Speech by PDHR Donald Hays "Investing in Bosnia and Herzegovina: Possibilities and Experience"to the International Business Forum in Mostar

Professor Hadziametovic,

Ladies and Gentlemen

We are here today to discuss the investment climate in Bosnia and Herzegovina and what can be done to improve it. So let's look candidly at why investors are hesitant about putting their money into the local economy. Some of the reasons are fairly straightforward: the recent war has left a legacy of negative perception – lingering images of violence and instability scare away business. Less dramatic but at least as serious is the lack of market transparency, a non-responsive bureaucracy, an outdated education system and the presence of unchecked corruption and criminality.

Basically, investors are faced with a divided state that is unresponsive to the needs of modern trade and industry, and that does not guarantee transparency, protection or clarity to those who wish to establish businesses. The government has even gone out of its way on a number of occasions both in the RS and the Federation to make it clear that foreign investment is not welcome in BiH.

Is any of this the fault of wealth creators – entrepreneurs, industrialists, or ordinary workers? No it is not. These shortcomings are a result of a failure of political leadership

over the past seven years. However, these things can be fixed and many of you in this room can play a role in making BiH a magnet for investment. I do not doubt your capacity to make a difference and to change the economic scene in this country. If you are to compete in the regional marketplace you have to take action now, you cannot wait for the hour hand to come around, you have to look at the second hand while others – in Belgrade, Tirana and Zagreb, for example – carve out their own share of the market.

Why am I so confident that investors can be attracted to this country? Well, it has a uniquely skilled workforce with an unusually broad familiarity with international business. The citizens of BiH have a long tradition of international travel and working abroad, and of course large numbers of refugees spent time in other countries during and immediately after the war. Furthermore, many citizens have worked closely with the international community for the past seven years.

BiH also has strategic advantages: it is situated on the doorstep of the European Union and it has strong cultural and geographical connections to the other countries of Southeast Europe and the Mediterranean. And to an even greater extent than any other Central or East European economy, BiH is both a green-field investment site and a country in which comprehensive privatisation offers lucrative opportunities to invest in established companies. Given the fact that the old economic system, based on heavy industry, collapsed during the war and has not been rebuilt, Bosnia is an open book for any investor with a bit of imagination and initiative. The possibilities are boundless for investors and for this country.

Yet, the results of the country’s efforts to attract investment have been disappointing.

Why is this?

Well, the answer isn't that hard to come by. We aren't listening to the people who know how to create wealth. As in other countries, small and medium-sized enterprises (SMEs) are the backbone of the new economy in BiH. I recently visited two companies which started up after the war with a modest amount of borrowed capital – borrowed, unfortunately, at exorbitant rates. One of these companies employs around 300 people in labour-intensive manufacturing. The other has fewer workers but has built up the business to the point where it now has sophisticated high-tech machinery that allows it to compete internationally. These companies are expanding, seeking out new markets abroad, building on their initial success. The entrepreneurs behind these firms' success clearly know how to achieve success. We should be talking to them and learning how to share their success.

Let me share some of their views with you, and what they expect from the government.

They want less red tape. The governments of the two Entities and the State have agreed an Action Plan for removing administrative barriers to investment. Let's ask them to implement it right away. They want clear and predictable tax laws, they want a level playing field where illegal traders don't have a built in advantage, they want a receptive banking system, a reliable data bank on companies registered in this country and they want a trained and skilled workforce.

This country is now finalizing the harmonization of excise tax. A single tax system is a standard in any modern state – avoiding double taxation within the country. The citizens of BiH, the entrepreneurs of BiH, and foreign investors in BiH are entitled to such basic – and sensible – fiscal policies.

The State Border Service together with improved policing have already provided the government of this country with a significant tool to increase its capacity to eliminate the unfair, tax-evading competition against which legitimate

businesses have had to contend for years. But more has to be done, not least here in Herzegovina, where the porous border with Croatia allows the import of cheap black-market goods that put BiH companies out of business and put BiH citizens out of work. This problem is also acute along the border with Montenegro.

Entrepreneurs, who have made the grade in the last seven years have done so in conditions where commercial interest rates have been higher then 20 percent. Banking reform has brought down the cost of borrowing, but it continues to be higher than the European average, and banks continue to view entrepreneurs, particularly those who are struggling to start their first business, as high-risk prospects to be handled with discretion.

What is needed is a banking culture that sees lending in the context of long-term partnership rather than short-term gain. One entrepreneur I spoke to recently noted that the bank wasn't interested at the beginning. Only when the business was up and running (at the entrepreneur's own expense) did the bank begin to think about granting a start-up loan. The government can help create an environment which will encourage potential lenders to be less risk-averse. Once the courts are functioning properly and a credit validation system is in place, some of the banks' reluctance to take a risk on start-ups will diminish.

