

# NepalUSA CHAMBER

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## Doing Business in Nepal

- Market Overview
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### Market Overview

With a per capita income (Gross National Product) of only \$300, Nepal is one of the world's poorest countries. Limited natural resources, a landlocked location, difficult topography, poor infrastructure, a weak human capital base and a long history of public intervention in the economy are some of the impediments to economic growth. Agriculture accounts for approximately 38.3 percent of gross domestic product (GDP) and 71 percent of employment. In the last five years real GDP growth averaged less than four percent per annum. The GDP growth rate

for FY 2004/05 was 2.04 percent. Nepal traditionally runs large trade and current account deficits, which are offset by equally large service, transfer and capital account surpluses. Based on the balance of payments statistics for Nepal's FY 2004/05 (from mid-July to mid-July), Nepal's overall balance of payments recorded a surplus of USD 80.05 million. This was a result of increases in official capital, due to large inflows of remittances from Nepalese workers employed abroad. Accordingly, the gross foreign exchange reserve of the banking sector reached USD 1.76247 billion, enough to finance 11.8 months of merchandise imports.

In FY 2004/05, Nepal's exports totaled USD 821.84 million and imports totaled USD 2.00 billion. Carpets and garments constituted the vast majority of Nepal's

officially recorded exports and are mostly exported to Germany and the United States, respectively. India accounts for 61.28 percent of Nepal's total trade. During FY 2004/05, exports to India grew 28.17 percent. However, exports to third countries, which had declined marginally by 1.73 percent in FY 2003/04, declined further by 15.73 percent in FY 2004/05. The decline in exports to third countries is primarily due to the decline in exports of readymade garments and jewelry, while the increase in exports to India is the result of fewer procedural restrictions imposed on certain items by the Indian government following the March 2002 Indo-Nepal trade treaty. Due to the 7.08 percent import growth and 9.32 percent growth in exports, the trade gap in FY 2004/05 increased by 5.6 percent as compared to an increase of 4.07 percent in FY 2003/04. The U.S. is the second largest market for Nepalese exports. Imports to Nepal from the U.S. are low as compared to those from other countries. In FY 2004/05, out of total imports of USD 2.00 billion, only 1.2 percent came from the U.S. However, imports from the U.S. increased by 23.06 percent in FY 2004/05 as compared to FY 2003/04.

## The Central Role of Economic Freedom in Democracy

By Ian Vásquez

*"Economic freedom allows for independent sources of wealth that serve both to counterbalance political power and to nourish a pluralistic society," says author Ian Vásquez. In this article, he presents evidence that in countries with the freest economies, citizens also enjoy comparatively high standards of living, and he discusses the interplay between the rule of law and economic freedom. Vásquez is the director of the Project on Global Economic Liberty at the Cato Institute in Washington, D.C., and a term member of the Council on Foreign Relations.*

Of the cherished liberties of a free society—economic, political, and civil—economic freedom holds a special place. It is not only an end in itself; economic freedom gives sustenance to the other freedoms. When personal choice, voluntary exchange, and the protection of private property are not secure, it is difficult to imagine how political freedom or civil liberties can meaningfully be exercised.

In 1962, Nobel laureate in economics

Milton Friedman observed:

History speaks with a single voice on the relation between political freedom and a free market. I know of no example in time or place of a society that has been marked by a large measure of political freedom, and that has not also used something comparable to a free market to organize the bulk of economic activity.

The collapse of central planning in Third World countries and of socialism itself in the past 20 years seems to support Friedman's thesis. The rise in economic freedom has accompanied that of political and civil freedom around the world, and both have been significant as countries have moved away from authoritarianism and opened their markets.

### ECONOMIC FREEDOM

Economic freedom is a desirable end unto itself because it generally expands the

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Nepal has had fourteen governments in the last 15 years. On February 1, 2005, King Gyanendra dismissed the coalition government. Under the chairmanship of the King, the new government laid down its priorities for maintaining peace and security in the country. Under the state of emergency declared following the royal takeover, the King had suspended most fundamental rights. Although the state of emergency was lifted on April 29, 2005, direct rule of the King still continues. Protests by the political parties against direct rule by the constitutional monarch

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## Doing Business in Nepal

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are intensifying, and the political situation is getting increasingly volatile.

The ten year-old Maoist insurgency and the Maoist use of terror negatively affect the market environment.

