Institutional perspective of Bosnia and Herzegovina’s tourism sector: The missing ingredient

Mirza Mujarić

This paper illustrates shortcomings of the formal institutional system in BiH, and consequences that these deficiencies produce in the tourism sector. We find that the emergence of informal economy in this sector was mainly an outcome of formal institutional rigidities, i.e. lack of strategical policy to development of the tourism sector. The paper provides four policy recommendations that should yield long run improvements of this sector, based on the research evidence and good practices identified in related literature.

In 2009¹, the World Travel and Tourism Council (WTTC) predicted that Bosnia and Herzegovina’s (BiH) tourism sector would grow 5-11% annually and contribute around 5% to the country’s GDP in 2015. The latest data from WTTC suggests that the tourism sector has generated 711 million KM (364 million EUR) and contributed to 2.5% of the country’s GDP in 2016. These indicators are implying that BiH has activated some 48% of its potential growth of this sector.

Figure 1: International tourism, number of arrivals (World Bank, 2017²)
It remains somewhat surprising that with such a strong trend in rising the number of tourists (Figure 1), the development potentials in the country remain weak and unused. This paper aims to look into the reasons why this is so.

Bosnia and Herzegovina is a country that has a lot to offer to tourists, with stunning nature and rich cultural heritage pushing it to figure on numerous “Top places to visit” lists. Barely over one hundred thousand tourists spent part of their vacation in BiH back in 1998, while some 777 thousands tourists visited this country in 2016. In statistical terms, the average increase in the number of arrivals from 1997 to 2016 is 11% annually, while the average increase from 2009 onwards is 14% annually. The highest rise in number of the arrivals was registered in 2015 when it increased by 142,000, or 26% compared to the year before.

Looking at these high increases in the number of arrivals, one cannot avoid asking the question why BiH has performed so badly when it comes to generating public revenues from tourism sector. Answer seems to be straightforward – the grey economy takes its bit, and if contribution of the grey economy could also be included in the official statistics, the line on the above chart would quite certainly have a steeper slope, and the public revenues would be considerably higher. As an illustration, in Medjugorje, a world-famous destination for religious tourism, in 2013 some 28 thousand overnight stays were reported, while at the same time an Italian airline company opened a twice-a-week direct air line from Rome to Mostar (near Medjugorje) based on estimations that close to one million Italians visit Medjugorje every year. But how is the institutional infrastructure tackling this issue? This paper aims to answer this question by looking into the institutional environment and actions undertaken to utilize the evidently increasing interest for visiting BiH among tourists internationally.

The paper explores the formal institutional environment, but also the existing informal institutions in the tourism sector. Particular attention will be paid to the question if there is an asymmetry between the two. The focus will be given to the transportation business activities inside the tourism sector. As it will be argued in the paper, the ineffectiveness of formal institutions encourages informality, particularly through inferior strategical approach to the sector.

We provide an extensive review of legislation concerning the tourism sector to explore the formal institutional environment. To understand the informal institutions and the consequences of asymmetry between the formal and
informal ones, accounts of both formal and informal entrepreneurs, alongside experts and government officials will shed light on current practices in the field of tourism.\textsuperscript{5}

The EU’s interest in the sector, with already several implemented projects, lies primarily in improving regulations to encompass rising informal economy, which this paper aims to help with. At the moment, a new law on tourism at the Federal level is being drafted and it is expected to be submitted to the Parliament in the beginning of 2018. It should include a fair share of the EU Acquis as laid out by the EU in the latest progress report\textsuperscript{6}, but also introduce some new country specific measures in order to better regulate the tourism sector. The Republika Srpska (RS) Law on tourism is, to some extent, aligned with EU acquis in 2011.

