

Europe and Eurasia

DEVELOPMENT CHALLENGE

The Foreign Policy Context

The United States has significant national interests in the Europe & Eurasia (E&E) region. Countering authoritarianism and economic stagnation, which provide fuel for domestic unrest, religious extremism, and international terrorism, is key to protecting American interests. In the aftermath of September 11, Central Asia and the Caucasus have become front line states in the war against terrorism. The Caspian region's tremendous oil and gas resources add to its importance to the United States; the proven oil reserves of just two states in the Caspian Sea Basin (Kazakhstan and Azerbaijan) are just slightly less than those of the United States. The internecine warfare accompanying the collapse of the former Socialist Federal Republic of Yugoslavia in the 1990s not only caused humanitarian catastrophes but also threatened the peaceful democratic and economic transitions in neighboring post-communist states. While marked progress has been made since the United States and its NATO allies intervened with military, diplomatic, humanitarian, and technical assistance, ethnic and nationalistic tensions combined with ongoing economic hardship and soaring unemployment continue to drive instability. The United States has broad trade relationships with the region; U.S. exports totaled almost \$7 billion in 2002 with direct investment adding to no less than \$3.3 billion in that same year. Extremism threatens to destabilize several areas within the E&E region; USAID must work to encourage political pluralism and unfettered access to the choice of religious affiliation as an effective buffer against the appeal of Islamic extremism. Finally, America's most important geopolitical and security interest in the region is its relationship with Russia. Given Russia's vast size, resources, and weapons stockpile, neither its neighbors nor we are secure if it is unstable. Russia holds one-third the world's proven natural gas reserves and was the world's second largest exporter of oil in year 2000.

Transition Status and Obstacles

Since USAID's work in the E&E region began over a decade and a half ago, extraordinary progress has been registered, particularly in the democracy/governance and economic growth assistance areas. Notable achievements include: a) the re-emergence of positive economic growth since 2000 after years of contraction; b) Freedom House's ranking of 21 of the former communist states as free or partly free with a return to communism unlikely in most countries; and c) the significant integration of the states into regional and global organizations such as the World Trade Organization, the European Union (EU), and the North Atlantic Treaty Organization. Performance has been sufficiently good that USAID's E&E Bureau no longer has bilateral programs for the eight Northern Tier Central and East European countries, allowing the closure of the five Missions that once serviced them.

While the eight Northern Tier countries have graduated, USAID has much unfinished business in the remainder of the region, especially in Eurasia. Both Eurasia and Southeast Europe have yet to regain income levels achieved prior to the fall of the Berlin Wall. In 2003, gross domestic product (GDP) in Southeast Europe averaged 10% below 1989 levels, and, in Eurasia, it averaged 30% below.

It is true that, with the exception of Kosovo, the seven Southeast European countries can now be classified as "middle income." Progress has been sufficiently good that graduation dates have been established for Bulgaria, Croatia, and Romania; FY 2006 will be the last year of bilateral assistance for Eastern Europe and the Baltic States (AEEB) funding for Bulgaria and Croatia with funding not to extend beyond FY 2007 for Romania.

Yet, Southeast Europe continues to be plagued by instability from ethnic conflict and the disintegration of former Yugoslavia. In particular, unemployment looms large as an issue in Southeast Europe where rates on average exceeded 20% in 2002, including a most consequential 41% in Bosnia-Herzegovina. Within Southeast Europe, economic progress in the western Balkan countries remains fragile due to large macro-economic imbalances (fiscal and current account deficits averaged more than 10% of GDP in

2002) and weak global integration (small export sectors and little foreign direct investment). And, despite registering increases in life expectancy since 1989, social safety nets have deteriorated, especially in the war-affected countries of the Western Balkans, producing a lack of protection for the unemployed, retired, and vulnerable.

