FY 2003 SEED Act Implementation Report

U.S. Government Assistance to Eastern Europe under the Support for East European Democracy (SEED) Act
January 2004

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I. Introduction

In the nearly 14 years since the fall of the Berlin Wall and the passage of the Support for East European Democracy (SEED) Act, the countries of Central and Eastern Europe have made great progress in their transition to stable, prosperous democracies. Programs and activities financed under SEED have played an important role in making this progress possible. By helping move the Central and Eastern European countries in the direction of democracy and market-based economies, these programs promote long-term stability in the region and contribute to U.S. national security. In addition, SEED countries have proven valued partners for the United States in the war on terrorism. In Fiscal Year 2003, SEED-funded programs continued to help advance good governance and fight corruption, strengthen civil society and the independent media, enhance market reforms, create economic opportunity, mitigate conflict, fight disease, reduce threats of weapons of mass destruction, prevent trafficking in persons and contraband, and promote the rule of law and human rights throughout the region.

As the United States pursues the global war on terrorism as a top priority, SEED programs have become an important tool in the U.S. Government's engagement with the countries of the region. Where SEED once was predominantly focused on supporting the creation of the building blocks for democratic, free market societies, it is now also involved in providing the technical and financial means to governments to make their borders more secure, target illegal activities that may be linked to terrorism, and improve law enforcement in accordance with democratic norms. As governments become stronger in these areas, the United States is more secure as well.

SEED programs, from their onset, were intended to be transitional in nature. There have been substantial changes and reductions in the program already, as most of the countries in the region have moved toward integration into Euro-Atlantic institutions, principally NATO and the European Union, and toward becoming members in good standing in the Western community of nations. Of the 15 countries covered by the SEED Act, three are NATO members already, with another seven scheduled for membership in spring 2004. Eight of the 15 are slated to join the EU at about the same time. As a result, the program's focus has shifted predominantly to Southeastern Europe, where most of the countries were involved in or deeply affected by the Balkan wars of the 1990s. All are still challenged, in varying degrees, by economic and social problems, high unemployment, interethnic tension, inadequate legal structures and practices, widespread corruption, and other problems.

Steps to begin the phase-out of SEED assistance for the most advanced countries have accompanied the program's redirection predominantly toward Southeastern Europe. Plans for Croatia and Bulgaria to phase out, with FY 2006 as the last year of new SEED funding, have been outlined already. The Romania program is expected to follow shortly thereafter. Under my direction, the Office of the Coordinator of Assistance to Europe and Eurasia is developing these plans and will look ahead to other possible candidates as well. Phase-out strategies can cover a whole country program or simply those parts that may no longer be required. They will be prepared on the basis of an assessment of progress, or lack thereof, against the broad range of economic and democratic reform indicators collected by the European Bank for Reconstruction and Development, Freedom House, and other such organizations. These assessments will inform our decisions on assistance priorities and keep funding focused on the areas of greatest need. In developing phase-out strategies for SEED assistance in a given country or sector within a country, the U.S. Government will make every effort to leave behind a legacy of sustainable institutions that can continue to promote democratic reform and the growth of market economies.

The past year was one of many important accomplishments, and some changing emphases, for the SEED program. Throughout the region, from the most advanced to the poorest countries, SEED stands as a symbol of continuing U.S. engagement and commitment. The greatest emphasis was on the still-volatile Balkans. The overarching goal of SEED assistance to such countries as Albania, Bosnia and Herzegovina, Macedonia, and Serbia and Montenegro is to help them stand completely on their own feet, politically, economically, and socially, and with reasonable prospects for eventual

full integration into Euro-Atlantic structures. Assistance to Kosovo addresses both the underlying causes of ethnic tension and the implementation of the standards that will be the basis for Kosovo's future status.

To that end, SEED has supported a wide range of democracy building, economic reform, rule of law, and civil society programs. As a result, in Bosnia and Herzegovina over a million refugees and displaced persons have returned home. Albania, along with others in the region, is effectively attacking the scourge of trafficking in persons. In Macedonia, political stability is taking hold under the Framework Agreement for peace. Serbia and Montenegro has taken initial steps on political and economic transformation and needs to move the process forward. In Kosovo, microfinance programs have created tens of thousands of jobs, but more needs to be done to help Kosovars develop confidence in their economic future and integrate all Kosovars into economic and political life. While progress has not been achieved in a straight line, most of these areas are well ahead of where they were even three years ago. There is reason to expect that such progress will continue, if the United States maintains its involvement and commitment to getting the job done.

Bulgaria, Croatia, and Romania represent the next tier up in the reform process. Though all three have experienced difficulties and even turmoil in the transition from their communist past, all have made marked progress. Support from SEED, as well as from other donors and the international financial institutions, has played an important role in their positive evolution. Bulgaria and Romania already are about to enter NATO and have expectations of becoming EU members in 2007. Croatia, while lagging behind the other two on the NATO and EU fronts, is catching up quickly and in many respects is a regional leader economically. The challenge for their governments, and for SEED, is to do everything possible to keep them on their current track. Relatively modest SEED assistance has filled critical gaps in all three countries, especially in such areas as the rule of law, health care reform, support for civil society, and anti-corruption.

In the eight countries where bilateral SEED assistance has largely phased out already – the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia – the Embassy Democracy Commission small grants programs were the main vehicle for assistance and continued to provide material and moral support to local non-governmental organizations to help strengthen civil society. These grants of up to $25,000 each (most were much smaller) helped indigenous NGOs to pursue important agendas, in such varied areas as human rights, interethnic understanding, Holocaust awareness, women's issues, the mentally and physically challenged, get-out-the-vote activities, the environment, and youth volunteerism, to mention only a few. Other SEED funds, through Department of Justice programs, have given important support to promoting the rule of law and improving law enforcement in the recipient countries. Also, USAID's Partnership for Financial Stability has given valuable, short-term assistance to Central Banks and Ministries of Finance to help them bring their practices up to Western standards.

Ever since the terrorist attacks against the United States on September 11, 2001, SEED assistance has focused more sharply on terrorism-related areas in all of the countries where the program is active. This can mean, for example, providing help to host governments in drafting anti-terrorist legislation, training in tracking illegal movements of funds, advice and equipment to strengthen border controls against possible smuggling of weapons of mass destruction or their components, and specialized training for police.

Following this introduction, two charts are included that provide snapshots of country progress on economic and democratic reform, the first from 1998 and the second from 2002. The charts reflect the overall progress made by each SEED country in various economic and democratic reform areas relative to the other East European and Eurasian countries, as well as to European Union levels of performance.

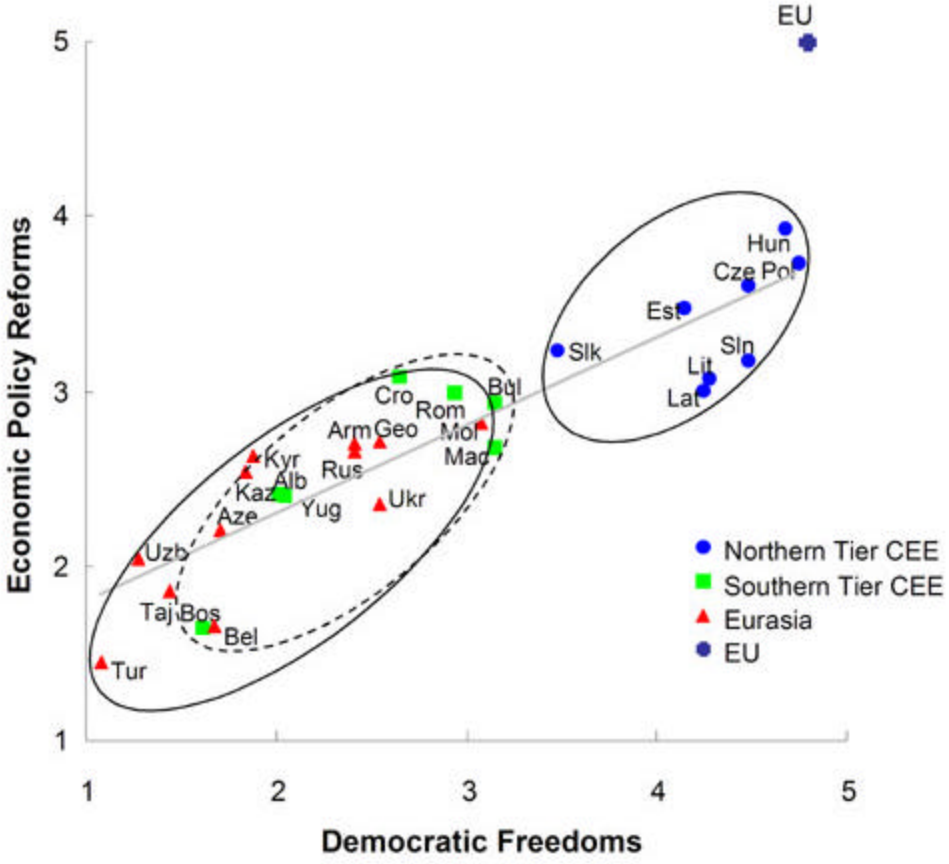
In a new departure for this year's SEED report, we are providing a brief statement of U.S. interests, an overview of U.S. Government assistance, sections on assistance priorities and sectoral assessments, and a section on country performance measures for the countries for which there are

bilateral SEED programs – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Romania, and Serbia and Montenegro, as well as Kosovo. For the eight countries where bilateral SEED assistance has already phased out – the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Hungary, Poland, Slovakia, and Slovenia – no country performance measures are provided, since their small residual SEED programs all are ending.

While much important work remains to be done in Central and Eastern Europe, clearly an important corner has been turned. Today the whole area covered by the SEED Act is much closer than at any time since 1989 to being part of a Europe whole, free, and at peace. For that we have to thank not only the dedicated, hardworking people of those countries, but also the visionaries who conceived the SEED Act and the countless people from the Department of State, USAID, U.S. law enforcement, American consulting firms, universities, NGOs, and many others for their dedicated work. While the job is not finished yet, we are headed in the right direction.

Carlos E. Pascual
Coordinator of U.S. Assistance
for Europe and Eurasia

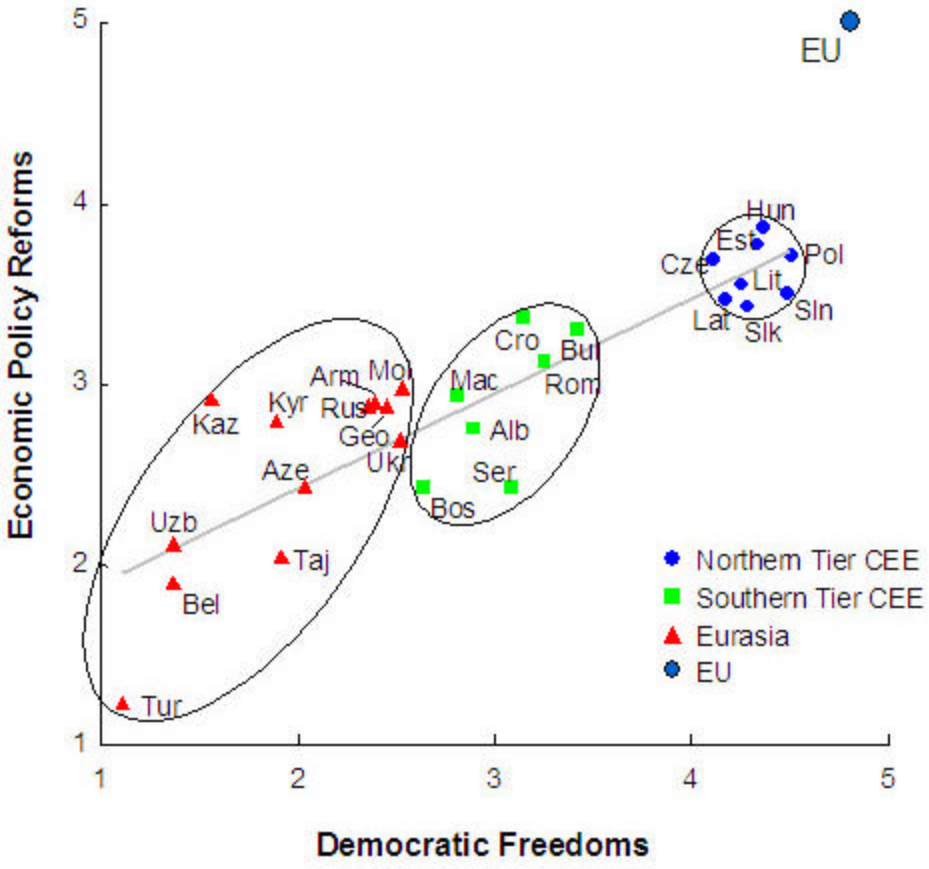
Economic Policy Reforms and Democratic Freedoms in Central & Eastern Europe and Eurasia: 1998



Ratings of democratic freedoms are from Freedom House, *Nations in Transit 1998* (October 1998) and Freedom House, *Freedom in the World 1998-1999* (June 1999), and assess reforms through

December 1998. With 1 exception, economic policy reform ratings are from EBRD, *Transition Report 1998* (November 1998), and cover events through early September 1998; economic policy reform rating for Yugoslavia is from Freedom House (October 1998). Ratings are based on a 1 to 5 scale, with 5 representing most advanced.

Economic Policy Reforms and Democratic Freedoms in Central & Eastern Europe and Eurasia: 2002



Ratings of democratic freedoms are from Freedom House, *Nations in Transit 2003* (2003) and cover events through December 2002. Economic policy reform ratings are from EBRD, *Transition Report 2002* (November 2002), and cover events through September 2002. Economic policyreforms include price liberalization, trade and foreign exchange, privatization, legal, banking and capital markets, enterprise restructuring (credit and subsidy policy), and infrastructure reforms. Democratic freedoms include political rights (free and fair elections; openness of the political system to competing political parties and to minority group representation; governance and public administration) and civil liberties (free media and judiciary; freedom to develop NGOs and trade unions; equality of opportunity and freedom from corruption). Ratings are based on a 1 to 5 scale, with 5 representing most advanced.

II. Country Assessment--Albania

Area: 28,748 sq km, slightly smaller than Maryland
Population: 3,582,205 (2003 est.)
Annual Inflation: 6% (2002 est.)
Population Growth Rate: 1.03% (2003 est.)
Gross Domestic Product (GDP): $15.69 billion (purchasing power parity, 2003 est.)
Life Expectancy: male – 69.53 years; female – 75.42 years
GDP Per Capita: $4,400 (purchasing power parity, 2002 est.)
Infant Mortality: 37.28 deaths/1,000 live births
Real Annual GDP Growth: 7.3% (2002 est.)

U.S. STRATEGIC INTERESTS

Albania is of key regional importance to the United States. Its crucial, positive role in promoting peace and stability in the Balkans, juxtaposed with its crushing poverty and record of instability, requires continued close and carefully considered international support. The success or failure of the SEED Program in Albania will impact the efforts of the U.S. Government (USG) and the entire international community to stabilize and integrate the Balkans. Albania is a close ally of the U.S. and fully supports of the USG's war on international terror. The Government of Albania (GOA) has deployed combat troops to both Afghanistan and Iraq and has entered into an Article 98 agreement with the U.S.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

From 1992 through FY 2003, the USG provided more than $358.5 million in assistance (excluding significant FMF and USDA assistance) to Albania to facilitate its transition to a modern democracy with a market-oriented economy, and to support long-term development. This includes $18 million through the 1999 SEED Supplemental Act and $12 million in budget support to ease fiscal pressures caused by the Kosovo refugee emergency.

In FY 2003, the U.S. Government (USG) provided $39.51 million in assistance to Albania:

SEED funds ($28.5 million)

- $6.8 million in democratic reform programs (including Public Diplomacy exchanges);
- $11.0 million in economic and social reform programs (including health sector reform);
- $4.9 million in security, regional stability, and law enforcement programs; and
- $5.8 million in cross-sectoral and other programs.

Other USG funding

- $7.9 million in Foreign Military Financing (FMF) funds;
- $1.5 million in Peace Corps support;
- $957,000 in International Military Education and Training (IMET) funds; and
- $650,000 in NADR funds.

In FY 2003, a total of 28 Albanians traveled to the U.S. on USG-funded exchange programs.

U.S. ASSISTANCE PRIORITIES

Democratic Reform Programs: In FY 2003, the main priorities for USG democratic reform assistance in Albania were strengthening civil society principles and institutions; fostering citizen

involvement in economic and political processes and decision making; increasing the flow and transparency of information, and citizen confidence in government and in the accuracy of news/ information; increasing the independence of local administrations from the central government; and strengthening representative government institutions. The USG's rule-of-law program worked to improve legal sector institutions and to promote a more transparent legal system.

Economic and Social Sector Reform Programs

Economic Programs: In FY 2003, USG programs advanced economic reform by providing technical assistance and finance to develop micro, small, and medium-sized enterprises; improving export and international competitiveness; facilitating better customs clearance procedures; developing farmer and agribusiness associations; providing management support in completing the first steps toward a full land registration system; and upgrading financial services, with a specific focus on central bank operations, bank supervision, deposit insurance, and GOA debt management. USG programs support training to high school and vocational college students in business skills. USG programs also helped non-profit organizations and other civil society institutions to foster citizens' awareness of and involvement in ongoing legal and regulatory reforms.

Social Programs: The primary health care (PHC) system was strengthened through programs that improved the technical competencies of PHC providers in a wide range of health areas, including family planning, HIV/AIDS and sexually transmitted infections, and antenatal care and breastfeeding; establishing key quality and management components within the PHC system to plan for and meet the population's demands in a sustainable manner; and supporting the pilot testing of new, more efficient health care models in support of the GOA Ministry of Health's (MOH) efforts. Programs also included advocacy of new reforms at the PHC level to address social sector, decentralization, and financing systems, and improved coordination and collaboration among all public and private sector health care providers and concerned donors.

Cross-Sectoral and Other Programs

Energy: GOA efforts to bring the energy sector to financial self-sustainability and put it on an environmentally sound footing were supported with technical assistance, training, and reform advocacy. A primary focus was restructuring the energy sector through the introduction of legislation establishing an independent energy regulatory entity and that would lead to the eventual privatization of the state energy monopoly and to the commercialization of its distribution, transmission, and generation assets.

USG support to date for restructuring and privatizing Albania's energy sector has been closely tied to, and structured around, the eventual integration of the national electrical system with that of the South East European Regional Energy Market (REM). This will facilitate the stabilization of the national electrical system and Albania's overall energy security through a least-cost approach that will link Albania more closely to the EU.

Anti-Corruption/Trafficking: Local anti-corruption efforts were strengthened through further enabling mechanisms to investigate citizen complaints and to empower coalitions of reform-minded individuals and NGOs. These efforts were reinforced by the advocacy of key legal reforms and by funding of public media that advocate citizen action against corruption. The prevention of trafficking in persons and the protection and reintegration of victims also received expanded attention. USG assistance included a new initiative against child trafficking and a separate umbrella activity directly to coordinate, integrate, and support NGO, GOA, and other donor efforts significantly to reduce trafficking in women and girls. These activities are undergirded by a separate activity to strengthen women's legal rights.

Security, Regional Stability and Law Enforcement Programs

Regional Stability: This issue was addressed through a range of USG programs and outreach efforts, including speaker programs, support for civil society organizations engaged in regional issues, and media and public information campaigns. Speakers from leading U.S. think tanks provided a variety of Albanian audiences (students, lecturers, media analysts, intellectuals, etc.) with detailed explanations of USG views on terrorism and the global war against it.

Law Enforcement: The USG continued its development support to the Ministry of Public Order (MoPO), Albanian State Police (ASP), and the Office of the Prosecutor General (OPG), to improve the GOA's performance and capabilities in law enforcement and public security services. Expertise, training, and equipment support were offered to the Vice Directorate of Organized Crime of the ASP to enhance its performance in the fight against organized crime. This activity spearheaded an international effort to establish, staff, train, and equip organized crime task forces in five major population centers.

Law enforcement accountability and professionalism were bolstered through training, equipment, and technical assistance to the MoPO's Office of Internal Control, which investigates police corruption, misconduct, and criminal activity, and to the OPG, both independently and through Albania's School of Magistrates. To improve the functionality, effectiveness, and crime fighting capabilities of police and prosecutors, comprehensive support was provided for the ongoing development of the information management resources of the police throughout the country.

SECTORAL ASSESSMENTS

Democratic Reform

Twelve years into Albania's transition, both positive and negative developments and sobering and encouraging realities have emerged in the democracy, governance, and the rule of law. Elections occur regularly, the news media are unfettered, the basics of a market economy exist, civil society demonstrates vitality, and universal standards of human rights are recognized. However, malfunctioning GOA bureaucracies consistently disappoint in the maintenance of rights and privileges due to citizens under law. Pervasive, endemic corruption within the political system undermines the democratic process and alienates the public.