The analysis conducted in this paper could be relevant for other sectors with similar challenges – high presence of existing informal institutions and gap between formal and informal ones which is mainly reflected in a significant share of the informal economy\textsuperscript{7}. Hence, the policy implications this paper yields should not be taken as sector specific, but rather issue specific. Because, as Mathias et al. (2015)\textsuperscript{8} suggest, the informal economy is always product of formal institutions. The “enabling” formal institutions provide entrepreneurs to achieve their interests within the socially desirable activities, while the “constraining” ones disincentivize them to engage into socially undesirable activities (informal economy).

The formal institutions of the tourism sector of BiH: a stumbling stone

The formal institutional system in the country, as some studies indicate\textsuperscript{9}, can be described as inefficient, lacking credibility and social recognition, which causes its users, the ordinary people, to be wary and untrustworthy towards it. The lack of trust in formal institutions, encourages citizens to avoid the formal system, and accordingly, leads them to rely more on informal institutions. In most cases, this increased reliance on informal institutions creates substitutive institutional arrangements (informal parallel structures) and hinders the formal ones. However, this informal institutional system allows citizens to “swim through muddy waters” on a daily basis. The reason for this can partly be found in the formal institutional system (defined as what is legal by the state) that was imposed from the outside without taking into consideration the culture and traditions of the society (socially legitimate institutions), and partly in the complexity and ambiguity of the system which make even small steps forward look like great achievements. Unfortunately, this complexity and ambiguity is causing numerous problems for citizens, as well as for entrepreneurs (both nascent and established).
The tourism sector is a very good example of this situation. It was not treated in the Dayton Peace Accord (the country’s constitution from 1995), but was left to be regulated at the entity level. Two decades later, there are immense discrepancies among the regulations between the entities (FBiH and RS), which makes it difficult for the entrepreneurs to operate, consequently constraining the options tourists have at their disposal. In some cases, it is even impossible to oblige regulations from both entities at the same time, leaving entrepreneurs in a challenging situation if they try to do their business in the whole country.

*Legal and strategic framework in RS*

In RS, the tourism sector is regulated through the 2011 Law on tourism\(^\text{10}\) which describes and sets the rules for operating in the tourism sector in this entity. It also prescribes that a new Strategy on tourism development will be adopted on a 10-year basis by the entity’s National Assembly following the proposal of the Government (Ministry of Trade and Tourism). The Ministry never proposed the Strategy to the RS Government, nor did the Government propose it to the National Assembly – so the Law was broken by all actors, including the responsible Ministry, the RS Government and the National Assembly. However, a strategy that is still in use was adopted two years prior to the Law – in 2009\(^\text{11}\) for the period 2010-2020, and was drafted by experts from University of Banja Luka. In 2011, the same Strategy was adopted once more as the new Law from 2011 required adoption of new Strategy. Even though the academic community was consulted about the Strategy in force, the failure to draft and adopt an updated one has deprived the academic community, probably the most credible institution with sufficient capacities to develop this kind of document, of steering the sector in the right direction. Consultations with the experts as prescribed by the Law have thus not taken place. The Ministry then reports on the strategy implementation to the National Assembly, via the Government, on an annual basis. The web page of the Ministry shows no track of any report submitted to the Assembly. Furthermore, the minutes of the Assembly are not publicly available. However, the Ministry presented its report on implementation of Strategy for 2015\(^\text{12}\) which shows that the Ministry has implemented 10 actions through financing 17 projects in 4 strategic areas.

It is interesting that there is not a single provision on the consequences for not implementing the Strategy for tourism development of RS. In other words, the responsibility of the Ministry on trade and tourism for implementing the Strategy is simply of reportative nature, and the strategic
management of the sector is completely left to the good will of officials in charge. Overall, the Law itself has more a regulatory purpose for the companies doing their operations within the sector, than it has a visionary or strategic purpose intended for the improvement of the entity’s tourist destinations, let alone improving its economic performance.

