

## ATTRACTING FOREIGN DIRECT INVESTMENT IN DEVELOPING COUNTRIES: WHY BOSNIA AND HERZEGOVINA SHOULD BE LEARNING FROM CHINA

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### Abstract

*The importance of capital inflows and outflows is something that country needs and encourage it to help the economies of countries to grow at a steady rate. The purpose of this study is to provide a framework and to explain what main drivers of FDI in the world are and what policies should be made to encourage the FDI in BiH. Main limitations of this study would be that, since this is rather an extensive study, it will not be able to cover all factors in-depth, but the author will try to explain in great detail the ones that she considers to be of great importance for Bosnia and Herzegovina. The author will examine factors that China took into consideration as it's incentives for attracting FDI. Furthermore, this study will show what the main factors are influencing the FDI of other countries and how Bosnia can improve its policies and change them to attract FDI.*

**Keywords:** *foreign direct investment, inflow, incentive, developing countries, government's actions*

**JEL Classification:** F10, G15, G18, H50

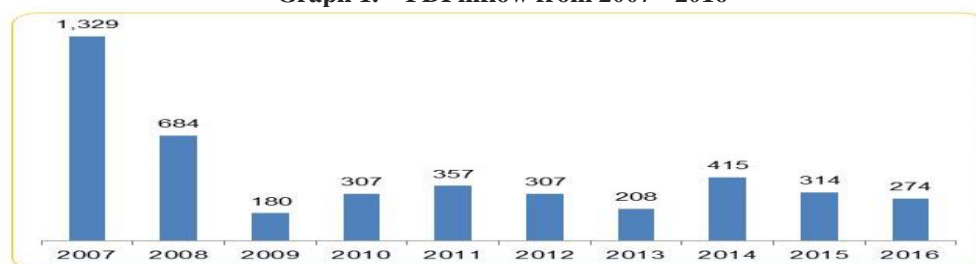
### I. INTRODUCTION

In the recent years, countries of BRICs (Brazil, Russia, India, and China) have become the most important emerging markets, which have a great potential of becoming even global superpowers. This has all happen because of their policies towards the foreign direct investment and capital inflows. As it will be explained during this study, Bosnia and Herzegovina have enormous potential to become one of the emerging markets and its market potential, with other things being equal, would drive all the economy to its steadily growing outcome. On the other side, not all factors could be fulfilled because of the political structure and complexity of Bosnia's government and state bodies.

### II. LITERATURE REVIEW

According to data derived from CBBIH report from August 2017, in the 2000s, Bosnia has made a significant number of policies towards encouraging and attracting capital in the country which resulted in 2007 that the FDI in Bosnia in EURO only was equal to 1.3 billion, which represent the highest ever attracted amount of FDI in EURO. After that, the Great Financial crisis of 2007/2008 struck Euro zone and FDI in EURO has decreased almost by half. In 2009, there is a decrease by 73.68% in the FDI in EURO. As we can see from the graph, in 2010 and 2011, Bosnia has recovered and there is an increase by 70.55% and 16.28% respectively in FDI by the Euro zone. After that, in 2012 and 2013 the FDI in EURO is decreasing by 14% and 32.24% respectively. In 2014 again there is a huge increase in FDI flows in EURO by 99.51% compared to the previous year. In 2015 and 2016, there is a decrease in FDI flows in Euro which are mostly caused by political instability. The FDI has fallen in 2015 by 24.33% and in 2016 12.73%. In 2017, there are some positive indications that FDI will increase, but that is to be discussed further in this paper.

**Graph 1. – FDI inflow from 2007 - 2016**



Source: Central Bank of B&H: FDI Flows, August 2017

„ Total amount of foreign direct investment (FDI) in Bosnia and Herzegovina till December 2016 was 12,964.4 million BAM or 13 billion BAM (6,629 million EUR or 6.6 billion EUR). “ (CBBIH, August 2017) Graph 1 shows us how poor Bosnia is in attracting capital since from 1994 to December 2017 it attracted only 6.6 billion EURO. This is quite disturbing since the report of the World Bank shows us that „since 2000, Serbia has received USD 25 billion of FDI. “ (World Bank report, 2017) Serbia is the first neighbor of Bosnia and had similar political situation due to war from 1992-1995.

Furthermore, we can see the main investors in Bosnia by capital inflows. According to the reports of CBBIH, we can see that the largest portion of FDI in Bosnia is going to Austria (1.3 billion EURO), Croatia (1.1 billion EUR), Serbia (1.1 billion EUR) and Slovenia (486 million EUR). This can all be seen as an investment from Bosnian people who have fled the country during the war, and after the war came back to the country and invested into the industry, banking sector or chemical industry.

**Table 1. – FDI inflow last quarter**

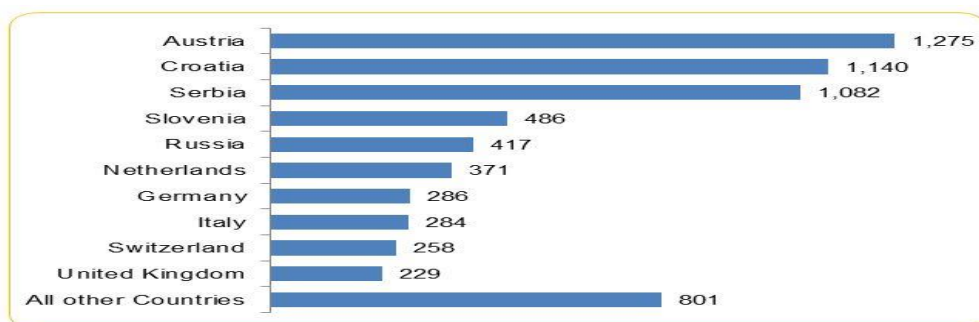
Actual	Previous	Highest	Lowest	Dates	Unit	Frequency
122.40	145.20	259.880	40.50	2004 - 2017	BAM Million	Quarterly

Source: tradingeconomics.com December 2017

Also, we can see from this Table 1 what the actual amount of FDI is quarterly. The highest amount ever recorded to come in one quarter in Bosnia in 259.8 million BAM and the lowest to come is 40.5 million BAM. This is data is derived from 2004 to 2017.

