



Free zones as a tool for attracting foreign direct investment in Bosnia and Herzegovina

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Summary

This policy paper provides a proposal for increasing the amount of foreign direct investment through improving the free zones regime in Bosnia and Herzegovina (BiH). Free zones are a comprising part of the foreign trade policy and are used as a mechanism to attract foreign direct investment. The experiences from the countries in the Western Balkan region indicate that free zones attracted a number of foreign investors who are currently playing a big role in their economies. Free zones in BiH are regulated on the state and entity level, and the implementation of current legislation is not creating additional value for foreign investors. By improving the BiH regime of free zones, the influx of foreign direct investment will increase, which will bring additional benefits to the state and entities in terms of higher income and employment level. Free zones are a significant foreign trade policy tool and the BiH Council of Ministers has affirmed the importance of free zones several times, and regularly monitors their functioning. This paper provides the improvements to the regime of free zones in order to increase the attractiveness of BiH to foreign direct investment, the improvements which would certainly lead to GDP growth and creation of jobs.



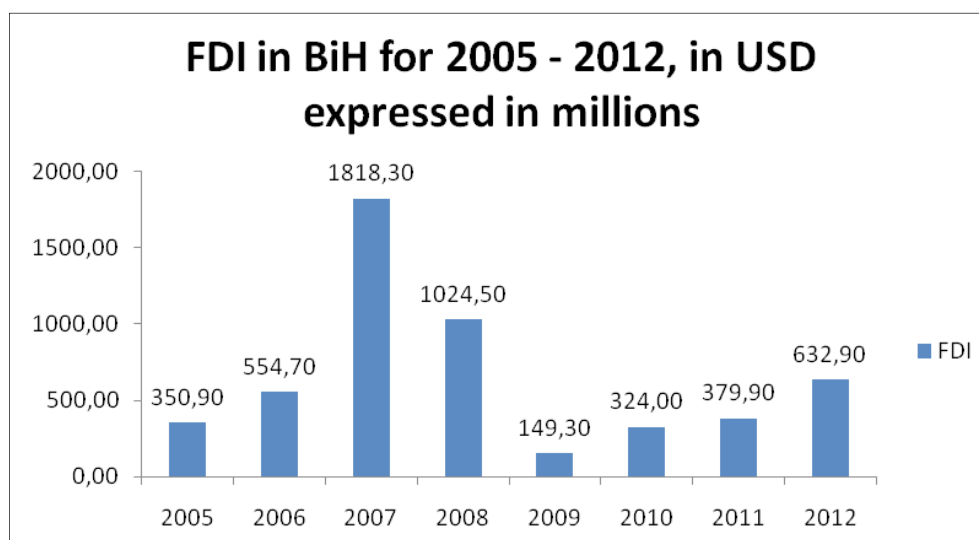
1 Introduction

1.1 FDI inflows in BiH

Bosnia and Herzegovina has been in the process of accession to the World Trade Organisation since 1999, and became a potential EU candidate country in 2003. The economy in BiH is characterised by a high external trade deficit, which amounted to slightly less than 7 billion BAM in 2013¹, and an export-import ratio of 55%. Foreign financial capital was used to cover such external deficits. However, the inflow of foreign capital has decreased abruptly since the beginning of the economic crisis.

The influx of foreign financial capital has suddenly decreased and the economic crisis is leading to an increasing trend of human capital drain from BiH. This Policy Paper focuses on a specific type of foreign financial capital - namely, foreign direct investment. It has been shown that there is a strong relationship between foreign direct investment and economic growth.² It has also been argued that larger inflows of foreign investments are needed for countries to achieve a sustainable economic growth. Foreign direct investment comes without risk for the country, and brings numerous advantages, the most important among which is creation of jobs.

The recent economic crisis has led to a huge drop in FDI in BiH. From 1.818 million USD in 2007, FDI has decreased to 149 million USD in 2009. Since then, there has been a slight recovery, but FDI is still far from its pre-crisis level. The following chart illustrates the FDI inflow to BiH in USD expressed in millions for the period 2005 - 2012, according to the data of the United Nations Conference on Trade and Development.



Source: *World Investment Report 2013: Annex Tables Annex Table 01 - FDI inflows, by region and economy, 1990-2012*³

The BiH Ministry of Foreign Trade and Economic Relations, which is in charge of the foreign direct investment policy, has somewhat different data for the 2009 - 2013 period. The Ministry collects its data from the electronic database on foreign direct investment, containing data from 2009 onwards. Since the adoption of the Law on Amendments to the Law on the Policy on Foreign Direct Investment in BiH⁴, all foreign direct investment must be registered in accord-

¹ Agency for Statistics of BiH. (2014) *Report on BiH Foreign Trade Exchange for 2013*. Retrieved from http://www.bhas.ba/saopstenja/2014/ETS_2013M12_001_01_hr.pdf

² Sanderatne, N. (2011). The importance of foreign direct investment. *The Sunday Times*. Retrieved from <http://www.sunday-times.lk/110529/Columns/eco.html>.

Chart 1:
FDI in BiH for 2005 - 2012, in USD expressed in millions

³ United Nations Conference on Trade and Development. (2013). *World Investment Report 2013 : Annex Tables*. Retrieved from <http://unctad.org/en/pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx>

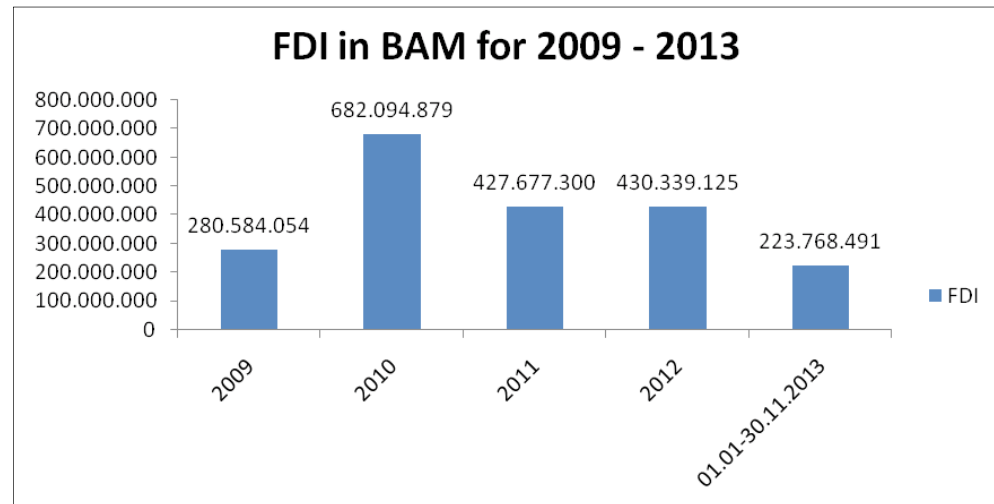
⁴ Law on Amendments to the Law on Policy of Foreign Direct Investment in BiH. BiH Official gazette n. 48/10.

ance with the procedure of registration for a business entity in BiH. Moreover, the competent courts are obliged to submit to the BiH Ministry of Foreign Trade and Economic Relations the information on registered companies with elements of foreign direct investment in electronic form - the database.⁵

⁵ Ibid.

The data available to the BiH Ministry of Foreign Trade and Economic Relations is shown below:

Chart 2:
FDI in BAM for 2009 - 2013



⁶ Data received through the Request for Freedom of Information to the BiH Ministry of Foreign Trade and Economic Relations, and meetings with civil servants of the Ministry.

Source: The BiH Ministry of Foreign Trade and Economic Relations⁶

The difference between the two sources of data is easy to notice. First of all, there is a non-negligible difference between the amounts of FDI, but also a difference in the trend. Both data samples show a significant increase in FDI levels from 2009 to 2010. However, the data of the United Nations Conference on Trade and Development also shows an increase in FDI levels between 2011 and 2012, while the data available to the BiH Ministry of Foreign Trade and Economic Relations shows stagnation.

Unfortunately, data related to foreign direct investment inflow in free zones in BiH is not available.

