

# Speech by Principal Deputy High Representative Donald Hays at the USAID-sponsored SME Donor Roundtable

Ladies and Gentlemen,

Just five years ago there was no system to speak of that supported SMEs in BiH. The whole orientation of economic policy, such as it was at that time, was based on a hopeless attempt to resurrect the old industrial conglomerates that were the centerpiece of the socialist economy of former Yugoslavia. It was as if economic planners in Pittsburgh or Manchester or Hamburg had spent the eighties trying to talk up the advantages of being part of the rustbelt.

Easy to make fun of that moment in history, of course, but there were reasons for this attitude. Pre-war BiH enjoyed a kind of heavy-industry golden age, or at least the illusion of one. People whose careers were built in that golden age naturally wanted to recreate it – so they channeled their energies into getting the old industrial combines back on their feet.

They failed, of course, because history had moved on and left this industrial network disconnected and irrelevant.

Those who understood the new global economic environment then are in large part the same people who are now running small and medium enterprises. For a long time they were like fish out of water – the business environment wasn't tailored to their needs. That's actually a considerable understatement. The business environment was in many cases *hostile* to their

needs. Prewar business legislation reflected only a rudimentary sensitivity to a market economy, and legislation in the years immediately after the war was either politicized to the point of obstructionism (I'm thinking of all those Entity regulations that made it hard to do business with the other Entity) or anachronistic because of the strong influence of command side economic planners.

This is a common Transition phenomenon. BiH was and is not alone. But the effect has been acute here because rapid economic development was all the more urgent in light of the devastation caused by the war, and because this economic transition was played out against a backdrop of profound political challenges.

But I believe today BiH is beginning to turn the corner on that particular set of problems. There appears to be a strategic shift – in thinking and in practice – into the new economy. This shift will have a positive impact on the technical and legislative initiatives being discussed at this conference.

If you are running a small or medium-sized enterprise in BiH today, your time and place have arrived.

I said that I thought we had turned the corner. We all know, though, that the situation still can use some improvement. Popular attitudes towards privatization, for example, reveal a mindset that is still unproductively blinkered. There is a sense that “national treasures” are being sold off cheaply. There is a failure (or a refusal) to understand that the money paid to acquire ownership in a company isn't the best measure of the company's value. What matters frequently in these cases is the amount of investment, new technology and management expertise that the new owners are prepared to put *into* the company.

But nothing succeeds like success, and while the privatization

process has been marked until now conspicuously by a lack of success, sustainable economic growth is beginning to be seen in the SME sector. This more than any theoretical argument will show BiH citizens and BiH politicians that the new economics delivers benefits—which in the end is the only justification of any economic system. And that realization will in turn prompt legislators to become more responsive to the needs of SMEs.

But the politicians have to be nudged in the right direction. The Bulldozer initiative has been a notable success in this respect. Fifty economic reforms in 180 days is a pretty impressive achievement, but the shift in attitude that the Bulldozer process generated is every bit as noteworthy. Before Bulldozer, politicians didn't seem to realize that when you draft business legislation you might reasonably consult businesspeople – that doesn't mean a handful of one's friends in the upper echelons of public companies; it means the tens of thousands of people who are running small and medium-sized companies, a group of people who are on their way to becoming the biggest employers in BiH.

Let me mention at this point some interesting things that are happening in the municipalities, because this has a direct bearing on the business environment in which SMEs work, and because it reflects a broader development in society that will ultimately have a profound (and I believe positive) impact on the economy.

In the course of the last year or so I have been meeting with mayors from all over the country, from very small rural municipalities to very large urban ones. I have come away from these meetings with a strong sense that there is a new momentum for change, coming not from the top down but from the bottom up. Municipal officials have begun to exercise their voices because they see close up the urgent need for a change in the status quo. One of the ways in which they have begun to take the initiative is by seeking directly to foster

enterprise in and attract investment to their municipalities.