Now we can see the graph which countries have invested into Bosnia and in which amounts.

**Graph 2. - FDI inflow per country**

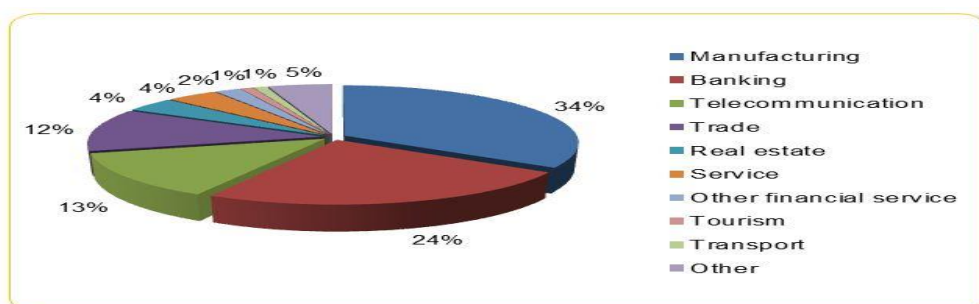


Source: Central Bank of B&H

As we have discussed, in the first place is Austria, the goes Croatia, Serbia, Slovenia, Russia, Netherlands, Germany, Italy, Switzerland, UK, and others. It is impressive to see that the sum of first three top FDI investors in Bosnia takes up 52.77% of the total FDI in Bosnia.

Next graph will show us which sectors of industry and economy are affected by FDI and which are most profitable to invest in.

**Graph 3. – FDI inflow per industry**



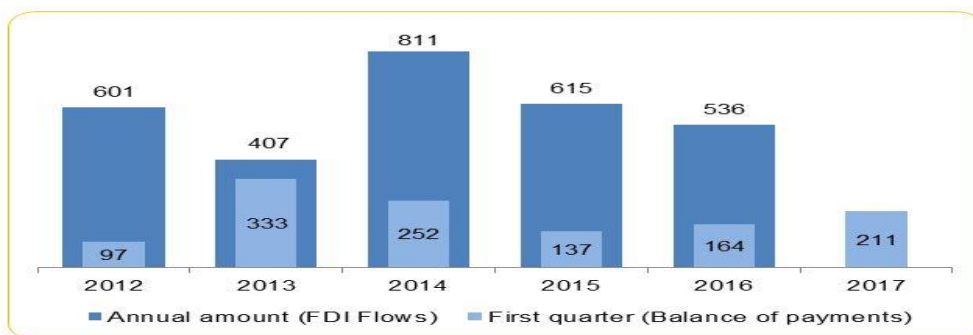
Source: Central Bank of B&H

As it is mentioned earlier, manufacturing is the No. 1 activity foreigners invest in Bosnia due to natural resources, favorable climate and the history of Bosnia as a heavy metallurgy producing country. Next one is banking services ( 24% of FDI), which is due to the suitable soil for banking expansion, due to lack of capital, purchasing power, not any domestic banks and new investment opportunities. Next are telecommunication services, which represent 13% of the FDI. Next go trade with 12% of FDI, real estate and services with both of 4% of FDI, other financial services with 2%, tourism, and transportation with 1% each and other services and products are 5% of FDI.

If we are discussing previous year (2016) according to the CBBIH report, there was a decrease in FDI, when compared to 2015, and it was 274 million EURO out of which „ 148 million EUR was equity, reinvested earnings were 98.9 million EUR, while the other capital was 27.3 million EUR. Although total investment in 2016 was less than in 2015, it is significant that the equity holdings were approximately the same as in the previous year and accounted 54% of total FDI in 2016.“ (CBBIH report, 2016) Also, Croatia was the biggest investor in Bosnia with 60.8 million, the second was Austria 37.8 million and on third place was UAE with 33.7 million. There was also a number of countries from the Middle East investing in Bosnia, besides of UAE, such as Saudi Arabia 17.2 million, Kuwait 15.1 million... The sectors in which FDI was invested were: Trade (Wholesale) with 76.1 million, followed by Financial Services 71.1 million, Manufacturing of Tobacco products 36.4 million, Manufacturing of Chemical products 25.2 million, Telecommunications with 17.5 million, Electricity 13.7 million, Manufacturing of Beverages 11.9 million...

As for forecasting the FDI in 2017, from the report of CBBIH, we can see that in the first quarter of 2017, there is an increase in FDI, with regards to 2016, by 28.65%. This can be considered as a positive sign for investors to further invest into Bosnia. Also, the preliminary data, which is derived for the first quarter, and can be used as an indicator, but it is not certain that outcome will happen. However, this increase will be seen by most investors and analyst as a positive sign and it will result in rising in the interest of potential investors, and we can be optimistic about future capital inflows in Bosnia.

**Graph 4. – FDI inflow from 2012 – 2017 (with first quarters)**



Source: Central Bank of B&H

As we can see from the Graph 4. main problem for Bosnia and Herzegovina, which can be used to boost the economic growth, is attracting FDI. As said before, Bosnia's total amount of FDI from 1994 to December 2017 is 6.6 million EURO. „Bosnia and Herzegovina ranks 81st (out of 190 economies) in the World Bank's 2017 Doing Business report, two spots down from the previous year. Major problems facing foreign investors include a lack of transparency of procedures and weak judicial structures, as well as the dual nature of the State. “ ( Santander Trade Portal, 2017) We can see from this World Bank report that Bosnia is in the middle of the list and that it has dropped two spots down. This should represent an alarming note to Bosnian government and it should change something in order to boost the FDI. For example, Serbia, first neighbor of Bosnia, with similar problems that arose from the war in Bosnia from 92-95, in the same report of the World Bank, „Serbia ranked 47th in the World Bank's 2017 Doing Business report published by the World Bank, higher than in the previous year (59th place). „ (Santander Trade Portal, 2017) Furthermore, Serbia has ranked No. 1 in the Greenfield FDI Performance Index of 2016 according to the FDI Intelligence, due to its tax breaks and quick granting building permissions. Bosnia can also use the same policies that other countries have taken into consideration and implemented to attract more FDI.

