

Zdravko Miović

What is the Real Priority: REGULATORY REFORMS OR COMPETITIVENESS OF ECONOMY?

Policy Brief





Enterprise Development Agency Eda
Banja Luka, Phone: +387 51 300 241, 319 507, Fax: +387 51 318 838
www.edabl.org; eda@edabl.org



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The aim of the project is to improve competitiveness of small and medium sized enterprises in the area of Krajina, so as to create and maintain jobs, reduce poverty and improve the economic status of this area.

The project should provide the creation of more than 200 new jobs and maintenance of up to 1000 jobs in companies, i.e. sectors included by the project interventions. Also, the project should ease the vertical and horizontal coordination of policies aimed at the small and medium sized enterprises in the project area.

DOES THE CHOSEN ROAD NECESSARILY LEAD TO A MORE DEVELOPED ECONOMY?



For more than two decades now, regulatory reforms have been on the agenda of international projects and all levels of governments in Bosnia and Herzegovina. Have we forgotten a great pomp, publicity and support with which a large-scale reform initiative, called “Bulldozer”, was started and implemented, under the auspices of the then High Representative in BiH and supported by practically all the then politicians and leaders, at all levels? On the 12th November of this year, the total of 12 years was completed since this initiative was started, with an explicitly expressed intention *to remove as many obstacles as possible and decrease, to the lowest possible extent, unnecessary bureaucracy in order for the economy to develop more freely*¹. Where are we after those 12 years? Are we with less or more *unnecessary bureaucracy* from the point of view of business companies? What is the real degree of development of our economy? To which extent have, the “Bulldozer” and many other regulatory reforms, contributed to such a development of economy?



If we have not moved far away, what or who is the reason behind it: is it up to the road which was selected (regulatory reforms), is it up to the selected vehicle (Bulldozer) or to the driver (us, the way we are, significantly increased by the High Representative, his apparatus and numerous projects)? What are we like – we, more or less, know; the heavy-weight vehicle has long been given up on, so it does make some sense to deal with what we mostly do not put in question: has the chosen road been necessarily the one inevitably leading towards better developed economy.



¹ http://www.ohr.int/ohr-dept/econ/bulldozer-initiative/default.asp?content_id=28724



SETTLING THE ACCOUNTS

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The control table shows the following results:

- At the ranking list Doing Business, managed by the World Bank, which speaks about simplicity of doing business in different countries, BiH moved from 87th place in 2006 to 104th place in 2014.
- According to data of the Global Competitiveness Indicators (GCI), BiH economy, in 2014, is at the same 87th place, where it was also in 2004, although, in the meantime, its place on the ranking list ranged from 82nd in 2007 to 109th in 2010.
- Percentage of export in the structure of GDP has increased, from 17.95% in 2002 to 29.66% in 2014.

Meaning that, when we settle the accounts, even with a continuous presence of regulatory reforms on the agenda, the only thing that changed was the increase of export percentage in GDP. From the point of view of expected progress on the list Doing Business (which is still one of the motives of regulatory reforms), it turns out that this is constant “spinning around in a circle”. Relative competitiveness of economy does not change, whereas positive moves in export obtained its real significance only after we compare it with the countries from which the main competitors to our companies in the European market come from. A share of export in GDP of the Czech Republic is 77%, of Hungary 94% and of Slovakia 95%. If we, as a country, do not compete against them, for different reasons, our companies are struggling real hard with their companies on the most demanding of markets, while customers and partners constantly compare competitiveness of the first, second and third, who keep coming, offering their competitive advantages.

For those who consider this comparison already too hard for us, as we speak about the countries that area already far ahead, here is another, somewhat closer, comparison. Macedonia is a highly placed country on the Doing Business list, at 30th place, while its economy is only somewhat better placed than ours, according to the GCI and it is at 73rd place. When you ask our exporters where their main competitors come from on the leading European markets, such as German, for example, nobody ever mentions Macedonian companies. So much for the influence of regulatory reforms onto competitiveness between companies yet.

THE ROAD TRAVELLED BY EVERYONE, WITH NO ARRIVALS



Whenever it focuses on regulatory reforms and creation of a favorable business environment, the country deals with itself, bringing the role of the private sector, i.e. economy down, to the questioned, who only need to express their objections and then wait for the result of repairs (not so often revisions) that the institutions do onto themselves. And the institutions, then, prepare and execute reforms, the way they are accustomed doing: bureaucratically, by making minor changes in legislation and procedures, without essentially changing anything in their behavior and without essentially contributing to actual economy development. Reforms begin and end on a piece of paper; a small group of professional staff from the institutions, with support of adequate projects, perform the largest part of the work; eminent officials (prime ministers, ministers, mayors of municipalities) promote achieved results, upon the measure of the project which supported them and the way it was written in the project proposal. Insufficiently interested and slightly asked in the beginning of the undertaking, businessmen end up looking at the whole thing with wonder, as they see no tangible and intangible benefits for their companies. In business reality, there are no serious steps forward, needless to mention some influence over improvement of business competitiveness. And it is precisely the improvement of competitiveness of businesses that is the issue here, when we speak about its development.



