

Speech by Principal Deputy High Representative Donald Hays at the JP Morgan Investment Seminar

19 April 2004

Ladies and Gentlemen,

One of the advantages of speaking about the economy of Bosnia and Herzegovina before an international audience – even an international audience as knowledgeable as this one – is that the reality is significantly better than the reputation. What I am going to tell you about Bosnia and Herzegovina today is largely positive – and it's not based on spin but on hard fact. The only reason this may seem surprising is that BiH has a negative image that it no longer deserves.

Bosnia and Herzegovina's image problem isn't hard to explain. The country endured a catastrophe at the beginning of the last decade, graphically depicted on TV screens around the world through images of shell-shocked civilians and burning cities and villages.

The country has a reputation for civil strife, poverty, corruption and crime.

I am here to tell you that this reputation – established a decade ago – is no longer justified.

BiH is no longer a failed state. It is a competitive investment destination. It is a country in which canny investors ought seriously to consider putting their money.

Let me offer a brief survey of the kind of strategic and

effective economic developments that have taken place in BiH in the last year alone.

In March 2004 the country received its first ever grading from an international credit-rating agency. Moody's Investor Service gave BiH a B3 rating, and assigned a positive outlook to the economy, noting that the B3 rating could be upgraded in six to 18 months.

Fiscal reform is well advanced; an Independent Taxation Authority was established at the beginning of this year under the chairmanship of an international tax expert. The ITA is supervising the consolidation and rationalisation of the customs services and preparations for the introduction of VAT, possibly towards the end of 2005.

A major legislative effort is being launched to set in place a long-term domestic debt repayment regime that will allow the BiH authorities to rationalise their substantial liabilities, most of which originated in the break-up of former Yugoslavia and the material and financial losses arising from the war.

In order to reduce the backlog of commercial court cases and set in place a system in which business disputes can reasonably be expected to be resolved in weeks or months rather than years, the authorities have recently established 15 commercial chambers, attached to regular courts. These chambers are staffed by experts in business law. The length of time it takes to get a court decision on a business dispute is one of the basic barometers used by prospective investors when assessing a country's business environment. In this respect, the BiH barometer has moved from "inclement" to "mild."

The judicial system as a whole is in the final stages of overhaul (during which all judges and prosecutors have been temporarily suspended in order to have their professional record scrutinised, with reappointment being dependent on a satisfactory review) and police reform is well underway – huge

progress has been made in transforming the paramilitary and politicized police forces and courts that existed at the end of the war into law-enforcement services that take as their benchmark European standards.

The BiH State Border Service is well trained and is beginning to exercise real supervision of the country's long mountainous border. Citizens have been issued with new, forgery-proof and electronically-managed identity documents – the most advanced and secure citizen-identity system anywhere in the world.

This rehabilitation of public institutions in BiH, undertaken in the context of the country's overall economic and political transition, has been sustained by substantial international economic and political support – but we are also seeing growing evidence that the self-sustaining mechanisms through which democracies reform and renew themselves from the inside are beginning to operate – in terms of active and independent participation in public life by NGOs, trades union, business associations and student groups, for example. At the end of 2002 the High Representative, Paddy Ashdown, and the Chairman of the BiH Council of Ministers, Adnan Terzic, launched the "Bulldozer Initiative", an attempt to get rid of pointless, investment-detering bureaucracy by encouraging businesspeople to lobby for change. The success of the initiative has confounded its proponents as well as those who initially greeted it with skepticism. Through Bulldozer, thousands of businesspeople have identified specific regulations and clauses of laws that make it harder rather than easier to do business. Their proposals are scrutinized by experts and then presented to the governments. Fifty reforms were secured under Phase I of the Initiative, in 2003; 50 new reforms are now being processed under Phase II, and Phase III is about to be launched. This innovative initiative – developed from scratch in BiH – has become a successful export, since the Bulldozer model is now being applied in other parts of the world under World Bank sponsorship.

I am well aware that many of the reforms I am describing are standard elements in the legislative and administrative programmes of transition countries. I would draw to your attention the fact that, because of the large-scale military, political and economic engagement of the International Community in BiH, stemming from the specific provisions of the Dayton Peace Agreement, it has been possible to speed up the pace of transition. In addition, because of the war, BiH began the transition process in peculiarly difficult circumstances, but it should be noted that the destruction of old heavy industrial plant to some extent cleared the way for the introduction of new technologies – something we are beginning to see in the emergence of a new SME sector. These factors render BiH a *more* attractive investment destination.