The October 2003 local government elections took [place in an atmosphere in which the political discourse was more civil and less divisive than in previous elections. ODIHR adjudged the elections as the best to date, though there were some technical problems and a few isolated incidents of irregularities, particularly in the village of Himara. GOA ruling structures remained relatively stable throughout the year -- as opposed to the previous year -- though infighting within the ruling Socialist party was noted. The opposition Democratic Party continued to take part in government, and while it at times engaged in disruptive behavior in Parliament, it refrained from its former tactics of using unruly public demonstrations to make charges of deceit and fraud. There were no serious threats to public order, although weak administration of an outdated civil registry system, on which voter lists are based, led to much confusion on election day, resulting in the disenfranchisement of a number of voters.

The GOA has taken some steps to combat organized crime and corruption, which remain endemic and continue to impede growth and investment. For example, in the past year the GOA nearly halted trafficking in persons by speedboat across the Adriatic and increased the number of arrests of senior police and public officials charged with corruption. It also passed important new reform legislation. However, there is a general lack of will on the part of political leaders and the bureaucracy to advance reform, especially in the fight against organized crime and corruption, through aggressive implementation of progressive laws enacted over the past decade. The best evidence of this is the failure to establish implementing rules and regulations (IRRs) for these laws. Many GOA agencies and officials simply do not have the procedures and systems in place to make legislative reform meaningful. These types of problems, and the disconnections they cause between legislation and reality, are common in many sectors.

In the late 1990s, Albania embarked on a decentralization process in which an impressive body of law was passed and significant authorities and resources were allocated to local governments. However, the supporting IRRs largely were not put into place, and the anticipated gains from the new legislation are yet to be fully realized. For example, while local governments have operational authority over various fiscal transactions, the Ministry of Finance refuses to allow them to open bank accounts due to a lack of enabling IRRs. Such IRRs are needed to give reform initiatives substance and reality to the bureaucracy, as well as the citizenry.

In FY 2003, USG assistance strengthened the rule of law in Albania in various ways. Some of the most gratifying results include the provision of legal services to victims of corruption and trafficking through the Citizens Advocacy Office; legal education in the Freedom of Information Act and the Administrative Procedures Code to local governments and citizens; introduction, on a pilot basis, of new systems and techniques in court administration, with the potential for nationwide rollout; and ever-higher levels of professionalism and scholarship at the Albanian School of Magistrates, where U.S. Department of Justice officials have participated with other foreign experts in conducting training courses and drafting curricula for sitting judges and prosecutors. Collaboration and cooperation have also been strengthened among Albanian, Greek, and Italian authorities and NGOs dealing with trafficking in persons issues, such as prevention, protection, assisted voluntary return, and re-integration of victims.

With prosecutors and police organizations, the USG has been extensively involved in conducting professional training, providing modern law enforcement equipment, and fostering inter-organizational cooperation. The USG has played a critical coordinating role in chairing the International Consortium, an organization dedicated to coordinating the many international actors in Albania that are involved in legal reform issues and rationalizing their activities. The Consortium has achieved particularly positive results in improving border control, coordinating anti-trafficking strategies, court reform, and legislative reform.

The USG has been intensively involved in providing feedback to the GOA and assisting in the drafting of several important new laws. Among the most significant indubitably is the landmark Law on the Declaration of Assets, which requires the disclosure of the assets of senior politicians, civil servants, and public officials. The USG has remained involved in assisting in the implementation of audit systems to enforce this legislation. Other recent legislation in which the USG has played a key advisory role includes new witness protection legislation (currently before the Parliament) and laws addressing money laundering and terrorism financing.

USG support in democracy and governance (D&G) has seen the strengthening of civil society (particularly NGOs) and political party activists, with growing participation of grass-roots citizen organizations in the political process. After years of effort, the slow and gradual maturation of the NGO community is increasingly evident, as is the GOA's commitment to the devolution of authority and resources to local governments. Democratic systems and practices have been strengthened through support of public information campaigns, women's rights and empowerment groups, and citizens' advocacy programs. Similarly, exchange programs and in-country English language teaching programs provide Albania's current and future leaders with invaluable exposure to, and insight into, democratic principles and values.

USG programs enabled the Central Election Commission (CEC) to run technically smooth local government elections, based on a new bipartisan electoral code passed in the summer, and a majority of its members carried out their work in a non-partisan fashion. USG assistance included a modern data center with 45 work stations; GIS maps of electoral jurisdictions; restructuring of the voter registry and voter list; and numerous training courses, including database management and procedures for organizing voting and ballot counting. The number of Albanian NGOs participating as domestic election monitors in the October 2003 elections was double that of the previous elections, in 2001. In addition, local organizations supported by the Embassy's Democracy Commission Small Grants Program, established a Forum of Local Monitors and produced a standardized monitoring form. They also conducted education campaigns and televised issue debates.

USG media training programs helped to develop a new, responsible, and more professional media cadre through on-site training, internships with U.S. media organizations, and study visits. The USG funded the widely watched TV programs "Heroes of Albania" and "Hapur," both of which focused on corruption and received acclaim for promoting civil empowerment. The GOA also is enforcing a new copyright law and has removed pirated programming from the airwaves.

Economic and Social Sector Reform

Economic: During 1993-96 and 1998-2000, Albania realized impressive annual economic growth rates of around 9 percent. GDP growth declined to 6.5 percent in 2001, mainly because of power shortages and a slowdown in the world economy. By 2002, GDP growth had fallen to less than 5 percent, due to lower public investment, continued energy shortages, political uncertainties, and delays in reforms. Inflation was 3.5 percent in 2001 and 5.7 percent in 2002, after spiking early in the year due mainly to higher prices for fuel and some basic food items. In 2003, inflation averaged a low 2.49 percent.

Tax revenue performance in 2001 was about 22 percent of GDP, an improvement over 1997 levels but short of the 30 percent average collected in 2001 in the poor-performing countries of Southeastern Europe. Despite revenue shortfalls, the fiscal deficit declined from 8.9 percent of GDP in 2000, to 8.2 percent in 2001 and 6.2 percent in 2002. Domestic borrowing remains at around 3 percent of GDP, and the budget deficit was expected to fall again, to 6.4 percent, in 2003. The external sector had stronger than expected imports, which worsened the 2001 trade balance, but the current account balance actually improved as a result of high private remittances. The current account deficit increased from 5.3 percent of GDP in 2001 to 9.5 percent in 2002, and was projected drop to 8.6 percent in 2003.

The private sector accounts for over 75 percent of GDP and over 80 percent of employment. Since the 1997 crisis, and consistent with the above figures, foreign investor confidence has been growing over the past two-three years. According to UNCTAD statistics, Albania attracted $143 million of foreign direct investment (FDI) in 2000, a three-fold increase over the 1997-99 levels. Despite this trend, Albania remains among the lowest recipients of FDI in Central and Eastern Europe (CEE). Unemployment estimates range from 10-22 percent, with 15.8 percent the official GOA figure. Surveys indicate that 25.4 percent of all Albanians fall below the accepted poverty line, with poverty reaching almost 30 percent in rural areas.

In FY 2003, the USG assisted 4,607 micro and SME enterprises, which now have improved technical, marketing, and managerial skills and better access to credit. The micro-loan program, serving over 2,500 poor Albanians, has achieved operational sustainability and received an A+ rating for a microfinance institution. Besides disbursing over $1.9 million to support a national micro-finance entity, the SME loan program used $0.75 million to leverage more than $5 million of loans from a commercial bank for its customers. The repayment rates were 99.8 percent for micro loans and 100 percent for SME loans. With USG support, other local entrepreneurs invested $4.86 million of their own funds in agribusinesses and were able to obtain $2.88 million in trade credit and $2.32 million in bank loans.

The USG provided financial expertise to the Central Bank of Albania. To help increase the security of private deposits in domestic banks, Albania's Deposit Insurance Agency participated in an executive exchange with the Bulgarian Deposit Insurance Fund and Hungary's National Deposit Insurance Fund. The Insurance Associations of Albania received training and consultations in claims management procedures and practices. USG efforts indirectly contributed to an increase in commercial bank deposits, which grew from $1.99 million to $2.77 million during 2001-2003. The USG also funded an intermittent Treasury advisor, who worked with the Central Bank and Finance Ministry on debt management, assisting in the creation of a government securities market, which improved the GOA's ability to raise funds for much-needed poverty reduction and infrastructural upgrade projects.

USG assistance supported implementation of the first registration of property in Albania's land titling process, to help create a viable real estate market. Firms now can make transparent purchase, sale, mortgage, and other legally valid property transfers. An amendment to the Immovable Property Registration Law to establish a self-regulating/financing land registration agency was drafted. Recommendations were prepared to modify the Land Restitution and Compensation Law, in cooperation with the OSCE, to assure equitable, timely treatment of valid claims.

In the NGO advocacy area, the USG strengthened the role of the Albanian Agribusiness Council (KASH) in serving the interests of farmer associations and agribusinesses by participating in negotiations on free trade agreements with neighboring countries and providing feedback on proposed and existing legislation. The interaction with the GOA has increased KASH members' confidence in the economy and willingness to invest. This has translated into a self-investment of $2.85 million among KASH members, $1 million in trade credit, and $0.51 million of bank loans.

USG education efforts continue to help raise the skills of the local labor force, as needed for a modern economy. Students, teachers, and entrepreneurs from all over Albania have graduated from business education programs and received non-formal training in business and economics. Local NGOs and private businesses signed contracts with the USG education program to obtain vocational and business training for their employees. Long-term education and training opportunities have prepared future leaders by targeting fields directly relevant to economic growth and stability. Many Ron Brown fellows have been, or are currently, filling high-level, private sector and governmental positions. Other exchanges have given representatives of Albanian business associations and chambers of commerce valuable insights into mediation between legislative and other government bodies and private businesses.

Social: Almost half of Albania's population of 3.6 million is under the age of 25. The primary causes of death are cardiovascular and respiratory diseases, cancer, and trauma. The incidence of cancer and respiratory diseases is increasing as tobacco consumption climbs. Viral hepatitis and tuberculosis are the main communicable diseases. Albania is considered a low-prevalence country for HIV/AIDS, with only about 120 confirmed cases of full-blown AIDS. However, UN Agencies believe the actual infection rate to be four to 10 times higher, with Albanian youth increasingly engaged in high-risk behavior. Abortion remains a common means of birth control.

According to surveys, the poor are twice as likely as others to lack access to key public and private services. Physical and economic barriers to health care include limited access to, and the poor quality of, hospitals and health facilities. Only one in four rural households has running water indoors, with over half having no running water at all; only 14.3 percent of households report receiving electricity continuously. Similar trends are evident in the education sector. At the beginning of its democratic transition, Albania had high participation rates at all levels of education, while enrollment rates now have declined in all but the tertiary level of education.

With USG assistance to the primary health care (PHC) sector, the proportion of the population having access to reproductive services increased by over 20 percent in the past year. The total of those with access to these services is now 68 percent. The nationwide, fully functional Contraceptive Logistics Management Information System is now being maintained by the MOH, a major step toward ensuring the long-term availability of contraceptives. In addition, the USG-inspired Contraceptive Security Commission passed its first-ever national Reproductive Health Strategy, which the GOA adopted formally.

In FY 2004, the primary health care model will be functioning fully and its components tested to ensure their feasibility and sustainability. Technical assistance and training will serve to strengthen health reform efforts by rolling out a fully integrated countrywide PHC system that will be able to respond to the population's basic health needs. Technical assistance will facilitate health care delivery responsibilities and strengthen capacity building at the central and local levels. In addition to the improvement of clinical competencies, training will expand to include modules in management, planning, and budgeting for both central and local health authorities.

Cross-Sectoral and Other Programs

Energy Sector Reform: The deplorable conditions in the power sector threaten economic growth, quality of life, and political stability, as it continues to drain GOA budget resources. No new generation plants have been added to the system in over 15 years. The physical plant -- from generation to distribution -- desperately needs overhauling. The virtual single-source reliance on hydropower and physical limits on the ability to import electricity place an enormous burden on the sector. Moreover, there are reported 35-40 percent system losses, and households account for over 60 percent of electricity consumption, at an artificially low tariff. Countrywide blackouts range from three to 14 hours daily. The World Bank estimates that, over the next 15 years, $1.1 billion in capital investment will be needed to rehabilitate and upgrade the sector.

The GOA seeks membership in the South East European Regional Energy Market (REM) and is targeting sector reforms and development for REM compliance. With USG assistance, the GOA adopted a National Energy Strategy and Power Sector Reform Law that established the Electricity Regulatory Authority (ERE) as a self-regulating/financing entity and provided for the unification of the legal framework for REM integration.

The managerial and technical capacities of the ERE were strengthened by USG financing of partnership programs with U.S. regulatory counterparts, and between the state power monopoly and U.S. utility counterparts. In 2004, plans for unbundling the energy monopoly into separate generation, transmission, and distribution entities will be initiated. The GOA and ERE are expected to adopt formally the concept of full cost-of-service based tariff mechanisms and initiate the first round of increases in residential tariffs.

Anti-Corruption: Corruption remains a major obstacle to meaningful political and economic reform in Albania. Transparency International's 2003 Corruption Perceptions Index of ranked Albania 92nd among 133 countries covered, with a score of 2.5 (same as last year) within a range of 0 to 10 (highly corrupt to highly clean). Though steady progress is being made in combating corruption, much remains to be done. Public awareness of what constitutes corruption is growing, and more people are empowered to speak out against it. The GOA has also taken steps to address corruption through the creation of a special ministerial post to deal with corruption issues, new legislation, and increased law enforcement efforts, directed at corruption both by police and public officials.

USG assistance has strengthened the Albanian Coalition Against Corruption (ACAC), a sophisticated network of individuals and NGOs. The Citizens Advocacy Office (CAO) investigates corruption complaints by citizens and provides legal services to victims of trafficking. The CAO conducts a weekly, one-hour call-in TV program on corruption that is the highest-rated program in its time slot. Public awareness about corruption and civic responsibility has also grown through investigative journalism training programs and information campaigns targeting transparency in public administration. With USG technical assistance, the GOA passed powerful enabling legislation on the Declaration of Assets for the country's top 3,500 public officials.

In FY 2004, a new rule-of-law umbrella activity will aim at giving "teeth" to existing laws. The emphasis will be on implementing and enforcing existing legislation and assisting institutions to set rules and regulations, as necessary. Any action regarding new legislation will be limited to that specifically targeted at corruption. The USG also will continue to put pressure on the National Judicial Conference to enforce its Code of Ethics, support the administration of the pilot courts of first instance, and ensure the implementation of the Law on the Declaration of Assets by assisting the recently formed High Inspectorate for the Declaration and Audit of Assets. To improve oversight, transparency, and accountability in Albania further, the USG will also assign a full-time advisor to work with the Supreme State Audit Commission, the independent agency charged with auditing central and local government entities, and with the audit/inspector general offices of each major ministry.

Anti-Trafficking: Albania is defined as a source and transit country, primarily for women and girls trafficked to EU countries for sexual exploitation. In the State Department's 2003 Trafficking in Persons Report, Albania was categorized as a Tier ll country for the second consecutive year, meeting minimum standards and making significant efforts to bring itself into compliance with the standards of the Trafficking Victims Protection Act 2000. The move up from Tier lll to Tier ll was due to the GOA's National Strategy to Combat Trafficking in Human Beings in 2001. Child trafficking remains a problem between Albania and neighboring Greece and Italy.

The USG initiated implementation of its Three Port Strategy in FY 2003. This strategy placed law enforcement advisors in each of the country's principal points of entry (POE): the Mother Teresa International Airport and the seaports of Durres and Vlora. In addition, the strategy offered equipment and training to support the enhanced control and screening of people, luggage, and goods moving through these POE's. As a consequence, the interdiction of traffickers and victims and the disruption of trafficking networks increased. As part of the Three Ports Strategy, a U.S. advisor was placed in the Minister of State's Office to assist in the drafting and implementation of the GOA's anti-trafficking strategy and to facilitate government cooperation with NGOs working to combat trafficking in persons. The USG continued its efforts to achieve a consensus between international donors and the GOA on the mission of the Vlora Anti-Trafficking Center to remove the impasse preventing full implementation and operation of this component of the GOA's anti-trafficking strategy. Promising developments took place at the end of the reporting period, with the principal international players convening and agreeing to make the center operational.

The USG's initial protection and reintegration support program for trafficked victims helped meet the diverse needs of trafficked women and children. It developed a systematic national referral mechanism based on the International Office for Migration's (IOM) regional and global presence, and tested models for a sustainable reintegration and shelter mechanisms for victims of trafficking. This USG-sponsored activity also assisted in completing, with IOM assistance, the reconstruction of a GOA-run shelter for women, children, and illegal migrants. Other innovative anti-trafficking efforts included training programs to develop economic opportunities for women and cultural activities that depict the dangers of trafficking. Key Albanian representatives were introduced to U.S. strategies and policies to combat trafficking in persons and investigated the role of the GOA in addressing the problem and collaborating with the U.S.

In the coming year, the USG will be engaged in a bilateral anti-trafficking initiative focusing on children, which is co-funded by five international NGOs. Specific areas of focus include prevention, protection, education/sensitization, and assisted voluntary return and reintegration of trafficked children into Albania. Unique to this program is its transnational and bilateral approach, where anti-trafficking efforts are coordinated not only within Albania but also among Albania, Greece, and Italy. In addition, a new and larger umbrella activity, which contains a grant-making mechanism, will focus on the preventive, reintegration, and regional aspects of trafficking of women and girls, and increase the coordination among the GOA, local NGOs, and international partners to deal with these issues more effectively.

Security, Regional Stability, and Law Enforcement

Security: As a signatory to the Athens MOU Power Sector Policy Statement, Albania seeks to increase its overall energy security by participating in the SEE Regional Electricity Market (REM) and ultimately the European electricity market. To do so requires the domestic power sector to be compatible with the technical, legal, and operational standards established by the REM within a defined timeframe. These standards are consistent with a financially sustainable and environmentally sound energy sector. These lofty goals stand in stark contrast, however, to Albania's continuing power sector crisis, as described above, which is undermining sustainable economic development and national political stability.

In 2004, the USG will help the GOA in designing the proposed Albanian energy market (AEM). This covers development and adoption of market rules, grid codes, and other technical requirements to

facilitate AEM's establishment and operation, as required for participation in the larger REM and European electricity market. This is directly supported by USAID and concerned donor efforts first, to unbundle the state power monopoly into separate generation, transmission, and distribution companies; then, to commercialize all three companies; and subsequently, to privatize generation and distribution. This will be done concurrently with the advocacy of full-cost-based electricity tariffs and the addressing of the theft and non-payment issues.

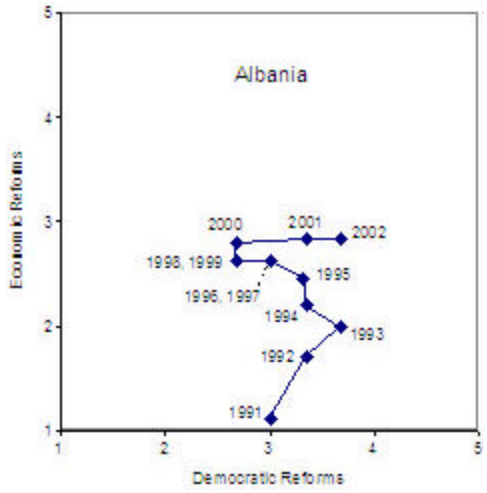
Regional Stability and Law Enforcement: USG efforts focused on combating organized crime; enhancing police integrity and accountability; fighting trafficking in persons, narcotics, and other contraband; and raising the professionalism and effectiveness of the Albanian State Police (ASP) by developing its information management capabilities. With USG support, the ASP created a Vice Directorate for Organized Crime within its Criminal Investigative Division to address more effectively the critical problem of organized criminal groups. Training, equipment support, and full-time technical assistance have been offered to the Vice Directorate and its five sectors: Financial Crimes, Anti-Narcotics, Anti-Trafficking, Criminal Analysis, and Special Operations.

The USG also supported the creation, development, and training of organized crime task forces for the five cities most afflicted by organized crime. Assistance is being offered to formalize the legal, organizational, and functional framework for these task forces, which will bring together elite and specially trained police and prosecutors. Advisory support, training, and equipment have been delivered to support the development of the internal affairs function of the Ministry of Public Order (MoPO) to investigate, prosecute, and remove from service police officers guilty of corruption, crime, or other misconduct. This assistance promotes a more professional and accountable police force at the service of the Albanian citizenry.

With USG assistance, law enforcement and other officials from Albania and Macedonia were brought together to discuss cross-border cooperation in promoting national and regional stability. A debate on national and regional security issues was conducted, which advanced collaboration between governments and NGOs and contributed to the development of national stability. The Department of State, Bureau of International Narcotics and Law Enforcement Affairs (INL), administered SEED funding in support of the Department of Justice, Office of Prosecutorial Development, Assistance and Training (DOJ/OPDAT) Resident Legal Advisor (RLA), Department of Justice, International Criminal Investigative Training assistance Training Program (DOJ/ICITAP) Police Reform project, and Three Ports Strategy, and the ICITAP-implemented anti-trafficking-in-persons training at the Vlora center.

