
U.S. Support for Reform in Central and Eastern Europe and the New Independent States

By

Strobe Talbott
Deputy Secretary of State

[The following is a reprint of a statement by Deputy Secretary Talbott before the Subcommittee on Foreign Operations, Export Financing and Related Programs of the House Appropriations Committee. This address was previously published in the *U.S. Department of State Dispatch*, Vol. 5, No. 21, 23 May 1994, pp. 332-337.]

I appreciate the chance to testify today in support of the Administration's program to assist the 26 nations that are emerging from communism in Central and Eastern Europe (CEE) and the former Soviet Union. Our policy toward that vast region of the world and the more than 370 million people that live there has been based on three basic premises.

1. Reform in Central and Eastern Europe and the New Independent States [NIS] of the former Soviet Union is in the most basic interests of the United States.

To the extent that the reformers succeed in their efforts, the community of market democracies and the boundaries of freedom and prosperity will be enlarged. The potential payoffs for America are immense: a reduced threat of war, lower defense budgets, and vast new markets that can fuel global prosperity and create jobs for Americans

As Vice President Gore said in Milwaukee in January, the great transformation underway in the post-communist world is "the story of the century—our century." We also have a part in that story. Through our programs to support reform, we have an opportunity—indeed, an obligation—to do everything we can to increase the chances that the story ends well; that is, that in place of the old Warsaw Pact and the old Soviet Union will emerge a community of nations at peace with themselves and each other, fully integrated into the larger community of nations to which we belong and of which we are, in many ways, the leader.

2. Reformers are locked in a struggle with opponents of reform and the struggle will go on for a long time,

Thanks in large measure to five years of support from the Support for East European Democracy (SEED) program and other U.S. assistance programs, most of the nations of Central and Eastern Europe are moving steadily toward full integration into the community of market democracies. There are bound to be delays and setbacks along the way, but the sooner these nations consolidate their gains, the sooner we will be able to benefit from their emergence as stable, secure democracies and as reliable trading partners.

Reformers in the former U.S.S.R. are fighting a hard, uphill battle to replace the Soviet system with political and economic institutions that will permit those countries to prosper. Even those NIS leaders who have been most tenacious in their pursuit of reform are going to have to overcome many obstacles.

3. We have already made a difference for the better—and must keep doing so.

Each of the nations of Central and Eastern Europe and the former Soviet Union must choose its course: the decisions as to how and to what extent they will join the community of market democracies are theirs, not ours. However, the events of the past five years have clearly demonstrated that in many cases our assistance can spur progress.

It is with these premises in mind, Mr. Chairman, that the Administration comes before you to request continued funding for the SEED and FREEDOM Support Act programs [i.e., Support for East European Democracy, and Freedom for Russia and Emerging Eurasian Democracies and Open Markets Support Act of 1992]. Our FY 1995 SEED request of \$380 million is in keeping with what we expect to be a general downward trend in SEED funding levels.

This trend is largely because of the success of the program in its first five years. SEED began in three countries—Hungary, Poland, and the former Czechoslovakia—and has grown to cover 14. Beginning in FY 1995, however, we will begin closing out SEED programs in countries that no longer need this kind of support. The Czech Republic, now well on its way toward full integration with the market democracies of Europe, will be the first country to “graduate”; Estonia and Slovenia may follow soon thereafter.

Our FY 1995 FREEDOM Support Act request of \$900 million also takes into account the considerable progress now being made in Russia and through out the former Soviet Union. The large amount of funds Congress provided for NIS programs in FY 1994 will enable us to continue—in cooperation with other international donors—to provide much of the assistance needed for the major steps toward transition, especially in Russia. In FY 1995 and subsequent years, we will request smaller levels of resources, and our initiatives will focus more on encouraging private sector trade and investment in the region.

In light of the substantial progress being made in Russia, our FY 1995 FREEDOM Support Act request also assumes that more than half of these funds will directly benefit the other states of the NIS—roughly a third of FY 1993 supplemental and FY 1994 FREEDOM Support Act funds were for programs in these states.