1.2 Importance of free zones in the global economy

Free zones, or special economic zones, are spatially delimited areas within an economy that function with typically more liberal regulatory, administrative, and fiscal regimes than those of the overall economy. These zones can have different forms such as free trading zones, free zones, export processing zones, economic processing zones, and foreign trade zones. Free zones usually aim to overcome the barriers that hinder investment in the wider economy, including poor governance, inadequate infrastructure, and restrictive policies.⁷

⁷ Farole, T. (2010). *Special Economic Zones in Africa*. The World Bank. Retrieved from <https://openknowledge.worldbank.org/bitstream/handle/10986/2268/600590.PUB01D181onomic09780821386385.pdf?sequence=1>.

⁸ Jansen, M. (2011). *Trade and Employment: From Myths to Facts*. International Labour Office and European Commission. Retrieved from http://www.ilo.org/employment/areas/trade-and-employment/WCMS_162297/lang-en/index.htm

⁹ Ibid.

It is known that free zones have become a prominent feature of the world economy. According to the International Labour Organisation, the number of new free zones has been on the rise since the mid-1980s. The International Labour Organisation database counted 176 free zones in 1986, and 3,500 in 2006.⁸ Overall, these free zones account for 68 million jobs worldwide.⁹ The size of free zones ranges from the size of a factory to the size of a large town. Zones are



under single authority of the state or the private sector. Free zones exist in most EU countries (not present only in six countries),¹⁰ as well as in most developed countries of the world, such as the United States of America.¹¹

As it is already widely known, the potential benefits of free zones include increasing foreign direct investment, generating employment opportunities, enhancing foreign exchange earnings, and boosting economic growth.¹² It has been argued that free zones represent a highly effective tool for creation of jobs. Evidence suggests that such zones are a much more significant source of employment in smaller countries with population of less than 5 million, countries such as Bosnia and Herzegovina, than in larger countries.¹³

Free zones also represent a comprising element of global value chains. Therefore, they facilitate the integration of a country's economy into the network of global value chains. Global investment and trade are intertwined through international production networks of firms investing in productive assets worldwide and trading inputs and outputs in cross-border value chains, which are commonly referred to as global value chains.¹⁴ According to the UNCTAD's 2012 Report, such value chains account for about 80% of global trade. Furthermore, it was shown that global value chains in developing countries can play an important role in economic growth. In developing countries, the value added trade contributes, on average, approximately 28 to the countries' GDP, compared to 18% in developed countries. Thus, there appears to be a positive correlation between participation in global value chains and GDP per capita growth rates.¹⁵ By enhancing the free zones regime, BiH would have a better prospect in becoming integrated into the network of global value chains.

There are currently four free zones in BiH; namely, in Visoko, Mostar, Vogošća, and Puračić. There are 81 companies operating in those four free zones. The company Prevent which produces leather and textile car seat covers is located in the free zone of Visoko and is employing approximately 2000 persons. Prevent is a German company and is one of the leading exporters in BiH.

The free zone legislation in BiH was motivated by the aim to create a favourable, stable, and transparent legal environment for domestic and foreign investments. The free zone regime of BiH is an important incentive in attracting FDI, similarly to other potential candidate countries to the EU. All free zone regimes provide for duty-free and VAT-free imports of raw, intermediate input and capital goods necessary for the production. Free zones are generally able to increase employment, investments, technology transfer, and exports. These benefits should justify the costs, such as potential revenue losses on indirect taxes.

There is a fierce competition for foreign investors between the countries and municipalities in the region. In this competition, free zones legislation and its implementation are an important policy instrument. Several countries in the region restructured their free zone regimes and attracted a wide range of major foreign investors. The export performance of firms in free zones has rapidly surpassed that of the firms outside free zones, and a great number of working places were created.

Thus, this Policy study intends to analyse the existing policy design related to free zones in BiH, as well as its implementation. It aims to propose recommendations in order to improve the overall implementation of the existing free zone policy in BiH.

¹⁰ European Commission, Taxation and Customs Union. (2013). *Free zones in existence and in operation in the Community, as notified by the Member States to the Commission*. Retrieved from http://ec.europa.eu/taxation_customs/resources/documents/customs/procedural_aspects/imports/free_zones/list_freezones.pdf.

¹¹ The multi-donor investment climate advisory service of the World Bank Group (FIAS). (2008). *Report on Special Economic Zones: Performance, Lessons Learned, And Implications for Zone Development*. Retrieved from <https://www.wbginvestmentclimate.org/uploads/SEZs%20-%20Performance,%20Lessons%20Learned%20and%20Implications%20for%20Zone%20Development.pdf>.

¹² Kituyi, M. (2013). *Maximising trade, investment and development opportunities of emerging markets through free trade & special economic zones*. Statement given on 21.11.2013 during the 3rd Global Free Trade & Special Economic Zones Summit. Retrieved from <http://unctad.org/es/paginas/SGStatementDetails.aspx?OriginalVersionID=62>.

¹³ Ibid.

¹⁴ United Nations Conference on Trade and Development (UNCTAD). (2013). *World Investment Report: Global Value Chains: Investment and Trade for development*. Retrieved from http://unctad.org/en/PublicationsLibrary/wir2013_en.pdf.

¹⁵ Ibid.

2 Problem description

2.1 Best practices in free zones of the Western Balkans region

2.1.1 Croatia¹⁶

¹⁶ Croatian Free Zones Association. Retrieved from <http://www.croatianfreezones.org/?lang=en>.

In Croatia, a free zone is defined as a part of the territory of the Republic of Croatia where business activities are performed under special and fixed conditions. According to the Croatian legislation, free zone business activities include the production, refinement, and storage of goods, wholesale, strategic business support activities, activities of the establishment of technological development centres of innovation, personal and estate insurance and reinsurance, provision of services except banking and other financial operations. Also, the Croatian legislation provides that retail trade shall not be carried out in the free zone. There are 13 free zone locations in Croatia, ranging from sea port-based free zones located in Pula, Rijeka, Split, and Ploče, and other strategically located zones in Krapina-Zagorje, Kukuljanovo, Osijek, Ribnik, Slavonski Brod, Split-Dalmacija, Varaždin, Vukovar, and Zagreb. A number of international companies from Italy, Germany, Austria, Switzerland, and France have already established their operations in free zones in Croatia. Their activities range from software development, medical devices, innovative technologies and machinery, to traditional manufacturing which includes automotive components, textiles, engineering, and boatbuilding. The free zones management is proactive and client oriented by ensuring the one-stop-shop approach for a number of services. These activities include customs clearance, shipment and forwarding, as well as assistance to obtain the necessary licenses from local and national authorities.

Goods imported and placed in the free zone are not considered to be in the customs territory of Croatia. Customs duties are not levied for such goods, and trade policy measures are not applied. Domestic goods intended for export and placed in the free zone are subject to measures commonly applied for regular export from Croatia. According to the Croatian VAT legislation, free zones are not the territory of Croatia. Shipments of goods in the free zone and internal shipments of goods are exempt from VAT and prepayment. The area of a city in which a free zone is located can give special privileges to free zone users from their competence, such as free land donations for construction of entrepreneurial objects and offices, privileges from communal taxes, and taxes from/on salaries. There are several other tax benefits in the free zones. Companies can also benefit from paying lower taxes, or be exempt from paying taxes, if they are cooperating in construction of infrastructure in the zone. Finally, users of free zones pay a profit tax amounting to 50% of the provided tax rate.

¹⁷ Brnić, M. (2013). *The two biggest free zones in Croatia are empty*. Poslovni dnevnik. Retrieved from <http://www.poslovni.hr/hrvatska/dvije-najvece-slobodne-zone-u-hrvatskoj-zjape-prazne-257478>.

¹⁸ Ibid.

¹⁹ FDI Intelligence. (2013). *Global Free Zones of the Future: 2012/2013 Winners*. Retrieved from <http://www.fdiintelligence.com/Rankings/Global-Free-Zones-of-the-Future-2012-13>.

The best results were achieved in free zones in Varaždin, Zagreb, and Rijeka. The total number of SMEs which were operating in free zones amounted to 234. Compared to 2011, it increased by 3%, but the number of employees decreased by 9%, from 8.700 to 7.900.¹⁷

Rationalisation had implications on financial results, since the income of companies amounted to 5.7 billion HRK and had slightly increased (2.3%, compared to 2011), and profits increased by 7.5% and amounted 649 million HRK.¹⁸ Zagreb Free Zone was ranked number 43 on the list of 50 top global zones of the future.¹⁹

A majority of Croatian free zones participated in the establishment of the Association of free zones. The goals of the Association are developing and improving business conditions in Croa-



tian free zones, promotion of free zones to stimulate foreign and domestic investments, offering expert assistance and stimulation of free zone founding and enlargement, and proposing incentive measures, procedures, and organization of free zone business activities.

