

## EUROPE AND EURASIA

### DEVELOPMENT CHALLENGE

#### *The Foreign Policy Context*

The United States seeks cooperative relations with Europe and Eurasia (E&E) countries<sup>1</sup> in fighting international terrorism, opening markets, and tackling cross-border issues such as the spread of HIV/AIDS and trafficking in persons. Regional stability in Southeast Europe and the Eurasia sub-regions remain one of the underlying principles of USAID engagement in this part of the world.

The Central Asian Republics and the Caucasus countries are U.S. allies in the global war on terrorism and, as such, will continue to receive significant resources in FY 2004 to promote domestic stability, economic growth, and democracy. Bolstering the independence and transition of all Eurasian countries is also based on the premise that a prosperous and stable neighborhood will reinforce Russia's growing relationship to the Euro-Atlantic community and improve U.S. economic opportunity in that part of the world, including commercial access to oil and gas reserves.

The European transition countries are preparing for membership in regional institutions such as the North Atlantic Treaty Organization (NATO). Three countries (Hungary, Poland, and the Czech Republic) gained entry to NATO in 1999. Seven more (Bulgaria, Estonia, Latvia, Lithuania, Romania, Slovakia, Slovenia) are poised to enter by the end of 2004. The European countries are also working toward meeting the requisite criteria for accession to the European Union, in part with USAID assistance.

Foreign policy priorities are influencing USAID's funding levels and role in the region. Continued progress in reforms in some of the Southeast Europe countries will permit significant cuts over the next several years. As the U.S. Government leaves this sub-region, it will look increasingly to the Europeans to support the integration of Southeast Europe into regional institutions. In Eurasia, funding has increased for the Central Asian Republics, partially as a result of their support for the war on terror. Levels for Russia will decline as the U.S.-Russian partnership in global matters continues to mature and economic assistance becomes less central to Russian and U.S. objectives. The high levels allocated to Ukraine during the 1990s will continue to decrease as a result of disappointing political developments in that country and in preparation for eventual closeout.

#### *Transition Status and Obstacles*

Extraordinary changes have occurred since the post-communist transition to market democracy began in 1989. Region-wide, the private sector now accounts for 62% of Gross Domestic Product (GDP) and Freedom House ranks 12 of the 27 former authoritarian states as free and 9 as partly free. Since 2000, the region has recorded positive economic growth, despite a downturn in the global economy.

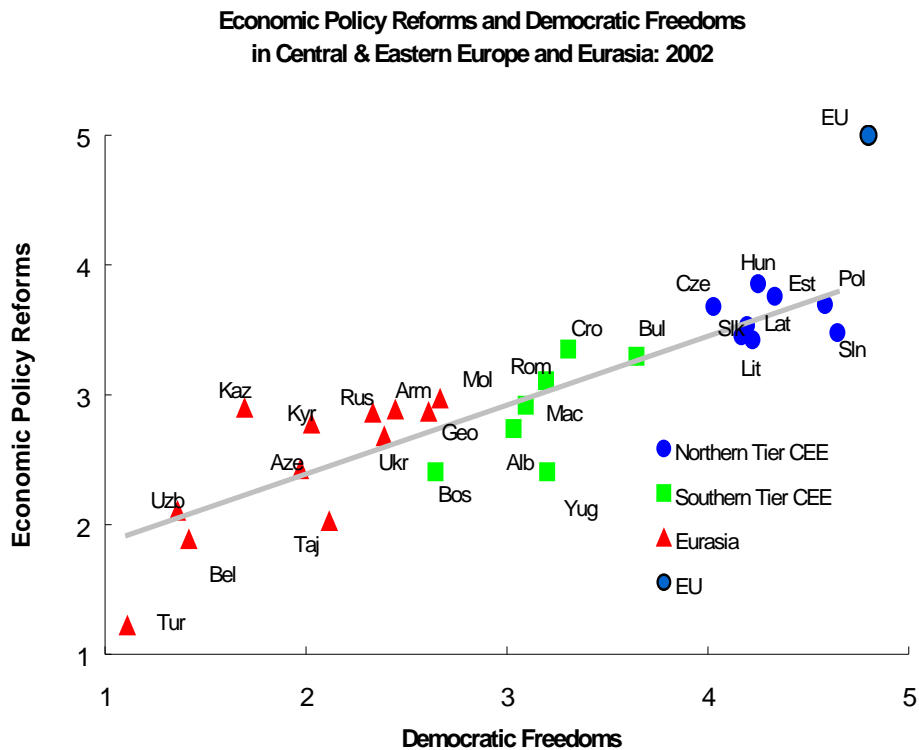
Nevertheless, progress across the region has been uneven. The following graph compares the advancement of E&E countries in democratic and economic reforms. The northern tier countries are the transition leaders. They are integrating into international markets and organizations and