As in previous years, we are requesting SEED and FREEDOM Support Act funds for use in three general areas:

- Support for democratic institutions;
- Support for transitions to market economies; and
- Quality of life and humanitarian assistance.

What I would like to do now is spend a few minutes focusing on our goals and achievements in each area, then make some more general points about each of these.

Creating the Building Blocks of Democratic Society

With the help of SEED and FREEDOM Support Programs, most of the countries in CEE and the NIS have been successful in creating the fundamental building blocks of democracy—national constitutions, political parties, and systems of fair and free elections. Now that these structures are for the most part in place, new sorts of assistance are called for—programs that strengthen non-governmental organizations (NGOs), local governments, and legal institutions, including courts.

In January, President Clinton announced a major new initiative called the "Democracy Network" to bolster emerging civil societies in Central and Eastern Europe [CEE]. The timing is right. As democratic institutions develop, public participation must also advance, assisted in part by NGOs involved in advocacy and watchdog work. The "network" will allow American NGOs to support their counterparts, thereby enlarging what one Hungarian philosopher has called "small circles of freedom" capable of overcoming the communist past.

In a similar program already operating in the NIS, we are providing support for already existing indigenous NGOs, as well as assisting in the formation of new ones. Four years ago, such organizations were all but unknown in the former Soviet Union. Today, there are over 12,000 NGOs in the region.

We are also providing assistance that supports the development of a free and independent media. One example is our support for the International Media Fund, which has trained hundreds of writers and broadcasters and provided the technical assistance and hardware that make a critical difference to the survival of fledgling journalistic enterprises.

Another is our support for Internews, a U.S. NGO that has helped independent Russian TV stations to produce local news programs that have a combined viewership of more than 70 million people. In Ukraine, Internews has helped create a network of independent TV stations that has a wider viewership than Ukrainian state television.

Since direct exposure to democracy is often the best teacher, we also are working to increase the size of our exchange programs. More than 8,000 leaders, business people, and students came from CEE and the NIS on such programs in 1993. We plan to fund another 20,000 to 30,000 of these visitors to our country over the next two years.

In our efforts to help decentralize the governments of the region we are supporting programs such as the one run by the International City Managers' Association, which provides technical assistance and training to local municipal government associations in Poland, the Czech Republic, and Slovakia. One of the most successful of our public-private democracy programs is the American University in Bulgaria (AUBG), which we opened in 11 months, from the first informal discussion to the selection of students and the opening of classes. AUBG brings together students from 14 countries and presents them with an American curriculum taught in English primarily by professors from the U.S. and other Western countries. The entering students have an average SAT score of 1220, an amazing feat considering that they all take the test in English.

U.S. Assistance in the Transition To Market Economies

With our help, the nations of Central and Eastern Europe and the NIS have already achieved a great deal in the way of economic reform. State-run enterprises are being privatized at a rapid pace; equally important, new businesses, especially small businesses, are also appearing in large numbers.

Privatization has been, and will continue to be, the necessary first step for economic reform in the region. Our assistance goals here are ambitious but finite: to help dismantle the edifice of state-owned enterprises that as one of the principal legacies of communism and replace it with the institutions of market democracy.

After five years of SEED support, this goal is well within reach in many of the nations of Central and Eastern Europe. In Poland, American advisers are helping to structure the \$4 billion

Mass Privatization Program of over 400 former state-owned enterprises. This effort is expected to enable 25 million Poles to purchase shares in new private businesses.

In the Czech Republic, our advisers helped the Ministry of Privatization to establish a fair and transparent process that has gained the confidence of foreign investors. Our team of accountants and bankers has helped complete 84 deals to date, representing investments of up to \$2.4 billion in foreign investment. American investments are 40% of this total. Given the speed at which the programs in the Czech Republic are proceeding, the last year that it will be necessary to fund them.