### Market Challenges

Nepal is a land-locked state, which makes market access a challenge. Surface transport into and out of Nepal is severely constrained. There is only one reliable road route from India to the Kathmandu Valley. The only practical seaport for entry of goods bound for Nepal is Calcutta in India, about 650 miles from the border.

A foreign company must either be registered in Nepal as a foreign investor, under the Foreign Investment and Technology Transfer Act of 1992, or have a permit to import and export commodities and services.

High customs tariffs imposed on most manufactured products increase the price of U.S. products in the Nepalese market. The ongoing Maoist insurgency adversely affects the market in Nepal.

### Market Opportunities

Nepal's overall potential as a market for U.S. exports is modest. Best prospect sectors for U.S. product sales include tele-

communications equipment, computers and peripheral equipment, water resources equipment, and aircraft parts. U.S. computers and peripheral equipment and telecommunications equipment are highly competitive in the local market. Best prospect sectors for U.S. investment are hydropower and civil aviation infrastructure building.

Prospects in hydropower include the 750 megawatt West Seti Project, which is being developed by an Australian consortium, and projects at the Pancheshwore and Karnali-Chisapani sites. Nepal expects to add approximately 2,537 megawatts to its generating capacity over the next decade.

A number of major projects are underway that hold potential for U.S. business. In its Medium Term Expenditure Framework for FY 2005/06, Nepal Telecom plans to spend approximately USD 100 million on expansion of telecom services. In the Civil Aviation sector, the Ministry of Culture, Tourism, and Civil Aviation (MOCTCA) Nepal plans to build a number of airports and invite global tenders from interested foreign investors.

Business opportunities exist within the ongoing NTC Telecommunication Development Project (2002-07) for equipment sales. Additionally, foreign investment opportunities are available through the MOCTA planned airport building projects.

## Market Entry Strategy

Relationship-building in Nepal is essential to conducting business. For large-scale business ventures, investors or suppliers are encouraged to visit. To access the Nepali market, foreign companies generally should use local representatives and agents. Supplying government projects offers opportunities for large volume sales, but requires an authorized local representative or agent.

The U.S. Embassy Commercial Section provides agent/distributor services for U.S. companies to assist in selecting a reliable partner. Requests for these paid services are normally routed through U. S. Export Assistance Centers, available through the U.S. Department of Commerce (<http://www.buyusa.gov/home/us.html>).

Country Commercial Guides can be ordered in hard copy or on diskette from the National Technical Information Service (NTIS) at 1-800-553-NTIS. U.S. exporters seeking general export information and assistance and country-specific commercial information should consult with their nearest Export Assistance Center of the U.S. Department of Commerce's Trade Information Center at (800) USA-TRADE, or go to <http://www.export.gov> or <http://www.tradeinfo.doc.gov>. ■

*Source: U.S. Commercial Service Nepal*

## Small Business Takes Leadership Role in Russian Regions

Business associations in Russia are successfully tackling the country's economic problems and working with local governments to improve the business climate. Amid recent attacks on economic freedoms and the host of other challenges that Russia continues to face, Regional Business Agendas - local business led initiatives are a bright spot, improving everyday life for business people and creating a foundation for sustained economic growth.

On February 18, 2005, Russian and American NGOs and business associations from across Russia gathered in Moscow to discuss the interim results of a four-year initiative, sponsored by CIPF and the U.S. Agency for International Development (USAID) to improve the small and medium sized enterprise (SMF) business environment in several Russian regions.

Two years ago, CIPF teamed with Chamber of Commerce and Industry of the Russian Federation (RCCI) and the Russian Union of Business Associations (known as OPORA) to provide technical assistance and support to business association coalitions in eight diverse Russian regions. Today, these coalitions are successfully working to identify local business barriers faced by their members and are organizing targeted advocacy campaigns to push regional governments to implement reforms. By putting the focus on finding local solutions to local problems, regional business leaders are successfully uniting in coalitions comprised of chambers of commerce, business service groups, and independent associations to identify barriers to business growth and to push local governments on reform priorities.

While speaking at the event, Sergey

Katyrin, Vice President of the Russian Chamber of Commerce and Industry, noted that "We are seeing positive trends in the development of SMEs in Russia. Since the first seminar for business executives organized here by CIPF 10 years ago, Russian business has applied many features of the American business model."

