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Introduction

Chairman Allen and other distinguished members of the Committee on Foreign Relations, thank you for the opportunity to testify on U.S. foreign assistance programs in the countries of Europe and Eurasia.

It has been over 14 years since this Committee authored the Support for East European Democracy (SEED) Act of 1989. Not long after the U.S. Agency for International Development (USAID) and other U.S. agencies began operating in central and eastern Europe, the Soviet Union collapsed. This Committee responded by passing the Freedom for Russia and Emerging Eurasian Democracies and Open Markets (FREEDOM) Support Act (FSA) of 1992. From the very beginning of the transition, USAID has been the main Federal agency managing programs to promote democracy, to introduce and institutionalize a market economy, and to alleviate the social and humanitarian problems in the former communist states of Europe and Eurasia.

I am happy to report that tremendous progress has been made since 1989, especially in central and eastern Europe. Yet great challenges remain, especially in those states that endured longer periods of communism, centuries of authoritarian rule, or recent civil wars. Peace, prosperity, and regional stability are the underlying objectives of USAID engagement in this part of the world.

The specific challenges that most concern our assistance programs in certain countries, as detailed later in this report, include declining quality of democracy and governance, increasing prevalence of HIV/AIDS and other infectious diseases, excessively high unemployment levels, continuing corruption in both public and private institutions, and trafficking in persons. Also, we appreciate Congress's support in providing the Agency with our full operating expense request and new program authorities enabling us to increase staff and capacity.

The Geopolitical and Security Context

During the second half of the twentieth century, the main threat to the United States emanated from Central Europe and the Soviet Union. Congress understood the geopolitical and security importance of the region when it first authorized foreign assistance to the region more than a decade ago. The world has changed dramatically, but the Europe and Eurasia (E&E) region continues to be of geopolitical importance. The United States has many new allies. Czech Republic, Hungary, and Poland have joined the North Atlantic Treaty Organization (NATO). Bulgaria, Estonia, Latvia, Lithuania, Romania, Slovakia, and Slovenia expect to join NATO this year.

The 1990s were marked by the internecine warfare accompanying the collapse of the former Socialist Federal Republic of Yugoslavia. These events not only caused humanitarian catastrophes, but threatened the peaceful democratic and economic transitions in neighboring post-communist states. The United States and its NATO allies intervened with military, diplomatic, humanitarian, and technical assistance to protect human rights, establish peace, and lay the foundation for sustainable democracies and open market economies. While marked progress has been made since the Milosevic era of the 1990s, ethnic and nationalist tensions continue and the area remains an important geopolitical and security concern to the United States.

Since the September 11, 2001 attacks on the United States, the geopolitical and security importance of the post-Soviet states of Central Asia and the Caucasus has increased dramatically. Countering authoritarianism and economic stagnation, which provide the fuel for domestic unrest, religious extremism, and international terrorism, is a key to protecting U.S. interests in the region. Central Asia's tremendous oil and gas resources add to its importance to the United States. The proven oil reserves of just two states on the Caspian Sea basin, Kazakhstan and Azerbaijan, are just slightly less than those of the United States. Also, Kazakhstan's Kashgan field is one of the most important petroleum finds in 30 years.¹

In the Southern Caucasus, the area's significant oil reserves, its unresolved ethnic and nationalist conflicts, as well as the threat of international terrorism underscore those states' geopolitical and security importance to the United States. An uneasy stalemate over Nagorno-Karabakh exists between Armenia and Azerbaijan. In Georgia, separatist movements in Abkhazia, South Ossetia threaten the integrity of the state internally, while the conflict in the neighboring Russian Republic of Chechnya threatens Georgia externally. Both Azerbaijan and Georgia provide the route for the planned Baku-Tbilisi-Ceyhan pipeline that will bring the region's vast oil and gas resources to world markets.

Trade with and investment in the E&E region are certain to benefit the United States increasingly, as recognized by the Committee on Foreign Relations when it wrote the FREEDOM Support Act soon after the collapse of the Soviet Union.² From the natural resources sector to the industrial equipment sector to the service sector and beyond, the United States is broadening its trade relationships with the region. U.S. exports to the region totaled almost \$7 billion in 2002 with direct investment adding to no less than \$2 billion in that same year. USAID's work to combat corruption, introduce and promote enforcement of contract and other commercial laws, help E&E countries join the World Trade Organization, and lay the foundation of a private sector have helped pave the way for American trade and investment.

¹ *National Energy Policy*, pp. 8-12, Report of the National Energy Policy Development Group, GPO: May 2001.

² Section 101(7) of the FREEDOM Support Act (P.L. 102-511).

Ethnic, religious, and political extremism are major sources of instability in several areas within the E&E region. The role of Islam, in particular, must be monitored, but at the same time it is vital that the leaders of the region democratize and respect human rights in order to avoid adding fuel to the fire for any kind of extremism.

Finally, America's most important geopolitical and security interest in the region is its relationship with Russia. The world's largest nation in area controls thousands of nuclear warheads and, despite its problems, fields one of the largest conventional militaries in the world. Russia is also an energy powerhouse. In 2000, it was the world's second largest exporter of oil. It also holds one-third of the world's proven natural gas reserves.³

Strategic Guidance

Our work in the E&E region is integrated with U.S. foreign policy as set forth in several key documents: the President's National Security Strategy⁴, the Joint State Department/USAID Strategic Plan⁵, and USAID's discussion paper entitled "U.S. Foreign Aid: Meeting the Challenges of the Twenty-first Century."⁶

The National Security Strategy integrates defense, diplomacy, and development into one overall foreign policy strategy. The E&E Bureau is working towards five of the eight objectives identified by the President's plan. We are *championing aspirations for human dignity* by promoting human rights and democracy throughout the E&E region. Our efforts in private sector development are *helping to ignite a new era of global economic growth through free markets and free trade*. Our health care and social sector programs *expand the circle of development by opening societies and building the infrastructure of democracy*. We *work with others to defuse regional conflicts* in the Balkans, the Caucasus, Cyprus, and Northern Ireland. Finally, USAID is adopting exciting new public-private sector business models such as the Global Development Alliance to leverage new resources to meet U.S. foreign policy objectives and *transform America's national security institutions to meet the challenges and opportunities of the twenty-first century*.