The tide of privatization is moving eastward as well. In Russia, our intensive assistance programs have made a difference. Two-thirds of all small shops—some 70,000-100,000 businesses—have been privatized; over 50% of large and medium firms—some 9,000—have been auctioned, and 40% of Russia's industrial labor force is now working in the private sector. Some 55 million Russians have become shareholders. Russian privatization officials have told Administration officials—and visiting congressional delegations—that U.S. support has been the most responsive and effective of any international donor.

Our next great privatization challenge is Ukraine, where the government has indicated new readiness to move toward wholesale privatization. When that government begins to make the tough decisions, we want to make sure that we have support ready at hand. Indeed, it is our hope that our FY 1995 aid package, when combined with the assistance that we were not able to allocate in FY 1994 due to the lack of reform, will it self provide a strong incentive for the Ukrainian Government to take courageous steps.

In that regard, I should mention that the President's Special Assistant for the former Soviet Union, Nick Burns, and an inter-agency delegation just returned from Kiev, where they had meetings with President Kravchuk and Ukrainian economic leaders. This was the third round, since November, of high-level talks designed to hasten economic reform in Ukraine and to improve the effectiveness of our assistance programs there.

We are, throughout the region, working to help create small- and medium-sized businesses. Enterprise Funds have been among the most successful of all our assistance programs in Central and Eastern Europe. These funds have been unique in their approach and unusual in their speed.

They have provided a source—in some cases, the only source—of debt or equity capital available to small- and medium-sized firms employing thousands of workers; and they have attracted investments from the multilateral banks, private institutions and pension funds.

The funds also tap into the experience of financial and business professionals to help develop banking and financial skills and institutions in the host country. They have attracted top-flight American business professionals who volunteer their time to serve on fund boards.

The Enterprise Funds in Poland, Hungary, Bulgaria, and the Czech and Slovak Republics are nearing full capitalization. Thus, we expect that the bulk of FY1995 SEED money for Enterprise Funds will be used to help establish new programs in Albania, Romania, and the Baltics.

As they gain experience, the funds are branching out into new and innovative ventures. In 1993, the Polish Enterprise Fund began making very small loans—in the range of \$400-\$7,500—available to new businesses owned by women in rural areas. In this way, the funds will support market economies at the smallest level as well as the largest. Similar micro-lending

ventures are now being planned by Hungary and Bulgaria, and we are working to expand this highly promising method throughout the region.

In the past year, we have started up Enterprise Funds in the NIS as well. In February, the Russian-American Enterprise Fund opened; next month, it will make its first loans and investments. FY 1995 FREEDOM Support Act money will also be directed toward new funds in Central Asia, Ukraine, Moldova, and Belarus.

For private enterprise to prosper—and for it to attract Western trade and investment—there must be a financial and legal infrastructure. Here, too, we are helping. Our assistance programs are facilitating the privatization of state-owned banks, and the creation of new private ones, by providing training to local bankers in both Central and Eastern Europe and the NIS. Recently, 255 senior bankers from Russia trained for eight weeks in the United States and then returned to their country to apply new approaches to their own banks. USAID is also playing a key role in the regulatory development and expansion of East European capital markets, especially helping with emerging exchanges that allow citizens to trade their vouchers and to engage in shared-issuance programs that can finance new businesses when bank loans are unavailable or too expensive

Further, in both CEE and the NIS states, we are assisting in the drafting of laws that establish anti-trust and competition procedures, permitting market forces to work better. Bankruptcy laws are also being developed, which will permitting the restructuring of many industries.

In these programs, in particular, the public-private partnerships we have crafted have greatly enhanced the reach of our programs. By supporting U.S. volunteer organizations such as the Financial Services Volunteer Corps and the International Executive Service Corps, we have been able to leverage the use of some of the world's great experts in the realms of law and finance.

We're also helping to put in place social service systems. Our FY 1995 SEED and FREEDOM Support Act requests place greater emphasis than in previous years on providing technical assistance to help CEE and NIS countries restructure their social services to the needs of a market economy.

