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DEVELOPING AND PROMOTING THE AUTOMOTIVE INDUSTRY IN THE WESTERN BALKANS
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Introductory remarks

The World Bank Group's Investment Climate Advisory Service, FIAS, is very happy to partner with the OECD on this initiative and event. We believe that the development of any industry, and of the auto industry in particular, is closely related to the improvement of the policy and regulatory environment, which are our areas of work.

As this event is about to start, I'd like to give you a point of view on the importance of policy reforms for investment generation.

When an industry doesn't develop as one think it should, three types of failures are sometime talked about: Information failures. Market failures. Regulatory failures

Information failures are sometime to blame. The market did not know what was needed either in term of technology improvement, or in term of innovation, or in term of investment environment.

I often myself dispute that argument since I believe market actors, either public or private, know their sectors and their economies pretty well.

But it is true that sometime the private sector has needs which are not addressed by the public sector, and that the public sector sometime issues rules and regulations which do not take into account the market realities.

In the case of the automotive industry in the Western Balkans, information failures will not be able to take the blame anymore, especially since the OECD produced the report which will be talked about today, and which very much fills the information gap.

I command the OECD and those who participated for the quality of this document.

When the information gap is filled, the market can itself fail to address its own needs. We then talk of market failures.

A classic example is the lack of connection between suppliers and manufacturers, which highlight the importance on linkages, and supply chain development.

One way to address such market failure is to adopt an outreach strategy. A cluster of companies reaches out to potential investors or buyers in other geographical areas so as to create synergies, generate investment and create growth.

FIAS, with the help of the EU, has attempted the past few years, with its program Invest in the Western Balkan, to tackle such market failures through a strategy of outreach and promotion of specific sectors.

To help develop the automotive sector, two events were for instance organized by Invest in the Western Balkans in partnership with investment promotion agencies, in Munich and Stuttgart, to which participated about 50 German automotive-related companies.

This resulted into 12 leads. Those leads, in turn, resulted in 3 site visits. But of those 12 potential investors, out of those 12 potential supply chain improvements, out of those 12 potential markets failures remedy, none actually did happen.

On one side, these German companies were attracted by lower operating costs. On the other side, the region had a good historical track record in light and heavy engineering. On paper, it was just a question of connecting the dots, of repairing the market failure.

Rather than citing particular companies, I'll only mention IHK (the German Chamber of Commerce in Munich) which represents the quite influential Bavarian auto components sector. They said no investment happened because of regulatory instability and complexity, political instability, and high labor costs and taxes. They for instance cited political volatility in Serbia, Kosovo and Bosnia as a major obstacle to investment. They said that labor costs in Croatia were "nearly as high as in Germany". Other reasons they gave were a lack of transparency in the decision making process, poor regulations for quality standards, and what they felt was an unhealthy tax and wage environment.

These are not market failures, but the third type, and most dangerous in my view, of issue: Regulatory failures.

If you look closely at the OECD report, you will see that competitiveness must be rooted in regulatory improvements.

In Bosnia and Herzegovina, there are high labor taxes which are not harmonized between the two Entities. The Total contributions are 69.47% of the net wage in the Federation and between 42% and 57% in the Republika Srpska; There are also complicated licensing procedures: The DB report shows that it take 60 days to register a business in BiH against 13.4 days in OECD countries. Moreover, the heavy regulatory burden is often felt as arbitrary, with non-transparent interpretations of laws depending on which different levels of government gives the interpretation.

In Croatia, judicial procedures are very long and there is a big backlog of cases. One extreme case is that one automotive component supplier interviewed by the OECD reported that a dispute involving land ownership has lasted for 15 years. Another issue is that the procedures for obtaining building permits and licenses remain very

complicated. Doing Business 2009 notes that Croatia requires the highest number of documents in order to build a warehouse of any other Western Balkan economy. And of course a much higher number than in OECD countries.

In Kosovo, the country still lags in implementing international quality certification and in improving the legal framework and the administrative capacity for protection of intellectual property rights, two key elements looked after by potential investors.