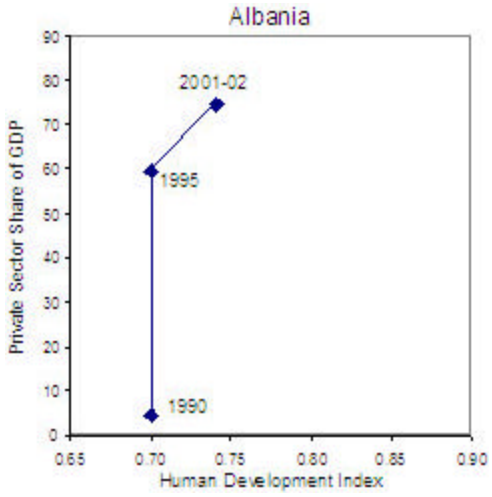
Country Performance Measures

Economic Policy Reforms and Democratic Freedoms in Albania, 1991-2002



Ratings based on a 1 to 5 scale, with 5 representing the most advanced.
Sources: EBRD, *Transition Report 2003* (November 2003); Freedom House, *Freedom in the World 2003* (2003); and (various years).

Economic Structure and Human Development in Albania, 1991-2002



The Human Development Index (HDI) is based on three indicators: longevity, as measured by life expectancy; educational attainment, as measured by a combination of adult literacy and combined primary, secondary, and tertiary enrollment ratios; and standard of living, as measured by real per capita GDP ($PPP). The HDI ranges from 0 to 1, with higher values representing greater human development. UNDP, *Human Development Report 2003* (July 2003), and previous editions; EBRD, *Transition Report 2003* (November 2003), and previous editions.

MEASURES OF PROGRAM EFFECTIVENESS IN FY 2003

DEMOCRATIC RERORM

Performance Indicator: Corruption -- Freedom House *Nations in Transit* Corruption Rating (1 = highest; 7 = lowest)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
5.25	5.00	**5.00**

FY 2003 Results: Corruption in Albania remains endemic, though the past year has seen some important progress. The Albanian Coalition Against Corruption mustered its technical and advocacy skills to ensure the passage of a strong, tough law on Declaration of Assets by Public Officials. The U.S. also assisted in the drafting of a new anti-money laundering law. The coalition continued to raise public awareness of corruption issues and anti-corruption initiatives. The Citizens' Advocacy Office handled 689 cases dealing with corrupt practices and/or trafficking in persons in the past year. The Albanian School of Magistrates graduated its third class of post-law-school students, providing a cadre of Western-trained judges and prosecutors. A new bi-weekly, "60 Minutes" style TV program on corruption is aired over a national network of 23 stations. Reform of judicial administration has begun in earnest, facilitating and easing business and citizen access to the judicial system. ICITAP assistance helped establish the Office of Internal Control with the police, charged with investigating internal corruption, and this office made a number of high-profile arrests. Arrests and prosecutions of senior government officials also increased, including that of a deputy minister and the deputy central bank governor.

Performance Indicator: NGO Development/Civil Society -- Freedom House *Nations in Transit* NGO Development/Civil Society Rating (1 = highest; 7 = lowest)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
3.75	3.75	**3.75**

FY 2003 Results: The current legal environment is generally favorable to NGO sector development. The law allows NGOs to provide both goods and services. Organizational capacity continues to expand, though slowly, with much remaining to be done. The NGO sector remains highly dependent on the donor community for grants and as customers for its services. There was a noticeable increase in issue-based efforts by coalitions of NGOs during the year. The public image and perception of NGOs continues to improve, though slowly and unevenly, across the board. NGO influence on public policy, while still relatively weak, is expanding gradually.

ECONOMIC AND SOCIAL REFORM

Performance Indicator: Private-sector share of GDP (Source: EBRD)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
75%	77% (Embassy estimate)	**Data not available yet**

FY 2003 Results: The privatization of small and medium-sized enterprises has largely been completed. However, delays have been encountered in the GOA's privatization of the few remaining large public properties (strategic assets), such as the Albanian Electric Corporation and the National Savings Bank. With donor community support, the GOA is moving (albeit slowly) toward privatizing these few remaining state enterprises. The relatively stable macro-economic situation, together with the GOA's efforts to create a more favorable business climate, is encouraging domestic and foreign private investments. However, high levels of corruption, the lack of streamlined administrative and tax/customs regulations, and inconsistent and unfair regulatory enforcement continue to hinder the development of the private sector.

Performance Indicator: Per Capita Income in purchasing power parity (PPP$) -- (Sources: World Bank and EBRD, August 2003)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
$3,865	$4,000 (Embassy estimate)	**Data not available yet**

FY 2003 Results: There has been a steady increase in per capita GDP from $673 in 1997 to $1,552 in 2002. However, the rate of the real growth of GDP has slowed since 1999. The rapid liberalization of the market following Albania's WTO membership, combined with expanding demand for imports of all kinds, significantly increased Albania's trade deficit. As a result, production in the manufacturing and agricultural sectors has been adversely affected, and the growing trade deficit has weakened the local economy. With assistance from the donor community, the GOA is taking steps to help local private enterprises raise their competitiveness in order to recapture the domestic market and penetrate new export markets. These actions are necessary conditions to reduce the country's trade deficit, stimulate SME growth, create more employment, and increase per capita income.

Performance Indicator: SME Employment -- Employment in small and medium-sized enterprises (SMEs) as a percentage of total employment (Source: World Bank, August 2003)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
9.49%	11.5% (Embassy estimate)	**Data not available yet**

FY 2003 Results: Rapid growth of SMEs is the primary hope for providing jobs and income to hundreds of thousands of unemployed and underemployed Albanians. The GOA has made special efforts to improve this sector's performance. Parliament passed an SME law to create a favorable legal environment in which this sector can expand. In addition to the Export Promotion Agency and the Business Advisory Council, the Ministry of Economy has established the SME Development Agency to create and implement an SME development strategy and an action plan to remove administrative barriers. The donor community, World Bank, and EBRD are providing considerable assistance for the development and financing of SMEs.

SECURITY, REGIONAL STABILITY, AND LAW ENFORCEMENT

Performance Indicator: Trafficking in Persons -- U.S. State Department 2003 Trafficking in Persons Report (Tier 1 = highest; Tier III = lowest)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
Tier II	Tier II	**Tier II**

FY 2003 Results: Albania first received a Tier II TIP ranking in 2002. Although the GOA did not meet the necessary criteria to move up to Tier I status for the 2003 reporting year, the State Department recognized it as having made significant progress in combating trafficking in persons. Examples include the near-total curtailment of trafficking by speedboat across the Adriatic; improved interdiction capabilities at Albania's three major ports; expanded national and regional anti-trafficking

sting operations; increased arrests and prosecutions; and the opening of a new shelter/reintegration center for trafficking victims. As a result of these efforts, trafficking in persons in Albania has decreased significantly, a trend that is expected to continue.

FY 2003 Support For East European Democracy (SEED)
Funds Budgeted for Assistance To:

Albania (In millions $, as of 12/31/03)

USAID - Democratic Reform $6.61
USAID - Economic Prosperity & Security $5.31
USAID - Social Sector Reform $3.25
USAID - Special/Cross-Cutting $6.29
USAID Total: $21.45

State - Bureau of Public Affairs $0.03
State - ECA Exchange Programs $0.96
State - EUR Public Diplomacy $0.45
State - EUR Social and Economic Programs $0.16
State - IIP Public Diplomacy $0.05
State - INL Law Enforcement Activities $4.79
U.S. Department of State Total: $6.43

Broadcasting Board of Governors - Public Diplomacy $0.05
U.S. Department of Commerce - CLDP $0.30
DHS/Customs - Law Enforcement Activities $0.27
Other Agencies Total: $0.62

GRAND TOTAL: $28.50

II. Country Assessment--Bosnia-Herzegovina

Area: 51,129 sq km, slightly smaller than West Virginia
Population: 3,989,018 (July 2003 est.)
Annual Inflation: 3.5% (2002 est.)
Population Growth Rate: 0.48% (2003 est.)
Gross Domestic Product (GDP): $7.3 billion (purchasing power parity, 2002 est.)
Life Expectancy: *total population:* 72.29 years; male*:* 69.56 years; female*:* 75.22 years (2003 est.)
GDP Per Capita: - $1,900 (purchasing power parity, 2002 est.)
Infant Mortality: 22.7 deaths/1,000 live births
Real Annual GDP Growth: 2.3% (2002 est.)

U.S. STRATEGIC INTERESTS

Eight years after the Dayton Agreement, Bosnia and Herzegovina (BiH) is still struggling to recover from a vicious ethnic war and to make the transition to a market economy. Despite significant progress in building political, law enforcement, and public administration institutions, and in developing a unified military, BiH remains a fragile state in a potentially unstable region. Dayton also created a highly decentralized system, with overlapping layers of governance at state, entity, cantonal, and municipal levels. Terrorists and traffickers have taken advantage of persistent corruption, porous borders, weak and often competing political structures, and ongoing ethnic tensions to use BiH as a destination or transit point. It is in the U.S. interest to help BiH complete its transition to become a modern European state, tied to Euro-Atlantic institutions, and one that that can contribute to regional stability.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

In FY 2003, the U.S. Government (USG) provided an estimated $73 million in assistance to Bosnia and Herzegovina:

- $50.15 million in Support for East European Democracy (SEED) funds for rule of law, civil society development, economic reform, and democracy building programs;
- $12.5 million in PKO funds to support OHR and OSCE programs in rule of law, civil society, economic reform, good governance, and counter-terrorism;
- $5 million in USDA funds for veterinary quarantine stations and student lunch programs;
- $2.5 million in OPIC funds to ease housing shortages;
- $2.5 million in FMF funds to strengthen state-level defense capability by down-sizing and professionalizing the military;
- $900,000 in IMET funds to support a state-level defense capability; and
- $30,000 in NADR funds and International Trust Fund in support for de-mining; and
- $20,000 from the Business Facilitation and Incentive Fund to support training of entrepreneurs.

In FY 2003, a total of 202 Bosnians traveled to the U.S. on USG-funded exchange programs.

U.S. ASSISTANCE PRIORITIES

Democratic Reform Programs: In FY 2003, U.S. democratic reform assistance in BiH focused on fostering responsible political behavior by both government and opposition parties, strengthening responsive and effective local governance, providing organizational and project support to NGOs to increase citizen participation and grass-roots influence, and nurturing the growth of an independent, responsible, and professional media sector. U.S. programs encouraged the development of a strong, self-confident Communications Regulatory Agency, similar to the FCC in the U.S.; promoted inter-ethnic reconciliation through the identification of over 1,500 mortal remains of victims from the 1995 Srebrenica massacre; set up effective NGO coalitions in key public policy areas; and brought over 40 Bosnian officials, journalists, and businesspeople to the U.S. for specific programs focused on democratic reform.

Economic and Social Sector Reform Programs: In FY 2003, USG economic reform programs focused on small and medium-sized enterprise development, fiscal management, and sustainable refugee returns. U.S. assistance is closely coordinated with the Office of the High Representative (OHR), World Bank, IMF, European Union, OSCE, and other donors. U.S. assistance led to a number of major accomplishments in FY 2003. A treasury system was implemented at the state and entity level to control expenditures. Long-term U.S. work in the energy sector resulted in the approval of a $30 million World Bank credit for further restructuring of the sector. U.S. technical assistance created a state-level deposit guarantee agency. U.S.-supported tax administration reform brought about increased tax revenues and a rise in the number of registered taxpayers in FY 2003. Infrastructure work to support refugee returns restored electricity to 1,800 families, provided potable water to 350 families, reconstructed schools for 650 students, and improved transportation links for 200 families.

Security, Regional Stability and Law Enforcement Programs: In FY 2003, U.S. security assistance helped establish and develop a secretariat for the state-level Standing Committee on Military Matters (SCMM), further to the development of a unified BiH military. The USG provided $2.4 million in Foreign Military Financing (FMF) and $900,000 in International Military Education and Training (IMET) to this end. Recognizing that the rule of law and fighting terrorism are inter-related, the USG focused extensive resources on strengthening the judiciary and developing effective law enforcement and counter-terrorism (CT) institutions, encouraging the adoption of effective CT/law enforcement-related laws, strengthening BiH's borders, and shutting down NGOs involved in terrorism. U.S. assistance in FY 2003 led directly to the adoption of new Criminal and Criminal Procedure Codes throughout BiH and continuous training of all Bosnian judges and prosecutors on the new codes; the establishment of new, national-level institutions, including the State Court, State Prosecutors' Office, and State Border Service; and the passage of legislation that will provide the basis for a unified military structure in Bosnia. USG assistance in FY 2003 to state, entity, and local law enforcement officials and NGOs also helped move BiH from Tier III to Tier II status in the State Department's annual report on trafficking in persons.

SECTORAL ASSESSMENTS

Democratic Reform

BiH's performance on democratization was mixed in FY 2003. On October 5, 2002, national and local elections, organized by BiH officials, were recognized as free and fair by domestic and international observers, but these elections returned coalitions of nationalist parties to power at state and entity levels in a demonstration of voter dissatisfaction with the record of the previous multi-ethnic Alliance for Change government. The present governing parties have yielded to intensive international community pressure to accept several important reform measures but have been slow to initiate such measures themselves. Corruption and the division of political spoils and appointments along ethnic lines remain serious problems. Repeated scandals concerning the involvement of ruling parties in the mismanagement of public companies have come to light.

With no new elections scheduled until municipal elections in October 2004 and national elections in October 2006, the bulk of USG FY 2003 democracy assistance focused on long-term efforts to strengthen and improve the accountability of political parties and legislatures. USG programs targeted reform parties; helped them understand the appropriate role of a modern, democratic opposition; and provided techniques and methodologies for promoting issue-based politics through local party structures. The programs' effectiveness has been evident in the increasingly sophisticated approaches by party activists to the electorate. USG programs for the legislature have promoted the professional development of parliamentary caucuses and committees. A parliamentary internship program gave 58 university students and recent graduates a chance to participate in the democratic process by working in state or entity-level parliaments.

USG assistance has also tackled the problem of overlapping layers of government administration, which often results in inefficient services to citizens, particularly at the local level. An FY 2003 USG program helped municipalities become more efficient and transparent by installing One-Stop-Shop service centers for citizens and businesses. This highly successful initiative reduced the confusion and burden of dealing with local governments.

USG assistance to the civil society sector focused on the organizational development of leading NGOs, resulting in four issue-based coalitions advocating for children at risk, the prevention of alcohol and drug addiction, environmental protection, and the rights of the disabled. Small, targeted grants funded local democratic initiatives, including information campaigns to help refugees return and search for employment, volunteer drives to clean up polluted rivers, radio call-in programs connecting citizens with elected officials, and youth centers promoting student integration and media education in high schools, as well as assistance to open 12 computer and information centers fostering civic activities in small communities.

The unresolved disappearance of up to 30,000 persons, presumed killed in the war, continues to inhibit reconciliation and undermine efforts to establish a culture based on democracy and human rights. In FY 2003, the USG supported efforts by the International Committee on Missing Persons (ICMP) to resolve missing persons cases and thereby provide closure to survivors and heal the breach among BiH's ethnic groups. Over 1,500 human remains, primarily victims of the 1995 Srebrenica massacre, were identified.

In FY 2004, the USG will continue to assist political parties in the run-up to municipal elections, providing local-level training on recruitment, research, political planning, and the strengthening of party connections to local communities. FY 2004 civil society programs will target corruption through grants to support investigative journalism, NGO monitoring activities, and implementation of a Law on Conflict of Interest. Additional grants will support the efforts of local organizations to monitor such issues as defense spending, healthcare, and environmental protection. Grants will also shore up the capacity of NGOs to perform credible financial reporting and encourage domestic funding for the NGO sector.

In media reform, the USG has sought to foster politically independent media that are professional and economically sustainable, as well as develop an apolitical telecommunications regulatory authority at the state level. In broadcast media, USG support to the Communications Regulatory Agency (CRA) enhanced its ability to function effectively as it completed the transition from an international community-created and staffed body to a domestic state-level institution. The CRA will be essential to ensuring that outside and domestic political forces do not dominate public broadcasting. USG assistance provided critical professional skills training to CRA staff and also enabled private broadcasters to develop the marketing and business skills needed to function in a market system. Journalists in both electronic and print media are sometimes subject to harassment and intimidation, while print media have been used as for a forum for political vendettas. The USG has worked to build effective journalist associations capable of protecting members' rights and helped the BiH Press Council foster professionalism through self-regulation.

Economic and Social Sector Reform

Economic growth is projected at 3.3 percent of GDP in 2003, down from 3.8 percent in 2002. The IMF estimates that inflation will remain low (around 1 percent), thanks to Bosnia's currency board arrangement, which ties the Convertible Mark (KM) to the Deutschmark component of the Euro at a rate of about 2:1. FY 2003 fiscal performance is likely to deteriorate as a result of pension increases in the Republika Srpska (RS) that have not been offset with corresponding structural revenue increases. Even before the pension hike, government spending was projected to consume almost 59 percent of total GDP in 2003, making public administration reform an urgent priority. Bosnia's domestic debt overhang is estimated to be as high as KM 8.4 billion, or 74 percent of projected 2003 GDP. Resolution of this issue is crucial for future economic development, and the USG may offer technical assistance in this area.

Trade data are unavailable for 2003, but the current account deficit rose sharply in 2002 (4.5 percent of GDP). Imports outnumbered exports by two to one. Remittances also dropped, as refugees continued to return, but the decline in reserves was modest (€125 million). The current account deficit was financed through a combination of assistance flows and increased foreign direct investment (FDI), which rose from €143 million in 2001 to €244 million in 2002. Assistance flows will be unsustainable in the long run, making it correspondingly more important to promote economic growth by removing obstacles to investment.

The UNDP ranks BiH as the second poorest country in Europe, after Moldova. In its January 2003 survey, 47.9 percent of households were below the poverty line, defined as the ability to purchase a basic basket of goods. Poverty varies sharply by region and ethnic group and is most acute in the RS.

After the war, U.S. assistance was aimed at channeling credit to the productive sector to stimulate economic growth through a $233 million finance program. During its operation, the program made nearly 600 loans worth $163 million, generating 15,000 jobs and preserving a further 30,000.

Current USG assistance efforts focus on fostering small and medium- size enterprise (SME) development through firm-level assistance to improve competitiveness in key sectors. A separate program to improve SME access to financing and to strengthen the financial sector is under way. Other USG programs seek to advance commercial law reform and support the adoption of international accounting standards. In FY 2004, a key U.S. objective will be to remove obstacles to SME growth, including excessive taxation and other burdensome regulations that impede the start up of new businesses.

On the macroeconomic side, U.S. assistance has funded the development and installation of treasury systems to control expenditure. For the first time, obligations to the budget are recorded when incurred, and unauthorized payments are rejected. Work is under way to expand the program to the cantonal level, where government expenditures have been unchecked in the past. Other USG programs focus on improving tax administration, which resulted in higher FY 2003 revenues collected and an increase in the number of registered taxpayers. Assistance efforts in FY 2004 will be devoted to streamlining and rationalizing direct taxes to encourage SME growth.

Progress on energy sector reform has been modest. However, the World Bank recently approved disbursement of a $30 million credit for the sector, indicating that long-term USG efforts to promote restructuring in that sector have begun to pay off. In FY 2004, U.S. programs will complement World Bank work with technical assistance to unbundle the energy sector by creating a transmission company and independent systems operator. Similarly, privatization has moved very slowly in BiH, hampered by political unwillingness to close outdated, state-owned industrial concerns. To promote reform, U.S. assistance has funded audits of corrupt state-owned enterprises with real profit potential in the future.

Following the war, U.S. programs facilitated the return of ethnic minorities to their pre-war homes through the repair of water, electricity, schools, and transportation networks. Infrastructure work will continue in FY 2004, but increasingly, USG programs provide income-generation grants and loans

to promote economic self-sufficiency in returnee areas.

U.S. assistance funded 65 long-term and 103 short-term exchanges in FY 2003, in the education, social sector reform, economic development, democracy, regional stability, and law enforcement areas. In the education reform area, USG exchanges and a major civic education initiative have helped tofoster classroom integration, support American Studies, and engage BiH youth. The U.S.-sponsored CIVITAS project has been instrumental in implementing a new civic education course in all BiH schools, teaching basic concepts necessary to support a democratic society.

Security, Regional Stability, and Law Enforcement

In FY 2003, BiH made tremendous strides toward transferring operational control over entity-level militaries to a future state-level Ministry of Defense, recognizing that such a step was a pre-condition for Bosnia's participation in Partnership for Peace (PfP) and other Euro-Atlantic institutions. When fully implemented, the process will create a smaller, more professional army under civilian state control, and that poses a minimal risk for inter-ethnic conflict and significantly enhances local and regional stability. FY 2003, U.S. programs supported this undertaking through the provision of Foreign Military Financing (FMF) and International Military Education and training (IMET) funds and technical assistance to the secretariat of the Standing Committee on Military Matters, which guided the process. The secretariat will form the core of a national-level Ministry of Defense, slated under new legislation to be introduced in 2004.