2.1.2 Serbia²⁰

Free zones in Serbia are defined as fenced and marked parts of Serbia's territory where business activities are carried out with certain benefits, such as beneficial customs treatment, exemption from paying taxes, and facilitated administrative procedures. Free zones represent highly developed centres of technology, telecommunications, modern infrastructure, industry, and logistic support. The zone area is established when the Government grants approval. Currently, eleven industrial zones are also licensed as free customs zones: Pirot, Subotica, Zrenjanin, Kragujevac, Šabac, Novi Sad, Užice, Niš, Smederevo, Kruševac, and Svilajnac. A number of benefits and advantages are offered to companies operating in free zones in Serbia.

Companies operating in free zones in Serbia enjoy fiscal benefits, such as VAT exemptions for entry of goods into the free zone, for trade of goods and services in the free zone, and for trade of goods between the users of two free zones.

Users of free zones who perform production activities in the zone are also exempt from paying VAT on energy consumption, and are exempt from certain taxes for foreign direct investment. Moreover, users of free zones are exempt from payment of customs duties and other import duties for goods intended for carrying out activities and construction of facilities in the free zone (raw materials, equipment, and construction materials).

Furthermore, users of free zones also enjoy financial benefits, such as the free movement of capital, profits, and dividends, as well as simpler and faster customs procedures as each free zone has its Customs Administration Office. Finally, there are certain local government incentives, such as the exemption from certain local fees and taxes.

According to the Serbian Customs Authorities, the biggest exporters from Serbia in 2013 were three companies located in free zones, namely, FIAT Automobiles Serbia, NIS Gazprom Neft, and Tigar tyres. Fiat Automobiles Serbia is located in the FAS free zone in Kragujevac and represents the biggest exporter in Serbia. From January until November 2013, their export amounted to over 1.46 billion Euro.

NIS Gazprom Neft is located in the free zone in Novi Sad and exported 270.8 million Euro, while Tigar Tyres from Pirot exported 216.9 million Euro, in the same period.²¹

There are other renowned companies that invest in free zones in Serbia, such as SIEMENS, Johnson Controls, MagnetiMarelli, and Dunkermotoren. Investments in Serbian free zones are measured in hundreds of millions of Euros.

The Free Zones Administration was established in 2008 as an administrative entity within the Ministry of Finance and Economy, in order to carry out state administration activities in the field of free zones. It operates on behalf of state interest, basing its activities on zone development, zone promotion, control, and supervision of zones. Serbia is fully focused on the development of its free zones.

²⁰ Ministry of Finance of the Republic of Serbia. Free Zones Administration. Retrieved from <http://www.usz.gov.rs/eng/index.php>.

²¹ Ministry of Finance of the Republic of Serbia. Free Zones Administration. *Biggest Serbian exporters*. Retrieved from <http://www.usz.gov.rs/lat/aktuelno.php#44>

Serbia has developed a Strategy for Development of Free Zones 2011 - 2016, and attracted a number of foreign investments which boosted its export and increased employment.

²² FDI Intelligence. (2013). *Global Free Zones of the Future: 2012/2013 Winners*. Retrieved from <http://www.fdiintelligence.com/Rankings/Global-Free-Zones-of-the-Future-2012-13>.

Two Serbian free zones, Pirot and Zrenjanin, achieved extraordinary global success. Free Zone Pirot was ranked 41st, and the industrial zone Jugoistok-Ečka, which is a part of Free Zone Zrenjanin, was ranked as 48th in the list of 50 top global zones of the future.²²

²³ Republic of Macedonia. Directorate for Technological Industrial Development Zones. Retrieved from <http://www.fez.gov.mk/>.

2.1.3 Macedonia²³

The Macedonian free zone regime is regulated by the Customs Law and by the Law on Technological Industrial Development Zones. The establishment, development, and monitoring of the zones is carried out by the Directorate for Technological Industrial Development Zones.

As the representative authority of the Government of the Republic of Macedonia, the Directorate for Technological Industrial Development Zones manages the administrative affairs of all Zones in the Republic of Macedonia. Presently, there are four Technological Industrial Development Zones established by the Government of the Republic of Macedonia: TIDZ Skopje 1, TIDZ Skopje 2, TIDZ Štip, and TIDZ Tetovo. Simultaneously, seven TIDZs intended for equal economic development of all regions on the territory of the Republic of Macedonia are in the planning phase.

The duty of the Directorate for Technological Industrial Development Zones is to establish a service centre within each of the zones, providing consultation and service for the users of the zones. In all zones, the administrative departments and customs offices provide administrative services and convenient and fast customs clearance. The Directorate has a one stop service mode, and a management mode which it carries out by closely following international practice so as to ensure benefits for the investors. Investors and users of Technological Industrial Development Zones can benefit from incentives, such as the corporate income tax exemption, for a period of up to ten years from the day of commencement of activities in the zone.

The benefits also include personal income tax exemption on salary payments for a period of up to ten years, as well as VAT exemption on the sales of goods and services within the zone, excluding the sales of goods and services considered as final consumption under the Law on VAT. and VAT exemption on the import of goods into the zone intended for export, excluding the goods intended for final consumption as per the provisions in the Law on VAT. Moreover, investors and users of Technological Industrial Development Zones enjoy exemption from taxes and other duties related to the utilization of construction land, connections to water, sewerage, heating, gas, and the power supply networks. Other benefits include the exemption from payment of customs duties for export production, subsidies of up to 500.000Euro to cover construction costs, land lease for up to 99 years at attractive concessionary rates, and free connection to utilities. The Free Economic Zone Bunardžik was ranked as 47th in the list of 50 top global zones of the future.²⁴

²⁴ FDI Intelligence. (2013). *Global Free Zones of the Future: 2012/2013 Winners*. Retrieved from <http://www.fdiintelligence.com/Rankings/Global-Free-Zones-of-the-Future-2012-13>.