In Macedonia, the system of acquiring land and protecting ownership still represents a major hurdle to both local and foreign investors. Also, with custom clearance taking sometime three or four days, the customs administration represents a serious barrier for local automotive component suppliers. Coupled with customs duties on imports of capital goods that are among the highest among the Western Balkan economies, this can easily discourage cross-border investments.

In Montenegro, the main challenge faced by the automotive components sector is the cost structure, with relatively heavy social security contributions and as a result, the operational environment is less cost-competitive than in neighboring countries. Montenergo should address this issue and focus its investment strategy accordingly.

In Serbia, despite the benefits of the Serbian Automotive Clusters and other forms of collaboration between companies and academia (in the fields of quality control and virtual manufacturing), there has been little or no progress on the restructuring and privatization of large and inefficient state-owned companies. About 20 large to medium-sized automotive suppliers employing around 6 500 persons remain to be privatized. Therefore, the country should support productivity improvements by accelerating privatization so as to facilitate technology transfers from foreign companies.

And thus, these regulatory failures complete the picture of the three gaps that need to be filled for the region to attract investment.

These regulatory failures are exacerbated during a time of crisis. Foreign investors have less patience for the complexities and costs associated with investing in supplying or partner countries.

There is some good news, though.

It is that of the three types of failures mentioned above, regulatory failures are actually the ones that are the most easily addressed by a government. Many issues I just mentioned for the Western Balkan states don't require enormous state budgets (they can actually help government save money), or knowledge which is out of reach. They require political will. They require dialogue between the public and the private sector. They require acting upon policy recommendations.

With the support of the Austrian Ministry of Finance and other donors, the World Bank Group's Investment Climate Advisory Service, FIAS, has established the Investment Generation Vienna Office.

From this location, a team of specialists provides advice and assistance to countries in the region of Eastern and Southern Europe and Central Asia to support improved policies, conditions and strategies to attract and retain productive cross-border investment.

Our goal is to help address issues that will lead to an improved investment environment, particularly for cross-border investment. We work on Investment law and policy, on specific sector-related legal and regulatory issues that relate to cross-border investment, on FDI sector-based strategy development, and on investment promotion, sector targeting and post-investment 'aftercare'.

We use an array of tools such as the Doing Business indicators, which measure the regulatory burden for investors; the upcoming Investing Across Borders indicators, a survey instrument that collects data on conditions for entry, operation and exit by cross-border investors; the Global Investment Promotion Benchmarking, which helps countries assess and strengthen their Investment Promotion Intermediaries. We help clients set up the right institutional framework to fit their FDI strategy. And we use Public-Private Dialogue as a powerful mechanism for engaging key players in the economy in the process of identifying and advocating reforms to improve conditions for more effective business operation, including for cross-border investors.

Based on this experience, and as this event is about to start, one message I want to convey is that regulatory failures noted in the OECD study represent not a threat, but an opportunity for the automotive sector. There is no better time than now, in the middle of a down market, to hurry in implementing these policy recommendations. These recommended reforms are relatively cheap, they can be done in a relatively short time, and although they require expertise, they are not rocket science.

We are ready to help. The community of practitioners, present here today, with public and private sector representatives for the automotive sector, can count international agencies as strong partners.

I find, in the collaboration of the World Bank Group with OECD on this topic, a great way to play on our respective strengths. We each bring some added value to the table.

The OECD, which coordinated this study, very much used its knowledge and reach to fill the information gap. My colleagues from the IFC investment group, Stefan Scweitzer and Zoran Martinovski, who will speak later on, will show how, from an investor perspective, with IFC investments, the World Bank Group can also help bridge the market gap. And on the end of the Investment Climate Advisory Service of the World Bank Group, we can help bridge the regulatory gaps I mentioned above, by helping your countries implement sector-specific policy recommendations and help your region reform its business environment so as to generate more investments.

I urge you to capitalize on this, as such reforms will help your countries retain existing investment, strengthen the region's image as a credible investment location and improve your industry's competitiveness. This event is a great step towards that objective.

Thank you.