In Eurasia, only three countries have achieved “middle-income” status, notably Belarus, Kazakhstan, and Russia. Eurasian countries encounter considerable difficulties penetrating global markets owing to the lack of competitiveness of their economies. The region is characterized by considerable underemployment; many workers in the region have low-paying jobs in the informal sector. Several Eurasian countries (Belarus, Tajikistan, Turkmenistan, and Uzbekistan) have very poor economic policy environments. Since the collapse of the Soviet Union, democratic freedoms have stagnated in most of Eurasia, and the gap between Southeast Europe and Eurasia in building democracies continues to widen. In 2004, three Eurasian countries, including Russia, evidenced backsliding with Turkmenistan sharing the global distinction with seven other countries of possessing the worst record in democracy. Finally, an alarming pattern of decline is occurring in social indicators in Eurasia, including falling life expectancies together with the largest gender differences in life expectancy worldwide, fast growing HIV rates, a soaring tuberculosis (TB) epidemic, high infant and child mortality rates, continued high rates of abortion and maternal morbidity, significant heart disease, and declining secondary school enrollment shares.

USAID-State Strategic Plan and the E&E Strategy

The E&E Bureau's assistance program is encompassed in three subject areas under the strategic goal “Advance Sustainable Development and Global Interests” of the joint State/USAID Strategic Plan covering the period 2004-2009 that makes operational the U.S. National Security Strategy. These subject areas include: a) economic prosperity and security; b) democracy and human rights; and c) social and environmental issues. While the E&E Bureau has a number of countries that the USAID White Paper would categorize as fragile or geo-strategic, the lion's share of E&E's work is transformational development in nature, encompassed by these three subject areas. In addition, USAID programs in the E&E region advance the joint strategy's subject areas of regional stability, humanitarian response, and public diplomacy.

Economic Prosperity and Security: In FY 2004, roughly 33% of all AEEB and FREEDOM Support Act (FSA) resources were targeted to programs in the economic transition area, including: a) the installation of a facilitative business environment that would assist in the establishment of competitive industries; b) trade and investment promotion with the aim of penetration of overseas markets; c) small and medium-size enterprise (SME) development, the provision of business development services, and the stimulation of agriculture; and d) the restructuring and rationalization of both financial and energy sectors. Most first stage economic reforms (liberalization of domestic prices, trade, and foreign exchange regimes and small-scale privatization) have been accomplished. Already, with USAID's help, the share of the economy controlled by the private sector has increased very impressively in nearly all E&E countries, producing vibrant and more inclusive private sectors especially in Southeast Europe. SMEs also are increasingly serving as engines of growth, enhancing productivity, creating jobs, providing incomes for an emerging “middle” class, and spear-heading integration into regional and global economic systems. In energy, USAID is making headway in providing for transparency in management (Georgia), and a number of its Southeast European recipients are now participating in regional electricity and gas markets integrated with Western Europe. And, finally, USAID has made sufficient progress to allow the termination of its work in the economic transition in six E&E countries over the next five years - Bulgaria, Croatia, Kazakhstan, Romania, Russia, and Ukraine.

Democracy and Human Rights: Democracy and human rights programs received 32% of AEEB and FSA resources in FY 2004. Southeast European countries are making good progress. They have independent media outlets that provide citizens with objective information and analysis they need to make decisions and engage in public and policy issues. They also have established viable, independent civil societies providing venues for citizens to join together to advocate for their interests. However, there is still work to be done on electoral, local governance, and rule of law issues. The state of democracy in Eurasia is much more fragile. In addition to deficiencies in the media and civil society areas, in Eurasia,

free and fair elections contested by political parties espousing a plurality of viewpoints and respecting the rules of democratic processes must be held; human rights must be protected and civil liberties guaranteed; and citizens must have a say in how they are governed at the local level. Recent efforts by civic activists to instill transparency in elections in Georgia and Ukraine provide optimism that the will of the people will be increasingly respected, notwithstanding the worsening situation for civic activists in Central Asia.

