could also reduce the operating costs, which would

¹²A World Bank Group Flagship Report, Doing Business 2018 Reforming to Create Jobs, Economy Profile Bosnia and Herzegovina, page 48

automatically make the business entities more competitive. By easing the economy from tax burden, workers' wages would increase, and their social and economic position would improve.

AmCham BiH and its members will continue to cooperate with relevant decision-makers (Ministry of Finance and Treasury of BiH, FBiH Ministry of Finance, RS Ministry of Finance, Indirect Taxation Authority of BiH, Tax Administration FBiH and RS) in order to achieve effective harmonization of regulations at the state level as soon as possible. The AmCham BiH activities carried out should directly facilitate the business of legal entities in BiH.

5. Public Administration Reform

In 2015, the governments adopted a comprehensive Reform Agenda which sets out the main plans for socio-economic and related reforms of all levels of government. In September 2016, the EU Council accepted BiH's formal application to become a candidate for EU membership. However, implementation of the Reform Agenda and progress toward EU accession (candidacy) have been slower than expected.¹³

There is still no unique policy-making system in Bosnia and Herzegovina. Responsibilities for policy making in BiH are decentralized, where different planning approaches are applied at the state and entity level and the Brčko District of BiH. The government's effectiveness excels through the quality of public services, in the ability of the state to formulate policies and achieve the set goals of the policies, the degree of self-sufficiency of political pressure, the quality of policy formulation and their implementation and the credibility of government commitment to adopted policies.

The public administration reform is the ultimate precondition for the successful integration of Bosnia and Herzegovina into the European Union, and also an obligation under the Stabilization and Association Agreement. The ability of the administration to adopt and implement basic regulations is one of the main conditions for EU membership. Apart from the public administration playing a key role in the implementation of the necessary reforms to enter the EU, it also ensures effective dialogue on the accession process.

Proposed Solutions:

Effective rule of law, transparency, high level of civil society participation in Decisions, low level of corruption are the characteristics of a high-quality public administration. This kind of public administration is based on political, institutional, legal agreement and cooperation. The Good

¹³ BOSNIA AND HERZEGOVINA 2017 ARTICLE IV CONSULTATION, FIRST REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, REQUESTS FOR EXTENSION OF THE ARRANGEMENT, REPHASING OF PURCHASES, AND WAIVER OF NONOBSERVANCE OF PERFORMANCE CRITERION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR BOSNIA AND HERZEGOVINA, IMF Country Report No. 18/39, February 2018, International Monetary Fund, Washington, D.C., page 7.

Governance concept includes elements such as reliability, predictability, accountability and transparency, as well as the technical and administrative capacity of the administration to effectively transpose and implement the basic EU regulations. It pays special attention to building effective administrative practices that will be able to generate a unique approach to coping with various, often very complex, challenges faced by the European Union and its member states.

In order for Bosnia and Herzegovina to respond adequately to the challenges of adaptation to the European Union and to ensure more efficient and effective provision of services to citizens, the BiH public administration must improve cooperation and transparency between all levels of government, harmonize the medium-term planning system and align it with the financial framework and provide a harmonized approach to policy development and coordination. By modernizing the public administration, BiH could have a more responsible and cost effective civil service.

Through its Tax/Legal & Regulatory Committee AmCham BiH will continue to advocate for mandatory involvement of business sector in all regulatory processes, as well as the impact of the civil society organizations to adoption of the public sector policies.

6. Single Economic Space & Harmonization of Regulations

One of the most common reported problems by the investors during the U.S. Business and Promotion Forum is a divided/fragmented BiH market economy. As long as the market of Bosnia and Herzegovina or its economic space remains fragmented, with different rules in force and applied in different parts of the country, the real freedom of movement within its borders cannot be achieved.

The absence of a single economic space with a joined-up approach to the policy of entrepreneurship, stands in the way of Bosnia and Herzegovina's economic growth and competitiveness. Although there are some changes in facilitating business registration, the process remains slow, because of the non-recognition of business registration across the country.

The inconsistency of certain regulations on the territory of BiH is a complicating factor for businesses to flourish, both for domestic and foreign companies. Harmonization of the regulations with the EU legislation and neighboring countries is of the utmost importance for potential and existing investments. Due to the lack of compliance between the harmonizations, there is a burden on the economy which lingers long-term investment planning.