Regional Business Agendas are a vital tool for the business community to identify and coalesce around key economic issues and pursue policy changes through private sector advocacy. This approach is improving the public perception of the business community and scoring several victories in its drive to improve day-to-day business life, including simplification and reduction of tax barriers, improvements in property leasing policies, simplified and faster business registration procedures, improved access to credit and improved access to state contracting opportunities. ■

*Source: Centre for International Private Enterprise (CIPE), No 26 fall 2005.*

# Win-Win Solutions

***ADB and the World Bank are encouraging Central Asian countries to optimize water and energy resources through a new power trade system, but traditional “zero-sum” attitudes remain a barrier***

By Ian Gill, (igill@adb.org)  
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## GULISTAN, TAJIKISTAN

In a village not far from Tajikistan's principal hydropower facility, the Nurek reservoir, a widow with 10 children says she has electricity for only 4 hours a day, even in the bitterly cold winters.

“In summer it is fine, but in winter, it is too difficult. What can we do with 4 hours of power?” asks Sogigul Ragabova in the village of Khusnobod. “There is no heat and the houses are cold; everywhere is cold. Because there is not enough electricity, the workshops where we sew are closed; we cannot clean the school because the water is so cold, and the kindergartens are not open.”

It is a sad irony that mountainous Tajikistan is rich in hydropower resources but the majority of its impoverished population has little electricity.

On the larger canvas of Central Asia, the irony runs deeper. Between them, the five Central Asian countries have more than enough water and fuel for their requirements and could earn much-needed revenue by exporting hydropower, natural gas, crude oil, and coal—if they could get their act together.

With their glaciers, Tajikistan and the Kyrgyz Republic have the snowmelt to produce hydropower as well as to feed Central Asia's two major rivers, the Syr Darya and Amu Darya. For their part, low-lying Kazakhstan, Turkmenistan, and Uzbekistan have abundant fossil fuels, notably oil, coal, and gas.

In the Soviet era, these complementary resources were harnessed to irrigate vast cotton- and wheat-growing regions and to produce electricity downriver. The Soviets also established a very high-voltage power grid linking the Central Asian republics.

In return for irrigation water in summer, the downstream countries provided the upstream countries with coal and gas on a barter basis for heating in winter.

“For all intents and purposes, everyone was happy,” says Simon Kenny, the World Bank's regional program coordinator in Almaty. “But as soon as the Soviet system collapsed, that trade cooperation system fell apart.”

Since independence, understandably, national interests have prevailed. For example, the Kyrgyz Republic, not content with the compensation it receives for irrigation water, prefers to operate its Totogul reservoir in the power mode to maximize electricity generation in winter. The same holds true for Tajikistan and its Nurek reservoir.

The downstream countries are unhappy either because they do not get enough water for their crops in summer, or they get flooded when the upstream countries release water for electricity in winter.

Both the World Bank and Asian Development Bank (ADB) are trying to help countries reach a new power trading agreement.

ADB has been supporting a bilateral agreement between Tajikistan and Uzbekistan by encouraging win-win scenarios. For example, both sides would gain if Uzbekistan bought more hydropower from Tajikistan in summer and provided Tajikistan with enough income to buy gasfired electricity from Uzbekistan in winter. As an inducement to reach agreement, ADB is offering to finance repairs to the power grid's aging infrastructure, including the dispatch center in Tashkent.

However, issues of pricing and control of the load dispatcher have been held up as sticking points in protracted negotiations.

Outside observers, however, say that political factors might be more of a barrier than technical issues. “There is a deeply embedded socialist idea that regional relations are a zero-sum game and that a gain for one country entails a loss to another,” says one analyst. “There is resistance to the idea that a country might benefit from regional cooperation by ceding any of its national interests.”

Such prejudice notwithstanding, “The case for more cooperation is that a power trade agreement between Tajikistan and Uzbekistan would encourage others to form a regional market,” says Xavier Humbert, an ADB energy specialist. “Increased power trade would also bring long-term savings to businesses and

consumers. Also, a fairer and more transparent operation of power systems in Central Asia would attract outside investment in new hydropower capacity and enable the Kyrgyz Republic and Tajikistan to export hydropower.”

An obstacle to monetizing the costs and benefits involved is the widely held view that water is a natural resource that should be free. The Kyrgyz Republic and Tajikistan do not argue with this, but claim they should be compensated for the storage costs in operating and maintaining their reservoirs.

