

Speech by Principal Deputy HR Donald Hays at the European Policy Centre

"Transforming the Balkans: A Critical Assessment"

Ladies and Gentlemen,

Transformation means different things to different people. It depends a good deal on one's vantage point. Southeast Europe has different contours when viewed from Brussels than from say Skopje, or for that matter, from Sofia or from Sarajevo.

Today I want to provide a perspective on Balkan transition from an insider point of view. When you see it from our perspective – and many of you, of course, share that view – you will recognize the opportunities that we feel exist.

Those of us who have experience working in the Balkans are not wide-eyed optimists. We can not ignore unpleasant realities nor can we overlook the difficulties that these countries face today. We have an optimistic mindset based on solid experience and on a recognition of the real potential for this region. Simply put we believe that Southeast Europe can within a generation become, like Southeast Asia in the eighties and early nineties, a global model for sustained and rapid economic growth. I have my own personal experience in that region and I can tell this is not an exaggeration. This region has enviable human and natural resources, huge potential for improved political and economic cooperation, and clear geographical advantages – it's on the doorstep of the world's largest economy, not a bad position if you plan to export your way to prosperity. But we need political and economic leadership, within the region that will lead change.

The focus of all our efforts now is to set in place a regional economic framework that will allow Southeast Europe's vast potential to be fulfilled. And in BiH we are striving to ensure that we capitalize on the opportunities that have been created by a regional economic renaissance.

The point I would like to make clear today, above all else, is that when Southeast Europe's economic potential begins to assert itself, citizens in the rest of Europe will benefit and the economies of central and southern Europe will grow as well.

There are two scenarios I would like to describe for you.

The European Union can have on its southeastern border a huge underdeveloped area that generates unstoppable waves of contraband, criminality and illegal immigration, not to mention political instability.

Or it can have within its southeastern boundary 55 million increasingly affluent consumers and a regional economy that offers an infinite number of opportunities for competitive outsourcing.

Clearly, we should all be striving for the latter scenario – it is within our ability to create this reality, but for that vision to come into existence all of the countries in the region and the EU have to get involved now. This means policymakers in Western Europe have to be involved as well as policymakers in Southeast Europe – you can not wait for the countries of the region to transform themselves and only then put out the welcome carpet, it will take all of us working together to make this happen. The economies of this region need an influx of strategic partners, there must be an EU investment strategy in the future of this region and a partnering of know-how and fresh investment both human and financial to make this happen. But let me be very clear it is our effort that will make this vision a reality; if we fail to

engage then that vision will recede into an uncertain future.

It is good to have representatives from other countries in the Balkan region with us today. I know that they will be bringing their experience, insight and perspectives to bear on today's discussion.. I will limit my own remarks to the specifics of Bosnia and Herzegovina – but I believe many of the issues facing BiH apply equally to our neighbors.

The Balkan Brand

There is a condition – symptoms of which may be found in conference halls from Dublin to Dusseldorf and from Narvik to Naples – which I would describe as acute geographical myopia. The principal symptom of this condition is an inability to grasp, let alone put into a real context, the huge economic opportunities that exist in connection with the countries situated between Slovenia and Greece.

And where there *is* a vision of these countries it is often outdated and badly skewed.

Bosnia and Herzegovina more than eight years after the end of the war continues to be viewed through an investment-detering prism of TV footage and front-line reports from the 92-95 period.

While I am sure that few in this room suffer from that distortion – unfortunately we are all forced to contend with its effects, which routinely make it harder than it should be for Balkan economies to attract investment. Of course it would be easier for all of us if these countries had a proactive public relation's campaign to educate and attract renewed interest in the region.

What I will call re-branding is a priority. There *has* been a transformation in the Balkans – but it goes largely unnoticed because we are still trading under an obsolete and discredited identity associated with the war.

Think Balkan: think business – think modern, globalised, networked business.

The future of this part of the continent can be built on the capacity to provide competitive services to multinational manufacturers and financial institutions and by using that toehold in the global economy to leverage local strengths – wood-processing, hydro-electric power, engineering, and mineral exploitation, are notable examples – into globally competitive companies. Southeast Asia showed the effectiveness of this model more than a decade ago; Southeast Europe can enjoy the same success – and savvy investors should think about securing an early place in that success. One thing that is not in doubt is the quality of the most essential ingredient – the people of the region. They will be an engine of growth if given only a window of opportunity.

