BOSNIA AND HERZEGOVINA

COMMERCIAL LEGAL FRAMEWORK AND ADMINISTRATIVE BARRIERS TO INVESTMENT

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Foreign Investment Advisory Service
a joint service of the
International Finance Corporation
and
The World Bank

At the request of the Government of Bosnia and Herzegovina (BiH), the Foreign Investment Advisory Service (FIAS), a joint facility of the International Finance Corporation and the World Bank, conducted a study of the administrative barriers to investment in BiH. In order to provide a comprehensive review, the scope of work for this project was widened to include a review of the legal and regulatory framework for foreign investment in BiH.

The main objective of this study of the administrative barriers to FDI in BiH is to identify the major impediments to investment and to make recommendations for improving the investment environment in BiH. It should be noted that while the primary focus of the study is on the issues that affect foreign investment, the impact of the review of administrative procedures and legal commercial framework is not confined to foreign investment. Since one of the fundamental characteristics of a liberal and effective environment for FDI is the national treatment of foreign investors (i.e., equal treatment for both foreign and local investors), this study is intended to contribute to the strengthening of the business environment for all investment – domestic and foreign.

The analysis presented in this report is organized to reflect the structure of the Government and administration of BiH established by the Dayton Peace Accord and embodied in the constitution. This structure consists of the State Government and two Entity Governments, each with different levels of responsibility for the legal and regulatory framework for business.

The final Chapter of this report proposes a framework for implementation and follow-up, recognizing that in some specific areas further technical assistance is required to develop a comprehensive solution for certain complex issues, e.g., land ownership and the transfer of rights to use. Annex B provides a summary of the recommendations of the report with a notional indication of priorities for implementation. However, it is expected that the process of consultation among the relevant stakeholders in the public and private sector will generate an action plan for the identification of priority areas of focus and implementation.

This project was co-funded by the United Kingdom Department of International Development (DFID), the Government of Denmark, and FIAS.

FIAS wishes to acknowledge the considerable inputs and assistance of the local counterpart team which is comprised of Messrs. Mekic, Zugic and Zukic.

TABLE OF CONTENTS

Page

EXECUTIVE SUMMARY

i. The Government of BiH is faced with an array of challenges in its efforts to achieve long-term, sustainable development and the transition to a market-based economy. To date, the economic growth generated by BiH is largely attributable to the massive reconstruction effort and the infusion of external aid. However, it is generally recognized that as the concessional flows inevitably begin to decrease, BiH will need to attract more private capital flows in order to sustain economic growth and development. Considering the low domestic savings rates, the most likely source of the required capital flows will be foreign investment. In addition to much-needed capital, foreign direct investment (FDI) can provide modern technology, management resources, and access to international markets.

ii. Following the devastating war and the subsequent 1995 Dayton Peace Accord, BiH has embarked on a challenging program of reforms and initiatives aimed at achieving political stability and economic reconstruction, with mixed results. As part of these reforms, the Government has initiated efforts to improve the environment for private investment at the State and Entity levels. These efforts include the passage and implementation of a liberal State Foreign Investment Policy Law, introduction of a common currency, and introduction of a uniform trade and customs policy across the Entities. The Entities have begun to introduce new property, mortgage, capital market, accounting, audit and labor laws. In addition, the legislative framework for privatization has been established and both Entities have initiated privatization programs.

iii. However, investors continue to face a difficult business environment given the complex legal and regulatory framework, the onerous and non-transparent public administration system and the weak judicial structure in BiH. The review of the commercial legal framework and the administrative procedures for business establishment and operation in BiH points to three fundamental issues that affect the environment for business in BiH:

- The absence of a seamless, transparent and predictable legal and regulatory framework for business establishment and operation serves as an impediment to investment in the relatively small market of BiH. The structure of the government as outlined in the Constitution, influences the multi-tiered and compartmentalized legal and regulatory framework in BiH and has resulted in a maze of often contradictory or duplicative laws and regulations at the State, Entity, cantonal and municipal levels of government. This complexity contributes to the difficulty, risk and cost of doing business in BiH. Therefore, some of the basic challenges faced by BiH in improving its attractiveness for investment are the harmonization of the legal and regulatory framework for business, simplification and streamlining business establishment and operations procedures, and the cultivation of a consistent,

transparent and predictable environment for doing business in a single economic space.

- The lack of consistent and transparent business regulations and administrative procedures provides opportunities for corruption and the abuse of power by officials at various levels of government, thereby increasing the risk and cost of doing business in BiH. This problem is compounded by the absence of effective and independent mechanisms for appeals and for public accountability of various government agencies.
- The lack of effective, efficient and adequately resourced administrative and judicial systems also negatively affects the ease, cost and risk of doing business in BiH.

iv. Investor perceptions of BiH as a location for investment reflect the weaknesses identified above. The 1999 Wall Street Journal Central and European Economic Review[1] survey asked leading economists to evaluate economic performance in 27 countries in the region. BiH is ranked eighteenth out of 27 countries (an improvement from No. 24 in 1998) on the overall scores, 18th for business ethics (just ahead of Russia and Ukraine), 21st for integration into the world economy (behind Georgia and Armenia), 21st for rule of law (behind Ukraine and Azerbaijan), 19th for investment climate (between Armenia and Moldova but ahead of Ukraine), and 26th for political stability (ahead of Yugoslavia only).

v. Clearly the Government of BiH must seek to significantly improve the business environment if it is seriously seeking to increase the levels of private investment. Considerable commitment and political will is needed to address the fundamental issues that affect the business environment in BiH.

A. The Commercial Legal Framework for Investment in BiH

vi. The existing commercial legal and regulatory framework in BiH is based on a labyrinth of formal and informal rules, across the state, entity, municipal and cantonal levels. The fundamental conclusion of this report is that the current commercial legal framework is still fragmented despite the significant and wide-ranging program of legal reform and harmonization that has been undertaken with the help of the international donor community. Although many of the key building blocks have been put in place, there are a number of areas, including the judiciary, that need to be strengthened.

vii. It must be recognized that the legal and regulatory framework in BiH is shaped by the complex political and governmental structure that underpins the constitutional and legal system. However, in some respects, this complex structure itself presents a barrier to private investment. The overwhelming challenges are to harmonize laws and regulations so as to develop a seamless, transparent and predictable framework for

[1] The Wall Street Journal, *Central European Economic Review*, November 1999.

investment and to re-constitute the judicial system so that it can function effectively and efficiently.

viii. Since a considerable body of work is ongoing, the report does not attempt a comprehensive overview of the existing legal and regulatory framework. Rather it focuses on specific laws and issues that impact the environment for foreign investment and makes recommendations for addressing these issues with the objective of promoting a sound legal and regulatory framework with clear, reasonable rules as well as efficient mechanisms of implementation, enforcement and dispute resolution.

1. Multiple Levels of Legal Authority

ix. The multiple levels of legal authority (State, Entity, cantonal and municipal) serves to further complicate and compartmentalize the legal framework, the judicial system, and the public administration structure. Also, it has led to the creation of a maze of sometimes contradictory laws and regulations at the State, Entity and municipal levels of government. For example, in the case of the Federation, implementation of legislation may be delegated to authorities at the municipal level, in order to accommodate the interests of ethnic groups. Overall, the fragmentary legal and regulatory system compels entrepreneurs to meet different requirements and grants them different rights depending on the municipality, canton, or Entity in which a business is located.

2. The Company Law

x. In both Entities, the respective company laws (The Law on Business Companies in the Federation and the Law on Enterprises in the Republika Srpska) regulate all aspects of corporate formation in BiH – both for domestic and foreign investors. Therefore, it is essential that these laws incorporate the best practices of business organization and are mutually consistent in order to create a consistent and harmonized regime for business in BiH.

xi. Clearly, a single company law for both Entities would provide an integrated and cohesive foundation for the business environment in BiH. However, if a single piece of company legislation is not politically feasible, then the two laws must be harmonized. Amendments must be made to the Entity laws to ensure effective means of governance by the board of directors, to guarantee shareholder rights – especially for minority shareholders, and to comply with European Union Directives. This report makes specific recommendations for harmonizing the provisions of the respective Entity laws. It also addresses the changes necessary for conformity with the EU corporate law directives.

3. The Law on the Policy of Foreign Direct Investment

xii. The Law on the Policy of Foreign Direct Investment in Bosnia and Herzegovina (Policy Law), was drafted with the assistance of FIAS and adopted by the State

Government in March 1998 (O.G. BiH No. 4/98). The Policy Law is designed to promote foreign direct investment and to protect the rights of foreign investors seeking to establish business enterprises in BiH. It also establishes policy guidelines and standards for adoption into the related laws and regulations by the State and the Entities. The Policy Law stipulates that all provisions of laws and by-laws regulating foreign investment in Bosnia that are not in conformity with or are contrary to the Policy Law are no longer valid. However, this provision does not negate the obligation of the State and the Entities to adopt laws that conform with the Policy Law. The implementation of subsequent sub-laws and regulations is left to the appropriate Entity and State authorities.

xiii. The Federation has passed a Law[2] nullifying its 1995 Law on Foreign Investment and is in the process of considering legislation on a new Investment Law. In the R.S, the law that is currently in effect is the 1996 Law on Foreign Investment and Concessions (O.G. R.S. -21/96) and the amendments to this law (O.G. R.S. 1/97 and O.G. R.S. No.5/99).

xiv. There are two possible approaches that BiH can follow to ensure that the full benefits of the State Policy Law are utilized. Under the first and most rational approach, both Entities would concede their current jurisdiction over foreign investment issues to the State, which in turn, would adopt a harmonized foreign investment law consistent with the Policy Law. The second option is to harmonize the Federation and the R.S. Investment Laws with the BiH Investment Policy Law.

xv. In view of the apparent intention to follow the second option, this report makes specific recommendations for strengthening and harmonizing the State and Entity foreign investment laws[3].

4. Law on Secured Transactions

xvi. In 2000, the R.S. BiH passed a Law on Registered Pledges on Moveable and Shares (O.G. R.S. 16/00). Similar legislation has been drafted in the Federation and is currently being reviewed by the Federation's Parliament.

xvii. The use of collateral in the form of moveable and immoveable property to secure transactions is an essential element in a market economy. Loans for capital investment are rarely provided without collateral in real estate or a mechanic's lien registered in the court. The centralized registry system that supports a simple and quick process must be implemented since an overly bureaucratic process will be a disincentive for registering pledges. Also, appropriate mechanisms for the enforcement of pledges need to be implemented.

[2] Law on Cessation of the Law on Foreign Investment O.G. FBH 32/00.
[3] In the case of the Federation Law, it is assumed that the new draft will incorporate many of the provisions of the 1995 law.

xviii. One potential problem with the new R.S. Law and the Federation's draft Law is the reliance on the relatively weak and over-extended judiciary for administration and enforcement of pledges. Therefore, as the implementing regulations are developed, it will be essential to review the requirements for administration and implementation in the context of the infrastructure and resources required.

5. The Judicial System

xix. A body of technically sound, well-written laws that reflect best practice comprise an essential building block for the modernization and restructuring of BiH's legal system. An equally important component is a well-trained, highly competent judiciary that is capable of interpreting and upholding the law without compromise or undue influence.

xx. The key issues affecting the judiciary include:

- Judicial independence. In order for the judiciary to be independent and impartial, all political and governmental influence and interference must be eliminated. This is also a prerequisite for BiH's efforts to achieve integration into the European Union.

- Resources. The lack of resources substantially affects the working of the courts in terms of administration and operational efficiency.

xxi. A comprehensive program of reform and capacity building must be implemented as a matter of priority in order to strengthen the judicial system. An interim solution for addressing the needs of the business community may lie with the establishment of specialized commercial, mediation or arbitration courts.

B. Administrative Impediments to Business

1. Business Registration and Approvals

xxii. In comparison with other countries in the region, BiH's business establishment procedures are among the most bureaucratic and lengthy. Since the steps of the registration procedure are largely sequential and interdependent, a delay at any single step would interrupt the entire process. This makes the investor very vulnerable to and dependent on each particular authority in the process. The complexity of the process is reflected in the relatively high costs of business registration and start-up in terms of document preparation and the professional services required for navigating the complex system. The business establishment process can take as long as one year in BiH.

xxiii. Key recommendations for improving the business establishment process include:

- Streamlining the business registration procedures.
- Simplifying the registration process by applying new technologies, including providing services through the Internet.
- Introducing a single, state-wide identification number for businesses and establishing a centrally coordinated business registration process that eliminates the need for multiple registrations (taxation, customs, etc.) across the Entities and government functions.
- Harmonizing the legal framework for the registration of foreign and local businesses across Entities.

2. Access to Land

xxiv. Access to land is an essential requirement for investment in certain sectors. In addition to being an important factor of production, land represents an asset which can be traded or utilized as collateral for long-term financing. Without secure access to land, the increased risk and cost of investing will negatively affect investors' location decisions. In the current global economy, with heightened competition and rapid changes in technology and products, the speed with which an investment project can be developed is a significant factor in investment location decisions. In most European countries, investors expect to find readily available, serviced industrial sites. At a minimum, it is expected that suitably serviced sites can be quickly identified, acquired, and developed.

a. Land Ownership

xxv. A necessary prerequisite for the transfer of ownership of property is a secure title on the part of the seller. In the case of BiH, the lack of accurate and current records in the cadastre and registry of rights to property makes it difficult to establish clear title to property where there is doubt. Also, there is no definitive policy on restitution and compensation for outstanding claims on appropriated property. Taken together, these factors increase the level of risk associated with the acquisition of rights to property and inhibits the development of a land market in BiH.

xxvi. The inconsistency of the Courts in upholding and enforcing sales and leasing contracts has further weakened the operation of the land market in BiH. Several interviewees cited examples of land transactions where landlords or landowners have broken contracts or ignored contracts to lease or sell land.

xxvii. As a starting point, the legal framework for property ownership and the transfer of rights to land needs to be reviewed and strengthened. As part of this process, tough political decisions need to be taken on the issue of restitution for land appropriations and a mechanism for resolving outstanding claims needs to be established. A number of

countries (e.g., Czech Republic, Germany, Hungary, and Poland) in the region have successfully addressed these issues and BiH can benefit from their experience in developing and committing to an approach for addressing this issue.

xxviii. Technical assistance is being provided by GTZ for the preparation of a new Land Law in each Entity and in conducting cadastral surveys. However, these efforts represent just two of the essential building blocks for the development of a modern and effective land management and ownership registration system in BiH. Further work needs to be done to strengthen the laws on contracts and the Law on Landlord and Tenant Relations.

xxix. Finally, the Entity governments' right of first refusal on all sales of property should be removed. This right under the existing laws serves to undermine the operation of an open market for property.

b. Land Use Planning and Management

xxx. The existing urban land use planning and management system in BiH needs to be strengthened and given the capacity to provide pro-active and efficient services. This is an important factor for industrial and commercial activity in BiH. Acquiring land and obtaining site development approvals are among the significant obstacles that investors experience in BiH. The process is lengthy, confusing, costly, unpredictable, and corrupt in some instances.

xxxi. The main recommendations for improving the land use planning and administration system include:

- Preparation of accurate and detailed real estate surveys to support the land registration system and thereby create a better basis for urban planning.
- Strengthening the urban planning system, including its organization and linkages at the Entity, Municipal and Cantonal levels.
- Development of a streamlined and transparent system for processing land use applications. This system must be well documented and publicized in order to minimize opportunities for corruption.
- Elimination of the mandated role of the Institutes for Construction and opening up site preparation and development to the private sector.
- Encouraging the development of privately-operated industrial parks to address the paucity of secure and serviced sites for investment.

3. Entry and Employment

a. Entry

xxxii. The process for obtaining residence permits and extensions should be reviewed and simplified to remove the delays that are common and frustrating for foreign investors. Further a review of the penalties for violation of permits is merited to ensure that penalties are commensurate with the severity of any violations.

xxxiii. The BiH government must allow for a more flexible work permit policy to encourage technology transfer from foreign skilled labor and management. At a minimum, the stringent requirements should be simplified. The requirement of a determination of the unavailability of qualified local labor should be removed along with the requirement for the posting of vacancies with the Ministry of Labor should be dropped.

b. Local Labor

xxxiv. It is recognized that the Entity governments of BiH are actively engaged in improving the legal and regulatory framework for labor , with assistance from the international donor community. Already there has been significant progress in changing the laws to modernize and harmonize the labor regulations, making them more compatible with Western European standards. The World Bank is currently supporting the reform of key labor legislation under the SISAC and legislation reform commissions have been established in the Entities.

xxxv. In order to address some of the issues that affect the operation of the labor market and, therefore, impact the operations of private enterprises, recommendations include the following:

- Completion of the legal and regulatory framework to ensure comprehensive coverage of labor issues.
- Streamlining the administrative procedures and documentation required for employers. This represents an additional cost to employers.
- Imposition of limits on the authority of municipalities to impose ad hoc taxes on wages.
- Reorganization of the labor inspection function. More transparent rules and accountability will help to eliminate corrupt practices.

4. Taxation, Customs and Inspections

a. Taxation

xxxvi. The ongoing legislative changes and the re-organization of the taxation systems in the Entities should help the authorities to address a number of issues, including corruption and abuse of powers, lack of transparent and consistent procedures, and inconsistency in the application and interpretation of tax laws. However, in order to facilitate sustained change, the reform process must extend beyond legal and structural changes to include implementing regulations, organizational goals and functions, as well as a service (as opposed to punitive) orientation. FIAS recognizes that a number of technical assistance projects are currently being implemented and that these projects may include some elements of these recommendations. However, it is essential that these elements be incorporated into a comprehensive program of change for the taxation system in each Entity.

b. Customs and Customs Administration

xxxvii. As specified in the BiH Constitution (Article III.1.(c)), customs policy is the responsibility of the state. Consistent with this provision of the Constitution, the Customs Policy Law of BiH, treats the whole of BiH as a single customs area with a single customs law and harmonized customs tariffs. Cooperation between the Customs Administrations of both entities is crucial in ensuring the functioning of unified customs systems and a common economic space in BiH. It therefore follows that the level of cooperation between the two Customs Administrations has a direct effect on the ease of moving goods into and out of BiH. Significant efforts are underway to coordinate and harmonize the work of the Customs administrations of both entities.

xxxviii.Since January 1996, the European Commission's Customs and Fiscal Assistance Office (EC-CAFAO) has been providing assistance to reform and strengthen the Customs service and to implement proper customs regulations and procedures. Despite the considerable progress, interviews with representatives of the private sector suggest that corruption continues to be one of the key issues affecting the provision of the customs services in BiH.

xxxix. Taking into account the ongoing reforms, this report includes recommendations for addressing some of the specific issues raised during FIAS discussions with the private sector.

c. Inspections

xl. The work of inspectorates is an important aspect of regulatory monitoring and enforcement in public administration systems. In BiH, as in many transition economies, inspections and licensing have been utilized for revenue generation. In the absence of clear mandates and laws governing the activities of these inspectorates, opportunities for

extra-legal activities and corruption abound. Unfortunately, the abuse of inspection requirements serves to increase the costs and risks of business operations in BiH.

xli. Inspections for various activities (e.g., labor, taxation, market, environmental protection, health and sanitation) are carried out at the various levels of the administrative system, depending on the legal jurisdiction. In some cases, the activities of inspectorates overlap. In order to minimize abuse and improve its effectiveness, the system must be rationalized, clear mandates, laws and regulations governing the activities of each inspectorate must be introduced and published, along with a mechanism for public accountability.

C. Conclusions and Next Steps

xlii. There is general agreement within BiH that the existing environment for investment in general, and foreign direct investment in particular, needs considerable improvement for BiH to begin to attract and sustain significant levels of investment. This report provides a starting point by identifying a range of administrative as well as policy-level issues that need to be addressed. More importantly, the report points to areas that need further review and additional technical assistance. The challenge is to develop an agenda for implementing effective change, building on the many ongoing legislative and administrative reforms, and creating the momentum for a sustainable process of improving the investment environment.

xliii. In the case of BiH, Government commitment is required at the State and Entity levels and the framework for the change agenda must include the participation and inputs of stakeholders at all levels. Stakeholders must be drawn not only from the public and private sector, but also from the international donor community which provides much needed technical assistance and resources to support reform in BiH. For example, the World Bank Business Environment Adjustment Credit is being designed to support BiH's efforts to improve the business environment.

xliv. A framework for sustainable change and improvement of the investment environment through administrative and institutional reform requires a number of basic elements, including:

- *Champions and leaders with the commitment, credibility and authority to develop a vision and galvanize action.* Options for organizing the leadership of this effort include assigning responsibility to appropriate leaders at the State and Entity levels or establishing a ministerial committee with representatives from the State and the Entity governments, possibly from the offices of the prime ministers.

- *Clear goals and objectives.*

- *An institutional home for the change agenda.* The organization of the change agenda must be anchored and coordinated at the State and Entity levels. A small secretariat should be established on the State level, with corresponding offices in each Entity's Office of the Prime Minister. The secretariats will serve as the focal point of the change agenda, with a mandated responsibility for promoting and advocating reforms in collaboration with the relevant agencies. The staff of the secretariats will constitute the core group of the implementation team, establishing a plan of action on the basis of consultation with the stakeholders, coordinating state, entity and agency activities, coordinating donor assistance and helping to identify supplementary resources for implementation.

- *Tools for analyzing the investment environment, soliciting investor perceptions and proposing reforms to address the issues identified.* The FIAS Study of Administrative Barriers to Investment and the review of the commercial legal framework provides the initial inputs and starting point for a systematic, periodic review of the investment environment in BiH. The procedural documentation provided in this report should be used to develop a **roadmap** of the business start-up and operation process in BiH.
  In addition to the roadmap, a periodic **survey of investor perceptions** should be developed and implemented to provide inputs for the reform agenda and the development of a strategy for promoting foreign investment in BiH.
  Another tool that may be utilized for analyzing the investment environment and identifying areas for improvement is the **Regulatory and Administrative Costs Survey.** The initial survey would provide a baseline against which progress can be measured by subsequent surveys. **Customer service and performance monitoring surveys** should also be implemented to help improve the quality of the services provided by the various public agencies. In order to assure quality and credibility, the surveys should be independent and confidential. Also, the results must be publicized and service recognition awards should be granted to deserving employees.

- *A process for consultation among stakeholders in the public and private sector.* This in necessary to ensure the relevance of the proposed actions and the integrity of the reform process. In keeping with its policy advocacy role, the national investment promotion agency should contribute to discussions on the development of the policy agenda for improving the investment climate.

- *Resources for capacity building and implementation*. Serious commitment and effort aimed at effecting change requires resources.

- *Accountability*. A system for monitoring and evaluation is necessary for assessing progress and facilitating public accountability.

xlv. FIAS proposes this framework as a basis for discussion with the State and Entity Governments and the development of an approach for implementation and follow-up.

xlvi. Annex B provides a summary of the recommendations of this report and provides a notional indication of the priorities that may be assigned to the various recommendations. FIAS proposes a series of discussions between the Government and the private sector to consider the issues raised in the report and to provide a basis for the development of an action plan and the establishment of priorities for implementation. From FIAS perspective, the process of discussion is necessary to help generate a sense of ownership for the implementation and outcomes of this work. The action plan will also help to assign responsibilities for implementation activities and to identify areas for additional technical assistance. Finally, it is expected that the outcome of these discussions will help to frame the inputs of the international donor community in providing further assistance to BiH in strengthening the business environment.

CHAPTER I

INTRODUCTION

A. Background

1. As Bosnia and Herzegovina proceeds with its extensive reconstruction program and efforts to achieve long-term sustainable development and a transition to a market-based economy, the importance of private investment (particularly foreign investment) to help fuel economic growth is increasing. Foreign direct investment (FDI) is viewed not only as a source of much-needed capital but also as a source of modern technology, management resources, and access to international markets.

2. The Foreign Investment Advisory Service (FIAS) provided assistance to the Government of Bosnia and Herzegovina (BiH) in establishing the building blocks necessary to improve the environment for foreign investment and attracting more and better-quality FDI. Under the first advisory project, FIAS provided assistance in developing a new Foreign Investment Law following the Dayton Peace Accord (DPA). This Law was enacted at the State Level on May 18, 1999. The second project, completed in September1999, provided assistance in the development of an institutional framework for a national investment promotion function and the establishment of the Foreign Investment Promotion Agency (FIPA). The implementation of this project is currently ongoing with funding provided by the European Union.

3. In July 1999, FIAS received a request from the Minister of Foreign Trade and Economic Relations to provide assistance in reviewing the administrative barriers to investment in BiH. This request was, in part, a response to the highly critical 1999 ICG Report[4] which detailed some of the experiences of foreign investors attempting to establish and operate businesses in BiH. The scope of work for this project was broadened to include a review of the legal and regulatory framework for foreign investment in BiH. The fieldwork for this project was conducted in July, 2000. Funding for this project is being provided by the United Kingdom Department for International Development (DFID), the Government of Denmark, and FIAS.

B. Project Objectives

4. The primary objective of this study of the administrative barriers to FDI in BiH is to identify the major impediments to investment and to make recommendations for

[4] *Why Will No One Invest in Bosnia and Herzegovina? An Overview of the Impediments to Investment and Self-Sustaining Economic Growth in the Post-Dayton Era.* International Crisis Group, 1999.

improving the investment environment in BiH. In order to accomplish this fundamental objective, this project report:

- Reviews specific aspects of the commercial legal framework for investment in BiH and make recommendations for strengthening the framework and the institutions responsible for implementing this framework;

- Documents the administrative procedures required for the formal establishment and operation of business in BiH - focusing on the key areas that affect investment and the cost of doing business in BiH;

- Identifies redundant and non-transparent regulatory requirements and procedures for businesses in both entities in order to support the operation of business in a single economic space;

- Makes recommendations for harmonizing the administrative procedures and requirements for business in both Entities and at the State level, as appropriate; and

- Provides inputs for the development of a plan of action and for prioritizing the steps necessary for improving the environment for business.

5. It should be noted that while the primary focus of the study is on the issues that affect foreign investment, the impact of the review of administrative procedures and legal commercial framework is not confined to foreign investment. Since one of the fundamental characteristics of a liberal and effective environment for FDI is the national treatment of foreign investors (i.e., equal treatment for both foreign and local investors), this study is intended to contribute to the strengthening of the business environment for all investment – domestic and foreign.

6. In the case of BiH, this issue is particularly germane since the Government is faced with an array of challenges in its efforts to achieve long-term, sustainable development and the transition to a market-based economy. According to the World Bank and the European Commission[5], the Government of BiH has made only modest gains in implementing structural policy reforms to encourage private-sector led growth and reach sustainable economic recovery. To date, the economic growth generated by BiH is largely attributable to the massive reconstruction effort and the infusion of external concessional assistance. However, it is generally recognized that as the concessional flows inevitably begin to decrease, BiH will need to attract private capital flows in order to sustain economic growth and development. Considering the low domestic savings rates, the most likely source of the required capital flows will be foreign investment.

[5] The World Bank and European Commission. *Bosnia and Herzegovina: Review of the Priority Reconstruction Program and Looking Ahead Towards Sustainable Economic Development*, May 1999.

7. The analysis presented in this report is organized to reflect the structure of the Government and administration of BiH established by the Dayton Peace Accord and embodied in the constitution. This structure consists of the State Government and two Entity Governments, each with different levels of responsibility for the legal and regulatory framework for business. Therefore, the analysis is conducted on the State and Entity levels as appropriate and is focused on contributing to the development of a harmonized business environment within a single economic space.

8. The Government of BiH, with the expert assistance of the international community, has initiated the extensive process of creating new laws, institutions, and governance structures consistent with the new structure under the constitution. Many of the existing laws and regulations are under review. Other laws are currently being revised or are slated for revision or abolition and new laws and regulations are being introduced to cover emerging issues. Therefore, the report documents administrative procedures largely based on the snapshot taken at the time of the mission, analyzes the existing issues and make recommendations for streamlined, transparent and consistent administrative procedures. Where applicable, the report anticipates the passage of new and revised laws and regulations and attempts to offer principles and guidelines for the implementation of these new and revised regulations, taking into account the best practices and experiences of other countries in the region. The final Chapter of this report proposes a framework for implementation and follow-up, recognizing that in some specific areas further technical assistance is required to develop a comprehensive solution for certain complex issues, e.g., land ownership and the transfer of rights to use.

9. The ultimate success in the implementation of the recommendations of this report will depend on the level of commitment and the political will to effect change at all levels of government.

C. BiH as a Location for FDI

1. Business Environment

10. Following the devastating war and the 1995 Dayton Peace Accord, BiH has embarked on a challenging program of reforms and initiatives aimed at achieving political stability and economic reconstruction, with mixed results. BiH still depends heavily on the international community for political stability and economic aid. BiH's macroeconomic performance (GNP per capita of US$ 990 and GDP growth of 10% in 1999) ranks it among the poorest in the region. The basic picture is not one that is fundamentally attractive for FDI.

11. Since 1995, the Government has initiated efforts to improve the environment for private investment at the State and Entity level. These efforts include the passage and implementation of a liberal Foreign Investment Law, introduction of a common currency, and introduction of a uniform trade and customs policy across the Entities. The Entities

have begun to introduce new property, mortgage, capital market, accounting, audit and labor laws. In addition, the legislative framework for privatization has been established and both Entities have initiated a comprehensive privatization process. However, as stated in the 1999 World Bank/EU Report[6] and consistent with the findings of this report, private businesses continue to face a complex legal and regulatory framework, a heavy public administrative system and a weak judicial structure.

12. The 1999 Central and European Economic Review[7] survey asked leading economists to evaluate economic performance in 27 countries in the region, on the basis of 10 investment location decision factors[8]. BiH is ranked eighteenth out of 27 countries (an improvement from No. 24 in 1998) on the overall scores. BiH is ranked 18th for business ethics (just ahead of Russia and Ukraine), 21st for integration into the world economy (behind Georgia and Armenia), 21st for rule of law (behind Ukraine and Azerbaijan), 8th for price stability, 19th for investment climate (between Armenia and Moldova but ahead of Ukraine), and 26th for political stability (ahead of Yugoslavia only).

13. Under the World Business Environment Survey (WBES) initiative of the World Bank[9]., a survey of the business environment in BIH was conducted in the spring of 2000[10]. The findings of the WBES are largely consistent with findings of the CEER and strongly support the conclusions drawn by the FIAS study of administrative barriers, even though the FIAS study focuses largely on the issues affecting foreign investors.

14. According to the findings of the WBES survey (see Figure 1), the three leading constraints to doing business in BiH – in either Entity – are business financing, taxes and regulations, and political instability/policy uncertainty. For firms in the Republika Srpska, the next leading constraint is anti-competitive practices by government or other firms, followed by corruption, then infrastructure, and finally functioning of the judiciary as the last of the "moderate" constraints. Firms in the Federation sub-sample placed only "infrastructure" in the second tier of moderate constraints, although anti-competitive practices, functioning of the judiciary, and corruption ranked close behind. Minor constraints, street crime and organized crime concerned firms in Republika Srpska more than those in the Federation.

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[6] The World Bank and European Commission. *Bosnia and Herzegovina: Review of the Priority Reconstruction Program and Looking Ahead Towards Sustainable Economic Development*, May 1999.

[7] The Wall Street Journal, *Central European Economic Review*, November 1999.

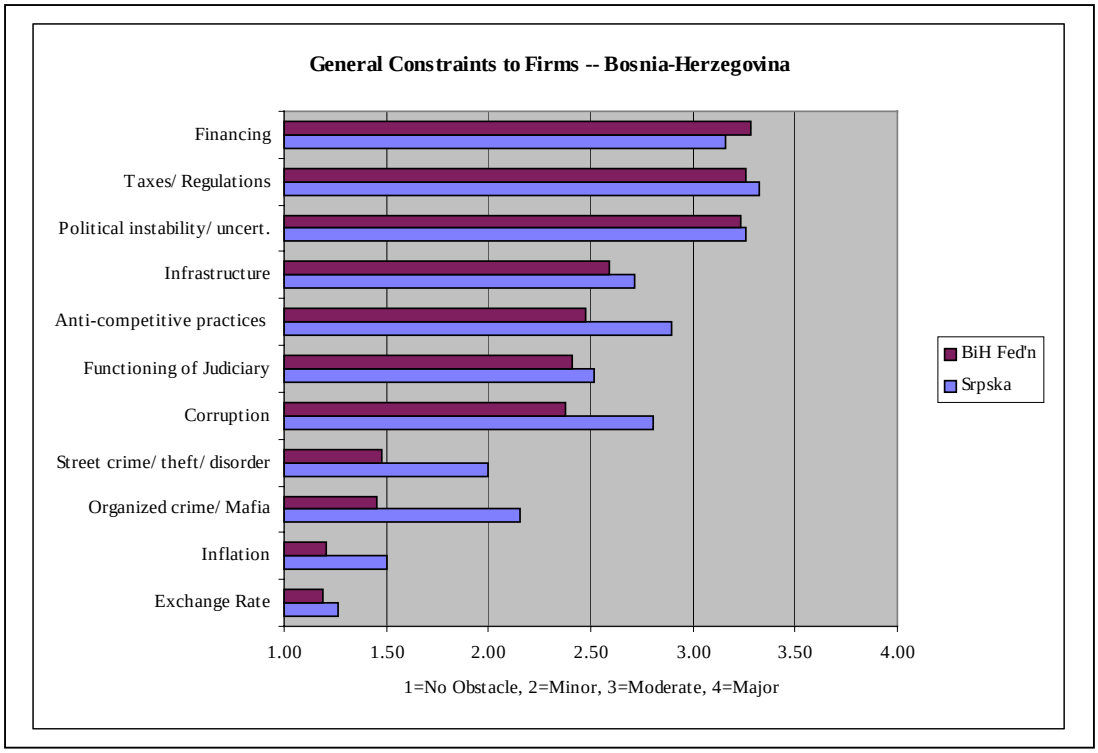
[8] Including economic strength, economic growth prospects, business ethics, integration into the new world economy, rule of law, productivity, investment climate, and political stability.

[9] The World Bank Business Environment Survey (WBES) is an initiative undertaken by the World Bank Group, in collaboration with other institutions, that seeks to assess the state of the enabling environment for private enterprise in approximately 100 countries, surveying a minimum of 100 domestic and foreign firms in each country.

[10] The survey sample of 100 firms was composed of two separate entity sub-samples, one of 60 firms carried out in the Federation, the other of 40 firms carried out in Republica Srpska. It should be noted that a high percentage of firms in the sample have some state ownership.

15. When compared to the transition economies of Europe and Central Asia, the WBES business environment indicators for BiH are close to the regional averages for taxes and regulation, corruption and anti-competitive practices. However, BiH is comparatively a poorer performer on certain indicators (financing, policy instability, infrastructure, and functioning of the judiciary) and substantially better with regard to

Figure 1



organized crime, street crime, inflation and the exchange rate. The differences in interviewee responses across firm size are generally not striking, except with regard to the perceived constraints imposed by corruption and anti-competitive practices, where smaller firms clearly feel more constrained than larger ones.

16. It should be noted that a significant proportion of the respondents to the WBES survey are enterprises with some public ownership. As such, the findings of the survey may not adequately reflect the perceptions of the private sector and the severity of the problems encountered by individuals or enterprises trying to do business in BiH without the benefit of connections or influence. The particular value of the findings of this study is that despite the public sector bias of the respondents, the major issues identified are consistent with those of the FIAS work and other studies that have examined the business environment from a predominantly private sector perspective.

17. Box 1 provides a summary of some of the factors that affect BiH's attractiveness as a location for FDI. It is clear that the improvement of the environment is a necessary but not sufficient condition for increasing FDI inflows. However, the business

environment is an important factor that will influence BiH's ability to attract even marginal FDI. Therefore, this should be a priority for the Government of BiH in its efforts to attract more FDI.

Box 1

Political and Economic Constraints in BiH

- Political Stability. Most surveys of foreign investors show that political stability is an important pre-condition for foreign investment. Some uncertainty inevitably attaches to the long term political and constitutional position in BiH, and this is bound to cause potential investors some concern, especially to those who are not knowledgeable about the country.
- Market Size and Access. Surveys of foreign investors suggest that market size and access is one of the most important determinants of international location decisions. Multinationals often use FDI as a means of accessing new, or growing, markets for their output. The BiH market is relatively small (3.6 million people), and is not fully integrated.
- Labor Costs. Many foreign investors choose locations in Central and Eastern Europe on account of their lower cost structures compared with western European locations. If BiH is not cost competitive with its regional neighbors, this will act as a constraint on the type of investment it might attract
- Productivity. Discussions with the private sector indicated that productivity levels in the economy were low. It has been suggested to us that the labor force and local management, if not trained overseas, are still geared to the production system which applied in the old Yugoslavia, and that they are not working to international standards. This is a problem which is common to all transitional economies, to some degree. As a result of he war, BiH face is facing this challenge later than some of its regional competitors. Therefore, it has more ground to make up. Relatively poor productivity levels and inflexibility of the labor force clearly add to total labor costs.

2. Trends in FDI Flows

18. FDI flows to BiH increased from net disinvestment of US$ 2.0 million in 1996 to net inflows of US$ 10.0 million in 1999. In relation to the other Eastern European economies and its Balkan neighbors (see Figure 2), BiH is at the bottom of the regional group with annual average FDI inflows of US$ 4.7 million (1996-99), compared to Armenia (US$ 103.1 mn.), Albania (US$ 56.0 mn.), Moldova (US$ 53.7), and Macedonia (US$ 43.6) in the same period.

19. In terms of FDI inflows as a percentage of GDP (see Figure 3 below), BiH is again the poorest performer in the region with less than half-a percent, compared to regional percentages ranging from 0.87 percent on Macedonia to 9.03 percent for the Czech Republic.

Figure 2

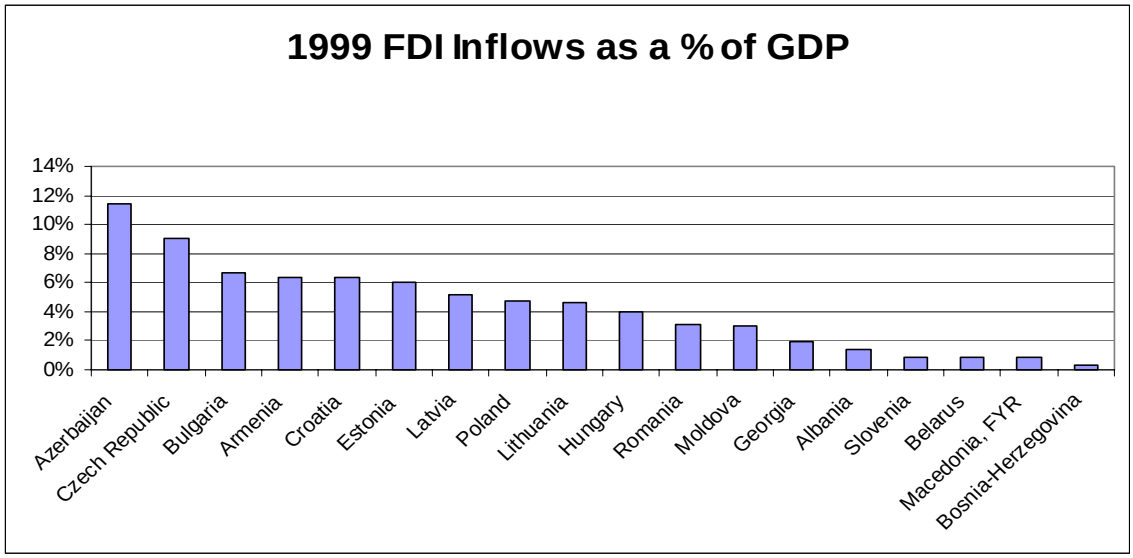
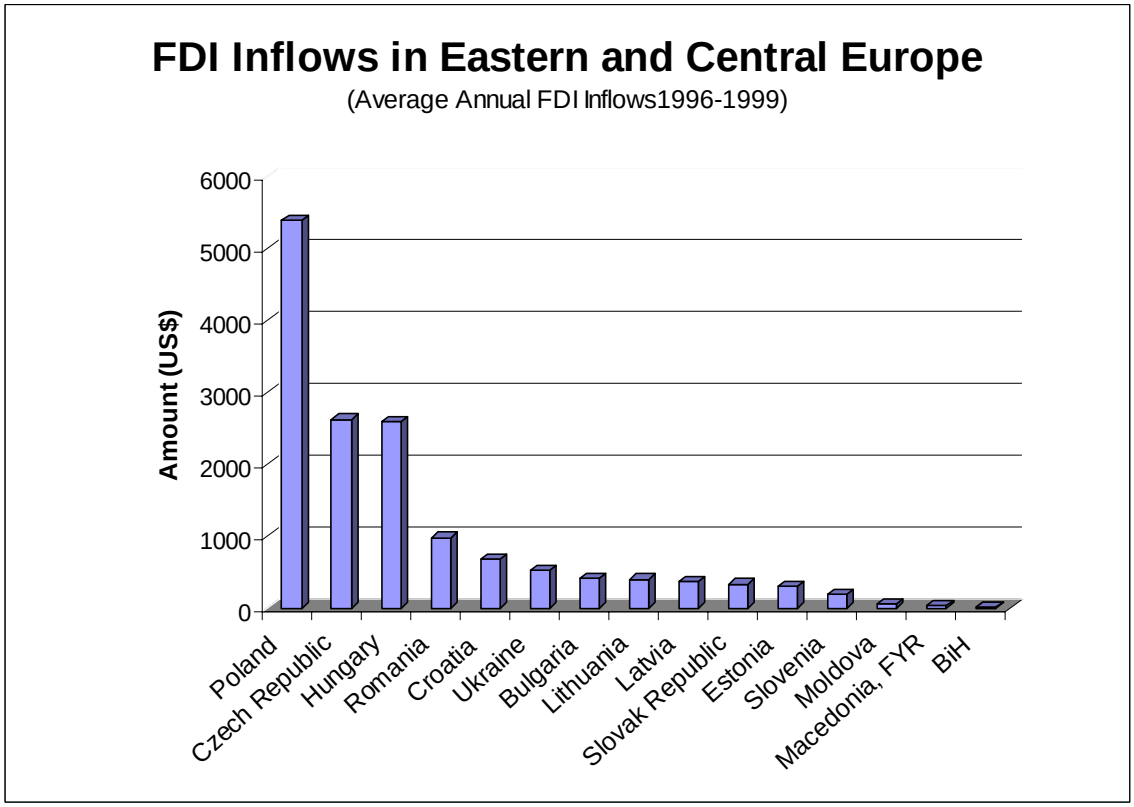


Figure 3



CHAPTER II

COMMERCIAL LEGAL FRAMEWORK FOR INVESTMENT IN BiH

A. Introduction

20. The existing commercial legal and regulatory framework in BiH is based on a labyrinth of formal and informal rules, across the state, entity, municipal and cantonal levels. It is recognized that since 1995, a significant and wide-ranging program of legal reform has been undertaken with the help of the international donor community. Many laws have already been changed and many are currently being revised and rewritten. Some of these laws are part of the legal framework for business in general (e.g., the Company Law) and foreign investment in particular (e.g., the Law on Foreign Investment Policy).

21. This Chapter focuses on particular aspects of the legal and regulatory framework that need to be addressed in order to more effectively support private sector activity. In particular, recommendations are made for improving and harmonizing the framework at the State and Entity levels, as appropriate. It is recognized that the government of BiH, with the assistance of the international community has initiated an extensive legal review and harmonization program. However, the fundamental conclusion of this report is that the current commercial legal framework is still largely fragmented and that there are a number of areas that need to be revised, updated, and strengthened. While the report does not attempt a comprehensive overview of the legal and regulatory framework since some work is ongoing, it focuses on specific issues that impact the environment for foreign investment and makes recommendations for addressing these issues.

22. Specifically, the report suggests amendments to certain key laws at the State and Entity levels (i.e., foreign investment law, company law, trade law, judicial restructuring law) taking into account the need to harmonize these laws as appropriate and to apply international standards, particularly those of the European Union. The recommendations contained in this report seek to promote a sound legal and regulatory framework that provides clear, reasonable rules as well as efficient mechanisms of implementation, enforcement and dispute resolution. The establishment of such a framework is essential for improving the environment for foreign and domestic investment in BiH. Finally, it is recognized that some of these recommendations may only be achievable in the medium- to long-term, while others may be implemented immediately given the political will to implement change.

23. Since the legal and regulatory framework is shaped by the complex political and governmental structure that underpins the constitutional and legal system in BiH, as a starting point, the following segment provides an overview of the government sector and serves to put the subsequent discussion in this context. In some respects, this complex

structure itself presents a significant barrier to private investment and the challenge is to harmonize laws and regulations so as to effectively provide a seamless, transparent and predictable framework for investment.

B. Government Structure

1. The State Government

24. The Dayton Peace Accord (DPA) that ended the conflict in BiH simultaneously created a framework for the future legal existence and constitutional structure of the BiH government. The parties, fearful of retaliation after nearly four years of gruesome conflict, wanted to maintain some degree of sovereignty. In order to accommodate the concerns of the parties of the agreement regarding the balance of power and protection of autonomy, the DPA established a political and economic framework based on a strong role for the country's two governmental entities {Federation of Bosnia and Herzegovina (FBH or the Federation) and the Republika Srpska (R.S.)} and a limited role for the state of BiH.

25. Each Entity has a high degree of autonomy. According to the DPA, all power not vested in the State Government is conferred upon the Entities. Therefore, considering the relatively limited scope of the State Government's powers, the Entities are endowed with significant political control.

26. There are thirteen constitutions in force in BiH. The 1995 State Constitution of BiH is laid out in Annex 4 of the DPA and governs the relations between the two Entities within the state. The constitutions of the Federation, which came into force in 1994, and the R.S., which entered into effect in 1992, were subsequently amended to bring them into compliance with the 1995 BiH Constitution.

27. According to the DPA, the State Government is delegated responsibility for foreign affairs; foreign trade and customs policy; monetary policy; finances regulating international debt; immigration, refugee, and asylum policy; international and inter-Entity criminal enforcement; international communications infrastructure; regulation of inter-Entity transportation; and air traffic control.[11] There are currently six Ministerial portfolios covering the State Government's areas of responsibility. The State Government is entitled to pass all necessary legislation controlling these areas of responsibility. With the exception of specifically identified areas, the State Government cannot generate revenue through taxation.

28. The Entities are expressly assigned responsibility for all governmental functions and powers that do not fall under the purview of the State Government.[12] Thus, the Entities have significant control of governmental and administrative functions.