We in USAID's Bureau for Europe and Eurasia (E&E) are heartened by the adoption of the Joint State Department/USAID Strategic Plan, which was created to harmonize State Department and USAID policies and actions, consistent with the National Security Strategy. Our Bureau has long had an excellent and very close working relationship with the State Department's Office of the Coordinator for Assistance to Europe and Eurasia. We are glad that the Agency and the Department have now moved towards a level of cooperation that has been the hallmark of the E&E Bureau's relationship with the Coordinator's Office ever since the Bureau and Coordinator's Office came into existence.

³ *National Energy Policy*, pp. 8-12, Report of the National Energy Policy Development Group, GPO: May 2001.

⁴ *The National Security Strategy of the United States of America*, The White House, September 2002.

⁵ *Security, Democracy, Prosperity. Department of State/USAID Strategic Plan for Fiscal Years 2004 to 2009: Aligning Diplomacy and Development Assistance*, August 2003.

⁶ *U.S. Foreign Aid: Meeting the Challenges of the Twenty-first Century*, USAID, January 2004.

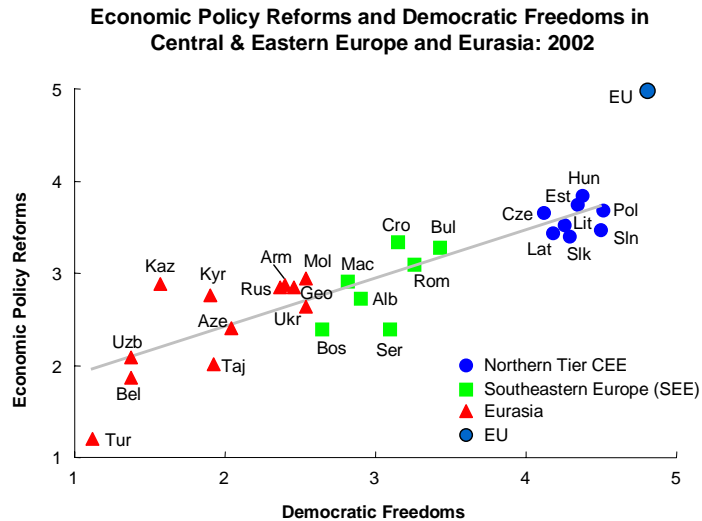
The Joint Strategic Plan outlines 12 strategic goals for the Department and the Agency. E&E Bureau programs promote 9 of those goals. Throughout the region, one of the E&E Bureau's key strategic assistance areas is the establishment of *democracy and human rights*. Another key strategic assistance area is the creation of *economic prosperity and security*. Our Bureau also has a major emphasis on *social and environmental issues* to safeguard and bolster gains in other sectors. We promote *regional stability* through our conflict reduction work--most of which is at the grassroots level--in the Balkans, the Caucasus, Central Asia, Cyprus, and Northern Ireland. The E&E Bureau works on *counterterrorism* by diminishing the underlying conditions linked to terrorism—such as weak institutions and neglected social systems—and by emphasizing accountable, legitimate, and democratic government. We minimize the impact of *international crime and illegal drugs* through our work to promote the rule of law, transparent financial systems that inhibit money laundering, and anticorruption regimes. In the unfortunate cases when it has been necessary, we have provided *humanitarian responses* due to crises in the Balkans, the Caucasus, and elsewhere. Through public outreach in Mission-level strategy development as well as training and exchange programs, our Agency has been involved in *public diplomacy and public affairs*. Our Bureau is strongly committed to *management and organizational excellence*. For example, it has provided the Agency with models of information technology innovation in the financial management field and continues to have one of the Agency's most efficient staff-to-program dollar ratios.

In light of the evolving nature of U.S. assistance in a rapidly changing global context, the USAID discussion paper suggests that we must increase aid effectiveness and policy coherence through greater clarity of purpose, alignment of resources with objectives, and strategic management. Our work is consistent with these ends. A fundamental element of our mission is to *promote transformational development*, consisting of sustained democratic, economic, and social change in the E&E region. With our work in the Balkans and the Caucasus, we also *strengthen failed (or recovering) states*. In response to dire conflicts, we have provided *humanitarian relief*. To achieve specific U.S. foreign policy goals, we *support strategic states* such as Cyprus, Ireland, and Turkey. The E&E Bureau also addresses *global and transnational issues* such as the spread of HIV/AIDS, multiple-drug-resistant tuberculosis, trafficking in persons, and environmental degradation.

Over the past several months, the E&E Bureau closely reviewed the larger strategic parameters set in the National Security Strategy, the Joint State/USAID Strategy, and the USAID discussion paper. We then took stock of the E&E region by measuring progress to date and assessing the remaining challenges. As a result of these reviews and analyses, the E&E Bureau drafted a new strategy that will guide our programs over the next four years, based on our mission to assist the transition of Eastern Europe and Eurasia to sustainable democracies and open market economies. For some countries, phase out of USAID assistance is on the horizon owing to their continued success. Yet other country programs are facing entrenched challenges that will be overcome only with hard work, close vigilance, and continued U.S. development assistance.

The Country Performance Context

Several years ago, the E&E Bureau developed a system for monitoring country progress that compiles, tracks, and analyzes independently-produced indicators from a variety of international sources. The chart that immediately follows shows a strong tendency for economic reform to accompany democratic freedom in individual countries. It also highlights the large disparities among E&E countries in progress toward economic and democratic reform as well as their standing vis-à-vis the European Union.



Ratings of democratic freedoms are from Freedom House, *Nations in Transit 2003* (2003) and cover events to 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.

The E&E Bureau classifies the E&E region into six groups of countries to identify the major gaps between performance and exit targets.

The Northern Tier Europe countries (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia) are the most advanced. They have achieved democratic freedoms roughly on par with some Western democracies and are working toward meeting EU economic reform standards. The Northern Tier European countries have considerably more to accomplish in second stage economic reforms, especially in competition policy. (First stage reforms entail the reduction of government intervention and ownership, while second stage reforms focus on the complex task of building market-based institutional capacity and better public governance.) All have graduated from substantial USAID bilateral assistance, but their continued progress is monitored for the lessons it provides for other countries.