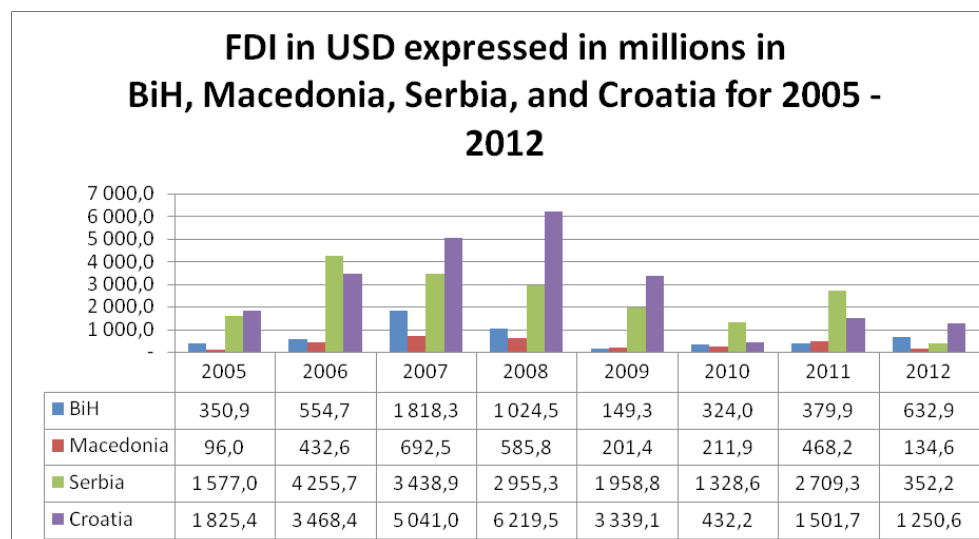


2.1.4 Overview of the privileges and incentives of operating in free zones in Croatia, Serbia, and Macedonia

	Croatia	Serbia	Macedonia
Number of free zones	13	11	4
Exemption from customs duties for goods imported and placed in the free zone	Goods imported and placed in the free zone are not considered to be in the customs territory of Croatia.	Exemption from payment of customs duties and other import duties for goods intended for carrying out activities and construction of facilities in the free zone.	Exemption from payment of customs duties for export production.
Exemption from VAT on goods imported and placed in the free zone	Shipments of goods to the free zone are liberated from VAT payment and prepayment.	Exemption from VAT payment on trade of goods and services in the free zone.	Exemption of VAT payment on the import of goods into the zone, excluding the goods intended for final consumption.
Exemption from VAT on internal shipments of goods within the free zone	Internal shipments of goods within the free zones are liberated from VAT payment.	Exemption from VAT payment on trade of goods between the users of two free zones.	Exemption from VAT payment on the sales of goods and services within the free zone.
Simpler and faster customs procedure	One stop shop approach for a number of services, including customs clearance, shipment, and forwarding.	Each free zone has its Customs Administration Office.	Administrative departments and customs offices provide administrative services and fast customs clearance. It operates on the basis of one-stop shop model.
Privileges related to land	The city in which the free zone is located can give free land donations for construction and entrepreneurial objects and offices.		Exemption from taxes related to the utilisation of construction land, connections to water, sewerage etc. Land lease for up to 99 years at attractive concessionary rates.
Privileges related to communal taxes	Privileges from communal taxes and taxes on salaries.	Exemptions from certain local fees and taxes.	Exemption from income tax on salary payment for a period of up to ten years.
Privileges related to profit tax	Users of free zones pay a profit tax amounting to 50% of the provided tax rate.		Corporate income tax exemption for a period of up to ten years.
Other privileges	Paying lower taxes or exemption from taxes if cooperating in the construction of infrastructure in the zone.	Exemption from VAT payment on energy consumption. Exemption from certain taxes for foreign direct investment.	Subsidies for construction costs.

2.1.5 Comparison of FDI inflows in BiH, Macedonia, Serbia, and Croatia

Chart 3:
FDI in USD expressed in millions
in BiH, Macedonia, Serbia, and
Croatia for 2005 - 2012



²⁵ United Nations Conference on Trade and Development. (2013). *World Investment Report 2013: Annex Tables*. Retrieved from <http://unctad.org/en/pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx>

Source: *World Investment Report 2013: Annex Tables Annex Table 01 - FDI inflows, by region and economy, 1990-2012*²⁵

This chart shows a comparison of FDI inflows in BiH, Macedonia, Serbia, and Croatia for the period of 2005 - 2012. As noted previously, it can be observed that there is an overall decrease in FDI in the region since the global economic crisis. Nevertheless, FDI inflows in Croatia and Serbia are far greater than in BiH for all presented years (except for 2012, where there was more FDI inflow in BiH than in Serbia). This shows how much potential FDI BiH is losing. According to this chart, FDI in Macedonia is constantly lower than in BiH. However, it is evident that a big share of total investments in Macedonia was targeted exclusively in free zones. Having that in mind, it is easy to argue that Macedonia is doing a good job regarding their free zones, since figures shown above represent good results when using only the free zones as FDI attraction tool.

2.2 Free zones regime in BiH

As mentioned in the introduction, the potential benefits of free zones are tremendous. By definition, a free zone is part of the customs territory of BiH, which is specifically fenced and delineated, and where business activities are carried out under special conditions in accordance with the BiH Law on Customs Policy and the BiH Law on Free Zones. Free zones are established by the Decision of the BiH Council of Ministers, if economically justified, i.e. if evidence provides grounds for estimation that value of goods exported from the free zone will exceed at least 50% of the total value of manufactured goods leaving the free zone in a period of 12 months.

However, the legal framework related to free zones in BiH is complex and its implementation threatens the existence of free zones. The work of free zones in BiH is regulated by:

- The BiH Law on Customs Policy and its amendments
- The BiH Law on Free Zones
- The BiH Law on Value Added Tax



Additionally, the Federation of BiH and the Republic of Srpska each have their own Law on Free Zones.

According to the BiH Law on Customs Policy, free zones are parts of the customs territory of BiH separated from the rest of the state territory. The perimeter and the entry and exit points of free zones should be supervised by the customs authorities.

Both BiH goods and goods of foreign origin may be placed in a free zone. Any industrial, commercial or service activity complying with BiH regulations is authorised to take place in the free zone, on the condition that the advance notice for such activities must be given to the customs authorities.

In free zones, the goods of foreign origin are considered, for the purpose of import duties and commercial policy import measures, as not being on BiH customs territory, with the exception of goods released for free circulation in BiH.

Equipment released for free circulation representing an investment by a foreign national, except for passenger vehicles, entertainment and slot machines shall be granted relief from payment of import duty. Additionally, the Law on Amendments to the Law on Customs Policy²⁶ reinforces the privilege that equipment which is put in use and is intended for the conduct of the production activity in the free zones is exempt from customs duty.

According to the BiH Law on Value Added Tax, the import of goods intended for the free zones is exempt from VAT. The supply of goods, provided they are supplied to or within customs-free zones, is exempt from VAT. These exemptions from VAT are recognised only on condition that the goods in question are not released into free circulation in BiH.

As BiH is in the process of accession to the EU and WTO, BiH Laws and Policies need to be in line with the EU and WTO rules.

2.2.1 The BiH free zones regime and EU rules

BiH is a potential candidate for EU membership and participates in the EU Stabilisation and Association Process. The Stabilisation and Association Agreement (SAA) between the European Communities (European Union), their Member States, and BiH was signed on 16 June 2008. This Agreement and its accompanying Interim Agreement (IA)²⁷ contain obligations for BiH to harmonise its laws with WTO provisions and with *acquis communautaire* on the issues of trade and competition policy, including state aid and customs policy. Most articles of the SAA and IA affect companies in the free zones and companies outside the free zones in the same way. Regarding the provisions specific for free zones, these Agreements²⁸ include only stipulations on the proof of origin of products.

The overall current free zones regime is in line with the EU *acquis communautaire*. Free zones in the European Union are regulated by the Community Customs Code (CCC)²⁹ and by the Community Customs Code Implementing Provisions (CCCIP)³⁰. The CCC provides the regulatory framework applicable to all customs related procedures in free zones for EU Member States. For instance, the detailed articles have provisions related to the designation of free zones,

²⁶ Law on amendments to the BiH Law on Customs Policy. BiH Official gazette n. 51/06.

²⁷ The Interim Agreement on Trade and Trade-Related Matters between the European Community (European Union) and Bosnia and Herzegovina (16 June 2008) contains the same provisions on Free Zones in BiH.

²⁸ Article 26 of Protocol 2 "Concerning the definition of the concept of 'Originating Products' and methods of administrative cooperation for the application of the provisions of this Agreement between the Community and Bosnia and Herzegovina"

²⁹ Council Regulation (EEC) No 2913/92 of 12 October 1992 and amendments, establishing the Community Customs Code (CCC)

³⁰ Commission Regulation (EEC) No 2454/93 of 2 July 1993 (CCCIP) and amendments, laying down provisions for the implementation of Council Regulation (EEC) No 2913/92 establishing the Community Customs Code

³¹ Modernised Customs Code (MCC) - Regulation (EC) No 450/2008 of the European Parliament and of the Council of 23 April 2008 laying down the Community Customs Code

³² On the scope of applicable provisions of MCC: see Article 188 of MCC.

³³ Directive on the common system for VAT, Council Directive 2006/112/EC of 28 Nov. 2006.

³⁴ I.e., the Customs Policy Law (CPL) and the Decision on Implementing Regulations to the CPL.

placing of goods, operating, removal of goods, re-exporting, destruction and abandonment of goods, buildings, and approval of stock records.

Furthermore, the CCC and the CCCIP are still in force for free zones, because the provisions of the new, so called Modernised Customs Code (MCC) on Free Zones³¹ are not yet applicable.³² Free zone regimes in the EU are regulated by certain provisions of EU legislation on VAT³³ and legislation on state aid.

The free zone regime in BiH is harmonised with the abovementioned components of the *acquis communautaire*, in particular with the CCC, the Implementing Provisions of the CCC, and the EU legislation on VAT. Regarding the customs regulations, the major instruments³⁴ in applying customs policy in BiH are harmonised with the Community Customs Code (CCC). As for the MCC and regarding the free zones, the existing gaps between BiH customs procedures on the one side and the MCC on the other side are not relevant, because the provisions of MCC on the free zones are not yet applicable even in the EU Member States.