[11] *See*, BOSN. & HERZ. CONST. annex 4, art. III(1).
[12] *See*, BOSN. & HERZ. CONST. annex 4, art. III(3)(a).

Responsibilities include control over the courts, police, "ordinary" legislation, local government and education.[13]

29. The Presidency of BiH leads the State Government consists of three members—a Croat and a Bosniac elected from FBH and a Serb elected from the R.S. The Presidency nominates the Co-Chairman and Vice-Chairman who take office upon the approval of the House of Representatives. The Co-Chairman and Vice-Chairman nominate the state-level ministers who are in turn approved by the House of Representatives.

2. The Entities

a. The Federation of Bosnia and Herzegovina

30. The Federation of Bosnia and Herzegovina (FBH) is divided into ten cantons which are largely controlled by ethnic groups. Two ethnically mixed cantons, Middle-Bosnia and Herzegovina-Neretva, have cantonal constitutions that contain veto structures to prevent one ethnic group from dominating the other.[14] As a result, legal and administrative authority on a range of issues has been decentralized and parallel institutions have been established for a range of legal and administrative functions throughout both cantons.[15]

31. The organizational and functional structure of public administration in the Federation is governed by the Law on Administration. According to this law, the public administration functions and responsibilities are distributed at the Federation Government, cantonal, and municipal levels. The FBH Constitution (Art. III (2)) provides for concurrent powers at different levels of government. The Federation Constitution also defines the roles of the Government, cantons and municipalities. The Constitution reserves powers at the cantonal level unless particular responsibilities are delegated to the municipalities in a canton's territory.[16]

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[13] *See generally*, BOSN. & HERZ. CONST. annex 4, art. III. *See also*, Fred L. Morrison, *The Constitution of Bosnia-Herzegovina*, 13 CONST. COMMENT. 145 (1996).

[14] Rulings that concern the vital interests of any of the constituent peoples need the approval of the majority of both the Bosniac and Croat Delegates of the Federation House of Peoples. This provision may be invoked by a majority vote of either the Bosniac or the Croat Delegates. If the majority of the remaining Delegates oppose invoking this provision a joint commission of Bosniac and Croat delegates will decide, within one week, how to resolve the issue. Failing progress, the question shall be determined by the Federation Constitutional Court. *See*, FED. BOSN. & HERZ. CONST. s. A, pt. 4, art. 18. Similar provisions are in place in both the Constitutions of Middle-Bosnia, (Articles 38 and 39), and Herzegovina-Neretva, (Articles 37 and 38).

[15] These parallel institutions are evinced most graphically with national emblems, flags and letterheads of the war-time political structures. *See, Rule of Law in Public Administration: Confusion and Discrimination in a Post-Communist Bureaucracy*, Dec. 15, 1999, <http://www.crisisweb.org/projects/bosnia/reports/bh52rep.htm> [hereinafter Rule of Law].

[16] *See*, FED. BOSN. & HERZ. CONST., pt.V, s. 1, art. 2(1).

b. The Republika Srpska

32. The R.S. Constitution details the structure and organization of the public administration function. According to the Constitution, the R.S. Government is responsible for public administration.[17] Governance is divided among a series of ministerial branch offices at the local level. The various ministries are responsible for implementing the laws and regulations adopted by the National Assembly of the R.S. Accordingly, each ministry is granted powers to issue statutes, decrees and regulations.[18]

33. The R.S. is divided into 63 municipalities.[19] In accordance with the principle of local self-rule, the Law on Territorial Organization and Local Self-Government requires the R.S. Government to transfer certain powers to the municipalities in order to facilitate easier citizen access to public administration.[20] Thus, pursuant to provisions laid out in their statutes, municipalities are allowed to regulate local communities and within this context, have responsibility for a number of administrative functions.[21]

3. The Council of Ministers

34. The DPA established the powers of the Council of Ministers in the BiH Constitution. The Council has the "responsibility for carrying out the policies and decisions of Bosnia and Herzegovina"[22] in the areas of law where the State was allocated jurisdiction and responsibility. The Law on the Council of Ministers[23] provided for six ministries.[24] By decision of the Presidency of BiH, the Chairman of the Council of Ministers is appointed. The chairmanship (a term of eight months) rotates between the six Ministers. The Council is financed from the budget allocated for State Government institutions of BiH. This budget is adopted annually by the Parliamentary Assembly.[25]

4. The Office of the High Representative

35. Under the terms of the DPA, the international community plays an important role in the governance of BiH during the transition phase. The Office of the High Representative (OHR) is the chief civilian peace implementation agency in Bosnia. The DPA designated the OHR to oversee the implementation of the civilian aspects of the

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[17] *See*, CONST. SERBIAN REP. OF BOSN. & HERZ., art. 97.
[18] *See*, CONST. SERBIAN REP. OF BOSN. & HERZ., art. 97.
[19] *See*, LAW ON TERRITORIAL ORGANIZATION AND LOCAL SELF-GOVERNMENT, as amended, Sluzbeni glasnik RS, 6/97, art. 11.
[20] *See*, LAW ON TERRITORIAL ORGANIZATION AND LOCAL SELF-GOVERNMENT, art. 16.
[21] *See*, LAW ON TERRITORIAL ORGANIZATION AND LOCAL SELF-GOVERNMENT, arts. 23, 24.
[22] *See*, BOSN. & HERZ. CONST., art. III(1), (4), (5)
[23] *See*, LAW ON THE COUNCIL OF MINISTERS.
[24] The Ministry of Foreign Affairs; Ministry for Civil Affairs and Communications; Ministry for Foreign Trade and Economic Relations; Ministry of Treasury; Ministry of Human Rights and Refugees and, Ministry of European Integration.
[25] *See*, BOSN. & HERZ. CONST., art. VIII(1).

DPA in Bosnia on behalf of the international community.[26] The mandate of the High Representative is established in Annex 10 of the DPA. It declares the High Representative the final authority to interpret the civilian aspects of the DPA. The High Representative is therefore given expansive power to implement reforms and to impose legislation in support of those reforms.[27] The responsibilities and powers allotted to the High Representative include monitoring the implementation of the peace settlement, ensuring full compliance with the DPA, resolving issues and giving general guidance to the Parties to the DPA.[28]

36. Under its current program of activity, the OHR is focusing on several salient issues for reform including: the effective functioning of institutions; economic initiatives; judicial and legal restructuring; the establishment of the rule of law; and BiH's integration into Europe.[29]

5. Analysis and Recommendations

37. The BiH Constitution does not grant the State Government any of the traditional enforcement powers to ensure that the Entities enact government initiatives. According to the Constitution, the budget of the State Government is determined by the contributions of the Entities and the State Government is precluded from generating income, except in a few specific cases (e.g., passport fees). Therefore not only does the State Government lack the power to enforce its legislation and initiatives, it also lacks resources. Further in keeping with the allocation of power in the constitution, the State Government does not maintain an army, police force, or local court system.

38. Partly as a result of the initial confusion as to whether the right to initiate legislation resided with the BiH Presidency or the Assembly,[30] with few exceptions[31], all State-level legislation has been drafted or revised with the assistance of the international community, by the State Government. In some cases, the OHR has imposed laws or forced them through the Assembly.

39. Another factor that limits the State Government's role in enacting new legislation is the allocation of power between the State and the Entity governments. As noted earlier, even within the areas of control that are given to the State Government, its powers are strictly limited. Therefore the State government is perceived as inherently weak.

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[26] *See, Office of the High Representative Information*, located at <http://www.ohr.int/info/info.htm>.
[27] *See*, The General Framework Agreement for Peace in Bosnia and Herzegovina, Dec. 14, 1995, annex 10, art. 2, located at <http://www.ohr.international/gfa/gfa-home.htm> [hereinafter Dayton Peace Accord].
[28] *See*, Dayton Peace Accord, annex 10, art. II.
[29] *See, Office of the High Representative Information*, located at <http://www.ohr.int/info/info.htm>.
[30] *See*, Is Dayton Failing?
[31] For example, the Law on Administrative Taxes that was drafted and passed in 1999 by the State Government's own initiative. *See, Is Dayton Failing? Bosnia Four Years After the Peace Agreement*, International Crisis Group, Sarajevo, Oct. 28, 1999, at 31 [hereinafter Is Dayton Failing?].

40. The multiple levels of legal authority serves to further complicate and compartmentalize the legal framework and the organization of the government and administrative structure, thereby creating a maze of contradictory laws promulgated at the State, Entity and municipal levels of government. For example, in the case of the Federation, implementation of legislation may be delegated to authorities at the municipal level,[32] in order to accommodate the interests of different ethnic groups.

41. In practice, the cantons in the Federation are given broad governmental powers.[33] In some instances, the decentralized nature of the public administrative system creates uncertainty for the private sector regarding the prevailing laws in a particular canton, since the system requires entrepreneurs to meet different requirements and grants different rights depending on the municipality, canton, or Entity in which the business is located.

42. In the Federation, a two-tiered legal and administrative system applies. The Supreme Court of the Federation acts as the court of highest appeal only in the Bosniac-majority cantons.[34] By contrast, the Croat-majority cantons[35] refuse to recognize the authority and jurisdiction of the Federation Supreme Court. This creates a situation where canton-level institutions are *de facto* the highest level of appeal. Thus, there is no appeal for administrative or judicial matters beyond the cantonal level.[36]

43. The generally confusing political and governmental landscape is a major disincentive to FDI in BiH. Bosnia is a country with thirteen different constitutions administered by two Entities with different economic regulations. This does not include municipal governments, where, as in the Federation, different municipalities may effectively impose their own set of regulations. From the perspective of potential foreign investors, the complexity of the legal and regulatory framework for business increases risk. Once it is determined that the uncertainties outweigh the benefits of investing in BiH, then alternative investment locations become more attractive to potential investors.

44. It is recognized that the existing structure and organization of the Government of BiH outlined in the constitution is a political compromise and is intended to serve the interests of the relevant parties. The challenge remains one of integrating the functions and responsibilities of the various branches of government in order to harmonize the legal and regulatory framework for business, minimize the distinctions between the three major branches of government, and establish a consistent, transparent and predictable environment for doing business in BiH.

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[32] *See, The Commercial Guide to Bosnia and Herzegovina*, Sarajevo, Bosnia and Herzegovina, June 1998, pt. II, located at <http://www.mac.doc.gov/eebic/balkan/bhccg98/gsp.htm>.

[33] *See, Rule Over Law*, ICG Balkans Report, July 5, 1999, at 2-5. The Constitution entrusts cantons with responsibility for policing, education, housing policy, land usage, and social welfare. *See*, FED. BOSN. & HERZ. CONST., art. 4.

[34] Cantons 1, 3, 4, 5 and 9.

[35] Cantons 2, 8 and 10.

[36] *See*, Rule of Law.

C. The Company Law

45. For both Entities, their respective company laws (The Law on Business Companies in the Federation and the Law on Enterprises in the R.S.) regulate all aspects of corporate formation in BiH – both for domestic and foreign investors. Therefore, it is essential that these respective laws incorporate the best practices of business organization and that they are mutually consistent in order to create a consistent and harmonized regime for business in BiH.

46. Clearly, a single company law for both Entities would provide an integrated and cohesive foundation for the business environment in BiH. However, if it is not politically feasible to formulate and promulgate a single piece of legislation governing companies within BiH, then the two laws must be harmonized. Amendments must be made to the Entity laws to ensure effective means of governance by the board of directors; to guarantee shareholder rights — especially for minority shareholders; and to comply with European Union Directives. The following analysis sets out changes necessary to achieve the desired harmonization.

47. Entrepreneurs in the Federation may establish four different types of business entities according to the Law on Business Companies: a general partnership, a limited partnership, a limited liability company (LLC), or a joint stock company (JSC).[37] Independent entrepreneurs are governed by a separate set of regulations.[38] In the R.S., businesses may take five different forms: a sole entrepreneur, a partnership, a limited partnership, a LLC, or a JSC.[39]

1. The Federation: Corporate Governance and Shareholders' Rights

48. The corporate governance structure for joint stock companies in the Federation is based on the German two-tiered model that includes both a management and supervisory board. Management is empowered to direct business operations and is responsible for the day-to-day operations of the business.[40] The supervisory board is responsible for appointing and dismissing members of the Board of Directors and has the authority to convene a General Assembly[41]. In addition, the supervisory board is responsible for the general supervision of business affairs, adopting reports to the shareholders, approving large transactions and for the election of management.[42]

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[37] *See*, LAW ON BUSINESS COMPANIES, art. 3.
[38] However, once an independent entrepreneur makes total profits over one million KM, they are forced to dissolve and reform under the Law on Companies. *See id.*, at art. 4.
[39] *See*, LAW ON ENTERPRISES, at art. 2.
[40] *See*, LAW ON BUSINESS COMPANIES, art. 275.
[41] *See*, LAW ON BUSINESS COMPANIES, art. 269.
[42] *See*, LAW ON BUSINESS COMPANIES, art. 275.

2. Republika Srpska: Corporate Governance and Shareholders' Rights

49. Like the Federation, corporate governance in the Republika Srpska is generally based on the German two-tier model. Authority is divided among a supervisory board, a management board, and an assembly of shareholders. The law creates an exception to the two-tier system for companies with fewer than 100 employees by offering the option to elect either a supervisory board or a management board.[43]

50. The supervisory board ensures that the company acts in accordance with the law, while management is tasked with supervising the day-to-day activities of the company. The assembly is empowered to approve management actions such as profit distributions and financial reports and may elect its representatives to the supervisory board and management.

51. As in the Federation, the supervisory board in the R.S. differs from German law since there are no provisions that mandate employee representatives. The supervisory board instead appears to act as an assurance that management will conduct business properly. It also acts as a filter through which shareholders are indirectly represented in management decisions.

3. Analysis and Recommendations

a. Federation

52. Although the language of the Federation's Law on Companies suggests a hierarchical relation between the supervisory board and management, the exact relationship between the two bodies is nebulous.

53. In order to enhance control and accountability of the board to investors, the law should provide that all directors in the one-tier system and all supervisory board members in the two-tier system are elected by stockholders. Shareholders should also be allowed to remove directors and supervisors at any time, following normal assembly meeting procedures. As a point of reference, Box 1 summarizes the basic approach to provisions on administrative boards in the laws of several European Union member states.

54. Minority shareholder rights need to be protected under the Federation Company Law. The Law currently provides several mechanisms for minority shareholder protection, but the following key areas of reform need to be initiated:

- Stock repurchase rights are key to minority shareholder protections under Federation Law. Repurchase rights give shareholders the power to force the company to repurchase stock when the conditions of investment have significantly changed. According to Federation Law, shareholders are entitled

[43] *See*, R.S., LAW ON ENTERPRISES, art. 65(1).

to request a stock redemption under nine specific circumstances outlined in Article 246. These circumstances include an increase or decrease of the registered capital; consolidation or mergers with other enterprises; division and termination of the company; and transformation of the company.[44] However, an amendment of the articles of incorporation is not provided for as a condition for the exercise of repurchase rights. An unfavorable amendment to the articles of incorporation could effectively disenfranchise an entire group of shareholders (e.g., foreign investors). Therefore, the requirement for an amendment should be included as a possible trigger for repurchasing stock.

Box 1

European Union Member States Company Law Provisions for Administrative Boards

In the European Union, under most Member States' company law provisions, members of the administrative board in the one-tier system and the supervisory board in the two-tier system are formally elected by the general meeting of shareholders, which also determines the number of seats on the board. However, a committee of shareholders may, on occasion, exercise the right to elect board members in some Member States (see, for example, the Danish Companies Act).

The removal of directors is treated differently according to the Member States' legal regimes. In most legal systems, directors can be dismissed at will (*ad nutum*). In at least French and Belgian law, this rule has been considered a rule of "public order," which disallows any contract or technique that would obviate the general meeting's right to dismiss at will. Spain, the United Kingdom, The Netherlands, Finland, Ireland, Luxembourg, Sweden and, to a limited extent, Italy participate in the practice of dismissal at will by shareholders.

- The phrasing of the stock repurchase provision is an additional problem. Article 255 of the Federation Company Law states that a "[s]hareholder . . . shall have the right [to] *request* that [the company] purchase his/her shares."[45] The use of the word *request* appears to contemplate that the company may refuse to honor such a request. If a request were denied, it would effectively undermine the underlying premise for providing shareholders with repurchase rights. The language should therefore clearly state that shareholders are entitled to a compulsory right of redemption.

- One important omission from the Federation Company Law is the absence of any provisions allowing derivative shareholder suits to be instituted. A derivative suit is an action brought by a stockholder on behalf of the corporation to protect the legal rights of the company. A derivative suit must show that the corporation has a right that the board of directors has refused to uphold. Along with shareholder elections, derivative suits serve as a one of the best restraints on the activities of the board of directors.

[44] *See*, LAW ON BUSINESS COMPANIES, art. 246. Article 255, which furnishes shareholder repurchase rights, incorporates the first nine provisions of Article 246 as the conditions when a redemption right may be exercised.

[45] *See*, LAW ON BUSINESS COMPANIES, art. 255 (emphasis added).

> The sole concept similar to a derivative suit provided in the Law is referred to in the conflict of interest provisions in Article 35. It states that the company "may request compensation and transfer of business deals entered into . . . that violates the ban on competition."[46] Derivative suits, however, serve a much broader function than compensation for violation of conflict of interest provisions. Derivative suits give shareholders the power to sue corporate management for poor business decisions or to compel action in a given matter. The Law should provide shareholders with derivative suit rights. It should also define the standard of care that corporate management should be held to, the conditions upon which shareholders may institute a derivative suit,[47] and how the derivative suit may be taken over by management. Access to derivative suits will ensure that stockholders are given oversight in management of the business.

55. Finally, minority shareholder rights need to be protected through the adoption of provisions that allow for cumulative voting rights. Under a straight voting system each share of voting stock carries one vote for each position to be filled on the board. Under cumulative voting all the votes may be cast for a single position during the election of corporate management. Cumulative voting therefore gives otherwise powerless minority shareholders the opportunity to elect a representative to the supervisory board. Therefore, it is recommended that the law be revised to provide the option for a cumulative system of voting.

b. Republika Srpska

56. As with the Federation Company Law, the ability to initiate a derivative action in R.S. Company Law needs to be examined. According to Article 73 of the Law, shareholders who control at least 10 percent of the outstanding stocks can institute a derivative suit against management if a "decision was made with negligence or with the intention of causing a damage."[48] However, Article 275(1) states that 10 percent of the shareholders may request the supervisory board to take action against management. If the supervisory board does not grant the request, a shareholder may "approach [the] shareholder's assembly."[49] The meaning of this provision is unclear. It does not elucidate what actions will be taken after a shareholder approaches the assembly with a complaint. It also does not specify whether the rights under Article 275 are accorded shareholders in addition to the powers to initiate derivative actions under Article 73.

57. The competition clause in the R.S. Company Law is lacks specificity and may pose an unnecessary burden on the affected parties. Article 88 prohibits a member of the

[46] *See*, LAW ON BUSINESS COMPANIES, art. 35.
[47] Generally, a minimum percentage of outstanding stock, such as 5%, should be required to initiate a derivative suit.
[48] *See*, R.S., LAW ON ENTERPRISES, art. 72. Article 73 incorporates paragraph 1 of Article 72 into its provision.
[49] *See*, R.S., LAW ON ENTERPRISES, art. 275(2).

company from engaging in "an activity that could be considered competitive."[50] This provision is so nebulous and sweeping that a member of the company would conceivably have difficulty determining which actions constitute a conflict of interest. The Law should not impose this type of bright line prohibition on competitive activities. Instead, the statute should provide for informed consent of such activities or transactions.

c. European Union Directives

58. The Entities' company laws should also be consistent with modern practices as denoted in EU Directives. This will have the added benefit of bringing BiH in line with the important legal regulations and practices established by the European Union.

59. In general, the European Union more strictly regulates its business enterprises in comparison with other jurisdictions such as the United States. The European Community is composed of states with vastly different corporate principles and laws. In order to promote a globally competitive market, the EU has chosen to adopt a more regulatory corporate atmosphere in its attempt to harmonize the different corporate laws of Member States and eliminate barriers that impede freedom of the marketplace. (The US system, by contrast, relies more heavily on information disclosure to shareholders and a very rigorous set of accountancy requirements.) In order to achieve this harmonization, the EU has examined the various corporate laws in each of its Member States and has extracted provisions that are effective in promoting and harmonizing business among Member States. This process has required that Member States make concessions and modify or change well-established practices.

60. The European Union has several different types of legislation it promulgates. The most common forms of legislation are EU Directives, which instruct Member States to enact national legislation that is in compliance with the Directives. To a limited extent, this allows Member States to create laws on an individual basis that take into consideration the politics and practices of their respective states. Some variance from EU Directives and, under limited circumstances, non-compliance of Directives seems to be the general practice. However, Member States run the risk of being sanctioned in court for non-compliance with an EU Directive. EU Regulations, on the other hand, dictate the law to Member States, and EU members must adhere to Regulations more strictly than Directives. Proposed Regulations are not binding law in the European Union but they may act as indicators of future EU laws or at least identify a tendency towards certain trends in EU law.

61. In Annex A, four EU Council Directives are examined in relation to corporate law in the Entities. The so-called First Company Law Directive articulates requirements for disclosure, validity of obligations, and nullity of limited liability corporations.[51] The so-

[50] *See*, R.S., LAW ON ENTERPRISES, art. 88(1).

[51] Council Directive 68/151/EEC, 1968, on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community.

called Second Company Law Directive concerns the formation and capitalization requirements of public and large companies, including a provision that increases in share capital are subject to shareholder approval with preemptive rights preserved.[52] The so-called Third Company Law Directive pertains to mergers between publicly held companies, setting forth procedural guidelines and providing safeguards for shareholders.[53] The so-called Sixth Company Law Directive supplements the Third Directive and sets forth rules regarding the division of public limited companies that are wound up without liquidation.[54]

62. Annex A provides detailed recommendations for specific changes to the company laws of the Federation and the R.S. in order to conform to EU corporate law directives.

D. Law on the Policy of Foreign Direct Investment

63. The Law on the Policy of Foreign Direct Investment in Bosnia and Herzegovina (Policy Law), was drafted with the assistance of FIAS and adopted by the State Parliament in May 1998 (O.G. BiH No. 17/98). The BiH Policy Law is designed to promote foreign direct investment and to protect the rights of foreign investors seeking to establish business enterprises in BiH. It also establishes policy guidelines and standards for adoption into the related laws and regulations by the State and the Entities. The Policy Law stipulates that all provisions of laws and by-laws regulating foreign investment in Bosnia that are not in conformity with or are contrary to the Policy Law are no longer valid. However, this provision does not negate the obligation of the State and the Entities to adopt laws that conform with the Policy Law. The implementation of subsequent sub-laws and regulations is left to the appropriate Entity and State authorities.

64. The Federation has passed a law nullifying its Law on Foreign Investment[55] and is in the process of considering legislation on a new Investment Law. However, in the absence of a law replacing the 1995 law and in view of the possibility that the new law will incorporate many of the provisions of the 1995 law, this discussion focuses on the 1995 law and an approach for harmonizing it with the Policy Law. In the R.S, the law that is currently in effect is the 1996 Law on Foreign Investment and Concessions (O.G. R.S. -21/96), corrections (O.G. R.S. 1/97), and the changes to this law introduced in 1999 (O.G. R.S. No.5/99).

65. There are two possible approaches that BiH can follow to ensure that the full benefits of the Policy Law are utilized. Under the first and most rational approach, both

[52] Council Directive 77/91/EEC, 1976, as amended by Directive 92/101/EEC on co-ordination of safeguards which, for the protection of interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent.
[53] Council Directive 78/855, 1978, concerning mergers of public limited liability companies.
[54] Council Directive 82/891/EEC, 1982, concerning the division of public limited liability companies.
[55] Law on Cessation of the Law on Foreign Investment O.G. FBH 32/00.

Entities would concede their current jurisdiction over foreign investment issues to the State, which in turn, would adopt a harmonized foreign investment law consistent with the Policy Law.

66. The second possible solution is to harmonize the Federation and the R.S. Investment Laws with the State Policy Law. In addition, all related laws should be consistent at the Entity level in order for the benefits granted to investors to be effective throughout BiH.

67. Following on our understanding that each Entity will have an Investment Law (option two above) rather than adopting a universal document meeting the terms of the Policy Law, this assessment will concentrate on harmonizing the Federation and the R.S. foreign investment laws.

68. The Policy Law is liberal legislation that broadly defines what constitutes foreign investment.[56] Salient aspects of the Law include the extension of national treatment to foreign investors, which guarantees the same rights and obligations to foreign investors as are granted to national residents of BiH.[57] The Law also forbids any discriminatory actions between or among foreign investors on the part of the Entities.[58] The non-discrimination clause also applies to corporate tax regimes, regardless of whether the investor is foreign or domestic,[59] as well as competition in granting incentives to investors.[60] However, the Entities are directed to establish progressive and favorable tax conditions that encourage foreign investment and Article 10 waives customs duties for foreign investors, subject to the provisions of the Customs Policy Law.

69. Investors are protected from changes in the laws and regulations pertaining to foreign investments that may decrease their current rights and obligations. In the event that changes in the laws and regulations are made, foreign investors are given the opportunity to choose the most favorable set of rules to abide by.[61] This provision guarantees that all of an investor's acquired rights and benefits cannot be terminated,

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[56] Foreign investment is defined as any "inquisition, creation, or extension of any business enterprise . . . which . . . has the effect of permitting [acquisition] or increase[d] control over a company." Such investments may include tangible or intangible property. *See*, LAW ON THE POLICY OF FOREIGN DIRECT INVESTMENT IN BOSNIA AND HERZEGOVINA, art. 2 [hereinafter Policy Law].

[57] *See*, Policy Law, art 8, which reads: "foreign investors shall have the same rights and obligations as the residents of Bosnia and Herzegovina."

[58] *See*, Policy Law, art. 8(b), which mandates that "Bosnia and Herzegovina and the Entities shall not discriminate with respect to foreign investors in any form, including but not limited to their citizenship, residency, religion, or the state or origin of investment."

[59] *See*, Policy Law, art. 9(c)(i), which stipulates, "corporate tax regimes should not discriminate between foreign and domestic investments."

[60] *See*, Policy Law, art. 9(c)ii., which states: "the Entities recognize that competition in granting incentives is undesirable and they are committed to avoiding such competition."

[61] *See*, Policy Law, art. 20, which mandates that "[t]he rights and benefits of foreign investors granted and obligations imposed by this Law cannot be terminated or eliminated by the subsequently passed laws and regulations."

rather, they may only be improved upon by allowing investors to choose regulations most favorable to them.[62]

70. There are no restrictions on the types of business activities foreign investors may engage in with the exception of armaments[63] and public information.[64] In these two industries, foreign control is limited to 49 percent of the capital in that enterprise.[65] If foreigners seek to invest in these industries, they must first seek approval from the designated competent body in the respective Entity.[66] To prevent the review process from becoming an obstacle to foreign investment, the Law dictates procedural time lines for review of an application. If the applicant does not receive a written response within the deadlines, the investment is automatically approved.[67]

71. An important factor for an attractive investment environment is the protection of investors' assets from expropriation or nationalization, except in specific circumstances that affect national interest and in these instances investors are entitled to compensation that meets international standards. In order to protect the assets of foreign investors, the Policy Law expressly forbids expropriation or nationalization actions against foreign investments except where it is in the public interest and in accordance with applicable laws and regulations.[68]

1. Analysis and Recommendations

72. It is especially important to safeguard legal guarantees protecting the assets of foreign investors in BiH, since the country has a history of state-owned and controlled enterprises and its transition from socialism to a market economy is still in progress. The Policy Law guarantees investors this protection in Article 16. However, the R.S. Foreign Investment Law does not provide this assurance. A provision should be added to the R.S. Law expressly prohibiting expropriation and include the basic assurances in Article 16 of the Policy Law.[69]

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[62] *See generally*, Seadeta Ceric and Milos Trifkovic, *Direct Foreign Investment, Report for Bosnia and Herzegovina*, Sarajevo, Oct. 1998.

[63] This exception includes both the production and sale of weapons, ammunition, explosives intended for military purposes, and military equipment. *See*, Policy Law, at art. 4.

[64] Public information is defined as radio, television (excluding cable), electronic media (excluding the Internet), newspapers and other publications produced in the local market. *See*, Policy Law, at art. 4.

[65] *See*, Policy Law, at art. 4(a).

[66] *See*, Policy Law, at art. 4(b).

[67] *See*, Policy Law, at art. 4(c).

[68] *See*, Policy Law, at art. 16(a).

[69] Article 16 of the Policy Law reads:

(a) Foreign investment shall not be subject to any act of nationalization, expropriation, requisition or measures which have similar effects, except in the public interest and in accordance with applicable laws and regulations, without any type of discrimination and against the payment of appropriate compensation.

(b) Such compensation will be deemed appropriate if it is adequate, effective and prompt.

(c) The details of the standards for compensation in event of nationalization, expropriation, requisition or such similar acts referred to in paragraph (a) of this Article shall meet international

73. In the event of an expropriation, the Policy Law stipulates that adequate and effective compensation that meets international standards is to be promptly provided.[70] To date, the BiH government has not expropriated any foreign investments. To the contrary, BiH has encouraged pre-war foreign investors to resume control of former foreign investments.[71]

74. However, the Policy Law does not provide an appellate mechanism to challenge expropriation decisions. Despite this shortcoming, the Law furnishes a great degree of protection to foreign investors by placing limitations on the BiH or Entity governments' authority to expropriate. The procedures and guidelines regarding expropriation are outlined in the *Rule Book on Standards for Compensation In Case of Expropriation*. This law allows a foreign investor who is subject to an expropriation action to receive a rapid review by an "adequate judicial or administrative authority."[72] Additionally, any expropriation decision must first be discussed publicly and passed into domestic law before action is taken.

75. The Policy Law permits local and foreign companies to hold accounts in any commercial bank, which can be used to initiate or receive payments in foreign currency.[73] Foreign investors also have the right to freely convert KM into any other freely convertible currency and may transfer abroad or repatriate any profits or remittances from their investments.[74] However, a company realizing dividends must pay a 15 percent withholding tax before repatriating dividends.

76. Neither Entity specifically guarantees these rights of convertibility in their respective foreign investment legislation. Although the R.S. permits foreign investors to utilize its banks, it restricts usage to "an authorized bank."[75] The Federation's Foreign Investment Law, on the other hand, does not regulate this aspect of investor's rights at all. Neither the R.S. nor the Federation's foreign investment legislation specifies that foreign investors may convert profits generated from their investment in the form of KM or another currency in circulation in Bosnia into any other freely convertible currency.

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standards and shall be spelled out in the implementing regulations referred to in Article 21 of this Law.

[70] *See*, Policy Law, at art. 16(a), (b).

[71] *See*, *Country Commercial Guides, FY 1998: Bosnia and Herzegovina, Investment Climate*, June 1998, at 2.

[72] *See*, RULE BOOK ON STANDARDS FOR COMPENSATION IN CASE OF EXPROPRIATION, art. 5. This appellate procedure will determine whether such expropriation actually happened, and if so, whether the expropriation and/or compensation was accomplished in compliance with this Law.

[73] *See*, Policy Law, at art 11(a).

[74] Remittances include "(i) income from investments received in the form of profit, dividends, interest, and other forms; ii. funds received by investors after partial or full liquidation of their investments in [BiH], or disposal of invested property or proprietary rights" and (iii) compensation from nationalization or expropriation. *See*, Policy Law, at art. 11(b), (c).

[75] *See*, LAW ON FOREIGN INVESTMENT AND CONCESSIONS, art. 14(2). This article should be omitted and the banking provisions should be covered in one cohesive article, recommended below.

77. Both the Federation and the R.S. laws, to varying extents, authorize foreign investors to transfer the proceeds from their investments abroad. However, in order to harmonize the two laws and bring them into compliance, it is recommended that both laws be amended to include detailed information on the right to transfer funds, and the types of funds generated by the investment that may be transmitted abroad.

> A single, unified article based on the Policy Law that incorporates investors' rights to banking, conversion of currency, and transfer of profits should be inserted into Article 21 of the Federation Law on Foreign Investment and Article 15 of the RS Law on Foreign Investment and Concessions:
>
> (a) Foreign investors shall have the right, for the purposes of their investments, to open on the territory of [Bosnia and Herzegovina or the RS] accounts in any commercial bank denominated in the national or any freely convertible currency.
> (b) Foreign investors, with respect to payments related to their investments in [the Federation or the RS], shall have the right to freely convert the national currency of Bosnia and Herzegovina into any other freely convertible currency.
> (c) Foreign investors shall have the right to transfer abroad, freely and without delay, in freely convertible currency, proceeds resulting from their investment in [the Federation or the RS].

78. The Policy Law defines foreign control as participation consisting of more than 10% of the enterprises capital land or voting rights held directly by foreign investors or by a duly constituted domestic legal entity subject to foreign control.[76] This provision is significant because it furnishes all foreign investors with over 10% interest in a company the rights and benefits of the Policy Law. This designation should be included in the Entity foreign investment laws in order to delineate what percentage of control a foreigner must have before invoking the protections granted in the Policy Law.

> The following language should be inserted in Article 2 of the Federation Law on Foreign Investments and in Article 2 of the RS Law on Foreign Investment and Concessions:
>
> Foreign control entails any participation with more than 10% of the capital and/or the voting rights held directly by foreign investors or by a domestic legal entity under such control.

79. Article 9(c)ii. of the Policy Law calls on the Entities to recognize that competition between the Entities in granting incentives is undesirable and to avoid such competition. However, offering incentives to foreign investors is encouraged if it does not put one Entity at a disadvantage. The entities are directed to establish progressive and favorable tax conditions that encourage foreign investment and to eliminate corporate tax legislation that discriminates between foreign and domestic investments.[77] To comply with these provisions, the Entities' foreign investment laws should be amended.

[76] *See*, Policy Law, art 2.
[77] *See*, Policy Law, art. 9.

80. Article 9 of the Policy Law states that "[t]axation of foreign investors and foreign direct investment shall be carried out in accordance with the tax legislation of the Entities."[78] Furthermore, the tax regimes of the two Entities must be governed by the principle of non-discriminations between foreign and domestic investments[79] and that the Entities should not complete in granting incentives to investors.[80]

81. Both the Federation and the Republika Srpska's foreign investment laws offer tax incentives for foreign investors, although these provisions differ between the Entities. For example, Article 25 of the Federation Law allows exemption from taxes on profits that are reinvested in the territory of BiH as well as taxes on profits that are deposited on a long-term basis at a bank in BiH, as long as the deposit continues.[81] The Federation tax incentive does not apply to all profits realized by the company, only to those that are reinvested or deposited in a bank in BiH. The R.S. provides a tax exemption from paying profit taxes until the final payment of the investment—up to five years from the day of the investment.[82]

82. On this point, FIAS maintains a long-standing position that a simple and stable corporate tax system is exceedingly more important to investors than special tax incentives. Foreign investors, in particular place great importance on the stability of tax rates and rules. BiH's foreign investment policy needs to focus more on guarantees, which are indispensable, and less on fiscal incentives that are often of little relevance for foreign investors. A system of special tax incentives is inconsistent with the goal of attracting foreign investors. Thus, even through the Policy Law warns against competition among entities in granting incentives, in general special tax incentives should be avoided by both Entities.

83. New tax provisions need to be created to provide equal tax treatment of foreign investments, regardless of where they are established. Tax provisions in the Entities' foreign investment legislation must also ensure that corporate tax regimes do not discriminate between foreign and domestic investors. This will ensure that investors do not favor one Entity over the other when seeking to locate its business enterprise, thereby giving one Entity an advantage in attracting and retaining investments to the detriment of the other Entity. The goal is to provide economic stability nationwide, not only in one Entity.

84. Although the Policy Law does not allow discrimination between foreign and domestic investments, it does confer the right of foreign investments to be exempted from customs duties, subject to the provisions of the Customs Policy Law.[83] Under the Federation law, customs duties are waived for a foreign investor on imported objects, raw materials, other materials and components necessary for the first year of regular

[78] *See*, Policy Law, art. 9.
[79] *See*, Policy Law, art. 9.
[80] *See*, Policy Law, art. 9.
[81] *See*, LAW ON FOREIGN INVESTMENT, art. 25.
[82] *See*, LAW ON FOREIGN INVESTMENT AND CONCESSIONS, art. 13, paragraph 2.
[83] *See*, Policy Law, art. 10.

production or export.[84] The R.S. Law states that foreign investors are exempt from customs duties on raw materials and other materials used for production,[85] as well as equipment, other capital assets and materials for construction of a building to be used in the investment.[86] However, the R.S. Law does not allow duty-free imports or exports on passenger motor vehicles, gambling machines and video games.[87]

85. As described above, the Policy Law places limited restrictions on foreign equity ownership of certain enterprises in BiH. These restrictions limit foreign ownership to 49 percent and extend to enterprises engaged in the production and sale of arms, ammunition, explosives for military use, military equipment and public information.[88] In addition to these restrictions, the Federation law places limits on foreign ownership of capital in excess of 49 percent in railroads, air traffic, links and telecommunications.[89] Article 10 of the Federation law should be amended to exclude these enterprises from prohibitions on foreign control.

86. The R.S. Foreign Investment Law also includes limitations on foreign "major participation" in the management of the enterprise[90] in the fields of "telecommunication objects of international and magisterial importance, networks with integrated services and satellite communications" as well as water works and district heating.[91] This law limits the potential activities of foreigner investors and is too restrictive to comply with the Policy Law. It should therefore be amended to exclude these provisions.

> Article 10 of the Federation Law on Foreign Investment and Article 7 of the Law on Foreign Investments and Concessions should be revised to read:
>
> > Foreign investors' investments may not be more than 49% of the capital in the following enterprises: for production and trade of weapons, ammunition, explosives for military use, military equipment and public information media, except as otherwise specified by special laws.

[84] *See*, LAW ON FOREIGN INVESTMENT, art. 22.
[85] *See*, LAW ON FOREIGN INVESTMENTS AND CONCESSIONS, art. 13.
[86] *See*, LAW ON FOREIGN INVESTMENTS AND CONCESSIONS, art. 12.
[87] *See*, LAW ON FOREIGN INVESTMENTS AND CONCESSIONS, art. 13.
[88] *See*, Policy Law, art 4(a).
[89] *See*, LAW ON FOREIGN INVESTMENT, art. 10.
[90] *See*, LAW ON FOREIGN INVESTMENT AND CONCESSIONS, art. 8.
[91] *See*, LAW ON FOREIGN INVESTMENT AND CONCESSIONS, art. 7.

87. Additionally, the R.S. law should define what percentage of capital ownership constitutes "major participation" in management of an enterprise set forth in Article 8. Major participation should be defined as foreign ownership that exceeds 49 percent of foreign control of the enterprise.

> Paragraph 2 of Article 8 of the RS Law on Foreign Investment and Concessions should read:
>
> In the case stated in paragraph 1 of this Article, a foreign person may not obtain the right of participation in management of the enterprise that exceeds 49 percent of the equity of the enterprise.

88. The Policy Law includes the assurance that foreign investors are granted national treatment: that they are not discriminated against in any manner and that they possess the same rights and obligations as residents of Bosnia and Herzegovina.[92] It would be best to have corresponding provisions in both the Federation and the R.S. foreign investment laws. This right should be expressly outlined in Article 21 of Section V entitled "Foreign Investors and their Protection" in the Federation law and Article 10 of Section III designated "Rights of a Foreign Person and their Protection" in the R.S. law.

> The amended portion of Article 21 of the Federation Law on Foreign Investment and Article 10 of the RS Law on Foreign Investment and Concessions should include:
>
> (1) Subject to the provisions of the Law on the Policy of Foreign Direct Investment in Bosnia and Herzegovina, and subject to other laws and treaties of Bosnia and Herzegovina and this Law, foreign investors shall have the same rights and obligations as the residents of Bosnia and Herzegovina.
> (2) [Bosnia and Herzegovina or The Republika Srpska] shall not discriminate with respect to foreign investors in any form, including but not limited to their citizenship, residency, religion, or the state of origin of investment.

89. National treatment must also be extended to foreign investors vis-à-vis property rights to ensure access to real estate, which is necessary in establishing business operations. This right is especially important to protect in an environment where Bosnia is in the process of distributing state-owned property into private hands. Article 12 of the Policy Law[93] assures investors of this right, but there are no corresponding provisions in either the Federation or R.S. foreign investment legislation. This safeguard should be included with the general protections on national treatment of foreign investors.

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[92] *See*, Policy Law, art. 8.

[93] Article 12 of the Policy Law states, "Foreign investors shall have the same property rights in respect to real estate as the citizens and legal entities of Bosnia and Herzegovina. Foreign investors, who are citizens of one of the successor states to the former Socialist Federal Republic of Yugoslavia, shall have such rights subject to investors of Bosnia and Herzegovina citizenship and legal entity status having like rights in the respective successor state.

This right should be inserted in Article 21 of Section V entitled "Foreign Investors and their Protection" in the Federation law and Article 10 of Section III designated "Rights of a Foreign Person and their Protection" in the RS law. The following is a model provision based on Article 12 of the Policy Law:

> Foreign investors shall have the same property rights in respect to real estate as the citizens and legal entities of Bosnia and Herzegovina. Foreign investors, who are citizens of one of the successor states to the former Socialist Federal Republic of Yugoslavia, shall have such rights subject to investors of Bosnia and Herzegovina citizenship and legal entity status having like rights in the respective successor state.

90. National treatment must be extended to foreign investors, not only to protect their rights, but also to ensure they fulfill their obligations. This guideline ensures that foreign investors are not excepted from laws that were employed to protect Bosnia. The Policy Law specifically denotes that restrictions regarding public policy, public health and protection of the environment are equally applicable to both domestic and foreign investors.[94] The Policy Law also explicates that foreign investors must abide by all of the laws of Bosnia and the Entities.[95]

91. The Policy Law also requires that foreign investors maintain books and file reports in accordance with internationally accepted accounting and auditing standards.[96] This provision should be included in both the Federation and the R.S. foreign investment laws, to ensure compliance with the Policy Law.

92. A foreign enterprise investing in Bosnia and Herzegovina will likely bring foreign workers to Bosnia to run its business operations. The right to freely utilize foreign employees is guaranteed in Article 14 of the Policy law and similar rights should be insured in the foreign investment laws of the Federation and the R.S.[97] This provision allows foreign entrepreneurs to employ workers with the qualifications and experience that they demand. It also attracts foreign experts with managerial and business skills into the country, thereby enriching the business environment.

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[94] *See*, Policy Law, art. 15(b).
[95] *See*, Policy Law, art. 15(a).
[96] *See*, Policy Law, art. 13.
[97] Article 14 of the Policy Law gives the assurance that, "Subject to the labor and immigration laws in Bosnia and Herzegovina, foreign investors shall have the right to freely employ foreign employees." Provisions conveying the substance of Article 14 of the Policy Law should be included in Article 21 of Section V in the State law and Article 10 of Section III in the RS law.

E. The Law on Foreign Trade Policy

93. The Law on Foreign Trade Policy was agreed upon under the Dayton Peace Accord and came into force for the State and the Entities in BiH in October, 1997. Article III(1)(b) of the BiH Constitution accords to the state the authority to preside over foreign trade policy. In accordance with the Law and the BiH Constitution, both Entities must apply the same principles and rules as set forth in the Law. The Foreign Trade Policy Law regulates basic elements of the foreign trade regime for the export and import of goods and services. This Law is of particular significance for foreign investors because it provides for the legal guidelines for the flow of goods, including those that constitute a capital investment from a foreign person or a legal entity.[98]

94. Any individual or company, whether domestic or foreign, is permitted to engage in foreign trade activities once registered to do so. Most goods can be imported into BiH without an import license, with certain exceptions, such as goods that are considered to endanger public health, the environment, or national security.[99] Similar regulations pertaining to foreign trade activities are found in the laws of both Entities.

95. Customs and foreign trade policy are the assigned responsibilities of the state-level government. The BiH Ministry for Foreign Trade and Economic Relations and the Ministries in charge in the two Entities are responsible for the application of foreign trade policy under the Law.[100] The Entities exercise any governmental powers not expressly allocated to the BiH Ministry for Foreign Trade and Economic Relations, including customs administration.

96. The R.S. Foreign Trade Law is derived from the Former Republic of Yugoslavia's laws. The existing Federation Foreign Trade Law is based on the laws of Croatia, although a new law or a set of amendments to the existing law is expected in the near future. These laws give the governments of both Entities considerable discretion in overseeing trade activities. The Entities are restricted in their trade activities to their respective areas of geographic control. Each Entity is responsible for the administration, supervision and implementation of the relevant laws affecting trade in its area. Both Entities have implementing laws which cover licensing requirements and the classification of import and export goods.[101] In effect, the Entities are conferred with responsibility for all aspects of foreign investment and trade development except for those powers that are specifically allocated to the State Foreign Investment Promotion Agency.[102]

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[98] *See,* BOSN. & HERZ. LAW ON FOREIGN TRADE POLICY, at art. 10.
[99] *See,* 1999 Country Profile, at 13.
[100] *See,* BOSN. & HERZ. LAW OF FOREIGN TRADE POLICY, at arts. 41-44.
[101] Goods are classified into categories: those without restrictions and those subject to quotas on physical quantities or values.
[102] *See, Foreign Investment and Trade Promotion: Bosnia and Herzegovina, Final Report,* Phare, Mar. 1999, at 5 [hereinafter Trade Promotion Report].

97. BiH's international trade agreements and affiliation include the following:

- World Trade Organization (WTO). In 1999, BiH obtained observer status in the WTO. A platform for negotiations was adopted by the State government in November, 2000 and steps are currently underway to conclude a memorandum of understanding with the WTO towards accession.

- European Union. In January 2000, Bosnia and Herzegovina negotiated trade concessions from the EU on the basis of autonomous trade preferences (ATPs). The ATPs include preferences covering both industrial and agricultural products.[103] In November 2000, a bilateral trade agreement with the EU was initialed. This agreement abolished all quantity restrictions on textile products (effective March 2001).

- At the end of 2000, BiH concluded WTO compliant bilateral agreement with Croatia. Under this agreement, it is expected that trade between BiH and Croatia will be fully liberalized by December 2003. Similar agreements Yugoslavia and Macedonia are being considered.

