

Speech by Principal Deputy High Representative Lawrence Butler at the 5th Regional Finance & Investment Conference for Southeast Europe

Competitive Advantage: the New Paradigm of Southeast European Development

Ladies and Gentlemen,

In the course of this month, Bosnia and Herzegovina has substantially completed the strategic policy agenda that was laid out in the European Community's Feasibility Study in November 2003. Economic elements in the Feasibility Study have included reforming the indirect tax system, creating a single business registration process, formulating a comprehensive trade policy, introducing EU product certification to boost exports, improving statistics gathering, and instituting modern, international-standard budgetary practice.

These elements highlight the detailed and comprehensive nature of reforms that have dominated the BiH parliamentary and government agenda for the last two years.

These reforms amount to a transition to-do list, an ambitious attempt to re-engineer the BiH economy.

So it will come as a surprise to no one that enacting and implementing this agenda has been an uphill task. The relevant

ministries have had to muster a huge amount of political will in order to forge a pragmatic consensus in support of reforms.

And they have risen to this challenge.

The principal lever, used to continuous and positive effect by proponents of reform, has been a near universal aspiration on the part of BiH's population to integrate further with Europe, and the concrete prospect held out by the European Commission that BiH can begin Stabilisation and Association negotiations once the Feasibility Study requirements are met.

However, it is important to stress that while European integration may have served as the main incentive for securing political support for reform – it does not represent *per se* the most compelling argument for reform.

Economic reforms have already started to raise living standards in BiH.

That is what they are, first and foremost, designed to do.

This is clearly very pertinent to the interests of every single citizen.

It is also very pertinent to the interests of prospective investors.

A country's capacity to integrate with Europe may be viewed as a rough and ready investment barometer. The closer to Europe, the lower the risk and the more attractive the business environment.

But reforms that *work* – reforms that raise productivity, enhance labour mobility, improve business regulation, upgrade banking services, and so on – these reforms directly and tangibly improve the investment environment.

If there is one message that I want to communicate today it is that, as a result of the structural reforms undertaken by BiH

in its bid for Euro-Atlantic integration, Bosnia and Herzegovina is now, more than ever before, open for business.

The reform process is not – indeed it *cannot* be – a smooth process. Exhaustive and exhausting political and media debate, however, over the pros and cons of reform should not be misinterpreted as a sign of insufficient commitment.

In this respect I would draw your attention to a recent report published by the European Bank for Reconstruction and Development, which notes that in mid-transition, perceptions of “happiness” among citizens tend to dip.

There are at least three reasons for this.

- Transition is painful – things tend to get worse before they get better. Old industries lay off workers before new industries take up the slack and then start generating additional jobs.
- Transition has in all the countries that have gone through it over the last 15 years been marred by major wealth disparities that place severe strains on the social and political fabric. There is understandable popular resentment against those who do inordinately well out of the flux created by administrative and political change. The process of social polarisation witnessed in other transition economies has been made more extreme in BiH as a result of the war and its attendant chaos.
- Transition is invariably accompanied by reform fatigue – a syndrome with which all of us who work in emerging economies are more than familiar. Unhelpfully, reform fatigue tends to occur around the midpoint of the transition process – when public satisfaction with the reform process is already dipping – and when successful reforms have generated a degree of restructuring that requires *more* reforms if the momentum is to be sustained. So citizens can come to have the sensation

that they are on a treadmill.

Popular weariness with reform is understandable – yet the only honest response to this is to highlight incremental improvements and ensure that these are spread as broadly as possible.

Transition works. That is it's best defence.

It works most satisfactorily if it is not put on hold as a temporary sop to public opinion.

The launch of Stabilisation and Association talks with the European Union will ensure that the BiH authorities stick with the programme, and press ahead with reforms that may be painful in the short term but will deliver real and sustained dividends over the long term.

Investors must understand this.

Now that BiH has a date for when it will formally enter the Stabilisation and Association process with the European Union – the official negotiations will likely start on 12 December – having set in place the essential administrative and regulatory mechanisms for rapid economic development, *all* of the countries of Southeast Europe are on the same trajectory – towards EU integration. They are at different stages in this trajectory, but the significance of this relative difference diminishes in the context of long-term investment planning.

So it is time to take standard risk-analysis tools and ensure that they reflect fundamentally new realities.

The only way to look at Southeast European economies is through the prism of competitive advantage.

Investors must *not* be distracted by outdated country image – the authentic criteria for making investment decisions are economic, and by these criteria BiH is beginning to look very

competitive indeed.

Let's take a brief look at the business environment:

- The previously fractured and inefficient customs system has been integrated under the Indirect Taxation Authority, which is preparing to introduce VAT at the start of 2006; the unified customs service has already staunched the hemorrhaging of revenue that was a function of the old fractured customs system. In 2005, revenue has already increased by at least 12 percent;
- Utilities regulation now meets international standards;
- Banking reform, which got properly underway in 2002, has produced a vibrant finance sector that is beginning to channel funds into promising SMEs;
- Standards of corporate governance at public companies (which continue to have a preponderant influence on the performance of the overall economy) are at last being raised, through effective audits and through a package of recently-enacted laws;
- Business registration has been streamlined – registering a new company until recently took longer in BiH than anywhere else in the region: that particular (and particularly damaging) bureaucratic nonsense has been turned on its head – BiH now boasts the *shortest* company registration process in Southeast Europe;
- The Convertible Mark is among the most stable currencies in the region.

The results of this are clear. For the first time since the end of the war there are signs that the BiH economy is turning the corner:

- GDP growth this year is around 5.6 percent – the fastest in the Balkans;
- Inflation stands at 0.5 percent, the lowest in the Balkans;
- Foreign direct investment was up 25 percent in 2004 and

is now five times higher than it was in the late nineties;

- Exports were up 25 percent last year;
- Industrial production is also up by around a quarter;
- Interest rates have halved since 2000;
- Real unemployment is about half the official rate of 40 percent.

Building on the substantial progress that has already been made – initially in the context of establishing the ITA and launching VAT – in formulating and implementing coherent countrywide economic policies, the governments are now drafting the necessary legislation for the establishment of a National Fiscal Council, consisting of the State and Entity Finance Ministers as well as Prime Ministers. This will ensure the coordination of budgetary policies at the State and Entity levels.

Since the restructuring of the banking system has progressed at a much faster pace than corporate reforms, a modern and dynamic banking sector now coexists with a weak corporate sector. To sustain and strengthen depositor confidence in banks, continued improvements in the quality of bank supervision and the regulatory environment will be required. One of the most important steps must be to ensure the continued independence of the Banking Agencies and increase their efficiency. Bringing the two banking Agencies under the Central Bank would best achieve these objectives.

Until now, the privatisation process has failed to deliver the kinds of economic advantage that have been seen in other transition economies. This has been due, among other things, to excessive administrative obstacles and continuous political interference in major privatisations. However, we are beginning to see a positive change here. An increased number of tenders for privatisations have been published this year, including companies such as Krivaja in Zavidovici (a large wood-processing factory) and KTK in Visoko (which is engaged

in garment and shoe production).

BiH is a promising emerging market on a clear and accelerated trajectory to full integration with Europe. Strategic sectors, including hydropower, forestry and tourism, are already attracting international investment interest. This is the tip of the iceberg. The tourism authorities are marketing the country as “Southeast Europe’s best-kept secret” – its huge business potential ought to be no secret among canny investors.

Thank you