**Legal and strategic framework in the Federation of BiH**

In the Federation of BiH (FBiH), the situation is more complicated. Formally, the FBiH adopted a 15-page Law on tourist activities in 2009\(^\text{13}\), which basically informs the reader that all the regulations and norms should be prescribed by the laws adopted at hierarchically lower government levels – the Cantons (there are 10 of them in FBiH, while RS does not have this level of governance). The word strategy itself is not even mentioned in the Law. Thus, the FBiH has several laws at the cantonal level regulating the tourism sector, on top of the FBiH Law – the latter providing a legislative justification for the need of one Federal and 10 Cantonal ministries of tourism that are fully administratively equipped with ministers, deputys from at least three constitutional nations, advisors on various issues and a lot of administrative staff.

The Law on tourist activities in the FBiH implies that the Ministry of Ecology and Tourism is the final instance when it comes to interpreting the Law, and that the Federal Direction for Inspection Activities has the right to enforce inspection on business entities operating in the sector. Still, there is not a single line on responsibility of the Ministry stated in the Law meaning that the Ministry, on top of having no responsibility for strategic management of the sector through implementing the Strategy on tourism development, has no responsibilities by the Law concerning the tourism sector. Still, it is the last instance to interpret the Law. This creates serious problems for the entrepreneurs in the sector, especially when it comes to the establishment of new businesses. For example, there is no standardized procedure to qualify someone to enter the tourism market. To validate this, the exam on tourist guides has not been held in more than 4 years, despite the enormous demand for it in this entity.

The Law starts by elaborating the terms used in the sector (tourist activity, tourist agency, travel agency, tourist guide, etc.), and jumps straight into regulating the forms which businesses can take to legally operate within the sector. The most elaborated part of the Law, written on more than seven pages, is the penalties for business entities, business owners, and business managers if they fail to comply with some of the requirements. These penalties are sometimes hard to understand; for example, the Article 8 states that a tourist agency can have registered vehicles meeting the strongly regulated safety criteria but cannot use them for transportation of their customers. The penalties are mostly multi-layered, meaning that it is unusual that the inspector issues only a penalty for the business entity. It happens quite often that both
the owner and the manager get penalised (sometimes the owner gets penalized from both aspects – for being an owner and for being a manager according, based on information gathered through our interviews). The penalties range from 1,000 to 10,000 EUR for business entities, and from 100 to 1,000 EUR for owners and managers, which is a significant amount for the average businesses or owners operating in this entity.

Thus, the Law in this entity provides no directives, let alone strategic ones, for the development of the sector. Still, an expert opinion on the sector is provided by the Federal Institute for tourism and ecology based in Mostar established in 2014. Prior to the existence of the Institute, the Strategy on tourism development\(^4\) was produced by a private company in cooperation with experts from University of Džemal Bijedić in Mostar and employees from relevant Ministries (both cantonal and federal). The Strategy has, however, not been discussed nor adopted at the Parliament of the FBiH, nor at the cantonal ones.

At the cantonal level, considerable differences exist. Some of the cantons have responsible ministries based on the above mentioned Federal Law – with no strategy for development of the sector and no responsibilities defined. In such environment, the Canton Sarajevo has both the cantonal Law on tourism\(^5\) and the Strategy for development of Canton Sarajevo\(^6\), which partly tackles the issue of tourism. The Law precludes a Strategy which should be adopted by the Cantonal Parliament, but fails to mention any repercussions or sanctions the Cantonal Government (and the Ministry of economy) would face in case of failing to implement the Strategy, and it contains no deadlines. The Law still regulates the forms businesses must fulfil in order to operate in the sector, and, like at the entity level, it does not lack penalties for companies, owners and managers. Having said this, one cannot escape the impression that the Law was written from a standpoint of a “prison guard” rather than some experts interested to provide the Law which ensures the sector to thrive.