The Advanced Southern Tier Europe countries (Bulgaria, Croatia, and Romania) have attained a level of democratic and economic reform equivalent to that attained by the Northern Tier countries when USAID was preparing to phase out its Missions in those countries. Nonetheless, unemployment rates are still very high. These high rates have been accompanied by a significant drop in real wages, still well below the levels of 1989. Macroeconomic stability is fragile, particularly in Croatia and Romania, though perhaps

not much more than in many of the economies in the Northern Tier countries. Inflation continues to be high in Romania, but is falling impressively. Macroeconomic imbalances (fiscal and current account deficits) are high in Croatia, although no higher than the Northern Tier average.

In the Western Balkans (Albania, Bosnia-Herzegovina, Kosovo, Macedonia, and Serbia-Montenegro), unemployment rates are the highest of the transition country groups, particularly among youth, a development only partially mitigated by the large informal economies within these countries. These countries are poorly integrated into the world economy, lacking even intra-regional trade. Macroeconomic imbalances are uniformly high, amongst the highest of all the transition country groups.

The countries classed as Resource-rich Eurasia (Russia, Kazakhstan, and Azerbaijan) particularly lag in measures to fight corruption. All three countries have fewer democratic freedoms today than in 1991. Backsliding in democratization has continued in recent years, particularly in Kazakhstan and Russia. Their private economic sectors continue to be dominated by large firms with significant market power. The major development task for these economies is to broaden economic growth beyond what has occurred in the energy sector. This will be hampered by their poor performance in human capital development, in which the sub-region scored lowest within E&E. Life expectancies in all three countries are among the lowest of all the transition countries. Health and education expenditures remain very low by any standard, while secondary school enrollment rates have declined over the 1989-2001 period from 78 to 70 percent in Russia, 76 to 54 percent in Kazakhstan, and 63 to 33 percent in Azerbaijan.

The countries of the Resource-poor Eurasia sub-region (Armenia, Georgia, Kyrgyz Republic, Moldova, Tajikistan, and Ukraine) have the largest gap between progress in first stage and second stage economic reforms. Sustaining reform gains will be especially difficult unless more progress is made in structural reforms and in building institutional capacities. Export shares are the lowest of all the six country groups (7 percent of GDP in 2001). These countries have neither the strong incentives for reform that EU membership provides to central and eastern European countries, nor the natural resources to sell as do the resource-rich Eurasian countries. Per capita income in this sub-region is the lowest in Europe and Eurasia, as are secondary school enrollment rates, education expenditures, and health expenditures. Among economic reforms, non-bank financial reforms and infrastructure reforms lag the most. Public governance and administration, including anti-corruption measures, also perform very poorly.

Countries in Non-reforming Eurasia (Belarus, Turkmenistan, and Uzbekistan) have not yet come close to completing first stage or second stage economic reforms. Economic structural change lags considerably as illustrated by the small share of the economy controlled by the private sector, only 32 percent. Inflation is much higher in Belarus than elsewhere in E&E, serving as an indicator that structural reform is needed. Secondary school enrollments and health and education expenditures are especially low in Turkmenistan and Uzbekistan, and under-five mortality rates are very high. In contrast, Belarus' human capital indicators are more in line with east European standards.

The Robust Response from USAID

Through FY 2004, Congress appropriated a total of \$16.3 billion in SEED and FSA assistance to the region. USAID has managed about 65 percent of this total with the remainder transferred to other USG agencies for security, nuclear safety, fiscal advisory, and other assistance programs.

In coordination with the State Department's Assistance Coordinator for Europe and Eurasia (EUR/ACE), USAID has played a lead role in planning and implementing assistance programs focused into three goal areas:

- democracy and governance (rule of law, civil society, political processes, independent media, and local governance);
- economic restructuring and growth (privatization, fiscal systems, enterprise development, financial sector, and energy); and
- social transition (humanitarian assistance, health, education, and related social protection issues).

Generally, activities have concentrated on the policy and institutional requirements for reform; the development of grassroots and local organizations such as NGOs, political parties, professional organizations, small and medium private enterprises (SMEs), and municipal government; and the promotion of health reform and other targeted social interventions to mitigate the adverse impacts of change. Humanitarian assistance was provided in the early years, especially in the aftermath of major military conflicts in the Balkans.

President Bush's National Security Strategy, which embraces the development of democracy and market economies as fundamental pillars of U.S. foreign policy, is bearing fruit in Europe and Eurasia. In my testimony last year, I highlighted successes at the macro level including, amongst others, the emergence of positive economic growth in the region, the great strides made in democracy as evidenced by 21 of our recipients ranked as free or partly free by Freedom House, and the impending integration of eight of our recipients into the European Union. Even more impressive may be some of the people-level impacts that USAID programming is helping produce in the countries in which we work.

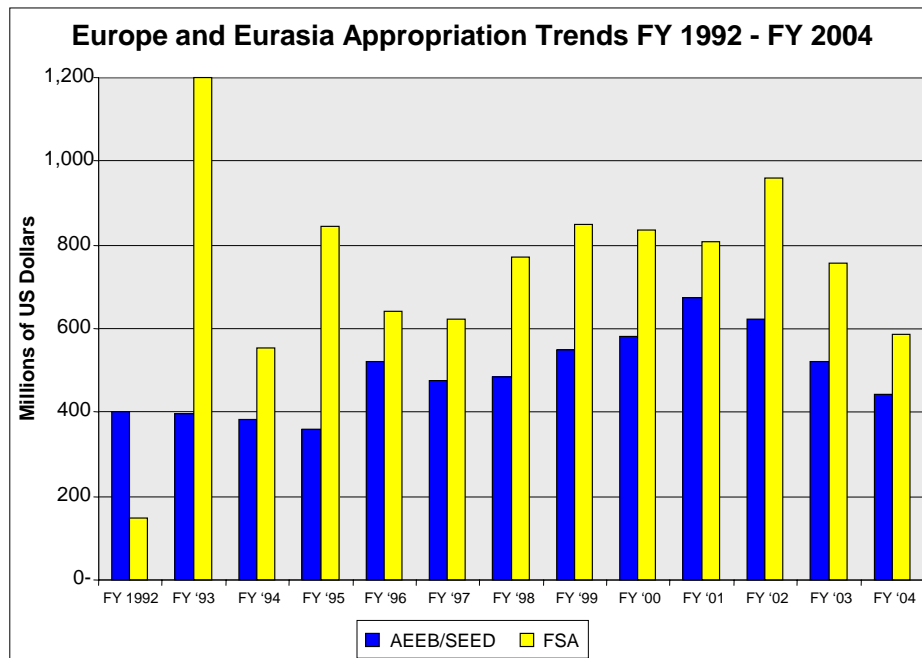
- Owing to our efforts with small and medium enterprises, that sector now employs over 4.3 million people in Ukraine.
- In Russia, a nationwide network of financial institutions that we helped strengthen has made over 114,000 loans with the amount lent doubling over the past year to reach \$129 million. The loans have significantly enabled entrepreneurs to grow their businesses.
- We are helping E&E countries to penetrate markets overseas. In the case of Macedonia, we helped establish a National Entrepreneurship and Competitiveness Council, two clusters that developed action plans to spur exports, and a Quality Control laboratory for meat and dairy processors.