As I said, I'm not an optimist because I overlook hard realities or the challenges ahead. But I have seen a quantitative shift in the past three years and I think it is time that others see the opportunities in the same clear light of day. But first let's reacquaint ourselves with some of the unpleasant realities. Southeast Europe can replicate the astounding success of the Asian economies, but only if it eliminates systemic problems that threaten its economic and political life. Consider the fact that the vast majority of illegal immigrants, contraband weapons and banned narcotics that make their way into the EU transit through the Balkans. BiH is considered a key axis in this trade.

This is a major problem. It has to be recognized and it has to be addressed. The good news is that in tackling this, and other issues related to crime and corruption, we have already made – and we continue to make – significant progress. The BiH State Border Service is well trained and is beginning to exercise real supervision of the country's long mountainous border. By the middle of this year, we will have completed the mammoth task of issuing every BiH citizen with new, forgery-

proof and electronically-managed identity documents – the most advanced and secure citizen-identity system anywhere in the world.

The judicial system is in the final stages of a massive overhaul, 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.

From an economic point of view, I would draw your attention to the fact that the modernization of the BiH legal system – which includes the setting up of a State Court with the capacity to take on organized crime – has also seen the introduction of commercial chambers designed to accelerate the pace of business litigation. Two of these chambers have already been established, a third will be launched next week (2 February) and a total of 15 will have been inaugurated by the end of March.

Furthermore, a new criminal code is in place, as are bankruptcy laws that will regulate the restructuring of companies in line with international practice (facilitating recapitalization of companies and encouraging more expansive bank lending). We are currently working with the authorities to secure speedy enactment of a Law on Business Registration, that will make it simpler and faster to register new companies (and will provide for due oversight so as to eliminate the widespread use of fictitious companies), and a Framework Accountancy Law that will introduce European standard accounting practices. A state Law on Procurement and Entity Laws on Public Enterprises will carry forward an initiative aimed at cleaning up the management of public corporations. Laws regulating the electricity and civil aviation sectors, allowing for faster commercial development in these strategic areas, are in the final stages of enactment. These are the kinds of nuts-and-bolts reforms now being implemented in BiH

to create a business environment that will allow local and international entrepreneurs to exploit what we believe will be a broadening range of business opportunities – they are the kinds of reform that will make doing business in BiH an experience comparable with doing business in most other parts of the continent.

European Perspective

The countries of the Balkans are seeking – and slowly but surely acquiring – closer integration with the EU. At the same time, they are tentatively beginning to reestablish regional economic, social and political synergies that can make Southeast Europe into a recognizable area of cooperative common interest. The region is emerging as an economically defined bloc.

The Sava River Initiative, launched by the Stability Pact, has seen Bosnia and Herzegovina work with Slovenia, Croatia and Serbia and Montenegro to reopen this major European waterway to commercial traffic. This will bring major economic benefits to the countries involved – in the case of BiH the revitalization of the Port of Brcko will serve as a key element in reconnecting the country and its exporters to their traditional markets in Central Europe. The work which the four countries have already completed on the Sava River project demonstrates the capacity of states in the region to work together to further their common economic interests. This is also reflected in the systematic progress, also under the auspices of the Stability Pact, of the Southeast European countries to negotiated a series of bilateral free-trade agreements that will turn the entire Balkans into a free trade area by 2006.

Power III is a multi-donor project worth \$283 million focusing on the reconstruction and reform of the power sector. BiH has signed the Memorandum of Understanding on the regional electricity market in Southeast Europe and its integration in

the international electricity market. This is BiH's first practical step towards the EU, by meeting the conditions required to participate in establishing a regional electricity market which will be integrated in the EU internal electricity market.