Here, too, are different views. World Bank estimates that while the Kyrgyz Republic incurred \$35 million to operate the Totogul reservoir in an irrigation mode in 2001, it was compensated with only \$29 million worth of coal and gas by the downstream countries.

Or, from another view, the Kyrgyz say that while it cost them \$35 million to operate Totogul in an irrigation mode, Uzbekistan and Kazakhstan gained \$69 million in agricultural produce with the extra water. The Kyrgyz wonder aloud if they should not get a share of that benefit.

A new power agreement remains elusive for the time being, but Mr. Kenny takes the long view.

“We are not looking at resolving regional cooperation issues overnight,” he says. “We have to be patient and find ways of selling a lot of these options as win-win situations, not as ‘you win, we lose’ situations.”

One win-win scenario would be if the Kyrgyz Republic and Tajikistan could develop their hydropower potential and export to Afghanistan, Iran, Pakistan, and Russia through the existing or a new transmission system. Earning more revenue would give them less reason to release water in winter. For Uzbekistan, too, an expanded regional power trading system would provide cheaper electricity, enabling it to export gas at international prices rather than use it to fuel expensive thermal plants.

Meanwhile, rehabilitating the power grid, along with institutional improvements, is estimated to raise available generation by as much as 30% in Tajikistan— providing electricity for longer periods for long-suffering consumers.

Such news would be welcome indeed to impoverished villagers such as Ms. Ragabova and her family. ■

*Source: ADB REVIEW, October 2005*



## The Central Role of Economic Freedom in Democracy

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range of choice of the individual, both as a consumer and as a producer. The larger role of economic freedom in society, however, is often under-appreciated, including by those who believe in political pluralism; human rights; and freedom of association, religion, and speech.

Yet the decentralization of economic decision-making supports civil society by creating the space in which organizations of all kinds can exist without depending on the state. A nation in which there is economic freedom is one in which the private sector can fund the institutions of civil society. Thus genuinely independent churches, opposition political parties, and a diversity of businesses and media are more likely to exist where economic power is not concentrated in the hands of bureaucrats or politicians.

By definition, economic liberalization implies a loss of full political control over the citizenry. That is something that authoritarian governments around the world have been finding out in the current era of globalization. Dictatorships have given way to democracies in countries that began liberalizing their markets as early as the 1960s and 1970s, including South Korea, Taiwan, Chile, and Indonesia. With the election of President Vicente Fox in 2000, Mexico's market liberalization in the 1990s helped end more than 70 years of the PRI's (Institutional Revolutionary Party's) one-party rule, once referred to by Peruvian novelist Mario Vargas Llosa as "the perfect dictatorship."

Economic freedom allows for independent sources of wealth to counterbalance political power and to nourish a pluralistic society. When the state owns or exerts undue control over banking, credit, telecommunications, or newsprint, for example, it controls not only economic activity, but expression as well. It has taken the world far too long to recognize the truth in the statement of early 20th-century writer Hilaire Belloc that "the control of the production of wealth is the control of human life itself."

Thus the dilemma that China's Communist Party currently faces is familiar. To maintain social stability, China must continue the economic liberalization that has fueled more than two decades of high growth. But market reforms have given hundreds of millions of Chinese greater independence from the state and have

created an emerging middle class that increasingly demands political freedom and representation. The party wishes to maintain political power, but economic liberalization is undermining that goal, while ending liberalization would reduce growth and cause instability.

As in the case of China and countless other nations, economic freedom encourages political pluralism by promoting the growth that produces a middle class and citizens less dependent on the state. Empirical evidence supports that relationship.

The most comprehensive empirical study on the relationship between a country's economic policies and institutions and a country's level of prosperity is the Canadian Fraser Institute's *Economic Freedom of the World* report. It looks at 38 components of economic freedom, ranging from the size of government to the rule of law to monetary and trade policy, in 127 countries over a period of more than 30 years. The study finds a strong relationship between economic freedom and prosperity. The freest economies have an average per capita income of \$25,062 compared with \$2,409 in the least free countries. Free economies also grow faster than less free economies. Per capita growth in the past 10 years was 2.5 percent in the most free countries, while it was 0.6 percent in the least free countries.