Our first challenge here is to help the governments of the region determine what services they can no longer afford and to find ways for the private sector to deliver some of those services. Our second task is to help governments find new ways to finance those social services that they do plan to continue to provide.

Housing and health care loom as two of the biggest social service challenges in both CEE and the NIS. With respect to housing, our programs are providing technical assistance to help governments phase out rent subsidies, while targeting allowances for vulnerable groups. With respect to health care, we are providing training and advice that will improve the efficiency and quality of delivery in the private sector.

Let me emphasize a key feature of our program. For the most part, the U.S. Government provides technical assistance, not cash, to the nations of Central and Eastern Europe and the former Soviet Union. It is trade, not aid, which will provide the bulk of the hard-currency capital that the region so badly needs.

Through our assistance programs, and through high-level political discussions, we are helping the nations of CEE and the former Soviet Union to establish a legal, regulatory, and institutional environment that is more conducive to American trade and investment.

The Gore-Chernomyrdin Commission has been particularly successful in finding where the problems for Western investment are and in trying to work to remove them. Secretary Brown, the Chair of the Gore-Chernomyrdin Business Development Committee, recently led a mission to Russia; it included 29 CEOs from Fortune 100 and leading smaller companies, as well as high-level representatives from the White House and our principal trade and investment-related agencies. One of the main goals of the mission was to communicate to the Russian Government that a stable, low-tax, low-tariff business climate will be necessary to attract the level of investment and trade that is need for economic recovery and reform.

In addition, our Eximbank and OPIC [Overseas Private Investment Corporation] programs are increasing their efforts to facilitate American trade and investment in the region. Eximbank has been particularly active in Poland, Hungary, and Czech Republic for several years now, and it is now stepping up its financing for projects in the Baltic states. In Russia and the other NIS, OPIC will provide up to \$2.5 billion in finance and insurance in 1994—a seven fold increase over last year's level. OPIC also has recently quadrupled its finance project limit and doubled its per-project insurance—both to \$200 million—in order to facilitate larger projects.

American businesses are not going to invest in the region for altruistic reasons. But as the basic mechanisms of the free market are established, the natural, industrial, and human resources of the region will make it an increasingly attractive market for investment and export. The markets that our assistance efforts are nurturing will create profits and jobs at home as well.

American firms already have invested more than \$4.3 billion in Hungary and \$2.5 billion in Poland. This gives us a 43% share of total foreign direct investment in the former and a 40% share in the latter, making the United States the number one foreign investor in both countries.

In the next decade, the nations of the former Soviet Union—particularly those in Central Asia—also will provide attractive investment opportunity for American firms. Last week, I participated in an extraordinary conference—financed by FREEDOM Support Act funds and sponsored by the Commerce Department—that brought representatives of the five Central Asian NIS together with representatives of nearly 400 American companies that are doing business there are interested in doing so. Those companies are motivated by facts and opportunities. Consider, for instance, that the mineral deposits in Uzbekistan alone are estimated to have a market value of \$3 trillion. Already U.S. firms such as Chevron and Philip Morris have concluded or are actively negotiating contracts in Central Asia that could result in the flow of \$3 billion in investment over the next few years.

Quality-of-Life and Humanitarian Programs

While we are interested in promoting economic development in CEE and the NIS, we also share the concern of the peoples of the region that development be sustainable. Thus, FY 1995 SEED and FREEDOM Support Act programs will also focus on problems such as energy conservation and efficiency, water resources management, and nuclear safety. In particular, we plan to increase the funding for our growing multilateral collaboration on regional environmental problems.

USAID advisers have and will continue to support the efforts of the Group of 7 (G-7) Nuclear Safety Account—efforts which have lead to agreements to close high-risk nuclear reactors in Bulgaria and Lithuania over the next four years. The G-7 is now hard at work trying

to reach a similar agreement with Ukraine, in order to shut down that country's notorious Chernobyl reactor.