A couple of months ago I visited Gradacac, a municipality that was completely devastated during the war but which has picked itself up and got on with the business of economic recovery. The municipality has registered 700 new businesses in the last eight years. One of its successful strategies has been to turn the former school, wrecked during the fighting, into a Business Incubator. Start-up businesses pay a nominal fee for rent and can stay from three to five years before they move to their own premises. There have been 36 successful businesses in four years, most notably the Thema shoe factory, which arrived at the Business Incubator with four employees and recently moved out to its own premises with 175 employees.

Another recent trip took me to Gracanica, where I visited the Vegafruit food-processing company. The structure of the company's business is interestingly flexible. It has 750 employees, but it maintains supply contracts with 5,000 families in its agricultural hinterland. I estimate that 30,000 people's livelihoods are positively affected by this company, which operates on a response-to-market basis that would have been beyond the capacity of the old economy's rigid agricultural conglomerates.

Now, let me come to the architecture of the business environment. In the last two or three years the International Community's economic engagement with BiH has become more focused and coordinated. The international financial agencies and the OHR have coordinated programs more tightly. In addition, the overarching orientation of economic reform has been predicated on integration in the European Union.

The Feasibility Study requires BiH to ensure full parliamentary adoption of the ITA Law. The target date for introducing VAT is the middle of 2005. The authorities have to get a handle on budget management at all levels of government; develop a coherent tax policy, implement the Statistics Law,

get the Phytosanitary Agency up and running, make serious progress in developing the Single Economic Space (including establishing a single business registry for the whole country), and forge a coherent BiH trade policy, and modernize/restructure the electricity sector.

Every one of these reforms will improve operating conditions for small and medium-sized enterprises.

By the way, that is in itself a very compelling reason for Chambers of Commerce, farmers, exporters, entrepreneurs and shopkeepers to lobby hard for these reforms. The business environment is their world, and this legislation is going to make their world a much healthier place in which to run companies.

The gaps in the system are clear – much of the economic reform legislation to which the governments have committed themselves still languishes at the drafting stage or in government or parliamentary procedure. When this legislation is enacted – and most of it is scheduled to be enacted at the latest by this summer – businesses can take advantage, upgrade their performance and take on new workers.

But I see a remaining gap, and this applies not only to legislators but to businesspeople too. It even applies to the generally optimistic people who run SMEs (you have to be an optimist to put your name on the sign outside a company and I salute anyone who takes that courageous step).

There is in BiH an ambivalence about the future. I get the impression that businesspeople along with the rest of the population in this country just don't have enough confidence in themselves or in their circumstances. BiH is not going to secure economic take-off unless its politicians get with the program and begin to understand the competitive demands of the global economy. But equally, BiH will only become rich when its businesspeople believe that they and their countrymen are

competitive on the world stage. I have confidence in them and they should have it too. We need a vision among most entrepreneurs and managers that this country not only can become self-sustainable economically but that it can do much better than that – it can prosper.

I have just come back from Japan, where, by the way, the large companies that are household names throughout the world – the Nissans, Sonys, and so on – all depend on small and medium-sized enterprises for their supply of parts. I was constantly reminded of the fact that the Japanese economic miracle is described as a “miracle” for the very reason that in the 1950s the prospect that a country as poor and war damaged as Japan would become wealthy was nothing short of miraculous. I remember the observation made by the founder of Honda Motors, Soichiro Honda, who made his first fortune turning out two-stroke motorbikes that put most of Asia and then Europe and America on two wheels. “I happened on the idea of fitting an engine to a bicycle,” Honda remarked, “because I did not want to ride the incredibly crowded trains and buses myself and it became impossible for me to drive my car because of the gasoline shortage.” Necessity is the mother of invention. Nothing there about how mind-bogglingly difficult the conditions were when Honda set out to found his automobile supercompany – in fact adversity appears to have been the spur that he relied upon to become a commercial success.

The Japanese managed to maintain and to be sustained by a valuable self-confidence. Something similar happened in Southeast Asia in the 70s and 80s. I believe that Southeast Europe can emulate the Southeast Asian economic model.

But only if the new realism we are beginning to see on the part of economic legislators is matched by a new self-confidence among businesspeople.

Thank you