Given the high unemployment rate in BiH, idle discharged soldiers could pose a potential security problem. In FY 2003, the USG funded a program to register discharged soldiers and provide them with prospective employment information, as well as training and tools for employment in such areas as farming, carpentry, and mechanics. The program helped over 7,000 soldiers from both entity armies make a successful transition to the civilian workforce. With extensive further demobilization expected in FY 2004, a follow-on program is under consideration.

After 2002 revelations that an RS-based arms facility was engaged in the illegal transfer of arms technology to Iraq, BiH took steps to strengthen national control over all exports of defense-related equipment. In FY 2003, the USG provided technical support for the drafting and implementation of improved export control procedures. An MOU has been signed under which, in FY 2004, the USG will provide hardware and software systems to track all defense exports.

In FY 2003, the USG contributed technical expertise and about $1.1 million to help BiH comply with its Chemical Weapons Convention obligations by eradicating potentially toxic residue from the former Yugoslavia National Army (JNA) chemical weapons facility in Livac. The USG also consulted extensively with state and entity-level military officials on eliminating light weapons, small arms, and Man-Portable Air Defense Systems (MANPADS). The USG is expected to provide financial support to destroy significant quantities of these weapons in FY 2004.

An estimated 4 percent of Bosnia's territory is riddled with landmines. The presence of these weapons constitutes a serious threat to internal security and an obstacle to refugee return and economic development, particularly in rural communities. To counter this menace, the USG in FY 2003 contributed $2.5 million to the International Trust Fund in Slovenia for mine clearance programs in BiH. About 3 million square meters were cleared in 2003. The USG also funded the local construction of a Mine Detection Dog Training Center.

Bosnia is a destination and transit point for terrorism, trafficking in persons, and other forms of organized crime. An important portion of USG assistance in FY 2003 was devoted to bolstering BiH's capacity to develop effective rule-of-law institutions capable of simultaneously administering justice, fighting crime, and defending BiH from terrorism.

With USG equipment support and training assistance (FY 2003 and previous), Bosnia's State Border

Service (SBS) has begun to exercise greater control over BiH borders. While Illegal migration dropped markedly in FY 2003, terrorists and other criminal elements still manage to infiltrate. USG assistance helped secure adoption of several key pieces of counterterrorism-related legislation in FY 2003, including new Criminal and Criminal Procedure Codes at state and entity levels and amendment of the Citizenship and Immigration laws to include provisions that will allow authorities to take action against foreign-born terrorists and terrorist supporters. USG equipment and training assistance also contributed to the more effective functioning of the BiH State Court and State Prosecutor's office, both of which have important CT and anti-organized-crime functions. FY 2003 assistance helped establish the State Information and Protection Agency (SIPA), an organization that, when fully functional in 2004, will have FBI-like investigative and law enforcement functions. USG training assistance, through the Department of Justice, International Criminal Investigative Training Assistance Program (DOJ/ICITAP), has made major contributions to enhancing the professionalism of local law enforcement bodies. USG-BiH cooperative efforts have led to the creation of a shared criminal, intelligence, and border security data network and to the shutting down of three terrorist-related NGOs.

Trafficking in persons (TIP) remains a problem in Bosnia, but USG assistance in FY 2003 to state, entity, and local law enforcement officials and NGOs helped move BiH from Tier III to Tier II status in the State Department's annual report on trafficking. This status was obtained after the BiH government demonstrated its commitment to fight TIP by passing a Criminal Procedure Code that makes trafficking a crime punishable by up to 20 years imprisonment, establishing a state-level Ministry of Security and national Anti-TIP coordinator, and arresting several high-profile traffickers, who face prosecution in the State Court under the new Criminal Code. With USG training and assistance, BiH now has a functioning investigative task force focusing on trafficking under the supervision of the State Prosecutor.

Bosnia's criminal justice system is still plagued by corruption, low salaries, and poor training. The ineffectiveness of the courts and law enforcement bodies weakens national security. USG FY 2003 support contributed to strengthening the courts and law enforcement bodies at all levels. Assistance to the Independent Judicial Commission (IJC) helped that body begin to restructure and rationalize the court system and to vet candidates for judicial and prosecutorial positions. In addition, assistance to the Judicial and Prosecutorial Training Centers developed a local capacity to train judges and prosecutors. USG assistance also contributed to the physical renovation of several court buildings and prosecutors offices. USG-funded programs trained judges, prosecutors, and police officials in the provisions of the new Criminal and Criminal Procedure Codes and trained public officials in freedom of information procedures. Other programs provided specialized police training in undercover and surveillance operations, money laundering detection, and other investigative tools. Custom-designed hardware and software IT support to prosecutor and court registry offices created a capacity to manage and track cases in what will ultimately become an area-wide network. USG assistance also supported study trips by bar associations and established an Administrative Law Clinic at the University of Sarajevo. USG-funded exchange programs brought 24 Bosnian police officers to the U.S. for hostage rescue and close combat training.

Corruption erodes the functioning of Bosnia's political, public, and business life. To combat this, the USG funded the secondment of four U.S. citizen crime and corruption investigators to the Crime and Corruption Unit of the Office of the High Representative. The USG also funded a Banja Luka-based NGO, the Narodni Front, to develop a nation-wide public outreach campaign to educate citizens about the problem of corruption and advise them on legal and institutional modalities for resisting corruption. The bulk of the campaign will be conducted in FY 2004.

A USG priority in 2004 will be to support the setting up of a state-level Ministry of Defense with full operational control over all BiH military units, further to BiH's entry into PfP. This will include the construction of a state-of-the-art command and control center and the formation and training of a military joint staff and a cadre of effectively trained civilian MOD personnel. The U.S. will also continue to focus attention on establishing SIPA as an effective state-level law enforcement organization, strengthening the State Border Service fully to control BiH's borders, unifying the

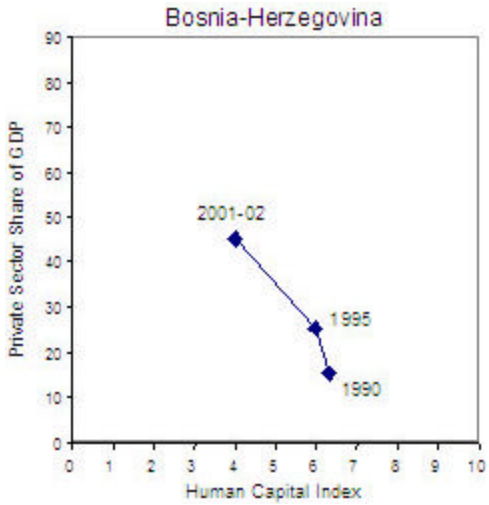
country's intelligence and security agencies, and building the capacity of domestic judicial and law enforcement institutions to dispense justice and fight crime and terrorism effectively.

COUNTRY PERFORMANCE MEASURES

Economic Policy Reforms and Democratic Freedoms in BiH, 1991-2002

Ratings based on a 1 to 5 scale, with 5 representing the most advanced.
Sources: EBRD, *Transition Report 2003* (November 2003); Freedom House, *Freedom in the World 2003* (2003); and (various years).

Economic Structure and Human Development in BiH, 1991-2002



The Human Capital Index is based on an average rating of four variables, scored on a 1 to 10 scale: per capita income; secondary school enrollment; health, as measured by life expectancy and under 5 mortality; and public policy, as measured by public expenditure on health and education as % of GDP. World Bank, *World Development Indicators 2003* (2003); and UNICEF, *Social Monitor 2003* (2003).

MEASURES OF PROGRAM EFFECTIVENESS IN FY 2003

DEMOCRATIC REFORM

Performance Indicator: Citizen Participation in Political/Social Decision-making (Source: USAID NGO Sustainability Index Ranking) (1 = highest; 7 = lowest)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
4.2	4.0	4.0

FY 2003 Results: USG programs, particularly support for NGO and other grass-roots networks, led to moderately improved levels of citizen participation in local and national politics, increased public understanding of civic rights and obligations, and improved public support for human rights, in FY 2003. These efforts specifically enhanced public understanding and support for initiatives leading to greater protections for the rights of children and the disabled, the environment, and drug/alcohol rehabilitation. In FY 2004, USG efforts will focus on working through NGOs to improve citizen/local community involvement with political parties and provide citizens with tools to combat corruption and monitor defense spending, healthcare, and environmental protection.

Performance Indicator: Independent Media (Source: IREX Media Sustainability Index)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
1.66	1.9	2.1

FY 2003 Results: USG support to the Communications Regulatory Agency in FY 2003 enhanced its ability to function effectively and professionally as an independent, state-level institution, capable of ensuring that domestic or outside political forces do not dominate public broadcasting. However, most media outlets, particularly in the print media, remain strongly influenced by political parties, and there were a number of cases of harassment and intimidation. Most media outlets are limited in their reach to one or the other of BiH's two entities.

ECONOMIC AND SOCIAL REFORM

Performance Indicator: Employment in small and medium-sized enterprises (SME) as a percentage of total employment (Source: World Bank, August 2003)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
Data not available yet	Data not available yet	Data not available yet

FY 2003 Results: SME development in BiH is hampered by an irrational and burdensome tax system, limited access to financing, and the presence of large, inefficient state-owned enterprises that discourage private sector development. Despite the existence of an extensive informal SME sector, unemployment rates remain high. Draft framework legislation to simplify and streamline indirect taxes was submitted to Parliament in the fall of 2003, but had not received final legislative approval by the end of the reporting period.

Performance Indicator: Effectiveness of Legal Rules for Investment (Source: EBRD, 2002)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
3.0	3.3	Data not available yet

FY 2003 Results: Significant progress has been made in recent years to create a legal framework for private investment, including legislation on companies, business entities, bankruptcy and liquidation, banking, taxation, securities, and land registries. However, considerable work remains to implement and enforce these laws. BiH institutions are weak and suffer from severe resource constraints. Judicial capacity must be strengthened.

Performance Indicator: Bank Reform and Interest Rate Liberalization (Source: EBRD, 2002)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
2.33	2.5	Data not available yet

FY 2003 Results: The financial sector has experienced the largest, most successful transition to a market-based economy in BiH. This sector has attracted the greatest share of FDI, and foreign banks are prominent and active participants in the local market. However, considerable work remains to implement fully Bank of International Settlements (BIS) standards, and strengthen prudential supervision. Private sector companies have difficulty obtaining financing, particularly long-term loans.

SECURITY, REGIONAL STABILITY AND LAW ENFORCEMENT

Performance Indicator: Trafficking in Persons (Source: State Department Annual Report on Trafficking 2003)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
Tier III	Tier II	Tier II

FY 2003 Results: BiH government and law enforcement authorities demonstrated heightened commitment to combating TIP by passing a new Criminal Procedure Code with anti-trafficking provisions, appointing a national TIP coordinator, and arresting several high-profile traffickers. These actions resulted in BiH's elevation from Tier III to Tier II status in the State Department's Annual Report on Trafficking for 2003.

Performance Indicator: Attain NATO Benchmarks for PFP Entry

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
Separate entity-level Militaries	Obtain broad support for defense reform including unified military	Target exceeded with full adoption by entities and state of legal framework for state-level Ministry of Defense

FY 2003 Results: In FY 2003, the BiH national government and both constitutive entities made dramatic progress in moving from separate, often contending entity-controlled armed forces, to

formal acceptance, through constitutional amendments, of a single state-level Ministry of Defense with full operational control over all military forces. These changes, which significantly reduce the likelihood of inter-ethnic violence and enhance overall regional stability, were accomplished under the guidance of a USG-led Defense Reform Commission. The reforms, when implemented, will establish baseline conditions for BiH's entry into NATO's Partnership for Peace program, a further stabilizing step that, with USG support, BiH could achieve in FY 04.

FY 2003 Support For East European Democracy (SEED)
Funds Budgeted for Assistance To:

Bosnia (In millions $, as of 12/31/03)

USAID - Democratic Reform $11.63
USAID - Humanitarian Response $8.76
USAID - Parking Fine Withholding $0.01
USAID - Private Sector $10.16
USAID Total: $30.56

State - Anti-Trafficking $0.30
State - Criminal Justice System $5.80
State - DRL/Int'l Commission Missing Persons $2.10
State - ECA Exchange Programs $1.88
State - EUR Democracy Programs $2.10
State - EUR Law Enforcement Programs $0.35
State - EUR Public Diplomacy $0.69
State - IIP Public Diplomacy $0.03
State - INL Law Enforcement Activities $3.20
State - INL Police Training $1.70
U.S. Department of State Total: $18.15

Broadcasting Board of Governors - Public Diplomacy $0.15
U.S. Department of Treasury - Technical Assistance $0.20
U.S. Department of Treasury - Advisors $0.95
Other Agencies Total: $1.30

GRAND TOTAL: $50.00

II. Country Assessment--Bulgaria

Area: 110,910 sq km, slightly larger than Tennessee
Population: 7,537,929 (July 2003 est.)
Annual Inflation: 5.9% (2002 est.)
Population Growth Rate: -1.9 % (2003 est.)
Gross Domestic Product (GDP): $49.23 billion (purchasing power parity, 2002 est.)
Life Expectancy: male 68.26 years; female 75.56 years (2003 est.)
GDP Per Capita: $6,500 (purchasing power parity, 2002 est.)
Infant Mortality: 13.7deaths/1,000 live births (2003 est.)
Real Annual GDP Growth: 4.8% (2002 est.)

U.S. STRATEGIC INTERESTS

Bulgaria sits at a strategic crossroad between Europe and Asia Minor. It borders on two NATO allies, and its NATO accession is scheduled for May 2004. The country has already been acting as a de facto ally on most issues and demonstrated repeatedly that it is a staunch friend of the U.S., a strong supporter of the war on terrorism, and a reliable partner in a volatile region. Bulgaria contributes troops to multinational peacekeeping efforts (such as SFOR, KFOR, and international forces in Afghanistan and Iraq) and has closely cooperated with U.S. forces in Operations Enduring Freedom and Iraqi Freedom. The USG's highest priorities in Bulgaria are continuing support for the war on terrorism and enhanced regional stability. In this context, the overarching goals are to ensure that Bulgaria remains a dependable ally and continues to play a stabilizing role in the region.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

In FY 2003, the U.S. Government (USG) provided an estimated $52.42 million in assistance to Bulgaria:

- $12.11 million in democratic reform programs (including Public Diplomacy exchange programs);
- $14.83 million in economic and social-sector reform programs;
- $22.67millionin security, regional stability, and law enforcement programs;
- $2.37 million in cross-sectoral and other programs;
- $0.30 million in Department of Defense (DOD) Humanitarian Assistance Program-Other; and
- DOD excess humanitarian commodities valued at $0.13 million.

In FY 2003, a total of 320 Bulgarians traveled to the U.S. on USG-funded exchange programs.

U.S. ASSISTANCE PRIORITIES

After 13 years of sustained U.S. assistance to Bulgaria, FY 2003 marked the beginning of a five-year period leading to the phase-out of such assistance. A strategic document is in place to guide USG activities during the 2003-2007 timeframe and laid the groundwork for a post-phase-out relationship between the two countries that serves as a strategic partnership in the region and strengthens the worldwide anti-terrorist alliance. By the time USG non-military programs end in 2007, Bulgaria will be securely grounded on a sustainable path toward democratic governance at all

levels, with its market economy better integrated in the international markets. The strategy identifies three areas as top priorities for USG assistance: enhanced rule of law; economic growth and increased prosperity, with focus on job creation; and strengthened local governance. Assistance efforts will increasingly concentrate on building self-sustaining local capacity. Given the limited timeframe and diminishing resources, the USG will maximize linkages among sectors in order to increase prospects for synergy and cooperation. In addition, the USG increasingly conditions support to key reform milestones that the Government of Bulgaria (GOB) must meet. Initial implementation steps in moving the country toward graduation and EU accession are encouraging.

Democratic Reform Programs: In FY 2003, the main priorities for U.S. democratic reform assistance in Bulgaria were the rule of law, strengthening local governance, and supporting civil society by building the capacity of independent media and non-governmental organizations (NGOs). The rule of law serves as the centerpiece of USG assistance to Bulgaria and consists of three major components: justice sector reform, anti-corruption efforts, and strengthened law enforcement and criminal justice institutions. The justice sector reform program was composed of enhancement of the institutional capacity to apply the law equally and expeditiously through training of legal professionals; formulation of codes of ethics for judges, prosecutors, and attorneys; and technical assistance in the administration of justice. The anti-corruption activities aimed to strengthen the GOB's institutional capacity to prevent corruption and enhance transparency and accountability, especially in the government audit, internal controls, and public procurement areas. In the local governance field, USG assistance focused on fiscal decentralization, building the capacity of municipalities to cope with increased responsibilities, and supporting NGOs that advocate on behalf of local governments. This effort was complemented by community-level activities that provided increased opportunities for ethnic minorities and encouraged greater ethnic and religious tolerance.

Building stronger civil society organizations, strengthening parliamentary practices, and improving the advocacy of the independent media further supported Bulgaria's transition to a strong democratic society. USG-funded exchange programs sought to familiarize Bulgaria's next generation of leaders with the day-to-day functioning of a democratic, market-based system, thereby helping to build a cadre of young leaders who can spearhead reform in the public and private sectors.

Economic and Social Sector Reform Programs: Despite the impressive reforms undertaken over the last five-to-six years, Bulgaria remains among the poorest EU applicants and lags behind other Central and Eastern Europe (CEE) countries on key economic indicators. Therefore, economic growth and increased prosperity through job creation continued as the overarching goal of USG economic assistance programs in FY 2003. By the time U.S. assistance phases out in Bulgaria, the private sector share of GDP is expected to reach 80 percent, GDP per capita (as a percentage of the EU level) will be at 46 percent, and unemployment will drop to 10 percent. In order to achieve these ambitious targets, USG economic assistance focuses on streamlining the enabling environment for business development, job creation, private sector growth, improved access to credit, and agriculture. More than 6,000 private companies receive support, and over 3,000 new jobs are created annually as a result of USG technical assistance and micro-lending programs. Support to energy regulation, bank privatization, and capital markets development were among the priorities in FY 2003. Social sector activities focused on consolidation of the pension reform; health care reform, with emphasis on hospital restructuring; and efficiency of the labor market. U.S. environmental programs promoted the sustainability of biodiversity conservation and ecotourism, and supported wastewater management.

Security, Regional Stability, and Law Enforcement Programs: In FY 2003, U.S. security-related assistance promoted civilian oversight of the Bulgarian armed forces and their modernization and professionalization. The USG continued to promote regional stability by helping Bulgaria enhance its interoperability with NATO forces. To this end, the USG provided the GOB with $19 million in Foreign Military Financing (FMF) and $1.35 million in International Military Education and Training (IMET). In the law enforcement arena, the USG worked on modernizing criminal justice institutions and strengthening Bulgaria's capacity to investigate and prosecute complex and trans-national

cases, particularly those involving trafficking in persons, cyber and financial crime, organized criminal activity, public corruption, and trafficking in narcotics and other contraband. Nuclear safety assistance targeted the upgrading the simulator at Units 5 and 6 of Kozloduy Nuclear Power Plant.

SECTORAL ASSESSMENTS

Democratic Reform

In FY 2003, Bulgaria continued to strengthen institutions responsible for democracy, the rule of law, human rights, and the respect for, and protection of, minorities. Toward improving the rule of law, Bulgaria enacted significant constitutional amendments, which govern the accountability of magistrates. However, further constitutional and legislative reforms are necessary to ensure that the justice system functions effectively and transparently. Major legislative changes further boosted the fiscal decentralization process, but work must continue to consolidate achievements and successfully implement reform. Despite the favorable legal environment and increased number of active NGOs, the sustainability of the civil society sector remains fragile. Media, while generally free, face pressure from the government and economic power groupings. The new implementation plan for the program for integration of Roma into society is a positive step. Determined and sustained efforts are needed to overcome discriminatory attitudes and behavior and to address the social disadvantages affecting the Roma minority. Corruption remains a serious problem. Furthermore, the decline of public confidence in Bulgaria's public institutions and growing public apathy to political life are alarming trends.

After years of inaction, the GOB demonstrated increased focus on rule-of-law issues in FY 2003. The role of assistance from the USG and other donors has been crucial in promoting justice sector reform, although progress has been uneven. The most significant achievements in FY 2003 were constitutional amendments involving accountability of magistrates and the establishment of the National Justice Institute (NJI) to train magistrates. U.S. and Western European constitutional lawyers provided a comparative law perspective for the constitutional amendments. In addition, the USG played a pivotal role in bringing the political parties into the dialogue. Prior USG assistance established the Magistrate Training Center, a private NGO, which will now be transformed into the NJI. When that process stalled in early 2003, the USG conditioned future training assistance on a series of milestones, all of which were met by November 2003. The modernization and expansion of court administration/case management practices continued, with major USG involvement.