The facts support a positive assessment of the economy and of the impact of strategic reforms. BiH has the most stable currency in the Balkans, with an inflation rate well below one percent per annum; the Central Bank puts GDP in 2003 at 12.2 billion KM, a 5.4 percent rise on the previous year; real GDP, taking into account an extensive, active and profitable (albeit problematic) grey economy, is probably in the region of 16 billion KM. When the Deutsch Mark gave way to the Euro at the end of 2001, BiH citizens deposited six billion DM in BiH banks in order to change their savings into KM – a remarkable testament to the volume of savings maintained in cash.

The number of banks has declined from a peak of 73 at the end of 1998 to 37, as non-viable banks have been removed and a progressive strengthening of standards has encouraged consolidation. Twenty banks are now in the deposit insurance program. Four banking companies hold about 65 percent of total deposits. Loans to citizens approximate 45 percent of total loans, and loans to private businesses (largely SMEs) account for more than 40 percent of total loans.

Central Bank Governor Peter Nicholl announced on 26 March that

a contract has been signed to upgrade the giro-clearing system, which will make possible the establishment of a single registry of bank accounts of legal entities in BiH. A key feature of the upgraded system will be to provide additional means to combat money-laundering and to facilitate the collection and implementation of court decisions.

Domestic investment is well over a billion KM per year. It needs to be higher, but since the statistics only record the initial investment in a company, the overall figures are significantly lower than the reality.

As I mentioned at the beginning, BiH has a bad reputation that it no longer merits. What I would emphasize is that the kind of reforms we are talking about are very much those which characterize a modernizing economy – they are, decidedly, not the kind of initiatives one associates with a dysfunctional state. Indeed, we have reached the point where a serious legislative effort aimed at improving corporate governance is no longer a quixotic undertaking but a logical corollary of a rapidly improving business environment. Legislation currently before parliament, or about to be sent to parliament includes

- a law on Business Registration that will streamline and standardize business registration procedures throughout BiH
- a law on Procurement that will codify and regulate procurement and tackle the pervasive and pernicious problem of rigged tenders
- a law on Accounting and Auditing that will create a framework for establishing European accounting and auditing standards in BiH, and set up an independent commission to supervise the profession
- a law on Public Enterprises that will codify the governing structure of BiH public companies
- a law on the Investment of Public Funds, that will reign in the exuberance with which some managers of public companies have hitherto doled out loans and gifts to

their friends.

To date, the privatization process, another barometer of a country's investment readiness, has been disappointing. This has been largely due to a failure until now to deal with the issue of outstanding corporate liabilities – unpaid salaries, welfare contributions, debts, and so on. We are tackling this issue, and, indeed, recently enacted bankruptcy legislation will clear the way for corporate restructuring activities that will facilitate recapitalization through investment.

Last month, I spoke at a luncheon organized by the American Chamber of Commerce in Sarajevo. I concluded my remarks with a call to the businesspeople of BiH to go forward with confidence – *visible* confidence, *sustained* confidence, *confidence-inducing* confidence. I called for confidence in the fact that BiH has decisively turned the corner, that it is a country that is open for business. I pointed out that our aspirations ought not to be limited. We ought not to be focusing our energy just on making ends meet. We ought to be striving for levels of prosperity that far outstrip what was achieved in former Yugoslavia before the war. In this respect I argued that Southeast Europe can emulate the successful model of Southeast Asia, which moved from a state of relative economic backwardness in the 1950s and 60s (plagued by regional unrest and chronic armed conflict) to a period of hyper-growth in the 1980s and 90s.

Southeast Europe can seize a prosperous place in the global economy.

And BiH can be in the vanguard of that.

But only if there is confidence.

Today, I would extend this call – the international investment community should take a fresh look at BiH. I do not appeal to your sense of humanitarian solidarity or good will. I appeal to your good business sense. This is an economy that is

rapidly righting itself. It is a country that is in the heart of an emerging free-trade zone, that is on the doorstep of the European Union, that has a renewed infrastructure, a modern fiscal and banking system and a rapidly developing SME sector.

It is a country that justifies confidence on the part of international investors, a country that will reward investment.

Thank you