Now we should analyze the different factors and indexes that influence on investor's opinion over countries and markets. For comparison, the author will use emerging markets of Eastern Europe and Central Asia and developed countries such as Germany and United States.

Table 2. - Comparing indexes – Bosnia, and others

	Bosnia and Herzegovina	Eastern Europe & Central Asia	United States	Germany
<b>Index of Transaction Transparency</b>	3.0	7.0	7.0	5.0
<b>Index of Manager’s Responsibility</b>	6.0	5.0	9.0	5.0
<b>Index of Shareholders’ Power</b>	7.0	6.0	4.0	8.0
<b>Index of Investor Protection</b>	5.5	6.4	6.5	6.0

Source: Doing Business - Latest available data.

As we can notice from the Table 2. that Bosnia has the lowest Index of Transaction Transparency, which means that the disclosure of information and their transparency is not as good as in other comparing markets and countries. Lack of transparency is not only seen in transactions but also in all business procedures, mostly in public tenders and offerings of state-owned enterprises for privatization. Next item in the table represents Index of Manager's Responsibility and as we can see Bosnia is second on the list right below the USA. The United States is on the first place because of their legislation and Acts, especially the Sarbanes-Oxley Act of 2002 which introduced more transparency in accounting and made managers of the company responsible for their acts in managing the company. After that Act has passed in Congress, Bosnian lawmakers have made a law very similar to the Sarbanes-Oxley Act and made managers responsible for its acts and decisions. Third in the table is Index of Shareholder's Power and Bosnia is again quoting in the second place. This is mainly because Bosnia has around 400 companies that are publicly traded and they are mainly still family businesses where shareholders are also managers and are also owners of the company. But, this kind of doing business has shown as very good since those managers have great incentives for business to succeed. Last in the table is the Index of Investor Protection in which Bosnia is not so bad but it is the worst when comparing to these markets and countries. Legislation in Bosnia is not so „evolved“ in comparison to other countries because all legislation and lawmakers are concentrated on national minorities and nationality so they are not changing nor implementing other laws which are in procedure.

Table 3. – General information about FDI inflows

Foreign Direct Investment	2014	2015	2016
<b>FDI Inward Flow (million USD)</b>	529	270	285
<b>Stock (million USD)</b>	7,22	6,792	6,848
<b>Number of Greenfield Investments</b>	21	25	16
<b>FDI Inwards (in % of GFC)</b>	16.0	10.5	10.6
<b>FDI Stock (in % of GDP)</b>	39.0	41.8	41.2

Source: UNCTAD - Latest available data.

As we can see from Table 3. FDI inflow is decreasing in the past three years and that is not a good sign for the economic activity and it shows us that something is happening in the country which has an unfavorable outcome. Next important thing that we can derive from this table is the number of Greenfield investment. Greenfield investment represents the inflow of capital into the country for starting up a new business from nothing, by buying the land and building the facilities to employing people from that part or region for the construction and production of the products or services. As we can see, in Bosnia the number is decreasing, which is mainly caused by the complex bureaucratic procedures and the length of time the papers for business will be ready. If we compare the No. of Greenfield Investments in the region we come to the information that „Serbia has topped the 2016 Performance Index for Greenfield FDI. The south-eastern European country is ranked number one in the annual study by FDI Intelligence, a Financial Times data division, which looked at inbound Greenfield investment in 2016 relative to the size of each country’s economy „ (FDI Intelligence, 2016)

### III. METHODOLOGY

For the purpose of this study, the author has selected the data derived from Official CBBIH reports, the CPI reports and analysis of microeconomic and macroeconomic indicators, World Bank reports and analysis of different countries and independent analyst. All the data were analyzed in SPSS and tables and charts were provided for further in-depth analysis and discussion of the results. For the analysis of the data, the author has been using descriptive statistics and regression analysis to further prove the hypothesis. Independent variables represent the different factors affecting FDI inflow and dependent variable represents FDI inflow.

From the dependent and independent variables, we can conclude the hypothesis as encouraging FDI to improve Bosnian economy. This actually means that if the different means of encouraging FDI improve that it will automatically influence the macroeconomic indicator, so it will affect the Bosnian economy. The real indicator will be based on the performance of the countries that have applied all these means of encouraging FDI and effects on their economies. The countries that will be taken into consideration will be China. China is part of the emerging markets of the world, the BRICs.

#### ANALYSIS

In this section of the paper, the author will present the way of improving the FDI and the discussion will be made based on the incentives, policies, and means for improving FDI in China.

In summary, there are three main factors that affect FDI:

- Skills and wage costs of labor,
- Infrastructure and access to raw materials and
- Communication and transport links.

#### Skills and wage costs of labor

One of the incentives of MNCs (Multi-National Companies) of countries for investing abroad is the outsourcing of labor from countries with lower wages and labor costs. If for example, an hour of labor in developed countries costs an employer \$20 per hour, in developing and emerging countries that number is much smaller (e.g. In India, costs per hour are around \$1 per employee). This is the main reason why Western countries outsource to developing and emerging countries. But, it does not mean that countries with high labor costs will not attract FDI, if it is the only incentive for the companies and if that is the only positive incentive. Also, there are some industries that require highly skilled labor forces, such as pharmaceutical, IT, nuclear etc. Therefore, the companies and countries will invest in countries which gave a high degree of educated labor forces. To conclude, countries want to invest and are willing to invest in countries which have low labor costs combined with a high degree of education of labor forces.

#### Tax rates

Also, in the part of labor skills and costs, tax rates are very important. The tax rates are corporate and income tax rates. Big corporations with high profits invest in countries that have low corporate income taxes because that means their profits will be significantly higher, so they get more money. Large IT corporations, such as Apple, Microsoft, and Google are investing into Ireland because it has the lowest corporate tax rates in Europe. In fact, all these countries are pulling their profits through Ireland, despite that they have operations all over the world.