The Fraser study also found that economic freedom is strongly related to poverty reduction and other indicators of progress. The United Nations' Human Poverty Index is negatively correlated with the Fraser index of economic freedom. The income level of the poorest 10 percent of the population in the most economically free countries is \$6,451 compared to \$1,185 in the least free countries. People living in the top 20 percent of countries in terms of economic freedom, moreover, tend to live about 25 years longer than people in the bottom 20 percent. Lower infant mortality, higher literacy rates, lower corruption, and greater access to safe drinking water are also associated with increases in economic liberty. The UN's Human Development Index correlates positively with greater economic freedom. Significantly, so too does Freedom House's index of political and civil liberties: Countries with more economic freedom tend to have more of the other freedoms as well.

Self-sustaining growth has, in fact, long depended on an environment that encourages free enterprise and the protection of private property. The West's

escape from mass poverty in the 1800s occurred in such an environment, which in turn initiated the era of modern economic growth. Even before then, the emergence of a commercial class of farmers in England led to its representation in Parliament, where in the 17th century it successfully limited arbitrary confiscations of wealth by the crown—in short, the rise of commercial farmers helped establish constitutional monarchy. Credible limitations on the power of government enhanced property rights and the rule of law, major factors in the rise of Great Britain as the world's preeminent economic and political power. As Great Britain grew wealthier, of course, it became a democracy.

More recent evidence supports the idea that growth and higher levels of income lead to, or at least help sustain, democracy. Political scientists Adam Przeworski and Fernando Limongi studied 135 countries between 1950 and 1990 and found that "per capita income is a good predictor of the stability of democracies." For example, they found that in countries with a per capita income below \$1,000 (in 1985 PPP dollars), democracies could on average expect to survive eight years. (PPP stands for purchasing power parity, a theory that states that exchange rates between currencies are in equilibrium when their purchasing power is the same in each of the two countries.) When incomes ranged between \$1,001 and \$2,000, the probability of democratic survival was 18 years. Those democracies in countries with incomes above \$6,055 could expect to last forever.

Economic freedom produces growth but does not always lead to democracy. Hong Kong and Singapore, among the world's freest economies, are notable examples. Nor is wealth alone always a product of economic freedom, as attested to by some resource-rich countries with relatively high incomes but where economic power is tightly controlled by the state; as expected, civil and political liberties are also severely limited in those countries. The central role of economic freedom in democracy, however, is clear. It can be a powerful force in promoting democracy, and a good measure of economic freedom is necessary to sustain political freedom.

## LIBERAL DEMOCRACY AND THE RULE OF LAW

Democracy is not a synonym of liberty. As we have seen, a democracy that is not accompanied by the other freedoms hardly succeeds in limiting the arbitrary power of political authorities, elected though they

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## The Central Role of Economic Freedom in Democracy

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may be. Thus, much effort is currently being placed on promoting the rule of law—a central component of both liberal democracy and economic freedom.

It is axiomatic that the rule of law is necessary for a well-functioning democracy. Increasingly appreciated is the fact that the rule of law is also necessary for economic development. The *Economic Freedom of the World* report, for example, found that no country with a weak rule of law could sustain a solid rate of growth (more than 1.1 percent) once income per capita rose above \$3,400. In other words, once an economy reaches a certain level of development, improvements in the rule of law are essential to sustaining growth.

It is possible that, unlike tariff reductions or privatizations, the rule of law cannot be directly promoted. It may very well be that the rule of law happens after, or at about the same time that, other things are done right.

I advance a modest proposal. Instead of focusing on directly promoting the rule of law, we should be creating the environment within which the rule of law can evolve. Among other measures, that means promoting market reforms or

economic freedom. For many poor countries, that includes reducing the size of government. The countries that today have a strong rule of law first established that institution and only later increased the size of their governments.

Unfortunately, too many poor countries are today trying to repeat that process in reverse. In countries as diverse as Brazil, Slovakia, the Republic of Congo, and Russia, for example, government spending as a share of gross domestic product exceeds 30 or 40 percent. Attempts to promote the rule of law where governments remain large are bound to fail or be exceedingly difficult. Indeed, although the trend during the past 20 years has been an increase in both economic and political freedom in the world, most countries still have a long way to travel down the path of economic freedom. Russia may have abandoned socialism, but it ranks 115 out of 127 countries in the *Economic Freedom of the World* index.