F. Law on Bankruptcy

98. With the increasing activity of small and medium enterprises and the ongoing privatization program in BiH, strong, clear and effective bankruptcy laws are essential to facilitate business restructuring and reorganization for private enterprises. The legislation for bankruptcy and company restructuring is the responsibility of the Entities. The Federation passed a bankruptcy law in 1998. This Law was drafted with expert assistance from USAID. The R.S., on the other hand, currently adheres to the old Yugoslav version of the bankruptcy law. It is clear that the R.S. law needs to be modernized and strengthened. Therefore, the following discussion focuses on the Federation law which could serve as a starting point for consistent, harmonized legislation between the two entities. It should be noted that the GTZ plans to provide assistance in reviewing and harmonizing both Entity laws.

1. Issues

99. The Federation Law itself is considered to be solid and well written. The most significant problem with the Law is that it is not being implemented. The bankruptcy process in BiH is inefficient and arduous. A major reason for this is the fact that there are simply a scarcity of well-trained judges, trustees and lawyers who can effectively handle the complexities of a bankruptcy proceeding and the courts in BiH are already overwhelmed by heavy case dockets (see section on the Judiciary).

[103] *See, New Trade Agreement Enables Free BiH Exports to EU,* OHR ECONOMIC NEWSLETTER, vol. 3, issue 1, <http://www.ohr.int/newsletter/eco-0301.htm>.

100. According to the Law, all bankruptcy proceedings throughout the Federation are conducted by the cantonal courts and there is no economic court system to address these specialized legal issues. As discussed in a subsequent section of this report, the general court system in BiH lacks the capacity and resources to handle the current case loads in BiH. The Law sets forth precise deadlines (e.g., filing, appeals) that the courts simply cannot meet under the current burdens of the judicial system. Thus, bankruptcy proceedings that should be completed in months invariably extend to years.

101. Under the Law, there is an additional burden placed on the courts in the form of a requirement of a three-judge bankruptcy panel. This panel has ultimate authority of review over the decisions of the Bankruptcy Judge, for every bankruptcy proceeding.

102. The Law also requires the appointment of trustees to posses the "necessary expertise and work experience." The local Chamber of Economy is responsible for recommending a list of trustees to the court. Under the Law, trustees have considerable authority and responsibilities. However, there is no certification program or training for potential trustees. There is also the need to develop a core of competent and certified professional valuers to support bankruptcy proceedings. There is no indication that the framework for developing this expertise exists in BiH.

103. The complexity of the bankruptcy proceedings requires the best and brightest of the participating individuals, namely trustees and judges. They not only must meet certain minimal requirements, but both must receive sufficient training and adequate compensation. The business community's faith and ultimate decision to participate in bankruptcy proceedings will largely depend on how these individuals are perceived based on the quality and consistency of their professional performance.

2. Recommendations

104. Strengthening the capacity of BiH's general court system is essential if BiH is to be able to effectively implement the Bankruptcy Law. The development of a commercial court to address business-related legal issues is potentially an essential element (see section on the Judiciary). FIAS recommends the following:

- The R.S. must immediately pass the Bankruptcy Law and both entities must work towards full harmonization of the respective laws.
- A certification program should be established for trustees.
- Training on bankruptcy law and procedures must be provided for judges, trustees and attorneys. Considering the novelty and complexity of this area of law in BiH, training is essential and should be mandatory. The bar associations and judges associations in the Federation and the R.S. should take the lead in providing this training.

G. Law on Secured Transactions

105. In 2000, the R.S. passed a Law on Registered Pledges on Moveable and Shares (O.G. R.S. 16/00). Similar legislation (same text) has been drafted in the Federation and is currently being reviewed by the Federation's Parliament.

106. The use of collateral in the form of moveable and immoveable property to secure transactions is an essential element in a market economy. Loans for capital investment are rarely provided without collateral in real estate or a mechanic's lien registered in the court. It is recognized that the use of immoveable property as collateral is generally restricted because of the nature of these assets. Security over immoveable property is essential. However, the foundation for securing immoveable assets rests on a system of land law and land registration. In the case of BiH, for reasons discussed in subsequent chapters, the existing system for land registration and the recording of rights to land is largely outdated and inaccurate. Therefore, improved registration of immoveable assets is essential. Also, effective secured transactions laws governing non-possessory security over moveable property and permitting investors to use moveable property to secure their indebtedness are necessary.

107. The basic core principles generally reflected in a law on secured transactions include: reduced risk for creditors; quick, cheap and simple non-possessory security rights; mechanisms for the satisfactions of claims by the holder of security; prompt enforcement of claims; effective means of publicizing the existence of security rights; rules establishing priority over competing rights of persons holding security; and, the availability of security over all types of assets, debts, and between types of persons.[104]

108. The R.S. Law does not incorporate securities. These are to be regulated by separate decrees. According to the R.S. Law, the registry of pledges will be a public book maintained as an electronic database. The data will be stored in a central base established and maintained by the Ministry of Justice. The courts will transfer the information to the central database.

109. According to the current Federation draft law, the new Law will regulate the establishment and execution of the pledges on moveable property. It will do so without requiring the surrender of the pledge. The owner of the pledge will remain in possession of the object of the registered pledge and shall have the right to use the object of the pledge in accordance with its purpose. The rights and obligations of the contract parties to the agreement will be maintained in the pledge registry. The registered pledge will encompass both individual and group objects. The pledge will become effective upon entry into the pledge registry (i.e., registry court) by the court competent in the relevant jurisdictions.

[104] Consistent with the EBRD approach.

1. Issues

110. The existing commercial legal framework does grant non-possessory proprietary security. The development of a system of non-possessory proprietary security in BiH is hampered by the absence of a functioning central registry for the registration of non-possessory pledges in either Entity.

111. The central system must support a simple and quick process. An overly bureaucratic process will be a disincentive for registering pledges. The registry should be centralized but with adequate provision for decentralized access. The central registry should establish a "first in time, first in right" claim over the pledge when there is more than one pledge over the same property. The registry should provide everyone with the knowledge that a pledge has legal standing only if it is registered. Further, the R.S. and Federation will need to integrate the use of the two separate registries.

112. Appropriate measures need to be established for the enforcement of pledges. Because the country's judicial system is relatively weak (see section on Judiciary), courts should be able to issue an execution warrant on the basis of a notarized security contract so as to avoid extensive judicial proceedings.[105]

113. One potential problem with the new R.S. Law and the Federation's draft Law is the reliance on the relatively weak and over-extended judiciary for administration and enforcement of pledges. The courts are being assigned a central role in the administrative processes. For instance, the Federation's draft Law will require the court registry to immediately register the pledge. The ability of the courts to accomplish this task is important because the date of receipt by the court of the request for registration determines the priority order of the pledges. In addition, the registered pledge is legally binding with respect to third parties as of the date of entry into the registry. Thus, it will be important for the courts to maintain an efficient registry process. The courts must also act on the same day the applicant submits a request. Similarly, the courts are used by the creditor to enforce any procedures required to secure his right to supervise the manner to which the pledge is being used. The courts are also responsible for the enforcement of all executions against the pledge. This will place additional burden on the courts. Thus, the courts' ability to respond quickly is an essential part of the new Law. The courts will also have to play the important role of determining the value of any pledged object, if a court considers that the value set forth in the agreement is lower than the market price at the time of such transfer.

114. The enforcement of the Law may also be weakened because of the nature of the enforcement mechanisms. For example, in the event of a dispute, creditors must rely on the police to take possession of the object of the registered pledge. In general, the enforcement mechanisms in BiH are fragile and in many cases ineffective.

[105] Other ways to enforce the pledge is for the parties to agree to sell the collateral jointly or permit the collateral to be sold unilaterally.

2. Recommendations

115. While the basic provisions of the new R.S. Law on Registered Pledges on Moveable and Shares and the draft Federation law may be technically sound, it is clear that further consideration must be given to the legal requirements for the administration and enforcement of the legal provisions in the implementing regulations. Clearly, in the absence of specialized commercial courts, the general court system with its limited capacity and resources cannot effectively support the legal requirements. Therefore, as the implementing regulations are developed, it will be essential to review the requirements for administration and implementation in the context of the infrastructure and resources required.

116. Recommendations for addressing the issues related to collateral are as follows:

- The Federation must pass the Law on Registered Pledges on Movables and Shares as a matter of urgency. Efforts must be undertaken to ensure the consistency and harmonization of the corresponding Entity laws.

- The court system in each Entity must be given the necessary resources to successfully implement the new Law.

- Court administrators rather than judges should have primary responsibilities over the registration process.

- Judges and court personnel must be provided training in the area of secured transactions. The bar associations and judges associations in the Federation and R.S. should be principal providers of the training.

- Effective enforcement mechanisms must be developed to support the Laws. Reliance on the police force, as currently constituted, will not necessarily be the most efficient method for enforcement purposes.

H. The Judicial System

117. A body of technically sound, well-written laws that reflect best practice comprise an essential building block for the modernization and restructuring of BiH's legal system. An equally important component is a well-trained, highly competent judiciary capable of interpreting and upholding the law without compromise or undue influence from other parts of government.

118. The business community as whole, and foreign investors in particular, consider the rule of law reflected in a reliable, consistent and impartial legal system to be one of the key elements of an attractive environment for business. Surveys of investor perceptions and indexes of investment attractiveness often cite confidence in the judiciary

as one of the key indicators of the business environment. Therefore, a sound legal framework for business and investment must include competent institutions worthy of public trust to interpret and implement laws. The formal legal sector, led by the judiciary, must play the primary role in creating, promulgating, interpreting and enforcing the rule of law.

119. On the State level, a Court of Bosnia and Herzegovina has been established. The court systems in both Entities of BiH are in the midst of legal and institutional reforms. In the Federation, substantial progress is being made through the adoption of major legislation in the areas of civil and criminal law and procedure. Similar laws are being proposed for adoption in the R.S. However, immediate and concerted action needs to be taken to upgrade and modernize the institutional capacity of the legal system. Over time, the strengthening of the judicial system's quality, capacity, and performance would contribute to an improved perception of and public trust in the judiciary – important factors for business activity. In turn, increased confidence in the judiciary would lead to reliance on the legal system for the resolution of legal conflict as an alternative to extra legal means. The following discussion addresses some of the key elements that need to be addressed in the judiciary and makes recommendations for implementation.

1. Judicial Independence

120. Judicial independence is at the forefront of the problems in the judiciary in BiH. Judicial independence and impartiality among judges are essential elements in protecting rights, safeguarding the supremacy of law, and ensuring against the arbitrary exercise of power.[106] BiH's judiciary is plagued both by a lack of impartiality among judges as well as a lack of judicial independence. An independent, well functioning judiciary is a fundamental factor in building an environment that attracts and retains private investment.

121. During the war, many qualified professionals fled the country or were killed, thereby affecting the quality and availability of legal professionals . In many instances, vacancies were filled by poorly trained judges and prosecutors, many of whom were selected on the basis of their loyalty to the large nationalist parties.[107] The general perception is that judicial appointments are made on the basis of political affiliation or ethnicity rather than merit and qualifications. [108] According to the ICG Report, as a consequence, members of the judiciary often lack meaningful training and experience in

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[106] *See, Concept Paper on Judicial Independence,* American Bar Association, Central and East European Law Initiative, Apr. 26, 1999, located at http://abanet.org/ceeli/conceptpapers/judicialindepd/judicialindependence.html>, [hereinafter Judicial Independence].

[107] *See,* David B. Dlouhy, Statement before the House International Relations Committee, *On Corruption in Bosnia-Herzegovina* (Sept.15,1999) available at <http://www.bosnia.org.uk/bosrep/augnov99/corruption_Dlouhy.htm>.

[108] *See,* Judicial Independence.

the law thereby impacting their ability to handle their caseloads. Delays in collecting civil judgments[109] pose another source of risk and uncertainty for investors.

122. Throughout BiH, close connections exist between courts of law and the ruling parties and it is believed that, the judiciary is subject to the coercive influence of the dominant political parties, as well as the executive branch.[110] Since judges are often dependent on local political parties to maintain their positions, it has been alleged that some legal decisions are based on instructions by party officials.[111] Further, it has been alleged that judges who demonstrate independence from political parties are subject to intimidation by the authorities[112] and that parties to an action routinely bribe judges to receive favorable dispositions of their cases.[113] Not surprisingly, "even when independent decisions are rendered, local authorities often refuse to carry them out."[114]

123. Insufficient financial and other resources, compounded by the effective control of judiciary budgets by political interests at the Entity and cantonal levels, affect the ability of the judicial system to offer adequate compensation to legal professionals. This in turn has helped to compromise the courts and further erode their judicial independence and impartiality. In addition to promoting dependence and mediocrity,[115] inadequate compensation has contributed to the lack of independent decisions made by judges.[116] Judges who accept bribes from unscrupulous attorneys or wealthy litigants in return for favorable decisions are often motivated by the need to supplement their meager incomes. Although there is no guarantee that increasing judicial remuneration would stem this type of corruption, indicators suggest that increasing salaries would have this effect.[117] Adequate compensation for professionals in the judicial system would help to enhance the quality and performance of the judiciary.

124. The international community has implemented several programs to strengthen BiH's judiciary and make it more independent and professional. The OHR, for example,

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[109] Delays may range from 14 to 18 months. *See*, ICG Bosnia Report.

[110] *See, Bosnia and Herzegovina Country Report on Human Rights Practices for 1998,* U.S. Dep't of State [hereinafter Human Rights Practices].

[111] *A Comprehensive Anti-Corruption Strategy For Bosnia and Herzegovina*, Office of the High Representative Anti-Corruption Task Force, Sarajevo, 1999, at 22-27.

[112] *See*, Human Rights Practices.

[113] *See, Why Will No One Invest in Bosnia and Herzegovina? An Overview of Impediments to Investment and Self Sustaining Economic Growth in the Post Dayton Era*, International Crisis Group, Apr. 21, 1999, found at <http://www.crisisweb.org/projects/bosnia/reports/bh47rep.htm>, [hereinafter ICG Bosnia Report]. Bribery is a systemic means for poorly paid or corrupt public officials to supplement their incomes. Many BiH citizens know of cases where lawyers have advised clients to pay an extra 20 to 30 percent to local officials to swing a decision in their favor. Proving that such activities occur is difficult, as both parties are reluctant to come forward. Officials keep silent for fear of being punished for their criminal behavior and claimants keep quiet due to fear of losing their illegal gains. *See*, Rule of Law.

[114] *See*, Human Rights Practices.

[115] *See*, Judicial Independence.

[116] There is a debate as to whether the failure to fairly compensate judges inadvertently promotes corruption. However, in BiH, corruption throughout the judiciary is so widespread that the nuances of this debate are moot.

[117] *See*, Judicial Independence.

has imposed laws to expand the jurisdiction of the Federation Supreme Court, strengthen the Federation prosecutor's powers, and provide special witnesses with identity protection. In addition, the United Nations established the Judicial Assessment Program in 1998 to monitor and assess the judicial system in BiH.[118]

125. The Federation's draft Law on Judicial and Prosecutorial Service and the R.S. Law on Courts and Court Services and Law on Prosecutors are important legislative initiatives directed at improving the efficiency and independence of the court systems in BiH. Both the Federation law and the R.S. laws provide safeguards against the politicization of the Judiciary by the establishment of independent judicial commissions charged with nominating, disciplining and recommending the dismissal of judges and prosecutors.[119] These laws also specify a period of eighteen months[120] during which the past performance of all sitting judges and prosecutors will be reviewed to ensure minimum standards of judicial competence.[121]

126. The Federation Law is intended to diminish the influence of political parties over the judiciary by placing responsibility of appointments and dismissals in the hands of independent commissions.[122] The R.S. law also promotes independence and impartiality of the judiciary. The R.S. law appointed the R.S. Supreme Court to administer the High Judicial Council. Separating politics from the judiciary is critical to an independent and impartial judiciary, and is essential as a precursor for BiH's membership in the Council of Europe and integration into the European Union.

127. Implementation of the Federation's draft Law on Judicial and Prosecutorial Service required intervention by the OHR. The draft Law was drawn up by a domestic working group and reviewed by the OHR, the OSCE, the UN Judicial System Assessment Program (UNJSAP) and the Council of Europe. The Federation House of Representatives passed the law in January 2000, but the Federation House of Peoples failed to consider it, reflecting a lack of political will to create an independent judiciary.[123] On May 17, 2000, the OHR issued a decision imposing the Law on the

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[118] *See, Testimony before The Comm. On International Relations, House of Representatives* (statement of Harold J. Johnson, Assoc. Director, International Relations and Trade Issues, National Security and International Affairs Division) at 4 [hereinafter Corruption Testimony].

[119] *See, Office of the High Representative Press Releases, Federation Law on Judicial and Prosecutorial Service*, Sarajevo, May 18, 2000, located at <http://www.ohr.int/press/p20000518a.htm>. *See also, Office of the High Representative Press Releases, Amendments to the Republika Srpska Judicial Reform Laws*, Sarajevo, June 12, 2000, <http://www.ohr.int/press/p20000612a.htm>.

[120] The review process was originally scheduled to take twelve months. However, the High Representative extended this period to eighteen months.

[121] *See, Office of the High Representative Press Releases, Federation Law on Judicial and Prosecutorial Service*, Sarajevo, May 18, 2000, located at <http://www.ohr.int/press/p20000518a.htm>. *See also, Office of the High Representative Press Releases, Amendments to the Republika Srpska Judicial Reform Laws*, Sarajevo, June 12, 2000, <http://www.ohr.int/press/p20000612a.htm>.

[122] *See, Office of the High Representative Press Releases, Federation Law on Judicial and Prosecutorial Service*, Sarajevo, May 18, 2000, located at <http://www.ohr.int/press/p20000518a.htm>.

[123] *See, Office of the High Representative Press Releases, Federation Law on Judicial and Prosecutorial Service*, Sarajevo, May 18, 2000, <http://www.ohr.int/press/p20000518a.htm>.

Federation. As stated by the OHR, "due to intolerable delays in the legislative process, the High Representative has seen himself forced to impose the Law."[124]

128. The courts in Bosnia are also plagued by the inadequacy of existing procedural rules.[125] Changes in the rules need to be instituted to improve efficiency in case management and prevent the significant backlogs that are common in BiH's courts. Proposals for the new rules include greater delegation of administrative tasks from judges to court staff.

129. Current BiH judicial administrative practices constitute a barrier to implementation. Changes must include improving the accuracy of recording evidence through the use of audio-tape equipment during court hearings, shifting administrative duties from judges to trained court clerks, staffing, improving the allocation of caseloads, strengthening trial management procedures to speed up the trial process, creating a judicial training facility, and reforming the budgetary allocation and management system.

130. The courts have also proven to be an ineffective mechanism for dispute resolution. The civil litigation process in both Entities is inefficient and is one of the major impediments to foreign investment in BiH. The court system has proven to be almost completely unsuccessful in resolving business disputes.

131. The problems associated with a judicial system that does not have the capacity to resolve disputes makes it difficult for investors to accurately forecast business expenses and risks. First, exorbitant up-front taxes on civil suits act as a deterrent to business owners wishing to take legal action.[126] Additionally, contracts are almost entirely unenforceable through the judicial system and there is no system of commercial and small claims courts where disputes may be resolved swiftly.[127] If a commercial dispute reaches the court, it may take several years in court proceedings before a company can obtain an enforceable judgment.[128] Furthermore, the cost of litigation may exceed the amount contested. Additionally, there is no guarantee that the proper decision will be handed down due to the prevalence of corruption and lack of legal training.

132. As an intermediate solution to some of the problems discussed above, the establishment of specialized commercial courts, mediation or arbitration courts may be feasible. Establishing one or more of these extra judicial mechanisms would also provide for an efficient and immediate recourse for commercial disputes. This is an important incentive for foreign investors. However, these intermediate solutions should not be considered as substitutes for efforts to strengthen in the general judicial system.

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[124] *See, Office of the High Representative Press Releases, Federation Law on Judicial and Prosecutorial Service*, Sarajevo, May 18, 2000, <http://www.ohr.int/press/p20000518a.htm>.

[125] Since 1998, The American Bar Association's Central and East European Law Initiative (CEELI) has been aiding Bosnia in developing model, uniform internal court rules in the Federation.

[126] *See,* ICG Bosnia Report.

[127] *See,* ICG Bosnia Report.

[128] It may take between three to five years to collect payment in a simple contractual dispute. Discussions with American Bar Association's Central and East European Law Initiative office in Sarajevo, July 17-28, 2000.

133. Currently in BiH, to successfully enforce a judgment, a party to a dispute must rely on the police who are not adequately accountable to the courts for carrying out judicial decisions and who play a limited role during the execution of court decisions.[129] Many of these problems stem from an inadequate civil procedure code in both Entities. While an initial revision of the civil procedure code was completed in the Federation, significant problems remain. In both Entities, further reforms are needed to the civil procedure code and the law governing the execution of civil judgments. Effective legal recourse is essential to attracting and maintaining foreign investment and no such mechanism currently exists in Bosnia.

134. In order to provide a coherent, consolidated approach to the issues of judicial reform and the promotion of the rule of law, a special organization to lead the implementation of judicial reform programs has be established. The Independent Judicial Commission (IJC) is attached to, but separate from, the OHR. Specifically, the IJC operates independently on a day-to-day basis, reporting to the High Representative who provides it with the means necessary to effectively execute its authorities and responsibilities.

135. The IJC has the power to intervene in the processes of the Entity and cantonal commissions responsible for selecting and disciplining judges and prosecutors, and conducting judicial reviews. It provides opinions and advice directly to Ministries of Justice, judges, prosecutors, and court administrators regarding the process of judicial reform and the promotion of the rule of law. Finally, the IJC represents a focal point for international assistance to judicial reform initiatives, assists in the identification and design of specific programs, and supports domestic training organizations.

G. Corruption

136. For the business community, corruption increases the cost and the risk of doing business. The issue of corruption affects almost every aspect of business in BiH and it constitutes a serious impediment to investment

137. Based on a U.S. Department of State report, corruption is widespread throughout the governmental system in BiH.[130] Corruption is so pervasive according to the U.S. Department of State, that the U.S. General Accounting Office considered recommending the suspension of additional monetary assistance until local governments demonstrate their willingness and ability to curb corruption.[131] Bribery appears to be a rampant and an acceptable way for civil servants to augment their meager salaries.[132]

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[129] *See,* Discussions with American Bar Association's Central and East European Law Initiative office in Sarajevo, July 17-28, 2000.

[130] *See, Bosnia and Herzegovina Country Report on Human Rights Practices for 1998,* U.S. Dep't of State.

[131] According to a draft copy of the report issued by the General Accounting Office, officials asserted "there has been no measurable progress in reducing crime and corruption in the four years since the end

138. Corruption is facilitated, in part, by the inconsistent and opaque regulatory framework for business operations in BiH. The Entity governments maintain a complex and often conflicting set of laws that regulate many business activities As a result, in the view of some commentators, even business owners who wish to comply with all laws and regulations may be faced with the situation where complying with one law equates to breaking another.[133] As most regulatory functions and implementations are left to local governments, laws are inconsistently and arbitrarily enforced.

139. Some actions have been taken to combat corruption in BiH. For example, The OHR has established the Anti-Fraud Unit (AFU), which became fully operational in Fall 1998. The AFU aims to eliminate opportunities for corruption through institutional reform; increasing transparency and reporting in government procedures; requiring penalties; and disseminating information to promote education and public awareness on the topic.[134] The AFU drafted A Comprehensive Anti-Corruption Strategy for Bosnia, which is being implemented by the AFU and other international organizations forming the Anti-Corruption and Transparency Group (ACT Group).[135] The governments of the State and the Federation have established anti-corruption commissions, however, few concrete results have been achieved. The BiH State and Entity governments must continue to "take appropriate measures for the prevention and control of corrupt business practices."[136] Reforms must be aimed at increasing the transparency and consistency of business laws and regulations at all levels of government. In addition, a system of monitoring the performance of government agencies and holding them accountable to the public should be introduced.

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of the war." *See,* Christopher Marquis and Carlotta Gall, *Congressional Report Says Corruption is Stifling Bosnia*, N.Y. TIMES, July 7, 2000, <http://www.nytimes.com/library/world/europe/070700bosnia-gao.html>.

[132] *See,* ICG Bosnia Report.

[133] *See*, ICG Bosnia Report.

[134] *See, International Efforts to Combat Corruption in Bosnia and Herzegovina,* ESI Bosnia Project, Oct. 1999, available at <http://www.esiweb.org/BGPapers4-1999.html>.

[135] The ACT Group is chaired by the Principal Deputy High Representative and includes representatives from the IMF, the World Bank, the European Commission, CAFAO, Economic Bank of Reconstruction and Development, USAID, IMG, the Council of Europe, OSCE, the UN Judicial System Assessment Program, IPTF, SFOR, and the US Anti-Corruption Team. *See, Office of the High Representative Information*, located at <http://www.ohr.int/info/info.htm>.

[136] *See, Guidelines on the Treatment of Foreign Direct Investment,* art. III(8), in *Report to the Development Committee on the Legal Framework for the Treatment of Foreign Investment,* The World Bank, at 40.

CHAPTER III

BUSINESS REGISTRATION AND APPROVALS

A. Introduction

140. This Chapter describes and analyzes the procedures necessary to establish a business in Bosnia and Herzegovina (BiH) and makes recommendations for streamlining and simplifying these procedures.

141. The legislation applicable to business registration exists mainly at the Entity level. However, the State Law on the Policy of Foreign Direct Investment also includes certain provisions for the registration of foreign investment enterprises.

142. Although each entity (the Federation and the Republika Srpska) has its own company legislation, both entities allow the following legal forms of business[137]:

- Sole proprietorship.[138] Any physical person older than 18 years is allowed to operate as a sole proprietor. The sole proprietor is liable with his personal assets. There is no minimum capital required. This form of business is confined, in part, to specified trades, owner-operator enterprises (a maximum of 1 employee in the R.S.) and businesses following below an established profit ceiling.[139]

- General Partnership.[140] Two or more physical persons can form a general partnership. The partners are liable with their personal assets. There is no minimum capital requirement.

- Limited Liability Company (LLC).[141] This is the most popular form of business in Bosnia. One or more physical or legal persons can form a limited liability company by a founding act. In the Federation, the minimum capital requirement is KM2,000 for a single proprietor and KM10,000 if for an establishment with multiple partners. In the R.S., the minimum capital requirement is KM5,000 for all LLCs. The company's liability is limited to its capital.

[137] Art. 3 Law on Business Companies (Federation); Art. 2 Law on Enterprises (R.S.).
[138] Law on Entrepreneur Activity (R.S.).
[139] For example, in the R.S. a sole proprietor's yearly profit must be less than KM200,000, in the Federation the limit is KM1,000,000. Sole proprietors must register with the municipality (see form in Annex D).
[140] Art. 78 to 95 Law on Business Companies (Federation); Art. 101 to 180 Law on Enterprises (R.S.).
[141] Art. 309 to 354 Law on Business Companies (Federation); Art. 327 to 385 Law on Enterprises (R.S.).

- Joint Stock Company.[142] One or more physical or legal persons can establish a joint stock company by a founding act. The minimum capital requirement is KM50,000 in the Federation and KM10,000 (KM20,000 for multiple establishments) in the R.S. The company's liability is limited to its capital. Shares of the JSC can be publicly traded. A JSC must have a Board of Directors and a Supervisory board. The General Meeting of the Shareholders appoints the members of the Supervisory board for 4 years. The Supervisory board appoints the members of the Board of Directors.

143. Once a business has completed the business registration process in one Entity, it is legally permitted to operate in both Entities. However, in practice, the registration of a branch in the second Entity is required to facilitate business operations. Legal advisers interviewed by FIAS have indicated that some business activities can be more difficult, or even impossible, if a company is not registered as a branch in the second Entity.

144. In order to register as a branch in the second Entity, a company is required to submit the primary company registration documentation along with the address of the branch. This submission must be made to the court with jurisdiction for the branch which will then inform the court with jurisdiction for the primary company registration. The exchange of information between the courts usually takes approximately 2 weeks.

B. Procedures for Establishing a Business Entity

1. The Federation

145. Applicable legislation in the Federation include the:

- Law on Business Companies[143]
- Law on the Policy of Foreign Direct Investments in BiH[144]
- Law on Foreign Investment[145]
- Law on Procedure of Entry of Legal Entities into the Court Register[146]
- Regulation on Registration of Legal Entities Carrying out Business Activities with the Court Registry[147]
- Regulations on standardized Classification of Activities in the Federation[148]

146. An applicant has to go through the following 14 steps, summarized in Figure 1, in order to establish a business and initiate activities:

[142] Art. 107 to 308 Law on Business Companies (Federation); Art. 183 to 326 Law on Enterprises (R.S.).
[143] OG of the Federation No. 23/99.
[144] Law of 29 May 1998.
[145] OG of the Federation No. 2/95.
[146] OG of the Federation No. 4/2000.
[147] OG of the Federation No. 37/2000.
[148] OG No. 28/98, 36/98 and 47/98.

1) The enterprise needs a business address to be stipulated in the founding Act. The address has to be chosen carefully because every change of the business address requires amendment of the registration. In addition, the authorities and courts do not accept pro forma mailbox addresses.

2) If the future company is a limited liability company or joint stock company, then a founding act has to be stipulated. This founding act must have by law a certain minimum content and has to be notarized[149]. Notarization can be done in the Municipality Office within one day and for a negligible fee of several marks.

3) A company, which is 100% foreign owned needs approval from the Municipal Office of the Federation Ministry of Defense confirming that the business location is not in a military zone. The applicant has to submit the notarized founding act of the company and sometimes identification documents of the foreign owner (notarized copy of the certified translated passport or of the company registration). The approval procedure takes about 7 days and fees are not levied.

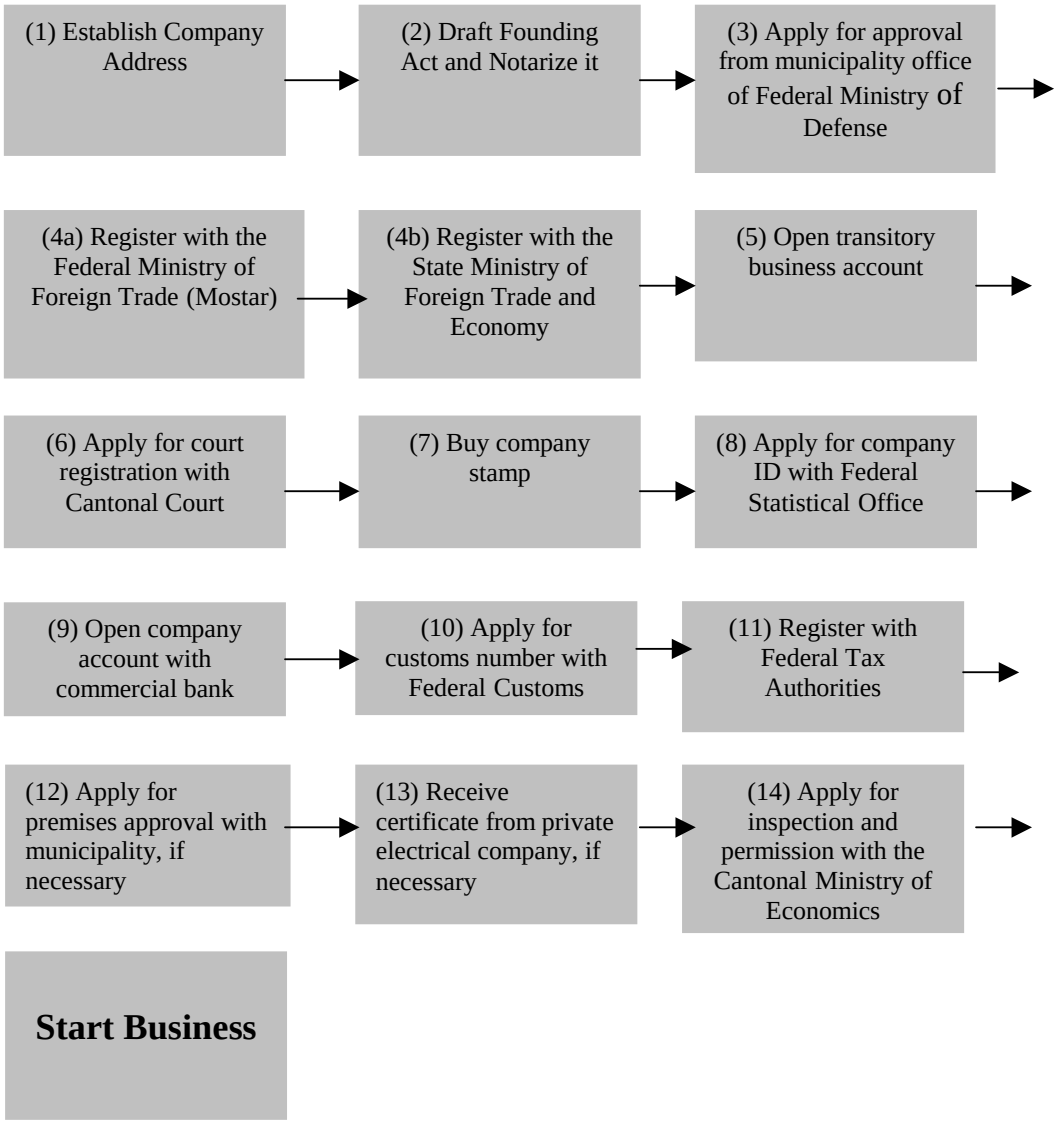
4) Subsequently, a foreign investor must register his investment with both the State Ministry of Foreign Trade and Economic Relations in Sarajevo and the Federation Ministry of Foreign Trade in Mostar in accordance with the Policy Law on Foreign Direct Investment in BiH. The procedures and required documents are in both ministries identical. The applications for both registrations can be submitted in parallel. Documents to be submitted to both Ministries are:

   - Informal request for approval
   - Notarized copy of the founding act
   - Notarized copy or original of the passport (physical person) or certified translation of company registration (legal person)
   - Copy of evaluation of asset by a certified expert as an evidence for foreign investment, if capital is in kind
   - Copy of the decision from the Ministry of Defense - while the Federation Ministry denies that this document has to be submitted, lawyers and business people confirm that it is still requested by some administrators.

   The foreign investment Registration Certificate must be picked up since they are not delivered or mailed. This is also advisable since in practice since the postal service is not very reliable.

[149] By law, the minimum content of a founding act is: name of the founder, name of the company, company address, company's initial capital, number of shares, identification of the business activities according to standard classification, name of Managing Director/representative(s), statement if company is involved in foreign trade.

Figure 1: Steps for Foreign-Owned Company Registration in the Federation*



* It should be noted that the registration procedures for foreign-owned and domestic companies are the same except for step 4a.

It is difficult to accurately estimate the length of time required for this procedure. According to officials from the Federation Ministry, approvals are issued within a couple of days. However, this estimation considers only the time from which an application is considered as complete in the eyes of the official in charge. On the other hand, private sector representatives alleged that unjustified requests for additional documentation cause considerable delays and give the authority an often-used and subjective tool for classifying an application as incomplete. In addition, the lack of communication between the authorities and the applicants increases the delays because the applicant is not automatically notified of the

incomplete status of the application or the specifics of the "missing" documentation.

Professional facilitators have indicated that it is necessary to follow up the registration procedures very closely and to keep contact to the administrators in order to speed up the procedure. Personal contacts are essential. For professional facilitators, it is possible to receive the approvals within 2 weeks. Private individuals acting without facilitators, on the other hand, say that the process can take several months from the date of the initial submission.

The fees for the foreign investment registration are about KM114 (60 for changes) in Mostar and KM55 (20 KM for changes) in Sarajevo.

5) At least half of the capital must be paid up - whether in kind or in cash.

6) The next step is the application for the court registration at the Cantonal Court Company Registry with jurisdiction for the region where the company will be located.[150]

The following documents must be submitted for the registration of a **limited liability company**:[151]

- Application with list of all submitted documents
- 7 official forms, including a form stating the intended business activities according to a classification list (see Annex D)[152]
- Notarized Act of Foundation
- Proof of existence of founders (passport; company registration)
- Proof that capital is paid in (commercial bank statement if capital is in money, evaluation of certified expert if capital is in kind)
- Notarized sample signature of the representatives allowed signing for the company
- Address and passport number of the representatives
- Written statement of General Manager or members of Board of Directors that they accept their appointment
- Statement of founder that no other company is owned in BiH. If another company is owned in BiH, statements from the tax authorities that tax obligations are required

[150] Art. 1, 8 Law on Procedure of Entry of Legal Entities into the Court Register (Federation).

[151] Art. 5 to 6, 32 and Art. 10 of the Regulation on Registration of Legal Entities Carrying out Business Activities with the Court Registry (Federation). For joint stock companies see art. 11 instead of art. 10 of the Regulation. The requirements for banks and insurances are stipulated in art. 21 to 28 of the Regulation.

[152] The 7 forms and additional 16 forms of a recording list are described in art. 47 and 48 of the Regulation on Registration of Legal Entities Carrying Out Business Activities with the Court Registry (Federation). See Annex D.

- If the company is involved in foreign trade, then the approval from the Ministry of Trade, a notarized signature of the person in charge of foreign trading operations and the part of the statute stating the foreign trade activity must be submitted
- Power of attorney, if a lawyer is involved
- Evidence that the court fee has been paid

NOTE: A regulation describes in detail the required size, print and even paperweight of the documents.[153]

If a foreign company wants to establish a **branch office**, the following documents must be submitted to the Cantonal Court:[154]

- Court registry of company
- Document confirming the appointment of a branch office manager
- Notarized signature of branch office manager
- Act of foundation of the company, or a separate decision of foundation of the branch stating the foundation of the branch, its activities, rights and obligations

NOTE: Companies registered in the R.S. that want to conduct business in the Federation are required to register a branch in the Federation. A notarized copy of the company registration must be submitted to the Cantonal Court with jurisdiction of the location of the branch.

For branches, the following data will be entered into the court registry:[155]

- Name and head office of the company
- Form of the company
- Scope of operations
- Subsidiaries and branch offices
- Name, address, responsibilities and scope of authority granted to the official representative of the company
- Address, activities and name of the person authorized to represent a branch office
- Name, address of the owner of the company
- Amount of the agreed registered capital and paid in capital
- Class, number and nominal value of shares in joint stock company

[153] Art. 30 of the Law on Procedure of Entry of Legal Entities into the Court Register (Federation) with art. 59 and 68 of the Regulation on Registration of Legal Entities Carrying Out Business Activities with the Court Registry (Federation).
[154] Art. 13 Regulation on Registration of Legal Entities Carrying Out Business Activities with the Court Registry (Federation).
[155] Art. 55, 56 Law on Business Companies and Art. 18 Law on Procedure of Entry of Legal Entities into the Court Register (Federation).

NOTE: Each change of this information must be registered.

NOTE: A company is only allowed to conduct business activities for which it is registered.[156] Every change of activity must be registered. In practice, companies register for all conceivable activities in order to avoid having to make changes in registration.

Upon the submission of registration forms and all required documentation, a judge must make a ruling on the application – for approval or rejection.[157] Once the application is approved, the registration is published in the Official Gazette. Judicial clerks prepare the decision. The applicant can appeal against the decision to the Supreme Court within 8 days of receipt of the notification of the ruling.[158] Box 1 indicates the costs of registration in the cantonal courts.

Box 1

Federation: Court Registration Fees

Each Cantonal Court sets the court fee independently. In Sarajevo, for example, the flat registration fee is KM405, in Mostar it is KM155. The fee for each change is KM400 in Sarajevo. That means, for example, if a company changes its name, adds a business activity and changes the manager, a fee of KM 1,200 must be paid.

The court will send the company an invoice to pay KM20-40 to the official journal for publishing the registration decision. The decision will be published upon payment.

7) Every company document must be stamped by a company stamp. The company is required to order a company stamp in a specialized shop. The stamp costs about KM20 and the representative of the company must present the company registration to the shop when he/she orders the stamp.

8) For the necessary application to the Federal Statistical Office, the company must submit:

   - A stamped application form
   - Evidence of payment of the fee of KM100
   - Copy of the court registration

   The office then issues a certificate with the company's ID number within 2 days.

9) The company has to open an account with a commercial bank.

10) **If the company intends to conduct foreign trade**, then it has to apply for a customs number from the Federation Customs. The applicant must be a company since sole proprietors are not permitted to conduct foreign trade. The customs registration number is valid for all border points in BiH including those in the Republika Srpska and allows the holder to import and export goods. The

[156] Art. 8 Law on Business Companies (Federation).
[157] Art. 13 and 42 Law on the Procedure of Entry of Legal Entities into the Court Register (Federation).
[158] Art. 56 to 61 Law on Procedure of Entry of Legal Entities into the Court Register (Federation).

registration certificate must be deposited at the border points to be used for imports. The customs in both entities exchange the registration data on a weekly basis.

In order to obtain a customs number, the applicant must submit a notarized copy of the statistical certificate and the court registration as well as evidence that the stamp duty of KM10 has been paid. The customs number can be obtained within one week.

In addition, an exporting company must be registered with the State (in Sarajevo) and Federation (in Mostar) Ministry of Foreign Trade. It is not clear whether registration on both levels is necessary or just one registration is sufficient. In either case, a copy of the court registration and of the statistical certificate must be submitted. The Ministry issues the certificate and it is not clear for what purpose this certificate is issued.

11) The company must register with the municipal office of the federal tax authority for all tax purposes. The tax registration procedure is described in Box 2.

12) Before commencing business the company needs an approval from the municipal economic unit that the proposed business premises is appropriate for the intended commercial use. The fee for this approval is KM32. The approval can be obtained within one week. This approval is often obtained from the landowner of the premises.

13) An electricity company is required to certify that the electricity supply to the premises is safe. As in step (12) this certificate is often provided by the landowner.

Box 2

Registration as a Taxpayer in the Federation

The following documents are required for registration as a taxpayer in the Federation:

- Copy of the extract of the court decision registering the company (the original document is also required for verification).
- Statistics number assigned to the company by the Statistics office.

In the Federation, the company is required to pay between 400 and 1000 KM dependent on the size and business of the company. Upon submission of proof of payment, the Tax Administration then provides a taxpayer identification number.

In addition, companies are required by cantonal law to pay a an annual levy, that is effectively a license that requires annual renewal. This levy is intended to generate revenues for the cantons and the levy varies by canton. For example, in the Sarajevo Canton (Law on Communal Levies – Official Gazette of Canton Sarajevo, no. 6/97 of April, 1997) registered companies are required to pay an annual levy of between 100 to 1000 KM, subject to the types of registered business activities.

14) Finally, the premises must be inspected and approved by the Cantonal Economic Ministry. To do so, the company has to apply with the following documents:

- Application form
- Copy of the court registration

- Copy of the rental or lease contract, or the land registry
- Copy of the approval from the municipal economic unit
- Certificate from the electricity safety examination
- Evidence that the fee of KM100 has been paid

Usually, a team of 3 inspectors will visit the premises in order to inspect the building and equipment. Based on the inspection, the Ministry in the Canton grants permission to use the business premise.

2. The Republika Srpska

147. The Laws applicable to business registration procedures in the R.S. are:

- The Law on Enterprises[159]
- The Law on Registration in the Court Register[160]
- The Regulation on Court Registration of Business Entities
- The Law on the Policy of Foreign Direct Investments in BiH[161]
- The Law on Application of the Law on Policy of Direct Investments to BiH[162]
- The Law on Foreign Investments and Concessions[163] and its implementing Decree[164]

148. The following steps are necessary before commencing business in the R.S.:

1) Establishment of the business address.

2) An act of foundation must be promulgated in accordance with the Law on Enterprises.[165]

3) In the case of a limited liability company, the founder is required to deposit at least KM2500 in a commercial bank.

4) According to the Law on the Policy of Foreign Direct Investment[166], a foreign owned company needs a registration certificate from the State Ministry of Foreign Trade and the Ministry of Foreign Economic Relations of the R.S. The registration procedure for the State Ministry is as described above in the section on the Federation.

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[159] O.G. of the Republika Srpska No. 24/98, 15 July 1998.
[160] O.G. of the Republika Srpska No. 24/98, 15 July 1998.
[161] Law of 29 May 1998; BiH Official Gazette No. 17/98.
[162] RS Official Gazette No. 17/99.
[163] RS Official Gazette No. 21/96.
[164] Decree on Registration of Direct Foreign Investments of 19 August 1999.
[165] Art. 11 Law on Enterprises.
[166] Law on the Policy of Foreign Direct Investment in B.H., O.G.B.H. 4/98, 20/03/98.

5) According to the Decree on the Registration of Direct Foreign Investments[167] the following information must be submitted to the Ministry of Foreign Economic Relations of the R.S.:

- Written request
- Application form
- Notarized copy of the founder's passport (physical person) or the excerpt from the registration (company) - not older than 6 months
- Document that confirms the status of the managing director
- If the founder is a business, then a document from the tax authorities certifying that due taxes and fees have been paid
- If the founder is a company, then evidence that account with commercial bank has been opened
- Special licenses, as required for the particular activities of the company

Any change of information entered in the application form (see Annex D) and enclosed documents requires a new application with the Ministry.[168]

The certificate is issued in about 1 week and the fee is KM100.

6) After securing the FDI registration, the designated Managing Director or the owners of the enterprise can apply for the court registration. Five Regional Courts in the R.S. process business registrations. The following documents must be submitted to the Regional Court in the region where the business is located:

- Application form
- Original or notarized copy of the foundation act
- Original or notarized copy of the company's statute
- In the case of foreign investment, registration from the R.S. Ministry of Foreign Affairs
- If foreign applicant, then notarized copy of the passport (physical person) or company registry (legal person)
- Signature of the founder (notarized by the municipality)
- Special licenses, as necessary
- Evidence that the court fee has been paid

The registration decision must be made by a judge and published in the Official Gazette of the R.S.

[167] Art. 3 Decree on Registration of Direct Foreign Investments (R.S.).
[168] Art. 5 Decree on Registration of Direct Foreign Investments (R.S.).

Box 3 provides details on the cost of the court registration procedure in the R.S.

Box 3

R.S. Court Registration Fees

The registration fees for legal entities which conduct foreign trade is KM1600. For all other types of enterprises the cost is KM600. The registration of a branch costs KM350. The fees for changes depend on the actual change. For example, the fee concerning a change of the managing director is KM200, the name of the firm is KM250 or the company's address is KM260.

The court company registration includes the following data:

- Name and seal of the company
- Company name and seat (legal entity) or name and address (physical person) of founder
- Capital of company
- Type of company
- Activities according to classification
- Foreign trade activities, if any
- Names of persons authorized to represent the company in foreign trade activities and limits of their authorizations
- Reference number and date of the founding act

Any change of a register entry including a change of the performed activities needs a new application with the respective court.