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<sup>1</sup> The transition countries of Europe are in two geographical zones. The northern tier includes Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia, and Slovakia. Southeast Europe includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Romania, Serbia and Montenegro, and the Province of Kosovo. The transition countries of Eurasia include the Russian Federation; Ukraine, Belarus, and Moldova; the Caucasus countries of Armenia, Azerbaijan, and Georgia; and the Central Asian Republics of Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan. USAID also provides economic support assistance to Ireland, Cyprus, and Turkey.

no longer require USAID bilateral assistance, although they still face challenges related to EU accession.

In Southeast Europe, reconstruction of war torn areas is near completion following a decade of ethnic violence. With some exceptions, these countries now appear to be following the transition path charted by the northern tier, although they are well behind the reform targets achieved by the northern tier countries when they graduated from USAID assistance. Weak labor markets in general, combined with large youth populations and poor human capital in select countries, pose special challenges. Corruption remains an issue across the sub-region. Frozen, but unresolved ethnic clashes could easily re-emerge without mechanisms for inter-ethnic understanding and cooperation, particularly given the scheduled decline in donor assistance to these countries.



Ratings of democratic freedoms are from Freedom House, Nations in Transit 2002 (2002) which cover events through December 2001 and are updated through 2002 by Freedom House, Freedom in the World 2002 (December 2002). Economic policy reform ratings are from EBRD, Transition Report 2002 (November 2002), and cover events through September 2002. Ratings are based on a 1 to 5 scale, with 5 representing most advanced.

In Eurasia, the picture is more complex. While economic growth for the sub-region has been positive, social conditions are dismal and trends in democratic freedoms are unfavorable. Despite policy reform progress in some of the largest economies (such as Russia, Azerbaijan, Kazakhstan) income inequality is increasing and long-term growth does not yet appear sustainable. Eurasian economies are highly dependent on primary commodities and Russia dominates the economic links within the sub-region. Depletion in human capital is a major concern given the decades-long deterioration of health and education systems. Lackluster reform in several countries has increased their economic and political isolation. With widespread corruption and an incomplete reform process, public trust in government and private institutions continues to deteriorate.

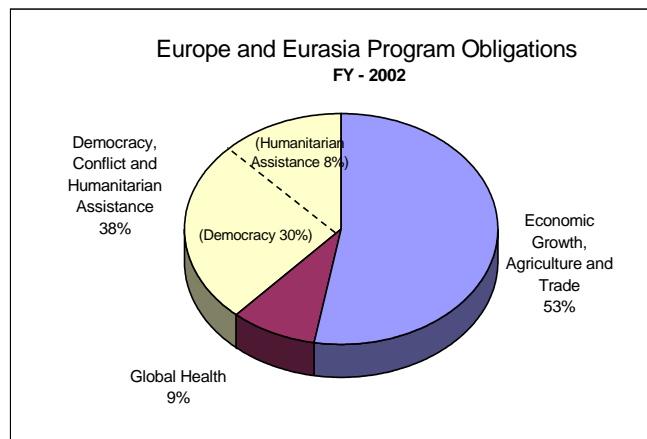
## **E&E Strategy and Linkages to USAID's Four Pillars**

The E&E strategy, both regional and bilateral, focuses on three core areas: economic restructuring and growth, democracy and governance, and the social dimensions of transition. In addition, USAID develops cross-sector approaches to address critical obstacles and changing circumstances in the region. During FY 2003 – FY 2004, these include: raising the profile of values inherent in transition programs; systematically addressing conflict and corruption in program analysis and design; and further developing social sector initiatives to broaden the benefits of reform and thereby sustain public support for it.