In addition to the efforts that Bosnia and Herzegovina makes towards the country's development, all other Western Balkan countries must also urgently double their efforts to

resolve key reforms and complete political, economic and social transformation along with all stakeholders from the political scene and civil society. Thus, AmCham BiH with its members, as part of the NGO sector, will continue to support decision-making in BiH that contributes to fulfilling the economic criteria for EU membership, and the implementation of European standards.

Proposed Solutions:

Since one of the main objectives of AmCham BiH is to build up throughout the territory of BiH, in compliance with international standards, a unified economic space by establishing full freedom of movement of people, goods, capital and services, without discrimination of investment climate in BiH, AmCham BiH will remain to carry out activities regarding the establishment of the single economic space in BiH, and the harmonization of regulations. AmCham BiH, through its cooperation with other AmChams from the Western Balkan countries, will endeavor to further contribute to the implementation of the European Commission's Strategy for the Western Balkans¹⁴, adopted at the beginning of 2018.

7. Software Development & Technology

Bosnia and Herzegovina is lagging behind on adopting EU frameworks in communications and media. Growth in software development business does not require extensive and expensive infrastructure in terms of capital investments for startup of the business, but as a base it needs world competitive broadband infrastructure throughout BiH and IT skilled people continuously flowing into market from education system, even though the education system in Bosnia and Herzegovina lags behind world trends. The absence of any kind of connection between academic and business community prevents the development of a strong software development industry. The Law on Communications based on the EU is outdated, from the year 1998. There is no adopted digital development strategy of BiH, because a decision was made at the level of the Council of Ministers on the Information Society Development Policy of BiH 2017-2021. Education system does not recognize the importance of ICT citizens in terms of digital skills and knowledge in line with those of developed countries creating an expanding digital gap with the world for BiH citizens. Lack of a proper and qualitative (non-traditional school) IT education Higher educational institutions in BiH are not synced and up to date. BiH education system does not follow the needs of the industry, neither with regard to the number nor the quality of qualified personnel. Instead of being based on the actual demand and needs of the industry and strategic development plans of Bosnia and Herzegovina, higher education

¹⁴ "COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS, A credible enlargement perspective for and enhanced EU engagement with the Western Balkans", EUROPEAN COMMISSION, Strasbourg, 6.2.2018, http://www.dei.gov.ba/dei/media_servis/vijesti/default.aspx?id=19395&langTag=bs-BA

enrolment policy (planning the number of students) rests on the data on available capacities and equipment at individual higher education schools. Enrolment policy is primarily based on the achievements in secondary education. Since primary and secondary education rest on inadequate values, the parameter “grade” reflects the same erroneous values.

As it was stressed out by KKR, currently the most important U.S. investor in BiH, during the Forum, public administration unfortunately does not recognize the importance of ICT in enhancing public administration efficiency and, consequently, the country’s overall competitiveness. The country has not adopted the Digital Signature Act, which is the basis for development of ICT service in the Public Administration. Investments in the BiH telecoms market is put at risk by the sector’s lack of reliable legal framework and institutions at state, entities and local level which leads to persistent violations of basic economic rights.

Proposed Solutions:

Given that high-speed broadband access of a country allows citizens and enterprises to communicate and produce in a faster and more efficient way, the growth of the broadband market must be a national priority in all developed markets, as it is widely recognized as one of the key platforms for the overall socio-economic development. In this regard, it is very important that BiH also focuses its efforts to accelerating the development of electronic communications networks and services, as well as the overall development of the ICT sector.

AmCham BiH activities on the growth of the ICT sector in BiH will continue to be implemented through the AmCham BiH ICT Committee. Members of this Committee will continue to be dedicated to advocating the adoption of a new legislative solution and therefore will continue to cooperate with the Ministry of Transport and Communications BiH, Ministries of Education at all levels in BiH and with all other relevant ministries and institutions, in relation to BiH ICT Sector issues.