Author Fareed Zakaria observes, furthermore, that the majority of poor democracies in the world are illiberal democracies—that is, political regimes in which liberties other than the freedom to choose who governs are not well established. He notes that in the West, the liberal constitutional tradition developed first and the transition to democracy developed later. In 1800, for example, only

perhaps the most liberal society in the world at that time. Zakaria further points out that in non-Western nations that have recently made a transition to liberal democracy, such as South Korea and Taiwan, capitalism and the rule of law also came first. That pattern may explain why regions like Latin America that have democratized first and then begun economic liberalization have had an especially challenging time at promoting economic freedom or growth.

Today, countries in Eastern and Central Europe, Latin America, and elsewhere are trying to achieve, with varying degrees of success, both democracy and economic freedom at the same time. In some cases, economic freedom has been rolled back or is no longer a priority, something that augurs poorly for democracy. In other cases, such as Estonia, economic freedom has steadily increased, thus strengthening democracy. Those of us who believe in democratic capitalism—whether we live in rich democracies, poor democracies, or autocratic states—should never lose sight of the central role of economic freedom in achieving a free society.

Ian Vásquez is the director of the Cato Institute's Project on Global Economic Liberty, and a term member, Council on Foreign Relations. ■

Source: *State Department's electronic journal Issues of Democracy, December 2005*

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## China's Business Associations Seek Representative Role

### Growing autonomy promises voice in policy-making

On the invitation of local officials, CIPE has organized workshops in Shanghai and other regions with dozens of these associations senior executives on issues critical to good business association management.

On January 5, CIPE staffers John Callebaut and Mark McCord and association expert Charles Rambarger traveled to the cities of Fuzhou and Quanzhou in Fujian Province to conduct a dialogue with more than 75 industry associations at the municipal and provincial level. As in Shanghai, these voluntary membership groups seek to develop new member services either in return for membership dues or for fees on top of dues as they become more and more financially independent of the government.

Although business associations of various forms have existed in China for many years, it is only in the last few years that they have begun to evolve into organizations representative of private

business interests. Chinese leaders, by implementing constitutional reforms that acknowledge the existence of the private economy and protect—at least on paper—private property rights appear to recognize the need to make government institutions more relevant to a globalizing economy and increasingly worldly citizenry.

Business associations created by the state to monitor and encourage adherence to official policies are becoming more independent in cities all over China, a process led by local initiative and not by directives from Beijing.

Although economics, not politics, is propelling this process, the political implications are unmistakable.

China's industry associations have expressed concern about how to function as independent organizations and how to skillfully manage the transition away from government control. In Fuzhou, Callebaut likened this transition to a new home buyer taking residence before the former

homeowners had departed and pointed out that such a situation was certain to present problems in defining authority and jurisdiction, at least in this short term. The associations agreed and suggested that a follow up CIPE program in Fuzhou should include successful models of association government relations, particularly those from other transition economics.

Private business in China have begun to recognize the value of associations as an efficient means of representing their interests, a development that will likely bring the leadership and management of business associations in China closer to those in Western market economics. In this way economic reforms in China and the evolutionary development of private business associations have become mutually reinforcing processes. ■

Source: *Centre for International Private Enterprise (CIPE), No 26 fall 2005.*

# Accepting Responsibility: Moving Beyond Political and Economic Dependence in Post Conflict Bosnia and Herzegovina

By Sanja Omanovic

## Recognizing Corruption at All Levels

Unfortunately, another heavy burden for the Bosnian economy is widespread corruption. In a Transparency International report released in October 2004, BiH was positioned between 82nd and 85th place on the global corruption perception index, out of 146 ranked countries. The report also stated that, "Institutions which rule just formally, together with the international community, which is the real ruler in BiH, should finally say that the reform process has failed, that BiH is plunging into disaster, and that unfortunately corruption, together with local mafia, is ruling this country. Everything else is just turning a blind eye."

Transparency International's representatives in BiH also say that it is necessary to make drastic changes, since the corruption perception index confirms their findings that local institutions are not self-sustaining and that corruption levels are high. Transparency International also claims that there is some cooperation between organized crime and the ruling elites in BiH, with no exit strategy developed for the predominant international community. "The elites who benefit from the corruption in BiH are not only local ones", warns Transparency International in its new report.

Besides making economic reforms, it is crucial for BiH to develop a comprehensive anticorruption strategy along with a strong, independent judiciary system.