Corruption continues to pervade Bulgaria at all levels and impedes economic growth and democratic development. Bulgaria's score deteriorated in Transparency International's Corruption Perception index in 2003. Increased corruption complaints by the business sector were the major reason for the lower mark. Despite this reversal, the country remains near the average for the EU candidates. In FY 2003, a significant part of USG democratization support focused on fighting corruption through technical assistance to the GOB and grants to civil society organizations. Two GOB ministries received help to streamline their internal control units (similar to Inspectors General) by work with their staffs to develop and adopt procedures that will ensure orderly performance of operations and guarantee adherence to effective management policies for fraud prevention and detection. The USG also assisted with drafting the new Public Procurement Law and related secondary legislation. Four pilot municipalities received support to develop a standardized documentation package for public procurement. On the civil society side, lobbying efforts resulted in passage of ombudsman legislation in FY 2003. USG grants enabled NGOs in pursuing initiatives addressing anti-corruption public awareness, advocacy, monitoring, and investigations of corruption. The investigations uncovered problems with public procurement, government concession contracts, and municipal property management, and have subsequently been turned into a "Sixty Minutes" type of nationally broadcast TV program.

In FY 2003, the USG democracy portfolio also focused on good governance at the municipal level and fiscal decentralization. Dominated by the municipal elections in October 2003, the year witnessed major legislative actions that have provided the basis for more effective, accountable

governance at the local level. USG assistance was the driving force behind these developments. Important changes to fight corruption allow for the establishment of a municipal ombudsman, prohibit councilors from serving on municipal company management boards, and provide for greater access by citizens to council meetings. The Municipal Budget Act adds significant transparency and predictability to intergovernmental fiscal relations, differentiates between centrally mandated services and local services, requires public hearings in the budget process, and provides for municipal borrowing. At the local level, municipalities continued to demonstrate their willingness to introduce new, more effective, and participatory practices. With a broader funding base, the number of Citizen Information and Service Centers continued to expand, to a total of 76.

Municipalities introduced new practices in local economic development and municipal marketing, with many revising local fee schedules to cover service costs. As a result, their own source revenues grew significantly faster than in previous years. All these successes are the direct outcome of long-term USG assistance. The October 2003 local elections demonstrated the improved capacity of local governments to provide better services and be more responsive to constituents, with the re-election of 54 percent of the incumbent mayors. The university linkage programs established with three American universities further supported the good governance and the decentralization efforts.

The USG provided assistance to the municipal elections by supporting a get-out-the-vote campaign by indigenous NGOs. All parties represented in Parliament also benefited from USG-funded training on outreach and articulating their platforms. The Embassy Democracy Commission small grants program supported NGOs that promote civic involvement and action. Assistance to the NGO sector continued at the community level and addressed issues of fundraising; insufficient service offerings, particularly in the social sphere; and low citizen participation. USG programs fostered public-private alliances by engaging the private sector, local government, and average citizens in resolving community issues. Community Funds were established in five cities. Ethnic integration efforts created models for addressing social, economic, and educational problems in towns having large Roma populations. The GOB developed its program for the social integration of Roma, with major USG assistance, and Peace Corps volunteers supported community-level efforts.

In FY 2004, establishing the rule of law and local governance issues will remain USG democracy priorities, complemented by community-level activities concerning ethnic integration and public-private partnerships. Through a new approach developed in FY 2003, improved coordination and collaboration among different entities delivering rule-of-law and law enforcement assistance will be refined and expanded. USG assistance will continue to address the ineffectiveness of the justice system by focusing on court administration reform, institutional strengthening of the Supreme Judicial Council, improved capacity of legal professionals through on-going training by the National Justice Institute, and policy assistance. Technical assistance to targeted professional/stakeholder organizations will be a new element. This will be complemented by an initiative targeting attorneys' professional development through strengthening the bar, continuing legal education, the setting up of legal clinics, and applying alternative dispute resolution. Anti-corruption activities will expand to additional ministries and will continue to enhance the GOB's transparency and accountability. The civil society aspect of these efforts will support investigative journalists and watchdog NGOs, as well as the advocacy building and public awareness endeavors of Coalition 2000.

In the local governance area, the USG will launch the final phase of its Local Government Initiative, in order to consolidate its achievements. Assistance will support ongoing GOB decentralization reform. The outcomes of the municipal elections in October 2003 will drive a significant part of the USG assistance. The more liberal election law defining lower thresholds for party registration allowed many local parties and a greater number of independents to compete successfully. Consequently, newly elected councils have a much broader base of representation. By supporting the National Association of Municipalities in Bulgaria and the Foundation for Local Government reform, the USG will help the new councils to organize themselves for more efficient and productive functioning and building the capacity of local government practitioners to apply new, devolved management and fiscal responsibilities.

Economic and Social Sector Reform

In FY 2003, Bulgaria managed to sustain good macroeconomic performance and sound fiscal policies. Real GDP growth has exceeded 4 percent a year since 1998, with an estimated 5 percent in 2003. New foreign direct investment (FDI), which had fallen to $458 million in 2002, is projected to recover in 2003 to over $1 billion, mainly from bank privatizations and the expansion of existing investments. Macroeconomic stability continued, with moderate inflation projected at slightly over 3 percent at year-end. Despite the weak global market environment, the Bulgarian economy registered a 12.6 percent increase in exports in the first half of the year. A sound fiscal policy and prudent revenue management have supported this strong performance. The GOB remained committed to key structural reforms and private sector development.

The EU recognized Bulgaria as a functioning market economy but warned that reforms must continue for it to cope with competitive pressures and market forces within the EU in the near term. Bulgaria's further economic progress is hindered by an inefficient judicial system; low-level corruption and organized crime; political interference and delay in privatizing state telecommunications and tobacco monopolies; persisting administrative barriers for businesses and foreign investments; and a high trade deficit. The IMF warned Bulgaria about its ballooning current account deficit (4.4 percent of GDP in 2002), stoked by its chronic trade deficit (projected at 9.5 percent of GDP for 2003, versus 10.4 percent of GDP in 2002) and by rapid growth in consumer credit and imports.

Persistently high unemployment (although declining recently to 13 percent from 17 percent officially) and low incomes continued to exacerbate popular dissatisfaction in FY 2003. With a minimum wage of $68, average salary of $175, and average pension of $67 monthly, Bulgaria maintains the lowest compensation levels in its region. Structural weaknesses of the labor market are long-term unemployment, high youth unemployment among those with lower education and skill levels, and wide regional variations. Though there has been some progress in increasing the scope of active labor market measures, these issues require further attention. Health care reform continues at an uneven pace and often is cited as a reason for public discontent. The population's health status is well below the EU average. Although HIV/AIDS infection rates remained be low, a recent World Bank report warns about the possibility of a pandemic increase in the region.

In compliance with the phase-out strategy, the USG focused its economic assistance on key areas, such as an improved business climate that will lead to economic growth and continue to attract investments; job creation through a strengthened private sector; improved access to financial resources; and a more competitive agricultural sector. FY 2003 marked the successful completion of U.S.-backed bank privatization in Bulgaria and the end of USG support to the capital markets. It leaves Bulgaria with stable institutions and a regulated market, though still operating with limited volumes. The USG continued to provide technical assistance to the financial sector, including work with the Central Bank to strengthen its oversight role and training to commercial banks through the International Banking Institute.

A significant portion of USG resources in FY 2003 was directed to enterprise development and investment, through improving the business climate, streamlining the tax collection system, and restructuring the energy sector. The USG provided substantive assistance in drafting key laws focusing on revamping and strengthening the GOB agencies charged with attracting investments and expanding the SME sector. The USG guided the development of a national Information and Communication Technology (ICT) Strategy that will make Bulgaria a center of ICT investment in the region and will add numerous jobs in the SME sector. The U.S. tax program aims to strengthen the capacity of the General Tax Directorate, as well as support the establishment and smooth transition of the National Revenue Agency to facilitate improved revenue collection.

With sector subsidies in place, Bulgaria is the least energy-efficient country in CEE, with the highest intensity of energy input per GDP and very limited incentives for conservation. The lack of a clear legal and regulatory framework and an autonomous, competent energy regulator are serious

deficiencies that limit FDI. Through a new program launched in FY 2003, the USG provided technical and legislative assistance to the GOB that focused on the creation of an independent regulator; supported the preparatory stage for the privatization of the electric distribution companies, and worked on the draft tariff framework ordinance for the electric power sector.

Over 56 percent of Bulgaria's land is agricultural, and since 1991, the country has undergone a complex and disruptive process of land restitution. The resulting fragmented structure of land ownership has adversely effected farm production. In 2003, the World Bank, together with the Ministry of Agriculture and Forests, began a long-term effort to facilitate land market transactions and increase the amount of land available for leasing for agricultural purposes. In FY 2003, agriculture's contribution to GDP was positive for the first time in 10 years, at 0.6 percent, and value added agricultural growth registered 5.1 percent.

The USG's agricultural programs target SMEs, increasing farm credit, supporting trade and investment, and Bulgaria's integration into the world economy. The USG's first agricultural sector trade and investment mission resulted in over $2 million in immediate sales and investment, mainly in the area of traditional agricultural products. Late in FY 2003, two new loan guarantee schemes were launched to stimulate agriculture sector lending. The USG also supported the sector's increased productivity and efficiency by providing assistance to the food processing and post-harvest food storage industry. Finally, in an effort to improve consumer health and the quality of local animal products, the USG supported four Bulgarian professors in an exchange program with U.S. universities.

With 99 percent of all registered companies, 62 percent of employment, and 20 percent of total export value, SMEs are now the main source of economic activity in Bulgaria. The SME sector continued to grow more rapidly and create more jobs and incomes than the state-owned enterprises during FY 2003. USG assistance contributed to that effect. In FY 2003 alone, over 2,600 private businesses were assisted through various business consultancy projects that resulted in 1,036 new jobs and retained another 614 jobs. USG assistance resulted in increased exports, the establishment of new business linkages among companies in the region and with counterparts overseas, and the introduction of key quality management and industry standards and international business practices. To increase opportunities for private sector growth, the USG continued to expand two micro-finance programs in the existing and new program centers, targeting the smallest, most disadvantaged micro-entrepreneurs. By September 2003, active clients had increased to more than 5,400 (71 percent to women), 32 percent more than in FY 2002. The micro-lending programs helped create more than 2,900 new jobs and sustain close to 16,000 jobs in the country. To improve access to credit further, the USG continued to implement three loan-guarantee schemes by covering half of the risk. The three facilities implemented by two Bulgarian banks placed 163 loans exceeding $15 million in FY 2003.

In FY 2003, the USG continued to support Bulgaria's pension reform efforts, thus helping the country to preserve its position as a regional leader in the area. USG assistance was instrumental in improving the system's transparency and in ensuring a higher level of protection for people's savings. With USG support, the GOB continued to address labor market efficiency, at both the national and municipal levels. Results of the assessments of local labor markets completed in four pilot municipalities will serve as a basis for introducing employment promotion measures. The USG continued to support Bulgaria's health reform by focusing on financing and hospital restructuring issues. It funded a large-scale education program to inform the public about new opportunities for both workers and employers for retraining and job creation. The USG Social Partnership Program focused on school-to-work and youth employment initiatives, combating gray market activities through joint efforts with labor inspectorates. A new youth initiative targeting underserved, disadvantaged, or at-risk groups started in FY 2003. In an attempt to build the capacity of Bulgarian business leaders, the American University in Bulgaria successfully launched its executive MBA program.

Bulgaria's rich biodiversity (third in Europe) has high economic value and is important to sustainable

economic growth and the preservation of its heritage. In FY 2003, the USG supported the establishment of a Protected Areas Fund, the first conservation trust fund in Eastern Europe. The World Bank Global Environment Facility has pledged a $2 million grant to the fund, and the GOB has promised matching contributions. Tourism (particularly ecotourism) is an important priority for Bulgaria. To this end, the USG helped in the development of the national eco-tourism strategy and action plan that will serve as a business promotion tool, fostering job creation and economic growth. In FY 2003, the USG launched a new initiative to support the establishment of Bulgaria's first training center for water and wastewater operators. In the long run, this will lead to the increased professionalism of water and wastewater operators, as well as improved quality of services and environmental protection.

Security, Regional Stability, and Law Enforcement

The focus of U.S. security assistance to Bulgaria in FY 2003 was preparation for its NATO membership, and upgrading forces for engaging in the international war on terrorism. To this end, the USG provided the GOB $19 million in Foreign Military Financing (FMF) and $1.35 million in International Military Education and Training (IMET). FMF facilitated Bulgaria's acquisition of up-to-date, NATO-compatible Communication Information System equipment. IMET ensured Bulgaria's continued exposure to Western models of force structure, tactical doctrine, resource management, and the professional military education (PME) of military and civilian personnel expected to occupy key positions in a defense-reformed environment. A total of 154 Bulgarian officials participated in different training courses under IMET. The Ministry of Defense continued to take advantage of the $1.1 million grant that the U.S. provided for Enhanced International Peacekeeping Capabilities (EIPC) in 1999, toward train-the-trainer types of instruction with the Center for Civil-Military Relations (CCMR) in Monterey, CA. In FY 2003, three Bulgarian students completed the Phase II Instructor course, and a CCMR team visited the country to conduct a site survey with the purpose of finalizing the Bulgarian peacekeeping concept/Country Action Plan. A new program targeting the safety of Kozloduy Nuclear Power Plant was launched in 2003. The simulator at Units 5 and 6 will be upgraded with $2 million in regional SEED funds.

Bulgaria's criminal justice sector remains weak, corruption is pervasive, and organized criminal activity threatens the country's long-term stability. U.S. criminal justice assistance in FY 2003 was designed to strengthen justice sector institutions to permit better investigation and prosecution of complex and transnational cases, particularly those involving trafficking in persons, cyber and financial crime, organized criminal activity, public corruption, and trafficking in narcotics and other contraband. To date, few such cases have gone to trial. With USG assistance, Bulgaria strengthened its ability to combat trafficking in persons by amending its penal code to penalize explicitly such trafficking. It also passed a comprehensive anti-trafficking act, which requires the development of national, regional, and local strategies to combat trafficking, and mandates extensive assistance to victims.

Bulgaria also took substantial steps toward institutionalizing a system of probation, as an alternative to incarceration for non-violent offenders, and toward developing a comprehensive witness protection program. Further, the Bulgarian Specialized Investigative Service and the Bulgarian Association for Informational Technology opened a Computer Crimes Training Center to teach computer literacy and forensics to police and magistrates. In addition, a unit was established within the Ministry of Interior to handle international requests for assistance with computer and digital evidence. The Department of State/Bureau of International Narcotics and Law Enforcement Affairs (INL) administered SEED funding in support of five projects in Bulgaria: Department of Justice, Office of Overseas Prosecutorial Development, Assistance and Training (DOJ/OPDAT) Resident Legal Advisor (RLA); CEELI Criminal Law Liaison; Department of Justice, International Criminal Investigative Training Assistance Program (DOJ/ICITAP) Forensics Lab Development; ICITAP and CEELI-implemented Regional Criminal Justice Initiative; and ICITAP Establishing the Analytical Unit.

Working with Bulgarian counterparts, U.S. advisors established a task force to investigate and prosecute financial crimes, particularly those with a Bulgaria-U.S. nexus. Task force cases to date

have involved fraud, embezzlement, illegal exporting, and counterfeiting, including large amounts of U.S. currency. A similar multi-institutional approach is being applied to improve the Bulgarian tax enforcement regime. The USG also provided assistance for the development of a Bulgarian law on money laundering, terrorist financing, and asset forfeiture, and currently is promoting criminal procedure, counterfeiting, and tax-related reforms. In addition, a comprehensive financial investigation techniques training program enhanced the professionalism of various counterparts: the financial intelligence unit, economic and organized crimes police, prosecutors, investigators, tax and customs authorities, as well as commercial banks. Through the SECI Center in Bucharest, the USG also supported cooperation between Bulgarian police forces and their counterparts in the region.

Through the International Visitors Program, key figures from the GOB, NGOs, and the media visited the U.S. for programs on combating international crime, probation and sentencing, and U.S.-European security issues. The Embassy Democracy Commission's small grants program supported NGO projects to build public awareness on NATO membership and foreign policy issues, anti-trafficking, and anti-corruption.

In 2004, U.S. security assistance will further support the reform efforts of the Ministry of Defense, in line with NATO requirements. The final stage of that reform continues through 2004, with a major equipment modernization effort. U.S. security assistance (through FMF and IMET) will provide the necessary support for a long-term force modernization plan. Security assistance objectives for FY 2004 will also foster greater mutual understanding and trust and doctrinal interoperability through: 1) the IMET program; 2) acquisition of up-to-date and NATO-compatible equipment through the FMF program or through the use of national funds in the Foreign Military Sales program; 3) support for Bulgarian efforts to aid the most disadvantaged citizens through Humanitarian Assistance Program-Excess Property (HAP-EP) and Humanitarian Assistance Program-Other (HAP-Other) projects; and 4) providing Excess Defense Articles (EDA), when possible, to help bridge equipment requirements until the reforms have been completely implemented.

Assistance to strengthen Bulgarian criminal justice institutions will continue in FY 2004, as an integral part of the rule of law program and with particular emphasis on increasing capacity to investigate and prosecute complex and transnational crime, and on modernizing criminal and criminal procedure codes. One indicator of strengthened criminal justice institutions will be more complex and transnational crime cases going to trial.

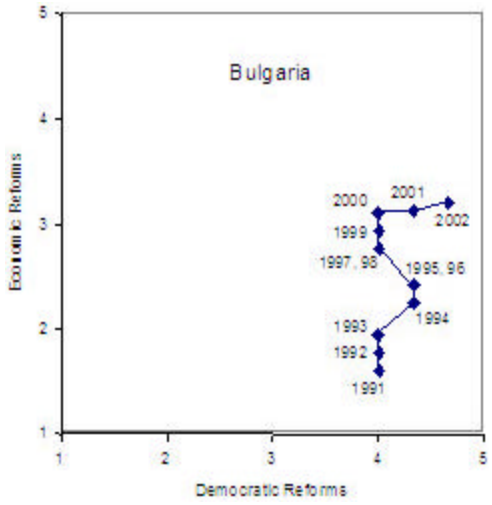
Humanitarian Assistance

The long-term commitment of Humanitarian Assistance Programs (HAP) aimed at cooperative efforts with the GOB to improve the quality of life and health care services for the population continued throughout FY 2003. In March, the USG coordinated the donation of excess property of about $0.13 million in medical supplies and equipment, furnishings, vehicles, and other property. A grant of $.30 million enabled the extensive renovation of the multi-profile wing of Haskovo United Regional Hospital. Twenty large patient wards and dilapidated structures were replaced with 120 up-to-date, single-patient rooms, fully integrated inpatient sections with spacious and functional waiting areas, and consulting stations. In addition, structural components (heating, plumbing, sanitation, lighting, etc.) of the cardiology, orthopedic, surgery and maternity wards were upgraded.

COUNTRY PERFORMANCE MEASURES

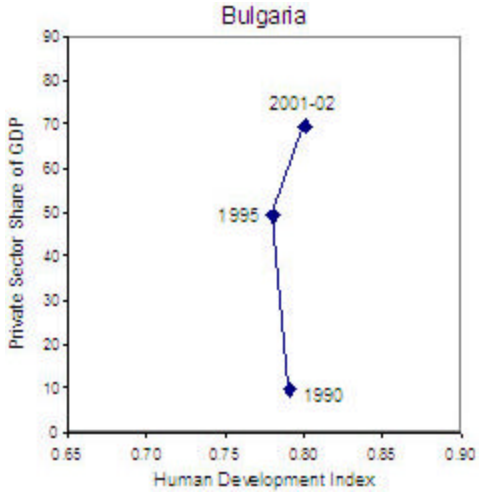
Bulgaria's macroeconomic policy performance was strong in FY 2003; the justice sector reform made progress; and civic organizations and media played a stronger role in creating checks and balances against the government. Corruption and organized crime, however, continue as major problems for the country.

Economic Policy Reforms and Democratic Freedoms in Bulgaria, 1991-2002



Ratings based on a 1 to 5 scale, with 5 representing the most advanced.
Sources: EBRD, *Transition Report 2003* (November 2003); Freedom House, *Freedom in the World 2003* (2003); and (various years).

Economic Structure and Human Development in Bulgaria, 1991-2002



The Human Development Index (HDI) is based on three indicators: longevity, as measured by life expectancy; educational attainment, as measured by a combination of adult literacy and combined primary, secondary and tertiary enrollment ratios; and standard of living, as measured by real per capita GDP ($PPP). The HDI ranges from 0 to 1, with higher values representing greater human development. UNDP, *Human Development Report 2003* (July 2003), and previous editions; EBRD, *Transition Report 2003* (November 2003), and previous editions.