- Our assistance in the areas of observing elections, voter education, monitoring, and exit polling paved the way for the transparent conduct of January's key presidential election in Georgia, a first in recent memory for this strategically-placed country. Also, our assistance with parallel vote tabulation in last November's flawed parliamentary elections was instrumental in proving that the official results did not reflect the will of the people.
- Seventy-six Citizen Information and Service Centers have been established in Bulgaria, enabling local governments to better serve the needs of their constituents.
- In Kazakhstan, 5 percent of intravenous drug users nationwide have already been reached through the deliverance of affordable, high quality condoms and the training of 260 peer educators and 43 teachers. These important developments are helping arrest the spread of HIV/AIDS.
- The Roll Back Malaria program in Tajikistan has established surveillance centers in each of the country's four provinces that provide equipment and training to diagnose the disease that has reached epidemic proportions in a number of our countries.
- In Romania, our program permitted the number of orphans in institutional care to be reduced by 8,550 last year, the closure of 43 institutions providing sub-standard care, and the drafting of legislation to set standards for adoption.

Current Budget Patterns

The FY 2004 appropriation and FY 2005 request levels continue to decline, reflecting the higher priority given to other countries in the world such as Iraq and Afghanistan, the progress that a number of our recipients have made especially on economic policy, and the deferral to the European Union for assistance to some of our SEED recipients.

The SEED appropriation for FY 2004 is \$442 million, of which USAID manages \$314 million (71 percent). For USAID, this constitutes a decline of a little more than 12 percent from \$359 million in FY 2003. Overall SEED levels declined 34 percent from 2001 to 2004 with the portion of these funds used by USAID decreasing 2 percent. In FY 2005, the SEED request totals \$410 million, of which \$271 million (66 percent) is



proposed for USAID programs. The overall USAID level is down almost 14 percent in FY 2005 from a year earlier, reflecting both the overall decline in SEED levels and the decline in the USAID share. SEED levels had peaked in FY 2001 at \$674 million.

SEED levels for all countries or other separately budgeted regions are lower in FY 2005 than they were in FY 2003. The steepest declines will take place in Croatia, Macedonia, and Montenegro. For its part, Croatia is on a glide path toward phase-out, with an end set for SEED assistance of 2006. On the other hand, levels fall off most modestly for Bulgaria from FY 2003 to FY 2005. Bulgaria, the other country in the region for which a phase-out date (2006) has been established, has been unwavering in its support for the war against international terrorism. In addition, while coming down, request levels remain robust in FY 2005 for Bosnia (\$41 million), Kosovo (\$72 million), and Serbia (\$87 million). These countries continue to contend with the aftermath of ethnic upheaval and its pursuant heavy economic and social costs.

The FY 2004 appropriation for FSA is \$584 million, of which USAID manages \$410 million (70 percent). For USAID, this amounts to a fall of more than 12 percent from \$468 million a year earlier. Overall FSA funding levels declined 18 percent from 2001 to 2004⁷ while the portion of these funds used by USAID increased 14 percent. In FY 2005, the FSA request amounts to \$550 million; \$389 million (71 percent of the total) is proposed for USAID programs. The overall USAID level in FY 2005 is down a little more than 5 percent from the year before. More than a decade ago (1993), FSA levels were \$1.2 billion, more than double the FY 2005 request level.