In addition, we have made good progress in fleshing out U.S.-Japanese cooperation on the environmental initiative for the region announced by President Clinton and the Japanese Prime Minister on February 11, 1994. As part of this initiative, the Japanese will contribute up to \$4 billion in untied loans.

SEED funding for humanitarian assistance increased in FY 1994, with a focus on the former Yugoslav Republic of Bosnia-Herzegovina. We expect this focus and level of spending to continue in FY 1995, with some funds set aside for rehabilitation of public utilities and services, to help that nation recover from the devastating war there.

Ethnic and regional conflict has, unfortunately, been all too much a consequence of the collapse of communism in the NIS as well. That is why we are requesting FY 1995 funds to help stave off starvation and reduce human suffering in war-torn areas of the former Soviet Union, including Armenia, Azerbaijan, Georgia, and Tajikistan. In addition to meeting immediate humanitarian needs, our humanitarian programs often serve to buy time, to cushion the immediate shock of transition, and to give peace-making and political reform processes the opportunity to establish themselves.

We are constantly putting our programs to the hard test of reality. We have in place a rigorous and comprehensive system of auditing. More than 35 external audits of our programs in Central and Eastern Europe have been completed or are in the process of being completed by the USAID Inspector General and the General Accounting Office. None of these audit reports contained any serious programmatic criticisms.

At the same time, however, some of our programs have not lived up to our expectations. Just as the leaders and citizens of the CEE and NIS states are pioneering—just as they are engaged in a great experiment—so are we. There is, and will continue to be, an element of trial and error to their efforts—and to ours. When we make mistakes, we learn from them.

For example, we also have reduced our use of consultants who “fly in and out.” Short-term advisers absorbed a significant portion of the assistance budget when the CEE program was first launched. We built on this lesson to reduce reliance on short-term consultants in the NIS and to focus them on specific tasks that require special expertise. Both SEED and FREEDOM Support Act programs now utilize long-term advisers, eschew the “seminar approach,” and are more concerned with building indigenous capacity. We started, for example, with one Russian for every foreign adviser on the Russian privatization program. The ratio is now 4 to 1.

In addition, we are revamping our contracting system to encourage broader competition and get the best skills for taxpayer dollars. We are also concerned about our rate of expenditures, which are still not as high as we would like for either SEED or FREEDOM Support Act programs.

In part, our rate of expenditures is low by design or for unavoidable reasons. Some programs are designed to last several years, and the expenditures will cover the same period. As I mentioned we are now directing more of our resources toward long term advisers, who tend to be more effective than short-term ones.

In some cases, our expenditures are dependent on the pace of reform. For instance, the funds that have been targeted for assistance to Ukraine can only be spent as the government takes concrete actions to advance economic reform. Simply put, we can't support privatization efforts until there are efforts to fund.

Other delays, however, are being corrected. While there is an inevitable trade-off between AID regulatory oversight and our ability to respond quickly in the region, we are confident that the experiences of the past year have taught us much of what we need to know in order to speed things along.

For instance, last year we realized that, despite good intentions, the G-24 was not playing an effective coordinating role. We therefore seized the initiative and pushed the coordinating function out into the field, especially in the realm of democracy building. U.S. embassies in Prague and Warsaw are now coordinating G-24 democracy-building programs. For Russia, we have shifted key coordination issues to a more manageable G-7 forum.

Changes such as these have enabled us to respond more flexibly to the expressed desires and needs of each of the recipient countries. There are a number of indications that we have, in fact, speeded up the response time of our assistance programs, particularly in the former Soviet Union.

We are now getting privatization advisers on the ground throughout the NIS within 30 days of our receiving assistance requests. We expect the FREEDOM Support Act expenditure rate to rise from the current level of \$438 million to more than \$750 million or \$800 million by the end of the fiscal year; this will represent an increase to 25% of appropriations.