#### Transportation and Infrastructure

One of the most important factors in attracting FDI are transportation costs and infrastructure. If a country has low labor costs and highly educated labor force, but if it has high transportation costs, then it is of no use, and the company will not invest in that country. Also, the geographic position of the country is important, because the countries with access to sea have the advantage of shipping on boats, and lower costs than landlocked countries.

#### Size of economy / Potential for growth

FDI is regularly focused on offering merchandise specifically to the nation associated with drawing in the venture. Hence, the span of the population and degree of monetary development will be critical for drawing in ventures. For instance, Eastern European nations, with an extensive population, e.g. Poland offers scope for new markets. This may pull in remote auto firms, e.g. Volkswagen, Fiat to put and fabricate industrial facilities in Poland to pitch to the developing country's market. Small nations might be off guard since it is not a large market due to the small population.

#### Political stability / property rights

FDI has a component of hazard. Nations with an unverifiable political situation will be a noteworthy disincentive. Additionally, a financial emergency can debilitate speculation. For instance, the current Russian

monetary emergency joined with financial authorizations, will be a central point to debilitate outside speculation. This is one motivation behind why previous Communist nations in the East are quick to join the European Union. The EU is viewed as a flag of political and monetary strength, which supports outside speculation.

#### Exchange rate

This represents also very important part of the tools and incentives for FDI. If you have a stable exchange rate, your country will be more attractive for foreign capital, especially if you have Currency Board arrangement, because there is not a possibility of loss due to exchange rate changes.

#### Access to free trade areas

A huge factor for firms putting resources into Europe is access to EU Single market, which is a facilitated commerce zone yet additionally has low non-tax obstructions as a result of harmonization of principles, directions and free development of individuals. For instance, UK present Brexit is likely on be less alluring to FDI, on the off chance that it is outside the Single Market.

#### Marketing of a country (Image building)

We live in the world of the media, which controls our lives in an unimaginable way. Every part of our lives is affected by media (studying – distance learning, presentations, videos...; everyday life – information about the world; business – many different programs, online forums and web pages of companies...). In the beginning of 2000s, many governments began to advertise their countries in media like TV, radio, newspaper etc. With the explosion of the .com companies and Internet, social media etc many governments began to promote themselves online. As today's, most dominant media is the Internet and social networks, government have chosen to advertise there. The main purpose of doing „marketing of a country“ is:

- to generate investment directly (investment-generating activities);
- to provide services to prospective and current investors (investment-service activities) and
- to improve a country's image within the investment community as a favorable location for investment (image-building activities).

World Bank report, „Marketing of a country“ (2000) identifies 12 different strategies of promotion of a country:

- Advertising in industry- or sector-specific media;
- Participating in investment exhibitions;
- Advertising in general financial media;
- Conducting general information seminars on investment opportunities;
- Conducting general investment missions from source country to host country or from the host country to source country.
- Engaging in direct mail or telemarketing campaigns;
- Conducting industry- or sector-specific information seminars;
- Conducting industry- or sector-specific investment missions from source country to host country or vice versa.
- Engaging in firm-specific research followed by "sales" presentations;
- Expediting the processing of applications and permits;
- Providing investment counseling services;
- Providing post-investment services.

#### Information Asymmetries

In the business of attracting foreign investment into the country, one very important trick one government should use is the asymmetric information. Although it is not ethical to use it, and it can create additional problems, asymmetric information can be used in „small doses“ like in doing marketing of a country. Also, investors are not so concerned about asymmetric information but what they are concerned about it only the reassurance if the information asymmetries are found out, that the placement of the products will not be affected by it and the integration of the company into global suppliers network. When they get a reassurance, the information asymmetries is no longer an important factor to the companies. So, countries like Costa Rica, Czech Republic, and Morocco have used it in the previous decades to attract capital into their country without any concerns that they will be seen in a negative way.

#### Adequate financing

Although many investors come into countries with foreign capital, there may be a need for additional capital. If it is too expensive for an investor to obtain capital in his/her home country, an investor can obtain it is

the country in which he/she invests in. For that, it is very important to have a very developed banking system, which encourages entrepreneurship and building.

Administrative processes

Host country governments streamline the process of establishing offices and production in their countries. By reducing bureaucracy and regulation environment, these countries appear more attractive to foreign countries and companies.

Exit strategy

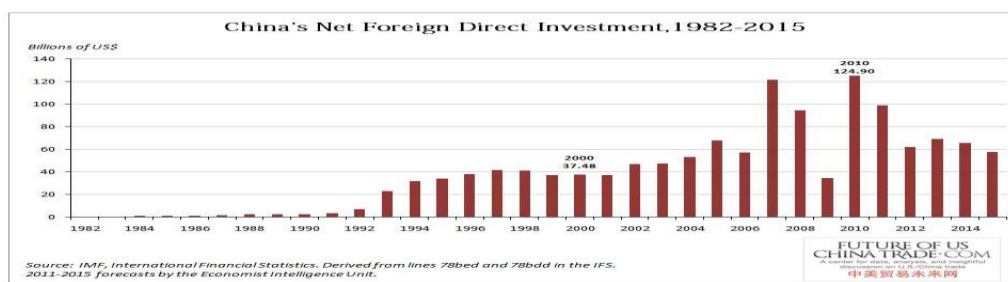
The exit strategy is very important part of the foreign investment into one country. If something goes wrong for the company or in the country itself, exit strategy provides them a framework and a salvation strategy in which companies do not lose money and do not alter the situation in country harmfully.

**IV. DISCUSSION**

This section will provide the findings and case study of world's most outsourced country: China.

The advantages of FDI flow is to both the provider of capital and additionally to the host district. China is one nation that has benefited gains by these advantages. As indicated by China's business service, FDI in 2010 outperformed \$100 billion out of the blue. With the year finishing December 2010 FDI increased 17.4% to \$105.74 billion. We should investigate the components that drive remote interest in China, and analyze what this implies for speculators - and the Chinese economy.