With the absence of a strategic approach in developing the tourism sector, the formal institutions regulating the sector have a limited purpose, comprised of a regulative and controlling functions. This absence of responsibilities regarding the development of the sector shifts focus from the strategically important actions and activities, to those less important and administratively more demanding. Moreover, those in charge of the institutions are both allowed to get through without significant results and constrained by abundance of less important, that is administrative obligations. Consequently, the development of the sector is pioneered and steered by private companies with little or no help from the institutions – which forces them to bypass the formal constraints in order to achieve adequate business rewards.
Inefficient regulations encouraging informal practices – experiences from the ground

Following the global trends in tourism\textsuperscript{17}, many tourists are coming to BiH usually to spend several days trying to see and enjoy as much as they can in a such short period. Given the scarcely developed airport and rail infrastructure, the tourists are often left with no choice but to use road transportation in order to see the country’s natural and cultural attractions. This created a lucrative niche for the tourist and travel agencies, but also for informal drivers offering transportation services without having registered their businesses. However, in the last few years the country is doing a lot to suppress the informal businesses organized around this sector in an effort to charge its fair share of the taxes and contributions. While this is a legitimate concern, the approach chosen seems to be problematic.

Accounts from entrepreneurs in the tourism sector

A majority of entrepreneurs interviewed as part of this research have been working in the informal sector of the economy for quite a long time, averaging 2.3 years. This includes both those who have informal as well as the ones who are now running formal businesses. All of the interviewees in formal economy rather agree that they used to be better off in the informal economy, as the risks taken were compensated by higher financial rewards, as partly portrayed by the following analysis. Each business is required to have at least one employee – and if the employee receives an average salary, which according to the BiH Agency for Statistics\textsuperscript{18} was 851 KM net or around 1,472 KM gross (435.10 EUR net, 752.60 EUR gross) for July 2017, the annual taxes and contributions paid by the employee and the business amount to around 3,810 EUR per employee. Furthermore, the business has to rent a premise which ranges from 2,400 to 12,000 EUR annually out of which the Government receives between 240 and 1,200 EUR through taxes; pay double the price for the registration of every vehicle it possesses compared to natural persons, and do technical inspections twice a year\textsuperscript{19} – which does not exceed 2,000 EUR out of which at least 500 EUR goes to various levels of tax authorities. That adds up to an annual gain between 4,510 and 5,460 EUR in taxes only, not accounting for the VAT that every business entity is obliged to pay. With this amount of minimum taxes paid only by one entrepreneur, who is the only employee at the same time, and one vehicle, it is economically more profitable to remain in the informal sector. From the point of view of the state, these amounts per one employee are not negligible and can hardly be matched by the income through fines (if a described hypothetical company operates as informal) – as one informal entrepreneur would have to be fined around 20 times per year, which is almost impossible to achieve.
Furthermore, many formal businesses that are complying to the majority of regulations are partly involved in the informal economy (INT_FOR_1, INT_FOR_2). Some businesses keep some operations, for example, the transportation of tourists, completely in the informal sector. This is because they are not allowed by the Law to provide transportation services despite having appropriate vehicles for the purpose and being registered as tourist agencies. Others are participating in the informal sector to some extent through not issuing invoices for rendered services, thereby evading taxes.

The main reason behind these activities is the entrepreneurs’ poor tax morality. Williams and Horodnic (2017)\textsuperscript{20} define tax morality as intrinsic motivation to pay taxes, which greatly depends upon feelings of alignment between state regulations (state morality) and credibility and recognition given to them by the people (social morality). The greater the asymmetry, the lower the tax morality. Our interviewees are consistent in sending a message of rather low tax morality among entrepreneurs. Simply put, the entrepreneurs do not see that the amounts they pay through taxes end up in improving their business environment, or general infrastructure which is essential for their businesses. At the same time, the informal entrepreneurs are usually consumed by the “feeling of guilt” – they constantly feel as if they are doing something wrong, and hence are very cautious of being caught. Therefore, they rather opt to pay the fine for operating informally than to enter into a dialogue with the inspection and the police, which in 99% of cases have no observable evidence that someone is operating informally; as an illustration, they could argue of transporting their friend’s families and hardly could they be proven wrong.