I should say also that we are concerned about the impact of crime and corruption both on our assistance programs as well as on the economic and political development of the nations of the region. As we work to improve the delivery of our assistance programs, we know that we must be alert to the growing potential for crime to undermine these efforts. Through careful program monitoring and selection of reliable implementors, we believe we have minimized the potential for corruption. Moreover, since most of our assistance is in the form of technical expertise, rather than cash, opportunities for abuse are considerably reduced.

However, the problem of more widespread crime and corruption in the region will be much tougher to fix. The growth of organized crime in CEE and the NIS is undermining many of the structures of civil society that reformers have worked so hard to nurture.

In Russia, we are assisting with the creation a new civil [law] code, which includes a new criminal code. Further, James Collins is now chairing an inter-agency task force to review the current legal, judicial, and enforcement programs that assist CEE and NIS governments in combating the spread of crime, and we expect that this task force will provide us with recommendations as to how these programs can best be adjusted, strengthened, and enlarged.

However, we know that the problems of crime and corruption do not lend themselves to quick solution. The growth in crime is a result of the breakup of the old authoritarian system and will only be controlled when new laws, enforcement structures, and judicial systems are in place. I come before you today with no magic wand; creating these new structures will take time.

As a general proposition, Mr. Chairman, let me assure you that we will continue to subject ourselves to rigorous self-criticism and to we are receptive to criticism and advice we get from others, particularly I might add from Members of Congress. Secretary Christopher, USAID Administrator, Brian Atwood, NIS Assistant Coordinator Tom Simons, Senior Coordinator Jim Collins, and I spent a very useful hour last month on the Hill with the Gephardt delegation, which had just returned from a fact-finding mission to Russia. The delegation made a number of thoughtful suggestions concerning our assistance programs, on issues ranging from crime to small-business creation, to tax reform, and we are currently working hard on concrete responses to those suggestions. For instance, we are now focusing more attention on Russia's regions and

issues of federalism. Our assistance projects will concentrate on 5-10 key regions in Russia, where U.S. interests and reform potential are the greatest.

Conclusion

In conclusion, let me make this point: from the beginning, our assistance efforts have assumed that advice and training, rather than cash transfers, are the most effective ways for us to support the whole spectrum of reform in the region. As the saying goes, 'Give a man a fish, he'll eat for a day; teach him how to fish, and he'll eat forever.'

One of America's greatest strengths lies in its human resources, and the strength of our assistance programs lies in the skills of its participants—our bankers, lawyers, environmental experts, and labor specialists. Generally, the people we engage are the same experts that American businesses employ when they need advice. Furthermore, many of these advisers work for us at reduced rates, or even *pro bono*.

Our programs are by no means flawless, but our achievements to date have demonstrated that American technical expertise can impart knowledge and help reformers arrive at creative solutions to the seemingly intractable problems they face. And above and beyond the transfer of knowledge and expertise, there are the intangible but still very real long-term benefits created by face-to-face interaction between Americans and the peoples of Central and Eastern Europe and the NIS.

For one thing, the American professionals now working on behalf of our assistance programs are building the contacts and relationships that will lead to strong private sector opportunities in the future. For another, there is no better way to expand the culture of democracy than by these face-to-face contacts. Thus, SEED and FREEDOM Support Act programs are building links between economies and people, rather than simply between governments.

A few minutes ago, I mentioned how enthusiastically American firms have been investing in countries such as Hungary and Kazakhstan. These companies are not in Central and Eastern Europe and the NIS for reasons of altruism; they're doing it because it makes good business sense. By the same token, our Administration is investing in the region because it makes good business sense.

By the same token, our Administration is investing in the region because it makes good economic sense—and good national security sense; we are investing for reasons that go to the heart of what we see as America's vital national interests. As the peoples of Central and Eastern Europe and the NIS take a greater role in the political decisions of their communities and their nations; as they consolidate their independence, stabilize their economies, and trade with other countries; the world—and the United States—will become safer and more prosperous.