MEASURES OF PROGRAM EFFECTIVENESS IN FY 2003

DEMOCRATIC REFORM

Performance Indicator: Freedom House *Nations in Transit* Rule of Law Rating: Constitutional, Legislative, and Judicial Framework (1 = highest; 7 = lowest)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
3.50 (based on events in CY 2001)	N/A	**3.50 (based on events in CY 2002)**

FY 2003 Results: With substantially broadened political support, judicial reform in Bulgaria made progress in FY 2003. The constitutional amendments pertaining to the judiciary, the establishment of the National Justice Institute, and the adoption of an electronic case management system constitute significant achievements. While these positive developments are not captured by the FY 2003 Rule of law rating, the Judicial Performance Index (JPI), developed in country, determines progress for the sector. On a scale from 2 to 6 where 2 is the lowest, the JPI score in FY 2003 was 3.7, compared to 3.5 in FY 2002. Nevertheless, Bulgaria still needs to address major deficiencies such as serious delays in the judicial system; legal professionals with inadequate legal expertise and experience; and the politicization of the judiciary.

Performance Indicator: Freedom House *Nations in Transit* Corruption Rating (1 = highest; 7 = lowest)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
4.50 (based on events in CY 2001)	N/A	**4.25 (based on events in CY 2002)**

FY 2003 Results: Despite the establishment of a GOB's Anti-Corruption Commission, amendments to existing legislation, and the adoption of new laws (including the Ombudsman Law) with the explicit objective of improving transparency and accountability, pervasive corruption continues at all levels. Lack of transparency and accountability and waste, fraud, and abuse in government procurement, and poor audit capacity remain major issues.

Performance Indicator: Freedom House *Nations in Transit* Civil Society Rating (1 = highest; 7 = lowest)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
3.25 (based on events in CY 2001)	N/A	**3.25 (based on events in CY 2002)**

FY 2003 Results: The sustainability of the civil society remains fragile,in spite of the increased number of active NGOs and a favorable legal environment. While the NGO sustainability ratings for organizational capacity, infrastructure, and public image have improved, financial viability, advocacy, and the provision of services remain issues.

ECONOMIC AND SOCIAL REFORM

Performance Indicator: Private-sector share of GDP (Source: National Statistics)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
65%	70%	**70% (projected)**

FY 2003 Results: The GOB's privatization program advanced more slowly than expected, due to many procedural problems and political interference. Trends are positive, nevertheless. The private sector continues to grow, with SMEs as the main source of economic activity in Bulgaria.

Performance Indicator: Unemployment Rate (Source: National Statistics)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
16.5%	16%	**13% (Jan-Oct)**

FY 2003 Results: Unemployment decreased in FY 2003, with the growth of new jobs in both the private sector and government entities. Due to the importance of active labor market policies, the large informal economy, and the difficulty in defining agricultural employment in structures of predominantly small-scale farming, the real situation in the labor markets remains difficult to assess. The ongoing reduction in unemployment should be supported further by correcting the rigidities of the labor market and improving the education system.

SECURITY, REGIONAL STABILITY, AND LAW ENFORCEMENT

Performance Indicator: TIP Ranking (Source: State Department)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
Tier II	N/A	**Tier II**

FY 2003 Results: The GOB still does not fully comply with the minimum standards for the elimination of trafficking in persons; however, it is making significant efforts to do so. The GOB passed anti-trafficking legislation in 2003, and showed some improvements in international law enforcement cooperation. Overall improvements from the previous year were, however, limited.

FY 2003 Support For East European Democracy (SEED)
Funds Budgeted for Assistance To:

Bulgaria (In millions $, as of 12/31/03)

USAID - Democratic Reform $8.47
USAID - Economic Prosperity & Security $5.46
USAID - Private Sector $8.75
USAID Total: $22.68

State - Criminal Justice System $0.36
State - ECA Exchange Programs $1.38
State - EUR Public Diplomacy $0.40
State - IIP Public Diplomacy $0.15
State - INL Law Enforcement Activities $1.05

U.S. Department of State Total: $3.33

Broadcasting Board of Governors - Public Diplomacy $0.08
DHS/Customs - Law Enforcement Activities $0.28
U.S. Department of Treasury - Advisors $1.00
U.S. Department of Agriculture - Technical Advisors $0.65
Other Agencies Total: $2.00

GRAND TOTAL: $28.00

II. Country Assessment--Croatia

Area: 56,542 sq km, slightly smaller than West Virginia
Population: 4,422,248 (2003 est.)
Annual Inflation: 2.2% (2002 est.)
Population Growth Rate: 0.31 (2003 est.)
Gross Domestic Product (GDP): $38.9 billion (purchasing power parity, 2002 est.)
Life Expectancy: male – 70.76 years; female – 78.2 years (2003 est.)
GDP Per Capita: $8,800 (purchasing power parity, 2002 est.)
Infant Mortality: 6.92/1,000 live births (2003 est.)
Real Annual GDP Growth: 5.2% (2002 est.)

U.S. STRATEGIC INTERESTS

Croatia's SEED assistance program continues to be an integral tool in achieving the goals embodied in the Embassy's Mission Performance Plan (MPP). SEED assistance resources enable the U.S. to support and, in some cases, accelerate Croatia's successful transition from communism and the legacy of ethnic war -- a critical ingredient for the U.S. Balkan policy goal of regional stability. SEED programs are aimed at ensuring that Croatia develops a fully democratic society and productive market-oriented economy that will serve as a cornerstone for peace and stability in Southeastern Europe, while promoting Croatia's aspirations for membership in NATO and the EU. SEED assistance also enables the Embassy to engage Croatia on important U.S. foreign policy concerns, such as trafficking in persons, professionalizing the police force, and combating international crime.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

In FY 2003, the U.S. Government (USG) provided an estimated $37.0 million in assistance to Croatia:

- $10.38 million in democratic reform programs (including Public Diplomacy exchange programs);
- $13.66 million in economic and social-sector reform programs;
- $12.05 million in security, regional stability and law enforcement programs; and
- $0.68 million in cross-sectoral and other programs.

In FY 2003, a total of 41 Croatians traveled to the U.S. on USG-funded exchange programs.

U.S. ASSISTANCE PRIORITIES

Democratic Reform: In FY 2003, U.S. assistance focused on giving citizens a greater voice in shaping their government and in helping political leaders understand the issues most important to citizens. This assistance was particularly critical during the campaign for parliamentary elections held in November 2003. U.S. assistance shaped the debate through extensive public polls, which -- when made public -- helped bring all of Croatia's mainstream political leaders to acknowledge the broad consensus for continued integration into Euro-Atlantic institutions. Other U.S. assistance priorities in 2003 included support to local governments that served to enhance their skills in financial and asset management, local economic development, and citizen participation in local

affairs. Support to the NGO sector continued to strengthen the capacity of Croatia's non-profit organizations to improve their financial sustainability through training and technical assistance.

Economic and Social Sector Programs: In FY 2003, the overarching objective of USG assistance in the economic sector was the growth of a dynamic, competitive private sector that can generate employment and higher incomes for more Croatians. The USG's economic program is addressing this goal in three ways: first, SEED-funded programs are assisting Croatian small and medium enterprises, to acquire the skills, tools, financing, and services needed for them to compete in local, regional, and global markets. Second, programs are working directly with farmers, producer organizations, and processors to increase the local consumption of domestically produced agriculture products and to raise the competitiveness of the Croatian agricultural sector. Third, the USG, together with the World Bank, is improving the investment climate by accelerating the privatization process, supporting the development of a competitive and well-regulated energy sector, and promoting interregional energy-sharing agreements between Croatia and its neighbors. The USG's priorities in the social sector included public awareness activities to combat trafficking in persons and increase the understanding of HIV/AIDS and the stigma brought upon its victims. The USG's successful efforts to establish a comprehensive pension program will soon be completed.

Security, Regional Stability, and Law Enforcement: In FY 2003, U.S. assistance sought to bring Croatia nearer to integration into Euro-Atlantic institutions and to encourage closer relations with its neighbors in the region. During FY 2003, U.S. security-related assistance improved the Croatian forces' ability to participate in international peace support operations and advanced Croatia's progress toward meeting NATO membership criteria. U.S. assistance is also directed to helping Croatia improve control of its borders, to prevent the flow of weapons of mass destruction and other illicit trafficking. Since long-term regional stability will depend also on permanently solving unresolved issues resulting from nearly a decade of ethnic war in the Balkans, the USG provided targeted assistance to help rebuild communities where refugees were returning and to support economic activities for the returnees. Law enforcement assistance focused on developing self-sustaining systems for professional training, performance monitoring, and ethical standards enforcement within the police and State Prosecutor's office.

SECTORAL ASSESSMENTS

Democratic Reform

Overview: In FY 2003, Croatia made significant but uneven progress toward meeting Western democratic standards; it still lags behind Northern Tier states on all major reform indicators. Preparations for a general election to succeed Croatia's first post-Tudjman government were transparent and accorded with democratic standards. OSCE judged that these preparations were "fundamentally improved" to a degree that short-term international monitors were not required to ensure proper conduct of the election. Election monitoring was conducted instead by political parties themselves and by highly professional local NGO monitors. Parliamentary elections took place in an orderly manner, which the OSCE determined was "generally in line" with Western standards, with no significant irregularities reported.

Major political parties competed for votes in a contest entirely devoid of nationalist rhetoric. All declared that progress toward membership in the EU and NATO was their overriding foreign policy goal, and that they were willing to make the necessary domestic political sacrifices to achieve them.

The next Croatian government coming to power in January 2004 will be led by the HDZ, the same political party which voters rejected in the January 2000 elections. During nearly four years in opposition, the HDZ went through significant internal changes, which its leaders claim have transformed it into a responsible, democratic party capable of continuing reform efforts in Croatia. These assertions will now be tested. The Embassy will be to press for consolidation of reforms and seek to convince the new government that it is in its interest to continue to work toward building Croatia's civil society.

Key Issues and USG Assistance: USG resources are strengthening Croatia's democratic institutions through a comprehensive development assistance program that includes strengthening political parties and the legislature, judicial reform, NGO and civil society development, and local government reform.

U.S. assistance in political processes will continue to be essential to further the consolidation of democratic reforms. Focus will shift from work with political parties to work with institutions, particularly with the new parliament. U.S. assistance will also be directed toward the shortcomings identified in the OSCE assessment of the November 23 election: improving the legislative framework for elections, improving access to voting for refugees, and increased transparency of campaign spending.

Judicial reform continues to lag behind other areas of democratic development. Inefficient courts and outdated, often contradictory legislation led to huge case backlogs, predominantly in civil courts. Lack of progress in judicial reform is hampering Croatia's economic development; civil cases can take years to come to trial.

The USG, European Commission, World Bank and Government of Croatia (GOC), reached agreement on a standardized, court-case management software platform that will be implemented in courts countrywide by 2005. The new system will improve judicial efficiency and significantly reduce GOC costs. The agreement demonstrated how collaboration among donors was able to break through GOC inertia to spark a real step forward toward improved judicial efficiency.

USG efforts to improve the legal environment for Croatia's non-profit sector achieved remarkable results during FY 2003. The USAID-funded International Center for Not-For-Profit Law (ICNL) provided a full range of legal, structural, and organizational advice to the Government Office for Cooperation with NGOs that resulted in the enactment of new laws on Humanitarian Assistance and the National Foundation for Civil Society, as well as a decree on the Distribution of the Lottery Proceeds to NGOs. USAID's NGO Support Program (CroNGO) engaged citizens around the country, as well as making stronger, more professional organizations to take the leading role in advocating for delivering services to those disenfranchised sectors of society, including HIV/AIDS and trafficking victims, the elderly, and the disabled. Over 123 new community projects reached every county of Croatia and mobilized more than 16,000 citizens in 2003, bringing long-needed change and improvement to communities.

The SEED-funded Local Government Reform Program (LGRP) has been instrumental in strengthening the capacity of over 400 of Croatia's 567 local governments that were ill prepared to take on the new, increased responsibilities devolved from the central government in 2001. Technical assistance modules in financial and asset management, local economic development, and citizen participation in local affairs have provided local governments with valuable tools as they begin to manage their own affairs. As a result of this program, cities have adopted asset management reforms leading to increased revenues from assets that had never been used for income. For example, the mayor of one of LGRP's partner cities, Varazdin, noted to the city council that the asset management effort the city had undertaken resulted in savings or additional revenues of about $3.4 million, or about 20 percent of the city's budget.

The Embassy's Public Affairs Section administered 16 Democracy Commission grants, three International Visitor projects, three Ron Brown Fellowships and six media/journalism projects in FY 2003. The Democracy Commission grants in this area were aimed at supporting democratic initiatives, media reform, the reintegration of refugees, and the promotion and protection of human rights. Specific projects included promotion of youth volunteerism and leadership, ethnic tolerance, NGO capacity building, investigative journalism, and community self-development and sustainability.

In FY 2004, Croatia's SEED assistance in the democracy sector will expand its efforts in local government reform to include 65 new cities and municipalities. Efforts to improve the capacity of the NGO sector will continue.

Economic and Social Sector Reform

Overview: Croatia's economy has undergone a remarkable transition over the last few years, especially in terms of achieving macroeconomic stability. With macroeconomic reforms locked in, Croatia's GDP grew at a 3.8 percent rate in 2001 and at 5.2 percent in 2002. In FY 2003, Croatia' GDPs is expected to grow at 4.5 percent. Tight monetary policy and increased competition have helped keep inflation at a low 1.7, 2.3 and 3 percent for the last three years. Economic growth has been driven by a recovery of the tourist sector from the travails of the 1990's; strong government investment, especially in roads; and a boom in consumer spending. The latter was fueled by the injection of foreign capital into the almost completely privatized banking sector and low tariffs. Unemployment decreased to 14.1 percent (ILO methodology) for the first half of 2003, down from 15.2 percent for the first half of 2002, and 16.0 percent for all of 2001. While no official statistics are available, a significant portion of the labor force remains underemployed in the heavily subsidized and yet-to-be-privatized state-owned industries that include shipyards and agrokombinats. The eventual transition of these industries through bankruptcy or restructuring could slow the decrease in the unemployment rate.

Key Issues and USG Assistance: The USG supported the 5,000-member Croatia Employers Association (HUP) in establishing the Association for Management Consultants (AMC) in order to ensure quality standards for consultants. The AMC now has over 100 individual and firm members. USAID technical assistance was instrumental in the AMC's development of internationally accredited standardization programs for International Standards Organization and Hazard Analysis of Critical Control Points (HACCP). As the EU requires these standards, SMEs that receive accreditation in these programs will be better able to meet EU criteria for export purposes. Over 200 trainees from more than 100 firms in the AMC have participated in these courses, enabling them to deliver valuable business development services to a wide range of Croatian businesses. Training recipients have secured more than 300 paid contracts from interested local businesses representing more than €1 million of revenue.

USAID's new Agribusiness Competitiveness Enhancement (ACE) program helped a major fresh produce supplier to meet the strict quality standards of the U.S. military. As a result of two successful test shipments, the distributor recently received a standing order for weekly shipments of produce to support U.S. forces in Kosovo that is expected to bring in more than €600,000 in revenues over the next year. Equally important, results of the program will enable Croatian agribusinesses to prepare for the daunting challenge of competing directly with heavily subsidized EU agriculture.

SEED-funded technical assistance played a key role in Croatia's progress toward the restructuring of its power sector. Croatia's geographic position and technical capability make it the leading actor in regional electricity interconnections, and it is pursuing the development of a Regional Electricity Market in Southeast Europe. Technical assistance provided by USAID has enabled the Croatian Energy Regulatory Council to assert its strong role.

Privatization remains critical for increasing the private sector share of the economy and reducing the level of cash subsidies for state-owned-industries that continue to heavily burden the Croatian Treasury. USG assistance was pivotal in 2002 to reducing the Croatian Privatization Fund's (CPF) portfolio of companies that remain to be privatized from 1,900 to 1,100. However, political differences among GOC coalition partners derailed the government's privatization program and almost brought it to a complete halt, in January of 2003. As a result, the Embassy severely restricted expenditures by the implementing contractor supporting CPF processes, primarily by reducing staffing levels to a bare minimum. Engagement with the (new) GOC will resume, should the environment become more favorable.

The Public Affairs Section supported one grant and two Ron Brown MBA Fellowships aimed at the economic sector, assisting Croatians to start and improve small businesses. Results of the small

business program include plans to establish a sister-city relationship between Miami and Rijeka and continuing contacts between the Croatians and the International Business Incubator in San Jose, CA.

The U.S. Treasury budget assistance mission to the Ministry of Finance (MOF) focuses on improving the process of preparing, presenting, and executing the budget, assisting the MOF with the requests of the international financial institutions (IFIs), and training MOF staff in all aspects of the budget process. Intra- and inter-ministerial turf battles have diminished the effectiveness of this assistance. Treasury also finances a program of intermittent assistance in the area of tax auditing and collection. While receptivity has been generally good, further progress on public administration reform would help increase the effectiveness of this (and other) assistance.

The Embassy's public education program on pension reform enabled the GOC to win essential popular support for this reform. Pension reform is considered one of the GOC's most successful transition activities. The popular support the program it garnered was pivotal in the GOC's ability to implement its Tier I and Tier II pension fund programs and has set the stage to roll out its 401k-like pension fund program early in 2004.

Media campaigns and journalist training focused on changing perceptions and resulted in increased knowledge of the effects of trafficking in persons from a baseline of 45.5 percent to 80.3 percent. The Public Affairs Section administered two International Visitor (IV) projects focused on assisting women entrepreneurs, increasing the knowledge base on biotechnology, and supporting efforts to combat trafficking in persons. Democracy Commission grants aimed at drug/alcohol abuse prevention, environmental protection, and assisting the Roma population. The Roma programs have assisted in the founding of a kindergarten for Roma children that teaches basic Croatian and helps prepare them for entry into the Croatian school system.

In FY 2004, Croatia's SEED assistance in the economic sector will expand its efforts in the agribusiness program to economically distressed areas, including Croatia's war-affected regions, with new project activities focused on increasing employment and incomes.

Security, Regional Stability, and Law Enforcement

Overview: Croatia's continued progress toward integration into regional and Euro-Atlantic security institutions and developing positive relations with other states in Southeast Europe is essential to achieving the U.S. goal of improving regional security in the Balkans. Croatia has the potential to become a strong regional leader on security issues, and U.S. assistance is directed toward achieving that goal. Croatia made significant progress in FY 2003 toward meeting the criteria for NATO membership. The GOC tackled the politically sensitive issues of restructuring the Defense Ministry and downsizing the armed forces and is on track to meet downsizing goals set in its NATO Membership Action Plan. Croatia's defense planning documents show that the GOC no longer sees a strategic threat from any of its neighbors, but the structure of its armed forces is still adapting to this change. Croatia participates in a number of international peace support operations and deployed a platoon of highly professional military police to assist international efforts in Afghanistan.

Croatia made important, if uneven, progress in building cooperative relationships with its neighbors in the region. Relations with Serbia and Montenegro are moving toward normalization. In FY 2003, Croatia reached agreement with Serbia and Montenegro to bring the UN Observer Mission in Prevlaka to an end, reached a provisional agreement temporarily lifting visa requirements, and implemented a free trade agreement. Relations with Bosnian Croats became more transparent, and the GOC continued to support international community efforts to build state institutions in Bosnia. Relations with Slovenia are generally good, but several irritants -- like a dispute over a maritime border and Croatia's unilateral declaration of an Exclusive Economic Zone -- remain unresolved.

Progress toward reintegrating those members of Croatia's ethnic Serb minority displaced by the war

was uneven and disappointing. Although the GOC announced a series of measures aimed at encouraging the return of refugees and the restitution of their property, implementation lagged far behind expectations. One bright spot was the passage of the Constitutional Law on National Minorities, which gave minorities a new level of representation at both locally and nationally.

Key Issues and USG Assistance: Croatia's ability to train its forces to meet NATO standards is limited due to budget constraints, and the armed forces lost an important resource in U.S. International Military Education and Training (IMET) funding when it chose not to sign an "Article 98" agreement to prevent the transfer of U.S. citizens to the International Criminal Court. FMF and IMET funding was suspended in July 2003, in accordance with the American Servicemembers Protection Act (ASPA). Before this cutoff, the USG had provided $750,000 in FY 2003 IMET funds to train 28 members of Croatia's armed forces and $5.5 million in FMF funds to purchase VHF radios to enhance NATO interoperability.

Croatia took steps to improve its export control regime and works cooperatively with the U.S. and other states in the region to interdict trade in narcotics and to protect against proliferation of weapons of mass destruction. Early in FY 2003, Croatia -- in cooperation with the U.S. -- tracked and then seized the suspect vessel MV Boka Star, which had an illicit cargo of explosives and rocket propellant, reportedly destined for a state of concern in the Mideast. In mid 2003, Croatian authorities worked with the U.S. Drug Enforcement Agency to track and seize a shipment of 350 kilograms of cocaine from South America. While the Boka Star and cocaine seizures were clear successes, outdated legislation, unclear lines of authority, lack of expert personnel, and insufficient resources prevent Croatia from maintaining full control over its borders. New U.S. Export Control/Border Security (EXBS) assistance, combined with assistance from other donors, including from the EU, is addressing this shortcoming.