2.2.2 The BiH free zones regime and WTO rules

BiH submitted its application for WTO membership in 1999. Since then, BiH has made serious steps to move towards its accession.³⁵ BiH has obliged to make progress in the implementation of new legislation to comply with WTO rules. The relevant WTO agreement related to free zones is the Agreement on Subsidies and Countervailing Measures (SCM).³⁶ This Agreement³⁷ allows certain benefits provided by free zones such as exemptions from customs duties and indirect taxes on goods exported from free zones.

BiH has clarified that the benefits granted to companies in free zones do not constitute a prohibited subsidy.³⁸ These benefits consist only of an exemption from import duties and VAT, and only in case of products to be exported. These benefits enable entrepreneurs to import and use raw materials from abroad without paying taxes, but goods leaving the zone and entering BiH territory are subject to normal customs and VAT. The total value of goods exported from any free zone, as summarised for every user of a particular free zone, must reach a certain percentage of the total value of goods produced in the zone. However, the abovementioned benefits are not contingent upon export performance of particular companies, or on the use of local products.

2.2.3 Free zones and foreign direct investment

Free zones in BiH function as independent bodies run by zone operators. Zone operators are registered as legal entities. There is no formal association of free zones in BiH, nor is there a government body exclusively in charge of free zones. The BiH Ministry of Foreign Trade and Economic Relations is the competent authority on the state level, which is in charge of legislation in the area of free zones, while the BiH Indirect Taxation Authority is the implementing body. Still, none of the mentioned bodies are competent for the promotion of free zones as a potential for investment.

The competent body in BiH for the promotion of investment is the BiH Foreign Investment Promotion Agency (FIPA). FIPA is a state level body which directly reports to the BiH Council

³⁵ Bosnia and Herzegovina's accession continues to move forward. World Trade Organisation. (2013). News Items, 7 June 2013 *Bosnia and Herzegovina accelerated membership negotiations*. Retrieved from http://www.wto.org/english/news_e/news13_e/acc_bih_07jun13_e.htm.

³⁶ World Trade Organisation. Agreement on Subsidies and Countervailing Measures. Retrieved from: http://www.wto.org/english/docs_e/legal_e/24-scm.pdf.

³⁷ Creskoff, S., and Walkenhorst, P. (2009). *Implications of WTO Disciplines for Special Economic Zones in Developing Countries*. The World Bank. Policy Research Working Paper 4892. Retrieved from <http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-4892>.

³⁸ Draft report of the Working Party on the accession of Bosnia and Herzegovina to the World Trade Organization. 23 February 2009.



of Ministers. It is organised into three Departments: the Department for Financial and General Affairs, the Department for Promotion and Analysis, and the Department for Investor Support and Development. The Department for Promotion and Analysis is in charge of the promotion of free zones as an investment potential, in addition to other promotional activities. It is clear that there is no focus on promoting free zones by FIPA since they are promoted among other investment opportunities.

2.2.4 Survey of companies operating in BiH free zones

It was concluded that the free zone regime in BiH is in line with the EU and WTO rules. However, the existing regime lacks proper implementation. As briefly presented in the text above, the privileges and incentives of BiH free zones include the exemption of paying customs duties and VAT on imports into the free zone, on the condition that the imported products will be used for export. Investments in the free zone, transfer of profit, and transfer of investment are free of charge. Import of equipment that will be used for manufacturing within the free zone are exempt from customs duties and VAT payment. Neither customs duties nor taxes are paid for export from the free zone, except for exports for the domestic BiH market.³⁹

³⁹ Articles 20 and 21 of the FBiH Law on Free Zones.

2.2.4.1 Survey design and analysis of the results

We used an online survey tool in order to survey companies that operate within the four existing free zones in BiH. We prepared a survey containing thirteen questions. Twelve questions of the survey were multiple choice questions (Yes/No/I do not know) and the thirteenth question was an optional additional comments window. The survey link was sent through e-mail to approximately sixty companies operating in free zones, and the zone operators. The survey was open for fourteen days and an e-mail was sent after seven days, reminding the companies to fill out the survey. We obtained twelve replies, and the complete overview of all questions and answers is available in Annex 2. We will present some of the most striking results in the text below.

The first question asked whether the respondents are satisfied with the enforcement of the BiH Law on Free Zones; 67% replied "No" and 33% replied "Yes". For the second question, which stated that the BiH Law on Free Zones gives privileges, but that it is impossible to use those privileges in reality, the ratio of replies was identical as for the first question.

Replies to questions three to five demonstrate the issues with the implementation of the existing laws regulating the operations of companies within free zones.

One half of the respondents replied that, in spite of being a free zone user, their company was obliged by the BiH Indirect Taxation Authority to pay VAT. Additionally, 67% replied affirmatively when asked whether their company was obliged by the BiH Indirect Taxation Authority to pay import custom duties on equipment to be used for manufacturing within the free zone, in spite of being a free zone user. Asked whether their company was obligated by the BiH Indirect Taxation Authority to pay import custom duties on raw materials, intermediate products, and semi-finished product to be used for manufacturing within the free zone, in spite of being a free zone user, 33% answered affirmatively.

On the one hand, 50% of the respondents replied that they would not recommend becoming users of free zones in BiH to foreign companies. On the other hand, 50% respondents replied "Yes", 33% replied "No" and 17% answered "I do not know" when asked whether their company was established on the basis or with an element of foreign direct investment, or whether the current capital of the company comprises foreign direct investment in BiH.

2.2.4.2 Results of the survey as illustrations of the lack of implementation of the current free zones regime

In the last decade, certain privileges of free zone users in BiH have been rendered irrelevant due to the process of accession to the EU, as companies are free to establish customs warehouses and use various customs procedures which grant exemption from payment of customs duty. Moreover, customs duty on imports from the EU has been eliminated for a wide range of goods.

As demonstrated by the answers to the survey, other privileges and incentives of free zones have been diminished by the fact that, during the recent years, the Customs Authorities, and especially the BiH Indirect Taxation Authority, have started to impose customs duties and VAT for equipment and raw materials imported into the free zones, contrary to the provisions of the BiH legislation. These developments have reduced the attractiveness of free zones in BiH, as demonstrated by the fact that only half of the current users of free zones would recommend becoming a free zone user in BiH to a foreign company.

In spite of the fact that the attractiveness of free zones in BiH for their existing and potential users (i.e. the investors) has been reduced, free zones are still a significant foreign trade policy tool for BiH, and the BiH Council of Ministers had affirmed the importance of free zones multiple times, and regularly follows their functioning.⁴⁰

In the present state of development of BiH, good implementation of the free zones regime is necessary in order to attract foreign direct investment. The country needs this institution in order to keep its competitiveness with other locations for investment in the Western Balkans region.

⁴⁰ For instance, conclusions from the 12th session of the BiH Council of Ministers, held on 04.06.2012, conclusions from the 43rd session of the BiH Council of Ministers, held on 25.03.2013, and conclusions from the 52nd session of the BiH Council of Ministers, held on 05.06.2013.



3 Policy improvement in BiH

Economic integration of BiH into European and global economic flows started more than ten years ago, by signing the Stabilization and Association Agreement with the EU and opening negotiations to join the WTO. Foreign Trade Policy was the first and main pillar developed within these integration processes, resulting in modern free zone legislation compliant with relevant EU provisions. However, the lack of consistent and comprehensive implementation of such legislation caused benefits granted by the BiH Law on Free Zones to become irrelevant. On the other hand, all neighbouring countries in the Western Balkans (Croatia, Serbia, and Macedonia), which are also implementing modern free zones legislation and promoting their free zones through relevant state bodies or Associations, are recording huge amounts of foreign direct investment in free zones, resulting in additional job creation. The fact that all three of these countries have their particular free zones listed in the worlds' top 50 zones for the future indicate how serious the BiH neighbouring countries are about the development and perspective of their free zones.

Such developments in regional free zone regimes seriously threaten to leave BiH isolated on the map of foreign direct investment, especially in free zones. Furthermore, BiH is also being left out of global value chains that generate high development rates for developing countries like BiH due to better investment conditions (competitive advantage) offered by neighbouring countries regarding the investments in general, and especially in free zones.

