

Speech by Principal Deputy High Representative Donald Hays at the IEDC – Bled School of Management Conference on the Impact of the Enlarged Europe on BiH and Slovenia

Economic Regeneration: It's Partly a Question of Confidence

Ladies and Gentlemen,

Throughout the former Yugoslavia, the old rustbelt leviathans that once dominated the economy are being replaced by small and medium sized enterprises.

This is not a neat, an easy or a painless process. It is complex, and it is fraught with social and economic dislocations.

And that's why the process is often engulfed in misunderstanding. This misunderstanding may be the product of ill will – among those who have their own reason for wanting to see transition fail – or it may be a genuine incomprehension among people who were brought up in a culture that consciously sought to sidestep the demands of the free market.

Whatever its causes, we should not make the mistake of viewing this problem merely as an irritant or an inconvenience.

Misunderstanding matters.

Misunderstanding can be the difference between successful transition and failed transition.

There is much too much misunderstanding in Bosnia and Herzegovina. There is much too great a disparity between the *reality* of the economic situation – its pitfalls, its hardships, its possibilities and its benefits – and the *perception* of these things.

This disparity often erodes confidence among investors, among citizens, and among policymakers. And this erosion of confidence could have a devastating impact if it is not addressed.

Even a cursory glance at the BiH economy today will reveal a huge amount of structural change that is positive.

The banking sector, following a rigorous shakeout, is remarkably buoyant. Lending to small companies and individuals is up, and banks are beginning to fulfill their appropriate place in this economy – as a natural and efficient capital resource, lubricating the mechanisms of production and job creation.

In the last two years or so we have seen interest rates drop from the high teens to somewhere in the region of 9 to 10 percent – still high, but moving into the kind of territory where bank loans can be characterized as a business stimulus rather than a business deterrent.

Yet creating a functional banking sector – a prerequisite for sustained economic development – is not of itself enough. You have to create the *perception* of a functioning banking sector too.

The perception must match the reality.

In BiH, however, there remains a climate of negative speculation – there are *assumptions* about banking in this

country which are no less damaging for being untrue.

The result is that many foreign investors, for example, are surprised when they hear that BiH has one of the most dynamic banking sectors in the region.

This country also has one of the most stable currencies in the region, and – this would come as a real shock to many – the introduction of the treasury system across a broad spectrum of an excessively broad multi-layered government system means that BiH also has developed one of the most rigorous public accounting systems in the region.

The improved standard of public accounting is one reason that the recent audit of the BiH Presidency caused such a stir. The auditors – civil servants given a clear brief and charged with scrutinizing the Presidency accounts according to exact criteria – could do a proper accounting and they did their job appropriately.

The consequences of properly supervised public accounting are, of course, often awkward from the standpoint of politicians.

Another area where real reform is beginning to take effect is in the management of the country's internal debt. Faced with a mammoth debt arising from claims for war damage, unpaid salaries and pensions, and frozen foreign currency deposits, the BiH authorities at the end of last year agreed on a plan with the IMF that will for the first time tackle the debt issue head on. The plan lays out a timetable for a mixed payout of cash and bond allocation – with the most vulnerable receiving cash payments while the remaining liabilities are met through a series of bond issues. The authorities simply do not have the resources to ensure that everyone will receive everything they are owed in cash, but under this plan creditors will receive a proportion of what they are owed, and long-term instruments covering the difference.

This will at last remove the issue of uncapped government

liabilities, which has until now acted as a major disincentive to attracting the investment that is needed to create jobs.

In another government action meant to address business sector needs, the BiH authorities have created 15 business courts to work their way through a backlog of business disputes, aiming to reduce the average duration of commercial litigation in BiH from months to weeks – an important signal to investors that this country is serious about attracting their money.

Legislation has recently been passed in both Entities facilitating the restructuring of insolvent companies so that they can be privatized – with adequate incoming capital – turned around and re-launched as competitive firms that can guarantee a decent livelihood for their employees.

Preparations are underway to introduce VAT in BiH at the end of 2005 and this, combined with the newly established Indirect Tax Authority, means that BiH finally has a single tax office to manage this critical element of the economy. Furthermore both public and private audits of BiH Public Companies have resulted in a package of corporate governance reform laws that the Entity governments are committed to enacting before the end of the summer.