Integration is *not* just about harmonizing legislation and signing trade agreements. BiH's economic links with Western Europe predate by decades its EU accession process. BiH has traditionally been a source of tens of thousands of guest workers employed in companies throughout Europe, principally in Germany and Austria. This, and the wartime Diaspora, has endowed the country with an unusually experienced workforce which has been exposed – to a greater degree than in neighboring countries – to the demands of West European industry.

Which is important, because it means that BiH has a large pool of workers who have the kind of mindset and the kind of skills set that can flourish in a competitive global market.

As I said, this process will take engagement by EU regional neighbors as well as those in the Balkans seeking to expand trade and improve their economic development. Some might say though: BiH may have the workers – but why should any corporate policymaker beyond BiH be remotely interested?

Well, we have seen over the last ten to 15 years the rise of outsourcing as the preeminent operating model of successful corporations. Partnership with smaller companies is the key means by which large companies maintain their competitive edge, and EU multinationals need to find partners to whom they can subcontract specialist tasks. I have seen such outsourcing already springing up around BiH in the clothing, engineering and automotive-parts businesses.

BiH is open for that kind of partnership.

BiH already has significant success stories. For example,

Prevent, a Slovenian car-parts supplier, has invested KM 35 million and created 1400 jobs in BiH, where its subsidiaries supply car-interior accessories and car seats to major manufacturers such as Renault and Volkswagen. BiH is potentially full of such companies, that can reliably and competitively supply the international market, basing their own prosperity on their capacity to expand the bottom line of partners in Western Europe and further afield.

As of today, this potential for mutually beneficial partnership has not begun to be exploited in a substantial way. A few pioneering firms are pointing towards the future, but until this cases grow significantly in number, we will continue to see a debilitating brain drain, as bright young graduates take their skills to Western Europe in the absence of a sufficient demand for their services in BiH itself. That is something which does not benefit BiH and does not, in the long-term benefit Europe, because it is contrary to our best efforts to turn Southeast Europe into a prosperous counterpart to Western Europe, not a place from which people relocate to Western Europe.

Business Environment

Let me repeat – I'm talking about realities here, not wishful thinking. BiH is lifting itself out of the abyss into which it was plunged at the beginning of the 1990s. It's triple transition, from war to peace, from socialism to democracy and from socialism to a free-market economy is only just now beginning to show results. But as little as two years ago, political life was still dominated by endless debates over ethnic quotas in government. Today, the debate has moved into more widely recognizable territory – like how to speed up privatisation and garner the economic benefits sooner rather than later, or how to translate investment into new jobs, or how to raise standards of corporate governance so that large companies achieve the optimum results for their workers, shareholders and customers.

Last year, the Special Auditor, appointed by the High Representative, issued a series of reports revealing extensive corruption and mismanagement in key public companies in BiH, including the telecom and electricity providers. Criminal proceedings have been launched against some executives. Equally important, however, the Entity governments have undertaken to push through a package of legislation that will regulate internal controls, procurement procedures, modern European standard accounting, distribution of profits and adherence to business plans. We believe this will have a positive impact on the management culture of BiH's public sector, and on the country's business environment as a whole.

In the next six months, the BiH authorities have committed themselves to rationalizing and modernizing the customs service and beginning preparations for the introduction of VAT in 2006. They will also streamline the business registration process, establishing a single countrywide registration system that will make it easier to set up new, properly documented, companies. Efforts are now actively underway to expand access to product certification so as to allow BiH producers to export their products to the EU with the "CE" marking. Improvements will be made in order to create an effective single state-level Statistics Agency, and to strengthen the Foreign Investment Promotion Agency, the State Veterinary Office, and the Institute for Standardisation. We also expect a BiH Investment Guarantee Agency to be established.

In the meantime, a major legislative effort will be 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 breakup of former Yugoslavia and material and financial losses arising from the war. Finally, a major effort is now underway to unblock the privatization process which has so far delivered only modest economic benefits but which could act as a major forward impetus for the economy if properly managed.

This is a massive agenda for reform but it must be carried out and quickly. Yet I am convinced that the transformation of BiH has already become irreversible. If sustained by a deepening, mutually advantageous commercial and political partnership with Western Europe this transformation will deliver material benefits, not only to the people of BiH but to citizens elsewhere on the continent.

Thank you