The SEED program has been actively engaged in improving the living environment in 10 municipalities in Croatia's war-affected area in order to promote the sustainable return of refugees and stability in the region. USAID's Community Infrastructure Program (CIRP) and Economic and Community Revitalization Activity (ECRA) have been successful in encouraging refugee returns and improvement in the overall economic conditions in the regions.

CIRP's infrastructure program has completed nearly 100 projects. The remaining projects are in the final implementation phase and were completed in CY 2003, at which time the project will close. CIRP restored eight community centers, 14 schools, five kindergartens, a health clinic, two roads, as well as renovating and rehabilitating water and electrical facilities, to the benefit of 55,000 people (about 18,000 families) in 144 communities. Completed water and electric projects provided over 2,500 new or repairedconnections to public utilities.

As of September 2003, ECRA activities had created employment for 716 people, generated 163 new contracts worth almost $1 million for assisted enterprises, and leveraged close to $500,000 of funding from other sources, including commercial bank loans. Almost 10,500 people of all ethnic groups have participated in ECRA-assisted community activities, and over 8,000 people received legal assistance, of which 45 percent had their cases resolved.

Croatia made significant strides in improving the professional capabilities and performance of its law enforcement organizations in FY03. The Department of State/INL administered SEED funding to support two projects in Croatia: the Department of Justice, Office of Overseas Prosecutorial Development, Assistance and Training (DOJ/OPDAT) Resident Legal Advisor (RLA) and the Department of Justice, International Criminal Investigative Training Assistance Program (DOJ/ICITAP) Police Reform and Professionalization project. Using technical guidance and material support received under the DOJ/OPDAT program, the State Prosecutor's office developed and distributed its first-ever professional handbook to guide prosecutors in the conduct of their duties from evidence collection and investigation to case preparation and trial court conduct. Also under OPDAT guidance, the State Prosecutor's office developed its first code of professional ethics. The true measure of the success of these programs is that both the manual and the code are accepted

and used as homegrown products and are already serving as models for similar efforts in the prosecutors' offices of neighboring states.

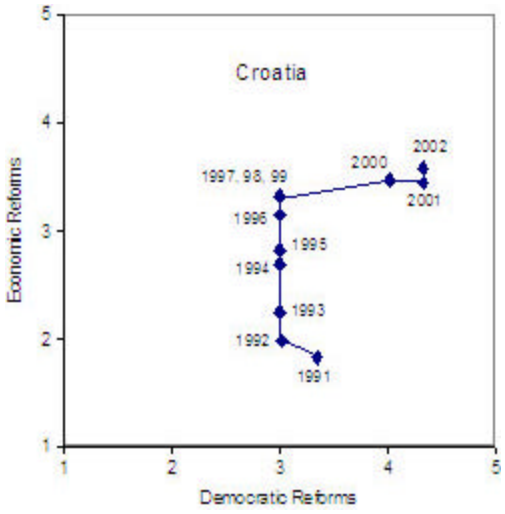
In the fall of 2003, the Police Academy enrolled its first class of police officers in a completely revamped nine-month professional training course developed with the assistance of the SEED-funded ICITAP program. These officers will graduate to probationary status and will receive six additional months of supervised field training, also created under the ICITAP program. The Ministry of Internal Affairs developed a new police policy and procedures field guide with ICITAP assistance in FY 2003. Pending final approval, 25,000 copies of the field guide will be distributed, and ICITAP will provide user training in early FY 2004.

In FY 2003, Croatia began to develop the capacity to prosecute war crimes domestically, and a series of new laws was passed. These laws updated court procedures and the criminal code, and created special war crimes courts, making it possible for prosecutors to move cases away from politically charged regions. However, at year's end, the Constitutional Court invalidated all of the amendments to the penal code. While this should not impact the GOC's cooperation with the International Criminal Tribunal for Yugoslavia (ICTY), it may complicate Croatia's ability to take over criminal cases initiated by Tribunal as called for in the ICTY completion strategy. The new government will have to reintroduce these changes in order to bring the criminal code into line with the EU *aquis*.

The Embassy's Public Affairs Section administered two International Visitor grants, involving 11 individuals, which focused on protective service issues and on combating corruption and organized crime. The prosecutors who participated in the combating organized crime group returned with a commitment to apply what they learned during their trip, despite the financial and legislative constraints they face in Croatia. They are sharing their new knowledge with their colleagues, through presentations and publications of the State Attorney's Office.

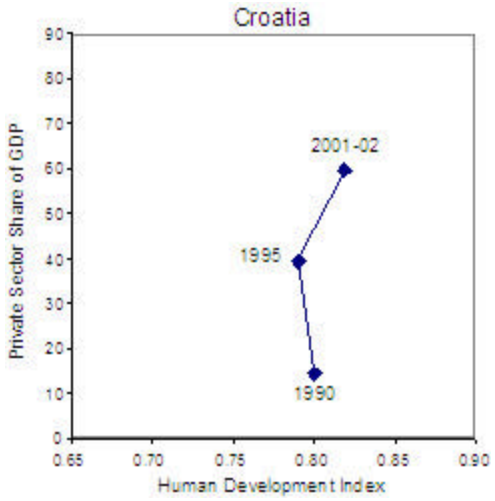
COUNTRY PERFORMANCE MEASURES

Economic Policy Reforms and Democratic Freedoms in Croatia, 1991-2002



Ratings based on a 1 to 5 scale, with 5 representing the most advanced.
Sources: EBRD, *Transition Report 2003* (November 2003); Freedom House, *Freedom in the World 2003* (2003); and (various years).

Economic Structure and Human Development in Croatia, 1991-2002



The Human Development Index (HDI) is based on three indicators: longevity, as measured by life expectancy; educational attainment, as measured by a combination of adult literacy and combined primary, secondary and tertiary enrollment ratios; and standard of living, as measured by real per capita GDP ($PPP). The HDI ranges from 0 to 1, with higher values representing greater human development. UNDP, *Human Development Report 2003* (July 2003), and previous editions; EBRD, *Transition Report 2003* (November 2003), and previous editions.

MEASURES OF PROGRAM EFFECTIVENESS IN FY 2003

DEMOCRATIC REFORM

Performance Indicator: Electoral Process. Source: (Freedom House, OSCE)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
3.25	2.5	3.25

FY 2003 Results: OSCE's Office for Democratic Institutions and Human Rights determined in September that the democratic environment in Croatia had changed so fundamentally that it would not deploy short-term international observers to monitor parliamentary elections scheduled for November and would rely instead on local media, NGO, and political party monitoring. OSCE concluded that the November 23 parliamentary elections were "conducted generally in line with OSCE commitments and international standards for democratic elections." Croatia's political parties continued to develop, and by the end of FY 2003 had generally aligned themselves with the various European political movements. Ethnic nationalism ceased to be a defining issue in Croatian politics. Shortcomings identified in the OSCE assessment include improving the legislative framework for elections, improving access to voting for refugees, and increased transparency of campaign spending.

Performance Indicator: Improved rating of Croatia on the NGO Sustainability Index-Legal Framework

2002 Baseline	FY 2003 Target	**FY 2003 Actual**
2.8	2.5	2.7

FY 2003 Results: The target for this year has not been met, as the actual rating for legal environment is 2.7, or lower than the planned target of 2.5. However, a comparison of the 2003 scoring with that of 2002 indicates that steady progress has been achieved. This is due to the recent enactment of new laws on humanitarian assistance, the National Foundation for Development of Civil Society, and the Decree on Distribution of the Lottery Proceeds. Although the GOC has been committed to support NGOs, changes were still slow regarding tax issues and the foundation law, which still provides restrictive conditions for the registration of organizations.

ECONOMIC AND SOCIAL REFORM

Performance Indicator: Increased private sector share of employment (Source: Croatian Bureau of Statistics)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
56.6%	58.0%	61%

FY 2003 Results: The selected indicator exceeded the performance target for the year. The target was 58 percent, while the actual private sector share of employment reached 61 percent, indicating a positive trend in the growth and expansion of Croatia's private sector. This is due in part to an improved and expanding SME sector.

Performance Indicator: Number of entities tendered at Croatian Privatization Fund (CPF) (Source: CPF)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
348	150	35

FY 2003 Results: Performance in the privatization area did not reach targets, due mainly to political infighting within the ruling coalition. The GOC's privatization program was halted in 2003 and failed to gain any significant traction with the approach of the national elections. The Embassy took restricted managerial steps to scale back assistance in this area. With signs of some renewal of political will to move forward in recent months, the Embassy stands ready to engage the newly elected government in continuing its privatization program.

Performance Indicator: National Action Plan to combat Trafficking in Persons (TIP) (Source: GOC)

2002 Baseline	FY 2003 Target	**FY 2003 Actual**
• No national TIP coordinator. • No National Action Plan (NAP).	• National coordinator appointed by GOC. • NAP finalized that defines and establishes GOC's TIP strategy. • Draft legislation on TIP passed by Sabor.	• National Coordinator appointed by the GOC • National Action Plan finalized and adopted TIP legislation passed by the Croatian Parliament

FY 2003 Results: The position of the National Coordinator in the National Committee was created and is held by the Head of the Office for Human Rights. The incumbent has a leading co-coordinating and operative role in the work of the National Committee. The National Action Plan was finalized and adopted by the GOC, in November 2002, and broadly defines the government's TIP strategy and activities. Legislation on trafficking, in particular TIP provisions in the Penal Code entitled Human Trafficking and Slavery, was adopted by the Parliament, in July 2003. However, in December 2003, the Constitutional Court invalidated the amendments of the penal code, including the TIP provision.

SECURITY, REGIONAL STABILITY, AND LAW ENFORCEMENT

Performance Indicator: NATO Integration and Defense Reform (Source: NATO)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
• Croatia enters MAP. • Participation in NATO programs. • Defense restructuring begins.	• First ANP review of Croatia. • Military downsizing begins. Increased participation in NATO programs. • Encourage cooperation with other NATO aspirants.	• NATO's Political Committee positively assesses Croatia's first ANP. • Defense Ministry meets interim Military downsizing goals. • Croatia signs "Adriatic Charter" with the U.S. and other NATO aspirants to enhance regional cooperation toward NATO membership.

FY 2003 Results: Croatia made good progress toward NATO membership, exceeding the U.S. targets for FY 2003 in some areas. Restructuring of the Defense Ministry is well underway, and the politically sensitive task of military downsizing is on track. Croatia completed its first annual cycle in NATO's Membership Action Plan and participated in a number of NATO-sponsored exercises. In March 2003, Croatia joined with Macedonia and Albania to sign the U.S.-Adriatic Charter, a political commitment of NATO's three continuing aspirants, to work together toward NATO membership.

Performance Indicator: Restructuring of police force/improvement of police training. (Source: GOC)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
• Ministry of Interior accepts U.S. concept of police modernization. • IC coordination on police issues begins. • Police downsizing of 15 percent completed as	• Police school restructured. • New police SOPs developed. • Pilot field training officer program launched.	• Police school restructured and first training class enrolled. • Field training set for this class when it graduates in 04. • New police SOPs developed.

planned.		

FY 2003 Results: After a long gestation period, the Police Academy launched a new basic school for police officers, in the fall of 2003, based on Western models of training for police in a democracy. Initial train-the-trainer courses for field training officers have begun, to prepare a cadre of 330 training officers to work with graduates of the new basic police school when they begin probationary field training in late spring 2004. The new police standard operating procedures have been developed and, pending final approval, will be distributed in pocket manual form to every Croatian police officer in spring 2004.

FY 2003 Support For East European Democracy (SEED)
Funds Budgeted for Assistance To:

Croatia (In millions $, as of 12/31/03)

USAID - Democratic Reform $5.14
USAID - Economic Prosperity & Security $11.20
USAID - Humanitarian Response $5.84
USAID - Social Sector Reform $3.11
USAID - Special/Cross-Cutting $0.69
USAID Total: $25.98

State - DRL/Int'l Commission Missing Persons $1.00
State - ECA Exchange Programs $0.78
State - EUR Democracy Programs $0.08
State - EUR Public Diplomacy $0.33
State - IIP Public Diplomacy $0.05
State - INL Law Enforcement Activities $0.65
U.S. Department of State Total: $2.88

Broadcasting Board of Governors - Public Diplomacy $0.05
DHS/Customs - Law Enforcement Activities $0.35
U.S. Department of Treasury - Advisors $0.75
Other Agencies Total: $1.15

GRAND TOTAL: $30.00

II. Country Assessment--Czech Republic

Area: 78,866 sq km, slightly smaller than S. Carolina
Population: 10,249,216 (2003 est.)
Annual Inflation: 0.6% (2002 est.)
Population Growth Rate: -0.08% (2003 est.)
Gross Domestic Product (GDP): $157.1 billion (purchasing power parity, 2002 est.)
Life Expectancy: male – 71.69 years; female – 78.87 years (2003 est.)
GDP Per Capita: 15,300 (purchasing power parity, 2002 est.)
Infant Mortality: 5.37 deaths/1,000 live births (2002 est.)
Real Annual GDP Growth: 2% (2002 est.)

U.S. STRATEGIC INTERESTS

The Czech Republic's longstanding ties to the United States, the values it shares with the U.S., its membership in NATO and upcoming membership in the EU, and the increasing awareness of the role Prague can play in international affairs make the Czechs excellent allies in joint campaigns against terrorism, and for more openness in countries with oppressive political systems and/or overly restricted markets.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

In FY 2003, the U.S. Government (USG) provided an estimated $29.2 million in assistance to the Czech Republic:

- $27.9 million in security, regional stability, and law enforcement programs;
- $835,000 in programs to promote trade with the U.S.;
- $268,000 in democratic reform programs (including Public Diplomacy exchange programs); and
- $140,000 in social sector and economic reform programs.

In FY 2003, a total of 125 Czechs traveled to the U.S. on USG-funded exchange programs.

U.S. ASSISTANCE PRIORITIES

Democratic Reform Programs: In FY 2003, the four main goals were: improving the effectiveness of the judiciary; promoting non-governmental organizations (NGOs) and the role of civic groups, particularly outside of the capital; raising the standards and professionalism of the media; and ethnic equality through minority rights. Trafficking in persons (TIP) and anti-corruption projects were also addressed through grants.

Economic and Social-Sector Reform Programs: In FY 2003, the U.S. Trade and Development Agency (USTDA) made three grants worth a total of more than $800,000 to promote the import of U.S. technology, particularly in the environmental field. The Foreign Agricultural Service sent seven Czechs from government and the private sector to the U.S. under a program to open up markets for U.S. agricultural products, introduce new American foods to the Czech Republic, and favorably to influence Czech agricultural policy, particularly during the country's accession to the EU. USAID, through its Partners for Financial Stability (PFS) and the Financial Services Volunteer Corps (FSVC) programs, advised in bankruptcy legislation and ran training programs on credit management,

private pensions, and the regulation of securities markets.

Security, Regional Stability, and Law Enforcement Programs: In FY 2003, U.S. security-related assistance was focused on upgrading the niche capabilities the Czech Republic will contribute to NATO. To this end, the USG provided the Czech Government with $25.9 million in Foreign Military Financing (FMF) and $1,923,000 in International Military Education and Training (IMET) funds for the training of 86 Czechs in the U.S. and the conduct of five seminars in the Czech Republic. In the law enforcement arena, the USG concentrated on efforts to combat the smuggling of drugs and trafficking in people through programs in schools aimed at demand reduction, techniques to detect and investigate money laundering, establishing witness protection programs, and donations of x-ray and other equipment to Czech border guards.

SECTORAL ASSESSMENTS

Democratic Reform

Just over $200,000 was given out in grants in this sector, with SEED funds accounting for just under half of that total.

The democratic and civic institutions and concepts were nonexistent in the communist era, which contributed to a sense of political apathy and low esteem for government and public institutions among Czech people. Even now, after more than a decade of difficult transition, this legacy of political indifference persists. As a result, there is a great need for civic education programs that convey the concepts of tolerance, equality, respect for authority, and personal responsibility. The Embassy's efforts in this sphere concentrated on making the judiciary more effective, the press more professional, and the NGO sector more influential, particularly in combating corruption and human rights abuses. In some cases, grants were given to individual NGOs, such as those conducting media training or promoting the rights of the disabled. In others, funds were used to establish an association of NGOs or to set up a center for information on non-profit activities. Several grants were given to support the development of local civic groups through cultural and historical restoration projects.

Some observers believe that corruption increasingly threatens democratic development, the functioning of a free market, and, more importantly, faith in public institutions in the Czech Republic. The NGO Greenways received a SEED grant to develop a program to prevent conflicts of Interest at the municipal level. Transparency International also was awarded a grant to promote reform of the Czech judiciary and to inform the public about problems of the judicial process in the country and the possibilities for reform. A third grant went to a group of predominantly young lawyers, who give their free time on a pro bono basis for activities aimed at safeguarding key legal values to will secure better observance of human rights and freedoms. The group will publish a magazine on human and consumers' rights and will conduct outreach to ordinary citizens across the country.

From a human rights perspective, trafficking in persons remains a major cause for concern in the Czech Republic, a country identified as a place of origin, destination, and transit. There is a need for sustained efforts to stem trafficking and for better care and protection of its victims. Raising public awareness, improving police sensitivity and practices, and providing victims with information and counseling support are required. The NGO La Strada received a grant to educate police and other law enforcement professionals through information-gathering and training; the improvement of practical skills among those in working with female trafficking victims; and through enhanced co-operation between state and non-state bodies, through government participation in training activities. An additional grant will focus on the creation of a network of seven coordinators based throughout the Czech Republic. The project will also include the preparation of regional reports outlining the general situation in trafficking in persons in each Czech region.

The NGO Living Together was given a grant to improve the living conditions of poor and

marginalized Roma in Ostrava and to promote social dialogue and assimilation.

Economic and Social Sector Reform

Impending EU accession, its geographic location, and relatively low costs have made the Czech Republic the leader in Central Europe in attracting foreign investment. These inflows, and domestic consumption fueled by rapidly rising wages at a time of low inflation, have kept the Czech economy going, despite mediocre exports to its main markets in Europe. In order to sustain economic growth, the Czechs must continue to accelerate the fight against corruption and improve the business climate further by reforming bankruptcy laws, the government's anti-monopoly office, and those institutions that regulate utilities, securities, and insurance.

The Czech bankruptcy law is viewed as largely inadequate, particularly regarding creditors' rights and in providing a constructive solution for financially distressed companies. The current law lacks an effective provision to facilitate reorganizations, comparable to Chapter 11 of the U.S. Bankruptcy Code, and appears to cause protracted liquidations as the only viable way to resolve insolvencies. It widely believed that a lack of creditor protection under the Czech insolvency law adversely impacts the flow of both foreign and domestic capital into the economy. A new bankruptcy bill has been drafted. Before it went to parliament for a vote, three U.S. bankruptcy judges, with a grant from the Financial Services Volunteer Corps (FSVC), provided technical assistance to the Drafting Committee to conduct an intensive section-by-section review and edit of the draft law.

Four officials from the Czech National Bank went to the U.S. on an FSVC program to study the practical aspects of managing credit risks. Czechs also attended programs in Croatia on private pensions and in Estonia on securities markets, through USAID's Partnership for Financial Stability (PFS) grants. PFS also made a grant to the NGO Leadership Forum to study and promote corporate social responsibility in the Czech Republic.

Security, Regional Stability, and Law Enforcement

In 2003, the Czechs received $25.9 million in Foreign Military Financing (FMF) assistance and nearly $2 million in International Military Education and training (IMET) funds. These two programs account for most of the U.S. assistance funds. The Czech Republic is in the process of reforming its military from a large, conscripted, static defensive force to a professional, modern, flexible, and deployable military. Drawing in large part on NATO's recommendations for lighter, more specialized forces, the Czechs have used a major portion of their FMF assistance to meet the capabilities commitments pledged at the Prague Summit in 2002. In 2003, 86 Czechs received IMET training in the U.S., while five seminars were conducted in the Czech Republic.