NOTE: Foreign companies cannot register and operate a branch in the R.S. because the necessary legislation has not yet been adopted in the entity.

The length of the court registration process depends on the particular regional court. In Banja Luka, registration takes about 1 to 2 months. In other regions it can take longer.

Box 4 provides details of the tax registration procedure for the R.S.

Box 4

Registration as a Taxpayer in the Republika Srpska

In the RS, when a company is registered with the municipal court, it is automatically registered with the Tax Administration. The company fills out a form for the prepayment of taxes and at the same time the company declares how it intends to pay its sales and excise taxes. This is a "free-form" submission on which the company states whether the taxes should be based on average, estimated or actual sales. The company must also supply details on where it operates.

Once the company has been registered with the tax authorities, the company becomes liable for taxes based on the types of activities it performs. These taxes generally include a sales tax on products and services, a wage tax, social contributions and the Corporate Income Tax.

In addition, the company is required to pay an annual levy. The levy is payable in two tranches. The amount of the levy varies (between 500 KM and 3000 KM) and is dependent on the size of company. The companies are informed of their status in writing in the form of a resolution.

8) A registered company needs a company stamp. The unique stamp must be made in a specialized shop and it costs approximately KM20.

The applicant must submit a copy of the court's registration decision in order to secure the stamp.

9) The temporary bank account can now be transformed into a regular one. In order to make the account operational, signatures of the officers of the firm must be deposited and verified with the company stamp. The procedure is instant and requires no fees. If the account is held in a commercial bank, one of the three forms that is confirmed and returned to the company must be photocopied (not notarized). At this point a decision is made on the number of signatories to the account and the authorization criteria for the withdrawal of funds.

10) A statistical number must be obtained from the statistical office in the R.S. The applicant must submit a notarized copy of the court registration and a completed application form stating the activities of the company. The statistical registration number can be assigned within one day for a fee of KM50.

11) If the company is engaged in foreign trade, it needs a customs registration number from the Ministry of Finance in Banja Luka. The applicant must submit:

- A notarized copy of the registration decision
- Statistical certificate
- Verification of bank account
- Evidence that the fee of KM20 has been paid

12) An electrical company must certify the safety of the electricity supply to the business premises.

13) Within 2 months of the court registration, the company must report to the municipality's inspection body. The following documents must be submitted:

- Copy of the court registration forms (7 forms)
- Copy of the act of foundation
- Rental contract
- License from municipal secretariat for urban planning (technical acceptance)
- Certificate for electrical supply to the premises. (Issue date no longer than 3 years)
- Evidence for secondary education of the managing director
- Fee of KM100 for inspection
- Tax stamp of KM70 for the municipality decision
- Approval from Town Hall that business can be conducted at business address
- Power of attorney as applicable

All these documents must be submitted to the municipal authorities before the inspector will visit the site. Inspections are conducted on a bi-weekly schedule. Upon inspection, the Municipal Secretariat for Economy will issue a “Decision on technical, safety, environmental and other legal standards acceptability” for the

premises. Inspections are usually be conducted within 1 to 2 weeks from the submission of the application.

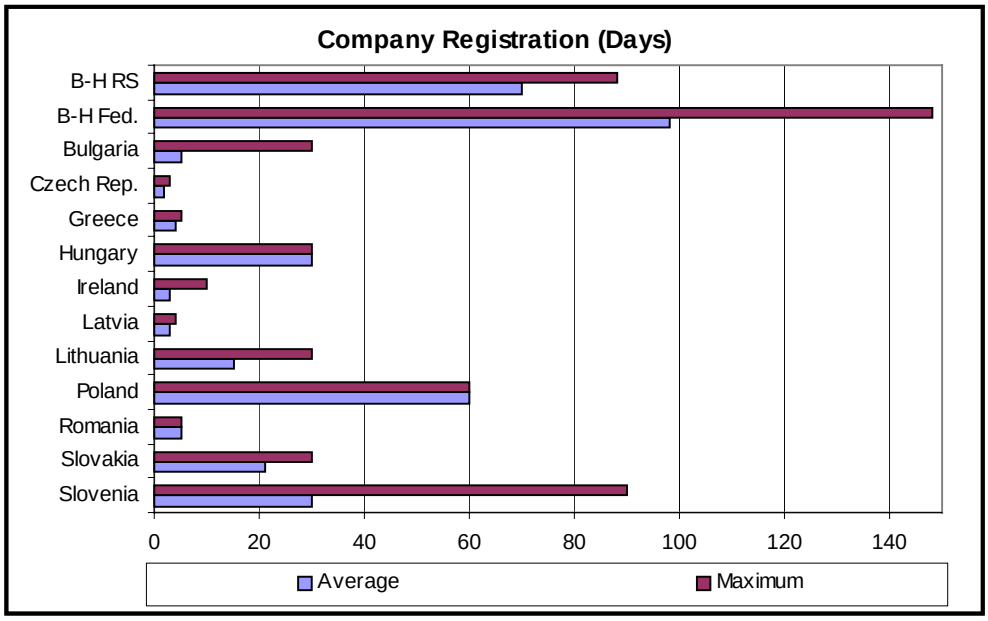
14) Municipality certification of the business premises.

149. Since the procedures are quite similar in both entities, the flow chart (Figure 1) presented for the procedure in the Federation can serve with minor alterations for the R.S.

3. Analysis

150. In comparison with other countries in the region, the procedure for establishing a business entity is extremely bureaucratic. As a result, the length of time required to complete the registration process is significantly longer than in other countries in the region (See Figure 2, below). This, in turn, has the effect of increasing the cost of business startup for domestic and foreign investors alike.

Figure 2: Comparative Company Registration



151. In addition, the procedures are very rigid. Every applicant has to go through the same process, regardless of the type of business activity. All procedures end with an "approval" from an authority. More flexible and effective alternatives like binding declarations of the applicant or reporting requirements instead of approvals are not in use.

152. Since the steps of the registration procedure are largely sequential and interdependent, a delay at any step, justified or unjustified, halts the entire process. This makes the investor very vulnerable and dependent on each particular agency involved in the process.

153. The main impediment to business is the length of the preparatory phase before business operations can begin. Though each step might take only days or weeks, it adds up. It is not uncommon for the entire approvals process to take a year or more. During this time, valuable resources are idle, business plans become obsolete, business partners and contacts turn away, and opportunities are lost. Therefore, it should not come as a surprise that investors view the business registration and establishment process as a major barrier to investment in Bosnia.

154. The business registration procedure appears to be overloaded by unnecessary but mandatory approvals. The fact that the sequential nature of the process precludes the simultaneous processing of most approvals renders the entire process even more unacceptable. When compared with other countries in Central and Eastern Europe as well as in the European Union, the approvals required and the procedure for business registration in BiH can be considerably streamlined.

155. The following procedures are either duplicative or redundant:

- Approval from the Ministry of Defense
- Registration with the Federal Ministry of Foreign Trade/ Ministry of Economy in the R.S.
- Registration with the State Ministry of Foreign Trade and Economic Relations
- Creating a company stamp

Box 5

Capacity of Courts in the Federation – Summary of Issues

In the Sarajevo Cantonal Court, the number of companies seeking registration increased from 1,351 in 1999 (as of July) to 4,527 in 2000 (as of July). In addition, there were 1,699 cases remaining from 1999 for a total of 6,226 registration requests for the year 2000. During the first six months of 2000, only 2,188 of these requests were resolved.

Many government officials interviewed state the actual approval time for company registration is only 10 to 15 days. However, this figure is calculated at the time the judge begins his or her review of the registration request; it does not include the significant delay that occurs prior to the judge actually reviewing the file.

In the experience of the professionals and business persons interviewed, in the Federation, the length of the procedure depends on the particular Cantonal Court. It also depends very much on how much the applicant follows up the procedures and shows presence at the court. Registration may be accomplished within 2 weeks if the applicant has a lawyer who follows up the procedure on a daily basis. Otherwise, the procedure can take several months.

The Sarajevo Court has five judges (up from three in 1999[1]) working on company registration requests. There are now a total of 15 court personnel working full-time on registering companies. This is an enormous amount of time and resources utilized for what should be primarily an administrative function. However, based on discussions with court personnel they hold the erroneous assumption that "only lawyers and judges can handle the matters of company registration."[1] The Courts should change its role as an administrator and focus only on verifying the information provided for in the registration forms.

The Sarajevo Cantonal Court is the only court with specialized software to keep track of documents required for the registration process. Aside from this court there is no system in place to monitor document filings and link information between the courts (both within the Federation and between the Entities). It is therefore difficult to obtain the information necessary to complete approval of

- Registration with the respective Office of Statistics
- Inspection by Cantonal Economic Ministry in the Federation
- Inspection by municipality in the R.S.

156. Government officials are also given the authority to deny applications for incorporating a business based on their evaluations of the merits of the business activities. No substantive decision by judges or government officials should be required for incorporation.

157. Currently, companies are required to provide detailed information and submit to a detailed review for business formation and registration. However, it is not business of the Courts to examine foreign investment and other approvals or licenses. It is also not business of the courts to examine the classification of the business activities. And it is certainly not the business of the courts to examine whether the founders paid their taxes or other obligations. In some cases, it has been alleged that this review process has been abused by corrupt officials.

158. The role of the Courts in the business registration process merits further review. Contrary to the modern practice in many European countries, the court registration process appears to give the court the role of a supervisory agency for business practices. A registration court is required to protect the business community from businesses that do not fulfill the minimum requirements of the company legislation. The company registry is designed to provide information to the public on the parties responsible for the business and its activities as well as the minimum capital guaranteed.

159. Further, the capacity of the Courts serve to further impede and lengthen the business registration procedures. For example, in the Federation, the courts currently have a major backlog of company registration files. This backlog stems largely from lack of capacity and the requirements for re-registration as a result of changes in the laws. In 1995, new company forms have been introduced and almost all existing business had to re-register. In 1999, single owner businesses were required to re-register as limited liability companies. Also, the minimum capital requirements for existing limited liability companies with more than one owner was raised. This also required re-registration.

160. In addition, there is the pervasive problem of overlapping authorities and excessive documentation requirements. This is largely a result of the complex procedures and overlapping regulations developed by the various layers of government administration (State, Entity, cantonal and municipal) as described in the previous Chapter. This problem is exacerbated by the fact that there is little or no information sharing between the various agencies. As a result, the same documents are often submitted to different authorities. This duplication increases the overall length of the business establishment process and the cost for applicants and the governments. The lack of transparency for some procedures also increases the opportunities for the abuse of authority by corrupt officials. This constitutes yet another cost to business and government.

Box 6

The European Union's Recommendations on Company Registration Procedures

Throughout the European Union, the procedural requirements for forming a business entity are undergoing changes. The trend in corporate law of individual EU Member States is towards removing administrative burdens through greater operational efficiency.

The European Union has recommended to its Member States several proposals for simplifying the registration aspect of starting a new business, which is outlined in the Commission Recommendation on Improving and Simplifying the Business Environment for Business Start-ups. Recommendations include:

- introduce a single business registration form;
- set up a single contact point where businesses can register;
- institute a single business identification number system;
- take measures to eliminate duplicate or superfluous forms and/or contact points;
- allow businesses to reject requests for duplicate information filed with other government agencies;
- set deadlines for processing requests and granting licenses or authorizations;
- introduce a system whereby an application is deemed to be approved if the administration does not meet its deadline;
- utilize information technology and databases to share information among government agencies.

In addition to registration requirements, some Member States also require authorization before commencing business. However, authorization is not required by the EU Directives. Where national law dictates, Article 4 of the Second Council Directive applies. Article 4 provides that, where the laws of a Member State require a company to have authorization before starting business, they shall also provide for responsibility for liabilities incurred by or on behalf of the company before the grant or refusal of such authorization other than liabilities under contracts which are conditional on the grant of authorization. National law in Italy and The Netherlands requires authorizations prior to commencement of business activities and legislation in these two countries is in compliance with Article 4 of the Directive. All other Member States do not require authorization.

These recommendations give a clear indication of the tendency towards simplification of the registration process for enterprises in Europe. Many Member states have taken numerous measures to improve the interface between administration and the business community. In Sweden, for example, a regulatory impact unit, know as "Simplex" conducts impact analysis on proposed legislation and works for reduced, fairer, and more easily understood regulations.

Box 7

Company Registration in Germany

In Germany, each business has to register with the commercial registrar. The documents and data to be submitted depend on the legal form. However, there are only marginal differences. The following data and documents need to be submitted to the commercial registry in charge of the location of the business for the registration of a limited liability company (§ 8 Law on Limited Liability Companies):

- Founding contract (original or notarized); by law, the founding contract must contain the name and address of the company, kind of business of the company, total capital, share of each founder;
- Signed list of owners including their names, addresses, family status and amount of shares in the company;
- If contributions are paid in kind:
    - copy of the contracts stipulating this;
    - documents giving evidence for the value of the contribution.
- Special license, if needed for the business;
- Statement from founders that shares and contributions in kind are paid in;
- Statement that managing director(s) fulfil(s) the minimum requirements (no conviction for certain commercial crimes, etc.);
- Description of scope of power of attorney of managing director(s);
- Sample signature of managing director(s).

The company register is maintained by the commercial branch of the civil courts. Judges and court clerks who are specialists in registration procedures are responsible for maintaining the commercial register. Most decisions are prepared by clerks, and only the establishment of limited liability companies and joint stock companies require the decision of a judge. Most changes in the registry are also decided by clerks.

Company registration takes about three to four weeks on average, depending on the type of business and the local court. After the registration has been completed, the business can start to operate.

The stamp duty for company registration costs a flat fee of approximately $100 to $140 for sole proprietors, partnerships, and limited liability companies. The stamp duty increases for partnerships, depending on the number of partners involved. The stamp duty to register a joint stock company depends on the amount of initial capital.

There is no obligation to register with the Statistical Office.

161. Many lawyers complain about the lack of transparency of certain procedures and the sometimes frequent changes in reporting requirements. Although the laws and regulations generally specify the requirements for applications, administrators are sometimes unaware of certain legal requirements or changes in the legal texts, since this information is not always promptly disseminated or shared among the various authorities. As a result, business registrations may be delayed while clarifications and verifications are sought.

162. Another problem encountered by investors is the mindset of administrators. There is a noticeable absence of a service-oriented culture aimed at providing prompt and efficient services clients. Instead, it appears that private business persons are viewed

with suspicion and as trouble-makers. Mistrust prevails and a certain control mentality can be found in many authorities. In this atmosphere, there have been instances of individual administrators overstepping their authority and areas of competency in order to pursue suspected irregularities. A foreign investor characterized his interpretation of the administration's role as a "defender of the state interest against hostile forces."

163. Finally, the fee structure for certain procedures is unclear. For example, the court registration fee for foreign-owned companies in the R.S. is with KM1600 in comparison to KM600 for other companies. This is not only disproportionate and high, it is also discriminatory. Further, there is no clear basis for the difference in this fee. In like manner the cost of changes in registration, particularly in the Federation (KM400) appears rather high. The fee structure should be reviewed and rationalized.

4. Recommendations

a. Registration Procedures

164. ***Establish objective criteria and procedures for court registration***. The government must eliminate investigations and subjective decision-making by judges on the merit of the proposed business enterprises. It is not the duty of the courts to function as a supervisory agency for business practices.`

165. ***Eliminate unnecessary procedures***. As mentioned above, some of the administrative procedures lack justification. These procedures should be abolished. Redundant and duplicative procedures include:

- Approval from the Federation Ministry of Defense. This mandatory procedure should be abolished. The following two options for satisfying security concerns should be considered: (1) only companies seeking to locate in specified military areas should be obliged to apply for approval; and (2) the approval procedure should be replaced by an inspection of sites within designated military zones.
- FDI Registration at the Entity and the State levels: First, there is the obvious duplication of procedures. Second, there is a question of the cost and benefit. It is not clear whether the apparent benefit of satisfying the reporting requirements of two separate authorities justify the cost to the administrations and the affected businesses. Options for eliminating this duplication include:
  - **Option 1** (maximum gain): Abolish both procedures and oblige the court registry to provide the necessary data to the State and Entity governments. Under this arrangement, the FDI registration would be included (perhaps on a separate form or as an addenda to existing forms) in the business registration process. The information can then be distributed among the respective authorities.
  - **Option 2**: Abolish what is now effectively an FDI approval procedure (at the State and Entity levels) **and** replace it with a simple notification

requirement for foreign-owned enterprises. The notification may be submitted at either the State or Entity level and shared with the appropriate authorities on both levels.

- **Option 3**: Leave the FDI registration procedure in place but abolish the requirement for the submission of the approval certificate to the Court for the business registration. This would effectively separate the two procedures, making it possible to pursue both in parallel.

- Creation of a company stamp; This requirement is a relict of the former socialist era when state-owned enterprises utilized the "seal" (company stamp) to validate official transactions. However, in the modern marketplace, company officials are granted authority to conduct business on behalf of the business entity and their signature validates this authority. BiH needs to update its business practices and requirements.
- Mandatory inspection by Cantonal Economic Ministry in the Federation and the municipality in the R.S. Clearly, certain inspections are necessary but the purpose of these two inspections is not clear. In the case of the Federation there appears to be duplication between the Cantonal Economic Ministry inspection and the municipality inspection.

166. ***Streamline and simplify the remaining procedures.*** The various authorities should be required to formally share information, perhaps with a centralized collection of basic information. This would help to decrease the workload of the authorities, minimize duplication and reduce the cost of doing business on the part of the private sector. For instance, the following authorities should be required to exchange information:

- Court registry
- Federation Ministry of Foreign Trade
- Ministry of Foreign Economic Affairs in the R.S.
- State Ministry of Foreign Trade and Economic Relations
- Office of Statistics

167. The duplication of procedures must be minimized. The development of computerized processing systems can support an effective information sharing system. The savings generated by such a system will certainly offset the cost of development and implementation.

168. ***Introduce a unique business identification number at the State and Entity levels.*** This business ID should be applicable across the State and Entity levels. Therefore, the same number should be utilized for all administrative transactions. This would facilitate the management of databases and the sharing of information. At a minimum, the Federation should simplify the registration process, adopting an approach similar to that of the R.S., so that the taxation registration number is automatically assigned as part of the business registration process.

In Sweden, for example, the practice of assigning a single identification number system has been in effect since 1985. This number is used by the enterprise from the start-up phase until its dissolution. The number can be retained even if the company changes its name. It is used for administrative purposes such as taxation, insurance, banking, and telecommunications. Comparable systems exist in Denmark, France, and Portugal.

169. ***Establish a centrally-coordinated business registration procedure.*** Through this central coordinating mechanism, companies should have access to public authorities at all levels when completing the registration requirements. This not only simplifies operations for businesses, but it also facilitates communication and transfer of information among government and regulatory agencies.

The French system of *Centres de formalites d'enterprise* allows all of the business formation formalities to be completed in one location with a single-page registration form and one identification number. Inspired by the French system, the Portuguese created the "CFE Network" (*Centro de Formalidades das Empresas*), which offers a single reference point for completing administrative formalities. This system, available in 7 regional offices, replaced the previous need to visit 6 different locations and has reduced the approval time from 4-6 months to 2-3 weeks.

In Spain, authorities have created a single access point for entrepreneurs wishing to create an enterprise as well. An unincorporated enterprise can be created in a single day and the number of procedures has been reduced from 17 to 15; the processing time has been reduced from 81 to 25 days.

170. ***Eliminate excessive documentation requirements.*** All documentation requirements should be reviewed with the objective of rationalizing the various requirements. The purpose of every required document should be thoroughly examined and subjected to a number of questions (e.g., Is the information really necessary? Can the information be obtained from or validated by another authority? Is the documentation requirement consistent with the objective of the procedure?) In many cases, documentation requirements are outdated, irrelevant and duplicative.

171. FIAS recommends the use a one- or two-page registration form to gather all of the information required to incorporate and register a new company. Businesses should provide the information necessary for registration once to a central processing unit, thereby eliminating duplicate requests for information from companies.

The French questionnaire gathers, on a single page, all of the information required by any administrative body to register the new enterprise. Many other Member States have implemented systems where they routinely review forms in order to simplify their language, detail, and the number of forms required as well.

172. Also, FIAS recommends the elimination of the requirement that an appraiser be selected from a court-approved list to appraise non-monetary contributions. This requirement is burdensome and unnecessary. More importantly, it limits the flexibility of investors to negotiate freely and to agree among themselves on the value of their respective contributions.

> Most continental European countries accept the principle of valuation of non-cash consideration for shares, at least for large companies. The EU Second Council Directive requires that an expert appointed or approved by an administrative or judicial authority appraise non-monetary contributions to the corporation. The expert may be either a natural or legal person.
>
> On this issue, BiH may wish to move away from European law and follow the US model, which does not require appraisals of non-monetary contributions. This practice is more efficient and convenient.

173. ***Make certain decisions in the registration process automatic, subject to the fulfillment of specific criteria.*** Currently, all court decisions on company registrations must be made by a judge. However, many of the decisions are rather pro forma and do not require the approval of a judge or senior official. Therefore, consideration should be given to making certain decisions automatic subject to the fulfillment of specified conditions and the clearance of the clerks of the court. This shift of the workload to the clerks is practiced, for example, in Germany and many other EU Member States.

174. ***Harmonize requirements across the Entities and at all levels.*** There are several advantages to be derived from harmonizing the registration procedures across Entities. First, administrative costs decrease with a more centralized approach. Second, transparency and consistency of the procedures are increased, thereby minimizing uncertainty and the cost to the investors.

175. ***Establish a service-oriented approach and improve the quality of the personnel in the courts and administration offices.*** The complex registration procedures are made even more difficult by the suspicious and otherwise indifferent attitude of the public servants responsible for administering the procedures. The court and related administrations need to change its fundamental approach to dealing with applicants. A better understanding of the purpose of the business registration, streamlined procedures, and better communication can contribute to a more efficient registration process and would help employees to develop a service-oriented approach in dealing with the public.

176. ***Re-evaluate the stamp duty in the R.S.*** The discrepancy between registration fees for domestic companies (KM400) and foreign companies (KM1600) is not justified and should be eliminated.

177. ***Utilize new technologies to facilitate the business registration process.*** In addition to computerizing and modernizing the existing processing systems, the government should consider developing an Internet access to allow applicants to download forms and to conduct preparatory research (e.g., searching for company names) more efficiently and cheaply. In addition, Internet capability should be developed to

permit the electronic submission of business registration applications and the electronic exchange of data between the various authorities. The development of a centralized electronic database would facilitate the filing and processing of registration forms, financial reports, tax returns, and other statistical data, thereby reducing or eliminating the need for business owners to appear in person. With modern technology, electronic processing of fee payments can also be facilitated.

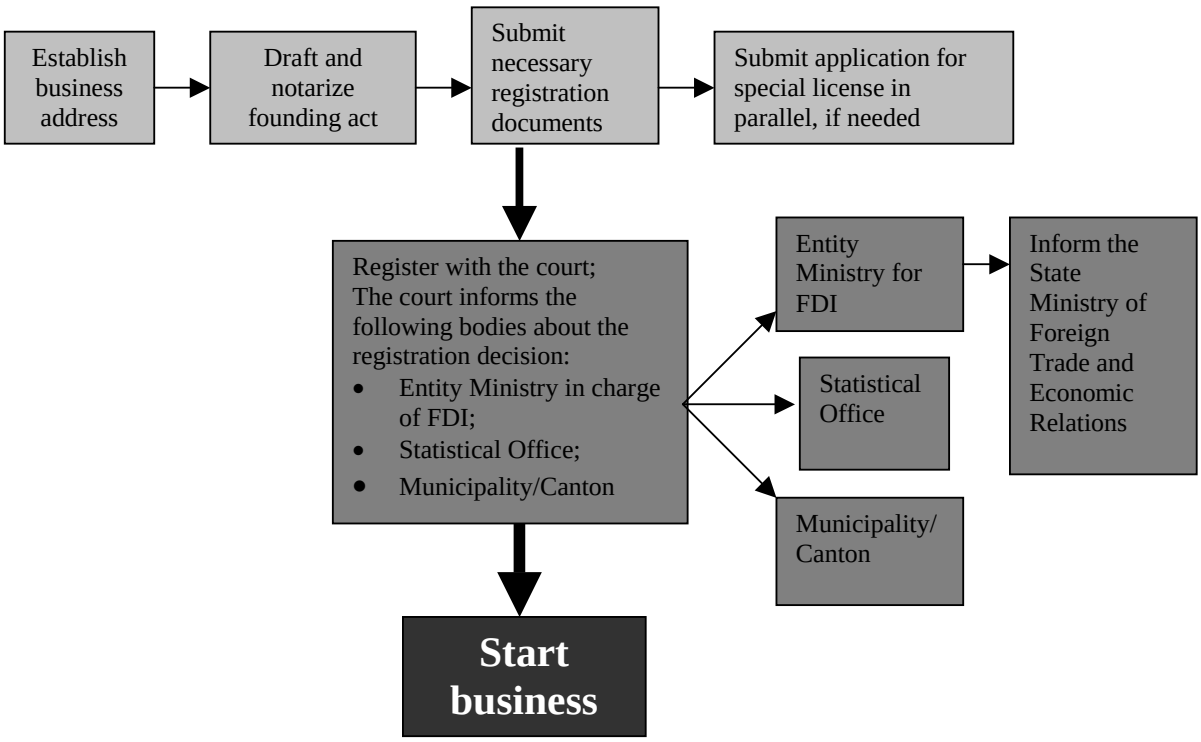
The business register in Italy gives information about all enterprises including its name, address, statutes, and annual accounts. Part of this information was previously stored in paper form at the local courthouse. This new register offers in a single database information regarding businesses, which can be used by the public administration.

The Danish authorities have utilized Internet technology to create a single web page where entrepreneurs can access all of the necessary forms and make the required payments online for a business startup. Austria has created a central electronic business register and small businesses are absolved from statistical and reporting requirements.

The United Kingdom has launched a pilot service on the Internet for one-stop shopping for regulatory information and forms called "Direct access government." Belgium has also established an agency for administrative simplification, which includes launching an electronic system for completing formalities.

Similar informational web sites and databases have been established in Germany, Greece, Spain, France, Ireland, Luxembourg, The Netherlands, Portugal, Finland, and Sweden.

178. The following provides the outline of a streamlined registration procedure that may be adopted in BiH:



179. With the streamlined procedure, the court registration encompasses all of the required company initiation information. It will serve a central registry thorough which all of the necessary information is submitted. This information can then be accessed or transferred to the relevant authorities (e.g., statistical agency, municipalities). The Entity Ministries would be required to inform the State Ministry in charge of FDI of the registration of foreign-owned enterprises. Also, the court registration should serve as a trigger for the necessary municipal and cantonal inspections procedures.

180. Therefore, a company should be able start business operations immediately on the completion of the court registration. In cases where specialized licenses are needed for the court registration, the applicant should be required to sign a declaration stating that all necessary specialized licenses have been obtained. If necessary, copies of the licenses may be submitted subsequently.

b. Harmonizing the Laws for the Registration of Foreign Investments

181. The Law on the Policy of Foreign Direct Investment in Bosnia and Herzegovina (Policy Law) stipulates that foreign investors must register their investments simultaneously with the competent body of the State and the respective Entity in which it is located.[169] The Entities have therefore enacted implementing legislation to comply with this directive. The Federation enacted the Instruction on Registration of Direct Foreign Investments in the Federation of Bosnia and Herzegovina (the Instruction) and the Republika Srpska passed the Decree on Registration of Direct Foreign Investments (the Decree) into law. The Instruction and the Decree (collectively referred to as the Laws) are substantively identical, with substitutions referring to the respective Entity or its laws as the only difference between them. The process of registering a foreign investment is essentially the same, whether the foreign entrepreneur is establishing a business in the Federation or the R.S. Although the harmonization of the Entities' foreign investment registration laws is a positive step towards a unified process of registering businesses in both Entities in BiH, some changes still need to be made to the Laws to facilitate a smooth registration process.

182. The Decree and the Instruction regulate the registration of business entities with foreign control over 10 percent.[170] To provide clarity, definitions of the terms "foreign control", "foreign investment", and "foreign investor" should be specified in Article 1 of both Entities' legislation. In accordance with Article 2 of the Policy Law, the Entities' respective foreign investment laws should either incorporate these definitions by

[169] *See,* LAW ON THE POLICY OF FOREIGN DIRECT INVESTMENT IN BOSNIA AND HERZEGOVINA, art. 5(a) [hereinafter Policy Law].

[170] *See,* DECREE ON REGISTRATION OF DIRECT FOREIGN INVESTMENTS, art. 2 [hereinafter Decree], and INSTRUCTION ON REGISTRATION OF DIRECT FOREIGN INVESTMENTS IN THE FEDERATION OF BOSNIA AND HERZEGOVINA, art. 2 [hereinafter Instruction].

referencing to Article 2 of the Policy Law, or the definitions should be set forth directly in Article 1 of both the Decree and the Instruction.[171]

183. The first paragraph of Article 2 of the Decree and the Instruction should specifically state that a foreign investment must be registered with the respective body competent for foreign investments in each Entity.

> This paragraph should state:
>
> Prior or upon its occurrence, a foreign investment made in the territory of the [Federation of Bosnia and Herzegovina or Republika Srpska] must be registered with the [Ministry of Trade of the Federation of Bosnia and Herzegovina or Ministry of Foreign Economic Relations].

184. The Laws allow an exemption from registration when foreign investments do not consist of foreign control over 10 percent.[172] The Laws should allow for a broader scope of investors to be exempted from the registration process. For example, registration exemptions should also be granted when the total value of the foreign investment does not exceed 10,000 KM or when the foreign investment does not result in foreign control over the enterprise. These exemptions should not be granted when authorizations are required for conducting restricted or regulated business activities.[173]

> An appropriate amendment to Article 2 of the Laws should read:
>
> Notwithstanding paragraphs 1 and 2, a foreign investment is exempted from registration when its total value is less than 10,000 KM, or when it does not result in a foreign control, provided, however, that the foreign investment does not require license(s) or authorization(s) required by law for the exercise of restricted or regulated activities.

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[171] Article 2 of the Policy Law defines "foreign control" as "any participation with more than 10% of the capital and/or voting rights held directly by foreign investors or by a domestic legal entity under such control."
A "foreign investment" is an "acquisition, creation or extension of any business enterprise, or any other activity which, alone or with others, concurrently or consequently, has the effect of permitting one or several natural or legal persons to acquire or increase control over a company carrying out industrial, agricultural, commercial, financial, real estate, service or other activity, or to ensure expansion of such company already under their control. Such investments may include any tangible or intangible property including, but not necessarily limited to: freely convertible currency or local currency, loans, advances, receivable, licenses, leases and conventional rights, including concessions, machinery, equipment, spare parts, raw materials, industrial or intellectual property rights or any financial facilities granted by a foreign natural or legal person under foreign control, except between parent companies and their subsidiaries if this does not result in increase of the foreign control over the domestic enterprises."
A "foreign investor" is defined as "a natural person, who is not resident of Bosnia and Herzegovina and does not have his or her principal place of business in Bosnia and Herzegovina or legal persons formed in accordance with a foreign law and does not have his or her principal place of business in Bosnia and Herzegovina or legal persons formed in accordance with a foreign law and having their registers office, central administration or principal place of business in a foreign country."

[172] *See,* Decree, art. 2 and Instruction art. 2.

[173] *See, Registration of Foreign Investments for Republika Srpska,* Phare, July 1998, at 53.

185. To register a foreign investment, a representative must file a submission containing numerous documents.[174] However, the requirement of providing a "copy of act about establishing when enterprise investments is concerned" is unclear.[175] If this is interpreted to mean that a copy of the legislation that identifies when foreign investment enterprises (as opposed to other investments) are involved, this requirement seems to be superfluous and unnecessary. This section should be elucidated to indicate exactly what is required of foreign investors. If this provision indicates that foreign investors must submit a copy of the legislation, it should be eliminated altogether.

186. The Register of direct foreign investments consists of a register book and a collection of documents.[176] The register book requires that every page of the book is marked with a number and confirmed with a stamp from the appropriate authority over foreign investments in the respective Entities.[177] This provision seems to be especially cumbersome and should be eliminated or modified to reduce the amount of administrative paperwork required. The collection of documents contains the registration form along with all of the documents enclosed with it.[178]

187. Article 4 of both Laws stipulates that an incomplete registration notice will not be entered into the Register, and that the body authorized for foreign investments "shall act in accordance with provisions of Article 36 of the Law."[179] This provision, however, does not state to which law it is referring. As there are currently only eight articles included in the Decree and the Instruction, it is unlikely that this provision is referring to either of these Laws. Article 4 should either clearly state which law it is referring to in order to avoid confusion, or it may be deleted altogether if it is deemed superfluous.

188. Article 4 of the Entities' foreign investment registration laws should place limitations on the response time of the competent bodies in the respective Entities once a foreign investment has been registered. If the application is incomplete or the necessary documentation has not been provided, the competent bodies should inform the foreign investor of the necessary steps to take to complete the registration. Should the foreign investment application be denied for a lack of compliance with the registration conditions, the foreign investor or its authorized representative should have the right of an immediate appeal. Enacting this provision will give foreign investors the assurance that registration will not be delayed as a result of bureaucratic inefficiencies or cancelled due to incomplete information.

[174] *See,* Decree, art. 3 and Instruction, art. 3.
[175] *See,* Decree, art. 3(f) and Instruction, art. 3(f).
[176] *See,* Decree, art. 4 and Instruction, art. 4.
[177] *See,* Decree, art. 4 and Instruction, art. 4.
[178] *See,* Decree, art. 4 and Instruction, art. 4.
[179] *See,* Decree, art. 4 and Instruction, art. 4.

Two additional paragraphs should be added to Article 4 of both Entities' Laws:

The body competent for foreign investments shall confirm to each authorized representative, within 10 working days from the date of filing of the information referred to in Article 3, that a foreign investment has been registered. If a registration condition has not been fully complied with, the body competent for foreign investment shall advise such authorized representative within 10 working days which specific item or items of the registration format have not been complied with.

Refusal to grant registration for lack of compliance of a registration condition may be challenged before the competent court.

189. Article 7 of the Laws authorizes the refusal of a registration if the authorized representative and/or the foreign investor acted contrary to the provisions of the foreign investment registration laws of the Entities. In practice this would equate to an annulment of the registration that was already carried out. This is an onerous action to take against an investor who may fail to comply with a simple administrative requirement. Rather, the Laws should furnish sanctions for non-compliance with the Laws, varying in degree depending on the severity of the violation. For example, fines should be assessed for a late submission of the registration documents; the submission of fraudulent or inaccurate information; and for any subsequent violations of the foreign investment registration laws.[180] Only for aggravated violations should cancellation of the registration certificate be imposed. The Laws should also define the administrative body that will determine which sanctions apply and provide for a right to appeal any sanction.[181]

Article 7 of both Entities' Laws should be replaced with the following information:

1. Non-compliance by an authorized representative and/or foreign investor of any of the provisions of the present Law shall be subject to the following sanctions:
   For late submission: a basic fine not exceeding five times the registration fee, and a daily fine, for an amount not exceeding the registration fee.
   For the submission of fraudulent or inaccurate information: a fine not exceeding ten times the registration fee.
   For any subsequent violation: a fine not exceeding twenty times the registration fee and, in aggravated cases, subsequent cancellation of the registration Certificate.

2. The foreign investment board shall determine at its sole discretion:
   the nature and the level of a sanction;
   whether it applies to the authorized representative and/or the foreign investor

3. Administrative sanctions may be appealed before the competent courts.[182]

190. When publishing foreign investment data, the Laws should explicitly state that the legitimate interests of foreign investors will be protected and that confidential information will not be published or revealed by any other manner. Doing so will also

[180] *See, Registration of Foreign Investments for Republika Srpska,* Phare, July 1998, at 55.
[181] *See, Registration of Foreign Investments for Republika Srpska,* Phare, July 1998, at 55.
[182] *See, Registration of Foreign Investments for Republika Srpska,* Phare, July 1998, at 55.

meet the requirements of the Policy Law, which gives the Entities the right to publish foreign investment data only of a general nature.[183] A foreign investor should have the option to file a written statement requesting that data contained in the registration documents be held confidential.[184]

> Article 8 of the Decree and the Instruction should be amended as follows:
> The [Federation of Bosnia and Herzegovina or Republika Srpska] shall, at any time, protect the legitimate interest of the foreign investors and ensure that their business secrets are not revealed. Unless a foreign investor files any written statement to the contrary, the publication of any data contained in the registration form shall be deemed consistent with the present Article.

191. An additional Article should be added to both the Decree and the Instruction, indicating the method of publishing the Laws and the date it enters into force.

> Article 9 should be added to the Laws of both Entities:
> The present Law shall be published in the Official Gazette of the [Federation of Bosnia and Herzegovina or Republika Srpska], and shall enter into force on the eighth day from the date of its publication in such Gazette.

192. The Policy Law also mandates that the State and the Entities ensure that their implementation regulations provide "registration formats" that are "alike and conform to international standards."[185] In compliance with this provision, the Entities adopted foreign investment registration laws that set forth identical registration forms. The forms are a vast improvement over earlier formats and allow investors to conduct registration of their foreign investments in a uniform manner, regardless of the Entity in which the investment is located. Entity officials should be commended for these positive changes.

193. However, to be more consistent with internationals norms, the forms could be further amended to secure only the most relevant information from foreign investors. Consequently, the following provisions of the current forms should be eliminated, as the information requested is irrelevant, confidential, burdensome, overly intrusive or repetitive. Provision 4 (other offices and/or property in capital, amount of local investment); Section B (data on local investor); Provision 11 (amount of local investment); and Provision 14 (number of employee on the basis of investment in BiH) should be omitted from the form.

[183] *See,* LAW ON THE POLICY OF FOREIGN DIRECT INVESTMENT IN BOSNIA AND HERZEGOVINA, art. 5(d).
[184] *See, Registration of Foreign Investments for Republika Srpska,* Phare, July 1998, at 56.
[185] *See,* LAW ON THE POLICY OF FOREIGN DIRECT INVESTMENT IN BOSNIA AND HERZEGOVINA, art. 5.

CHAPTER IV

LOCATING

A. Introduction

194. Bosnia and Herzegovina's existing legal framework and administrative arrangements for the ownership and transfer of land are largely influenced by three distinct events or periods in its political and economic history during the twentieth century. These events are the:

- Transformation to a socialist regime with state ownership of all property at the end of World War II;
- The recent war and subsequent property appropriation and distribution; and
- Transition to a market-oriented economic regime, following the Dayton Accords.

195. Prior to the socialist era there was a comprehensive system for both land and ownership registration, established under the Austro-Hungarian rule. However, this system lapsed under socialism as principles of collectivism and state ownership of property were implemented. Today in BiH, as in most of the other countries in the region, issues related to land ownership, restitution for appropriated property, and the re-establishment of land and ownership registration systems are highly-charged political issues with significant economic implications for the State, its citizens and the private sector.

B. Land Ownership and Administration

1. Ownership of Land

196. Consistent with the provisions of the Constitution of BiH, the legal framework for the ownership and transfer of property consists of laws on the State and Entity levels. The basic framework Law on the Basis of Ownership Relations and the Law on the Basis of Property Relations have been promulgated at the State level. The responsibility for spatial planning, land management, the administration of property transactions, and the registration of property ownership reside at the Entity, cantonal and municipal levels. The Entity Laws on the Survey and Cadastre of Immovables and the Law on Land Registry are currently being revised with technical assistance from GTZ. The existing laws and regulations governing ownership of land by the state and private persons are fundamentally the same in both Entities of BiH.

197. In the R.S. and in the Federation, foreign persons (whether residents or non-residents, whether legal entities or physical persons) cannot own property.[186] Under the BiH Law on Foreign Investment, a foreign direct investment enterprise (whether wholly foreign-owned or a joint venture) is registered as a domestic legal entity. As a result, under the principle of national treatment, such an enterprise has the same rights as a domestically owned enterprise or physical person of BiH citizenship, including rights of and ownership of property in BiH.

198. Most land in urban areas is the property of the state. However, legal or physical persons may obtain rights of use for such land. For land on which buildings have been constructed, the owner of the building has rights to the land for as long as the building exists. Therefore, the transfer of the rights of use of the land may only be effected by a transfer of the ownership of the building. State-owned enterprises have the right of disposal of state-owned land allotted for their use. As such, this right of disposal corresponds to ownership rights since state-owned enterprises have the right to transfer rights of use to private legal persons. In the case of vacant urban land, only the municipalities (not the holder of the right of use) have the authority to transfer rights of use.

2. Ownership Rights and Documentation

199. In each Entity of BiH, there are two registration books documenting real estate ownership and rights to use. Firstly, the land registry documents ownership of land. This register fell into disuse under socialism as the State assumed ownership of all land. Secondly, there is the "Cadastre" which contains topographic data and information on interests or rights in real estate. The cadastre generally documents the rights to use land and buildings rather than ownership.

200. Under the existing system, the fundamental issue with regard to land ownership and the official registration of ownership rights or interest relates to the following:

- The recording system has been truncated and some of the original land ownership and rights to use records were destroyed during World War II.
- During the Socialist era the land was appropriated by the state and rights of use were granted to various public entities.
- In the post-socialist era, transfers in ownership have occurred through formal, officially sanctioned transfers (e.g., privatization and sales to citizens) or informally through the establishment of de facto ownership and rights through use or possession.

201. Under the current regime, the legal obligation to register property transfers has largely been ignored and is rarely enforced. Many owners have neglected to register their purchases of real estate because of the relatively high taxes (as much as 15%) or to

[186] The only exception pertains to entities with diplomatic status in BiH. These entities may acquire property for their activities, including residences for staff.

register construction and improvements of property because statutory conditions have not been fulfilled. As a result, there is no indisputable record of the current land ownership and land rights in BIH.

202. A further complication exists because there are discrepancies between the two registers, as a result of reporting inaccuracies and omissions in both the land register and the Cadastre. These inconsistencies remain despite sporadic updates that were largely compromised due to the lack of trained personnel as well as political and social indifference. As a result, it is difficult to establish clear title to land and this presents considerable risk and uncertainty for investors seeking to acquire ownership of or rights to use land. Also further complications often arise when a purchaser attempts to register the transfer of the property and is required to go through complex, lengthy and costly court procedures to prove ownership.

203. Entity level Laws governing restitution for appropriated property have been drafted. The R.S. Law was enacted in August 2000. These laws are intended to establish the rules and conditions for the restitution of property, to establish an effective mechanism for compensation and to facilitate the sale of disputed property. Also, the OHR has imposed a Law limiting restitution claims for land transferred to private ownership through the privatization of state-owned property.

204. Technical assistance is currently being provided by GTZ to conduct cadastral surveys of land in BiH in order to update and modernize the cadastre.

3. Process for Transferring Ownership

205. Once the ownership of property has been established and the rights of disposal clarified, the process for the transfer of ownership is basically the same for state-owned and privately-held land.

206. According to the 1978 Yugoslav Law on Transfer of the Ownership of Non-movable Property (Articles 29 and 30), the legal person with rights to land zoned for construction is required to offer the land to the municipality (and agricultural land must first be offered to the closest state agricultural company) before transferring these rights to another party. According to the Law, the municipality or the state agricultural company could file a claim to render the sales contract null and void, within 30 days (maximum 1 year) of official notification of the proposed transfer. In practice, this legal requirement is not enforced in the transfer of privately held land in the Federation or the R.S. However, a certificate is still required to certify the waiver of the right of first refusal at the time of registration of the sales contract. In addition to this certificate, proof of identity of the seller is required before proceeding to the next stage in the process.

207. The agreement and specifications for the transfer of property are established in the sales contract. A sales contract must specify the property to be sold and the price. It

must be supported by documents showing: proof of ownership for a seller; certification of the period of ownership for a seller; and, taxation certification confirming payment of all taxes assessed against the property. The agreement must be signed by the seller who is registered as the owner of the land and also by the buyer. The signatures of both parties have to be witnessed in the court in order for the purchase agreement to become legally valid and binding.

208. The sales contract and supporting documentation are then submitted to the Tax Administration in the seat of the property for evaluation. In the R.S., the tax on the sale of real property is 3% of the evaluated price of the property (not on the contractual price). An evaluation fee is paid in the amount of 0.3% of the evaluated price. In the Federation, Cantonal Laws on Tax on Transfer of Property of Real Estate specify that the amount of tax should be determined in proportion with the value of real estate. The regulations of each Canton specify the rate for the Canton. For example, the transfer tax in the Canton of Sarajevo is 8%. The evaluation fee is 0.5% of the evaluated price of the property. According to the law, the seller is liable for the payment of this tax.

209. When this process is completed (taxes and fees paid), the Contract has to be stamped and certified by the Court in the seat of property. In the R.S., Court fees are 108.00 KM for the stamp and 20.00 KM for provision of certificate waiving the rights of the state to purchase the property. The certified and stamped Contract is then submitted to the real estate registry for the title change and registration. In the R.S., a fee of 100.00 KM is charged for this service. The Certificate of ownership is issued to the buyer along with a copy of the land plan for the fee of 24.00 KM.

4. Registration of Mortgages

210. In the Federation, mortgages on real estate can legally exist only when they are registered in the Land register (Law of Ownership Relations Official gazette FBIH No. 6 of March 9, 1998). The mortgage can be registered on the basis of an agreement or on the basis of a court decision.

211. Registration of the mortgages on the basis of an agreement is almost the same as registration of transfer of title. A request and the written agreement with the witnessed signatures have to be filed at the land register. The costs and time needed for registration are almost the same as for registration of title transfer.

212. It is important to mention that the creditor cannot become the proprietor of the mortgaged real estate. If a court decision requires the debtor to repay the amount secured by the mortgage to the creditor, the creditor’s remedy is limited to the proceeds of the sale of the mortgaged real estate. Therefore, the property must be sold in a public auction organized by the court.

5. Land Use Planning

213. The issue of urban planning is important in the context of the administrative procedures for real estate processing and development, since sound urban planning/real estate planning should be linked into the land registration and mapping systems as well as the real estate development process. To the extent that an effective system of urban planning is not in place, then some of the fundamental rules necessary to guide the decisions and policies regarding industrial real estate development are absent. Often this leads to subjective and ad hoc decisions on land use.