We need to take steps to develop the capability to check companies' and investors' credit worthiness so that banks can lend money to reliable investors. They won't be able to partner with those trying to rebuild this country unless they are sure that they are good credit risks, however.

In the case of many of Bosnia and Herzegovina's competitors for foreign investment, new businesses can be registered in a matter of days. In this country, that same process can take up to three months or more, and there is no BiH-wide harmonized

registration system. In addition, after businesses have completed the laborious registration process, the authorities are apparently unable to deliver useful information, such as existing firms' addresses and the particulars regarding their management. Under a program currently being implemented by Britain's Department for International Development, a countrywide company registration system is being established which will allow companies to register, at various locations around the country, in weeks rather than months, and will provide a corporate database that offers practical benefits to business people. Among other things, this database will discourage the attempted registration of fictitious companies.

Similarly, entrepreneurs and investors make the unanimous and not at all unreasonable plea for the establishment of an efficient land registry listing clear ownership titles. This isn't an administrative luxury that we can deal with in the course of time, it is simply a precondition for a functioning market economy.

A properly administered system of commercial law – in particular company law and contract law – is another such precondition.

In the context of the comprehensive reform of the BiH legal system, which has now entered a new and more intensive phase, the administration of commercial law will have to be updated and improved so that it meets European standards. This will take time; with the right level of political support it will not take too much time. Again, I wish to emphasise that every day that potential investors believe they cannot go to the courts in order to protect their investments, BiH businesses will be deprived of the foreign capital they so desperately need.

Education is an area where entrepreneurs have voiced a consistent complaint. There is an over emphasieson theory at the expense of practice, which in secondary schools and

technical colleges means that new workers with the right academic qualifications require substantial and expensive training before they start making a positive contribution to their companies. For those in vocational schools there must be a system of internships that combine classroom experience with real-life on-the-job training. Start-up companies cannot afford the added burden of training newly hired employees from scratch. Internship programs require flexibility on the part of schools and imagination on the part of employers, but they don't require much money. Such programs could be implemented comprehensively and quickly, and the authorities could play a useful and effective role by ensuring that this is done immediately.

The cost of utilities and telecommunications is another impediment to investment. The telephone service alone can be up to three times as high in Bosnia and Hercegovina as it is in Croatia. With the right application of political will, efficient and impartial regulation of the cost of these services can be drastically reduced for the consumer by introducing competition. Foreign investors see no reason why they should put their money in a country where a staple of modern business – electronic communication – is backward and expensive. Regulation can also reduce the unnecessary cost burden borne by domestic businesses, struggling to compete with firms in neighbouring countries where phone calls are cheaper and utilities bills lower. But once again, we will have to find the political will to make this happen.

An area where government can show verve and leadership is export promotion. By this, I do not mean the tried and failed but still tempting practice of subsidizing uncompetitive exports with taxpayers' money. Rather, the government should promote an efficient standardization and accreditation system. A first step in this process was brought about by the High Representative's Decisions establishing a BiH Institute of Standards and a BiH Institute of Accreditation. The

certification of goods for export, for example with the CE logo for technical products and the ISO product-quality certification, must be streamlined and made uniformly available throughout this country. The provision of veterinary control and certification at State level is also essential for successful export generating agroindustrial companies – if, for example, the fish farms along the Neretva and milk producers elsewhere in the country are to survive and prosper. The companies themselves are already doing their part. It is up to the authorities to do the same.

The Foreign Investment Promotion Agency is one of the most crucial agencies in the entire government. It is charged with attracting the lifeblood of business – capital. FIPA's underfunding suggests an acute absence of vision on the part of the authorities.

Here in Mostar the deleterious results of divisive politics are still painfully visible. The politics of division don't make economic – or any other kind of – sense, and will only serve to impoverish those that practice it. Recently though there are signs that political compromise is begining to be found.

Everyone engaged in business in BiH wants a stable state and a stable market, with clear rules, fairly applied. My friends, this is not difficult to understand. It is the norm in other parts of Europe. The absence of these factors in BiH to date is the reason that so many of you and your fellow citizens continue to invest your money abroad.

Please note that the BiH authorities are not being asked to do anything exotic or extraordinarily difficult. As one entrepreneur remarked to me, "We want European-standard business legislation. We don't want a system where today something is legal and tomorrow it's not."

Many of the problems I have mentioned have already been

identified in the Global Economic Strategy adopted last June by the Council of Ministers and in the Interim Poverty Reduction Strategy drawn up by the Ministry of Foreign Trade and Economic Relations at the end of last year. The authorities have identified the problems; they must now find and implement solutions. The debate is about how to put BiH on the path to prosperity. The entrepreneurs of this country know how to do that. The authorities should listen to them

Thank you very much