8. Intellectual Property Rights Policy

In 1992 BiH joined WIPO (World International Property Organization) and Copyright Treaty and the WIPO Performance and Phonograms Treaty. Even so, Bosnia and Herzegovina has not prioritized systematic IPR enforcement, despite the fact that local and foreign right holders, foreign investors, industry associations and foreign governments have clearly articulated a need for such enforcement in the country.

The protection of intellectual property rights is of global and local economic significance. Despite significant investments in building an effective IPR system, BiH does not have the necessary capacity and has not demonstrated results. Ex officio enforcement has largely been non-existent and enforcement at the request of right holders is slow and inconsistent.

Although not every industry provides data on IPR infringement and losses suffered by piracy and counterfeiting, it is evident that the two are correlated. BiH was first included in the Fourth Global Piracy Study in 2004 when the piracy rate in the country was estimated at 70%. By 2013 this rate had dropped by a mere 5%, according to the BSA Global Piracy Study published in 2014, while in 2016 The BSA Global Piracy Study published that the use of unlicensed software in Bosnia and Herzegovina amounts to 63%, thus confirming that computer users in BiH continue to use unlicensed software on alarming scale, regardless of the connection between unlicensed software and cyber-attacks.¹⁵ Companies such as Oracle, Microsoft, Adobe, VMWare, etc. are still struggling with sub-licensed users, both in the public and the private sector.

Proposed Solutions:

AmCham IPR Committee has successfully collaborated with the Institute for the Protection of Intellectual Property of BiH since its establishment, on the creation of legislation that treats the IPR in BiH. This legislation is compliant with the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and EU legislation. Although existing legislation provides a basic level of protection, BiH's civil and criminal enforcement remains weak. In this regard, a large number of round tables, campaigns, trainings, workshops for customs officers and inspectors was organized by AmCham BiH in order to provide practical knowledge on how to better identify unlicensed software and other counterfeiting goods. In this direction, AmCham BiH with the members of the IPR Committee will continue its activities on raising the awareness of the importance of the protection of intellectual property rights, due to the fact that the protection of the IPR is important for promoting innovation and creativity, developing employment, and improving the country's competitiveness. Cloud services must become a priority use. There is no law or regulation that explicitly states that any public-sector or private-sector institution cannot or may not have data in the Cloud (in the country or in the foreign country).

9. Customs Policy

Custom policies and procedures is one of the most important areas of interest for investors when deciding on entering the country. Investors thus highlighted the need for certain improvements in the customs policy and procedures in BiH, such as recommendations regarding the improvement of the customs system, customs rates, and more efficient customs clearance. Apart from these necessary improvements of the customs policies, investors see a great chance for the development of BiH's economy in the functioning of the free-trade zones.

¹⁵ See: <http://globalstudy.bsa.org/2016/countries.html>

Given that the new Customs Policy Law did not come into force, there are several possible initiatives to modify lower rights under the existing Act (Guidelines and Decisions), which would drastically help exporters/importers, simplify and streamline the process; primarily changes to the Export Procedures Guidance Manual. The change initiative was sent to the UIO addressed by the UO Speditor Association in BiH at VTK and the President of VTK.

By definition, a free-trade zone represents a zone of the customs territory of Bosnia and Herzegovina that is specifically marked, in which potential investors in BiH can be free to perform production and service activities with certain stimulating benefits. The free-trade zone of Bosnia and Herzegovina can be one of the most effective tools in attracting investments. However, given the obstacles that these zones and operators face in practice, many planned activities to empower the free-trade zones in BiH cannot be implemented.

Investors propose launching an initiative to establish a one-stop shop at the state level to register free-trade zones. Also, as one of the basic shortcomings, investors emphasize the discrepancies between legal solutions that clearly specify tax and customs benefits and their application in practice.

The United States of America allowed Bosnia and Herzegovina a new extension of preferential imports to the U.S. For all entities that export or are preparing to export goods to the U.S. market, the validity of the United States General System of Preferences for Bosnia and Herzegovina, which was valid until the end of last year, has been extended. By the new revision of the U.S. Congress, the GSP program will be effective from 22 April 2018 until 21 December 2020. The United States' general system of preferences is a program to promote economic growth in developing countries through the provision of preferential imports. Bosnia and Herzegovina is on the list of countries that have been granted privileges on the basis of which BiH businessmen receive preferential customs treatment for certain products while exporting to the United States.