214. The real estate planning systems in the Federation and Republika Srpska differ only slightly, with minimal organizational differences reflecting the additional level of Cantons in the Federation. The agency responsible for urban planning in the Federation is the Institute of Urban Planning. In the case of the R.S., the comparable authority is the Institute of Urbanism. These institutes are responsible for developing and maintaining the primary land use plans and for regulating and approving compliance with theses plans through the permit approval process at the Entity level. At the Cantonal level (in the Federation) and the municipal level (in the R.S.), urban plans are also developed and implemented. However, since these plans are not necessarily in conformity with the Entity-level plans, there are instances of conflicting regulations and requirements within each Entity.

a. Agricultural Land

215. The use of agricultural land is governed by the Law on Agricultural Land which limits the use of agricultural land for industrial purposes and establishes the zoning process as a mechanism for controlling the use of agricultural land. According to the Law on Agriculture Land, there are 8 categories of agricultural land and each unit of land in the cadastre must be categorized accordingly. The land in the first 4 categories is designated solely for agricultural use. The land in categories 5 and 6 is designated mainly for agricultural use, but may be re-zoned. Only agricultural land in categories 7 and 8 may be used for other purposes without special consideration.

216. For land in categories 5 thru 8, permits to change the use of arable land may be requested from the Municipal Secretariat for Urbanism and Civil Construction. Approval may be granted upon the recommendation of the Agriculture Inspectorate. The approval process typically takes two weeks. The applicable fee for this is based on the quality of land as follows: 1st class land 6.6KM/sqm, 2nd class land 4.4KM/sqm, 3rd class land 2.7KM/sqm, 4th class land 0.7KM/sqm and 5th class land 0.5KM/sqm.

b. Urban Land

217. The Entity-level urban land use plans allocate general areas for public spaces as well as industrial, residential and other uses. However, in the absence of detailed real estate surveys, these plans are not comprehensive and do not include the level of detail required for effective management of the use of urban land.

218. The use of non-agricultural land may be changed only after revisions are made to the urban development plans by the Cantonal assemblies (in the Federation) and the municipalities (in the R.S.).

6. Availability of Land for Investment Sites

219. Ownership of and the rights to use land for private business activity may be obtained through:

- The privatization process and the purchase of property from state-owned enterprises;
- The acquisition of buildings owned by private legal persons;
- The allocation of rights of use by the municipalities for vacant land; and
- Leases granting the right to use land for defined periods of time.

220. Rights to industrial land may be acquired with the purchase of the plant and buildings of privatized companies. Currently, blocks of industrial land controlled by companies awaiting privatization are not being utilized for productive activities. Consideration should be given to clearing this land for use by greenfield investors or converting the existing, unused plants into factory shells. However, it should be noted that some of the existing SOE sites are not necessarily suitable for new investment projects, either due to location or the high cost of clearing and cleaning those sites.

221. Access to land may also be acquired through leasing contracts. These contracts are designed and fall under the domain of the Law on Contracts. In the R.S., only the long term leases (5 years or more) are registered in the cadastre. The process for leasing land is similar to that required for the transfer of ownership rights.

222. In the Federation, there is no distinction between long term and short term leases. Building leases are covered by the Law on Leases of Business Buildings and Spaces. Leases on all other property are covered by the Law on Obligation Relations. The registration of lease contracts in the Courts is not required by law. However, as with any other contract, the terms of lease contracts may be enforced by the Courts.

223. In both Entities, the absence of a consistent regime for leases and requirements for the registration of lease agreements presents a problem. Since all leasehold claims on property are not part of the official record, this information is not available to a potential buyer unless it is disclosed by the landowner or the lessee asserts his rights to the land.

This adds an element of risk for the short term lessee who does not enjoy the same level of protection as a long-term leaseholder in the event of a change in the ownership of the property. The purchaser of property on which there are existing but unrecorded leasehold claims is also exposed the risk of contested rights to the property.

7. Analysis

224. A necessary prerequisite for the transfer of ownership of property is a secure title on the part of the seller. In the case of BiH, the lack of accurate and current records in the cadastre and registry of rights to property makes it difficult to establish clear title to property where there is doubt. Further, there is no definitive policy on restitution and compensation for outstanding claims on appropriated property (except in the case of privatization). The problems resulting from the lack of an efficient and effective system for recording ownership and rights to land are compounded by political issues affecting ownership and restitution for disputed claims on land. Taken together, these factors increase the level of risk associated with the acquisition of rights to property in BiH.

225. Misplaced records, errors and omissions in the cadastre and the land register have compromised the official records. Further, inconsistencies between the information in the two registers make it even more difficult to verify ownership rights. In part, omissions in the public record result from the fact that many transfers of land are not registered and legally validated by the parties involved. In some cases, land transactions are not officially registered because the parties to the transaction are not aware of the legal requirements, but more often the legal requirements are ignored in order to avoid taxation. As a result, in cases where the ownership or rights to land is disputed, the only recourse is the Courts and a lengthy, costly legal process. The capacity of the authorities to enforce the legal requirements for recording the transfer of rights to land is clearly inadequate. This is a very serious problem since it is effectively undermining the land administration system and impeding the development of a robust land market.

226. The apparent inconsistency of the Courts in upholding and enforcing sales and leasing is also a matter of concern. Several interviewees cited examples of land transactions where landlords or landowners have broken contracts or ignored contracts to lease or sell land. In one specific case involving a foreign investor, the contract for the lease on land was broken by the landlord who secured a more profitable offer after the lessee had occupied the property. Discussions with the private sector indicate that the existing legal framework for the transfer of property is too complex and non-transparent, and more importantly, the laws are not being upheld consistently. As a result, as discussed in Chapter II, there is little faith in the court system and there is little trust among business counterparts on the issue of honoring contractual obligations. This is a fundamental issue that affects businesses and increases risk since contracts are important instruments for business negotiations and the impact on foreign investment is evident.

227. The legal provisions that give the Entity governments the right of first refusal on all sales of property also undermine the operation of an open market for property. Under

the existing regulations, the state effectively exercises a veto on sales of real estate. The rationale for this stipulation, according to some officials, is to protect the interests of publicly-owned enterprises. With the shift to a market-oriented economy and the privatization of SOEs clearly this rationale no longer applies. Possible explanations include the regulation of the ownership of property among ethnic groups and efforts to deter under-pricing and the avoidance of transfer taxes. Since there are no obvious rules for determining the basis for the decision whether or not to exercise the right of first refusal, clearly this injects a high degree of subjectivity and non-transparency into the process of identifying and acquiring land. More importantly, this legal provision not only presents opportunities for corruption and political manipulation, it also increases the cost and risk associated with land acquisition.

228. The process of transferring real estate is generally slow and time consuming. In addition to the fact that many of the required official documents are out of date or missing, the lack of adequately trained staff, modern systems and facilities in the offices responsible for the administration and processing of registration and transfers results in a system that is slow, distinctly non-service oriented, and, according to some people interviewed by FIAS, corrupt. Also, since there are no penalties for delays in the process, there is little incentive to improve performance. As a result, the process which should take approximately 15 to 20 working days often takes 1 to 3 months and even longer in some cases.

229. On the basis of discussions with the Urban Institutes responsible for developing the general master plan for land use, there appears to be a good understanding of the need for strong and clear land use allocation. However, from an implementation and regulation perspective (for example on the requirements for permits) the administrative process exhibits serious problems. The problems generally stem from:

- Poor ownership documentation and enforcement of reporting regulations. This is generally related to the lack of trained and adequately resourced staff.
- Lack of transparency and consistency in the administrative processes. This provides opportunities for corruption.
- Relatively high taxation rates on land transactions. The cumulative cost of the administrative procedures result in widespread non-compliance to avoid payment of taxes and fees.

230. The lack of an integrated approach to land use planning across Entities, Municipalities and Cantons results in inconsistencies in implementation. It is evident that general urban land use planning is being carried out at the Entity level. However at both the Municipal and Canton levels, the implementation of the plans is often compromised by local deviations and different approaches to implementation on the ground and the lack of qualified and experienced planners to process land use applications.

231. The absence of a comprehensive, consolidated planning system across the Entities, Cantons and Municipalities is further compounded by the fact that much of the real estate in BiH has not been surveyed adequately. As a result of the lack of current

cadastral surveys, the existing urban plans lack sufficient detail to support effective urban planning and there is no clear mechanism for linking the information from the surveys to other relevant information such as environmental factors.

232. From discussions with representatives of the public and private sector, one of the major problems with the land use plans, besides their accuracy, is enforcement of the plans at Municipality and Canton levels. This lack of enforcement can be attributed to a number of reasons, including the lack of effective compliance enforcement and corruption. Throughout BiH, one can observe buildings that are clearly being constructed without permits. This is generally part of an effort to avoid the payment of land use taxes. In this regard, the reasonableness of the relatively high land use taxes merits review.

233. The issue of adequate staffing and compensation was highlighted during discussions with members of the private sector. In the opinion of one of the interviewees, staff of the urban planning agencies need to be motivated and remunerated appropriately in order to improve service delivery while minimizing corruption. With reasonable levels of compensation, effective performance evaluation mechanisms, and a shift to a service-oriented work ethic, significant improvements can be made in the delivery of services by the land use planning agencies.

8. Recommendations

234. A robust and efficient land registration system is essential for the economic development of BiH. It will provide the necessary foundation for an active land market and productive land use by securing rights tenure to land and supporting the development of a mortgage market.

235. As a starting point, the legal framework for property ownership and the transfer of rights to land needs to be reviewed and strengthened. As part of this process, tough political decisions need to be taken on the issue of restitution for land appropriations and a mechanism for resolving outstanding claims needs to be established. A number of countries (e.g., Czech Republic, Germany, Hungary, and Poland) in the region have successfully addressed these issues and BiH can benefit from the experience of these countries in developing and committing to an approach for dealing with this issue.

236. As noted earlier in this Chapter, technical assistance is being provided by GTZ for the preparation of a new Land Law in each Entity and in conducting cadastral surveys. However, these efforts represent just two of the essential building blocks for the development of a modern and effective land management and ownership registration system in BiH. Further work needs to be done to strengthen the law on contracts and the Law on Landlord and Tenant Relations. Also, the capacity of the appropriate authorities for enforcing the legal requirements needs to be strengthened.

237. As a next step, it will be necessary to clean up the land registers and to integrate the ownership and rights information with the cadastre. This is a complex process that will require clear legal guidelines and resources to research and resolve title issues. It is clearly an area where BiH would benefit from the assistance of the international community, drawing on the experiences of other countries. Computerization can help to facilitate integration of the ownership registers with the cadastre. It can provide for more efficient processing of records and providing the public with access to the property records. Access to the information in the registers would facilitate the research of potential buyers on the physical characteristics and rights to available land (including mortgages) even before establishing contact with the seller, thereby reducing the risk and cost of land transactions for the buyer.

238. The Entity governments' right of first refusal on all sales of property should be removed. This right under the existing laws serves to undermine the operation of an open market for property.

239. With conflicting regulations and inconsistent implementation of land use regulations at the Entity, municipal and cantonal levels, there is a need to strengthen the land use planning system. It is necessary to establish clear and consistent regulations at the Entity, municipal and cantonal levels. Transparent and consistently enforced regulations would help to minimize the opportunities for corruption and non-compliance to avoid taxation. Specific steps to be taken include:

- Preparation of accurate and detailed real estate surveys to support the land registration system and thereby create a better basis for urban planning.
- Strengthen the urban planning system, including its organization at the Entity, Municipal and Cantonal levels.
- Give the urban planning agencies the authority and resources to enforce the urban plan.

240. The planning process needs to be streamlined and duplicative procedures need to be eliminated. Improving the quality and availability of basic information on land and building sites would facilitate the streamlining of the regulatory requirements and the rationalization of the associated administrative procedures. This in turn would reduce costs for the administrative authorities and for the public.

241. It is clear that an essential first step for remedying the problems of compliance is the empowerment of the authorities charged with developing plans to ensure compliance. These authorities must be given the necessary legal authority to carry out the enforcement process. In addition to legal empowerment, these agencies will require resources in terms of staff, training and development, and equipment to facilitate the work and to increase efficiency and effectiveness.

242. The implementation of an efficient system based on a transparent, well-documented system of rules and procedures for carrying out the work of land use supervision, regulation and enforcement will contribute to the development of a

responsive and effective land use planning system and minimize opportunities for corruption.

243. The downstream effects of the streamlining and strengthening of the urban planning system will have implications for the judiciary and the legal system. Laws must be revised and rewritten, as necessary. Further, the judiciary must uphold the law, permitting the honoring of real estate contracts and the enforcement of the urban land use plans. This implies that the severely stretched judiciary will also require training in property law and resources to effectively carry out its role in this area.

244. Boxes 1 and 2 provide examples from Germany and Ireland on spatial planning. Box 1 summarizes the underlying principles and features of the land planning systems in Germany. Box 2 provides a summary of the spatial planning process in Ireland, a country that has, in the last few decades, made a successful transition from a primarily agricultural economy to one that is now industrial, while implementing good land and environmental preservation policies

Box 1

Land Use Planning System in Germany

In Germany, the State Government enacts laws setting the framework for land and urban development, but land use planning is delegated to the regional and municipality authorities. The regional authority prepares a spatial plan (Flaechennutzungsplan) which determines the general use of land (e.g., forests, agricultural land, lakes and rivers, roads, public buildings, residential areas, etc.) Based on the regional plan, the municipality develops a more detailed zoning plan which further specifies the use of land (e.g., areas for pure residential purpose, areas that are residential with small shops, the number of apartments and stories of houses, etc) Municipalities must seek participation from the general public in preparing urban land use plans, and present those plans, once adopted, to higher administrative authorities. The formal procedure to adopt these plans is written in the laws. An investor cannot initiate or modify construction without first complying with these plans.

Neighboring municipalities are obliged to agree on the use of borderline land. In case no agreement can be reached, it is the regional authority which makes decisions. Municipalities can go to court if they do not agree with the decision of the regional authority.

Box 2

Ireland's Experience with Spatial Planning

In Ireland, the zoning process involves a general hierarchy of development plans at the national, regional, and town levels. The national plan sets the overall agenda. It assigns general designations of land to each region, a range of land use purposes, such as agricultural, residential, commercial, and industrial.

A county plan aims to assign what kind of development may occur on any particular plot of land within the county, in accordance with the large zoning requirements set out in the national and regional development plan. County plans are prepared by teams of professionals who consult with the public through processes such as displays and oral hearings. County plans are approved by local councils whose members are elected by residents. Once a plan has been adopted it remains relatively stable for a period of time, usually about five years.

County plans often incorporate the concept of "white lands," which are designated for agricultural purposes, but can accommodate residential or light industrial development. To convert white land from agricultural use to accommodate a residential or light industrial development does not require a formal amendment to the existing zoning plan. This facilitates speedy and appropriate development.

County plans contain specific guidelines for subsequent investment projects, and if a project falls outside the guidelines, there is usually a mechanism in the rezoning process through which a project can be authorized by the same local council that originally approved the zoning plan.

245. A land commission should be established to provide leadership and effect change in the land planning and management system in BiH. This commission should include representation from the state and entity governments. It should have the mandate and the authority to address the fundamental policy issues affecting land and effect change.

246. The Land Commission will have to work closely with stakeholders in the public and private sector. Its work should also impact the judiciary and the judiciary systems responsible for land.

247. The Land Commission will be expected to take responsibility for the development of:

- An effective mechanism for addressing land ownership and rights to use issues, supported by a comprehensive legal and regulatory framework for land ownership and development. The objective should be to establish a consistent, integrated approach to land management throughout BiH, across the various levels of administration.
- An efficient land market and the requisite mechanisms for financing transactions.
- Capacity building initiatives to provide training for technical and service professionals in the public and private sector, including real estate lawyers, contractors, architects, engineers and surveyors.

248. The land commission model has been successfully applied in a number of countries (e.g., the United Kingdom and Ireland) in dealing with complex and difficult land ownership issues. In addition, BiH may benefit by drawing on the experiences of other countries in the region in addressing the problem of restitutions for expropriated land.

C. Site Development

249. At present, the real estate planning and land management systems in the Federation and R.S. differ only slightly. The basic difference relates to the additional administrative level of the Cantons in the Federation. The agencies responsible for urban planning in the Federation is the Institute of Urban Planning and the R.S. Institute of Urbanism.

250. Urban development and construction permits are required before construction can begin on any site in order to ensure conformity to urban and environmental plans and building codes. In addition, at various points in the construction process, a range of permits and approvals are required. The enforcement of the legal requirements for permits and approvals are generally the responsibility of the specific municipality and/or canton for a particular location.

1. Site Selection, Urban Development, and Construction Permit Process

251. The site selection and urban development permit process for industrial construction consists of the following steps:

- Determine the allocation of land outlined in the urban plan. As a first step, it is necessary to contact the Municipality (in the R.S.) or the Institute of Canton Development Planning (in the Federation) to obtain the list of locations designated for construction according to the urban plan.

- Identify and select the site.

- Submit application for urban development permit. In the R.S., the application must be submitted to the municipality. In the Federation, the application must be submitted to the Cantons (for land 5000 sq. meters or more) and the municipality (for land less than 5000 sq. meters). This application must be accompanied by a general project description outlining the purpose of construction, size, type of business activity, and production process if applicable. The urban development permit confirms that the proposed development for a particular lot of land conforms to the requirements of the urban plan. This permit does not authorize construction.

- Review of the application and urban development permit decision. If it is decided that the proposed project conforms to the requirements of the urban plan, the permit is issued with details of the conditions for the use of the land.

a. Urban Development Permit

252. The urban development permit for construction on a particular location is issued when it has been established that the proposal for development complies with the physical plan for the site (zoning regulations, environmental protection, community preservation standards, and access to utilities) and approves the detailed construction or renovation plans. This permit does not authorize construction and, in fact, urban planning permits may be granted for different projects on the same site.

253. Figure 1 provides an outline of the urban development permit process. In the R.S., the application for this permit must be submitted to the Municipal Secretariat for Urbanism and Civil Construction. In the Federation, the application must be submitted to the Canton Ministry of Physical Planning and Environment Protection (for land 5000 sq. meters or more) and the municipality (for land less than 5000 sq. meters). In either Entity, if the proposed construction/renovation site is on the territory of two or more municipalities within a city, then the application must be submitted to the office of the Mayor.

254. The application for urban development consent must contain the following:

- Detailed description of the proposed construction/renovation project, outlining proposed use of the building and the size of the project.
- Design details, preliminary drawing, and all information necessary to facilitate the assessment for compliance with the urban plan.
- A cadastre drawing and geodesic survey drawing for the site.
- Certificate from the Land registry of the Municipal Court, identifying the owner and providing proof of ownership.

255. Based upon the expert opinion from the Institute of Canton Development Planning in the Federation or the Institute of Planning in the R.S., the application for the urban development permit a decision is rendered on the application submitted. If the application is approved a permit is issues certifying compliance with the urban plan. The permit is granted and accompanied by the urban planning and technical conditions for construction and the location documentation. In the case of major projects, the attachments to the permit also contain terms and conditions for the implementation of the detailed design. In principle, there is a statutory requirement to issue the permit decision within 30 – 60 days of the application submission date. However, in practice this takes as much as 3 months and even longer in some cases.

256. The approval order on the urban development permit contains the following:

- Details of intended use, position, function and shape of the building.
- Cadastre drawing showing the borders of the properties adjoining the building lot.
- Obligations and rights (e.g., easements, rights of way) assigned to neighbors and other legal persons.
- Permits (terms and conditions) for construction granted by other authorities and legal persons (public utility companies for electric power, water supply, sewerage, gas, PTT services).
- Urban planning and technical conditions for the site.
- Environmental conditions.
- Estimate of the cost of improvements for the site.

257. It should be noted that as part of this process, the authority with which the urban permit application is filed is obligated, ex officio, to provide all permits required by other authorities.

258. The urban development permit is valid for one year from the approval date. Extensions may be granted on an exception basis. The application for the building permit must be submitted within one year of the urban permit approval.

b. Site Preparation and the Settlement of Property Rights

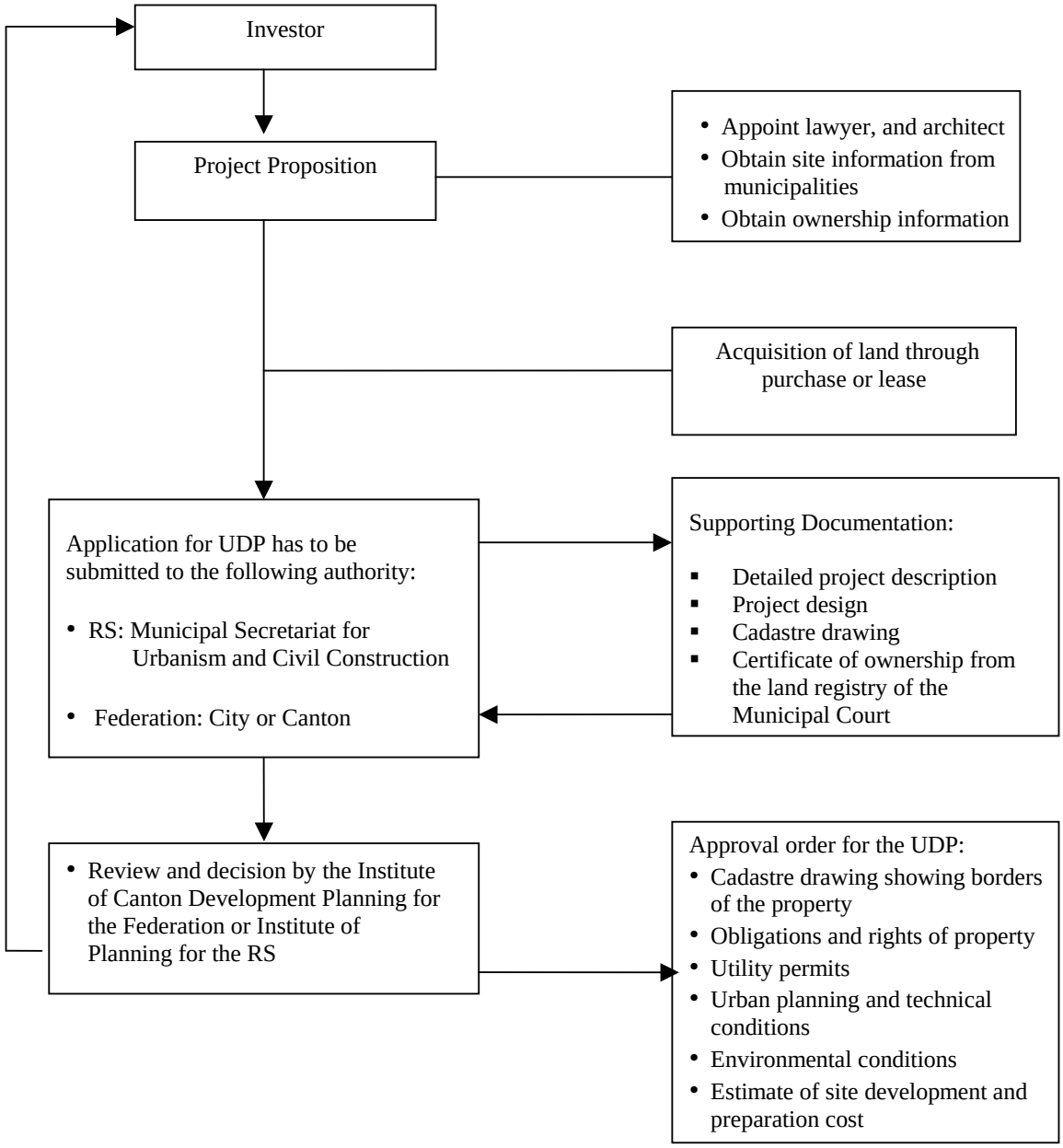
259. The settlement of all property rights on a given site is required before a building permit can be issued. In the Federation, the Cantonal Institute for Construction is responsible for the site preparation and settlement of property rights process. The Municipal Institute for Construction has a similar responsibility in the R.S.

260. According to Cantonal Laws on Physical Planning, site development encompasses preparation and improvements (including utilities) of land approved for construction. For example, according to the Law of Sarajevo Canton, site preparation includes:

- Settlement of property rights relations.
- Allotment of land.
- Demolition of existing buildings, removal of ground and underground installations in conformity with physical planning plan.
- Rehabilitation of land (landslide, drainage, waters regulations, and other).

261. Execution of documents and works on protection of building and natural heritage that might be endangered by the works on land development works.

Figure 1: Urban Development Permit (UDP) Procedure



262. Site improvements include:

- Construction of communication lines.
- Construction of facilities and installations for power energy supply.
- Construction of facilities and installations for water supply and waste waters discharge, purification, etc.
- Arrangement of public green areas, recreational venues, etc.
- Construction of telecommunication facilities and installations.
- Regulation of the waterways and banks.

263. All costs related to land preparation and site development are borne by the purchaser.

264. For municipal land, all site development work is performed by the Municipal/Cantonal Institute for Construction. These Institutes for Construction are service providers with a monopoly on the land preparation and site development work in each canton or municipality. Since all site development and land preparation costs are borne by the purchaser, the Institute prepares an estimate of the cost of preparations and improvements as part of the total price of acquiring the right to build on a given municipal site. The price also includes municipal rents (i.e., any costs and compensation for the advantages the land provides to the user) and the value of the land. In the Federation, the cantonal assemblies determine the price of land on an annual basis. So the price of land is established by law and does not reflect the market value of land.

265. In order to obtain an estimate of the land preparation and development costs and the municipal rent, it is necessary to file a request with the Institute for Construction of the canton or municipality. The following must be attached to the request:

- Protocol for the regulation and leveling of the site.
- Cadastre drawing.
- Land registry certificates.
- Architectural design drawing.

266. Usually the permits of public utility companies (detailing the terms and conditions of providing services) are also submitted with the request. On the basis of the request, the Institute for Construction reviews the submission and supporting documentation and prepares estimates of the land development costs and the municipal rents.

267. The land development cost and municipal rents include the following factors:

- Compensation for expropriated building land. As stated above, vacant municipal land is public property, with temporary rights of use assigned to both legal and physical persons. In a special procedure, during the preparation for construction, the land will be expropriated from the temporary users and compensation is paid.

- Compensation for expropriated facilities, fruit trees and other crops. If there are any buildings, fruit trees or other crops on the land, then the expropriation of these assets is conducted as a separate procedure with appropriate compensation to the owner. The compensation is determined on the basis of the real value of the expropriated property.
- Compensation for dislocation of communal infrastructure, as applicable.
- Compensation for the construction of infrastructure facilities up to the point of connection. This point is determined in accordance with terms and conditions defined by utility companies and contained in the urban planning permit.
- Compensation for the construction of access roads needed for use of the building under construction.
- Compensation for meeting any other conditions that may be stated in the urban planning permit.

268. Compensation for the last four items above is determined on the basis of the real costs of the services rendered by the Institute of Construction. If the estimated cost of land development and municipal rents is accepted by the purchaser, then a contract is drawn up between the Institute and the purchaser for the services of the Institute in preparing and improving the site.

269. In some cases, sites are already in the possession of the Institute. Therefore, once a purchase decision is made, the following contracts may be entered into immediately: the contract on the right of use transfer, the contract on building land development and the contract on municipal rent. If, on the other hand, the land is in the possession of other users, thereby requiring procedures to expropriate land and facilities, then the contract for site development and the contract on the right of use transfer may not be concluded until the expropriation process is completed. Under these circumstances, preliminary contracts may be drawn up providing a basis for the Institute to initiate some of the relevant procedures, pending the resolution of existing rights, expropriation and compensation.

270. Upon the fulfillment of the prerequisites of the contract, the contract may be signed, compensation payments are made and the right of use is transferred for the purpose approved. The purchasers rights are then registered in the land books with the Land Registry of the Municipal Court. The entry is made on behalf of the purchaser by the Institute, subsequent to the allotment of the land and creation of the plot allotted.

c. Construction Permit

271. When property rights have been settled, it is necessary to obtain the construction permit from the Municipal Administration for Urbanism and Civil Construction. The construction permit is an administrative document issued in the form of a decision stating that the proposed construction project complies with the urban plan and related conditions of the law and implementing regulations.

272. As part of the application for a construction permit, it is necessary to submit:

- The urban development permit.
- Evidence on the right of use on the land (copies of the contracts concluded with the Institute for construction).
- The actual full design plans (2 copies).
- Utility approvals for electricity, water, telecommunications, fire protection, sanitary and road (if the construction is near a main road approval for connecting the road from Roads Directorate).
- Stamp charge of 50 KM.

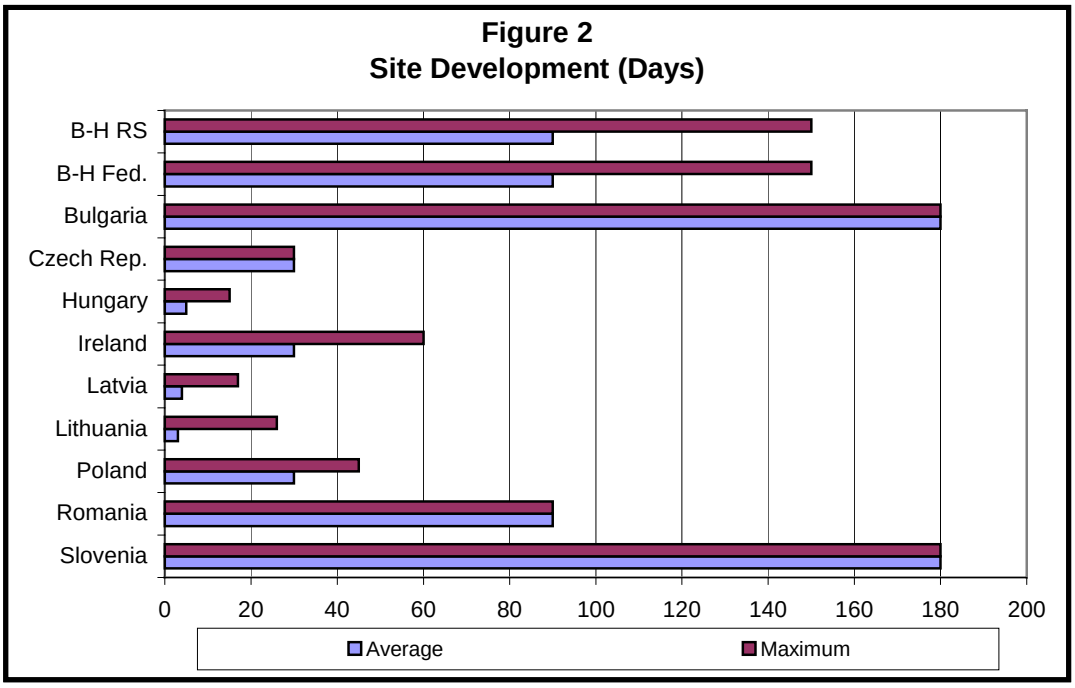
273. An authorized committee then performs an audit of the design. There is no standard fee for the audit. Rather, the cost is dependent on various criteria including the purpose and size of the proposed construction project, and the consumption of utilities. A bill based on the relevant criteria is prepared with a detailed description of each criteria applied.

274. At the completion of the audit, a decision is rendered and the construction permit is issued as applicable. Provided all the necessary conditions have been met, the municipality is required to render a decision within 30 days (maximum 60 days). On average the procedure takes approximately 45 days. The permit is limited to one year, with the possibility of a one-year extension. Construction must be initiated within one year of the permit issuance date and completed within 24 months (this is variable depending on the type of construction).

2. Analysis

a. Procedures

275. The process of acquiring land and obtaining site development approvals are among the significant obstacles that investors experience in BiH. The bottlenecks typically occur in the process of finding available sites, registering titles, obtaining rezoning approvals, and acquiring the necessary permits. The process is long and risky and some procedures lack transparency. Taken together, these factors make it difficult for investors to reliably estimate the duration and cost of land development and construction projects in BiH.



276. Figure 2 presents an estimation of the average and maximum time required for site development, including the permit process. Estimates for BiH, based on the time required for project review and the processing of the urban development and construction permits, indicate that the process in BiH is much longer than in other countries in the region. In the case of the urban development permit, despite a statutory requirement to issue a permit decision within 30 – 60 days, in practice the process can take 3 months and even longer in some cases.

277. The urban development and construction permit requirements and processes are largely duplicative. The urban development permit authorizes the development of plans for a certain site (permits may be granted for different projects on the same site) while the construction permit authorizes actual construction for the development of a plan authorized by the urban development permit. There is no need for two separate permits and basically the same documentation. Consideration should be given to rationalizing the two permits and improving the availability of site information to eliminate the need for the urban development or location permit.

b. Role of the Institutes for Construction

278. The Institutes for Construction in both Entities enjoy a monopoly position on land preparation and site development work. Their role is mandated by cantonal and municipal regulations and in the existing system their function is apparently the same as that of the state construction companies under socialism. There is no reasonable explanation for the monopoly position of these Institutes apart from the protection of jobs and a holdover from the old system.

279. Since these companies enjoy a monopoly, there is little room for negotiation on the cost of their services, which are evidently overpriced. As stated by one lawyer, "there is no way to influence the cost of their services in a natural way". Many interviewees indicated that corruption is an insidious factor in the process for securing the urban development permit.

c. Costs

280. On the basis of information provided by the various cantonal and municipal authorities and service providers (e.g. lawyers), the cost of building and urban development permits in BIH appears to be prohibitive when compared to other Western European countries such as the United Kingdom. In BIH, there are two or even three levels of permits in addition to inspection fees and the cost can exceed 300DM per sq. meter (approximately £100 per sq. meter) for permits required prior to construction. In contrast, the cost of permits for a 5000 m^2 industrial unit in the U.K. is roughly £2 or £3 per sq meter. Evidently, the basis for assessing these permit fees should be reviewed in order to ensure that they are not excessive.

281. Table 1 provides a comparison of fees for BIH and the UK for industrial building costs per square meter.

Table 1: Development Fees: Permits and Related Expenses*

Cost Factors (average)	United Kingdom	BiH
Cost of permits (per sq. meter)	8.5 DM per sq meter (approximately)	300-400 DM per sq meter Before construction starts, without utilities.
Design fees	4.5 DM per sq meter	7-10 DM per sq meter
Property transfer tax (% of capital)	4% maximum	8% (Sarajevo)

* Based on 5000 m^2 industrial building for permits (i.e. urban development and building permits).

282. The site development services provided by the Institutes of Construction should include utility permits as well as access to utility services. However, the experience of some investors has shown that the access to utilities is often inadequate. It is not uncommon to find that the utility connections do not fully service the needs of the construction site. For example, the electricity connection may be installed outside of the boundaries of the property even though the full connection to the property was paid for. The owner of the property is then required to incur the additional cost of actually bringing the service on to the property. This represents an additional cost to the potential investor for a service that was inadequately provided by the Institute for Construction.

283. This problem may be attributable to a combination of factors, including the inadequacy of the site inspection procedures and enforcement of the inspector's decisions. Further, since the Institutes of Construction and the Inspection authorities are part of the same municipal and cantonal administrations, it is possible that the standards for inspections are waived or overridden at the expense of the investor.

3. Recommendations

284. Access to land is an essential requirement for investment in certain sectors. In the current global economy, with heightened competition and rapid changes in technology and products, the speed with which an investment project can be developed is a significant factor in investment location decisions. In most European countries, investors expect to find readily available, serviced industrial sites. At a minimum, it is expected that suitably serviced sites can be quickly identified, acquired, and developed.

285. The urban development permit and construction permits should be rationalized and consolidated into a single approval. The preparation of land use plans that are comprehensive, accurate and sufficiently detailed, would allow a potential buyer of land to assess the information on a particular parcel of land (following regulatory requirements and zoning specifications in relation to the needs of the purchaser) to determine whether or not the parcel is suitable, with inputs from a certified , independent consultant. This would eliminate the need for the urban development permit. Then only the building permit would be required. In cases where for example, an investor wishes to construct premises outside of an area designated for industrial land use, then this request could be evaluated by the appropriate authority (and a change of use approved or not) as part of the construction permit process. In order for the proposed approach to work, the regulations, decision criteria and procedures must be clearly established, documented in the relevant legal/regulatory documents and publicized.

286. The maximum length of permit processing periods should be specified in the laws and enforced. Under the existing regime, although the regulations stipulate maximum review periods (e.g., the urban development permit) the approval process can actually take significantly longer. Delays can significantly increase project costs and can negatively impact project financing. Mechanisms for fast-tracking construction permits (e.g., partial construction building permits) should be introduced. This would permit work to proceed in phases instead of delaying the progress of a project pending the clearance of the entire project.

287. The role of the Institutes of Construction in site preparation and development should be eliminated. This activity should be opened up to the private sector role, since there is no obvious reason (e.g., safeguarding public interests) for restricting these activities to the public sector. In fact, the Institutes' monopoly position on the provision of these services results in higher costs and unsatisfactory services for site preparation and development.

288. Reasonable and realistic fees should be established for permits and related services. Fees should be established on a transparent and consistent basis. Reasonable rates would help to minimize the pervasive evasion of the urban planning regulations and approvals, thereby increasing the overall revenues generated for these procedures.

289. Boxes 3 and 4 provide examples from the Germany, Ireland and the United Kingdom on site development approval procedures. Box 3 provides a detailed outline of the process for securing planning and construction permits in the U.K. Box 4 illustrates the system of building permit approvals in Germany and Ireland. The systems of approval in most other European countries are similar.

Box 3

British Land Planning System

The British land planning system falls under the Town & Country Planning Acts of the United Kingdom Despite local variations, the system is uniform across the U.K. Every 15 years the primary local administrative authority prepares a Structure Plan. This is a land use plan covering the authority's administrative boundaries. It is prepared in cooperation with the corresponding agency in the adjacent area. The Plan provides a detailed plan of land use and is based on an extremely detailed land survey mapping system.

The Structure Plan is developed through a process of consultation with leading Government bodies and major land owners. The document is then submitted for public review. The additions/amendments or objections are then considered by the local administrative body and either included or excluded. There is also a procedure for the right of appeal to State Government should any significant objections be raised.

Once this Structure Plan has been approved, then requests for use of the land or for building permits are made to the local planning authority under a planning application permit. The application can either be a detailed application (with detailed drawings) or a simple application (e.g., requesting permission to change the use of the land from industrial to housing or simply to obtain a general allocation for the site of the building on a piece of land) prior to submission of a detailed building design. Once the applications are submitted to the local planning authority, the authority then has a defined period of time (8 weeks, with the possibility of an extension) to determine whether or not the application will be granted. If the decision is not rendered within that time, then the requestor can assume that the request is denied and may then appeal to State Government. The State Government will then appoint a Planning Inspector to make a ruling. For a simple planning consent (e.g., an Outline Planning Consent), the consent is valid for 5 years. A Detailed Planning Consent is valid for 3 years and may be made effective through the initiation of even a minor part of the project.

Whilst the developer is submitting his planning application in detail to the local planning authority a copy of his plans are also sent to the Building Regulations Department to check that the proposed building is compliant with current building regulations and law. Amendments to the conditions of the permit are made at this stage, if appropriate.

Two separate fees are due at this point - one for planning permission and another for building regulation permission.

Once building regulation and planning permission have been granted the development can progress to site and whilst on site the Planning Office and Building Regulation Officer will inspect the works to ensure that they comply with both the Planning Application and Building Regulations Consent.

If the above procedures are not followed and a developer proceeds with a building the local planning authority and the building regulations officer has the ability to stop the development through the courts and this can take a number of forms. He may decide to serve a notice upon the developer requesting either that the Planning Application be submitted or that building regulations complied with in order to regulate the development or they may issue a stop notice on the developer requesting the development to stop. These procedures are enforced through the courts and can carry heavy penalties.

Box 4

Site Development Approval Procedures in Germany and Ireland

In Germany, a location permit is not required. However, if an investor feels uncertain about some construction issues that are critical to his project, he can ask the authority for opinions on such issues before starting the project planning Vorbescheid. This is optional and is up to the investor. The time it takes to receive the opinions from the authority depends on the questions asked. Opinions obtained are not binding to the authority, but the investor usually can rely on them, and they give a high degree of planning certainty.

An investor needs a building permit before starting construction. It takes about 3 months to receive the building permit. The building permit will be issued by the regional building authority with participation of the municipality.

After completion of the construction, a civil servant from the building authority will come to the site to verify that the construction is in compliance with the building permit (Gebrauchsabnahme)."

In Ireland, local authorities such as county councils, county boroughs, and borough corporations are responsible for approving building permits. Local authorities have reserved and executive functions. Reserved functions are performed directly by elected members of a local authority, all other functions are performed by the manager and the manager's executive staff. The manager is bound by the decisions that were made by the elected members, and has the right to attend meetings and take part in discussions, but is not entitled to vote.

Local authorities must grant permission for any projected development that includes building or similar construction work. Permission must be granted or denied within two months after a local authority receives a construction application. Any person may appeal a local authority's decision within a month after the decision has been made. Appeal boards must make their decisions within a four-month period, and their decisions are final.

Environmental impact assessments are required for large or complex developments in accordance with the EU's "schedule of developments." Integrated Pollution Control (IPC) Licenses are required for a project that may have a significant environmental impact. An IPC license application is submitted to the National Environmental Protection Agency, but it is not part of the building permit process. An IPC license is required in order for a plant to begin operation. Obtaining an IPC license generally takes three months but can take up to seven months if there is a third-party appeal.

290. The development of privately operated industrial parks should be encouraged. In many other countries in Europe and around the world, industrial parks provide a partial, short-to-medium-term solution to addressing the issues and uncertainties associated with securing land for investors. Industrial parks have become popular in most other countries because they help achieve several objectives. First, they provide investors with land with proper ownership titles or lease contracts. Second, they enable industrial development within an overall geographic development plan that also considers the need to preserve land, natural and cultural heritages, and protect the environment. Thirdly, industrial estates house concentrated industrial infrastructure, and they provide investors with ready-to-use land. Finally, industrial estates help simplify the bureaucratic procedures for site development approvals faced by investors. In a designated industrial park, a

developer usually receives a blanket permit to construct a standard factory building. Individual investors as tenants are released from the burden of various approvals and can simply move in, get hooked up, and start operation.

291. Industrial parks have made significant contributions to development in many countries in both Europe and around the world. Many countries in transition in the East European region have actively developed industrial parks as a way to address the land and infrastructure constraints in the short to medium run. In the Far East (in Korea, Taiwan, and Singapore), industrial estates or zones helped initiate the orderly growth of manufacturing industries and have prevented the concentration of industrial activities in urban areas. Industrial zones have encouraged industrial clustering in those countries, which has enabled similar industries to be situated near each other and has fostered backward and forward linkages.

292. Developing an industrial zone requires significant investment and expertise. Many transition government lack the resources and skills to develop and operate industrial zones. In some of the cases where governments have undertaken this role, the roles have been poorly managed and maintained, under-priced and subject to corruption. The role of the government should be limited to making land available (e.g., by auction) and expediting utility hook-ups. The operation of the zones should be handled by the private sector, either through ownership or concessions from the government. In the case of BiH, private sector ownership and management in developing industrial zones should be encouraged. This will ease the financial constraints faced by the Entity governments and, most likely will result in higher quality, market-driven configurations and services.

293. In Thailand, for example, the development of industrial estates was initially the exclusive domain of the government but the private sector has been invited to develop its own estates, as long as they comply with public standards for facilities and utilities. The governments of China, Philippines, and Vietnam are actively promoting foreign investment participation through special industrial zones, the result of which is that investors have more choices and better services. Most countries that encourage private sector development of industrial parks and export processing zones have done so on the basis of a framework law that sets out the rights and obligations of developers.

CHAPTER V

EMPLOYMENT

294. This Chapter focuses on the procedures necessary to gain entry into BiH for foreign managers and expatriate labor. It also addresses the legal and administrative requirements for domestic labor.

A. Expatriate Labor

295. The State level Law on Citizenship of BiH and Law on Travel Documents govern the entry and exit of aliens in BiH and the granting of visas and residence permits.

1. Expatriate Labor- Visa Requirements

296. Bosnia-Herzegovina requires entry visas for many different foreign nationals.[187] The authority to issue and process visas resides at the State level. For those nationalities requiring visas, there are four types of visas (business, private visit, tourist, and transit) available through the consular offices at BiH embassies abroad.

297. To obtain a visa, the foreign national must fill out the application, "Request for Issuance of Visa". The form itself is in three languages, Bosnian, English and French. In addition to this form, the applicant must have a valid passport.

298. For a **business visa**, a letter of invitation must be sent by a partner from BiH (a company registered in BiH) in addition to the abovementioned form. The letter must be certified by a Chamber of Commerce in BiH, but it can be sent by fax. The visa is valid for up to 3 months.

299. The application for a **visa for a private visit** to a citizen of BiH must be accompanied by:

- A certified letter of guarantee sent by a BiH citizen.

[187] Exceptions include citizens of the following countries who do not need visas, subject to specific bi-lateral agreements: Malaysia and Croatia based on bilateral agreements; Hungary, Iran, Italy, Macedonia, Romania, Russian Federation, San Marino, Turkey, Tunis and the Vatican based on reciprocity agreements; Austria, Bahrain, Belgium, Brunei, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Japan, Kuwait, Luxembourg, The Netherlands, Norway, Oman, Portugal, Qatar, Spain, Sweden, Switzerland, United Arab Emirates, United Kingdom, USA due to the significant relations with these countries; Former Republic of Yugoslavia in accordance with temporary agreements; China, Egypt, Pakistan, Slovenia, Slovakia and Jordan for holders of diplomatic or foreign service passports

- Bank account statement showing the applicant has sufficient funds to cover minimal costs of his/her visit to BiH, the equivalent of 30USD for each day.

300. For a **tourist visa**, the applicant must provide:

- Photocopy of voucher/receipt from approved travel agency
- Photocopy of return travel ticket (air, bus or any other ticket)
- Bank account statement showing the applicant has sufficient funds to cover minimal costs of his/her visit to BiH, the equivalent of 50USD per day.

301. A **transit visa** application must be accompanied by a certified copy of the applicant's passport and the relevant page for the destination country visa or proof that a visa to the destination country is not needed.

302. Visas to BiH cost are dependent on length of stay and are as follows:

- Single entry or single transit visa: US$ 45
- Multiple entry visa valid for less than 90 days: US $ 65
- Multiple entry visa valid for more than 90 days: US $ 85

303. Visas for diplomatic and foreign service passports are issued free of charge.

2. Residence Permits

304. Foreigners desiring to stay longer than one month in BiH must apply for a residency permit within the first thirty days of arrival in BiH with the Ministry of Internal Affairs at the entity level. A standard application form must be submitted. The form requests basic personal information and the reason for extending her/his stay in BiH. Residency permits are available for periods of 3, 6, and 12 months.