Our analysis also implies that formal entrepreneurs are facing difficulties with being caught as well. Despite having registered businesses and fulfilling all the known formalities, due to abundance of administrative constraints the possibility for being fined is also high. Compared to informal entrepreneurs who can only be fined for operating informally, formal ones are facing seven pages of the Law detailing various fines for various law-breaching activities. This is only in the Law on tourism. The formal entrepreneurs are viable to be fined by various laws – from the VAT Law to the Law on basics of traffic safety in BiH. For example, if the sticker containing the company logo usually displayed on the driver’s side of the company’s vehicle is slightly ripped (i.e. missing one letter) the company is liable for a 1,000 EUR fine, plus additional fines of 200+ EUR for the owner and/or 200+ EUR for the manager.
“I have been working in the travel business for six years, and for two years I have a registered company. It was far better when I worked informally – there was more money, the business was doing better and easier, while the feeling [of getting caught] is pretty much the same. And, I am saddened by the fact that this feeling of doing something wrong and the fear of getting caught made me to register a company, while I do not see advantage of it. I mean, I have no feeling right now that I am doing something wrong, but the fear of getting caught despite fulfilling all the formal requirements is much greater, because the penalties are much greater too.” (INT_FOR_1)

Current responses by the state authorities

The state formal system responded to the informal drivers by enforcing constraints through employing more inspectors and engaging police with this particular focus. On every major road connecting cities interesting to tourists, one can see at least one police patrol and one inspection patrol. Penalties are given evenly to those deserving them and those not deserving them, as they can’t prove to travel with their friends (INT_FOR_2).

Our impression from the interviews is that formal penalties are encouraging informal practices, as it is pointed out by the sticker case, for example. The fact that a registered company can be penalized for various reasons, and informal drivers only on one criteria – informality – evidently puts formal businesses into disadvantage. The penalty for an individual operating informally is 250 EUR, but only if they get caught. However, the individual has a legal right to pay only 50% of the fine if paid within eight days of the date s/he gets penalized. Among interview partners working in the informal sector, the first one (INT_INF_1) was penalized three times during the four years he has been working informally, while the second one (INT_INF_2) was not penalized in his first two years while working informally. After increased inspection activities from recently\(^1\), both of them got penalized twice in the last year. The total costs (public revenues) of these penalties for these two examples is 875 EUR – over several years. According to Canton Sarajevo Inspection report, the Cantonal inspection for market and tourism issued some 150 thousand EUR of fines in the first 8 months of 2017 – the amount includes hotels and other accommodation facilities, as well as hospitality facilities\(^2\). It is precisely due to these inefficiencies of the state institutions in both providing a fruitful business environment from one, and failing to deal with informality from the other side, that we propose a rather radical solution compared to the existing, and inefficient ones.
Conclusions and policy recommendations

According to the interviewees, the number of informal businesses in the tourist sector ranges between 650-850 in the country\textsuperscript{23}. If they all were in the formal economy, this would mean that the country’s income from taxes and contributions would be greater for some 3.0 to 4.7 million EUR. This assumes that only one entrepreneur, i.e. one employee is registered per company. This is a strong assumption indeed, and the real estimate of the taxes and contributions could be much higher. In practice, there is no possibility to collect this amount through penalties and fines, because, as previously stated, each of the 650-850 informal drivers would have to be fined around 20 times per year, which, is hardly possible to achieve with the existing state inspection capacities.

Instead of acting strategically to allow subsidies for hundreds of informal business to register their operations and collect those funds, plus “return on investment” through taxes and contributions, the Government is trying to suppress the existing and emerging informal businesses through enforcement and penalization. This lack of a strategic approach is the key ingredient in the lack of strategic orientation and cause inefficiency of the formal institutional system, and one of the main reasons for the existence of informal economy. This analysis also implies that the informal economy is mainly a consequence of policies that are tailored as constraints, rather than some visionary standpoints with the aim to see the sector development. Since the informal economy is a deep-rooted challenge that cannot be tackled overnight, nor can any policy measure remove it immediately, we come up with several measures that should yield the long run improvements.