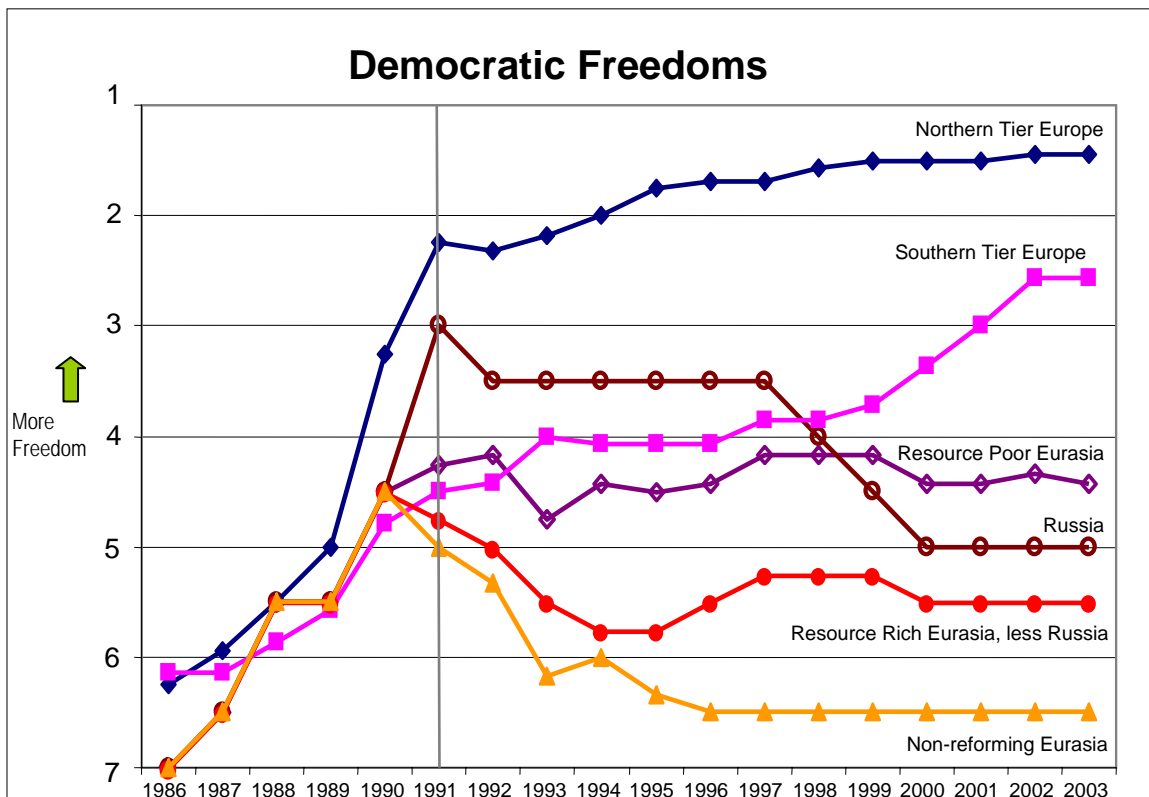
The only FSA country whose request level is substantially higher for FY 2005 than it was in FY 2004 is Georgia, an outcome of American policy to support the new reform government and the transparent manner in which the presidential election was conducted recently. With assistance levels during FY 2003-FY 2005 relatively steady at about \$25 million per annum, Tajikistan is one of the United States' most cooperative development partners in the region. On the other hand, assistance declines are precipitous for Kazakhstan, Russia, and Ukraine. Over the three-year period FY 2003-FY 2005, levels will have come down for Kazakhstan (by 35 percent to \$28 million), Russia (by 45 percent to \$79.5 million), and Ukraine (by 43 percent also to \$79.5 million). We can reduce assistance to Kazakhstan, owing to its massive oil and gas resources. In Russia, development assistance is perceived as less necessary in the economic arena, allowing Russia to be considered a candidate for phase-out in FY 2008. We continue to monitor the situation in Russia closely. Ukraine's leadership is regarded as a weak development partner whose democratic transition, characterized by vested interests, weak political accountability, corruption, unequal enforcement of the rule of law, and tightly controlled media, casts a pall on the country's development prospects. The two countries with the most repressive governments in the region (Belarus and Turkmenistan) are also experiencing reductions in support over FY 2003-2005.

⁷ This figure excludes funding for the ECA office in the State Department which was included in the FSA appropriation in 2001 but not in 2004.

Critical Gaps for Future Assistance

We, however, need more resources than less. Indicators of progress in several areas of assistance that are essential to sustainable transition of countries in the E&E region do not show adequate improvement, and a number of key issues remain to be addressed.

- While there have been improvements in democracy indicators in our Eastern and Central European recipients, most of our Eurasian countries have no more democratic freedoms today than in 1991, notwithstanding the continued development of civil society. In fact, a number of countries have less freedoms, most notably Russia.



Data are from Freedom House, and are an aggregation of Freedom House's political rights and civil liberties indices; Freedom House, *Freedom in the World 2004* (2004 forthcoming and previous editions).

Ratings from 1 to 7, with 1 representing greatest development of political rights/civil liberties.

Resource Poor Eurasia includes Moldova, Ukraine, Armenia, Georgia, Tajikistan, and Kyrgyzstan.

Resource Rich Eurasia, less Russia includes Azerbaijan and Kazakhstan.

Non-reforming Eurasia includes Belarus, Turkmenistan, and Uzbekistan.

- Combating HIV/AIDS must be given particular priority because current programs from all sources have slowed, but not halted, an impending catastrophic epidemic. If infection rates are not further slowed in places like Russia, the impact on the population, health system, budgets, employment pool, and political stability could be grave, and our investments in reforms in these countries may be swept away.
- Widespread unemployment continues to be a problem throughout the entire E&E region. It leaves large populations, particularly among youth, frustrated by their inability to share in the benefits of economic growth and freedom.

- Corruption is recognized as a critical factor, limiting performance towards many E&E goals. Institutional reforms, unless they counter incentives for corruption, will not be sustainable. Corruption affects negatively all E&E goal area work and the lives of citizens in all our countries.
- Trafficking in persons has expanded with the freedom of movement that has accompanied the collapse of strong central governments and has been exacerbated by the economic deterioration and reductions in living standards which have frequently accompanied the transition era. In addition to the extreme suffering and degradation associated with this problem, trafficking undermines the future of regions where it occurs by striking vulnerable youth.

Phase-out of USAID assistance

The U.S. Government always has assumed that assistance to the E&E region would be temporary, lasting only long enough to ensure successful transition to a sustainable democracy and an open market economy. Today, programmatic success and declining resources result in the need to plan for phase-out of our assistance in some countries. Indeed, the E&E Bureau has already exited from eight countries, and phase-out is being planned or is under consideration in a number of others such as Bulgaria, Croatia, and Romania on the SEED side, and Russia and possibly Ukraine on the FSA side. We will monitor closely all transition indicators. If these indicators do not show progress, we are prepared to re-visit exit decisions. A case in point is our serious concern about the democratic transition in Russia. In any event, exit from an individual country need not take place at the same time across all sectors nor all regions. For instance, we may want to stay engaged in the Russian Far East longer than in European Russia.

USAID and the State Coordinator's Office are now undertaking phase-out assessments for all our country recipients in order to begin identifying exit dates and adjusting our strategies to address remaining gaps. In phasing out assistance, an overriding theme is to find ways to decrease the region's vulnerability to conflict and ensure that political and economic instability do not provide a seedbed for terrorist activity and financial networks. Failure to achieve a sustainable transition would leave both the region and its neighbors vulnerable to instability.

