

# Speech by Deputy HR and Head of OHR Economic Department Patrice Dreiski at a conference on “Expanding the European Investment Frontier”

## *Promoting FDI Through Privatization. Does Privatization Deliver?*

Ladies and Gentlemen,

It is my great pleasure to be back in Bucharest. I am particularly honoured to be part of such a distinguished panel.

The topic – promoting foreign direct investment through privatisation – is a crucial one for all transition countries.

And the question – does privatisation deliver? – is by no means rhetorical.

Indeed, as far as Bosnia and Herzegovina is concerned the answer till now must be – no, it does not deliver, because if we are honest, it was not real privatization, but rather a continuation of socialism. This lack of a clean break with the socialist past did not produce an influx of capital.

But we are changing that.

We are focusing our efforts on fixing a privatisation programme that has failed to live up to expectations. In the coming months we believe the governments will take a series of steps to address the obstacles that have undermined this privatisation effort. I am confident that they will create,

and put their full political support behind, the proper administrative and technical machinery to turn the privatisation process around.

For that reason I believe we will shortly be able to give a more positive answer to the question, "does privatisation deliver?"

I believe too, that other countries can learn from the experience of BiH.

Bosnia and Herzegovina's transition to the market economy has been undertaken in peculiar circumstances. The decentralised governing structure, with its intrusive party influence, bequeathed by Dayton has produced an exceptionally unwieldy decision-making process. In addition, the years immediately after Dayton were dominated by issues of security, reconstruction, refugee returns and primary peace-keeping. Economic reforms were deferred.

In the last two to three years, however, political priorities have changed. Against a backdrop of declining aid flows and a voter-driven need to find solutions to bread-and-butter issues such as unemployment and a nonresponsive social infrastructure, migration and brain drain, the political debate in BiH has moved decisively away from nationalist nostrums of the war years and the immediate post-war years. A new pragmatism has emerged.

There is a window of opportunity for fundamental change. But it is a window that can still close – which is why the political leadership of BiH must succeed in its efforts to turn the privatisation process around and create a business environment that welcomes foreign and domestic investment. There is a secret out there and it is that citizens of BiH heretofore have hesitated to invest in the future of their own country.

The outlook has considerably improved. In just the last four

months, specialized Commissions established by the High Representative to forge a political consensus on tax reform, defence reform and reform of the intelligence services have successfully drafted modern, European-standard legislation. The legislation drawn up by the Commission on Indirect Tax Policy – now being considered by the BiH parliament – will establish a unified customs administration and a countrywide VAT system, and will at last give BiH the kind of modern fiscal system without which sustained economic development is not possible. In addition there are now intergovernmental working groups addressing such issues as sales tax, public debt, agricultural reform, and privatization itself. These working groups are led by representatives from the International Community, but the experts are all local-government representatives working side by side with their counterparts from the other Entity or State authorities.

This process I would describe as being part of a strategic move “from mantras to mechanics”.

It's all very well to say, yes, we welcome inward investment and we are prepared to privatise. But delivering the necessary legislative and administrative reforms to make this happen will require real political will.

I believe the BiH authorities are beginning to develop that political courage and willpower.

There has been a similar development in the area of refugee return, and this has a direct bearing on the country's capacity and willingness to effect economic reform. In the last two years the pace of refugee return has picked up sharply, as the domestic authorities have clearly embraced the need to fulfil their mandatory Dayton obligations and facilitate returns. The momentum of return is self-sustaining – the more people return, the easier it becomes for more people to return. To a great extent, returns are no longer being held up by bureaucratic or political obstruction. The

main problem is the absence of employment opportunities and social welfare infrastructure in, predominantly rural, return areas.

Which has made all the more acute the need for the authorities to relaunch the privatisation programme and start securing the investment capital without which the rural economy cannot be revived.

In this respect I should address an apparently superficial yet hugely significant aspect of the whole FDI issue.

BiH has had for some time a bad image – and image, in economic terms, matters.

Inevitable, of course, because of the war – yet in many respects BiH's image is simply unwarranted. It has, for example, a crime rate lower than that of Switzerland; the large diaspora created by the war, followed by a wave of returns from overseas, has endowed the country with an unusually polyglot workforce; salaries are highly competitive, and the infrastructure recovery made possible by US\$ 6 billion in international aid and assistance has rebuilt the roads, airports, and highways, and reopened the Sava River. Goods and services from this country can be easily moved to the European market.

BiH has a lot going for it.