## Opening the Public and Private Sector Dialogue

There are some specific characteristics to BiH as a political-economic entity. With heavy involvement from the international community in all political, social and economic structures in the country, the overall recovery of Bosnia and Herzegovina has depended and continues to depend on three key players: local

community, and the international community. Up until now, the international community has been leading all initiatives, with support provided by local governments. The local business community, however, has mainly been an observer in the process, absorbing the consequences of all political and economic decisions, beneficial or not.

From a cynical perspective, Bosnian governments at all levels are mainly concerned with fulfilling the international community's requests, due to their influential power, while putting aside needs of the citizens in general, including those of the local business community. For this reason, when it comes to designing policies, there are often just two players: local governments and the international community. The voice of the local business community is barely heard. The situation is even worse because there are simply too many governments in BiH: a state government, two entities' governments, the government of Brčko District (a specially designed area in the north of the country with its own independent institutions), plus 10 cantonal governments (in the BiH Federation entity). All of these governments can create their own policies, which are not necessarily coordinated. BiH's private sector is similarly divided, and requests often have to be dispersed to different governments and administrative levels. Additional layers of confusion are introduced from the international community when positions among countries and organizations differ and they advocate for their own interests.

To compound the problem, there are few channels for communication between the public and private sector, making it nearly impossible for the priority issues of the local business community to reach governments' agendas. Representatives of the private sector are rarely given the opportunity to influence policy, and efforts to change this have not always been successful. The Bulldozer project, an idea

from the Office of High Representative (OHR), was designed to overcome a visible gap in communication between the business community and local governments.

Along with a loud promotional campaign, BiH business people were asked to list their most urgent needs in order to better run their businesses. Participation from the business community was enormous in Bulldozer Phase 1. Organized into regional committees, they presented their demands to the respective governments and international institutions that participated in the project including OHR, the World Bank, IMF, USAID, and the European Commission. The business community was led to believe that if governments did not adopt their proposed changes, the OHR would impose them. However, not all of the proposals were accepted both by local governments and international institutions.

The main objection to Phase 1 was that no major issue was tackled, and only cosmetic changes were made. One local business community proposal was to introduce a temporary moratorium on log exports. Since there is a huge black market for log exports, local wood processors do not get enough raw materials, though they have the capacity to produce final products. The proposal that Bulldozer actually accepted was a temporary moratorium on cherry and nut tree logs. The business community viewed this and similar solutions as unnecessary compromises influenced by many factors, including international interests. For this reason, the enthusiasm of the local business community has waned, and although Phase 3 is under way, no one expects spectacular results since the proposals that have been adopted do not reflect the real issues affecting businesses in BiH on a daily basis.

## Business Associations and Informal Coalitions

One positive outcome, though, is that governments and international organizations have started to recognize that

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## Accepting Responsibility: Moving Beyond Political and ...

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further economic development in BiH requires active involvement of the local business community. But the business community itself needs to build the tools it needs to effectively influence policy. An essential device for facilitating communication between the private and public sector is local business associations, which can represent the voice of business both for particular industrial branches and for the broader business community.

There are a significant number of business associations in BiH, ranging from chambers of commerce to independent voluntary associations, but they are acting independently of each other and are not strong enough due to low membership or weak internal structure. Representatives of business associations complain that local governments do not have time to listen to or adopt their members' suggestions, regardless of the potential positive impact to business. Business association members tend to leave advocacy in the hands of associations, considering it a paid service.

Though business associations existed, there were problems in perceiving how an association could do more in the field of advocacy than one particular company could, and that a coalition of associations could achieve more than one single association. Progress has been made, though, and business associations have evolved with help from CIPE's two-year program, funded by USAID, that has focused on strengthening business associations in BiH, so that they are capable of representing the business community in policy dialogues with governments.

A tremendous achievement that provides direction for the future is the creation of several informal coalitions. Initially coming together to organize joint public campaigns, ultimately, business associations should aim to reflect the needs of an entire industry rather than just the specific needs of one association's members. It is vital that these informal coalitions are composed of both independent associations and chambers of commerce. Crossing over regional and ethnic barriers, the voice of business is unique when it comes to

common issues – a fact even more important in a country like BiH.

These coalitions, regardless of their unofficial nature, have brought about a significant change in the business community's communication with the government. Thanks to the power of numbers, business associations and their members have realized that the private sector has a legitimate right to demand reforms and changes from governments, and that it is no longer necessary to use any other, informal means of communication with executive authorities or legislators.