To be successful, reform efforts must be grounded in essential values. Such values require citizens to exercise civic and moral responsibility and to demand protection of inalienable human rights. When embraced, these values insist on an equitable and fair market economy, and help overcome the irrational passions, hatred, and bitterness which ignite and fuel conflict. With eight Muslim-dominated countries in the region and strong Muslim minorities in several other countries, USAID will promote opportunities to positively engage Islam and bridge the growing divide between Islamic and Western society. Successful economic and political reforms will help eliminate fertile soil for Islamic radicalism, as will dialogue which makes clear that the Islamic traditions in Central Asia and the Balkans are not consistent with political and radical Islam. The E&E strategy also provides an integrated approach to combating corruption, looking at the key elements of transparency, accountability, awareness, prevention, and enforcement across the program portfolio.

**Economic Growth, Agriculture and Trade:** About 53% of USAID E&E resources were targeted to economic and related reforms during FY 2002. The program's focus is on the development of

market systems, and performance in this area is strong. Fifteen of the 27 countries have achieved full membership in the World Trade Organization. In addition, per capita foreign investment flows have improved overall, although they have been 10 times higher in the European northern tier than in Eurasia. Land reform continues to make a significant contribution to agricultural development in the E&E region and agribusiness development is becoming more prominent in countries possessing a comparative advantage in agriculture.



An emerging theme in the economic growth area is increased competitiveness, in which macroeconomic reforms and microeconomic foundations for business growth are pragmatically developed and linked to local markets. The economic rubric also includes activities related to anti-corruption and business ethics as well as programs aimed at mitigating the adverse impacts of transition. These programs include, for example, social insurance reform, employment generation, and education reform.

**Democracy, Conflict Prevention and Humanitarian Assistance:** About 38% of USAID resources to the region were allocated to this pillar during FY 2002. The E&E strategy focuses on the development of full democracies rooted in the rule of law and based on elections, constitutionalism, a vibrant civic culture, guaranteed human rights, religious freedom, independent and responsible press, and limited government responding to the will of the people. USAID integrates conflict prevention modules into strategies for at-risk countries, such as Macedonia, Georgia, and the republics of Central Asia.

**Global Health:** In FY 2002, about 9% of USAID resources were allocated to health priorities in the region, including HIV/AIDS, infectious disease control, and maternal-child health. According to UN statistics, the steepest rise in new HIV infections worldwide took place in the former Soviet Union, most of it linked to intravenous drug use. The introduction of community-based, primary health care practices has upgraded the clinical skills of family physicians, achieved cost-efficiencies, saved lives, and reduced the number of abortions.

**Public-private Alliances:** Currently, public-private alliances operating in the region include Enterprise Funds, the American International Health Alliance, the Baltic American Partnership Fund, the Balkan Children and Youth Foundation, and a new initiative with the German Marshall Fund to support democracy and governance in Southeast Europe. Building on these experiences, USAID will continue to develop new ways to engage present and potential partners.

### ***External Debt***

Trends in external debt have varied widely in the transition region. Overall levels, while increasing, remain below those found in most developing countries. Total debt was roughly 142% of exports in the transition region in 2001; in the developing countries in 2000, it was 173%. Some transition countries have successfully reduced debt burdens, including Yugoslavia, Russia, and Ukraine in 2001. Nevertheless, external debt remains an issue even for some of the more advanced transition countries. Four of the ten European countries exceeded the Maastricht debt ceiling of 60% of GDP in 2001: Bulgaria (76%); Latvia (71%); Hungary (69%); and Estonia (61%). Of greatest concern, however, are high debt burdens of five relatively poor Eurasian countries: Kyrgyzstan; Georgia; Tajikistan; Armenia; and Moldova. Kyrgyzstan's debt burden is highest (2001 external debt is 288% of exports; debt service is 29% of exports). Debt service is also high in Tajikistan (22%) and Moldova (20%). Total external debt as a percent of exports in Georgia and Armenia is close to levels in Kyrgyzstan.

## **PROGRAM AND MANAGEMENT CHALLENGES**

In light of shifting foreign policy goals and funding trends, USAID must find ways to maximize the impact of the E&E program while systematically planning for graduation and closeout of targeted bilateral programs. In Southeast Europe, Croatia and Bulgaria are on a glide path for graduation and, in Eurasia, strategies for the graduation in several years of Russia and Ukraine will be developed and implemented. Of greatest concern is the slow pace of democratization in Eurasia. In fully functioning democracies, citizens will demand and work on the changes needed to expand economic opportunity and well-being. Where democratic processes and institutions remain fragile, reversals in the transition process are possible.