Time is of the essence if BiH still wants to join the battle for foreign investment in free zones, both short and long term. In order to select the best policy options in this regard, the most relevant criteria have been established as follows:

- Proper enforcement of the current legislation and benefits of the free zones regime
- Improvement of the attractiveness of BiH free zones for foreign direct investment
- Better cooperation and coordination between BiH administrative bodies in charge of free zones

3.1 Policy options

Three policy options were considered, along with their expected impacts and implementation steps:

3.1.1 Option 1: Keep the status quo, maintaining the current legislation and legal practice in place.

This policy option means that no new measures should be taken regarding the free zones regime and its implementation. It will contribute to further elimination of benefits in the free zones and a decrease of the already low level of competitiveness of BiH in the region regarding foreign direct investment. It will also have no positive impact on BiH export performance or job creation. This policy option requires no costs, but it does not bring any additional direct or indirect benefits.

3.1.2 Option 2: Improve the implementation of the free zone regime, especially in relation to the current legal implications of its implementation.

Second policy option reinforces the existing legally provided benefits by implementing the free zones regime. This option means that no customs duties and no VAT are levied for the

equipment and production inputs to be used in the free zones, and administrative burdens are decreased.

Policy option providing the improvement of current free zone regime implementation would be implemented through joint interpretation of the existing legislation regulating the functioning of free zones, namely the BiH Customs Policy Law, the BiH Law on Free Zones, and the BiH Law on VAT. This interpretation would be implemented by the experts from the BiH Ministry of Foreign Trade and Economic Relations (leading role), the BiH Indirect Taxation Authority, and the BiH Ministry of Finance and Treasury. Such interpretation would evolve into the implementation of provisions of the BiH Law on Free Zones, which would be adopted by the BiH Council of Ministers.

Implementing the provisions would bring more clarity regarding the implementation of free zones legislation and would facilitate the utilization of the legally provided benefits. Additional impacts caused by this policy option would be:

- **Costs:** Relatively symbolic costs for creation of joint interpretation by state experts and adoption of the BiH Law on Free Zones implementing provisions. Also, it can be expected that moderate reduction of state revenues from customs duties would occur. VAT is not defined as a cost regarding the claim for refund.
- **Direct benefits:** Moderate increase of investment in the free zones by existing users, somewhat increased attractiveness of the free zones for new foreign direct investors and new local investors.
- **Indirect benefits:** Moderate increase in creation of jobs, as well as in exports and direct tax revenues.

3.1.3 Option 3: Overall improvement of the implementation of free zones regime and the improvement of their foreign investment potential.

The third policy option would be to generally improve the implementation of the free zones regime and to establish new bodies which would be in charge of promotion and improvement of free zones with regards to their foreign direct investment potential.

Implementation of this policy option would include several phases and stakeholders. The first phase would encompass the activities related to the improvement of current free zones regime and reinforcement of the legally granted benefits through adoption of the BiH Law on Free Zones implementing provisions. This process would be led by the BiH Ministry of Foreign Trade and Economic Relations and would also include the BiH Indirect Taxation Authority and the BiH Ministry of Finance and Treasury. This phase would set healthy foundations for the subsequent phases.

In the second phase, the end result would be the adoption of the Strategy for Improvement of Free Zones Foreign Direct Investment Attractiveness. This strategy-making process would be led by a competent ministry, namely, the BiH Ministry of Foreign Trade and Economic Relations, and would include other important stakeholders such as the companies in BiH free zones, the BiH Indirect Taxation Authority, the BiH Ministry of Finance, the BiH Foreign Investment Promotion Agency, and the BiH Directorate for Economic Planning. Other levels and bodies of government would also be included in this process, depending on their relevance in specific areas. The strategy is supposed to bring additional clarity and new activities, on top of the foundations established in the first phase. The strategy would clearly foresee the estab-



lishment of a Unit or an Office in the BiH Foreign Investment Promotion Agency which would exclusively deal with promotion of BiH free zones to foreign investors. The strategy would also lead to the establishment of the Association of Free Zones, which should act as a private non-profit organisation, initiating and implementing specific development projects in free zones, and driving the constant development of free zones.

In the third and final phase, new bodies would be established and the implementation of Strategy for Improvement of Free Zones Foreign Direct Investment Attractiveness would be initiated.

Clear structure of the competencies regarding the state bodies involved in the functioning of free zones and the functioning of new bodies (the Association of Free Zones, and the Unit or Office in the Foreign Investment Promotion Agency) would have the following impacts:

- The benefits of free zone users would be reinforced and companies would be less burdened.
- Free zones would be used as focal points for direct investment promotion policy.
- Competitiveness of BiH on a global foreign investment map would be strengthened.
- Larger and more significant integration of BiH into global value chains.
- Free zones could be used as accelerators of development in other areas, such as in development of industrial policy and entrepreneurship
- Costs: Additional costs for the adoption of the BiH Law on Free Zones implementing provisions and the Strategy for Improvement of Free Zones Foreign Direct Investment Attractiveness. Costs would arise through the establishment and functioning of a Unit or an Office in the Foreign Investment Promotion Agency which would exclusively work on the promotion of free zones. Private sector costs include moderate cost related to the functioning of the Association of Free Zones. Moderate reduction of state revenues from customs duties would occur. VAT is not defined as a cost regarding the claim for refund.
- Direct benefits: Significant increase of Foreign Direct Investment in BiH free zones.
- Indirect benefits: Increased job creation, significant increase of BiH export performance and increased revenue from direct taxes.

3.2 Choice of policy option

Keeping in mind the previously mentioned criteria, the third option is recommended. If a regular amount of effort was invested without any political barriers, this option could be implemented quickly. Having in mind all the risks on the path of implementation of this option, it is expected that 2-3 years will be needed for its implementation. It brings long term and sustainable solutions to the BiH free zones regime and its implementation, and enables the utilization of free zones as a tool for attracting foreign direct investment.

The first option (status quo) cannot be considered as a valid option for creating an environment for the attraction of foreign direct investment. The second option can be implemented in a short amount of time but its results are characterized as “quick wins”, providing a normal functioning environment for companies currently doing business in free zones, and giving clarity to activities of government bodies which are competent in the area of free zones. The solution offered by the second option would generate moderate foreign direct investment in free zones as it lacks the entire concept related to the improvement of the attractiveness of BiH free zones and their promotion.

4 Conclusions and recommendations

This study has shown that there has been a decline in FDI inflows in BiH since 2009. Even though a slight recovery can be noted in the years following the global crisis, FDI inflows are still not at their pre-crisis level. In order to attract more FDI into BiH, this study focused on a particular tool of foreign trade policy: free zones. There are currently four free zones in BiH and the BiH free zone regime offers several privileges and incentives for companies operating within a free zone. However, certain privileges of free zone users have been rendered irrelevant due to the process of accession to the EU, since the companies are free to establish customs warehouses and use various customs procedures, which grants them the exemption from customs duty payment - one of the most important privileges of operating in free zones.

An online survey of companies operating in BiH free zones was conducted and provided striking replies and results. A majority of respondents replied that they are not satisfied with the enforcement of the BiH Law on Free Zones, stating that, while this Law does provide certain privileges, it is impossible to use those privileges in reality. The overall results of the survey show that privileges of free zone users have been diminished by the fact that, during the recent years, the Customs Authorities, and especially the BiH Indirect Taxation Authority, have started to levy customs duties and VAT for equipment and raw materials imported into the free zones, contrary to the provisions of the BiH legislation. These developments have reduced the attractiveness of free zones in BiH, as demonstrated by the fact that only a half of the current users of free zones would recommend becoming a free zone user in BiH to a foreign company. In spite of the fact that the attractiveness of free zones in BiH for their existing and potential users (i.e. investors) has been reduced, free zones are still a significant foreign trade policy tool for BiH.

In the present state of development of BiH, good implementation of the free zones regime is necessary in order to attract foreign direct investment. The country needs this institution in order to keep its competitiveness with other locations for investment, such as Croatia, Serbia, and Macedonia.

This paper recommends a long term, sustainable solution to this problem. The process consists of three phases: the reinforcement of benefits for companies operating in free zones, development of a Strategy for Improvement of Free Zones Foreign Direct Investment Attractiveness, and its implementation. The Strategy would precede the establishment of the Association of Free Zones which would be competent for constant development of free zones, and the establishment of a Unit or an Office in the Foreign Investment Promotion Agency which would be exclusively responsible for the promotion of BiH free zones to foreign investors. This solution would have moderate costs through a decrease of customs revenue, but its direct impact would significantly increase the level of foreign direct investment in BiH, indirectly increasing the creation of job, export performance, and revenue from direct taxes.