Systematic planning for the eventual end of assistance enables USAID to ensure the sustainability of assistance gains in a number of ways. This includes: focusing resources on the most critical vulnerabilities and gaps in a country's transition, determining areas that may need attention after USAID departs, and preparing for an orderly close-out of activities. Building on our experience with the European Northern Tier graduates, USAID is exploring appropriate post-presence initiatives as a way to consolidate assistance gains and carry support for democracy and markets into the future, even after a local USAID mission is closed. Post-presence initiatives consist of American or East-East regional partnerships established with USAID assistance, commercial relationships with the U.S. private sector, diplomatic relationships with other USG agencies, and, where well defined gaps are identified, post-presence programs funded by USAID.

The USAID Program

The strategy adopted by USAID for the E&E region closely follows the approach to foreign assistance described in the Joint State/USAID strategy by focusing on three of its Strategic Goals: economic prosperity and security, democracy and human rights, and social and environmental issues.

Progress in each broad area is monitored systematically for each country that we assist, and individual country programs are tailored to the local needs that correspond with USAID capabilities.

Economic Prosperity and Security: For the majority of E&E countries, the central focus of USAID assistance in this goal area is to assist in the economic reform

process and to establish an environment that promotes growth. Most first stage economic reforms (liberalization of domestic prices and trade and foreign exchange regimes and small-scale privatization) have been accomplished, except in the three non-reforming Eurasian countries (Belarus, Turkmenistan, and Uzbekistan). Therefore, most remaining policy assistance will emphasize second stage reforms that focus on building market-based institutional capacity and better public governance. The six resource-poor Eurasian

Small and Medium Enterprises

Having largely succeeded in installing a solid macroeconomic environment in our recipient countries, USAID is increasingly emphasizing work with small and medium enterprises (SMEs) because they are the engine for economic growth and employment in our recipient countries. For example, our SME program in Ukraine, that combines regulatory reform, business skills, and micro lending, is producing excellent results. The sector now employs over 4.3 million people. The convening of 211 community roundtables and 143 formal hearings paved the way for progressive regulatory change, including the development of one-stop-shops that reduced business registration time from 30 to 14 days and the enactment of a national law on regulatory policy. As a consequence, the number of registered businesses spiked in 2003 to 2,660,000 from 1,793,000 in 1999. Over 11,000 women received business training; of these more than 3,000 started their own businesses. Under the EBRD's micro lending program (to which USAID is the major donor), the total loan portfolio expanded by 15 percent during the fourth quarter of 2003 to \$86.1 million; the program is available in 23 regions and 42 cities in Ukraine.

Credit

Credit is an important emphasis within USAID's SME programs. In Russia, a nationwide network of non-bank financial institutions has made a cumulative total of 114,000 loans with the amount lent doubling over the past year to reach \$129 million. In Bulgaria, the number of active clients under USAID's two micro-finance programs increased by September 2003 to more than 5,400, of which 71 percent were women; these programs helped create more than 2,900 new jobs and sustain close to 16,000 more. The Bosnia-Herzegovina seven-year Business Development Program provided over 600 loans worth \$162 million and created over 15,000 new jobs while sustaining another 27,636 jobs in the post-war environment. The loan program offered concurrently intensive training and technical assistance in areas such as credit analysis, loan collection, and problem bank management. The program, which ended in 2003 when local banks bought the portfolio from USAID, was instrumental in developing international banking standards and practices in Bosnia. In Romania, USAID's lending programs provided over \$8.1 million to the private sector in FY 2003; another \$2.2 million went for mortgage lending. In addition, USAID-assisted credit unions extended services to over 10,900 individuals, mobilizing \$2.5 million in savings and providing \$4.2 million in loans. An important by-product of the work was the creation of Romania's first private residential mortgage company.

countries (Armenia, Georgia, Kyrgyz Republic, Moldova, Tajikistan, and Ukraine) have the farthest to go to reach acceptable standards in these areas, and they are most vulnerable to recidivist policy changes.

We will target SME development particularly in Eurasia since SME sectors in the central and eastern European countries are already much larger than those in Eurasia. About 45 percent of employment in central and eastern European countries comes from SMEs, compared to only 24 percent in the resource-poor Eurasian countries and 10 percent in the resource-rich Eurasian countries (Azerbaijan, Kazakhstan, and Russia). While energy programs are needed throughout the E&E region,

we will emphasize such work in those Eurasian countries where issues such as winter heating could prove destabilizing, e.g., Armenia.

Democracy and Human Rights:

E&E supports the development of democratic institutions, processes, and values within the context of promoting a more equitable distribution of both horizontal and vertical power. Horizontally, power shared among different branches of the national government (executive, legislative, and judicial) ensures transparent and accountable government through a system of checks and balances. Vertically, the devolution of power to local governments and the empowerment of citizens through civil society and political processes keep governments responsive to the needs of people. Enhancing the rule of law, particularly in terms of protecting human rights, controlling corruption, and guaranteeing civil liberties, is an important component of this work and includes ensuring the rights of minority groups and other disadvantaged segments of the population. Progress in fostering a more equitable distribution of power is expected to be incremental and requires a long-term commitment, particularly in the more difficult cases of Eurasia.

Election Monitoring

In Georgia, USAID's funding and support for electoral processes (observations, voter education, monitoring and exit polling) enabled the Georgians to track and prove fraud in the November 2, 2003 Parliamentary elections. This was one factor which contributed to large scale protests resulting in the resignation of the President, appointment of an interim President, and announcement of fresh Presidential elections on January 4, 2004 and Parliamentary elections in March 2004. The Presidential elections subsequently were conducted in a far more transparent fashion than the Parliamentary elections held in November 2003.

Because democratic reforms are stalled or regressing in most Eurasian countries, most areas of assistance in democracy and human rights will be emphasized in that region, including municipal governance, elections, rule of law, independent media, and development of political parties and civil society. Especially important in the near term will be elections assistance in countries of key foreign policy interest to the United States, such as Azerbaijan, Georgia, Russia, Ukraine, and several of the Central Asian countries. The eastern European countries are relatively advanced in civil society and electoral processes, so other forms of democratic and governance assistance, including public administration, rule of law, independent media, and anti-corruption, will receive emphasis.