1. A strategic approach to tourism development should be adopted to determine long-term mission, vision and strategic objectives. Then, new/updated strategies for tourism development should be drafted in consultations with domestic and foreign experts in the field, following the aforementioned approach. They should also be updated regularly on mid-term basis to be timely aligned with new trends in this sector. The strategies should also clearly state long, medium and short-term (up to 1 year) objectives and deadlines. Finally, the National assemblies should take a more rigorous stand towards breach of deadlines or failure to meet the objectives.

2. Laws should be amended to include responsibilities of relevant Ministries or other public bodies, particularly those in regard to strategic approach, as well as repercussions for those in charge to improve their accountability. We recognize that amendments should also focus
2. on enabling the entrepreneurs to engage in formal activities through changing the formal institutions into their “partners”, rather than focusing on constraining (penalizing) them for every little mistake. Therefore, it is crucial to make the inspections less “frightening” and more “collaborative/consulting”. The element of fine/penalty should only be utilized for serious violations and malfeasance – never on “the missing letter on company stickers”.

3. Our simulations and calculations imply that it is in the Government’s best interest to provide incentives for the informal businesses to register formally, i.e. to invest in their businesses via subsidizing some of their registration costs to capitalize their returns from taxation which will follow.

4. In the end, the benefits of formalisation of businesses should be introduced and developed through combination of the above recommendations and more transparent communication. This should also be properly communicated to entrepreneurs which should increase their tax morality and retain them in the formal sector. One way of doing this is through appeals to formal entrepreneurs which emphasize the benefits of operating formally, and offer quick support in clarifications of ambiguous issues which exist in the current laws.

Mirza Mujarić is a PhD student in Economics at the University of Sarajevo, School of Economics and Business. He works at Centre for Intradisciplinary Social Applied Research – CISAR, Sarajevo, with research interests in informal institutions and informal economy. Currently, he participates at Horizon 2020 INFORM Project “Closing the gap between formal and informal institutions in the Balkans”.

This policy brief has been prepared in the framework of the TRAIN Programme 2017 (Think Tanks Providing Research and Advice through Interaction and Networking), which is supported by the German Federal Foreign Office (Stability Pact for South East Europe) and implemented by the German Council on Foreign Relations (DGAP).
References

1 Strategija razvoja turizma Republike Srpske za period 2010-2020, Univerzitet u Banjoj Luci, 2009


5 For the scope of this research, 7 interviews were conducted: 2 with managers of tourist/travel agencies (abbreviation FOR), 2 with individuals operating in the travel business for more than 2 years in the informal sector with no registered businesses (INF), 1 with a young entrepreneur who is in the process of registering a travel agency (ENT), 1 with an expert on tourism working in the Association of tourist agencies (EXP), and 1 interview with an employee from the Ministry of trade, tourism and telecommunications (MIN). The abbreviations in the brackets are used to refer to the interviews. For example, INT_FOR_2 is the second interview with a manager of a formally registered travel agency in Sarajevo.


10 Službeni glasnik RS 70/11, 2011

11 Strategija razvoja turizma Republike Srpske za period 2010-2020, Univerzitet u Banjoj Luci, 2009

12 Report for 2016 was not adopted at the point of writing this paper

13 Službene novine Federacije BiH 32/09, 2009


15 Službene novine Kantona Sarajevo 19, 2016


17 Upravljanje turisti kom destinacijom, Zoran Bibanović, Oxfam Italia, 2010


19 According to Law on basics of traffic safety in BiH, natural persons with a clear traffic history (no incidents) are eligible to 50% rebate in vehicle insurance policies – whereas such a policy doesn’t apply for legal entities. Furthermore, natural persons are obliged only to technically inspect their vehicles once a year – whereas legal entities have to do the inspection twice a year. See more: Zakon o osnovama bezbjudnosti saobraja u Bosni i Hercegovini, Službeni Glasnik BiH 8/17


23 This is the number of active participants from several Viber, WhatsApp, and Facebook Messenger groups the interviewees are all members of. One of the Viber groups has 832 members.