Annexes

5.1 Annex 1: Overview of free zones in BiH

In 2014, there are 4 free zones in BiH: in Vogošća, Visoko, Puračić-Lukavac, and Mostar. Physically, these establishments are fenced industrial zones of an area between 100.000 and 500.000 square meters. The dominant user companies of the four existing free zones are several large and a few medium-sized companies, all of them active in various sectors of manufacturing, such as metal processing industry, wood processing industry, and chemical industry. Among these, the large companies and several middle-sized companies are fully or partly foreign-owned, while others are privately owned by BiH citizens. Additionally, there are numerous small and micro companies among free zone users, equally distributed between the manufacturing, trade, and service sectors.

⁴¹ Kragulj, T. (2009). *Free zones - Institute for dynamising developing countries*. Master's Thesis. Retrieved from <http://www.apeiron-uni.eu/centar/radovipdf/radovinovi/TatjanaKragulj.pdf>.

⁴² Decisions on the closing of free zones. BiH Official Gazette n. 26/2004.

From 1997 to 2004, 11 free zones existed on the territory of Bosnia and Herzegovina, namely: free zone Sarajevo, free zone Vogošća, free zone Visoko, free zone Hercegovina Mostar, free zone Unsko-Sanski Kanton in Bihać, free zone Lukavac, free zone Mostar Istok, free zone Kiseljak, free zone Orašje, free zone Tomislavgrad, and free zone Slobomir in Bijeljina.⁴¹ According to the official information published in 2004⁴², five of these free zones (Orašje, Sarajevo, MostarIstok, Tomislavgrad, and Lukavac) have lost their free zone status because they did not satisfy the legal criterion of exporting at least 50% of the total value of manufactured goods.

5.1.1 Free zone Visoko

The free zone Visoko is situated in the town of Visoko. Its total area is 200.000m², while the area available for additional users is 18.000m². This free zone has an advantageous position:

- Road connection: Orašje-Doboj-Zenica-Sarajevo (Vc Corridor)
- Rail connection: Zagreb, Beograd -Vinkovci-Sarajevo-Ploče
- 30 km away from the Sarajevo Airport

Free zone Visoko was established in 1997 by the following companies:

- VITEX, Leather-textile combine (KTK),
- Vispak, Distribution Centre (DC), and
- Velepromet Interšped from Sarajevo

Following its expansion in 2001, the free zone covered an area of 224.761m² and extended to two sites.

⁴³ BiH Ministry of Foreign Trade and Economic Relations. (2013). *Report on the operations of the free zones in 2012*.

In 2012, there were 20 companies established in this free zone.⁴³ The total value of goods produced in the free zone and exported to foreign countries in 2012, compared to the total value of goods produced in the zone, is 99% and exceeds the legally defined minimum threshold of 50%.

⁴⁴ Organisation for Economic Cooperation and Development.(2008). *Company information on Prevent Group*. Retrieved from <http://www.oecd.org/dataoecd/30/61/45560167.pdf>.

Prevent in BiH. By far, the biggest company in this free zone is Prevent d.o.o. Prevent is among the top three exporters in the country. In 2008, Prevent employed 3.087 people in Bosnia and Herzegovina, with plants in Visoko, Zenica, Goruša, Goražde, and Jelah.⁴⁴

⁴⁵ Prevent Group. (2012). *Company News*. Retrieved from <http://www.preventgroup.com/1/news/news-archive/>

In 2010, Prevent Group was the leading exporter in BiH, with more than 427 million BAM (218 million Euro), with an increase of export which enabled them to create 1.000 new jobs in BiH.⁴⁵ Prevent in BiH was established in 1999 with manufacturing facilities in Visoko.



Statistics on domestic and foreign trade in the free zone Visoko in 2012⁴⁶

	Value of imported foreign goods into the free zone (in BAM)	Value of domestic goods that entered the free zone (in BAM)	Value of the produced goods exported abroad (in BAM)	Value of the goods placed on the domestic market (in BAM)	Value of the goods produced in the free zone (in BAM)
Total	390.196.878	12.884.348	718.216.701	6.508.417	724.725.119

⁴⁶ The BiH Ministry of Foreign Trade and Economic Relations. (2013). *Report on the operations of the free zones in 2012.*

5.1.2 Free zone Hercegovina-Mostar

The free zone Hercegovina-Mostar is situated in Mostar, on the territory of the former SOKO aeroplane factory. Its total area is 435.633 meters squared. This free zone has an advantageous position for the following reasons:

- Connection to the main railway: Budapest - Sarajevo - Banja Luka - Zagreb/Belgrade
- Connection to the main road (Corridor Vc): Budapest- Osijek- Sarajevo-Mostar- Ploče
- Near the Mostar airport
- 60 km far from the Port Ploče (Adriatic sea)

	Value of imported foreign goods into the free zone (in BAM)	Value of domestic goods that entered the free zone (in BAM)	Value of the produced goods exported abroad (in BAM)	Value of the goods placed on the domestic market (in BAM)	Value of the goods produced in the free zone (in BAM)
Total	23.257.588	73.508.625	61.043.324	23.290.539	84.333.863

The free zone houses 41 companies, most of which are small and medium-size manufacturing companies with significant export activity.

The dominant companies in the free zone are highly export-oriented. The total value of goods produced in the free zone and exported to foreign countries, compared to the total value of goods produced in the zone, was 73%⁴⁷, thus exceeding the legally defined minimum value of 50%. Ergo, this free zone meets the requirements⁴⁸ of economic justification, as defined in the BiH Law on free zones.

Statistics on domestic and foreign trade in the free zone Hercegovina-Mostar in 2012⁴⁹

⁴⁷ The BiH Ministry of Foreign Trade and Economic Relations. (2013). *Report on the operations of the free zones in 2012.*

⁴⁸ Article 8 Paragraph 3 of the Law on Free Zones in Bosnia and Herzegovina stipulates that the value of goods exported from a free zone must exceed 50% of the total value of manufactured goods leaving the free zone for a period of 12 months.

⁴⁹ The BiH Ministry of Foreign Trade and Economic Relations. (2013). *Report on the operations of the free zones in 2012.*

5.1.3 Free zone Vogošća

Vogošća is a suburb of Sarajevo. The free zone was founded in 1999 as a subsidiary of Volkswagen Sarajevo d.o.o. and has an area of 85.500m², out of which 42.000m² is under roof (production and stock area). Users of the free zone can use the zone for production, trade purposes, shipment-, bank- and insurance-activities, and for all other services. In 2012, 15 companies were established in the free zone Vogošća⁵⁰. The free zone has an advantageous geographic position:

- Direct Connection to the main railway: Ploče - Sarajevo - Banja Luka - Zagreb/Belgrade.
- Connection to the main road Budapest - Osijek - Sarajevo - Mostar - Ploče.
- 10 km away from the Sarajevo airport.
- Connection to the Trans-European gas supply.

Volkswagen Sarajevo d.o.o. is the only big exporter company in the free zone Vogošća. Car assembly started here in 1970 when TAS (Tvornica Automobila Sarajevo) was established in cooperation between Volkswagen AG and UNIS. 1989 was a record year for the plant, with a total of 3.500 employees assembling 37.000 vehicles. However, the plant was destroyed during the war. Volkswagen re-started production in 1998, but in 2010 the plant employed a workforce of only 282. Since 2001, Prevent Group joined Volkswagen as the new joint venture partner of Volkswagen Sarajevo, instead of UNIS D.D. The plant now manufactures car components, including stub axles, flywheel ring gears, wheel hubs, and wheel flanges. In 2012, Volkswagen Sarajevo d.o.o produced goods amounting to 43 million BAM in value. 100% of this production was exported.⁵¹ The Volkswagen Sarajevo d.o.o. plant has a total surface area of 166.871 m², with production and assembly buildings covering 92.391m².

Statistics on domestic and foreign trade in the free zone Vogošća in 2012⁵²

	Value of imported foreign goods into the free zone (in BAM)	Value of domestic goods that entered the free zone (in BAM)	Value of the produced goods exported abroad (in BAM)	Value of the goods placed on the domestic market (in BAM)	Value of the goods produced in the free zone (in BAM)
Total	45.197.304	11.098.859	43.461.454	-	43.461.454

⁵⁰ Ibid.