None of this is of itself extraordinary, but when you lay out what has already been achieved the results are both surprising and in large part unrecognized by the outside world..

They shouldn't be.

That surprise is a function of misperception.

The achievements in terms of BiH's economic reform over the last two years or so however, do not justify complacency – they are not enough. They have been brought about often only through concerted international pressure; they are in some cases overly modest, but nonetheless they are redressing many of the critical problems this country has faced for almost a

decade. And they *do* justify a measure of confidence in the capacity of policymakers and businesspeople in this country to turn this economy around.

And that confidence is of paramount importance.

Misunderstanding about the current situation in BiH must not be allowed to erode that confidence.

Since I have spent a sizeable proportion of my time over the last 18 months traveling around municipalities in BiH, let me share with you some thoughts on the nature of economic transition at the municipal level.

Municipalities throughout this country are beginning to show a business savvy that belies their image as bastions of bureaucratic sclerosis.

Why would this be? Why would mayors around the country see the light when many of their counterparts in publicly own corporations have yet to be weaned away from old-fashioned notions of economic planning?

Well, necessity is the mother of invention. Communities that were once served by now-defunct industrial plants have no option but to look for alternatives.

Those alternatives exist – in the form of SMEs and new plant financed by private investment.

It doesn't take long to learn the workings of the new economy once you realize that this same new economy can deliver jobs.

There is no longer the same kind of knee-jerk hostility to private ownership that there was two to three years ago

At the national level too we have seen a new pragmatism, largely defined by the specific legislative requirements of the Euro-integration process. Progress, particularly with regard to some Feasibility Study requirements, has been

disappointing – but progress has nonetheless been made, and it has been made by a political leadership that appears to have made the decision in principal to do the right thing as far as economic reform is concerned and has been confounded more often than not by organizational, administrative and technical shortcomings.

And it's not just the Euro integration process. BiH has forged a political consensus around the medium-term Development Strategy, which lays out detailed steps for moving transition forwards and anchoring it in the delivery of systematically improved living standards.

As the volume of aid declines precipitately, the focus of BiH politics has turned from arcane disputes over constitutional niceties to more conventional debate on the ins and outs of economic strategy.

This focus on economics is, to say the very least, healthy.

At the same time there has been a sustained effort to shift political discourse conclusively away from conflict issues and towards issues related to a viable civil society.

These twin developments – emphasizing the primacy of economics, de-emphasizing the causes of conflict – dovetail with the emerging trend in the municipalities. While market realities begin to exercise a conclusive sway over every level of BiH politics, the people who have shown that they understand the dynamics of the market are the same people who understand the kind of dialogue that sustains and flourishes in a civil society.

It's no surprise that the Bulldozer Initiative, which brings both of these trends together – development of a market-driven business environment and development of a durable and constructive dialogue between lawmakers and citizens – has come into its own in the course of the last year.

What about investors?

Well, investors remain leery. Given BiH's recent past, that is understandable – three years of war followed by several wasted years of nationalist foot-dragging on real reform rendered BiH an investment prospect that could not by any stretch of the imagination be characterized as attractive.

But the last few years have seen a fundamental sea change – and the perceptions generated by the previous decade are simply no longer justifiable.

Any investor looking at this country should bear in mind that even in a developed economy investment carries risk. In BiH the risk may be relatively high – but it is not as high as negative perceptions would make it.

And the potential rewards are equally substantial – since growth from a modest base such as exists in BiH is more likely to be exponential than growth in a market that has already matured.

BiH is in the midst of consolidating a set of strong economic fundamentals: it is a country that justifies investor confidence

Zenica Steel is a case in point. If the proposed privatization of the plant goes ahead, as it is scheduled to do in the next two weeks, then a company that had become a byword of all that was unviable about the old BiH economy – and of the economically unsound policies that have characterized much postwar economic management – will be transformed into a flagship of the new economy, capable of generating positive momentum in related industries from coal to transport infrastructure, and it will have done this because a major international investor has assessed that the business conditions in BiH are now sufficiently promising to justify a multimillion dollar risk.

As Shakespeare put it: "Our doubts are traitors, and make us lose the good we oft might win, by fearing to attempt."

In other words – this is not the time to listen to the habitual pessimism that has attended BiH for a decade; it is the time to share in the confidence that several years of intensive economic reform have rendered reasonable.

Thank you