Could things have been done in a different and a better way? Both yes and no, depending on which point of view and action we chose. If we remain at the point of view of regulatory reform and creation of a favorable business environment, we can hardly do anything different with more real effects. The reason is simple and it comes down to the limitations immanent to the very approach. Reforms are run and implemented by the public sector, externally supported by experts, through a linear process, which consists of a three separate phases:

(1) initial situation assessment done by external experts (usually through surveying the private sector),



- (2) selection of priorities of reforms through a public-private dialogue (usually at meetings with the chamber of commerce and associations), and
- (3) implementation of reforms left to the public sector.

Former experiences with the application of this approach support quite a discouraging hypothesis *that reforms lead by the state are insufficiently focused on the aspects, which are the most significant for the companies, unless decision-makers from the companies provide continuous contributions to the process*². The focus on reforms is on the governments, as they need to overcome the failures of the state, i.e. of the public sector, which is reflected in complicated and unadjusted legislation, creation of the necessary bottle necks and barriers, too high costs, etc. This focus may also be productive, but only with previously resolved the so-called *market failures*³, i.e. the problems that the market and companies competing and cooperating on it cannot resolve on their own, without some kind of systemic interventions. This alone presents a change of the point of view and action.

² You may read more about that in: Hindson, D. and Meyer-Stamer, J. The Local Business Environment and Local Economic Development: Comparing Approaches; at:http://www.mesopartner.com/publications/publications-blog/archive/2007/april/article/the-local-business-environment-and-local-economic-development-comparing-approaches/?tx_ttnews%5Bday%5D=27&cHash=f70d4b4edc203c143c94b4e5c6099c82

³ Market failures include the situations when market itself fails to efficiently deliver some goods or services, for some reason which is outside the influence or cost-effectiveness for companies, for example, natural monopoly of the public sector to forest exploitation (with consequences for the supply of the market with raw materials) or, for example, impossibility to organize own research and development with adequate laboratories for small and medium size companies (because of huge investments, too high costs and slow return).



THE ROAD LESS TRAVELLED



Such other, different and potentially better point of view and acting represents a systemic improvement of business competitiveness, whether we speak about local and regional level (local and regional economic development), whether it was a sectoral approach or improvement of selected value chains, which may be done both locally and regionally, as well as at a level of the whole national economy, frequently including international business dimensions.

CREDO
K R A J I N A

This approach puts at the center of attention such market failures, which are significant for company competitiveness and failures of the companies to, through networking and cooperation, achieve effects higher than the sum of individual effects. Neither failures of the state (through the so-called regulatory reforms and creation of a favorable business environment) are neglected, but rather they are identified and implemented, starting from the perspective of improvement of company competitiveness⁴ and locations. And such processes cannot be done without a continuous involvement of the private sector, not so much through its representatives (chambers and associations, already pretty much bureaucratized and distanced from the real market events and problems)⁵. Namely, within all this, the private sector has a leading role and the process is done in a spiral manner – diagnosis through a dialogue, operating is organically connected to the diagnosis, the first steps are the ones that can be started immediately and get done fast, without help of outside resources, the focus and scope of interventions expands with time, as the stakeholders advance in learning through action and from direct experience. When this approach is used, we get a significantly different repertoire and schedule of priorities of interventions that may and should be implemented.

⁴ Competitiveness of the companies finally comes down to their ability to successfully operate on the competitive markets. In our case, these are mainly the markets of the EU states.

⁵ There are exceptions such as the Chamber of Commerce and Industry of Republika Srpska.



This is how, let us say, the final list of interventions for the improvement of competitiveness of the wood processing industry sector was defined by the leading companies within the “CREDO Krajina”⁶ project, where only somewhere, towards the end (on 8th and 9th place) it puts the usual regulatory requirements (the initiatives for decrease of parafiscal charges and changes of the law on labor). In the first place we have interventions providing and easing stronger connection between the companies with the competitive markets, as it has been shown that, for example, the link with a very demanding German buyers and partners is of a decisive influence over the building of competitiveness of some of our best industrial companies. In the second place are the interventions related to adjustments of the profiles and skills of the labor force coming from the education system and from the labor market with the actual and prospective needs of the leading companies in this sector, as, without good quality and specialized engineers and craftsmen, companies cannot count either on maintenance, let alone on the improvement of their competitive position in the international value chains they are involved in. In this order, through differently set criteria and priorities for the supply of raw materials, laboratories for rapid prototyping and testing products, at the end is what, if a different approach is used, usually appears in the beginning of the list: decreasing of charges, changes of the law, improvement in the electrical energy supply, financial support to companies... This is a great amount of work to be done for both the public sector and local and entity governments, as well as for a number of institutions, from different agencies to secondary schools and faculties, public companies and others.