Proposed solutions:

AmCham BiH, together with its members, will continue to advocate for the improvement of the customs legislation in BiH, taking into account the fact that free-trade zones can become one of the key ways of attracting foreign direct investments to the country.

10. Education and the Workforce Market

By analyzing the link between the necessary staff for economic growth and the available human resources a clear lack of the required educational profiles can be identified. Apart from the lack of staff, lack of skillful employees in the companies have also been recorded. So, the first issue is related to the current situation where persons who had already acquired certain skills and

qualifications through the education system are now in the labor market, and so possess certain qualifications and skills but they do not meet the needs of the labor market, thus remain unemployed. The second problem concerns the differences between education policies and labor market needs because education policies do not regulate the number of qualifications and skills of future generations of students in line with labor market needs, but are driven by other parameters, creating a long-term problem of the development of Bosnia and Herzegovina. The biggest lack of the education system in BiH is the absence of the Ministry of Education at the state level.

Proposed Solutions:

AmCham BiH already implements educational projects such as “JOB LAB - education on social and IT skills for finding jobs for unemployed persons in BiH” with member companies Telemach BiH and Link Group, as well as in cooperation with employment services in BiH, to educate the unemployed in BiH in order for them to acquire new skills and increase their competitiveness in the labor market. Some companies in AmCham BiH membership, with an emphasis on the companies coming from the ICT sector, make daily efforts to train young people according to their needs through re-training programs or the so-called quarter-to-six-month camps. With these positive examples, AmCham BiH intends to continue its work. In addition to these activities, AmCham BiH actively gives a chance to young people, through volunteer work in its executive office. This is a quarterly practice for students in their final year of studies.

In the future, AmCham BiH will try to create a program with its members that will be aimed at training and lecturing students in the final years of their studies, and thus give a significant contribution for the development of leader skills and entrepreneurship among young generations in BiH. Since some of AmCham BiH members are active participants of the Business Council on Education program within the U.S. Embassy in BiH, AmCham BiH will continue to cooperate with the U.S. Embassy in BiH and support such programs and activities. AmCham BiH will work on establishing a better cooperation with the Ministries of Education in both entities in BiH.

11. The Rule of Law

The principle of the rule of law is one of the fundamental principles on which democracies are based. The principle in its general meaning signifies the rule of law, law, and even more narrow rule of (respect) of the legal norm within one society (the community). First of all, respecting the highest legal and political act of Constitution means respect for the law in terms of equality of all before the law and the existence of a clear and harmonized legal system that guarantees respect for the fundamental human rights and freedoms of the individual - citizen and includes

independent judiciary. Particularly important is the segment of work of the courts in the sphere of affirmation of the principle that no one is above the law.

The division of the state of BiH into several political units also caused the division of the court system into four court systems (the judicial system at the state level, the two entity systems and the Brčko District Court system). Such a complex organization of the judiciary led to the fact that the judiciary in BiH consists of regular specialized courts that are regulated at the state and entity levels, the BiH Court Law, the RS Law and the FBiH Law on Courts. In addition to these laws there is a large number of bylaws regulating this area.

Unfortunately the court system in BiH is one of the most problematic court systems in the whole Europe, even more than in the Central Asia. All business in BiH is affected by the court system, as it was emphasized during the U.S. Business Promotion and Networking Forum. Investors stated that one of the major problems they are faced with when doing business in BiH is that a significant diversity exists in between entity courts in the sense that RS has recently adopted commercial courts, while that is not yet the case in the Federation of BiH. In that regard, stakeholders in the FBiH requested from the World Bank to conduct a feasibility study on how best to improve the processing of commercial cases in the FBiH. The feasibility study is titled "Improving Commercial Case Management in the FBiH" and AmCham BiH together with its members – Law offices – actively participated in the process of collecting data for the study, and shared their experiences of rule of law practices.

Proposed Solutions:

AmCham BiH will continue to cooperate with World Bank and other institutions responsible for carrying out next steps necessary for implementing the reforms stressed out in the Feasibility Study in order to improve the business climate in BiH.