Lower resource levels in FY 2004 and beyond require considerable adjustments to USAID's regional and bilateral transition programs. Given the need to accelerate reform progress in Eurasia, especially on the democracy front, USAID will develop strategies to preserve reform gains as well as promote continuing progress toward broad-based economic growth, democratic culture, and good governance. The need for innovative post-presence initiatives will be explored for countries targeted for graduation or closeout, in order to safeguard the U.S. assistance investment already made. These initiatives may include wrap-up activities that complete work already underway, legacy mechanisms (such as endowments, local institutions, etc.) that can carry assistance into the future without relying on a local USAID mission, and instruments for humanitarian relief in event of emergencies.

Funding increases in Central Asia pose a different challenge. There USAID is managing a greater magnitude of assistance resources with limited staff who manage activities in five countries. The program challenge is to continue pressing for progress in democracy and human rights within the context of high budget levels resulting from their cooperation in the war on terror.

## **OTHER DONORS**

Principal partners include the European Union's programs for technical assistance to transition countries in Europe (PHARE) and Eurasia (TACIS), the World Bank, European Bank for Reconstruction and Development (EBRD), European bilateral donors, and Japan. Based on the latest available information for official development assistance, the United States stands out as the largest bilateral donor in Eurasia, followed by Japan and Germany. USAID also collaborates with the Asian Development Bank on activities in the Central Asian Republics. In Europe, the European Union is the largest donor, with a contribution about three times that of the United States. The U.S. has been the single largest bilateral donor to Europe countries, followed by Germany, France, Austria, and the Netherlands. In 2003, policy dialogue with European donors and the European Union regarding assistance to Southeast Europe will be a foreign policy priority for the U.S. Government.

## **FY 2004 PROGRAM**

The FREEDOM Support Act (FSA) request level for Eurasia totals \$576 million to fund programs of USAID and other agencies supporting economic and democratic transition and the war on terrorism. This represents a reduction of nearly 10% from FY 2003, after accounting for the separate FY 2004 appropriation for Economic and Cultural Affairs under the U.S. Department of State.

The Assistance for Eastern Europe and the Baltic States Act (AEEB) request level totals \$435 million, a reduction of 12% from FY 2003.

Under the Agency's Economic Growth, Agriculture and Trade area, USAID proposes \$157.3 million under AEEB and \$311.4 million under FSA to foster the emergence of competitive, market-oriented economies in which the majority of economic resources is privately owned and managed. USAID programs will emphasize competitiveness, assistance to small and medium enterprises, agribusiness development, anti-corruption initiatives, and social reform. Energy and environment programs are also included under this rubric. In addition, \$200 million in Economic Support Funds (ESF) is proposed to Turkey for debt servicing in support of its economic recovery.

Under the Agency's Democracy, Conflict and Humanitarian Assistance area, USAID proposes \$262.9 million in AEEB funds and \$197.7 million under FSA to support transparent and accountable governance, the rule of law, and the empowerment of citizens through democratic political processes, civil society, freedom of information, and human rights. Funds will also promote inter-ethnic dialogue and cooperation, and, as needed, facilitate the transition from emergency relief to more traditional development programs in times of crisis. USAID proposes \$12.5 million in ESF for Ireland and \$7.5 million in ESF for Cyprus to promote reconciliation and conflict resolution.

Under the Agency's Global Health area, USAID proposes \$14.9 million in AEEB funds and \$66.9 million under FSA to fight the spread of infectious diseases, including HIV/AIDS and tuberculosis, and improve primary health care practice, with a special focus on mothers and children.

Proposed AEEB and FSA funding under the economic growth and democracy and conflict prevention areas include other USG agencies participating in technical cooperation programs through inter-agency transfers from USAID, such as the Environmental Protection Agency and the Departments of State, Justice, Energy, Treasury, Agriculture, and Commerce.

The E&E bureau is requesting \$10.4 million in non-emergency P.L. 480 funds in the FY 2004 request year for Tajikistan.