Graph 4. – China's FDI inflows from 1997 – 2014



As it is shown in the graph we can see an increase in the FDI inflows in China. It all began in 1994 and still, it has not stopped. It is important also to mention that China is the only country in the world which has “Twin surpluses“ meaning that both current and finance account of Balance of Payments of China is positive, which is absolutely impossible in theory, all thanks to the enormous FDI.

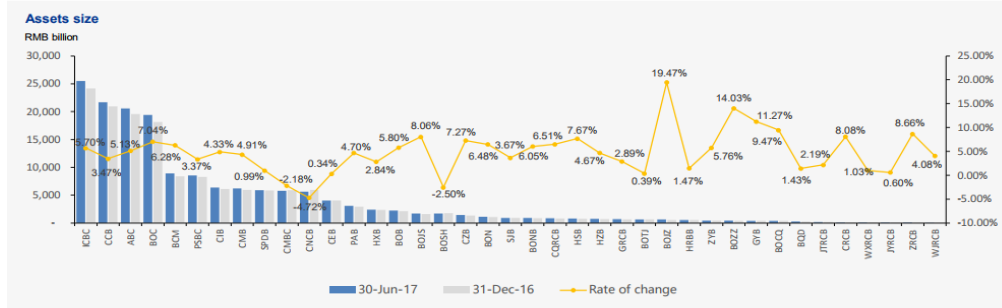
There are several factors affecting the amount of FDI that pours into China:

Capital Availability & Banking sector

In the mid-2000s, China surpassed the United States as the world's biggest beneficiary of remote capital. FDI is composed out of capital that an outside investor will place (and risk) inside a region. Conditions in the worldwide capital markets and general financial condition channel a part in deciding the stream of FDI into China. A flourishing worldwide economy, capital markets, and business condition make huge swaths of investable capital, a segment of which is changed over to FDI. A lot of investable capital that proportionately overpower the quantity of sound neighborhood venture thoughts can cause institutional, organization and individual financial specialists to put their riches in rising and creating markets. Also, as for capital, China has a developed banking sector composed out of

“Big five“ which are state-owned: Bank of China, the China Construction Bank, the Industrial and Commercial Bank of China, BCM China and the Agricultural Bank of China, all of which are among the largest banks in the world. According to the KPMG China report (2017) which states that if we look credit and currency perspective growth, credit assets had a solid growth from Jan-July of 2017 and the currency expansion and aggregate financing to the real economy increased RMB 1.42 trillion from 2016 end to reach RMB 11.17 trillion by the end of July 2017. Moreover, the regulatory policy became more cautious and comprehensive, especially for the off-balance sheet accounts and interbank business.

Graph 5. – China's currency expansion and bank financing



Source: KPMG China „Banking sector report Q2 2017“

Infrastructure

China's engaging attractiveness as a destination for investing capital lays on its advancement of infrastructure, asset accessibility (physical and work), efficiency and workforce skills, and the improvement of the business value chain. The level of development of these components can make China more alluring for FDI in respect to different countries, for example, India, that contend and compete for a similar speculation capital. A developing and emerging economy requires framework and assets keeping in mind the end goal: to encourage the offer of merchandise and sale. Lower exchange costs, because of the development of these components, empowers investors to earn returns on their ventures as their ventures can produce benefits. Roads, highways, bridges and different types of infrastructure need to be available, maintained and given adequate security to the transportation of merchandise and in addition to the drive of workers. Another part to attract FDI includes the accessibility of ease, talented employees who have the essential aptitudes, experience and proficiencies to make, produce, and give products and ventures that can contend in worldwide markets. Infrastructure development remains first priority for China's government and is a major budget - sucker, which has recognized a long time ago that a modern economy's drivers are reliable roads, rails, electricity, and telecommunications. From the late 1990s to 2005, China has invested a large portion of the budget and FDI profits into development of the infrastructure and 100 million Chinese people have benefited from electricity and telecommunications upgrades. Between 2001 and 2004, investment in infrastructure in rural parts of China grew by a massive 51% annually. In recent years, China's government has used large portion of infrastructure spending to hedge against enormous and exponential growth.

Figure 1. – Inequality in China's infrastructure



As we can see from this figure above, there is inequality in the development of the infrastructure in China. Coast and more Eastern part of China are more developed and, in contrary, the western part is underdeveloped which represents rural China.

Regulatory Environment

At the point when a national government sanctions and implements guidelines and arrangements went for favoring state elements to the detriment of privately held firms, such a situation can be unfavorable to activities encouraging FDI. In that capacity, the administrative condition can either empower or block outside direct interest in China. Inadequate controls have a tendency to ruin entrepreneurial and business exercises, as directors and representatives must invest more energy and cash to conform to principles and laws. If an investor wants to set up an office in China, high start-up costs, lawful introduction, and other awkward policies may force the investor to set up the office somewhere else, where the business atmosphere is more helpful for the industry. Different sorts of frameworks incorporate obligatory joint venture organizations in which, together with the



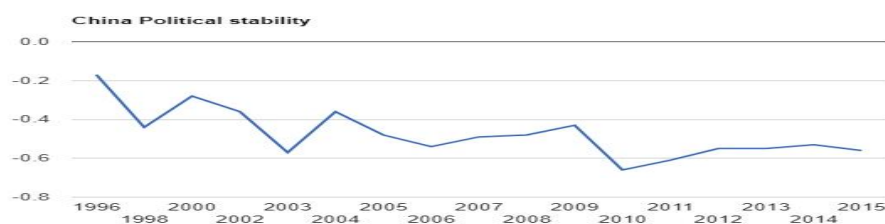
outside investors, the business is required to have a Chinese government agency or nearby organization as a partner. A legal framework that is protective toward Chinese local, can contribute to making China a less positive venture location. Another administrative determinant includes the administration's promotion of venture by giving appealing monetary incentives as tax cuts, grants, and minimal government credits. Government-supported financial actions give the likelihood of making a business more productive and in a shorter period of time.