The process of post-war recovery has also given BiH the modern legal tools that can sustain investments and give confidence to investors. The comprehensive overhaul of the judicial system and the police, now nearing completion, has set in place a modern, independent and professional law-enforcement system. Efforts are also underway to establish a system of modern and efficient commercial departments within the judiciary that will greatly enhance the efficient administration of commercial law.

Significant strides are being made in the area of corporate governance. In the wake of scathing reports issued this year by the Special Auditor, appointed by the High Representative, regarding the management operations of the Elektroprivredas, the Vodoprivredas, the employment bureaux and the telecom companies, the two Entity Prime Ministers have committed themselves to an all-out campaign to tackle corruption and inefficiency in public companies. They have also endorsed the need for targeted measures that will include adoption of a new Law on Public Enterprises containing a detailed code of ethics for all public-company employees, from the chairman down. The proposed law will require the setting up of internal controls and strict approval processes for procurement, and distribution of profits and adherence to business plans. Companies will be obliged to compile financial statements to international bookkeeping standards – that means every last KM accounted for. And if they break the rules they will be liable to a fine, or imprisonment in serious cases.

European-standard regulations at the level of public companies will have a positive impact on the management culture of BiH's public sector, and on the country's business environment as a whole.

This, by the way, is an example of the kind of synergy which reform efforts throughout the region create. A positive change of business culture in BiH will benefit its neighbours, and BiH is benefiting from corresponding improvements in the business culture of other countries in Southeast Europe. None of the Stability Pact countries is going to succeed on its own – we will all succeed or we will all fail.

The Stability Pact countries want to exploit the possibilities of a combined market of 55 million consumers by eliminating trade barriers among themselves by 2006 – and part and parcel of that exercise is the creation of business cultures that are compatible with one another and capable of competing productively with one another.

As in other transition countries in Central Europe, the strange corporate practices revealed in the BiH public companies exist for a reason – they benefit a small but powerful constituency. This constituency has not been slow to orchestrate a press campaign against reform.

I believe this is a last gasp, but their campaign has put into sharp relief a significant aspect of privatisation and attracting foreign direct investment.

We are asking: does privatisation deliver?

My answer is: yes it does when it is done properly, but it hasn't yet delivered in BiH.

However, there are many people for whom the answer is negative not for reasons of recent economic performance but for reasons of politics and philosophy. We should not overlook the importance of this.

Some people – and not just in Bosnia and Herzegovina – have yet to make the mental transition to an open market economy and all that it entails. For these people, privatisation and international investment are a spectre, a catchall for foreigners looting the country's assets. Political opportunists opposed for their own personal reasons to privatisation and foreign investment have played on popular fears and misunderstandings.

So the International Community and its pro-reform partners among the BiH authorities have often had to make the case for privatisation and FDI from scratch.

The most effective way of doing that has been to give a voice to those who don't need to be persuaded that privatisation and investment can create wealth – people who understand that investment is necessary to generate jobs and raise living standards.

In late 2002, the High Representative noted that BiH needed a “bulldozer” to push aside the huge amount of pointless bureaucracy and job-destroying regulations that make it harder rather than easier to do business. This led to a “Bulldozer Initiative”, through which businesspeople were invited to recommend changes to laws and regulations. The success of the scheme surprised even hardened skeptics. A total of 50 reforms were enacted in a period of 180 days. Bulldozer Phase II is now underway, and we expect to see a further 50 reforms enacted before the end of the year.

This has demonstrated that positive and rapid change can be made to happen when local constituencies are given the tools to demand that it happen. Obstacles to privatisation can be bulldozed by an active civil society. Obstacles to inward investment can be bulldozed. There is a large constituency ready to make privatisation and foreign capital work for the benefit of the investor and for the community as a whole.

However the key to success will be the quality of local government, which can determine the success or failure of State-level efforts to attract investment, and increasingly we are seeing a proactive approach to investment on the part of municipalities throughout BiH as they band together in regional associations. This is a process that still has a long way to go, yet I believe that when those municipalities that know how to roll out the red carpet for prospective investors begin to reap the material benefits, in terms of incoming capital and new jobs, the philosophical arguments over FDI will resolve themselves.

BiH may be turning a corner in its transition. Until now, privatisation has been a disappointment and levels of inward investment have been inadequate – but both of these phenomena are at last being addressed. There is a new political focus on the economy, and there is a growing and powerful impatience on the part of the public to catch up with the rest of the region and integrate more quickly in the European mainstream.

Privatisation and inward investment are increasingly viewed as a natural part of that integration.

BiH now stands on the threshold of real and rapid economic progress, in which privatisation and inward investment will play an integral part.

Can privatisation deliver? I believe it can. And I believe in BiH it will.

Thank you.