Trafficking in Persons (TIP) is a global problem that requires a multi-faceted response (its discussion is included here owing to its implications for human rights). The underlying factors that give rise to TIP in the E&E region include economic dislocation, a breakdown in traditional social structures, corruption, the absence or decline in personal values, the rise of international organized crime, disenfranchisement of women and ethnic minorities, regional conflicts, and the demand for legally unprotected, cheap labor in the sex

Civil Society

With USAID assistance, NGOs in Kyrgyzstan undertook a large advocacy campaign in 2003 to allow grants and humanitarian aid to become tax-exempt. They conducted 14 roundtables in all provinces of the Republic, and over 350 people from NGOs, mass media, and state institutions participated in the campaign. In March 2003, the bill amending the Tax Code was signed by the President and became effective, a major success for civil society generally and for our programs more specifically.

Orphans in Romania

USAID is directly confronting the orphan crisis in Romania. During the past year, USAID assistance has contributed directly to: the reduction of the number of children in institutional care by 8,550 (17 percent); the closure of 43 institutions with more than 50 children each that were providing sub-standard care; the creation of over 200 alternative community services; the drafting of legislation to govern standards for adoption; and the implementation of life skills training for youth and child welfare case management procedures to follow up on cases of child abuse and neglect. Also, mayors from all of Romania's 41 counties have been trained in child welfare services. Finally, over \$3 million from businesses and other sources and another \$6 million from governmental programs have been secured to address the needs of disabled children. These partnership programs are now being implemented for the first time through Romanian NGOs.

trade and other illegal venues. Programs in all three of the E&E Bureau's strategic assistance areas address TIP. We address the TIP problem using the framework of prevention, protection, and prosecution. Programs to prevent trafficking include economic empowerment of individuals through SME activities, public education and awareness campaigns, capacity-building of governments, NGOs, and the media to address the problem, and legal reform and implementation. Our programs also help protect victims through support of government and NGO referral services and the establishment of safe houses and counseling services. While the E&E Bureau does not directly work on criminal law

prosecution, it does support reform of the overall legal system, including prosecutors and public defenders.

Social and Environmental Issues: Progress in this goal area requires investing in systems as well as addressing the most urgent problems and diseases. The areas of greatest concern include health, social protection, and human capital. Coordination with programs designed principally to meet other goal areas will be necessary to direct more resources toward reversing the decline in health and other welfare levels.

We will emphasize child survival and maternal health interventions as well as family planning and reproductive health in Eurasia. The Caucasus countries and the Central Asian Republics have the highest under-five mortality rates in the transition region.

Also, most Eurasian countries have experienced decreases in life expectancy since 1989-1990. Life expectancies now range between 65 and 69 years in Eurasian countries, and the male-female life expectancy gap in a handful of Eurasian countries is the highest worldwide. In contrast, life expectancies stand at between 72 and 74 years in the central and eastern European region. We will need to continue to address the causes of these adverse trends

Health

In Russia, the encouragement by USAID of international best practices in 42 maternity hospitals in the Tver region reduced maternal deaths to zero and neo-natal mortality from respiratory distress by 64 percent. In Kazakhstan, in addition to a doubling of government expenditures on health care and the start-up of a new two-year family medicine residency program, USAID (in its targeted work in prisons) has hiked TB case notification by 53 percent and decreased TB mortality by 30 percent. In Ukraine, 483 family clinics have been started, including 200 alone in 2003. Financed locally, they are staffed by better trained family medicine providers. An end result is a decreased number of patient referrals for more costly specialized health care. In Georgia, owing to USAID help, the infant mortality rate has been decreased from 25.2/1,000 births to 11.9/1,000 births; child immunization coverage has reached 87 percent; and the country was declared a polio free zone in July 2002. In Tajikistan, local health committees have been established in 200 communities, and the Roll Back Malaria program has established surveillance centers in each of the country's four provinces and provided equipment and training to correctly diagnose the disease.

in Eurasia, with interventions to mitigate diseases stemming from unhealthy lifestyles.

Infectious diseases such as HIV/AIDS and tuberculosis will be targeted in those countries where they are the most virulent. For its part, the HIV/AIDS pandemic has the potential to erase much of our hard-won development gains, most notably in Russia and Ukraine.

Depending on the availability of resources, education assistance in the Eurasian resource-poor countries will be pursued. It has particularly high long-term potential, especially through further collaboration with the World Bank and other donors.

Finally, largely through programs for economic growth, we will need to focus our assistance and expertise on creative means to decrease unemployment, particularly in the southeast European countries. Unemployment rates average 20 percent in the southern tier. A very high percentage of the unemployed consists of the long-term unemployed and youth. In some countries such as Bulgaria and Macedonia, high unemployment also is accompanied with still very low real wages relative to pre-transition levels.

Cross-Cutting Issues: The E&E Bureau works on several issues that broadly fall in all three strategic assistance areas of the economic, democratic, and social transitions. A key initiative of the E&E Bureau is to work to incorporate the positive values that are necessary to sustain the development of a free society with a market economic system. We are also working to combat corruption that undermines reforms necessary for economic growth and democracy.

In Western Europe and the United States, the stock of social capital, that has made democracy and capitalism effective and that helped develop the institutions that support democracy, the rule of law, and a market economy, evolved over many centuries. The terms “values” and “social capital” refer to the prevalent mindset that results in voluntary compliance with established laws, trust, cooperative behavior, and basic codes of conduct. One of the fundamental differences between long-standing market-oriented democracies and centralized authoritarian ones is how individuals relate to the state. Communist systems fostered attitudes of dependency and fatalism. The system was sufficiently corrupt and inefficient to require nearly everyone to use bribes or other illegal means to get ahead. While the rule of Communist parties has ended in most E&E countries, the culture that it created continues to hamper efforts to build a free and socially cohesive civil society based on the rule of law with a functioning market economy. The international donor community initially underestimated the social capital that would be necessary to introduce and secure essential reforms. We have learned that both patience and programmatic attention are needed to achieve the desired reform results. The E&E Bureau will focus more consciously and effectively throughout its portfolio to nurture the culture, values, and social capital necessary to accelerate and secure reform.