On 3 September of 2016, the Standing Committee of the National People's Congress (NPC) made a decision on changing four major laws regulating FDI in China. Under the existing regime, the law states that the establishment of any foreign enterprise is subject to a two-step approval and registration procedure: In the first step the application and gathering of documents which are subject to the approval of MOFCOM or some other government agency. The next step, after obtaining the approval, is that the company needs be registered within the competent industry by the government agency. With this new decision, the four major Chinese laws on FDI will be changed. The amendments generally revoke and cancel the requirement of a MOFCOM's approval for the foundation as any other changes of enterprises with foreign investment.

**Stability**

Political and monetary steadiness can encourage FDI. Stability speaks to consistency and the openness for ventures to increase better foresight into what's to come. On the other hand, consistent social distress, revolting, uprisings and social turmoil are settings that are not helpful for business. Monetary instability can likewise add to hyperinflation, which can render the money overnight. To encourage FDI, residents and also organizations ought to have a sensible reason for regarding Chinese peace. Viciousness, criminal movement, shakedown, kidnappings, and fake money and items have all been issues in China that serve to undermine the adequacy of conducting trade activities. The justice system ought to likewise have compelling components for reducing and eliminating rebel and degenerate components of law enforcement offices. As for the currency, the official Chinese currency is Renminbi. Up until 2005, RMB was pegged to US\$. Now it is freely floating, with occasional interference of the government. It is usually expressed in US\$ and the current exchange rate is CNY 6.49 / 1 \$US. RMB is a rather cheap currency which is a great incentive for investors to come into China.

**Graph 6. – China's political stability**



Source: TheGlobalEconomy.com, The World Bank

As for political stability, the Chinese government is graded differently over the years by the World Bank, but it was all negative. The index measures the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically-motivated violence and terrorism. If it is above zero, the country of interest is stable and if it is below zero, it is unstable. The mean for China during that period was -0.47 pts with a maximum of -0.17 points in 1996 and minimum of -0.66 points in 2010. In 2015, the trend is negative, which means that China is rather an unstable country regarding the political stability.

**Local Chinese Market and Business Climate**

The most glaring part of China is the sheer size of its population and market, and the prospects for development that comes from its size. The capacity of enterprises - supported by remote capital - to sell to a sizeable market makes China an appealing destination for FDI. As the Chinese economy keeps on succeeding, advancing and developing, higher-end ventures, for example, medicinal services, data innovation, designing, mechanical technology and luxury goods, among others, can pick up a greater impression in China as its nearby conditions, assets and other FDI determinants are upgraded. Moreover, financial development and FDI can begin a "win domino impact." The more the area draws in FDI, the more it develops. The more it enhances and develops, the more investors will invest FDI. This point underscores the upside of China's sizeable market, which presents development openings in present and forthcoming business movement. The more FDI streams into the nation, the more prominent the financial chain response is, giving a constructive outcome to manage such development. Market openness serves a few essential roles in pulling in FDI. Of basic significance is a business' capacity to sell its items and services to both domestic and outside business sectors. If the Chinese-based enterprise has constrained or no entrance to outside clients - especially the United States, Western Europe,

Japan and others - then the nearby market may not be sufficient to warrant a critical interest in cash and energy. Exchange barriers, for example, tariffs, are ordinarily seen as disincentives by different countries. An American item that is liable to high taxes in China will be less sought after in the Chinese market because of the misleadingly expanded cost. Such activities ordinarily incite retaliatory duties from the U.S. on Chinese items, or in certain outrageous cases, an altogether prohibition on specific merchandise and ventures.

Taxes

China's corporate income tax is rather high 25% but it can be reduced by 10% to 15% for qualified enterprises which belong to the industries which are encouraged by the Chinese government such as IT companies and enterprises with the production of integrated circuits. Tax breaks are also offered to employers engaged in other industries and are known as „Tax holidays“. Individual income tax is offered at progressive rates ranging from 3% to 45%, with different deductibles, depending on the amount of income.

In 2007, the Chinese government has reduced the corporate tax rate for all enterprises, state, domestic and foreign, from 33% to 25%.

Graph 7. – China's tax rates from 2006 - 2016



Labor costs

We all know when on the label says „Made in China“, it is quite cheap, at least when we compare it to Bosnia. Labor in China is considered to be relatively cheap, which was one of the key determinants for attracting FDI into China. Low labor costs, mainly in production facilities and enterprises, are very important factor for outsourcing, with the main line “Why produce it here, when we can outsource to China or India, and make a huge profit. But it turns out that wages were low until 2011. From 2011 to 2016, wages have increased: average hourly wages hit \$3.60 in 2015, rising 64 percent from 2011. In 2016, Chinese labor costs are only 4% lower than those in the United States. Since labor costs have increased dramatically for investors, they have turned to robots. In 2013, robotic industry market has become the largest in the whole world and they are still growing. As for skills, in previous years, China has invested a substantial amount of funds into the education of its residents in coastal and developed areas, but since it is the world's largest state own education system, which is obligatory, the education rate is quite high. Literacy rate of entire population is 91.6% out of which males are 95.7% and females are 87.6%. We can see the gender gap since China is closed country.

Exit strategy

China does not have clearly defined exit strategy. With the increased labor costs, many big companies such as Google, Apple etc. are developing strategies to exit China. China is a relatively closed economy, with most of their communication with outside world, is made through FDI and production of goods and services (exports and imports). But, since the game is changing, many companies want to shift their headquarters and offices to other emerging countries and markets. This is rather difficult since the „Impossible Trinity“ which is consisted out of fixed exchange rates, free movement of capital and independent monetary policy, does not allow to have all three. If you choose one, you need to give up one of the other two. China has a floating exchange rate with a periodical interference of the government into the revaluation of RMB, which means that there is no full free movement of capital and that they have an independent monetary policy. This free movement of capital is what disables investors to pick up their money and leave China.