305. To obtain the residency permit, applicants must submit:

- A valid passport that is valid beyond her/his planned stay in BiH;
- Evidence and documentation that will determine the purpose of residence, a valid work permit if the stay is for the purpose of pursuing employment; and
- An employment contract, if residence is pursued due to an offer of employment (see below for Ministry of Labor approval).

306. If the foreigner is an investor establishing a company, the following forms and documentation are necessary to obtain the residency permit:

- Company registration document188
- Valid passport with appropriate visa (if needed)
- 50 DEM (KM)

This process is considered urgent and is considered a priority by the Ministry of Internal Affairs. Approvals are granted within 3 to 7 days.

307. If a foreigner intends to reside in BiH with a spouse and/or children this must be stated in the application for the first residency permit. Applicants must prove that they have sufficient funds to support family members and that the proposed physical residence meets minimum standards.

308. If a residence permit is granted on the basis of an employment agreement, then the validity of the residence permit is directly linked to the work permit issued by the Ministry of Labor. However, the first residence permit is not valid for longer than one year, at which time the foreign worker must extend the residence permit for another one-year period.

309. The official estimated time for processing residence permits is 30 to 60 days.

3. Work Permits

310. Foreigners seeking work with an established company in BiH are required to have a work permit. The Ministry of Labor at the entity-level issues work permits. An employer must apply for the work permit on behalf of the foreign worker. Work permits are issued for a specific person, for a particular job, a specific employer and for a definite period of time. Work permits become invalid when employment ceases. A work permit is valid for one year and may be extended. The documentation required for an extension consists of the original documentation submitted for the original permit.

311. The law[189] requires all companies to post job vacancies with the Ministry of Labor to determine if domestic workers can fill the open position. The vacancy must be filed at least on week prior to the application for a work permit. The Ministry of Labor will permit the hiring of a foreign worker only if an appropriately qualified BiH citizen cannot be identified to fill the vacancy.

312. The application for the work permit must be submitted along with the following documentation:

- A description of the position
- An explanation why a foreigner should fill the position
- 5 copies of draft employment contract
- Certified copy of company registration

[188] The investor must establish the company before obtaining a residency permit.
[189] The relevant provision of the respective Entity Labor Law is the same.

- Notarized copy of the foreigner's passport
- Evidence that the foreigner has the required qualifications, including the foreigner's resume, translated into the local language. A translated copy of the applicant's degree and relevant coursework should also be included. If there are any questions about the relevant qualifications, the Ministry of Labor will include the Ministry of Education in the decision in order to validate the education of the applicant.

313. Officially, the approval process is considered a priority by the Ministry of Labor and can be completed 7 days after filing the necessary paperwork.

4. Issues

314. Obtaining the first residence permit and extensions are supposed to take about 30 to 60 days but delays are common and have proven frustrating for foreign investors. Foreigners who violate the terms of these permits can be fined or deported depending on the severity of the case. Further, applications for residency can be rejected. If the application for a residency permit is refused, an appeal is not permitted and the Ministry of Internal Affairs is not obliged to give the reasons for rejection. Rejection of residency applications is uncommon and this was not mentioned in interviews with foreign investors.

315. Most countries in Europe have clear laws and policies that govern who may and may not work. For example, Germany's Aliens Act gives the government power "to issue regulations on the conditions for the issuance of work permits for foreigners according to the interests of the country." The United States also has similar policies which allow foreign high-technology workers to work in the United States for specific periods of time. However, the stringency of such policies is reflective of labor market conditions and the availability of highly skilled workers in these countries. These countries should not be considered as appropriate benchmark for BiH policy in this area.

316. The documentation required for labor permits under current BiH policy is excessive. For example, the requirement for the submission of proof of qualifications (resume and copy of certificates) for skilled positions is unnecessary. It is the responsibility of the hiring company to verify qualifications as part of its recruitment process. It is in a company's best interest to hire appropriately qualified staff. Furthermore, since the cost of employing skilled and managerial expatriates is relatively high, most foreign investors will employ local staff wherever and whenever in order to minimize costs.

317. Although the official estimate of the time required to process a work permit is 7 days from the filing of the requisite paperwork, in practice the approval process is much longer. In some cases cited by interviewees, the approval process has taken as long as two years. The work permit is only issued after the Ministry of Labor has determined that suitably qualified local candidates are not available but this decision process is not

transparent. As a result, some companies circumvent the work permit process and hire foreigners without approval.

318. All foreigners go through the same procedures and receive the same treatment (with limited exceptions to former countries of Yugoslavia). Regardless of the employee's position, the same documentation and processes are required. While expedited procedures are available for foreign investors establishing companies (directors), there are technically no fast track procedures available for foreign managers and skilled workers.

Box 1

The European Union's Guarantee of Free Movement of Persons

According to Article 8a(1) of the European Treaty, every citizen of an EU member country has the right to freely move and reside within European Union territory. Article 48 of the treaty entitles every EU citizen to work anywhere in the EU under the same conditions as citizens of the host member state.

To guarantee free movement of workers, member states are obliged to abolish all administrative barriers in which other EU citizens would seek access to the labor market. This includes abolishing the need for residence and work permits. The right of free movement was recently expanded to include the European Economic Area, which encompasses Iceland, Liechtenstein, Norway, and the EU member countries.

319. Box 1 summarizes the European Union's Guarantee of Free Movement of Persons. This is a standard to which the BiH regulations may be compared, particularly if BiH ultimately plans to seek membership in the EU. The current work permit requirements are not in line with EU regulations.

5. Recommendations

320. Recommendations for simplifying and streamlining the existing system for residence and work permits include the following:

- Streamline the approval process. The application process should be streamlined in order to facilitate the processing of residence and work permits for expatriate professionals. The expedited procedures that are currently available for the directors of foreign investment enterprises should be expanded for all classes of expatriate labor. This would help to minimize the delays that are common and frustrating for foreign investors.
- Review the application requirements and introduce time limits. The supporting documentation required for work permits is excessive. Documents required as proof (e.g., evidence of qualifications) could be replaced by a statement or declaration by the employer or employee. Applications for extensions should not require the re-submission of documents already

provided with prior applications. As in many other countries, a time limit for processing (e.g., 45 days) could be introduced. With such regulations, permits not issued within the time limit should be automatically granted by default.

- Abolish the requirement for the determination of the unavailability of local labor. The requirement for the posting of vacancies with the Ministry of Labor should be abolished.
- Combine the procedures for obtaining residence and work permits. Combining the procedures the burden on employers and employees would reduce the administrative costs for the authorities as well as the applicants. This approach is practiced with good results in Germany. In addition, the validity of residence permits should be linked to work permits.
- Review of the penalties for violating residence permits. A review of the penalties for violation of residence permits is merited to ensure that penalties match the severity of any violations.

B. Domestic Labor

1. Legal and Regulatory Framework

321. Consistent with the provisions of the Constitution of Bosnia and Herzegovina (BiH), the laws and regulations pertaining to domestic labor are promulgated at the Entity level. With the assistance of the international community, the Entity Governments have initiated an extensive process of revising the current legislation on labor-related issues and harmonizing the laws for both Entities. Some of the new legislation has already been promulgated.

322. There are currently four major legislative instruments that form the backbone of the legal framework on labor issues. These laws enunciate major definitions, procedures and provisions for labor-related issues and they are supplemented by a set of implementing regulations addressing the detailed provisions and regulations.

323. In the R.S., the following laws constitute the foundation of the legal framework for labor :

- The Labor Law (Law No. 777 entered into force on November 8, 2000, replacement for the 1993 Law on Labor Market Relations)
- The Law on Job-Placement and Social Security of the Unemployed (Law no. 778 entered into force on November 8, 2000)

324. In the Federation, the corresponding laws are:

- The Labor Law (enacted October, 1999 and amended on August 28, 2000)
- The Law on Job-Placement and Social Security (imposed and entered into force on December 28, 2000)

325. In addition, the following labor-related legislation either has been enacted or is currently being drafted in each Entity:

- Law on Strikes
- Law on Health Funds/Insurance
- Law on Pension Funds
- Law on Payroll Tax and Social Contributions
- Law on Labor Inspections
- Laws on Work's Councils

326. The Labor legislation of the Federation and the R.S. have been significantly harmonized. Any differences are limited to minor details and implementation procedures, all of which are relatively easy to overcome.

327. The Office of the High Representative imposed the Law on Job-Placement and Social Security of the Unemployed in the Federation in December 1999 containing extensive revisions endorsed by the Government. A similar law was enacted in the R.S. This legislation is an integral component of policies designed to create conditions for a flexible and modernized labor market, and self-sustaining, market-driven economic growth.

328. The purpose of the General Collective Bargaining Agreement is to regulate the rights and obligations of employers and employees and secure agreement on workers compensation and benefits. In each Entity, collective bargaining agreements, based on the respective Labor Laws have been negotiated with significantly different conditions and coverage. These collective agreements between the unions and the Entity governments apply only to the public sector and state-owned enterprises (SOEs)[190]. This point is relevant, since during discussions with members of the private sector, it appears that there was some uncertainty whether the general collective bargaining agreements applied to the private sector.

[190] According to the provisions of the R.S. Labor Law (Article 29), collective agreements are applicable to the signatory parties who are direct participants or represented by the signatories. Only in exceptional circumstances is it possible to extend the applicability of a collective agreements to other groups, and only after consultation with trade unions, employers or employer associations. The Federation Labor Law (Articles 114 and 115) include provisions similar to those of the R.S. law on the coverage of collective agreements, with the additional provision that parties may opt to join an already concluded agreement (Article 115).

2. Participatory Rights

329. As is common in many transition societies, the role of trade unions in Bosnia and Herzegovina is quite strong. Under the previous laws, all employers, both private and public, were required to permit the participation of trade unions in the decision-making process for matters concerning employees, depending on the size of the company or organization.

330. Under the revised Labor Laws of the Entities, provisions of participatory rights clauses and practices, include the following:

- Management. For companies that have a supervisory board, 20 to 50 percent of the board must be comprised of employee representatives, depending on the size of the company.
- Works Councils. In companies with more than 15 regular employees, workers are entitled to establish a Works Council for representation and protection of employee interests deriving from the employment contract (Article 109 of R.S. Labor Law). A similar provision exists in the Federation Labor Law (Article 108). However, the required implementing Laws on Works Councils are still being drafted.
- Collective Bargaining. Collective bargaining agreements are currently very broad and tend to restrict the employer's flexibility to respond to market conditions that are specific to a given enterprise. The existing general agreements apply only to the public sector and SOEs.
- Rule Book. According to article 107 of the Federation Law on Labor, an employer hiring more than 15 workers must publish a rule book on matters concerning salaries, the organization of the work, discipline, and other employee regulations. The employer is obliged to consult with the Works Council or the trade union before finalization of the Rule Book. Article 162 of the R.S. Labor Law stipulates that an employer with more than 15 employees is obliged to adopt and appropriately publish a rule book. The R.S. law does not include provisions for obligatory consultations with the Works Council or trade unions. [191]

3. Labor Contract

331. According to the new Federation Law a contract of employment between employer and employee may be written or oral, indefinite or fixed term. The same requirements are established in the Labor Law for the R.S. The written statement of the terms of the contract of employment should include[192]:

[191] For more information on this issue go to Article 107 of the Federation Labor Law and Article 19 in the case of the Labor Law for the RS.

[192] For details, see amendments to the Federation Labor Law Article 18.

- Name and location of the employer
- Name, surname, residence or domicile of the employee and address
- Duration of the employment contract
- Day of start of employment
- Location of employment
- Working position and employee is employed for and a brief job description
- Length and schedule of work hours
- Salaries, additions to salaries, benefits, and periods of payment
- Duration of annual leave
- Dismissal notice period to be complied with by both the employee and the employer
- Other information related to the terms of employment as determined in the collective agreement

4. Working Hours

332. Working hours are regulated through legislation and collective bargaining agreements. Article 29 of the Federation Labor Law and Article 35 of the R.S. Labor Law set the weekly maximum for full time work at 40 hours. Article 32 of the Federation Law stipulates that an employee may not be required to work more than 20 hours overtime per week (of which 10 hours may be mandatory and 10 hours may be voluntary overtime). For the R.S. overtime is limited to10 hours a week In exceptional cases, an employee may volunteer, at the request of the employer, to work an additional 10 hours a week but not in excess of 20 hours.

333. Part-time work is permissible but not explicitly defined in the Federation's labor legislation. In the R.S. law, it is explicitly defined and there is a general provision stating that conditions must be proportional to those for full-time employment.

5. Annual Leave

334. The Federation Labor Law establishes paid annual leave at a minimum of 18 days regardless of time on the job and maximum of 30 days in certain sectors/positions.[193] According to Article 46, an employee is also entitled to paid personal absence of up to 7 days per year in cases of marriage, birth of a child, disease or death of a close family member.

335. The R.S. Labor Law stipulates that for each calendar year, an employee who has worked for at least six months uninterruptedly, should be entitled to paid annual leave of at least 18 working days. A juvenile employee should be entitled to annual leave of at least 24 working days. Authorized absence from work during which time the employee continues to be paid a salary in accordance with the law, is not considered an interruption

[193] In RS, minimum paid vacation is 18 days plus 1 day for each three years of service.

of service. A major change on leave policy in the R.S. law relates to the provision permitting an agreement between employer and employee regarding the use of vacation in two segments, provided that one part of the annual leave is no less than two weeks of uninterrupted vacation.

336. Provisions for annual leave are the same in the case of Federation Law (Article 42) except for the segmented use of the vacation entitlement.

6. Retirement

337. With more than 20 years of service, employees are eligible for full pensions at the age of 65 regardless of gender. Pension amounts are based on an average of salaries of the most recent 15-year period and adjustments are allowed for current economic conditions.[194] The Law on Pension Funds and the Law on Social Contributions for each Entity stipulate the required contributions for employees and employers.

7. Labor Inspections

338. Under article 149 for the R.S. Labor Law, labor inspections may be conducted to verify and enforce the conditions of the rule book. Articles 131 and 132 of the Federation Law include similar provisions.

339. The Ministry of Labor is responsible for monitoring health and safety rules and ensuring appropriate documentation. Inspections are conducted on a regular basis and prior notice is not required. Labor inspectors have the power to levy fines and may even close down operations in the event of severe violations.

8. Wages, Compensation and Contributions

340. According to the terms of the 2000 Collective Bargaining Agreement for the public sector in the Federation, the minimum salary cannot be lower than 55% of the average salary in the country. However, for the private sector there is no legally mandated general minimum wage requirement in either Entity. The Labor Laws of both Entities simply state that the minimum wage should be negotiated by collective bargaining and stated in the company rule book. The existing collective bargaining agreements (applicable only to the public sector) in BiH have been fairly rigid on compensation.

341. Employees and employers are required to contribute to the various following social funds (based on gross salaries). The employer/employee contributions for the Federation and the R.S. are detailed in Table 1 below.

[194] "Pension and Disability Insurance Law," *Official Gazette*, No. 29/98, Article 30.

Table 1: Contributions to Social Funds

Employee Contributions	**Federation** [1/]	**R.S.** [2/]
Pensions	7.00%	9.00%
Health Insurance	5.00%	7.50%
Unemployment Insurance	1.00%	0.50%
Protection of Children		1.00%
Water		1.50%
Total	13.00%	18.85%

Employer Contributions	**Federation** [1/]	**R.S.** [2/]
Pensions	17.00%	9.00%
Health Insurance	13.00%	7.50%
Unemployment Insurance	2.00%	0.50%
Protection of Children		1.00%
Total	32.00%	18.00%

[1/] Contributions Law, Official Gazette of the Federation BiH 35/98, September 1998.
[2/] R.S. Law on Amendments and Additions to the Law on Contributions, March 2000.

9. Termination

342. The Labor legislation in both Entities gives employers the right to terminate employment, subject to certain conditions. According to the Law on Labor Relations for the Federation, termination of the employment contract can be the result of actions by or the circumstances of the employer or the employee. The following conditions apply:

- An employer may cancel the employment contract of an employee with the prescribed period of notice of cancellation, when such cancellation is justified for economic, technical or organizational reasons; or the employee is no longer able to perform the job for which she/he was employed.

- The termination period may not be less than 14 days if the employer cancels the employment contract. The termination period shall start from the date of the delivery of notice to the employee or the employer. Under the specific provisions of collective agreements, Rule Books and the employment contract the length of the cancellation period may be increased.

- In the case that a court finds that the termination contract is unlawful, the court has the option of reinstating the employee or requiring the employer to

pay damages including salary, severance allowance and other benefits to which the employee may be entitled (Article 99, Federation Labor Law).

343. An employer may cancel the employment of an employee without providing the required notice of cancellation, in cases where the employee is guilty of serious misconduct or a serious breach of obligations under the employment contract or under conditions in which it would be unreasonable to expect the employer to continue the employment relationship.

344. It should be noted that there is severance pay after regular dismissal of an employee on contract for an unspecified period. Article 100 of the Federation law and article 127 of the R.S. law states that an employee with an indefinite employment contract who is being terminated after a minimum of 2 years of uninterrupted work, is entitled to severance. If the terminations is due to default of the obligations arising from employment or due to failure to fulfill the obligations arising from the employment contract on the part of the employee, the severance pay provision does not apply. The severance pay amount is determined by the collective agreement and/or the Rule Book and may not be less than one-third of the average monthly salary of the employee as paid in the last three months before the termination of employment contract, for each full year of employment with the terminating enterprise.

10. Analysis

345. The legal framework for labor in BiH is a work in progress. Although the key foundation Labor Laws have been revised with the assistance of the international community and have been promulgated, many of the complementary pieces of legislation and the corresponding implementing regulations are still being drafted. Under the current circumstances, BiH lacks a modern and comprehensive legal system for regulating domestic labor issues. This presents a challenge for the private sector and foreign investors in BiH since there are certain labor issues that are not clearly addressed by the law.

346. Given the tradition of strong labor unions and the importance of workers' rights in BiH, some members of the private sector perceive a certain level of risk on labor issues until the comprehensive package of legislation is complete. However, it must be recognized that in the current economic environment, with high domestic unemployment rates, in principle the current laws provide adequate coverage of the basic issues in employment relations.

347. The labor laws have addressed one of the key areas of concern for foreign investors – the right to hire and fire. The Labor Laws of both Entities clearly address this issue and employers have the right to terminate employment, with clearly stated conditions for doing so. In addition, the new laws offer flexibility in hiring practices and employers have the option of offering indefinite or fixed term contracts, with full-time and part-time employment. Among other improvements is that the wait-list issue has

been solved satisfactorily, that the monopoly of the employment bureaus to mediate job vacancies have been abolished along with a series of reporting obligations by the employers.

348. In a market economy, a fundamental principle of worker compensation is that remuneration should reflect productivity. Since productivity varies from sector to sector and from region to region, it is necessary for remuneration to be flexible enough to reflect this situation. While the basic wage rates in BiH are competitive, the payroll taxes and cost of social contributions are high relative to some of the other countries in the region (See Table 2). Some in the private sector view these costs as excessive and as a result many employers are being forced into the gray market and the avoidance of social contributions is widespread. This situation is exacerbated by the fact that some municipalities are increasing the contribution rates beyond the specifications of the Law on Contributions. Box 2 relates the anecdotal information provided by one investor in the Federation. Clearly the level of payroll taxation needs to be addressed, with due consideration for the social and fiscal sustainability issues. The governments in both entities have taken initial steps to reduce payroll taxes. Also, the new job placement laws considerably reduce unfunded employment benefits, thus keeping caps on payroll taxes. However, with the large unresolved issues including the financing of pension and social benefit systems, the prospects of decisive reductions of payroll taxes remain unclear.

Box 2

Commentary of Wage Taxes in BiH*

"Wage taxes aren't going down, they're going up. Maybe not in legislation, but it seems each month each municipality's employment bureau adds another service tax to the processing of our wage payments. Last month the increase was 22DM per woman. On a monthly wage of 180DM, that is an unexpected, unforecasted, and uncommercial development increase of 12% that increases the tax rate on temporary employment indirectly to 56%. Before the war, taxes on hand crafts wages were only 12% - actually sustainable."

349. Another area of concern to the private sector and foreign investors in particular relates to the role and operations of the Employment Institutes. In the Federation in particular, these Institutes are functioning with unclear legal mandates and with a monopoly on job mediation.

350. In similar fashion, the system for labor inspections lacks clear rules and reasonable remedies for violations of the labor code. For example, labor inspectors have the power to shutdown operations and individual inspectors have a considerable amount of power over the company being inspected with apparently little accountability. Given the excessive documentation requirements it is very easy for an inspector to find a "violation" and threaten closure, while expecting bribes to overlook violations.

Table 2: CONTRIBUTIONS TO SOCIAL FUNDS

Rate (percentage)

	Federation	R.S.	Slovenia	Armenia	Romania
Employee Contributions					
Pensions	7.00	9.00	15.5		5.00
Health Insurance	5.00	9.00	6.36		7.00
Unemployment Insurance	1.00	0.50			1.00
Protection of Children		1.00			
Maternity Contribution			0.1		
Water Contribution		1.50			
Total	13.00	18.85	22.10	28.00*	13.00
Employer Contributions					
Pensions	17.00	9.00	8.85		30.00
Health Insurance	13.00	7.50	6.36		7.00
Unemployment Insurance	2.00	0.50	0.14		5.00
Protection of Children		1.00			
Maternity Contribution			0.10		
Accident Insurance			0.53		1.00
Total	32.00	18.00	15.98	28.00*	43.00

* For salaries ranging from 8,931-71,430 Armenian Drams.

351. As a result of the lack of transparency of the inspection procedures, corruption and abuse of the labor inspection function is widespread. The BiH government would be well served to reassess its excessive documentation processes, especially as they relate to employee files. By streamlining processes and reducing repetition of policies and work paper, the government would save itself time and money as well as private companies. It is also very important to rethink labor inspections. By giving inspectors so much authority (enough to shut-down operations), the system creates the opportunity for graft and corruption. If inspectors witness a violation, a ticket should be issued and the matter should be handled in a court of law. If the court then deems it appropriate to cease business activity, the employer should be shut down.

352. Another consideration is the amount of annual leave. While BiH offers employees 18 days vacation annually plus up to 7 personal days per year, the latest ILO recommendation (1970, No. 132) sets a benchmark of 15 days. Developed countries throughout Europe usually have more than 15 days annual leave while less-developed countries are diversified. For example, paid leave is from 7 to 14 days in Hong Kong depending length of service while in Malaysia it ranges from 8 to 15 days. Once BiH begins performing at the level of other European and Asian countries, such a generous annual leave could be considered, but until then, a it may be necessary to reevaluate this policy.

353. Under the existing system, with the lack of a strong private sector in BiH, the power of the unions has largely gone unchallenged and the unions have exercised this power to their advantage. With the recent establishment of the Employers Federation and the boost to the Chamber of Commerce along with an increasingly active private sector, the level of dialogue and interaction between workers (unions) and employers is expected to increase. Taken together with the changes in the political and economic environment in BiH, increased pressure to minimize productions costs in order to compete effectively, and the increased competition to attract private investment, the dynamics of the employer/employee relationship will support a more collaborative approach to labor issues and a shift towards company negotiated labor contracts.

11. Recommendations

354. It is recognized that, with the assistance of the international community, the Entity governments of BiH are actively engaged in improving the legal and regulatory framework for labor. Already there has been significant progress in changing the laws to modernize and harmonize the labor regulations, making them more compatible with Western European standards. The World Bank is currently supporting the reform of key labor legislation under an adjustment credit operation (SISAC) and legislation reform commissions have been established in the Entities.

355. However, as this work progresses it is important to recognize that legal reform must be supported by mechanisms for implementing the laws and monitoring the interpretation of the laws are necessary. Since this is part of the responsibility of the respective Entity-level Ministries of Labor, then it will be necessary to help the Ministries to develop their capacity for implementation, improve the administrative systems and institutionalize reforms.

356. The specific recommendations of FIAS relate to the key points of discussion in the preceding analysis section are as follows:

- Complete the legal and regulatory framework to ensure comprehensive coverage of labor issues. For example, the regulations covering worker participation rights and the role of works councils still need to be completed. There are a number of worker participation models that may be adapted and applied in BiH (See Box 3). However, it is necessary to ensure that the approach adopted does not restrict the rights of business owners to make decisions on how to conduct business or eliminate options for improving productivity and profitability of enterprises.
- Conduct a review of wage taxes and the level of social contributions. This has a direct impact on BiH's ability to compete for FDI inflows. The World Bank has committed to providing assistance in developing and evaluating a package of changes for social contributions aimed at broadening the base and lowering

contributions since the present system places a significant burden on contributors.

- Limit the authority of municipalities to impose ad hoc taxes on wages such as those described in Box 2.
- Review the role of the Employment Institutes and eliminate their monopoly on arbitration services.
- Streamline the administrative procedures and documentation required for employers. This also represents a cost to businesses.
- Reorganize the labor inspection function and increase the accountability of labor inspectors. More transparent rules and accountability will help to eliminate corrupt practices.

Box 3

Best Practices – Worker Representation

Mechanisms for joint consultation between labor and management at the enterprise level have become ubiquitous in industrialized economies since the second world war, and have been accompanied by the development of policies for employer-labor relations and human resource management disciplines.

Voluntary mechanisms for consultation coexists with (or have over time been replaced with) mandated systems of worker's representation at the enterprise level, typically in the form of work's councils, which act as counterparts to management. In such arrangements, employees have acquired a number of formalized and enforceable rights, the most important if which are:

- The right to share information;
- The right to be consulted; and
- The right to decide jointly in specific areas.

Moreover, in many countries work's councils will have significant roles in the collective bargaining process and in industrial disputes.

The authority of the works councils is reflected in their rights to consultation or joint decision making on personnel matters such as welfare, accident prevention, leave arrangements and hours of work. They also have a strong influence on decisions relating to recruitment, termination of employment and training, and have the right to receive information pertaining to social and economic issues in regard to which they are entitled to be consulted.

Works councils are elected bodies constituted by the employees. In most industrialized countries there is a coexistence at enterprise level between elected bodies and trade union representatives, regulated by law or collective agreement. In a few countries the trade unions will either appoint members of the works councils or have a dominating influence on their composition.

In a few countries, representational systems involves the participation of employee representatives at board level, thus forming part of the legal framework of corporate governance. This is the case in Germany, Austria, Denmark, France, Sweden and the Netherlands, although a closer examination will reveal considerable differences in the practical implementation. Representation at (supervisory) Board level does not constitute co-management in the sense that employees participate in the day to day running of the enterprises.

International law and standards:

- European Works Council Directive (Council Directive 94/45/EC of September 22, 1994.
- ILO Recommendations: Co-operation at the Level of the Undertaking, 1952 (No. 94); Communication within the Undertaking, 1967 (No. 129).

CHAPTER VI

OPERATING

A. Introduction

357. The purpose of this Chapter is to review the administrative procedures required once a business becomes operational. This Chapter focuses on routine business operations and procedures related to taxation, customs, and inspections.

B. The Taxation System in BiH – Legal Framework and Institutions

358. Articles III.1 and III.3.a. of the Constitution of BiH stipulate that tax policy and tax administration are the responsibility of each Entity and not of the state. In keeping with the stated objective of creating a single economic space in BiH (Article I.4 of the Constitution of BiH), all levels of government in BiH, with considerable assistance from the international community has undertaken a series of initiatives aimed at harmonizing taxation policies and regulations in order to develop a single tax policy and revenue collection regime throughout BiH.

359. A number of projects are currently underway to improve the legislation and administration of taxation and Customs in BiH and much of the focus is on harmonization of the relevant laws and regulations between the two entities. The ongoing projects include the International Monetary Fund (IMF) work on sales taxes, USAID-sponsored assistance on taxation administration, the European Union Customs and Fiscal Assistance Office (CAFAO) assistance on taxation and customs,[195] and World Bank assistance on a number of related issues. In addition, the following initiatives relating to tax harmonization are ongoing:

- There is a tax harmonization group, composed of the Ministries of Finance of both entities, their Treasuries, the OHR, CAFAO, the IMF and the World Bank.
- An international advisory group on taxation has been established. Representatives are drawn from CAFAO, CBBH, GTZ, OHR, IMF, the United States Embassy, the United States Treasury, USAID, and the World Bank. Unfortunately, individual business owners or business associations are not represented.

[195] The scope of CAFAO's work in BiH extends beyond taxation harmonization and includes: trader control, tax investigation & intelligence, debt management, tax training, tax legislation, and assistance in the implementation of new tax legislation.

- The IMF was involved in sales and excise tax reform. The World Bank is expected to provide assistance on social contributions. The excise rates have already been harmonized and related work is ongoing. The new Excise and Sales Tax Law has been accepted by the R.S. government and is awaiting further action. In the Federation, the changes of the laws on excises on luxury goods have been adopted by the previous Government and are pending action by the incoming Government.

360. However, there is still significant substantive and methodological work to be done on the implementation of the new taxation and customs regime. Therefore, the objectives of this section of this Report are to: describe the existing administrative procedures; review the anticipated changes; and provide guidelines on implementation with the goal of ensuring simple and transparent procedures. The successful implementation of transparent and efficient procedures would serve to reduce the pervasive uncertainty, risk, and cost currently associated with the taxation and customs regimes of BiH.

1. Legal Framework

361. The specific laws governing customs, taxation and tax administration in each of the two entities Federation and the R.S.) are as follows:

- Law on Corporate Income Tax
- Law on Personal Income Tax
- Law on Property Taxes
- Law on Sales Taxes
- Law on Excise[196]
- Law on Wages Tax
- Law on Contribution
- Law on Customs Service
- Law on Customs Policy

362. As of December 2000, new laws on each of the above-mentioned topics have been promulgated in both Entities, with the following exceptions:[197]

- Amendments have been passed for the Sales Tax Laws of the Federation (O.G. FBiH 36/00) and the R.S. (O.G. R.S. 29/00).
- Amendments were passed to the Federation's Law on Corporate Income Tax (O.G. FBH 29/00). Also, further changes are expected in the R.S. Law on Corporate Income Tax which was last amended in 1998.
- In the case of the Personal Income Tax and Property Tax Laws in the Federation, these laws have not been fully introduced at the cantonal level. In

[196] The Federation has six separate excise laws (one for each excise). R.S. excises are covered under the Excise and Sales Tax Law.
[197] December 2000, OHR Checklist of Laws.

the R.S., the new Personal Income Tax Law has been adopted while a new Property Tax Law or amendments to the existing law are expected.198

- At the state level, the amendments to the Law on Customs Policy which was adopted by the BiH House of Representatives and House of Peoples in 1999 were imposed by OHR in December, 2000.

2. Institutional Arrangements for Tax Administration and Enforcement in BiH

a. Republika Srpska

363. Under the existing system, the R.S. Public Revenue Administration and the Financial Police are separate organizations within the Ministry of Finance, each with a specific mandate and legal authority. However, in practice there are areas of duplication in the activities of the Tax Administration and the Financial Police.

364. The Law on Control, Determination and Collection of Public Revenues and its subsequent amendments (R.S. O.G. No. 11/93, 8/94, 18/94, 16/96, 23/98, 01-465/00) establishes the role and functions of R.S. Public Revenue Administration and its relationship with the R.S. Financial Police. According to the 1993 Law, the Republic Administration (R.S. Public Revenue Administration) "at its central office shall ensure carrying out of all the tasks related to application of the law and other regulation from the field of public revenues, and shall be accountable for the performance to the Government …" Subsequent amendments preserve the allocation of the control responsibilities to the Financial Police and other aspects of taxation administration (including fiscal policy, the assessment and collection of personal and corporate taxes) to the Public Revenue Administration.

365. Within the specifications of the laws referred to above, discussions with the staff of the Public Revenue Administration and the Financial Police indicate a functional allocation responsibility as follows:

- The Financial Police is responsible for enforcement – the control and audit functions, as well as the collection of additional liabilities identified through the audit process.
- The Public Revenue Administration is responsible for the administration and collection of personal and corporate income taxes, communal taxes, and taxes on commercial activity (e.g., sales taxes).

366. In the R.S., a working group has been established to reorganize the Tax Administration and the Financial Police. Options being considered include merging the two functions.

[198] Ibid.

b. The Federation

367. In August 2000, the FBiH Parliament adopted a Law on Amendments and Addenda to the Law on Federation of BiH Tax Administration (O.G. FBiH 01-449/00). This amendment expanded the authority of the Taxation Administration to handle all taxation issues, including the taxation control of large enterprises as well as taxation audit and investigation. The corresponding amendment re-defining the role of the Financial Police amendment is yet to be passed. Therefore, the Financial Police is still legally covered by the existing law which assigns it extensive tax control and audit functions. As a result, there still exists considerable overlap with the Federation Tax Administration.

368. Under the reorganized structure, the Federation Tax Administration, along with the Customs Administration and the Financial Police, are part of the Ministry of Finance. The management and administration of the taxation administration function in the Federation is centralized at the Entity Level. According to the Law on Federation Tax Administration, all staff including cantonal and municipal office managerial staff are appointed by the Director and Deputy Director of the Federation Tax Administration on the nomination of the cantons and municipalities. However, Federation Tax Administration management is not obligated to accept the nominations. The role of the municipal and cantonal offices of the Federation Tax Administration is to collect taxes and enforce compliance, as part of the Entity-level taxation system.

3. Findings and Recommendations

369. In both Entities of BiH, the traditional role of the Financial Police was primarily to enforce compliance with taxation regulations. This enforcement mandate covered a broad spectrum of activities and was accompanied by wide powers including search and seizure and the authority to close business establishments during investigation. Interviews with representatives of the private sector suggest that the actions of the Financial Police were often arbitrary, subject to political manipulation and highly corrupt.

370. Under the August 2000 Federation Tax Administration Law, the Financial Police functions have been merged into the Taxation Administration. The changes have been designed to exercise better control over the tax police functions. Approximately 70% of the current Financial Police staff as well as a majority of functions of the Financial Police. The Financial Police will continue to have authority only in criminal investigations (money laundering, tax evasion, etc.). All other powers and activities will be transferred to the Tax Administration."

371. In contrast to the recent changes in the Federation, the R.S. Financial Police is still responsible for the routine audit of legal entities, in addition to tax fraud cases. However, it is anticipated that there will be a reorganization of the R.S. Financial Police and the Public Revenue Administration, presumably so that the reorganized Financial Police will deal with fraud and criminal activity and the Tax Administration will deal with audits and the administration of the taxation system.

372. The ongoing and proposed changes in the structure and organization of the taxation systems in both Entities are intended to incorporate many of the activities of the Financial Police into the Tax Administration, increase the clarity of the regulations governing the activities of the two Government agencies at the central and regional levels, reduce corruption, and ultimately to harmonize the role and functions of the agencies. It is expected that, in general, the Financial Police will continue to have enforcement authority only in criminal investigations (money laundering, tax evasion, etc.) and all other powers and activities be transferred to the Tax Administration.

373. Annex C provides a summary of the current division of responsibility between Tax Administration and the Financial Police in the Federation and the proposed allocation in the R.S., based on information provided by CAFAO.

374. The ongoing legislative changes and the re-organization of the taxation systems in the Entities should help the authorities to address a number of issues including corruption and abuse of powers, lack of transparent and consistent procedures, and inconsistency in the application and interpretation of tax laws. However, in order to facilitate sustained change, the reform process must extend beyond legal and structural changes to include implementing regulations, organizational goals and functions, as well as service orientation. FIAS recognizes that a number of technical assistance projects are being implemented and that these projects may include some elements of the recommendations below.

375. As part of the comprehensive program to strengthen the taxation system in each Entity, the development of clear, objective implementing regulations for the new laws and revisions of existing laws is essential. These laws and regulations must be published, disseminated and explained to the relevant stakeholders. Also, resources should be provided for electronic access to taxation information. Organizational change programs to support the implementation of new laws and regulations should include adequate and fair remuneration to help reduce the incentive for corruption as well as the introduction of employee codes of conduct.

376. During discussions with officials within the tax system at different levels, FIAS often heard different versions and interpretations of the re-organization and issues to be addressed. Further, there are rumors of changes among members of the private sector but in the absence of official information the rumors fuel suspicions, since there is no process for consultation with the business community or taxpayers in general. Clearly, this is an issue that needs to be addressed. Therefore, as part of the ongoing reform process, the development and implementation of a consultative mechanism between the various levels of the tax system and with external stakeholders, including the business community should be developed and implemented. Rules and guidelines need to be developed and implemented for sharing information with the public and the business community on a regular basis. This will minimize the public uncertainty, help to clarify the issues, increase transparency, and help to minimize the opportunities for corruption and abuse of authority by tax officials.

C. Tax Assessment and Payment

1. Corporate Taxation in BiH

377. Business enterprises in both Entities of BiH are subject to three major types of taxes:

- Corporate Income Tax
- Excise tax
- Social security tax

378. Other relevant taxes include:

- Real Property Tax
- Land tax
- Sales Taxes
- Customs Duties

379. All business enterprises are required by law to register and to pay taxes, subject to the specifications of the respective Entity. Tables 1 and 2 provide a summary of the tax rates applicable to businesses on income and other related taxes.

Table 1: Tax Rates – Republika Srpska

Tax	**Rate**
Corporate Income Tax	20%, 15%, 12%, 10%, depending on the amount of profit generated
Sales Tax on Goods Sales Tax on Services Railroad Tax	18% or 8%, depending on type of goods 10% 2%, paid along with sales taxes
Customs	0%, 5%, 10% or 15%, depending on goods
Customs fee	1%
Surcharge tax	Levied on a specific (per unit) basis, paid along with customs duty
Excise	Levied on a specific (per unit) basis

Table 2: Tax Rates – The Federation

Tax	**Rate**
Corporate Income Tax	30%
Sales Tax on Goods Sales Tax on Services	24% or 12%, depending on type of goods 12%
Customs	0%, 5%, 10% or 15%, depending on goods
Customs fee	1%
Surcharge tax	Levied on a specific (per unit) basis, paid along with customs duty
Excise	Levied on a specific (per unit) basis

a. Corporate Income Tax

380. Corporate income tax must be paid on income generated by any resident or non-resident company in the territory of an entity. The taxable profit is the positive difference between the gross income and the deductions allowed under the relevant Laws on Corporate Income Tax in each Entity.

381. The current Entity Laws on Corporate Income Tax and Law on Personal Income Tax have been deemed obsolete. The process of developing new laws was initiated in November 2000 with a workshop on the subject.

(1) The Republika Srpska

382. The R.S. Law on Corporate Income Tax (amended 1998) provides a regressive rate for profit tax due. According to the Government, the reason for this is to provide an incentive to declare profits, but a representative of the R.S. Ministry of Finance stated that there has been no success yet as a result of this approach. The Corporate Income Tax rates in the R.S., as specified under Art. 31 of the R.S. Law on Corporate Income Tax, are as follows:

up to 100,000KM profit:	20%
from 100,000KM to 300,000KM profit:	15%
from 300,000KM to 500,000KM profit:	12%
over 500,000KM profit:	10%

383. The taxable profit is determined from annual accounts. Taxable profit is calculated as follows: the income from all sources (except gains from dividends) is aggregated together and after deducting all allowable expenditures, capital allowances and any allowable losses for the prior year, the balance is liable for taxation in accordance with the prescribed rate.

384. Allowable expenditures are generally based on expenses incurred in the production of income. Deductible expenses include:

- Materials costs
- Labor costs
- Depreciation
- Donations for humanitarian, cultural and sporting funds up to a maximum of 0.5% of the total turnover
- Donations for scientific work up to a maximum of 1% of the total turnover
- Paid interest rates
- Estate duty, stamp duties and other local taxes

385. The losses from one source of income may be set off against profits from other sources of the next five year period with the exception of capital gains/losses.

(2) The Federation

386. The Corporate Income Tax rate in the Federation is 30%. The Ministry of Finance has issued a Book of Rules on the Application of Provisions of the Law on Corporate Income Tax, which has provisions on determining the taxable base.

387. As in the R.S., in the Federation the taxable profit is determined from annual accounts. Taxable profit is calculated as follows: the income from all sources (except gains from dividends) is aggregated together and after deducting all allowable expenditures, capital allowances and any allowable losses for the prior year, the balance is liable for taxation in accordance with the prescribed rate.

388. Allowable expenditures are generally based on expenses incurred in the production of income. Deductible expenses are the same as in the R.S., with the exception of membership in chambers of commerce and contributions to political organizations (up to a maximum of 0.1% of total income).

b. Filing and Payment of Corporate Income Taxes

(1) The Republika Srpska

389. In the R.S., the Corporate Income Tax is paid in advance on a quarterly basis. In the first year of operations, since the taxpayer's financial plans and anticipated tax liabilities are not available to facilitate the advance payment, payment is made at the end of the year instead. The company's financial plans and anticipated tax liabilities are the basis for the estimate of profit taxes due. The Tax Administration can compare whether the company's financial plan is accurate and they also compare it to the plans of similar companies. Once the plan is approved, a periodic payment schedule is established. In the first year of operations in the R.S. the company pays a profit tax only at the end of the year.

390. A tax return on corporate profit must then be filed yearly. In the R.S., the tax return must be submitted by March 8. The Tax Administration reviews the returns and has the authority to investigate the company books.

(2) The Federation

391. Just as in the R.S., in the Federation during the first year of operations the Corporate Income Tax is paid at the end of the year. Subsequently, the taxpayer pays a monthly profit tax advance on the basis of the decision of the Tax Administration, assessed on the basis of the data obtained from the tax return and the tax balance sheet for the prior year.

2. Corporate Income Tax Incentives

a. The Republika Srpska

392. According to Art. 39 of the R.S. Law on Corporate Income Tax, the key features of the foreign investment incentives package are as follows:

- Reduction in profit taxes for a period of 5 years, based on the percentage of foreign capital invested, provided that the foreign capital is greater than 20% of total capital. This incentive includes companies with 100% foreign capital investment. For example, if foreign investor contributes 70% of the assets of a company, the company will be exempted from 70% of their corporate profits, for a period of five years from establishment of operations.

- Special provisions apply for companies that have established but are not operational. Corporate Income Taxes are levied when operations are initiated and the Final Usage License for the production site is granted.

393. In order to claim this incentive, the company needs to be registered as a legal entity with the court, pursuant to regular company registration procedures. The company is required to have the approval of the Ministry of Foreign Economic Affairs in the R.S., which has prepared a document included among the registration papers that states the proportional equity and the foreign owner. At the end of the year, based on this document (copied to the Tax Administration), the company is exempted from payment of the Corporate Income Tax in relation to the amount of foreign investment.

394. In accordance with Art. 36 and other relevant provisions of the R.S. Law on Corporate Income Tax, reductions in the Corporate Income Tax are also available for the following:

- Newly established companies (without foreign capital): 100% for the first year of operation, 70% for the second year and 30% for the third year;
- Newly established companies in an under-developed region (as determined by law):100% for the first three years of operation;
- Free zones and companies in the free zones: 100% for the first five-year period;
- If a part of taxable profit is reinvested into the company: up to a maximum of 15% of taxable profit.

b. The Federation

395. As in the R.S., the Federation Law on Corporate Income Tax provides that the Corporate Income Tax is reduced for a period of 5 years equal to the percentage of foreign capital invested in the assets of the company, provided that the foreign capital is greater than 20% of total capital. This incentive includes companies with 100% foreign capital investment. In the Federation, the starting date for the 5-year period is unclear,

whether from the date of establishment of operations or the date of beginning of production. It is up to the Tax Administration to determine the relevant date for each case.

396. In order to claim this exemption, the company needs to be registered as a legal entity with the court, pursuant to regular company registration procedures, and to secure the approval of the Ministry of Trade in the Federation. At the end of the year, based on the company registration information filed with the Court and Ministry of Trade in the Federation (and copied to the Tax Administration), the company is exempted from payment of the Corporate Income Tax, in accordance with the rules stated above for FDI enterprises.

397. Pursuant to the relevant provisions of the Federation Law on Corporate Income Tax, local companies with no foreign investment have the following tax incentives:

- If the company reinvests its taxable income, the tax liability is reduced by the invested amount (this is applicable for investments in direct production only). If the company invests its taxable income in activities other than direct production, the Corporate Income Tax can be reduced up to 75% of the taxable income.
- Newly established companies are 100% exempt from the Corporate Income Tax in their first year of existence, exempt from 75% of taxable income during the second year, and 30% during the third year.

3. Sales Tax on Goods and Services

398. The sales tax on goods and services is provided for in the Federation Law on the Sales Tax on the Turnover of Goods and Services and in the R.S. Law on Excise and Sales Tax.

399. The sales tax on the sale of goods and services is the largest tax-based source of revenue in both entities. As a result of harmonization efforts, the sales tax is collected in both entities at the retail level. In the Federation, the sales tax is paid to the canton where consumption takes place. In the Federation, the sales tax is paid to the canton where consumption takes place. In the R.S., 70 percent of the sales tax revenues accrues to the Entity Government budget and 30 percent is allocated to the municipalities.

400. The Fiscal Affairs Department of the IMF prepared a study “Bosnia and Herzegovina: Taxation of Consumption and Inter-Entity Trade”, dated February 2000. As a result of this study and much related follow-up activity, the entities each now have two sales tax rates. The IMF will undertake further work on this subject. The IMF has conducted a study of the feasibility of introducing a VAT system and recommends that, as a preparatory step toward the introduction of a VAT, a single-stage, single rate sales tax at the retail level should be introduced The study has established July 2003 as the target implementation date for VAT.

a. Sales Taxes on Goods in the Federation and the Republika Srpska

401. In the Federation, there were until recently 4 different rates sales taxes. The Sales Tax Law of the Federation was amended in September, 2000. There are now only rates of 24% and 12% for goods, and the 10% rate for services has been increased to 12%. The following is a selective list of items that may be of particular concern to the investor:[199]

- Tax-exempt goods include: certain food products, export products and services (goods and services sold within BiH to a foreign person and paid for in convertible currency are deemed as export and thus are tax exempt), medicines and medical equipment, products imported and prescribed for customs duty exemptions and products sold in duty-free shops, agriculture equipment.
- Goods with a 12% rate include: tourist promotional material, electric power, basic agricultural and fish products, various construction-related materials.
- The 24% rate includes all other products used for final consumption (unless otherwise exempted).