Unfortunately, corruption is endemic in many countries of the E&E region in both the public and private sectors. We further believe that corruption is a development problem, not just a law enforcement problem. Corruption flourishes when transparency,

accountability, prevention, enforcement, and education are weak. The E&E Bureau is working to bolster all five areas. We are promoting transparency through our work to create open, participatory governments. To promote horizontal accountability, our programs support checks and balances among government branches at the same level, inspector general functions, and clear hierarchical (not ad hoc or personal) structures within agencies. To promote vertical accountability, USAID programs support the decentralization of power to other layers of government as well as checks and balances from outside sources, such as independent media, trade associations, and political parties. Our programs also support prevention of corruption through the systemic reform of institutions and laws to decrease opportunities and incentives for corruption. USAID is working to promote enforcement through the consistent application of effective standards and prohibitions. Finally, USAID programs support education efforts that point out the adverse consequences of corruption, the tangible benefits of reform, and the concrete potential for positive change.

Innovative Assistance Tools

The E&E Bureau is making every effort to increase the impact of the resources appropriated by Congress. Some of the methods include building partnerships and public-private alliances within the context of on-going USAID programs and putting in place post-presence mechanisms to sustain goals and promote reform after bilateral assistance ends.

To achieve its objectives, the E&E Bureau has always depended on a wide range of partners, including host country governments, NGOs, other international donors, and the American private sector. Working with organizations that rely heavily on volunteers and sister-institution relationships has the potential for attracting major in-kind and financial resources to advance our strategic objectives. The E&E Bureau encourages U.S.-based partnerships to build constituencies for our objectives that will last beyond the endpoint of USAID funding. Such partnerships will become a larger part of the program in the years prior to mission close-out.

Consistent with the initiative expressed by Secretary of State Colin Powell and USAID Administrator Andrew Natsios, the Global Development Alliance (GDA) encourages joint funding by USAID and the private sector for activities that serve mutually recognized objectives. We are committed to attracting private business donors and foundations to accomplish common objectives. In FY 2002, the E&E Bureau utilized \$33 million to leverage an additional \$59 million from our partners in the private sector in support of programs in Armenia and Bosnia-Herzegovina. USAID as a whole leveraged nearly \$1.5 billion in 2002. To encourage further the adoption of public-private alliances, the E&E Bureau has established a GDA-incentive fund on which our missions are bidding competitively. A series of training courses for USAID staff contributed to the success of the competition through facilitating contact with potential private sector partners.

USAID's legacy is the long-term impact that its programs have on a country after the bilateral mission is closed. Most of USAID's legacy results from programs implemented

during the existence of USAID's bilateral mission, but occasionally a further programmatic impact will be sought after the mission is closed to ensure the sustainability of gains made during USAID presence. Such legacy mechanisms include partnerships with U.S. private sector institutions, scholarship funds, and other programs that do not require large amounts of recurrent funding or USAID administration.

The Millennium Challenge Corporation (MCC), which had its first meeting on February 2, 2004, will administer the Millennium Challenge Account (MCA) that provides for increases in assistance to developing countries of 50 percent over three years totaling \$20 billion through FY 2008. The funds are earmarked for countries that have adopted appropriate policies; i.e., that demonstrate a strong commitment to:

- ruling justly (e.g., upholding the rule of law, rooting out corruption, and protecting human rights and political freedoms);
- investing in their people (e.g., investment in education and health care); and
- encouraging economic freedom (e.g., open markets, sound fiscal and monetary policies, appropriate regulatory environments, and strong support for private enterprise).

These three criteria correspond to the three goal areas in the E&E strategy. USAID assistance will be targeted on those areas where improvements are needed to qualify for MCA funding.

Cyprus, Northern Ireland and the Republic of Ireland, and Turkey

The E&E Bureau also provides oversight for Economic Support Funds (ESF) allocations to Cyprus, Northern Ireland and the Republic of Ireland, and Turkey. ESF monies have been furnished to Cyprus and Northern Ireland and the Republic of Ireland to promote reconciliation and conflict resolution through local, bi-communal initiatives. The FY 2004 appropriation for Cyprus is \$13.4 million and \$21.9 million for Northern Ireland and the Republic of Ireland. The FY 2005 request proposes \$13.5 million for Cyprus and \$12 million for Northern Ireland and the Republic of Ireland. The FY 2004 and 2005 budget requests include \$99.4 million and \$50 million, respectively, in ESF funds to Turkey for debt servicing in support of the country's stabilization and economic recovery efforts. In the 2003 War Supplemental, Turkey received \$1 billion in ESF funds administered through the U.S. Department of Treasury.

Assistance from the Senate Foreign Relations Committee (SFRC)

In the invitation to this hearing, the SFRC asked if there was any way that it could help us. In general, we are pleased with the authorities that you have accorded us. They provide us considerable flexibility and latitude in our programming. In particular, we have greatly appreciated the use of "notwithstanding authority" and Development Credit Authority, both of which have contributed to the impressive development results that we have achieved in such a short time. We also appreciate Congress's support in providing the Agency with its full operating expense request, as well as new program authorities that will enable us to increase our staff and strengthen our capacity to meet critical development challenges – both in the E&E region and worldwide.

Conclusion

We are proud of our successes in the region. Our programs, which are integrated into the frameworks set by the National Security Strategy, the Joint State/USAID strategy, and USAID's discussion paper, have permitted us since the fall of the Iron Curtain to make tremendous strides in furthering democracy, installing market-based economic systems, and tending to the social and humanitarian needs of the former Communist states of Europe and Eurasia. We are very aware that there is much left to be done. In particular, the post-Soviet states of Eurasia appear to have a long transition path ahead of them. As new priorities emerge in other parts of the world, we urge the distinguished members of the Senate Foreign Relations Committee to provide continued support to our programs in Europe and Eurasia. The geopolitical, security, and trade and economic importance of the region remains of vital interest to the United States, and our very close working relationships with the Coordinator's Office in the Department of State allow us to program resources in a way that will be most responsive to these interests.

Thank you, Mr. Chairman. Without the support that this Committee and Congress have given us over the years, the progress that we have made in the region would not have been possible. In closing, I want to assure you of our continued commitment to achieving the noble goals you set out in the SEED and FREEDOM Support Acts.