Social and Environmental Issues: Roughly 13% of FY 2004 AEEB and FSA funds went for work supporting social transition - health and education. Infant mortality rates are coming down across the region, owing, in part, to the E&E Bureau's aggressive programs to address the causes of infant and child morbidity. In addition, education expenditures are rebounding, slowly increasing in a majority of E&E countries. Moreover, USAID's ambitious and multi-faceted programs in economic growth are having an impact on social indicators within the region; poverty rates are declining and real wages are on the increase. Yet, progress is anything but uniform in the region. On the one hand, Southeast European countries are experiencing an improvement in social indicators; e.g., life expectancy is rising, averaging between 72 and 74 years in 2002. On the other hand, social indicators are deteriorating in Eurasia. A health crisis is unfolding in the sub-region attributed to the rapid spread of infectious diseases (HIV/AIDS, multi-drug resistant TB) combined with lifestyle behaviors and resultant diseases. A crisis also has emerged in Eurasia in education where secondary school enrollment shares have declined from 60% - 70% in 1989 to 45% - 55% in 2002. In response, USAID is continuing its secondary education program in Central Asia.

Cross-Cutting Programs: E&E is pursuing programs in cross-cutting areas, including values and social capital, corruption, trafficking in persons (TIP), and conflict.

-- Social capital refers to the prevalent mindset that results in voluntary compliance with established laws, trust, and cooperative behavior. The evidence shows that social capital has deteriorated significantly in the E&E region since the transition began a decade and a half ago. The E&E Bureau, where feasible, is seeking to incorporate a values and social enhancement dimension in existing programs.

-- Corruption is endemic to much of the region. Sixteen E&E countries score five or higher on a Freedom House scale where "7" represents the worst level. The E&E Bureau approach to corruption promotes transparency, accountability, prevention, enforcement, and education.

-- With as many as 25% of trafficking victims worldwide emanating from the E&E region, TIP is a problem within the E&E region. In addressing TIP, USAID focuses on prevention via economic empowerment, public education, capacity-building of public institutions, and legal reform, and direct support to victims through assistance for government- and NGO-sponsored referral services and protection of witnesses.

-- Bloody conflict has ensued in the wake of the collapse of the Soviet Bloc; over 300,000 people alone lost their lives over 1991-95 in the violence associated with the break-up of Yugoslavia. To address conflict, USAID integrates conflict mitigation efforts within its work in each of the three transition areas (economic, democratic, and social).

External Debt: While external debt levels and burdens vary widely in the transition region, they generally remain manageable in most countries. The countries of greatest concern are five relatively poor Eurasian countries where the debt service burden (annual debt service as a percent of annual exports) remains very high. These proportions in 2003, though lower than those in 2002, are estimated to be 263% in the Kyrgyz Republic, 172% in Moldova, 162% in Georgia, 121% in Armenia, and 115% in Tajikistan. Total debt as a percent of GDP, another indicator of the debt burden, is highest in the Kyrgyz Republic: 121% of GDP in 2003. Some concerns also exist for Northern Tier and Southeast European countries as they integrate into the EU. Latvia, Estonia, and Bulgaria all have debt levels that exceed the Maastricht debt ceiling of 60% of GDP, including respectively 83%, 71%, and 66% for 2003.

PROGRAM AND MANAGEMENT CHALLENGES

A number of programmatic challenges emerge for the E&E Bureau. One, most Eurasian countries have no more democratic freedoms than in 1991, when the Soviet Union collapsed. USAID's efforts have planted fertile seeds (e.g., Georgia, Ukraine), but the pull of the authoritarian past remains strong in

Russia, the Central Asian Republics, and Belarus. Two, missions in Bulgaria, Croatia, and Romania will be closing in the near future. Ensuring that sustainable, lasting legacies are in place prior to close-out will pose challenges. Three, while USAID is spending a greater proportional share of our declining budget on the HIV/AIDS scourge, the spread of this disease has only slowed. The impact of HIV/AIDS in Russia, for example, could unleash internal and regional instability. Four, unemployment is very high in Southeast Europe with a high of 70% among Macedonian youth. This lack of economic opportunity is fertile soil for extremism.

On the management side, USAID's Regional Service Center in Budapest will be closing in FY 2008; compensating for the losses of its services as a regional platform for Southeast Europe will not be easy.