In the R.S., the rates are as follows:

- Tax exempt goods: export products and services (goods and services sold within BiH to a foreign person and paid for in convertible currency are deemed as export and thus are tax exempt), bread, milk, medicines and medical equipment, certain products for agriculture, agricultural equipment, second-hand goods (except cars).
- 8%: food, basic agricultural products, electricity, coal, firewood, natural gas, soaps, paper, natural juices.
- 18%: everything else.

In the R.S. an additional 2% must be paid with any of the taxes on sales of goods and services for the development of railways.

402. The R.S. Law on Sales Tax also provides for certain incentives in cases where the company purchased the goods as manufacturing inputs. In order to receive these reductions, the company fills out an Order Form for the goods. The company is required to provide the details of both purchaser and supplier, a description of the goods and the method of payment. The second part of the Order Form contains a declaration regarding the tax exemption which the company is choosing for each particular case. The company either declares that it will use the goods for further processing, for wholesale, or for performing its activities (passenger cars are not subject to this rule). The Financial Police

[199] These rates are listed in the Law on the Sales Tax on the Turnover of Goods and Services.

then checks the invoices and the Order Form the company has opted for and further checks whether the company is eligible for such a tax exemption.

403. The Federation Law also provides that manufacturers are exempt from paying a sales tax on goods that represent inputs in the manufacturing process.

b. Sales Tax on Services in the Federation and the Republika Srpska

404. The sales tax on services is provided for in the Federation Law on the Sales Tax on the Turnover of Goods and Services and the R.S. Law on Excise and Sales Tax. The sales tax on services is based on the turnover of services rendered and charged.

405. The rate of the sales tax on services in the Federation is 12%.[200] In the R.S., the rate is 10%.[201] The definition of services in both entities is very broad and it includes wholesale activities. The tax is assessed on the difference between the price bought and the price at which the product is sold wholesale – a service tax on the gross margin for wholesalers. In the Federation, if a company buys wholesale, it must provide a statement to the Tax Administration that it is not the end user. It is the responsibility of the wholesaler to pay 12% of the difference in price between what was paid and what was sold. For example, if a wholesaler paid 1500KM for goods and sold those goods for 2500KM, the tax is 120KM (12% of the difference of 1000KM).

406. Also, in the RS there is an additional tax for the development of railways (2% payable with any of the taxes on sales of goods and services).

c. Filing Payments for the Sales Taxes on Good and Services in the Federation and the Republika Srpska

407. In the Federation, the retail sales tax (both for goods and services) must be paid within 5 days of the end of the week during which the sale was charged. This means that payment must be made at the latest on the Friday for goods and services charged between the Monday and the Sunday of the previous week. Taxes on wholesale transactions must be paid every 7 days (on Fridays).

408. In the R.S., the retail sales tax (both for goods and services) is payable twice a month on the 5th and 20th day for the preceding 15 days. Taxes on wholesale transactions must be paid every 15 days. The tax payable is assessed on the amount arising from invoices issued during the period against the calculation of the goods.

409. A separate payment order (for goods under different tax brackets) must be prepared for all sales during a given week. This requirement is simple if a company is selling goods that fall under a single bracket. However, the procedure is significantly more complicated if the company is selling goods that fall under different brackets, since

[200] According to the Federation Sales Tax Tariff, item 2, Tariff number 1.
[201] According to the R.S. Law on Excise and Sales Tax

each bracket has a different account number. This proves to be a very burdensome and complicated system for firms. In addition, this system is difficult to administer. The sales tax is considered "not paid within the prescribed time limit" if the tax is paid into the wrong payment account. In such a case, interest payments may accrue. Further, the Tax Administration can, pursuant to Art. 32 of the Federation Law, issue an order for immediate payment if the payment is not timely or is not done in the specified manner.

(1) Filing of Returns in the Federation

410. In the Federation, in addition to the weekly payments, sales tax returns are filed monthly. The PPMI form is submitted by the 15th of every month to report the tax payments made over the last month. Pursuant to Art. 30 of the Federation Law, the final calculation of the sales tax on the turnover for goods and services in the previous year must be submitted by February 28. The supporting documentation that must be submitted to the Tax Administration include the company's tax balance for the previous year and the standard form for sales taxes. In addition, with the abolition of the payment bureaus (effective January 5, 2001), companies are now required to required to submit their balance sheets and income statements to the Tax Administration.

(2) Filing of Returns in the Republika Srpska

411. In the R.S., in addition to the twice monthly payments, sales tax returns are filed monthly. The procedures are similar to those in the Federation, with the exception that the company files its final calculation of the sales tax on July 20th and January 20th for the preceding period.

4. Excise Goods

412. Excise goods include the following:

- Tobacco
- Alcoholic beverages
- Imported non-alcoholic beverages
- Coffee
- Fuel products
- Luxury products
- Timber for export

413. It should be noted that excise on luxury products and timber exports are specific to the R.S. Further, the collection of excise was abolished by decree as of October 5, 2000, following the introduction of the State level export levy on timber (effective September 1, 2000). The amendments to the R.S. Excise and Sales Tax Law (currently awaiting parliamentary approval) will eliminate excises on luxury items and timber, in keeping with the Excise Harmonization Agreement (June 1999).

414. Different rates of the excise duty apply depending on the nature of the product or its packaging. These rates are specified in the R.S. Law on Excise and Sales Tax (O.G. R.S. No. 29/00) and the Federation set of Special Tax Laws.[202]

415. Significant progress has been made on the harmonization of the excise rates in both entities with the objective of preventing tax evasion, avoiding tax competition and removing impediments to trade between the entities. All the relevant laws have now been re-drafted in both Entities and are awaiting passage through the parliaments.

416. In both entities, excise taxes on imported goods are collected upon import. Excise taxes on domestically-produced goods are collected at the manufacturing stage. As a result, as the IMF Report points out, excise revenues accrue to the entity where production originates or the goods are imported. Also, in both Entities the sales tax on excisable goods is collected at the retail stage. In the R.S., the company submits form APP twice a year – on July 20 and January 31. A new law on Excise duties is being prepared in the R.S.

417. The surcharge tax is determined by the BiH Council of Ministers and is paid along with customs duties within the same procedure. The payment of the surcharge tax is then directed to specific government accounts. The purpose of the surcharge is to support locally produced goods. Members of the business community have opined that the surcharge tax is the result of lobbying by special interest groups.

5. Personal Income Tax

a. The Republika Srpska

418. Personal taxation is regulated by the R.S. Law on Personal Income Tax. Residents are subject to personal income tax on the aggregate income accruing in, derived from, or received in the R.S. from:

- Employment
- Income from agriculture and forestry
- Income from a trade or business
- Any sums received on the sale of patents or patent rights, and royalties or other income received in respect of such patents
- Dividends
- Income arising from property
- Any other profit not specified

[202] Special Tax on Oil (Official Gazette of F BiH No. 51/99); Special Tax on Beer (Official Gazette of F BiH No. 51/99); Special Tax on Coffee (Official Gazette of F BiH No. 51/99); Special Tax on Soft Drinks (Official Gazette of F BiH No. 51/99); Special Tax on Alcoholic Beverages (Official Gazette of F BiH No. 51/99); Special Tax on Tobacco Products(Official Gazette of F BiH Nos. 8/00 and 13/00.

419. Exempt incomes include: income based on rights of war veterans, salaries or wages of invalids, scholarships, death gratuities, interest on public loans, interest on deposited sums, vouchers and bonds etc.

420. The personal income tax rates are determined by income levels, as follows:

less than 10,000KM (per year):	0%
10,000-15,000KM:	25%
15,000-25,000KM:	20%
over 25,000KM:	15%

421. The Wage Tax is paid jointly by the employer and employee. The employer generally withholds the income tax at the source of income. In order to pay the monthly salary to its employees, an employer is required to sign over 20 different documents for each employee every month. The procedures are extremely bureaucratic and onerous, resulting in significant processing and compliance costs for the employers.

b. The Federation

422. In the Federation, personal income taxes are provided for by cantonal laws. These laws stipulate different taxes depending of the category of the income, including:

- Tax on profit of persons
- Tax on property
- Tax on income of property
- Tax on income of copyright
- Tax on income of inheritance
- Tax on income of agricultural activities

The rates of these taxes are specified by each canton. In addition, there is a Tax on the Total Personal Income. A person is liable to pay this tax if their total income is three times greater than the average annual salaries in the respective canton. The tax rate of 10% is applied to the amount by which the individual's income exceeds the average annual salaries times three.

6. Tax refunds

423. According to the R.S. Ministry of Finance, an individual or a company can claim a refund if there has been overpayment of taxes. The lowest level of authority issues a decision, which is then sent to the Ministry of Finance for approval. Since the refunds are paid out of the Treasury, the approval of the Minister is required for every refund.

424. Art. 49 of the Federation Law on the Sales Tax on the Turnover of Goods and Services also provides for refunds (of paid tax, paid income, related expenses, and penalties) to taxpayers who are incorrectly assessed sales taxes

7. Taxation Inspections

425. The Financial Police gets its information on targets for inspections from the Tax Administration, the Ministry of Finance, other inspections, and ordinary citizens. Anyone can report irregularities to the Financial Police. The identity of the informant is kept confidential. Whereas the Financial Police in the Federation avers that it conducts regularly scheduled checks, the R.S. Financial Police does not appear to have a system of scheduled audits or random checks – it is mostly a reactive system.

426. Formally, the Financial Police follow the Law on Administrative Procedures and the Law on the Financial Police of each entity. However, in practice, the rules governing taxation inspections are unclear. The Financial Police have significant latitude in their activities – they can enter a business (as well as any related property other than the registered premises), audit the goods and the company's paperwork, confiscate goods, and even shut down a business.

a. Federation Inspection Procedure

427. Regulations require that a minimum of two inspectors participate in each on-site inspection by the Financial Police. After the inspection, a draft report (zapisnik) is prepared. There is no time limit for preparation of the draft report. On the basis of prior experience, it is recommended by some members of the private sector that the target of an investigation try to comment while the draft report is being prepared. In such instances, the concerns and views of the target can be included in the draft report.

428. A copy of the report is sent to the target of an inspection for review and comment. The company is given 3 days to prepare and submit a written comment on the draft report. If the inspector does not agree with the comments of the company representatives, the inspector is required to provide an explanation. Then, within 5 days of receipt of the comments, the Financial Police is required to issue a legally binding resolution (rješenje) detailing the decision and the penalties for non-compliance, as applicable. This decision is included in the final report. It is only upon the basis of the decision that the Financial Police can initiate actions to penalize the target of an investigation.

429. Art. 45 of the Federation Law on the Sales Tax on the Turnover of Goods and Services provides that "[t]he authority competent for auditing the sales tax may issue a decision on the temporary suspension of further operation of the taxpayer by sealing business premises, making the usage of machines, equipment and other facilities impossible, or by preventing the disposal of funds on the transfer account and other accounts until the reasons for the suspension are eliminated. The appeal against the decision shall not withhold the implementation of the decision." As the powers of the Financial Police are changed, it will be necessary to review and clarify existing

provisions of the law to ensure that they are consistent with the new authority of the Financial Police.

b. R.S. Inspection Procedure

430. In the R.S., once a target is identified for inspection,[203] the inspector has the right to inspect premises and records, seize articles, and "temporarily close the taxpayer's undertaking before the decision on an offense and protection measure becomes valid …." (Article 10e). Further, the inspector is required, by law, to respect "the taxpayer's dignity and to enable him to protect his legally established rights and law-based interests …" (Article 10j).

431. A team of two inspectors is mandated for each inspection. The inspector is required to prepare a report within 3 days of the inspection. The report must be submitted to the Republic Administration Regional Center and a copy is sent to the taxpayer. Within 10 days of the submission of the report, the inspector is required to render a decision to remedy the violations identified during the inspection (Article 10h). The taxpayer may lodge a complaint against the substance of the report within 8 days of receiving the inspector's report.

432. It is worth noting that during interviews with the Financial Police in the R.S., the information provided regarding some of the above-mentioned deadlines differed from those provided in the Law. FIAS was told that the taxpayer is required to submit a written complaint within 3 days of receiving the inspector's report. Also, according to our interviewees, there is no deadline for the inspector's decision, although decisions are issued as quickly as possible.

c. Appeals Mechanisms

433. After an unfavorable decision is rendered by the Financial Police or other institution auditing a company, the company may choose to appeal that decision. However, the initial appeal must be filed through the institution that imposed the decision.

(1) Federation

434. Article 46 of the Federation Law on the Sales Tax on the Turnover of Goods and Services stipulates that the method to be followed for appeal of a decision relating to the sales tax on goods and services depends upon the institution imposing that decision. If the Tax Administration has made that decision, then the appeal must go to through the Tax Administration. If the decision is rendered by the Financial Police, then the appeal process is pursuant to the Law on Financial Police. In like manner, the decisions of the Customs Administration must be appeal through the standard customs proceedings.

[203] According to the Law on Amendments and Supplements to the Law on Control, Determination and Collection of Public Revenues (R.S. O.G. 16/96)

435. In the Federation a taxpayer has 7-15 days following the receipt of the final decision by the Financial Police to appeal to the director of the entity Financial Police. Once the director of the Financial Police issues a decision, that decision can be appealed to court.

(2) Republika Srpska

436. The R.S. Law on Amendments and Supplements to the Law on Control, Determination and Collection of Public Revenues (R.S. O.G. 16/96) stipulates that "An appeal against the decision of the public revenue inspector may be lodged with the Republic Administration Director, whereas an appeal against the decision of the public revenue inspector in the Republic Administration Central Office may not be lodged." (Article 10i) The permissible appeal must be lodged within 8 days from the date of the delivery of the decision. However, the "appeal shall not delay the execution of the decision."

8. Accounting Standards

437. Currently, the R.S. is undertaking reform of its accounting standards. A new law became effective on January 1, 2000. The law is considered to be quite broad and envisions that the Association of Auditors and Accountants will prepare more detailed regulations based on international accounting standards. Nevertheless, there appears to be some uncertainty regarding the implementation of the Law by the Association.

438. The Federation Law on Accounting has been in effect since 1995 (Official Gazette of F BiH No. 2/95).[204]. In addition, new accounting standards and codes were adopted last year and they are reported to be generally compatible with international accounting standards. According to some sources, the Federation is in the process of further revising its Law on Accounting Standards.

9. Rulings, Opinions and Dissemination of Information

439. The written rulings and opinions of the respective Entity Tax Administration on specific issues and cases issued establish precedents and provide guidance for the public on interpreting and complying with legal requirements. Therefore, it is in the interest of the Tax Administration and the public it serves to issue and publish opinions. Publication of this information also increases transparency and strengthens requirements for consistent treatment and interpretation of the law.

a. Rulings and Opinions in the Federation

440. In the Federation, opinions are issued by the Ministry of Finance at the Federation or cantonal level, depending on the level of tax collection. On the strength of the

[204] Amended by the Law issued and published in the Official Gazette of F BiH No. 12/98

cooperation between the Tax Administration and the Federation Ministry of Finance, requests for opinions are handle expeditiously. However, it should be noted that in cases where the Tax Administration requests an opinion from the Ministry of Finance, the interpretation provided serves as a guideline for action by the Tax Administration. The Tax Administration is not obligated to accept the interpretation.

441. Individuals or enterprises may also submit questions for interpretation by the Ministry of Finance. According to one company representative in the Federation, the Ministry of Finance issues opinions questions submitted by the company. However, these opinions can be very confusing. Another Federation small business owner indicated that the level of service from the Ministry of Finance varies. In some cases, officials are courteous, while in others they can be quite rude. As a result, this businessperson relies on information provided by the publishing houses that submit questions for interpretation in order to publish the responses.

b. Rulings and Opinions in the R.S.

442. As in the Federation, the R.S. Ministry of Finance has the responsibility for interpreting tax laws and preparing opinions. The R.S. Ministry of Finance also disseminates a newsletter that includes interpretations and information of general interest to the taxpayer. In addition, the Ministry prepares specific opinions and responses for issues not covered in its publications.

c. Dissemination of Information

443. In addition to publication of opinions and rulings on specific tax issues, other methods of information dissemination are often employed by tax administrations, including seminars and periodic publications. Active dissemination of taxation information yields a number of benefits including building trust and credibility amongst the body of taxpayers.

444. According to officials at the R.S. Ministry of Finance, several institutions (including the Association of Accountants and Auditors) hold taxation information seminars throughout the R.S. In addition, the Ministry's monthly publication covers all the new laws and regulations.

10. Issues and Recommendations

a. Corporate Income Tax

445. During FIAS discussions with representatives of the public and private sectors, two fundamental issues emerged that color the problems of BiH in administering and collecting taxes. First, a significant portion of the financial transactions in the BiH economy are cash transactions, partly a result of efforts to bypass the now-defunct ZPP system. Therefore, many cash transactions are not officially registered by most

businesses. Second, relatively few business enterprises have reached the point where they are making a profit, and if they do, they are not likely to report it.

446. Further, the tax administration system and the tax regulations are perceived by many taxpayers as unfair and non-transparent. For example, there is the perception by some businesspersons in the Federation that tax collection only takes place in the cantons of Sarajevo and Tuzla. Similarly, there is a widespread concern throughout the business community in BiH that the Entity governments demonstrate favoritism toward the state-owned companies, particularly in relation to tax collection, and that government companies and state companies are not on the same playing field regarding tax payments. For foreign investors concerns about inequities in tax collection often affect business location decisions since foreign-owned enterprises are often highly visible and are, therefore, easy targets in such situations. If these perceptions are incorrect, they need to be addressed with appropriate public statements and documentation. If they are correct, then appropriate action must be taken to strengthen the tax administration to ensure equitable treatment.

447. Several businesspeople expressed their dissatisfaction with the current rules for assessing tax obligations. Under the existing system, businesses are required to estimate taxes beforehand on the basis of sales revenue. This presents businesses with a particularly onerous burden, especially if the company makes no profit in the following year when the predetermined tax is due. Although the purpose of such a system is to ensure payment of taxes, the burden on the taxpayer is immense, particularly if the company is experiencing a loss. If the Tax Authorities continue to adhere to this system, then at a minimum, an efficient and effective mechanism for tax refunds must be developed. This system is particularly difficult to maintain in the long run since companies are likely to under-report income, thereby undermining the use of income estimates to ensure tax payments.

448. Under the system in the R.S., even if a company is making a loss the following year, it must pay at the rate determined based on the previous year. Readjustment can be made if the company is earning less and the company wishes to claim a refund (see the section on Tax Refunds). Although the law provides for this refund, local businesspersons stated that in reality it is very difficult (and in some cases impossible) to get the refunds.

449. In general, the tax filing and payment procedures are oriented more towards enforcement by the authorities and less towards self-assessment and compliance by the taxpayer. Although the estimation of earnings for tax purposes may facilitate the work of the tax authorities, in the relatively unpredictable business environment of BiH, this requirement places businesses at a considerable disadvantage. In effect, the system requires the preparation of an income tax plan that may differ significantly from actual income performance. Therefore, at best, this system encourages the development of creative financial plans that underestimate anticipated revenues in order to minimize taxation liabilities.

450. In order to address these issues, the following recommendations should be taken into consideration:

- The practice of estimating the Corporate Income Tax liability and requiring payment on the basis of those estimates should be eliminated.
- The existing tax refund system should be replaced with an objective and efficient method for refunding taxes. The system should be entrusted to a board and not to any individual, including the Minister of Finance.
- Increased efforts must be made to introduce an attitudinal shift within the system of tax administration – away from strict enforcement by the tax authorities and toward self-assessment and compliance by the taxpayer.

b. Incentives

451. A number of issues related to incentives emerged during discussions with the private sector in both entities, including the:

- Lack of clarity on the Federation's Law on Corporate Income Tax provisions for incentives.
- Inconsistencies in the interpretation of incentive regulations.

452. Some interviewees complained that the incentives provisions of the Federation Law on Corporate Income Tax are unclear. For example, the Law does not specify when the tax holiday becomes effective – at the time of registration or the start of production. Depending on the interpretation, this could have a significant accounting impact (e.g., often a difference of three years). There were also reports that in practice the Federation's 5-year tax holiday does not apply to wholly-owned foreign companies, only to joint ventures. Although the problem has reportedly been resolved in favor of wholly-owned foreign companies, many members of the business community believe that the law needs to be clarified.

453. In addition to problem of lack of clarity on the provisions of the relevant laws on incentives, the interpretation of these provisions differ within the Tax Administrations of both Entities.

454. In addition to examining the clarity of the laws and consistency at the Entity level, the following considerations should be taken into account:

- Equal treatment of domestic and foreign investors. The international experience demonstrates that incentives based on the nationality of investors are ill-advised and may be counter productive. Discriminatory incentives create an unfair advantage to selected investors. They create a powerful incentive to cheat, as domestic investors may seek to obtain the benefits ascribed to foreign investors by acquiring nominal foreign partners. This behavior has been observed in a number of countries including Hungary in the early 1990s. Also the discriminatory allocation of incentives could produce ill will and mistrust between the foreign and domestic business communities.

- The need for incentives aimed at foreign investors. Several studies have shown that granting foreign investors favorable treatment produces distortions, incurs costs for the government and does not necessarily produce the desired impact of increased levels of FDI. Surveys of international investors indicate that decision makers emphasize the importance of fundamental factors in an attractive business environment (cost of doing business, market size, labor costs and productivity, stability and simplicity of the tax regime) over the effect of fiscal incentives in influencing investment location decisions.[205]
- Consistency between the incentive provisions of the Foreign Investment Laws (State and Entity level) and the Entity tax laws.

c. Sales Tax on Goods and Services

455. The R.S. system of tax payments is more streamlined and less burdensome to the taxpayer than the system in the Federation, particularly since R.S. has less frequent filing requirements. The weekly and monthly filing of tax payments and returns is burdensome to both taxpayers and the tax administrations. Other international organizations, including the EC-Phare (SOFRECO) Project Report on the BiH Tax System (1998), have recommended that this overly burdensome method of tax filing be revised. Phare has suggested that at least tax payment dates and tax return filing dates coincide, for example by instituting a system of monthly payments and returns (perhaps quarterly for small taxpayers).

456. As noted above, the IMF is providing assistance on the introduction of a VAT system. The introduction of an administratively complicated tax like the VAT necessarily requires a great deal of training for all levels of Tax Administration officials, as well as for the private sector. Unfortunately, judging by the criticism of many representatives of the private sector, the previous training initiatives were inadequate. Therefore, sufficient resources should be made available to ensure the delivery of effective training and timely information resources.

d. Tax Refunds

457. In practice, the process of obtaining of refunds is onerous and time-consuming. Some members of the business community have indicated that it is particularly difficult to obtain approval for the payment of refunds, since the refunds come out of the state budget and the Minister of Finance must personally confirm every such payment.

458. The practice of paying a refund only upon the decision of the Minister of Finance is non-transparent, highly subjective and conducive to corruption. <u>This procedure should be abolished, and repayment should be determined by a committee or "rebate units" within the Ministry of Finance or Tax Administration central offices</u>. These units could

[205] The exception being relatively "foot loose", export-oriented investments, such as low-value assembly operations.

handle all rebate claims. The formation of such a unit may not involve extra costs since it may be possible to reorganize the functions of related units to provide efficient service on the processing of rebates.

e. Taxation Inspections

459. The Financial Police have significant latitude in their activities – they can enter a business (as well as any related property other than the registered premises), audit the goods and the company's paperwork, confiscate goods, and even shut down a business. However, the rules governing the frequency of inspections and the use of the tax inspector's authority are unclear, thereby presenting opportunities for abuse and corruption.

460. In the view of one businessperson from the Federation, business operations may or may not be disrupted depending on the motivation for the audit. If the Financial Police is engaging in a regular check, business can probably go on as usual. If they are instead responding to a complaint, the business may effectively have to stop operations. However, the use of this authority is generally subjective and has significant consequences particularly for small and medium-sized enterprises.

461. According to the experience of one Federation businessperson, the tax inspectors spent one month on his premises for an audit. In the businessman's view, the inspectors were incompetent and inflexible in adapting to the actual needs of the company's business practices. He characterized their behavior as "arrogant and furious". During this audit, about one quarter of the staff of the Finance Department of the company had to be assigned to the work of the Financial Police inspectors.

462. The R.S. Law on Amendments and Supplements to the Law on Control, Determination and Collection of Public Revenues (R.S. O.G. 16/96) stipulates that the inspector is required, by law, to respect "the taxpayer's dignity and to enable him to protect his legally established rights and law-based interests …" During discussions at the R.S. Financial Police head office, FIAS was informed that employees are well-trained. However, the experience of taxpayers has led to view that the inspectors are aggressive and generally corrupt.

463. In addition to the ongoing changes in the regulations governing the organization and role of the Financial Police, FIAS recommends the institution of a code of conduct for inspectors, supplemented by better official remuneration, extensive training, independent monitoring of performance, and the enforcement of penalties for misconduct.

(1) Appeals Mechanism

464. In both Entities, assessed payments must be made during the appeals process. If an appeal is resolved in favor of the company, the taxpayer is refunded the amount in question, plus interest. However, the experience in making appeals seems to be mixed.

One company representative in the Federation indicated has never successfully appealed a decision of the Financial Police. Some interviewees (from the R.S.) shared the view that the appeals procedure is lengthy but it works, while others have suggested that the process for handling appeals in the R.S., prior to submission to the court, is not transparent and subject to internal influence by the Financial Police.

465. In accordance with the revisions to the procedures for appeals mechanisms in the Federation and the merging of the Financial Police into the Tax Administration, the first level for an appeal will include both the cantonal and Federation Tax Administration. These agencies will be charged with the responsibility for carrying out the initial investigation and rendering a decision. Appeals of these decisions will be resolved by the Federation Ministry of Finance. Revisions to the relevant laws are being prepared by CAFAO.

466. As discussed in the section on the Inspections system, the appeal of a decision through the official channels is often the last resort chosen by a company. It is therefore very good that there is an opportunity for the company to comment on the draft decision of the Financial Police, and the comments may then be taken into account in issuing the final decision. This structure is sound. Problems with the system occur where procedures are not transparent and opportunities for corruption arise.

467. FIAS recommends a review of the current system with the objective of making the process more transparent and independent, since the credibility of any appeals system is enhanced by complete independence from the target of the complaint. As a preliminary solution, consideration should be given to setting up a mechanism within the Tax Administration to hear complaints, ensuring that the persons hearing the appeal have little or no connection with the original decision. A long-term solution may be the introduction of a separate institution that reviews appeals of decisions made by officials from the Tax Administration, Financial Police, Customs. In addition, information on the procedures and rules governing the appeals process should be published and widely disseminated.

f. Accounting Standards

468. The new accounting law in the R.S. is reportedly largely harmonized with EU practices. The major problem, which USAID has recognized and is acting on, is the need for training. USAID is implementing a parallel project in the Federation. It is reported that the Federation law is also based on EU standards and is, therefore, basically harmonized with the R.S. law.

469. International accounting standards serve as guidelines for the consistent application of accounting rules and practices across countries. The implementation of these standards also reduces the costs of doing business in a foreign country (there is no need to spend time and money learning new rules or keeping double books).

g. Rulings, Opinions and Dissemination of Information

470. Some representatives of the business community expressed concern about the relatively frequent changes in tax laws and regulations and the resulting cost of compliance to businesses. In addition to the frequency of changes and the lack of a process of consultation with the private sector, businesses complained about the lack of advance notification and lead times for compliance. In many cases by the time a new law is published in the Official Gazette, it is often too late for the business community to prepare accordingly (revise contracts, reorganize staff, retrain staff). According to one interviewee, in one particular case, a law was passed in the Federation Parliament and became effective immediately, posing a problem for the affected businesses.

471. FIAS recommends that the following:

- Ensure that the business community is informed of upcoming changes and that reasonable lead times for compliance are established.
- Establish a channel of communication between the government and the business community.
- Provision should be made for members of the private sector and its representative organizations like business associations to participate in the reform process by creating a forum for them to present their views on draft legislation. The government of each entity is by no means required to adhere to the views of the private sector, nevertheless, in order to anticipate the possible effects of their decisions, they would be well-advised to ensure that a feedback mechanism is created. One option, being followed in Estonia, Latvia and other transition economies, is the publication of all draft laws on the internet so that there is at least an opportunity to become acquainted with anticipated changes.

D. Customs and Customs Administration

1. Legal Jurisdiction

472. In accordance with Art. III.1.(c) of the BiH Constitution, Customs policy is the responsibility of the state. Pursuant to Art. 3.1. of the Customs Policy Law of BiH, "[t]he customs territory of BiH shall be unified." As a result, the whole of BiH is deemed to be a single customs area with a single customs law and harmonized customs tariffs.

473. The Law on Customs Policy of BiH is based on the EU Customs Code. It was adopted on September 2, 1998, became effective on January 1, 1999. This Law was amended by the OHR decision of December 20, 2000 and all implementing regulations are expected to be in force in 2001. Article 217 of the Customs Policy Law invalidates any provisions of the Entity Customs Laws that are contrary to the State Law. Some implementing regulations are issued at the State level. Also, the entities and their

respective Customs Administrations are required to enact the relevant laws and regulations implementing the Customs Policy Law identically in each entity. When the implementing regulations of the State are promulgated they will effectively abolish the Entity-level laws.

474. The Law on Customs Tariffs was adopted on February 3, 1998 (effective March 13, 1998). The tariff schedule has not been amended since. However, additional import duties for specific products were introduced in January 1999 in an amendment to the Council of Ministers' Decision on the Determination of Imports Liable for Duty Additional (O.G. BiH No. 15/99). Customs duties were amended for a range of products and tobacco and oil products were excluded from the list. The BiH Ministry of Foreign Trade and Economic Relations is currently drafting a proposal aimed at including the additional tariff duties in the tariff schedule in the Law on Customs Tariffs.

475. As of January 1 2001, the Free Trade Agreement between BiH and Croatia became effective. Under the terms of this agreement, BiH products entering Croatia are not subject to customs duties. For Croatian products imported into BiH, the customs duties will be decreased and eliminated over a period of 4 years.[206] BiH is currently in the process of applying for WTO membership.

2. Role of CAFAO

476. The work of the European Commission Customs and Fiscal Assistance Office (CAFAO) has justifiably been heralded as one of the most successful endeavors by the international community to assist BiH in introducing and implementing customs reform. CAFAO work on customs includes:

- Customs Legislation – Introduction of uniform customs legislation throughout BiH, development of a system to ensure its uniform application and empower the two Customs Administrations in BiH to enforce the law in an efficient manner, taking into account that Customs Policy is a State matter, while other customs matters are Entity issues.
- Implementation of the Customs Policy Law and its implementing regulations – Development of efficient customs control operations at BiH borders and inland, capable of facilitating the flow of legitimate passengers and trade while ensuring collection of revenue.
- Organization & Infrastructure of Customs – Development of appropriate headquarters and regional structures, including evaluation and improvement, as required, of human resource management.
- Strategic Planning & Reporting Systems – Development of Strategic Planning and reporting systems to encourage better performance, increase output, and improve budgetary and financial planning.
- Communication – Development and implementation of effective internal and external communication structures in both Entity Customs Administrations

[206] 70% in 2001; 60% in 2002, 40% in 2003, and 0 in 2004.

- Computerization (ASYCUDA++) – Implementation of a country-wide customs computer system using ASYCUDA++.
- Customs Compliance & Enforcement – Establishment of an effective customs enforcement capacity aimed at contributing to the general improvement of customs revenue compliance.
- Internal Audit – Customs – Development and implementation of internal audit structures within the Entity Customs Administrations, including drafting audit and assurance programs.
- Customs Training – provide training to ensure that customs officers in BiH (i.e. its two constituent Entities) possess a sufficient customs education to carry out their duties effectively and develop self-sustaining customs training structures in each Entity

477. Given the comprehensive package of ongoing expert assistance that is being provided by CAFAO, the purpose of this section on Customs is to describe the procedures relating to importing/exporting taking into account the reforms that have already been implemented, identify some of the existing problems, and make recommendations for improving addressing the issues raised.

3. Harmonization and Cooperation Between Entity Customs Administrations

478. Cooperation between the Customs Administrations of both entities is crucial in ensuring the functioning of unified customs systems and a common economic space in BiH. It therefore follows that the level of cooperation between the two Customs Administrations has a direct effect on the ease of doing business in BiH.

479. Significant efforts are underway to coordinate and harmonize the work of the Customs administrations of both entities. An Agreement on Mutual Assistance and Administrative Cooperation on Customs Matters between the Federal Ministry Finance, Customs Administration and the R.S. Ministry of Finance, Republic Customs Administration, was signed on May 26, 2000. This agreement which provides for the manner of exchanging information and assistance. It also anticipates the establishment of a Joint Customs Cooperation Committee to oversee the proper functioning of the Agreement. It is generally agreed that this agreement codified existing cooperation channels between the Entities on most aspects of customs administration.

480. Representatives of the R.S. Customs Administration stated that there are no major barriers to communication between the two and that they have been communicating well. In cooperation with CAFAO there has been ongoing improvement in transport of goods, exchange of documentation, combating crime and staff training and education. However, one high-ranking Federation Customs official said that the two Customs Administrations do not have direct formal/official contacts. Instead, they rely on informal telephone contacts, and the level of exchange of information is very low. This problem, if it truly exists, is in contradiction to the provisions of the Law on Customs Policy of BiH,

including Art. 5 relating to administrative assistance. This official cited the situation when goods enter through the border controlled by the R.S. and the goods are to be cleared in the Federation. He described occasions where the Federation Customs Administration does not receive information that the goods have entered the country and are being transported to a Federation Customs house. Thus the goods were then illegally unloaded somewhere within the country. This official suggested that problems like this could be solved with the establishment of a single Customs Administration.

481. Representatives of the private sector, while critical of the Customs Administrations in other respects, did note that they were, for the most part, satisfied with the level of cooperation between the two. Nevertheless, it is still not possible for a company with a customs registration number in one entity to clear goods in the other entity. For example, at R.S. border crossings, Federation enterprises must report the incoming goods as in transit through the R.S. Then they clear those goods at the relevant Customs office in the Federation, where the importer is registered, because there are different Customs registration numbers. Again, unlawful importers and forwarders can take advantage if there is, as described above, lack of sufficient communication between the two Customs Administrations and the private sector is aware of this. The current solution is that if a company registered and operating in the Federation wants to import into the R.S., that company will have to obtain a R.S. customs registration number, but this seems to be an unnecessary and time-consuming extra step. Representatives of CAFAO stated that they are aware of this issue, but the underlying problem is ownership of revenue.

4. Customs Administration

a. Republika Srpska

482. Until 1999, the R.S. Customs was an independent authority. It is now part of the Ministry of Finance.

483. There are 8 regional Customs Houses (carinarnica) which are found inland and which administer the Customs Offices within their respective territories. These regional Customs houses issue decisions on administration of revenues and guarantees and they also deal with complaints.

484. The responsibility for processing customs clearances rests with Inland Customs Stations (ICS) and border crossing points (BCBs). The BCBs are typically located near road, river, rail and air points of entry.

485. The R.S. Customs Administration states that all customs points are computerized. The implementation of the ASYCUDA ++ by CAFAO is planned for September 2001. It is expected that this system will standardize and integrate the operations of customs procedures and administration in BiH.

b. The Federation

486. There are approximately 1200 employees in the Federation Customs Administration. One official expressed his belief that this number was unnecessarily high and led to a very cumbersome and inefficient system. This surplus will be particularly acute when the system is fully computerized; however, the level of computerization is currently not very high. As in the R.S., there is a system of Customs offices, BCBs and regional Customs Houses with similar functions.

487. According to CAFAO, proposals are currently being made for a comprehensive restructuring the headquarters and regional organization and infrastructure of the Federation's customs service. A Federation Customs official in commenting on the organization and structure of the Customs Administration noted that the majority of Customs offices in the Federation are controlled by a single ethnic group and, that they are in turn, controlled by political parties. Related discussions with the private sector appeared to show differing views on whether or not the ethnic composition and political affiliations of the staff of the Customs Offices affected the administrative process. A representative of a large forwarding company stated that this factor does not hinder its work with Customs while smaller importers and forwarders indicate otherwise.

5. Customs Registration

488. Any natural or legal person can import/export goods in BiH, provided they are registered with Customs. The purpose of Customs registration is to ensure that the company will pay all customs duties on imports. Pursuant to Art. 82 of the Law on Customs Policy, the person submitting the declaration must be registered with the Customs authorities in one of the entities, unless the declaration is for transit or temporary importation.

a. Republika Srpska

489. A company wishing to register as an importer/exporter with the R.S. Customs Administration must provide the following to any regional Customs house (carinarnica):

- request for registration
- a copy of the extract of the company's registration with the court (it is advisable also to take along an original extract)
- statistics number assigned to the company by the R.S. Bureau of Statistics
- fee for registration (approximately 20 KM)

490. The company's lawful business activities must include importing/exporting (many companies list these activities anyway, even if they have no present intention of engaging in import/export). The Customs Administration then issues a Customs registration number within 15 minutes.

b. The Federation

491. A company wishing to register as an importer/exporter with Federation Customs Administration must provide the following to any regional Customs house (carinarnica):

- request for registration
- a copy of the extract of the company's registration with the cantonal court (it is advisable also to take along an original extract)
- statistics number assigned to the company by the Federation Bureau of Statistics
- fee for registration (between 10 and 20 KM)

492. The Customs authorities look to ensure that the company's lawful business activities include importing/exporting.

6. Freight Forwarding

493. Article 6 of the Customs Policy Law provides that the importer may appoint representatives for importing goods (although the importer may import goods on its own, see the description of registration with the Customs authorities). The Law provides that such representatives (namely, freight forwarders) have to fulfill special conditions prescribed by the entity for carrying out such activity and must be registered in the relevant entity's Customs Administration. The business activities of freight forwarders are also governed by the regulations of non-customs related laws such as the Entity-level Laws on Special Conditions for International Forwarding Activities in Relation to the Customs Clearance of Goods.

494. In order to operate as a freight forwarder in the R.S., a company must be registered with the Customs Administration. The forwarder must have the business premises inspected just as any other business must do, and there is a recommendation that among the employees there is at least one person qualified to engage in forwarding activities (although it is not clear how strict this recommendation is).

495. According to the Customs Administration in the Federation, there is no separate procedure for registering a forwarding company with Customs. There is a law (adopted in 1996) defining special criteria for the establishment of a forwarding company but it appears this law has never really been implemented.

7. Border Crossing

496. In both the R.S. and the Federation, the following government institutions can be found on the BiH border:

- Customs.

- BiH Border Police. This is a recently established institution composed of citizens of both entities. Its purpose is to check persons crossing the border and to see whether vehicles are properly registered. Within 10 kilometers of the border, the BiH Border Police also fulfills the functions of the criminal police and may arrest persons found in the criminal register. It should be noted that the State Border Service (SBS) is not yet fully operational. Therefore the scope of its activities is limited in some areas.
- Various inspectorates, including Sanitary, Phyto-Pathological, Veterinary, Market.

497. According to CAFAO, customs officers are only present at authorized border crossing points (BCPs). There are a number of unmanned BCPs which are referred to as green borders. Agreement has been reached between the SBS, UNMBiH, OHR and the Customs Administrations of the Entities on a number of international and inland BCPS. As a result, there has been a reduction in the number of freight BCPs along the border with Croatia (from 35 to 21).

498. Unlike Customs and the Border Police which are on duty 24 hours a day, the inspectors work only on standard daytime schedule (until 5 p.m.). As a result, for all practical purposes, goods requiring border clearance by inspectors, can only be cleared during standard working hours. Alternatively, special arrangements can be made to ensure the presence of an inspector outside the normal working hours. In the view of one of the businesspersons interviewed, this arrangement provides yet another opportunity for corruption.

8. Procedures for Importing/Exporting

a. Authorization to import

499. In accordance with Arts. 34 and 57 of the Customs Policy Law, goods brought into BiH shall be conveyed to a Customs office (ispostava) by the person who brought the goods into BiH or by the person who assumes responsibility for carriage of the goods following the entry (e.g., the forwarder).

500. If the importer is using a forwarding company, the forwarder provides a form to Customs that it is authorized to do the importing for the importer. This “dispozicija” is generally a free form document on company letterhead that is filled in by the forwarder. Customs then checks whether the forwarder is duly registered.

b. Declaration of Goods and Selection of Customs Procedure

501. Upon the entry of goods into BiH, the importer or forwarder is required to declare the type and volume of goods, and to present the relevant invoice and the application for customs clearance to the Customs office. Also, the importer or forwarder is required to present his customs number. In accordance with Art. 66 of the Customs Policy Law,

where goods are covered by a summary declaration, Customs must, within 15 days from the date when the summary declaration was lodged with Customs, assign a Customs-approved procedure.

502. If the importer/forwarder does not want the goods cleared at the Customs office on the border, it must state that the goods will be declared at a Customs office within the country. According to the new Customs Law in the Federation, strict transport routes and Customs offices to be used by the importers/forwarders of high tariff goods (tobacco, oil, coffee, alcohol, etc.) will be defined.

503. In accordance with Art. 76 of the Customs Policy Law, all goods processed under a Customs procedure shall be covered by the relevant declaration for that Customs procedure. The written declaration is known as the Single Administrative Document, which is harmonized with the EU documentation. The declaration must be accompanied by all other documents required for the selected Customs procedure. The declaration may be submitted by the importer or its duly authorized representative (forwarder). Several members of the private sector opined that procedures have improved with the introduction of the Single Administrative Document.

9. Customs Procedures

504. Under the Customs Policy Law (article 4.17) BiH has adopted the following customs procedures in accordance with EU standards:

- Release for free circulation
- Transit
- Customs warehousing
- Inward processing
- Processing under Customs control
- Temporary importation
- Temporary exportation
- Exportation.

a. Assessment and Payment of Duties

505. On the border, customs officials calculate the fees and the bank guarantee is debited, meaning that the total customs value of the goods declared must be less than the bank guarantee. If the guarantee has already been debited and the customs value of the goods is higher, the importer must present an additional bank guarantee.

506. The forwarder then delivers the goods to a customs office (ispostava) where the duties are assessed. In practice, payment cannot always be made where the assessment was done. However, this problem does not exist at the major border.

507. Art. 171 of the Customs Policy Law provides that for excise goods, cash (in local or foreign currency, based on the Central Bank exchange rate) or a bank guarantee are acceptable methods of payment. For non-excise goods, the importation process is completed when the goods are cleared at the customs office, where all customs duties are calculated and collected. Afterwards, the customs desk at the border crossing at the point of entry is informed that the customs duty was paid.

508. According to CAFAO, the usual procedure for goods entering the customs territory of BiH via a BCP is to transfer the goods to an inland customs station(ICS). Consistent with the EU standards, a guarantee (cash or bank) is required for this operation. At the ICS, the goods may be cleared by Customs. During the customs clearance procedure, the goods are classified in accordance with the BiH Customs Tariff and a valuation of the goods is made. With clearance, the goods are released to the domestic market and the assessed customs duties are due to the Customs administration. If this payment is not settled immediately, then a bank guarantee must be provided.

509. One Federation businessperson stated that their forwarding company tries to import through the R.S., because the R.S. Customs officials tend to be more liberal – they do not always debit a guarantee.

b. Customs Debt

510. The Law on Customs Policy makes the following provisions regarding customs debt:

- According to Art. 93.1., where acceptance of a Customs declaration gives rise to a Customs debt, the goods covered by the declaration shall not be released unless the Customs debt has been paid or secured.
- Arts. 166-209 of the Law on Customs Policy cover Customs debts, including security to cover the Customs debt, incurrence of a Customs debt, recovery of the amount of a Customs debt, extinction of Customs debt, repayment and remission of duty.
- Art. 167 of the Law on Customs Policy provides for the availability of comprehensive guarantee to cover multiple operations in respect of which a Customs debt has been or may be incurred. Security may be provided by either a cash deposit or a guarantor.
- The Customs debt is incurred at the place where the customs procedure is carried out (Art. 188 of the Law on Customs Policy).
- The debtor (or any third person) must pay the amount of duty communicated to it within a 10-day period. In cases of duty not paid within the prescribed period, interest on arrears is charged in addition to the amount of unpaid duty (Arts. 195 and 199 of the Law on Customs Policy).

c. Bank Guarantees

511. A bank guarantee serves as an insurance that indicates that the importer applying for customs clearance of goods is able to pay all obligations to Customs. The importer is

obliged to produce a bank guarantee as proof once it comes to the border with the goods to be imported into the country. The Customs Administration in the Federation cooperates closely with the Banking Agency which helps Customs in controlling the validity of the bank guarantee submitted by the importer.

512. In addition to the bank guarantee, there are reports that, at least in the Federation, a company is required to leave a deposit, although the amount and the means to determine it could not be ascertained. The explanation offered for the need for such a deposit is that one can steal somebody's ID card, register a company on that very name, import certain goods and then disappear. This seems to be an unnecessary burden that is unlikely to be a cost-effective solution for this problem.

d. Border Waiting Times

513. The R.S. Customs Administration states that the waiting time for customs clearance (provided everything is in order with the goods) is between 5 and 6 hours. However, members of the private sector have reported waits of between 40 minutes up to several days.

514. According to CAFAO, if all documentation is in place and subject to traffic volume, transactions should be processed within 2 hours. Processing time, in CAFAO's view, is increased as a result of incomplete documentation, absence of payment guarantees, and other non-compliance factors.

e. Exports

515. There is a relatively low level of exports from BiH and, therefore, the related administrative procedures for exportation was not raised as an issue among existing domestic and foreign investors. However, as the volume of exports increase over time, it is likely that this will emerge as an issue.

516. Preliminary indications and anecdotes from small enterprises exporting goods suggests that the existing problems relate largely to lack of knowledge of the established regulations by the Customs Houses and the delays resulting from unnecessary consultation with the technical advisers before clearing the export goods. As expressed by one local producer, "The sheep working at the BiH customs office still don't have the confidence or desire to grant the proper export documents without the written permission of their foreign overlords." In this exporter's experience, CAFAO's intervention/ approval is required even conducting repeat transactions for the same goods to the same clients abroad.

f. ASYCUDA++

517. The Automated System for Customs Data (ASYCUDA) is an integrated customs transactions processing system that is based on guidelines promulgated by UNCTAD. CAFAO is implementing this system in BiH. A prototype has been developed and field

tests are being conducted. Implementation is now scheduled for September, 2001. The anticipated benefits of ASYCUDA include fully standardized and documented requirements, precisely calculated duties, unified and standardized customs procedures, expedited customs clearance.