⁶ The project was supported by the Government of the Kingdom of Sweden and implemented by the Agency *Eda*; more about the project can be found at <http://www.edabl.org/Credo/Default.aspx>



There is more than enough work for everyone, only the point of view and acting is now completely open to companies and it follows their priorities. If the governmental institutions and institutions of support take over such a point of view and follow such schedules, the results will approximately follow the following logic:

- (1) companies invest and innovate more, and they operate more and more easily on the competitive markets;
- (2) in such a way, so as to be able to pay more attractive salaries and, thus, more directly contribute to the improvement of the living standard and social status of the areas where they operate;
- (3) in such a way, they can pay taxes and also provide to the government to make further improvements of the basis for competitiveness of companies (education, infrastructure, safety, etc.) and to support the groups, which are unable to participate in highly-competitive areas of high performance (marginalized groups, the young, the retired, etc.).



WHICH ROAD TO TAKE

Just as we have in the famous fairy tale about Alice in the Wonderland, this depends on where we want to arrive. If we want to have more developed economy, it means that we would like to have more competitive economy, in which companies, which can successfully do business on the competitive markets are drivers of economic development.

Regulatory reforms make sense and they may give real effects only after previously realizing positive steps forward in terms of competitiveness of businesses, when the so-called market failures are resolved to a more significant extent, which are particularly characteristic for transitional economies, where small and medium size companies are fighting extremely hard to get into an international game, played by the standards set by the best and the most demanding of players. They try to do this without a developed research and development infrastructure (as the companies they compete with have in their countries), without a good quality support from the educational system and from the labor market, with an underdeveloped consultancy market on which everyone does everything (meaning: nobody does anything) and all this in the so-called phase of initial accumulation of capital, in which mutual cooperation, solidarity and connection of competitors still present undesirable forms of behaviors.

The question of *regulatory reforms or competitiveness of economy* is not about excluding one or the other, but it covers what the priority is, what should go first, what should be the focus on, and, then, what should go along with that or after that. The selection of priorities is clear from the responses that have no major disagreements about: regulatory reforms have not built competitive economy anywhere, although competitive economy welcomes regulatory reforms.

IS OUR ECONOMY COMPETITIVE ON THE LEADING EUROPEAN MARKETS?



The first question for us is, then: can we say that our economy is competitive on the leading European markets? In this, we must not be lead aside by the nominal export growth – it is realized mainly at the price of simultaneous decrease of profit and decrease of the number of employees, as was the case in the currently most competitive industry branch, metal industry: in the area of Krajina, export of metal processing companies in 2013 is by 28% higher compared to 2011, the total revenues are higher by 35%, with a simultaneous decrease of the number of employees by 3% and decrease of profit of about 50%! And the profit rate was not too high even before: it was 5.4% in 2011 and 2.1% in 2013.

The shortest response is: the focus should be put onto the improvements of business competitiveness, as a major joint challenge for the public-private dialogue, through which we arrive to necessary interventions, which are immediately tried and realized⁷. Together with this, some burdens should be reduced, as soon as possible, for which we certainly know that business companies will welcome – decrease of taxes and contributions on salaries and release from payment of profit tax by exporters would be a good start.

There is work to be done at a local level, too. Not so much in terms of regulatory reforms, as in terms of creation of entrepreneurship climate, inclusion of the private sector in making decisions that are significant for local development, development of business infrastructure and services, support to networking of

⁷ A good example of the interest of leading companies for such an approach are sectoral boards formed through the “CREDO Krajina” project and proposals of interventions created by the participants. A similar innovative process of arriving to systemic solutions for the improvement of competitiveness of the leading industrial sectors happens quite successfully in Tešanj and Žepče, within the project ProLocal, implemented by the GIZ.



companies, introduction of standards, exhibition fairs, energy efficiency, and, then, acceleration of procedures and decreasing of costs for companies⁸.

Regardless to which level it is about, the basic form should be the same: improvement of competitiveness of export-oriented companies and sectors should be the focus of a continuous dialog of the public and private sector, through well targeted and quickly implemented interventions and with a constant adjustment of institutions to the needs and priorities of development of companies. This is not easy and it does not immediately give large effects, however, it is much more substantially profitable for everyone than “spinning around in a circle” of regulatory reforms and it provides for the cumulative effects that lead to better export of companies and significantly better share of export in the GDP of the country, with a more favorable feedback on the quality of business operations and life in the country.

⁸ Very good initial experiences of the “CREDO Krajina” project may also be used here for the establishing of local business councils, as a permanent form of dialogue between the private and public sector, aimed at the improvement of competitiveness of local businesses, using especially adjusted “localized” and significantly reduced version of the European Small Business Act.