DONOR FLOWS

Donor flows to AEEB and FSA recipients totaled \$8.1 billion in 2003, having peaked at \$9.2 billion the year before (these data consist of net disbursements of official development assistance from all donors, including the United States). The United States is by far the most significant donor for Eurasian recipients, outpacing by a large margin Japan, the EU, the World Bank's soft loan window "International Development Association (IDA)" and Germany. For Southeast Europe, the EU is the largest donor, contributing more than twice the amount of that of the United States Government. EU programs include technical assistance to transition countries in Europe (PHARE) as well as Eurasia (TACIS). While trailing far behind, IDA is the next most important multilateral donor. Following the United States, which is the single largest bilateral donor to Southeast Europe, are Germany, France, Japan, Greece, Switzerland, and the Netherlands.

FY 2006 PROGRAM

The FSA FY 2006 request level for Eurasia totals \$482 million to fund USAID and other USG agencies' programs in the economic, democratic, social, and security transition areas. The FY 2006 FSA request level is approximately a 13% decrease from the FY 2005 level. The FY 2006 AEEB request level is \$382 million, a decrease of a little less than 3% from the FY 2005 level.

Proposed FSA and AEEB funding includes monies for other USG agencies that manage technical cooperation activities using inter-agency transfers from USAID. These other agencies consist of the Department of State (democracy programs, law enforcement & police training, exchange programs, and support for the International Commission for Missing Persons), Treasury (fiscal affairs advisors), United States Department of Agriculture (agricultural marketing assistance), Energy (nuclear reactor safety), Department of Homeland Security (customs and border protection), and National Science Foundation (support for the Civilian Research and Development Foundation).

In addition, the FY 2006 request includes \$42 million in Economic Support Funds. As a front line state in the war against terrorism, Turkey will benefit from \$10 million for activities, including: a) support for a World Bank pre-natal care and education activity; b) an International Office of Migration anti-trafficking activity; and c) a business partnering program implemented through the American Chamber of Commerce. In addition, \$20 million is requested for Cyprus and \$12 million for the Republic of Ireland and Northern Ireland, both allocations supporting reconciliation and conflict resolution amongst warring factions. The Cyprus monies also will fund partnership activities for economic growth and a scholarship program.

Under the Economic Prosperity and Security assistance area, broad-based economic growth will be supported at FY 2006 request levels of \$133 million in FSA monies and \$114 million in AEEB allocations. Focus areas will consist of SME development, agricultural stimulation, second stage reforms emphasizing building market-based institutional capacity and better public governance, elimination of "red tape," financial sector restructuring, property rights adjudication, and energy sector rationalization. Promotion of competitiveness will take center stage because USAID believes that it is key to the generation of meaningful employment opportunities.

Levels of \$127 million in FSA monies and \$140 million in AEEB funds in FY 2006 are requested for the Democracy and Human Rights goal area. Traditional democratic transition themes such as municipal governance, rule of law, independent media, civil society, political party development, and elections, not to mention anti-corruption, will be pursued. These resources will encourage additional advances in Southeast Europe and help stem the backsliding in Eurasia.

To address Social and Environmental Issues, \$74 million in FSA and \$28 million in AEEB resources are requested in FY 2006. In health, these funds would emphasize reproductive health where there are high abortion rates and low contraceptive rates, implement child survival and maternal health interventions, target HIV/AIDS and TB funds where infection rates for these diseases are highest, take on health systems and administration where there is commitment to reform, and pursue innovative efforts to combat the enormous deleterious effects of non-communicable disease. In education, secondary education will take top rung, followed by vocational education, general university education, and university-level business management education. Other issues to be addressed include targeted social assistance and safety net programs, pension reform, labor market reforms, and rent-seeking in the delivery of social services.

Finally, the FY 2006 request for the humanitarian assistance goal area includes \$19 million in FSA monies and \$458,000 in AEEB resources. These allocations will support an array of activities, consisting of assistance for minority returnees, community-based care for the elderly, help for conflict-affected communities, micro-credit and small business development, health services, and soup kitchens, among others.