⁵¹ Ibid.

⁵² Ibid.



5.1.4 Free zone „Holc“ d.o.o. Puračić

Free Zone “Holc” is located in the village of Puračić in the Canton Tuzla, near the town of Lukavac. The free zone has an area of 99.000m². It was established and used by a single company, Fen d.o.o. This export-oriented furniture manufacturing company, employing 300 people, was established in 1997, and the majority owner is a German firm. Fen d.o.o. bought this site in 1997 with the help of the local government. In 2004, the site was granted the free zone status. 99% of their products are exported: the major export target countries are the Benelux countries, Germany, and Sweden.

Throughout the years, the firm has gradually expanded, built an increasing number of workshops, and employed an increasing number of staff. Most male employees in the company are working in the wood processing professions, while most female employees are working in the furniture textile processing professions.

Statistics on domestic and foreign trade in the free zone Tuzla-Puračić in 2012⁵³

⁵³ Ibid.

Name of the free zone user	Value of imported foreign goods into the free zone (in BAM)	Value of domestic goods that entered the free zone (in BAM)	Value of the produced goods exported abroad (in BAM)	Value of the goods placed on the domestic market (in BAM)	Value of the goods produced in the free zone (in BAM)
Fen d.o.o.	11.899.129	7.580.315	29.558.705	103.462	29.662.168

5.2 Annex 2: Overview of the survey conducted on the companies operating in free zones in BiH and the free zone operators

The survey contained twelve multiple choice questions ("Yes", "No", "I do not know") and the thirteenth question was an optional additional window for comments.

The outline of the survey is provided in the text below

Question 1	We are satisfied with the enforcement of the BiH Law on Free Zones.
Question 2	The BiH Law on Free Zones gives us privileges, but we cannot use these privileges in reality.
Question 3	In spite of being a free zone user, our company was obligated by the Indirect Taxation Authority to pay VAT.
Question 4	In spite of being a free zone user, our company has paid VAT, not because we were obligated to pay it, but in order to avoid too much administrative burden/paperwork.
Question 5	In spite of being a free zone user, our company was obligated by the Indirect Taxation Authority to pay import custom duties on equipment to be used for manufacturing within the free zone.
Question 6	In spite of being a free zone user, our company was obligated by the Indirect Taxation Authority to pay import custom duties on raw materials/intermediate products/semi-finished products to be used for manufacturing within the free zone.
Question 7	We have no advantages from operating in the free zone.
Question 8	There is no substantial difference between operating in the free zone or operating outside the free zone and maintaining a customs warehouse.
Question 9	The only advantage of operating in the free zone is that we have immediate access to customs services whenever we want.
Question 10	We can closely cooperate with other users of this free zone, which is a business advantage for us.
Question 11	We would recommend becoming free zone users in BiH to foreign companies.
Question 12	Is the company established on the basis of or with an element of foreign direct investment, or does the current capital of the company comprises a foreign direct investment in BiH?
Question 13	Additional comments



We collected twelve replies to this survey. Replies to questions one to twelve are first shown by percentage and then by number. Three respondents chose to add comments. These comments are also shown below.

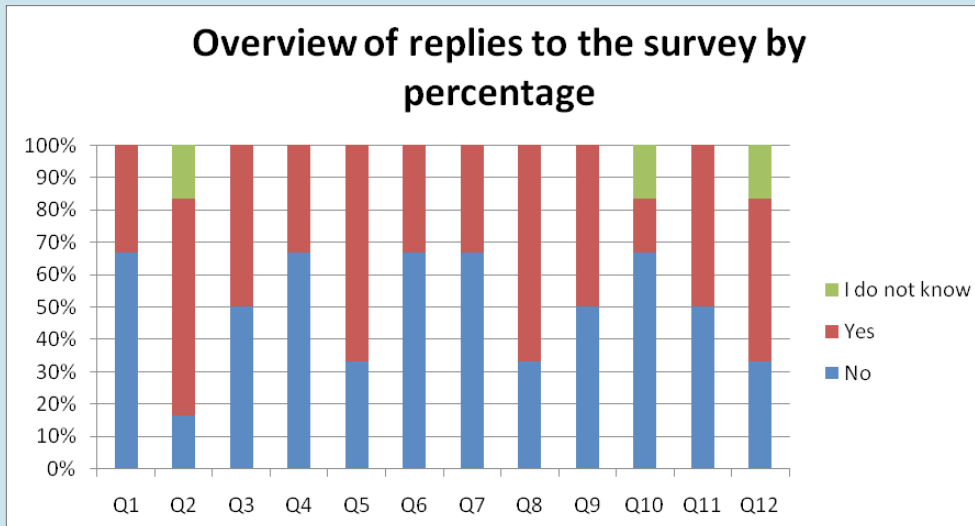


Chart 1:
Replies to the survey by percentage

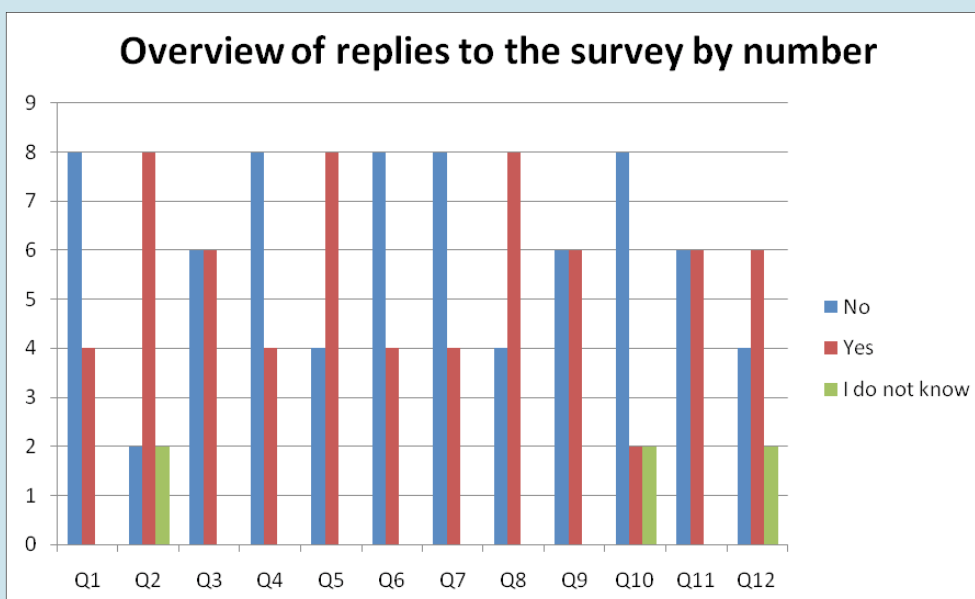


Chart 2:
Replies to the survey by number

As mentioned in the previous text, three respondents gave additional comments, while nine respondents skipped this option.

Question 13 additional comments:

- Since the free zone does not offer direct benefits and privileges, but only causes administrative burden for businesses, the free zone should be abolished or it should become a free zone in the true sense of this word. In terms of doing business with the countries of the EU and CEFTA, the free zone is becoming pointless.
- Free zone users pay additional costs for the import of equipment to be used during production, even though the regulations stipulate otherwise. The Court decision on the reimbursement of these costs is not implemented. By an internal act of the Indirect Taxation Authority - Instructions on the customs procedure in free zones, the normal work of foreign companies has been rendered impossible, and trade in goods in the free zone between users of the

free zone, without the payment of customs duties, has been rendered impossible. Also, the temporary removal of goods from the free zone for presentations and exposition is rendered impossible (even with the condition of providing a customs guarantee for the import costs). In BiH, there were approximately 20 approvals for the opening of free zones. Now, there are 4 free zones. Operating in the free zone often depends on the opinion of the customs officer. The work of the free zones is exclusively under customs surveillance. The zones are fenced, are well lit, and are guarded. On the other side, no one has the information on how many approvals were given for the work of customs warehouses. Where are those warehouses, what is the value of goods in warehouses, and whether that is the real status. No one assesses the economic justification of the existence of certain customs warehouses.

- I currently work in a free zone, and we only have obligations related to additional administration, all invoices need to be copied and submitted to the administration of the customs authority. The sentiment inside the zone is that we should shut down the free zone and establish a business zone with customs warehouses for people who need them.



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