The power of associations, gathered behind the unified voice of business can not, and will not be ignored anymore. These initial successes serve as a stimulus for additional progress in the right direction. Coalition building is still at an early stage in BiH, and it will take additional time for governments to accept business associations as real partners, but when it happens will depend both on the associations and their members. Through continued hard work and clear articulation of demands, governments will be unable to avoid their responsibility to the business community.

However, even the strongest business associations will find it difficult to gain the governments' attention if they are not supported by the broader public. Such support can not be gained without public knowledge about the basis of market economy, including corporate governance. This element – public education on economic issues – may be one of the most crucial elements for further development of the BiH economy. Unfortunately, not enough has been done in this field.

### Conclusion

BiH is currently at a turning point. Whether the country takes decisive steps towards real democracy and economic progress, or sinks into poverty, is dependent on the behavior of local governments and the international community.

Several actions can be taken immediately. For attracting both foreign and local investors, BiH governments at all levels need to work together to develop comprehensive, feasible and realistic policy changes. These might include simplifying the company registration process,

introducing VAT and increasing export taxes, and customs reforms.

The government can also do more to promote business opportunities in BiH. The country still has some competitive advantages that have not been exploited enough: the environment is completely secure, which is rare post-September 11; the labor force is relatively cheap compared to neighboring and other European countries; BiH has natural resources which can be used in making final products (especially wood products). If the BiH government succeeds in reforming policy, and if it launches a promotional campaign afterwards, foreign and local investors would be encouraged to invest in BiH.

Elected governments need to realize that they are responsible for finding solutions to the challenges that are facing BiH. Governments also need to learn how to spend less money on public administration, which would include more efficiently coordinating among bureaucratic layers. The BiH public also needs to realize that it has the right to hold the government accountable for acting in the best interest of its citizens.

This is where the international community can have a decisive impact in the future. Massive international aid has been spent to successfully reconstruct the infrastructure, but it is clear from the Bosnian example that donor help directed mostly towards the infrastructure is simply not enough to rebuild an efficient society and economy in a post-conflict environment. In the shadow of reconstruction efforts, the strengthening of basic principles of democracy has been somewhat neglected and not enough attention has been paid to developing the governance tools necessary for democratic and economic progress. Governments, the business community, and the public in BiH need to be educated on how to provide efficient means for democracy and market economy development.

Future involvement of the international community should include supporting this development with expertise and resources. BiH is in need of basic education programs focused on good governance, government responsibilities, corporate governance, and the involvement of the private sector and

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## Accepting Responsibility: Moving Beyond Political and ...

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the public in policy debates. These debates will not occur without stimulus, and their importance needs to be recognized. And none of the aforementioned objectives can be achieved without active participation of the local people.

Efforts in this direction have already been made, but it has not been sufficient. The public in BiH is aware that it is necessary to put the economic agenda at the forefront, and that political survival of the country in general, could depend on the economy. Having a successful economy would guarantee not only future economic growth, but also basic political stability. It would also make the reconciliation process easier, and nationalistic sentiment generated from poverty and apathy, the surviving tools for nationalistic parties, would lose their attractiveness for the average person. The real issue then, is how to create the critical mass needed for pushing an economic agenda to the forefront - and the resolution can be found through involvement of the local business community with support from broader public.

Since the strength of the private sector is necessary for successful transition to a market economy, the private sector needs to advocate for changes and economic reforms. As the European Stability Initiative (ESI) described in its report on BiH, some groups in the society having never received any assistance from the socialist authorities, do not expect it now and are not organized in interest groups to advocate for programs and policies they need. In democratic societies these interest groups play a very important role in supervising government actions and providing ideas and feedback necessary for proper governance. The message has to be sent to the BiH citizens through media and civic society that they need to become much more active in advocating for changes.

There is no doubt that BiH is faced with immense political, economic, and social challenges on its way to European integration. No one expects things to improve overnight - it will take time, patience, and money to create the proper environment for a market economy and functional state. It is encouraging that there

are so many people in BiH ready to do whatever it takes to make a better future for themselves and their country. Success will be marked in Bosnia and Herzegovina when the governments no longer rely on international organizations to make decisions for them, and once the governments, local business community, and citizens are completely responsible for the future of the country.

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