Marketing of country

China's self-image is not confined to any agency outside China but is based on the previous experiences of companies and enterprises that came to China in previous years. China is viewed as a low – cost, medium – skilled country with a large number of resources and open doors for foreign investors. But, times are changing, and China is no longer low – cost country, medium – skilled and that is what concerns investors the most. But China is fighting against that by taking all knowledge and money that foreigners have invested and founding their own facilities and enterprises and producing their own products..

## V. CONCLUSION

Now the author will discuss the reasons why should some company or country invest in Bosnia and what are cons of the Bosnian economy and politics that are discouraging FDI.

Investors have numerous reasons for investing in Bosnia. For example, No. 1 reason why FDI should come to Bosnia is that it is a land of great amounts of available natural resources and beauties such as woods and forests, water, fresh air, historical monuments and natural landscapes. It is rich in hydropower, wood, coal, nickel, iron ore, different minerals, petroleum salt, bauxite, copper, lead, zinc, chromate, timber, cobalt, manganese, clay, gypsum, and sand. Out of all of these, we can say that hydropower and some types of metal and wood are exploited by the companies and other rarely. Next reason is Bosnia's strategic location because it is located in the center of Balkan and South - East Europe and since forever it has been a path for goods to be transported, all wars have been waged in its borders and always was a strategic position for occupation for every empire. Furthermore, it is rich in industrial zones, which are abandoned since the previous war, full of untouched nature and available production facilities. Also, one of the main reasons why you should invest in Bosnia is that it is a candidate for EU and WTO and it has regional Free Trade Agreement with all neighbor countries. Also, the biggest reason why you should invest in Bosnia is that Bosnia's currency BAM is one of the most stable currencies in the region, because it is pegged to EURO with Currency Board Agreement where 1.95583 BAM/EURO. That means that Bosnia's currency is not fluctuating in terms of EURO but it does not mean that it does not fluctuate against other currencies, such as US \$, RSD, GBP..., which is a really good thing because a company can never be in loss due to changes in the exchange rates and has to exchange rate risk. This is maybe most important and prominent feature of Bosnia and should be put into the marketing strategy. Because of it is pegged to EURO, countries that are using EURO as it's official currency cannot experience loss, only if BAM is revalued or if all capital feeds Bosnia and the value of the currency drops in value. Also, since Bosnia is affected by the „Impossible Trinity“ and it chose to have a fixed exchange rate, it also chose to have a free flow of capital, which means that Central bank cannot have an independent monetary policy. Due to the free flow of capital, an exit strategy in Bosnia is rather easy, because one company can simply declare bankruptcy and to search another investor to buy the company or to perform bankruptcy process. Labor costs can be a drawback and a positive thing because Bosnian layout is cheaper than the Western but it is not as cheap as the labor of emerging countries. On the other hand, Bosnia's population is rather highly educated, mostly young population, which offer very good workforce. But, Bosnian youth is fleeing Bosnia and going to work mostly in EU countries like Germany, Austria, and Slovenia. Moreover, because of big investments in the Banking sector, Bosnia now has one of the most developed banking sectors in the region. There is a huge network of foreign, very liquidity and solvent banks, which are offering many types of corporate loans, which are a great way of financing for entrepreneurs. And at the end, we have that Bosnia has low corporate income taxes ( 10% ), which indicates higher profits for the firms and corporations operating in Bosnia and tax rate is amongst lowest in Europe. Also, the government gives a lot of tax incentives in forms of tax breaks and other incentives. Policymakers may concern also to make Bosnia a tax haven in Europe, which will draw many investors into Bosnia definitely. Furthermore, the government and judicial system do not discourage the involvement of foreign investors in government-financed research and development programs. Moreover, Bosnia's policy and laws are quite open for FDI, rather than close, with policies that give the right to foreign investors to have a 100% ownership in shares over some company. When we look at the different incentives that the government has offered to the investors, including exemption from payment of customs duties and fees, BiH is divided into three jurisdictions which offer totally different incentives and tax legislation. These are three legislations in BiH: Federation, RS and Brčko district. In Federation and District Brčko, investors can open bank accounts in all jurisdictions and can easily transfer all profits and losses out of the country. The most important law in those two jurisdictions is Law on the Policy of Foreign Direct Investment which cannot be overruled or terminated by any other set of rules and regulations. However, there is one positive side of having many levels of government and that is that investors can choose the subsequent law, which is better for which type of the investment. Moreover, in addition to the incentives that author have listed above, the three jurisdictions have different incentives based on their territory. For example in District Brčko investment in PPE are subject to tax relief. In Federation of BiH, the Law on Corporate Income tax offers a company in Federation different tax exemptions that in other two jurisdictions. The legislation states that there is a tax incentive that states if the company bears losses, they can be transferred, in whole or in different portions of the loss, in the future tax period. It also states that the tax base for the next tax years will be reduced for the loss that was postponed for that year. This offers a great incentive to the investors and domestic companies since that means you can postpone your tax obligations on period of 5 years without any dispute with the law. A taxpayer investing in production not less than 20 million KM over the period of 5 consecutive years in the Federation shall be exempt from profit tax during the period of 5 years, starting with the first year when taxpayer has to invest at least four million KM. Shall the taxpayer from the Paragraph 1. of this Article, over the period of 5 years fail to reach prescribed investment amount, s/he shall lose the right to tax exemption, and unpaid profit tax shall be determined according to the provisions of this Law, and

increased for the penal interest that shall be paid onto the untimely paid public revenues. Articles 31, 32 and 33 are discussing about the incentives for investing in terms of exports, investing in terms of the money amount and the employment of people with special needs. As we can see, if one invests in Bosnia more than 20 mil BAM in the period of 5 year in Federation, it will be exempt from the corporate income tax for that tax period. If the investment does not reach 20 mil BAM in 5 years, then the company is excluded from the exemption. Also, Article 31 argues that the company does not need to pay corporate income taxes if the exports are 30% of its net income. Article 33 states that the company does not need to pay taxes if it employs people more than 50% of people that have special needs or disabled persons. Smaller entity of BiH has different legislation than other two jurisdictions, so it has some different incentives. In the Law on Profit Tax and its amendments, RS has offered tax base reduction incentive for investments in:

- Equipment for production activities
- Property and Plants as manufacturing facilities

Also, in the law there is an incentive for the employers for the employees which says that for companies which have more than 30 workers during the fiscal and calendar year, there is a tax base reduction for personal income tax paid by employees, only if the employees are not illegal workers and are listed in the RS Employment Office. Furthermore, with the adoption and implementation of the Decree on Conditions and Implementation of the Investment and Employment Support Program new incentives were introduced which are based to encourage foreign investment ( greenfield investments mostly ) from which it will be derived and transferred technology, knowledge and new workplaces. As we saw, in FBiH if you invest 20 million BAM in period of 5 years, for that tax year you will be exempt for corporate income taxes. In RS there is also a minimum investment amount which is 2 million BAM and the employment of at least 20 new workers to be able to apply for the incentives. Also, this article states that you need to have already investing project in RS to be qualified. However, there is no fixed amount, but the amount of incentive is calculated in proportion of the number of workers employed, development of the location where the plant or equipment is set and the value of investment for manufacturing. In previous years, the government of RS also made a significant number of laws which encourage investment and for decreasing the tax contributions of employers that are paid on salaries by 1.4%. Although there are many incentives for FDI there are some industries and companies which investors cannot be owners more than 49% such as public media (radio and television) and transportation, weapon, explosives, military equipment making and public information. If we exclude these sectors, we can conclude that Bosnia has no restrictions for FDI. However, in March 2015, the government has adopted amendments in the FDI Law in which states that now foreigners can publish their own journals, articles, newspapers freely and should be equal in the eyes of the law, but the amendments did not change the percentage of ownership. Bosnia's government has made some progress to motivate FDI in previous years and one of the most important policies are: establishment of foreign investor's fund, the adoption of State Foreign Investment Policy Law and uniform trade and customs policy. Also, Bosnia's government has made significant efforts to open economy for FDI in terms of establishment of free trade zones, equal treatment of foreign and national investors and many others. Furthermore, we need to talk about the investor's preferences or instinct for business. Instinct or feeling for business as a factor in making decisions causes companies to invest higher amounts in form of Foreign Direct Investments (FDI). Having previous experience in industry makes companies likely to invest more in foreign markets, which relates to familiarity and feeling safer in certain business industry area. More visible investment opportunities in local markets are related to lower investments by companies from abroad. So, salience effect does not hold in case of making decisions related to FDI. (Halilbegovic S., 2017)

In the end, we can say that Bosnia has a lot to offer. Most of the investors in Bosnia are fascinated by the natural beauty of the country and the landscapes and hospitality. But to be honest, that is not enough for a serious amount of funds to come into Bosnia. Main Bosnia's drawback is the legal system and the judicial branch. The country is divided into two governmental entities, in which both of the entities has its own government and acts as a country inside a country. Then goes the lack of transparency, especially in public tenders, takeovers and acquisitions. Furthermore, Bosnia's central government is very weak, since the entities are acting as countries. Even though corporate income taxes are quite low and now harmonized ( about 10% ), employers bear a big burden contributing about 52% in FBiH and 69% in RS ( entities of BiH ) as a payroll taxes for mandatory health and pension systems. At the end, the weak judicial structure is one of the biggest disadvantages of the encouraging FDI in Bosnia. To conclude that Bosnia has a complex, multi-tiered legal and regulatory framework this is often contradictory and cannot be used as a tool to attract foreign investors. Bureaucracy is very difficult in Bosnia since there are many different jurisdictions and those jurisdictions have different laws. In Bosnia, there are four different jurisdictions which have a different set of laws and procedures, and obtaining documents that are needed for the establishment of enterprises, whether they are greenfield or brownfield investments, is very difficult and time-consuming. In Bosnia, it takes a full of two months to obtain all permissions and documents needed for the establishment of the enterprise, and, for example in Germany, it takes two days to get all

necessary documents, permits, and information about the industry. Next goes the political instability, which is derived from the previous political events, and the Dayton Peace Agreement, which defined Bosnia to have 3 presidents which have a mandate for 4 years and rotate every 16 months. This further adds to the complication in the country which was devastated by the war. „Generally, BiH’s legal framework does not discriminate against foreign investors. However, given the high level of corruption, foreign investors can be at a significant disadvantage in relation to entrenched local companies, especially those with formal or informal backing by BiH’s various levels of government.“ (Report of US Department of State, 2015) As we can see, main reasons why countries and companies refuse to invest in Bosnia is that the government is not centralized, there are many different levels of government each with different, sometimes overlapping sometimes contradictory framework, and high levels of corruption and low levels of transparency. Furthermore, the infrastructure of Bosnia was destroyed in the war 92 – 95 and slowly it is developing. Currently, Bosnia's government is in the construction of highway A1, whose construction began in 2008. From 2008 to 2017, 91.6 km has been built out of 334 km. Moreover, Bosnia is not very developed in the terms of the free trade zones. Currently, it has 4 free trade zones, which are not in function as they used to be: Slobodna zona Visoko, Vogošća, Hercegovina and Holc. In the previous year, free trade zones have exported total amount of 552.2 million BAM. As for access to free trade zones, Bosnia and Herzegovina is located in Europe, and it's first neighbor, Croatia, is in the European Union, so Bosnia is now exporting and placing it's products and services into EU more easily. At the end of the drawbacks for investment, we can say that Bosnia's government is doing a poor job of marketing the country and making it more favorable for investment. Only in recent years that Bosnia has started a campaign of marketing itself and it's products. Currently, the most famous marketing strategy that government agencies have started is „Kupujmo domaće“ or „Buy domestic“. That campaign is still very important and one of the most successful campaigns ever in Bosnia since it raised awareness among Bosnian population of the importance of buying domestic products and using domestic services.

To conclude, Bosnia needs to get on the right track and use its main advantages to obtain FDI so it can develop in full potential which has.

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