518. A representative of the business community stated his belief that the introduction of the ASYCUDA system will make life easier for importers and forwarders. Since the Customs system will be linked electronically, debiting and crediting of customs guarantees will be faster and there will be a faster exchange of information.

10. Customs Tariffs and Other Duties

a. Customs Tariffs

519. Pursuant to Art. 19.1. of the Law on Customs Policy, rates of customs duty shall be the same in both entities. Art. 19.2. provides that "Import duties shall be paid on all goods which are released for free circulation in the Customs territory of BiH at the rates stipulated in the Customs Tariff Law of BiH." Depending on the type of goods, a Customs tariff of 0%, 5%, 10% or 15% is imposed. Since the tariffs are adopted at the BiH level, they are the same in both entities.

520. Interviews with some importers suggest that there is some difficulty in obtaining guidelines and published material on tariffs and procedures. FIAS was told that the Federation has issued a book on the tariff nomenclature, with detailed annotations. Further, although the tariffs are the same in both entities, R.S. Customs officials do not accept the Federation-issued book and this has caused misunderstandings for importers on the border.

521. However, according to CAFAO, the publication in question is the World Customs Organization (WCO) Explanatory Notes to the Harmonized System (The Customs Tariff). Copies have been made available to the Customs Administrations in both Entities, although not in sufficient quantities for distribution to all customs officers. It appears that some enterprising customs officers have reproduced copies and are selling them to those willing to pay.

b. Other Duties

522. In addition to the Customs tariffs, the following duties are imposed and must be paid on import:

- A fee of 1% of the value of the goods is imposed in both entities. This is to cover operating costs of the Customs administrations. Pursuant to Art. 13 of the Law on Customs Policy, "[t]he amount of customs value for customs record keeping shall be charged for the goods to be imported."

- An excise tax is imposed on certain goods (see the description of Excise Taxes in the section on Taxation). The Tax Administrations collect the excise tax on locally-produced goods (for imported excise goods, the tax is collected by Customs).
- There is a special fee imposed on certain goods in order to the protect domestic production of those goods (see the description of Surcharges in the section on Taxation). Tariffs are determined in monetary amounts per measure unit of imported goods (for example, the tariff is 1.45 KM for 1 kg of chicken meat).

523. There is also a requirement in the R.S. that all companies that are engaged in import/export must pay a Tourism Tax – 0.10% of entire turnover, but this tax does not seem to exist in the Federation.

11. Revenues and Refunds

524. Customs revenues belong to the entity where customs clearance takes place. Customs constitutes the largest portion of revenue in both entities. In the Federation, one official stated that Customs was up to 95% of revenue.

525. Art. 203.2. of the Law on Customs Policy provides that import duties shall be repaid or remitted upon submission of an application to the appropriate Customs office within a period of three years from the date on which the amount of those duties was communicated to the debtor (this period can be extended for cause). Representatives of the private sector stated that repayments and remissions can take up to 2 years. According to CAFAO, it should be noted that this provision applies to a small number of cases in very special circumstances. However, the fundamental point is that repayments and remissions are slow.

12. Customs Duty Exemptions

526. Companies may receive exemption from customs duties on equipment imported as fixed assets. In accordance with Article 162 of the Customs Policy Law (as amended, December 2000), "… equipment released for free circulation [import] representing an investment by a foreign person, except for passenger vehicles, entertainment and slot machines, shall be granted relief from payment of customs duty."

527. The conditions to be fulfilled by the importer are defined by the Decision of the Council of Ministers (Official Gazette No. 27/98). In order to receive the exemption on equipment, the following conditions must be met:

- The company must be duly registered with the relevant court.

- If the importer is a joint venture, the foreign partner must be registered with the Ministry of Foreign Economic Affairs of the R.S. or the Ministry of Trade and Tourism of the Federation.
- There must be an agreement on foreign investment certified by the R.S. Ministry of Foreign Economic Affairs or the Federation Ministry of Trade and Tourism.
- The equipment to be imported must be specified in accordance with the correct tariff nomenclature.
- The equipment being imported may not be older than 10 years.
- The equipment must satisfy all environmental regulations (the relevant government institution, such as the R.S. Standardization Institute, the Ministry of Energy and Mining or Ministry of Civil Construction, must issue a certificate).

528. The R.S. Ministry of Foreign Economic Affairs provides the decision that a company is exempt from customs for importation of fixed assets. It is worth noting that under the existing regulations, only the minister can approve this exemption. Since there is no provision for other signatories, the process may well be delayed by the unavailability of the minister. Once this approval is obtained, the duty exemption is processed through the regional Customs house. When the equipment is entering the country and it is inspected by the customs officer, the importer (or its forwarder) must submit the Resolution of Customs. Once this procedure is completed and approved, the goods are cleared for import. A fee of 1% of the value of the goods is imposed to cover the operating costs of the Customs administration.

529. In the Federation, if the company has all the documentation as defined by the Decision of the Council of Ministers (Official Gazette No. 27/98), the Customs Administration is authorized to decide whether a transaction is exempt from Customs duties for fixed assets.

13. Decisions, Information and Appeals

530. The Law on Customs Policy (Art. 7) provides that a person may request that the Customs Administrations take a decision relating to the application of Customs rules. The authorities are required to respond within 30 days, unless there are justifiable grounds for delay. There are reports that no relevant case has been brought up yet, but it may only be a matter of time as more complex transactions evolve.

531. In addition, the Law on Customs Policy provides that any person may request information concerning the application of Customs regulations from the entities (Art. 11). It is unclear the extent to which this is actually practiced.

532. The procedures for appeals are regulated in the Law on Customs Policy (Arts. 210-213). Any person has the right to appeal against decisions taken by the entities which relate to the application of Customs legislation, and which are of concern directly and individually. The person can appeal the decision in terms of amount, duties, calculation. The person first appeals to the regional Customs house (carinarnica) to which the Customs office (ispostava) belongs. The Law provides that the company can then appeal to an independent body according to the provisions in force in the entities. The Administrative Procedures Act supplements the provisions on appeals in the Law on Customs Policy.

533. According to CAFAO, in practice in the Federation (with similar practices in the R.S.), the appeal for an administrative procedure may be lodged at the Ministry of Finance and may be referred to the Courts for resolution. In the case of on "offense" procedure, the appeal may be lodged at the Federal Offense Council (a body independent of Customs) and may be referred to the Courts.

534. Art. 211 of the Law on Customs Policy stipulates that the lodging of an appeal does not cause implementation of the disputed decision to be suspended, but the entity may choose to suspend implementation. A representative of the business community in the Federation stated that the appeals procedure is very slow, but an appellant can win with strong arguments and lots of time. Another businessperson offered a more skeptical view – indicating that it is difficult to appeal a decision through the Customs house (carinarnica) when the complaint must be routed through the object of the complaint. It appears that very often appellants simply do not receive replies to complaints, and when responses are provided a significant delay is standard. In the experience of one interviewee, in order to avoid delays, it is necessary to make the contested the payments (considering them to be only temporary charges) while continuing to press the appeal. The entire process can take between 15 days and 6 months.

14. Free Trade Zones

535. In accordance with Art. 149 of the Law on Customs Policy, the entities designate parts of the Customs territory of BiH as free trade zones (FTZs).

536. Any industrial, commercial, service activity is authorized in a free zone, under the conditions laid down in the Law on Customs Policy (art. 154.1). There are seven FTZs currently in operation in the Federation. However, it appears that these zones function primarily as duty free shopping areas for domestic consumers with little production or investment activity. These zones offer unfair competition to producers outside the zones, permitting duty-free importation of goods for sale to domestic consumers. To date, there are no free zones in the R.S.

537. A State Law has been drafted for the regulation of FTZ, based on EU standards, in order to attract export-oriented investment. According to CAFAO, if this law is implemented, it will significantly reduce the number of free zones in the Federation.

15. Analysis

538. As noted above, the business community largely perceives the Customs Administrations of both Entities to be extremely corrupt. A number of specific instances of corruption were cited by interviewees in the private sector. Nevertheless, the incremental changes introduced by CAFAO and the Customs Administration are producing some improvements. According to CAFAO's timetable for the implementation of new systems, all the changes are expected to be in place by the end of 2001 so that monitoring can begin in 2002.

a. Cooperation among the Customs offices.

539. It has been noted by private sector representatives that there is significant and increasing cooperation between the Entities' Customs Administrations. Nevertheless, situations arise where that cooperation degenerates and negatively impacts the flow of goods. For example, one R.S. businessperson complained that R.S. Customs declined to accept a Federation bank guarantee for excise goods bound for the Federation. In this situation, with the goods sitting on the border and no immediate access to authorities for an appeal, this situation presented yet another opportunity corruption and the abuse of authority. In the absence of a regulation governing the acceptance of guarantees and the sharing of information between Entities on which Bank guarantees are to be honored, flow of goods can be disrupted.

540. Since customs revenues are credited to the Entity conducting customs clearance transaction, there is some potential for competition among the Entities. This is a situation for which protocols should be established and monitored to avoid manipulation and negative results.

b. Book on Tariff Nomenclature

541. The Federation has published a book on Tariff Codes. One freight forwarder opined that this book is very useful, since it specifies the classification of goods by code. However, when the forwarder tried to use the Federation book in the R.S., he was informed by a Customs officer that the book was not applicable in the R.S., despite the fact that the same law governs both Customs jurisdictions. In this case, an official publication with this information for both Entities should be prepared and disseminated. In order to offset the cost of publication, it may even be sold to the public at on a cost basis.

c. Border Authorities

542. The Border Police have an important role to play in securing the borders of the country. In order to ensure that the work of the Border Police helps rather than hinders business activity and the flow of goods, it is necessary to clarify the mandate and

functions of the Border Police and to establish procedures for its operation along with a code of conduct for its officers. Efforts to draft a Memorandum of Understanding (MoU) between the BiH Border Police and the Customs Administration are underway. The provisions of this MoU must be honored and they must be communicated to officials at all levels in both agencies.

543. Given the problems with corruption in the inspectorates, the facilitation of inspections at border crossings outside of standard working hours should be regulated and monitored. The procedure for arranging this service and a schedule of fees should be posted and adhered to.

d. Information Dissemination and Training

544. One businessperson stated that one of the problems affecting the flow of goods across BiH's borders is the poor flow of information on legislative and regulatory changes within the Customs services. Although the private sector has access to the Official Gazette, it is necessary to ensure that this information is disseminated among customs officials in a timely manner.

545. One forwarder stated that there have been cases where the government accepts a law but Customs continues to operate in accordance with the old rules. This is a particularly difficult situation, because efforts to inform the Customs official on the border of the changes in the rules are generally ineffective. Another businessperson stated that her major recommendation to improve the work of the Customs officers is increased training regarding the use of the TIR Carnet. It appears that Customs officials currently require these trucks to undergo the same procedures as other trucks.

546. Both Customs Administrations claim to have systems in place for disseminating information on changes in regulations. FIAS was informed that this information is also entered into the computer system. Although the Customs officials have internet access, some are reported to ignore the latest information so they can use the highest valuation available (not the newest valuations, which may be available on the internet), which they may have found in an old book. This situation suggests that dissemination of the information needs to be supplemented with training and a system for monitoring implementation to minimize abuse.

547. The newsletters that both Customs services have just begun to publish are a good beginning, provided they are easily available to all interested parties (both in Customs and the private sector) and that they contain useful information. More direct mechanisms for disseminating and explaining changes in Customs regulations nee to be developed. As part of this process, contacts need to be established business associations and freight forwarders as well as individual business owners, where applicable.

e. Decisions and Appeals

548. The Law on Customs Policy includes explicit provisions on binding decisions, the availability of information concerning the application of Customs regulations, and the right to appeal decisions made by Customs officials. Clearly the next step is the effective implementation of these provisions. Some of the private sector representatives interviewed by FIAS voiced skepticism about the implementation.

f. Documentation Requirements

549. Some interviewees complained that some of the required documentation for the processing of goods is excessive and unnecessary. A review of the documentation requirements for customs clearance and the process for routing information and documentation is necessary as part of efforts to streamline the customs process. Because the need for particular documentation is driven by various parties, it is necessary to convene a meeting of the various parties (Customs, Financial Police, as well as the private sector) in order to clarify the information needs of each party and ensure that an effective system routing the required documentation. This information should be published and disseminated to all relevant parties.

g. Service Orientation

550. Some users of customs services have commented on the notable lack of service orientation on the part of customs officials and the perception that customs officials do not see themselves as providers of a public service but rather as enforcers of the law. The Law on Customs Policy (Annex 1) provides a "Code of Conduct for Customs Officers". This is obviously a necessary and good first step. Nevertheless, merely proclaiming such a code may be insufficient to change attitudes. In keeping with the experience of other transition countries, changes in attitudes and behavior require commitment and time. Rule changes must be supported by training in client-orientation, introduction of a system of individual accountability (where the official is responsible for his or her actions and knows it), and, inevitably, compensation and rewards.

h. Corruption

551. Corruption is viewed to be one of the greatest problems afflicting the Customs system. Representatives of CAFAO expressed the hope that by administrative reorganization and introduction of a computer system, opportunities for corruption will be reduced. CAFAO also stated that they are helping to build an internal audit capacity for Customs. This must be supplemented by an external, independent monitoring system and public reporting on performance.

552. Corruption can be resolved only in part by streamlining administrative procedures, increasing availability of information and improving audit mechanisms. Corruption is a society-wide problem and its resolution requires intensive and persistent action by all levels of government and society.

16. Recommendations

553. Box 1 provides a summary of the customs reform program in Mexico. Mexico's experience and the experience of other Eastern European transition economies may provided useful inputs or lessons for the BiH customs reform effort. On the basis of the points of analysis discussed above, FIAS makes the following recommendations for strengthening Customs procedures and services:

- Expedite the system of refunds and repayments.
- Eliminate deposit requirements in situations where importers already have guarantees.
- Review and enforce the rules for FTZs to ensure that the zones are not utilized to import or produce goods for the local market.
- Adopt customs registration numbers that are recognized by and valid in the other entity.
- Improve computer access in all customs offices and, as a matter of priority, link them into a state-wide network. The introduction of the ASYCUDA++ system will be an integral part of this endeavor.
- Establish a mechansim for the timely the publication and dissemination of changes in the customs legislation and regulations of each Entity. This information must be disseminated to officials as well as the business community, including forwarders and importers. In addition, as part of the harmonization process, information must be shared and disseminated across entities.
- Establish an independent appeals body for the review of unfavorable Customs decisions.
- Develop a forum and process for consultation with the private sector, e.g., a Customs/Business consultative council.
- Identify and define, in a written document such as a Memorandum of Understanding, the authority of all institutions on the border.
- Continue training of Customs officials in new substantive issues and introduce client-orientation and other relations-based training.
- Establish external auditing and performance review mechanisms to help reduce corruption in Customs.

Box 1

Customs Reform in Mexico

In the late 1980s, Mexico initiated a major program of customs reform to accompany its new policy of trade liberalization. In addition to reducing tariffs, Mexico completely abolished official reference prices on all imports and almost all exports. From mid 1989, a radical reform was begun to modernize and improve efficiency of the customs process. The excessive costs of clearing customs were effectively another barrier to trade, because customs procedures did not keep pace with the trade reforms. Traders faced long processing delays and substantial undocumented costs in clearing merchandise. The authorities had effectively lost control of the customs process and revenues and the system had become bogged down in a mire of bureaucracy, ad hoc decision-making, and corruption. Customs regulations implied that every merchandise transaction had to be inspected individually, and hundreds of regulations could be applied. Enormous discretion and negotiating power were given to customs officers, with the predictable result that the authorities effectively lost control of the process.

Importers used private customs brokers to find their way around the myriad statutory obligations and provisions. Customs brokers were generally considered to be major accomplices in customs irregularities. Entry to the profession had been tightly controlled by means of licenses and the number of customs brokers remained roughly constant for over a decade.

As of January 1, 1990, Customs was integrated with general tax collection, which was based on voluntary declaration of tax liability. Similarly, customs duties in Mexico are now paid in advance of clearance procedures, and are made through commercial banks rather than directly to customs officials. A basic premise of the new system was that meaningful individual inspection of each transaction is impossible. A computer generated random selection process now determines which trade transactions are inspected. The authorities refined sampling techniques based on lessons learned from the information being gathered - for example, more frequent inspections where higher irregularities are found.

The number of steps in the customs process was reduced by two-thirds, and the reduction in processing time is a major source of savings for both the authorities and the traders. Entry to the formerly tightly controlled customs brokers' profession was freed-up, and fees are determined by market competition. The random inspection system is complemented by stiff fines and penalties for all parties involved if irregularities are discovered during the inspection. The normal processing time per transaction was cut from around 3 days to 20 minutes, or a maximum of 3 hours if selected for merchandise inspection. The volume of operations increased by 50% after six months at some of the main entry points, while daily collections adjusted for trade increased by over 10 %.

Source: The World Bank

E. Inspections

1. Legal Jurisdiction

554. Once operations have begun (even before in some instances), a business is subject to inspections for various reasons. Since there are many common features relating to the organization and procedures of the inspectorates, this section describes those common aspects of the inspections system in both Entities. This description of structures and procedures is followed by a focus on some individual inspectorates that may be of particular concern to investors.

555. The general laws that define the work of inspectorates in the Federation include:

- The Law on Administrative Procedures (Federation Official Gazette No. 2/96)
- The Law on Government Administration (Official Gazette No. 48 and 49)

556. Similarly, the R.S. laws governing inspectorates include:

- The Law on Administrative Procedures (published in 1997)
- The Law on Administrative Disputes (published in 1994).

557. The Laws on Administrative Procedures adopted in both entities are based on the Law on Administrative Procedures of the former Yugoslavia. These Laws on Administrative Procedures provide for various penalties, deadlines, and complaints systems. There is legislation passed by Parliament and published in the Official Gazette of each entity regulating each inspectorate individually. Although each inspectorate is governed by a separate law, these laws are fairly similar.

558. For example, in the Federation, each inspectorate at the municipal level has a different set of laws governing its activities. These include:

- Veterinary Inspectorate – Law on Protection of Animals from Contagious Diseases, Law on the Health Protection of Animals;
- Sanitary Inspectorate – Law on Sanitary Inspectorate, Law on Food Quality Control, Law on Contamination of Food, etc.;
- Communal Inspectorate – activities are based on 6 different decisions defined by the Municipality Council (Decision on Water Supply and Sewerage, etc.);
- Labor Inspectorate – work based on the Law on Protection at Work and 13 other policy documents published in the Official Gazette of the Former Yugoslavia.

559. Penalties are based on different laws. For example, penalties imposed by the Financial Police in the Federation, for example, are based on the Law on Tax Administration, the Law on Sales Taxes on Goods and Services and the Law on Corporate Income Tax.

2. The Inspectorates

a. Inspectorates in the R.S.

560. The inspectorates in the R.S. include the following:

- Financial Police (described in a separate section)
- Labor Inspectorate (entity and municipal level)
- Market Inspectorate (entity and municipal level)
- Sanitary Inspectorate
- Health Inspectorate
- Firefighting Inspectorate
- Environmental Inspectorate
- Institute for the Protection of Cultural Monuments.

561. In addition to these officially sanctioned inspectorates, there are also reports of extra-legal inspections activities, inspectorates with unclear mandates (e.g., the Foreign Exchange Inspectorate and pension and health insurance fund "inspectorates").

562. There are R.S. (entity level) and municipal inspectorates. The Entity-level inspectorates are under the jurisdiction of the relevant Entity-level ministries (the Sanitary Inspectorate is under the jurisdiction of the Ministry of Health, the Market Inspectorate is under the jurisdiction of the Ministry of Trade in the R.S.).

563. There are also municipal inspectorates in the R.S. These inspectorates report to the municipal authorities or to the relevant Entity-level ministry. The municipal inspectors are appointed by the executive authority of the municipality. In Banja Luka, for example, the municipal level inspectorates are under the Secretariat for Inspections (soon to be shifted to the municipal Secretariat for Economy). In the future, it is expected that the inspectorates will be moved to the Entity level, placing them under the jurisdiction of the relevant line ministry.

b. Inspectorates in the Federation

564. The inspectorates in the Federation include the following:

- Financial Police (described in a separate section)
- Labor inspectorate (entity and cantonal level)
- Market inspectorate (entity and cantonal level, in some cases also municipal)
- Sanitary Inspectorate
- Tourism and Catering Inspectorate
- Firefighting Inspectorate
- Environmental Inspectorate
- Institute for the Protection of Cultural Monuments

- Veterinary Inspectorate
- Communal Inspectorate
- Construction Inspectorate (some municipalities)

565. In addition, there are other inspectorates that have been established within cantons or municipalities. These inspectorates are not covered in this report.

566. In the Federation, some inspectorates (e.g., the Market Inspectorate and the Labor Inspectorate) function across the Entity, canton and municipal levels. Similar to the R.S., the entity-level inspectorates are under the jurisdiction of the relevant line ministries (e.g., the Federation Ministry of Trade and Tourism supervises the Market Inspectorate as well as the Tourism and Catering Inspectorate).

567. The cantons determine the if and how jurisdiction for inspectorates are allocated at the municipal level. On the municipal level, the organization of the inspection functions vary. For example, in the Zenica Municipality, a single Inspections Department has been established with authority over the Market Inspectorate, Veterinary Inspectorate, Communal Inspectorate, Sanitary Inspectorate, Construction Inspectorate, Inspectorate for Protection at Work, and until recently the Labor Inspectorate. Responsibility for Labor Inspectorate was transferred to the Canton, while the Construction Inspectorate was transferred to the Municipality Centar in Sarajevo.

3. Basis for Inspections

568. The relevant laws (including the legislation governing each inspectorate and the Administrative Procedures Law) do not specify the criteria for targeting enterprises for inspection or the frequency of such inspections. Instead, the line Ministries design and adopt operational plans and pass them on to their respective inspectorates. In practice, inspections are initiated on the basis of information from government institutions or from natural or legal persons.

569. From time to time the government organizes so-called “actions” or campaigns. For example, recently the Government of the R.S. mobilized the Labor Inspectorate to improve the collection of social contributions and wage taxes. In the view of the private sector, inspectors do not follow a regular schedule and surprise inspections do not seem to be based on discernible, valid criteria. One member of the private sector stated that inspections take place when the inspectorates need money.

4. Inspection Procedures and Decisions

570. The inspection procedures for the R.S. and the Federation are basically the same. At least 2 inspectors are required to participate in each on-site visit. The on-site procedures are generally based on the specific laws governing the inspectorates and the implementing regulations developed by the line ministries.

571. During or after the on-site visit, the inspectorate can:

- Issue a warning to resolve the problem by a certain deadline (this forms the bulk of most decisions). The period given to resolve the problem depends on the type of irregularity and it may be anywhere between several days to many months. In this case, the inspector is issuing a Decision on the Removal of Irregularities and Illegalities.
- Prohibit operations if measures to comply have not been performed since the previous inspection.
- Temporarily close down the business premises (until the final decision has been issued).
- Fine the business and/or individuals in case they tried to hinder the inspection.

572. In addition, the Market Inspectorate has the authority to confiscate goods.

573. After the on-site inspection, the inspector is obliged to prepare minutes and leave a copy with the target of the inspection, regardless of whether or not violations are found. Companies are allowed to comment on the inspector's minutes. The comments have to be submitted to the inspectorate within five days upon receipt of the minutes. It is general procedure that both the inspected company representative and the inspector doing the on-site visit have to sign the minutes of the on-site inspection. The minutes should incorporate all comments made by the company representative. Also, the company can choose not to sign the minutes if it is not satisfied with the way the inspection was performed.

574. Pursuant to the final decision, the inspectorate can:

- Prohibit operations for a certain period of time.
- Close down the business, but there are provisions for reviewing this decision.

5. Inspection Appeals

a. Appeals in the Republika Srpska

575. In the R.S., the target of an inspection has the right to appeal an inspection decisions. This appeal must be submitted within 8 days of the notification of the final decision of the inspectorate. The relevant ministry to which the appeal is submitted must respond to the appeal within 30 days. It should be noted that the submission of an appeal postpones enforcement of the decision until the appeal has been resolved, unless the decision prohibited operations or called for a closure of the business.

b. Appeals in the Federation

576. In the Federation, the target of an inspection has 15 days after receipt of the inspectorate's final decision to appeal that decision.

577. In cases of inspectorates under cantonal or Federation jurisdiction, the company sends its appeal to the canton department which issued the decision. This department is obliged to forward this appeal to the Federation headquarters of the inspectorate. It is not clear why the company cannot send its appeal directly to the Federation headquarters of the inspectorate, and the fact that the appeal must go through the institution that made the decision in the first place may cause companies to reconsider a decision to appeal, since there is no guarantee of objectivity.

578. The Federation headquarters of the inspectorate has 30 days to make a decision. Decisions may include:

- Termination of decision of the cantonal department;
- Correction of the decision of the cantonal department;
- Refusal of submitted appeal.

579. Submission of an appeal does not cease or postpone the implementation of actions determined by the decision of the cantonal level inspectorate in the Federation. However, there are reports of plans to allow the implementation of the decision to be postponed until the appeals process is completed.

580. If the company is not satisfied with the decision of the Federation headquarters of the inspectorate, it has the right to appeal to the Supreme Court. This process may be lengthy. If a company disagrees with a decision of a municipal level inspectorate, the company is entitled to file a complaint at the municipal court.

6. Market Inspectorate

a. The Republik Srpska

581. The work of the R.S. Market Inspectorate is governed by the Law on the Market Inspectorate and the Law on Trade and the Law on Tourism. Through the Market Inspectorate, the R.S. Ministry of Trade ensures the implementation of trade laws, including quality and goods control by certifying that goods being sold are supported by the appropriate paperwork and that the goods are in compliance with the prescribed quality standards. There is evidence of cooperation between the R.S. Market Inspectorate and the Health Inspectorate to ensure that companies are in compliance with proper health standards. Unlike in the Federation, there is no specific Tourism and Catering Inspectorate in the R.S. The R.S. Market Inspectorate is responsible for those areas as well.

582. In the R.S., the Market Inspectorate is found at two levels (entity and municipal). The entity level market inspectors work in the entire territory of the R.S. The municipal level market inspectors work only in that municipality. The entity level Market Inspectorate supervises the work of the municipal level Market Inspectorates and has formal authority over them. Nevertheless, every municipality has followed its own approach. A draft Law on the Market Inspectorate has been submitted that provides for consolidation of the two levels of Market Inspectorates. As of January 1, 2001, the entire Market Inspectorate falls under the jurisdiction of the Ministry of Trade. With the consolidation of the municipal Market Inspectorates at the entity-level, it is expected that the work will be better organized and better supervised.

583. The Laws governing the work of the Market Inspectorate (i.e. the Law on Trade, the Law on Tourism, the Law on the Market Inspectorate etc.) mandate the penalties for violations. The inspector can issue a warning and require the correction of irregularities within 7-15 days. On-site payments can be made immediately. The second level of penalty is confiscation of the goods. The confiscated goods may be sold or destroyed. Another penalty entails the shuttering of an entire enterprise or some of its shops.

584. There are amendments planned to the Law on Violations in order to limit the penalties to the enterprises, assigning vicarious liability to employers. Recent amendments have abolished the two-layered system of violations under which individuals could be found criminally liable (level 2).

b. The Federation

585. The Federation Market Inspectorate is under the supervision of the Ministry of Trade and Tourism. There is a set of Laws (10 to 15) which govern its activities, and, among them, major ones are Law on Market Inspection, Law on Administrative Proceeding (Official Gazette No. 2/96) and Law on Government Administration (Official Gazette No. 48 and 49). It is organized at the entity and cantonal levels, and, in some cases, at the municipal level as well.

7. Analysis

586. Many of the private sector interviewees support the work of the inspectorates provided that they are effective in eliminating illegal competition and business practices. Nevertheless, discussions highlighted a number of allegations about corruption, meddling by politicians and government officials, entrapment, disruptive and unclear procedures, unclear mandates, and ineffective appeals systems. Interviewees also lacked a clear understanding of the basis or triggers for inspections and the criteria for imposing penalties.

a. Inventory of Inspectorates

587. In general, it seems that, on the cantonal level in the Federation, almost each ministry has its respective inspectorate, whose activities overlap with municipal inspectorates' work. As a result, it is difficult to determine the extent of duplication or overlap among the various inspectorates, taking into account the municipalities, cantons and entity-level governments which have different inspectorates under their jurisdiction.

588. As a first step in minimizing redundancies that are costly to both business and government, each Entities should prepare an inventory of inspectorates (including those that function extra-legally or under questionable mandates) and their mandates. Such an exercise is essential for rationalizing and evaluating the system of inspections.

589. The planned consolidation of the R.S. entity level and municipal level Market Inspectorates is an encouraging sign. The existence of identical inspectorates at several levels is not only a severe drain on government resources, it is also very problematic and costly for businesses to be subject to the same inspection at least twice.

590. In addition to lawful inspectorates described above, there were reports in the R.S. of extra-legal inspection activity by institutions that are not authorized to engage in on-site inspections, namely the institutions responsible for the control of pension funds and, in certain municipalities, the health insurance fund. Members of the private sector suspect that these "inspectorates" are formed to supplement the income of the relevant governing institutions. One businessperson stated that after he laid off 30 employees in accordance with the law, representatives of the pension fund showed up to check the records. Although these "inspectorates" do not have the authority to close down a company, if their requests are not complied with, they can inform the Financial Police.

591. There are also reports that there is a Foreign Exchange Inspectorate in the R.S. It was difficult to ascertain whether this particular inspectorate exists, perhaps and indication of the confusion within the inspection system. This inspectorate was part of the former Narodna Banka Jugoslavije and it controlled the foreign exchange operations of legal entities. Its mandate was authorized by the Foreign Exchange Law of the R.S. However, now that the Convertible Mark has been introduced and the Law on the Central Bank of BiH has been adopted, there is a contradiction with the still valid Foreign Exchange Law of the R.S. There were some reports from different companies that this inspectorate still controls foreign exchange. If the laws upon which this inspectorate bases its work in fact no longer apply, this may be a case of a well-established practice taking precedence over the law.

b. Inspection Criteria

592. Members of the private sector expressed skepticism about the upon which inspectorates base their activities. There were several allegations that inspectors target business which in their view has deep pockets and that inspections are conducted when an inspectorate is low on funding. In addition, there was an even stronger allegation that

the inspection system is used by politicians to harass competitors and "independent" operations. These allegations surfaced in both the Federation and the R.S.

c. Cooperation among Inspectorates

593. A great deal of time and effort can be saved if inspectorates coordinate their visits. In doing so, the disruption of business is reduced, the inspectors can cross-check their findings, and the opportunities for complicity and corruption are reduced. The statements of the R.S. Market Inspectorate that they coordinate visits with the Health Inspectorate are encouraging and should be replicated among other groups of inspectorates, such as the Firefighting and Labor Inspectorates.

d. Inspectorate Mandates and Authority

594. The relevant legislation and regulations governing the mandates and procedures of inspectorates should be readily available to the public. Inspectors should be required to follow established guidelines on criteria for selecting businesses for inspection, the authority of the inspectorate and what punishments can be imposed and the criteria for selecting those punishments.

595. Overlapping mandates for inspections is a problem that must be addressed in order to minimize inefficiencies and the waste of resources in the inspection system and reduce the burden on the private sector.

596. The market inspectorate is a candidate for review and rationalization. Market inspectors are responsible for, among other things, policing the traders on the streets. Since the market inspectors have occupied this niche, the Ministry of Finance of the R.S., for example, cannot take appropriate actions to reduce illegal trade without going through the Market Inspectorate. In fact, some of the quality control activities of this inspectorate can probably be assigned to other inspectorates, such as the Phyto-Pathological Inspectorate, the Sanitary Inspectorate, the Health Inspectorate. In addition, Customs inspects incoming goods and is responsible for ensuring that goods like cigarettes are brought in legally (Customs looks for a proper receipt/invoice). The Financial Police also play a role.

e. On-site Inspections

597. The practice of making on-site payments is still followed by many inspectorates. Although this practice may, in the short run, reduce some administrative costs, the potential for bribery is often overwhelming. If a fine is imposed for, say 100KM, it is very often in the interests of both the inspector and the inspectee to agree on a smaller fee, say 50KM, to be paid directly to the inspector. Then the violation is ignored or deemed "resolved".

598. If violations are discovered, the decision should describe what follow-up steps are required pursuant to the relevant legislation. The practice of issuing a document even

where no violations are found appears to be followed by almost all inspectorates (in accordance with the Law on Administrative Procedures). Such a laudable practice improves transparency and accountability.

599. The concerns raised by interviewees ranged from the impolite attitudes of inspectors to the perception that inspectors focus on enforcement and punishment, not on facilitating or encouraging compliance. In addition, concerns were raised about the methods of inspection and enforcement. For example, it is not clear whether inspectors (including the Financial Police) are fully aware of the harm that shutting down operations involves. Not only are revenues lost for that period, but contracts with business partners are broken and the company's reputation may damaged.

f. Comments on Draft Inspection Reports

600. It seems that in most cases the company inspected is able to comment on the draft decision before it is issued. In cases where the health and safety of the population is not at risk and speedy action is not required, such an opportunity to comment may be beneficial for resolving differences (companies rarely want to prepare a full-scale appeal, since internal appeals are of questionable transparency and neutrality, and appeals to courts are time-consuming and expensive).

601. Unlike the provisions relating to the Financial Police, there are reports that in the R.S. the company inspected is not given the opportunity to comment on the draft final decision before it is issued. The inspector has to issue a resolution in every case where major breaches of law are found. For this reason, a trustworthy process of appeals is particularly important since the company will have had no input in the decision made.

602. On the other hand, the experience of other countries suggests that any company will hesitate to go through an appeals process due to its length and possible non-transparency. Instead, it has been found to be much more effective to impose penalties that are acknowledged by the company to be just.

8. Recommendations

603. This discussion on inspectorates has taken a rather broad look at the problems faced by businesses in their dealings with the various inspectorates. In other transition countries where blanket recommendations to improve the work of the inspectorates were made, there was initial resentment and resistance to reform by the various inspectorates. Nevertheless, the experience of some transition countries (see Box 2 for a commentary on the Inspectorate Reform Program in Latvia) shows that over time inspectorates eventually see the benefits of a streamlined system and collaborate to effect change.

604. The FIAS recommendations for streamlining and strengthening the system of inspections in BiH are as follows:

- Make an inventory of all inspectorates functioning in each entity and establish a process for rationalizing inspections and coordinating the activities of the inspectorates. Eliminate duplication and overlap. Implement initiatives for joint training and information sharing.
- Articulate and publish the mandate of each inspectorate. Ensure that legislation governing the mandate and operations of each inspectorate is promulgated.
- Halt extra-legal inspectorate activity.
- Eliminate on-site payments.
- Establish and enforce procedures for conducting visits. For example, require written documentation for each site visit. A pattern of complaints against a particular business should be established before an inspection is triggered. Adherence to such a system would ensure a more transparent approach and incur a less harmful effect on businesses.
- Introduce a code of conduct for inspectors and train inspectors to understand that their primary function is to ensure public health and safety.
- In the Federation, introduce legislation to delay the effectiveness of a penalty until the completion of the appeals process, except where the health and safety of the public are threatened.

Box 2

Inspectorate Reform in Latvia

The problem. In 1998, a FIAS Report on Administrative Barriers to Investment identified significant systemic problems with the 22 different inspectorates in Latvia. The entire inspections system was acknowledged to be a major factor inhibiting the development of a welcoming business environment in Latvia. The Report identified a series of problems, including:

- Harassment of businesses in order to solicit bribes
- Absence of transparent appeals mechanisms
- Lack of coordination among the inspectorates in arranging site visits
- Lack of requirements for written documentation on inspections. Documentation was not given to the "inspectee" after an inspection (and virtually never when no violations were found).
- Lack of publicly available information on the mandate of the inspectorates and the rights and obligations of the inspectors and their targets.

Solutions:

- The Latvian government committed to action by adopting an Action Plan to Improve the Business Environment and designated the Secretariat for Government Reform to champion the reform process and prepare legislation regulating the activity of the inspectorates.
- The Secretariat for Government Reform and World Bank experts understood that the goal of improving the work of the inspectorates required a multi-faceted approach, including legislative change, training in procedures and client-orientation, experimentation through pilot projects, cooperation among the inspectorates and the government.
- One of the underlying principles in the inspectorate reform program in Latvia has been a reorientation away from punishment for violations and toward ensuring compliance with health and safety rules.

Attitudinal change. A fundamental obstacle to the reform process was the initial attitude of the inspectorates and their unwillingness to change a system that served them well. Many participants at the initial roundtable discussions with representatives of the business community did not understand why they were there, what they had in common with the other inspectorates and how their activities affect the business environment. With changes in legislation and the political backing of the Government in pushing for change, over time skepticism and resistance changed to the desired service oriented mentality. In the words of an inspectorate director, the focus of the inspectorate is to determine "How can we [the inspectorates] cooperate to assist our clients [businesses]?"

Legislative change. One of the first steps in the effort to improve the work of the inspectorates was the preparation of an instruction, issued by the Cabinet of Ministers, mandating the preparation and adoption of rules governing the activities of each inspectorate. These rules had to cover all major activities, including procedures to be followed on-site, preparation of reports, appeals procedures and informational materials describing the mandate of the inspectorate. The purpose of this instruction was to ensure that all inspectorates observe certain common principles and that this information is disseminated among the business community. This exercise also forced each inspectorate to reevaluate its modus operandi.

Cooperation. An Inspectorate Coordination Council was established to maintain an informational link among the inspectorates to review implementation of reforms and discuss the results of the pilot projects. The Council also serves as a forum for information sharing and operational collaboration among inspectorates. The Council is chaired by the director of an inspectorate who is elected by the other participating inspectorates. It Council was an important mechanism for helping the inspectorates to take ownership of the reform process.

Pilot projects. With the assistance of the World Bank, the Secretariat for Government Reform implemented pilot projects on strategic planning in two inspectorates. Through the Inspectorate Coordination Council, the results have been discussed and evaluated for implementation in other inspectorates.

Training. With the assistance of the School of Public Administration, the European Commission Phare program in Latvia, and various government institutions, the Secretariat for Government Reform arranges training courses for inspectors in the following areas: introducing standard working principles in the inspectorates, risk assessment, strategic planning, client orientation, conflict resolution, performance measurements, internal audit, penalty gradations, stress management, feedback mechanisms and administrative regulations.

Financing. The Secretariat for Government Reform has accessed a number of different sources for financing and assistance, including the World Bank (the government requested that inspectorate reform was to be one of the conditionalities for a Structural Adjustment Loan), the European Commission Phare Project "Support for Government Administrative Reform in Latvia", the School of Public Administration, and the Government budget provides some funding.

Impact. As the training courses are completed and new systems are introduced in the inspectorates, it will be necessary to evaluate the success of the Inspectorate Reform Program. Therefore, a crucial element of the Program is the introduction of feedback mechanisms in order to assess the actual impact on businesses and the business environment. This will also assist each inspectorate in its own performance evaluation.

CHAPTER VII

CONCLUSIONS AND NEXT STEPS

A. Introduction

605. There is general agreement within BiH that the existing environment for investment in general, and foreign direct investment in particular, needs considerable improvement for BiH to begin to attract and sustain significant levels of investment. This report has focused on some of the key impediments to investment in BiH, analyzing the issues and making a range of recommendations for addressing these issues.

606. This report provides a starting point. It has identified a range of specific as well as policy-level reforms that need to be made. More importantly, the report points to areas that need further review and additional technical assistance. The challenge is to develop an agenda for implementing effective change, building on the many ongoing legislative and administrative reforms, and creating the momentum for a sustainable process of improving the investment environment.

607. The experience of other countries clearly demonstrates that sustainable change cannot be achieved without Government commitment and the political will to effect change. Policymakers at the highest levels need to provide a clear vision and consistent direction for reform by the respective agencies. Successful and sustained change requires leadership, strong champions, and shared goals among the stakeholders within the Government and the private sector. On the basis of shared goals and consensus among the relevant stakeholders, the process of rationalizing, streamlining and simplifying bureaucratic procedures can develop, gain momentum and affect the values of Government agencies – transforming them into service oriented organizations. It must be recognized that a comprehensive approach to change is necessary and that commitment and time are two essential ingredients. The required procedural and institutional reforms will require the support and informed participation of public servants at all levels of Government, with support of changes in the system of performance monitoring and evaluation (institutional and individual) and rewards (institutional and individual).

608. In the case of BiH, Government commitment is required at the state and Entity levels and the framework for the change agenda must include the participation and inputs of stakeholders at all levels. Stakeholders must be drawn not only from the public and private sector, but also from the international donor community which provides much needed technical assistance and resources to support reform in BiH.

B. A Framework for Change and Implementation

609. A framework for sustainable change and improvement of the investment environment through administrative and institutional reform requires a number of basic elements, including:

- Champions and leaders with the commitment, credibility and authority to develop a vision and galvanize action;
- Clear goals and objectives;
- An institutional home for the secretariat of the change agenda and an organizing structure;
- A structure for analyzing the investment environment, soliciting investor perceptions and proposing reforms to address the issues identified;
- A process for consultation among stakeholders;
- Resources for capacity building and implementation; and
- A system for monitoring and evaluation.

1. Leadership

610. As stated earlier, leadership and commitment for the implementation of change in order to improve the investment environment must come from the highest levels of Government at the State and Entity level.

611. Options for organizing the leadership include assigning responsibility to appropriate leaders at the State and Entity levels or establishing a ministerial committee with representatives from the State and the Entity governments, possibly from the offices of the prime ministers.

2. Structure

612. A small secretariat should be established on the State level and should include representatives from each Entity. The secretariat will serve as the focal point of the change agenda, with a mandated responsibility for promoting and advocating reforms in collaboration with the relevant agencies. The staff of the secretariat will constitute the core group of the implementation team, establishing a plan of action on the basis of consultation with the stakeholders, coordinating state, entity and institutional activities, coordinating donor assistance and helping to identify supplementary resources for implementation.

613. The work of the secretariat should be guided by the established leadership and a committee of stakeholders drawn from the public and private sector, as well as the international donor community.

614. Box 1 provides selected examples from other countries in the region.

Box 1

Regional Examples

Armenia. An Armenian Business Council was established by Presidential decree. One of the responsibilities of the Council is to develop an action program and establish priorities for implementing the recommendations of study of the administrative barriers to investment.

Georgia. A commission for Liaison on Investment-related Issues was established by Presidential decree. The purpose of the commission is to elaborate practical considerations and proposals for improving the investment climate and business environment for private sector development.

Latvia. The Latvian Government committed to action by adopting an Action Plan to Improve the Business Environment and designated The Secretariat for Government Reform to champion the reform process and prepare legislation regulating the activity of the inspectorates. The Latvian Development Agency (LDA) oversees the action plan and, through the Ministry of Economy, works on legislative reform. To monitor the impact of reforms, the LDA utilizes surveys and other feedback mechanisms. The Secretariat for Government Reform was assigned the responsibility for the inspectorate reform program. Including the preparation of legislation regulating the activities of the inspectorates.

3. Analytical Framework

615. The FIAS Study of Administrative Barriers to Investment and the review of the commercial legal framework provides the initial inputs and starting point for a systematic, periodic review of the investment environment in BiH. The procedural documentation provided in this report should be used to develop a **roadmap** of the business start-up and operation process in BiH. A detailed roadmap of all the steps required for obtaining access to land, business registration, employment, taxation reporting, importing/exporting, licensing, and inspections should be prepared to provide guidance to new and existing investors. In addition, this roadmap should provide a basis for streamlining and simplifying the administrative procedures. Therefore, it must be regularly updated to reflect the procedural changes.

616. In addition to the roadmap, a periodic **survey of investor perceptions** should be developed and implemented to provide inputs for the reform agenda and the development of a strategy for promoting foreign investment in BiH.

617. Investors' perceptions of a country as a location for investment are generally based on a combination of facts: objective information compiled to support business decisions, personal experience, general information obtained through the media or third parties (e.g., consultants, business associates, competitors), and interactions with the international business community. These perceptions play an important role in

influencing investment location decisions. Negative perceptions – even if partly inaccurate – can remove a country from even the first, "long list" of possibilities for investments. Perceptions thus constitute a critical factor that must be taken into account in efforts to attract foreign investment.

618. Another tool that may be utilized for analyzing the investment environment and identifying areas for improvement is the **Regulatory and Administrative Costs Survey**. The objectives of the survey are:

- To provide feed back from enterprises on the constraints faced by the private sector.
- To measure the quality of governance and public services delivery with regard to key procedures and formalities with which businesses must comply.
- To evaluate the types and magnitude of costs imposed on private enterprises by administrative and regulatory procedures, and to pinpoint areas of excess or unnecessary cost that might benefit from reform or streamlining.
- To establish the basis for several internationally comparable indicators which can track changes in the business environment over time to assess the impact of market-oriented reforms.
- To stimulate systematic public-private dialogue on business perceptions and the agenda for reform.

619. The initial survey would provide a baseline against which progress can be measured by subsequent surveys. In addition, hard data should be gathered from the relevant agencies themselves about the work they undertake based on established performance measurement factors. These factors should include measurements of inputs and outputs (e.g., the volume of work - number of applications for business registration, number of shipments processed through Customs) and average processing times. Over time, as reforms are implemented, such data should provide information about the impact of the reforms. The expected impact is simpler, better, faster, cheaper administrative procedures for business.

620. **Customer service surveys** should also be implemented to help improve the quality of the services provided by the various public agencies. In order to increase accountability and the usefulness of these surveys for employees and customers, the results of these surveys should be publicized and service recognition awards should be granted to deserving employees.

4. Action Plan and Priorities

621. Annex B of this report provides a summary of the recommendations of this report and provides a notional indication of the priorities that may be assigned to the various recommendations.

622. FIAS proposes a series of discussions with the Government and the private sector to consider the issues raised in the report and to provide a basis for the development of an action plan and the establishment of priorities for implementation. In FIAS view the process of discussion is necessary to help generate a sense of ownership for the outcomes and implementation of this work. The action plan will also help to assign responsibilities for implementation activities and to identify areas for additional technical assistance.

623. The World Bank Business Environment Adjustment Credit is being designed to support BiH's efforts to improve the business environment. FIAS will closely coordinate activities under this project with the World Bank, OHR, and the international donor in BiH. Although FIAS itself is not in a position to provide detailed technical assistance in most of the areas covered in this report, its comparative advantage lies in working with clients to oversee the process of reform, monitor impact and guide on-going revisions.