The Czech Republic became a member of NATO in 1999. Since then, it has participated in every NATO-led operation, including IFOR, SFOR, KFOR, and ISAF. It also has taken part in every major, U.S.-led, non-NATO operation in the war on terrorism, including Operation Enduring Freedom and Operation Iraqi Freedom. Although the Czech government approved the deployment of a nuclear, biological, and chemical (NBC) unit to Kuwait and field hospital to Iraq, the public opposed Czech participation. Experts believe there is insufficient public debate on security issues in the Czech Republic, as well as a gap in education for the next generation of policy makers on security topics of national, European, and international concern. SEED funds were used to establish the Security Studies Institute, the only cohesive and accredited study program of its kind in the country. Its purpose is to promote dialogue on key issues related to U.S. foreign policy, including the role of NATO in regional security, international efforts to advance a peaceful settlement in the Middle East, and the role of NATO and the international community in addressing the war on terrorism. SEED funds were also used to organize a conference, in October 2003, on NATO and the Middle East. Keynote speakers included Prince Hassan of Jordan, former Czech President Vaclav Havel, former Secretaries of State Madeline Albright and Henry Kissinger, and U.S. Permanent Representative to NATO Nicholas Burns. A separate grant funded a tour by NATO representatives, with accompanying exhibitions and information booths, to six Czech cities

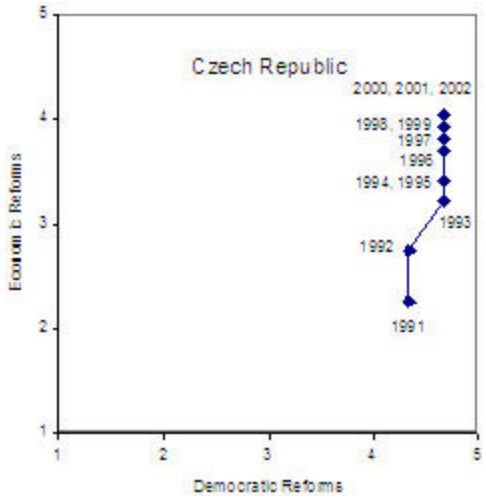
The Department of State/Bureau of International Narcotics and Law Enforcement Affairs (INL) administered funding from its own appropriation in support of a Department of Justice, Office of Overseas Prosecutorial Development, Assistance and Training (DOJ/OPDAT) Resident Legal Advisor (RLA) program, as well as U.S. Marshals Service (USMS) and Internal Revenue Service trainings in the Czech Republic. A major problem with cases of trafficking in persons or drug smuggling is getting those involved to testify against ringleaders. The Czechs wanted to know how the USG deals with this problem. The USMS showed the Czechs how the U.S. program is run.

Both geographic and economic factors render the Czech Republic vulnerable to money laundering. Domestic white-collar crime is believed to be the main source of laundered funds. It is also assumed that proceeds from narcotics trafficking, smuggling, auto theft, arms trafficking, embezzlement, racketeering, prostitution, and trafficking in illegal aliens are laundered there by organized international groups, although that is yet to be proven. Past, cooperation among government law enforcement, intelligence, and administrative agencies was ineffective. The IRS ran two programs on techniques for identifying and investigating money laundering, and demonstrating how different U.S. agencies work together to fight the problem.

The USG contributed both to police drug interdiction efforts and to those of NGOs and schools to reduce demand for drugs through education. Czech Customs officers were trained and equipped through the Department of State's Export Control and Related Border Security (EXBS) program. USAID made a $150,000 grant to the Lions Club to run programs on demand reduction in Czech elementary and middle schools.

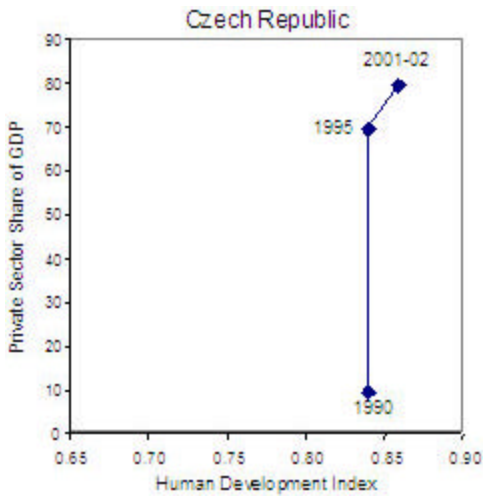
COUNTRY PERFORMANCE MEASURES

Economic Policy Reforms and Democratic Freedoms in Czech Rep., 1991-2002



Ratings based on a 1 to 5 scale, with 5 representing the most advanced.
Sources: EBRD, *Transition Report 2003* (November 2003); Freedom House, *Freedom in the World 2003* (2003); and (various years).

Economic Structure and Human Development in Czech Rep., 1991-2002



The Human Development Index (HDI) is based on three indicators: longevity, as measured by life expectancy; educational attainment, as measured by a combination of adult literacy and combined primary, secondary and tertiary enrollment ratios; and standard of living, as measured by real per capita GDP ($PPP). The HDI ranges from 0 to 1, with higher values representing greater human development. UNDP, Human Development Report 2003 (July 2003), and previous editions; EBRD, Transition Report 2003 (November 2003), and previous editions.

II. Country Assessment--Estonia

Area: 45,226 sq km, slightly smaller than NH and Vermont combined
Population: 1,408,556 (July 2003 est.)
Annual Inflation: 3.7% (2002 est.)
Population Growth Rate: -0.49% (2003 est.)
Gross Domestic Product (GDP): $15.52 billion (purchasing power parity, 2002 est.)
Life Expectancy: male – 64.36 years; female – 76.57 years (2003 est.)
GDP Per Capita: $11,000 (purchasing power parity, 2002 est.)
Infant Mortality: 12.03 deaths/1,000 live births (2003 est.)
Real Annual GDP Growth: 6% (2002 est.)

U.S. STRATEGIC INTERESTS

Estonia occupies a strategic corner of the Nordic-Baltic region, sharing common borders with Russia and Latvia and located roughly 50 miles across the Gulf of Finland from Helsinki. Along with its Baltic neighbors Latvia and Lithuania, Estonia will formally join NATO and the EU in spring 2004. Estonia supports most United States foreign and strategic policy interests in a wide array of fora, including in the UN and the OSCE. In support of the U.S.-led war on terrorism, Estonian troops participate in military-security operations in Iraq and Afghanistan, and Estonia contributes to the NATO-led KFOR and ISAF operations in Kosovo and Afghanistan respectively. Estonia's commitment to a liberal, open-market economic policy environment has created a strong investment climate and helped to generate sustained economic growth. The U.S. has a strong interest in maintaining close relations with this ally in order to bolster solid partnerships with the EU and NATO and to further U.S. global policy objectives. The burdens of EU and NATO membership, together with expensive deployments in support of operations in Afghanistan, the Balkans, and the Middle East continue to stretch Government of Estonia (GOE) resources. Continued U.S. support for Estonia will allow the GOE to meet its obligations in these areas, while also consolidating gains in dealing with regional "soft security" challenges.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

In FY 2003, the U.S. Government (USG) provided an estimated $12,994,386 in assistance to Estonia:

- $226,857 in SEED-funded democratic reform programs (not including ECA-funded Public Diplomacy exchange programs)
- $227,745 in SEED-funded economic and social-sector reform programs
- $11,809,784 in security, regional stability, and law enforcement programs, including the following:

  SEED -- $180,784
  Defense Environmental International Cooperation (DEIC) -- $50,000
  International Military Education and Training (IMET) -- $1.1 million

- Foreign Military Financing (FMF) -- $9.25 million

  Defense Threat Reduction Agency (DTRA) through FBI -- $502,000
  State INL through FBI -- $127,000

DTRA and Nonproliferation and Demining and Related Activities (NADR) through Export and Border Security Program (EXBS) -- $600,000

- $365,000 in humanitarian programs: $235,000 for HA demining and $130,000 for other HA programs.

In FY 2003, a total of 114 Estonians traveled to the U.S. on USG-funded exchange programs, including 12 International Visitor grantees; one Voluntary Visitor grantee; 13 educational program participants (Fulbright teachers, scholars, Humphrey Fellows, and teacher exchange participants); one police officer, one chief justice and six businesswomen on special SEED-funded programs; 10 police officers to the FBI academy; and 70 individuals through the IMET program.

U.S. ASSISTANCE PRIORITIES

Democratic Reform Programs: Since Estonia has a vibrant and durable democracy, FY 2003 USG Democratic Reform programs focused on specialized areas. These included further integration of the Russian-speaking community into the mainstream of Estonian life; building Holocaust awareness; a municipal anti-corruption program; and promoting women's entrepreneurship.

Economic and Social Sector Reform Programs: Estonia enjoys a strong, free-market economy. USG assistance programs in this area were weighted heavily toward health and science projects, most notably those addressing the growing HIV/AIDS problem. These included one project focused on HIV/AIDS in prisons, where Estonia's HIV positive community is disproportionately represented. Other projects will help fund scientific research and exchange of scientists. One SEED project aimed to develop the economy of the region bordering Lake Peipsi (Europe's fourth largest lake), an economically depressed area with considerable tourism potential.

Security, Regional Stability, and Law Enforcement Programs: Programs in this sector have been aimed at developing a professional military, increasing NATO interoperability, promoting Estonian-Russian cross-border exchanges, and combating trafficking in persons and financial crimes. In FY 2003, International Military Education and Training (IMET) funding focused onthe creation of a professional military, the implementation of defense reform in such areas as strategic planning and resource management, and NATO/coalition interoperability. IMET provides the education and training to achieve both greater professionalism within the defense establishment and to bring about necessary reforms in planning and resource management. The primary use of Foreign Military Financing (FMF) funds is to establish a standardized, secure-mode capable, NATO-interoperable communications network from the strategic down to the tactical level. FMF funds support the purchase of tactical radios for several high-readiness Army units and a complete ship-to-shore communications package for the Estonian Navy. FMF funds have also been used to improve Estonia's air surveillance network, increase its Host Nation Support capability, and provide a U.S. military instructor at the Baltic Defense College. USG assistance efforts in the financial sector went to training programs related to corporate governance and responsibility, auditing, and combating money laundering and terrorist financing. A significant portion of SEED funds was directed to the trafficking in persons issue, both in terms of educating young people about the dangers of this trade, as well as to quantify the extent of the problem in Estonia. Regarding regional stability, 2003 saw the fruition of a number of long-planned exchanges between the Estonian city of Tartu and the neighboring Russian city of Pskov. Both SEED and FSA funding supported these exchanges. In addition, cross-border travel funds provided more Estonians with first-hand information about their eastern neighbor. Democracy Commission funds enabled the Estonian Atlantic Treaty Association to educate Russian-speakers in Estonia about the implications of Estonia's forthcoming accession to NATO.

SECTORAL ASSESSMENTS

Democratic Reform

Estonia's pending EU and NATO accession is in part a reflection of its successful consolidation of democratic reform. The OSCE deemed an observation mission to Estonia's March 2003 parliamentary elections unnecessary, citing the "high level of confidence in the professionalism and impartiality of (Estonia's) election administration" and the conduct of previous elections "in a transparent manner, enjoying the confidence of the political parties and the public."

Estonia's independent media are active and express a wide variety of views without government restriction. The OSCE has concluded that Estonian public TV generally seeks to give equal access to all electoral candidates and to cover campaigns impartially.

Estonia's constitution provides for an independent judiciary, and the GOE generally respects this provision in practice. While there are some incidences of corruption in government, the GOE continues to investigate charges of corruption aggressively. Estonia placed 33rd (out of 133 countries) in Transparency International's 2003 ranking of perceived corruption, or higher than all other EU accession candidates except for Slovenia (29).

With NATO and EU accession pending, Estonia is now firmly in "The West," where it always wanted -- and deserved -- to be. This achievement, together with the creation of a healthy democracy, years of sensible fiscal policies, and strong economic growth, put Estonia in a position to consider which challenges to take on next.

Estonia's populist Center Party had the strongest performance in the 2002 municipal elections, and did well in the March 2003 national elections. However, political newcomer Juhan Parts, leader of the "clean government" Res Publica party, received the nod to form the government. Parts, the former State Auditor, leads a three-party coalition that promises to maintain high standards of government ethics, bring down the flat-tax rate, and offer social support that will lead to increased family sizes. While intra-coalition tension has led to bickering over domestic policy, Parts' government is continuing Estonia's history of strong support for the U.S. and NATO.

Estonia is slightly smaller than New Hampshire and Vermont combined, with a declining population of not quite 1.4 million. Just under one million inhabitants are ethnic Estonians, leaving them to carry on the Estonian language, culture, and traditions. It will be no easy task, as Estonian becomes the second least-spoken language in the EU.

The integration of Estonia's Russian-speakers is not complete. However, the GOE has taken steps to ease citizenship requirements and improve opportunities for non-citizens to learn Estonian. In many ways, the solution to Estonia's integration challenge will come simply with time. The generations of Russian-speakers who arrived in Estonia when it was occupied by the Soviet Union will die out, and younger generations born into Russian-speaking families will recognize the economic usefulness of mastering Estonian, not to mention having many opportunities to learn the language in ways earlier generations did not.

The Embassy used SEED funds to help further the integration process. One SEED grant funded a project to identify undocumented Estonian residents and educate them about their rights and obligations in terms of registering with the government. Another was for the production of a handbook for citizens in Russian. Yet another provided Estonian-language teaching materials for Russian-language kindergartens.

Three Embassy Democracy Commission grants addressed Holocaust awareness: to produce one of the first Estonian-language books published in the re-independence period about Jews and the Holocaust; to fund an Estonian-language print-run of a Swedish-produced book designed to educate young people about the Holocaust; and to fund an online presentation by a museum about the Holocaust.

One SEED program introduced anti-corruption strategies to municipal officials from a number of locations around Estonia. Other SEED funds were used to send a delegation of important Estonian women business leaders to the Washington follow-up to the Helsinki Women's Business Leaders' Summit.

Some SEED funds were transferred to the Department of State, Bureau of Educational and Cultural Affairs, so that three Estonians could earn Master's Degrees at U.S. universities. One of the successful candidates is the head of the stock market supervision office at the Estonian Financial Supervision Authority.

Economic and Social Sector Reform

Estonia's economic reform policies have led to a liberalized, nearly tariff-free, open market economy. The privatization of state-owned firms has been completed. Estonia joined the World Trade Organization (WTO) in 1999. Currently, most of Estonia's economic policies are geared toward accession to the EU, in 2004.

Economic reforms have reduced the weight of government activity in the economy. In addition, the constitutionally required balanced budget and the use of a currency board system restrict the range of monetary and fiscal instruments available for influencing the economy. With the Estonian *kroon* pegged to the Euro at a ratio of 15.6 to one, the size of Estonia's money supply is directly determined by the amount of foreign exchange it can attract through exports, loans, or investments.

Last year the Estonian economy continued its growth at a solid pace. GDP grew by 6.0 per cent in 2002, and observers expect 5-6 percent growth in 2003. The inflation rate -- 4.2 percent in 2001 -- dropped to 2.7 percent in 2002. The estimate for 2003 is only 0.3 percent. The overall unemployment rate in 2002 was 11.3 percent, with rural areas most affected.

Estonia's economic policies have received high marks from international institutions and organizations. It was ranked sixth in the world -- tied with the U.S. and Denmark -- in the U.S.-based Heritage Foundation and Wall Street Journal 2003 Index of Economic Freedom. The index is a composite of scores in monetary policy, banking and finance, black market, and wages and prices.

Due to Estonia's success in managing macroeconomic policy, USG financial sector assistance in 2003 focused on training programs related to corporate governance, auditing, and combating money laundering and terrorist financing. In 2003, the Estonian Financial Supervision Authority took the initiative to co-sponsor, with the U.S. Securities and Exchange Commission and USAID, a seminar on issuer disclosure and corporate governance.

USG Environment and Science grants offered a big bang for the buck in 2003. USG assistance to the Globe program sent Estonian teachers to a regional Globe workshop and bought equipment to be used by school children to take environmental measurements. In 2003, NASA sent a letter of appreciation to Globe Estonia for the scientific quality of the environmental measurements taken by the school children through the program.

The biggest concern in Estonia's social sector is the growing incidence of HIV/AIDS. In the recently published UNAIDS report, Estonia was ranked third, behind Russia and Ukraine, among European countries with the fastest growing HIV infection rates. Currently, Estonia has about 3,600 cases of HIV, and about 800 new cases were diagnosed in 2003. The USG has been one of the largest donors of aid to combat HIV/AIDS in Estonia. In 2003, USG HIV/AIDS assistance was about $120,000. One grant was aimed at addressing the spiraling rates of HIV incidence in Estonian prisons by raising prison inmate and employee awareness of HIV/AIDS. USG assistance was critical in leveraging more substantial resources in the fight against HIV/AIDS. A USG-sponsored expert helped Estonia prepare its successful application for a $10 million grant from the UN Global Fund to Fight HIV/AIDS, Malaria and TB.

Security, Regional Stability, and Law Enforcement

Estonia deployed nearly 200 personnel in FY 2003 to support UN, NATO, and coalition military operations. That number is above the European average in terms of percentage of the overall force, and a good indication of Estonia's willingness and ability to contribute to global security. In addition to maintaining an explosive detection dog team detachment in Afghanistan that began serving in FY 2002, Estonia sent explosive ordnance detection personnel to support the International Security Assistance Force and deployed an infantry platoon and cargo handling unit under U.S. command in support of Operation Enduring Freedom.

The deployments have become more complex both logistically and operationally, and demonstrate the increasing readiness and growing interoperability of the defense forces. Continuing participation in NATO and Partnership for Peace (PfP) exercises, as well as active involvement in Marshall Center courses and seminars (Estonia was able to utilize all of its course quotas at the Marshall Center in FY 2003), have accelerated Estonia's integration into NATO structures and programs.

The primary goal of the International Military Education Training (IMET) program in Estonia in FY 2003 was to promote stability, democratization, and military professionalism within the Ministry of Defense (MOD), Defense Force, and Border Guards. In FY 2003, Estonia received $1.1 million in IMET funds. The program funded the training of 70 Estonian military and defense-associated personnel in the U.S. IMET helped Estonia work toward its goals of increased self-defense capability and NATO membership by providing training on three levels. On the national/strategic level, priority was on attendance at war colleges, the Naval Post-Graduate School, and the Defense Resource Management Institute. On the operational level, IMET focused on staff colleges, executive courses, and mobile training teams. At the tactical level, courses consisted of specialized training for junior officers and NCOs. Expanded IMET courses continued to provide critical training for defense policy and resource planners at MOD. The U.S. Coast Guard International Maritime Officer Course will remain indispensable for the training of selected Estonian Border Guards personnel. In FY 2003, two six-month TDY English language instructors conducted language training for 120 Estonian officers and soldiers. Also in FY 2003, two mobile training teams trained 40 officers in Brigade operations and planning.

Foreign Military Financing (FMF) funds went to purchase equipment, training, or services that increased Estonia's self-defense capabilities and ensured interoperability with NATO structures and forces. In FY 2003, Estonia received $9.25 million in FMF funds, of which $2.75 million was Iraqi Supplemental Funds. The priority use of these funds was to establish a standardized, secure-mode capable, NATO-interoperable communications network from the national/strategic down to the tactical level. FY 2003 funds supported the completion of the communications package for the eight major Estonian naval vessels. Among other secondary purposes, this grant money supported continued upgrades to the Airspace Sovereignty Operations Center and sustained a U.S. instructor at the Baltic Defense College and an advisor to the Air Force. The Iraqi Supplemental Funds, recently waived from American Servicemembers Protection Act (ASPA) restrictions, will be used to equip troops serving in Iraq and Afghanistan and follow-on Estonian forces for deployment to these theaters.

The Defense Environmental International Cooperation (DEIC) program used $50,000 from the U.S. Army Corps of Engineers to conduct an Environmental Compliance Project. This military environmental project was used to assist the MOD and Estonian Defense Force (EDF) in establishing environmental compliance procedures and processes for the development of military training areas. The project included a three-day seminar in Tallinn that outlined environmental compliance procedures consistent with EU and Estonian law, as well as a handbook that can be used on for reference and as standard operating procedures. The handbook also serves as a useful reference document for program managers.

Estonia does not have an indigenous terrorist threat, nor are any organizations named on the Department of State's list of recognized terrorist organizations present. Estonia's terrorism threat is

closely linked with its border security, which will be of particular interest to the U.S. and the EU in 2004, when Estonia becomes a full member of NATO and the EU. Due to its border with Russia, Estonia is a potential transit risk for Weapons of Mass Destruction (WMD) materials. This potential risk is offset by the robust DOD/DTRA /FBI WMD Counter-proliferation program, wherein the FBI and Defense Threat Reduction Agency (DTRA) have provided considerable training and assistance since 2001. This program is funded through FY 2007 and will continue to bring annual training and technical equipment enhancements.

Another potential terrorism threat arises from the liberal banking environment. Banks in the entire Baltic region, including Estonia, routinely engage in foreign transfer transactions with little known or fictitious customers. Many of these transactions have been identified with transnational and organized criminal activity.

The Estonian Prosecutor General's Office has named cyber-related crimes among the top three crime problems facing the country. Several significant FBI computer intrusion cases have originated in the Baltics, including Estonia. This trend continues, as evidenced by pending investigations of persons in Estonia who have intruded into U.S. financial infrastructure, resulting in millions of dollars in losses. The perpetrators of cyber-related crimes also take advantage of the regional banking environment by receiving and laundering their proceeds.

Recent developments in the region warrant a reassessment of the structure and prevalence of organized crime. Previous crime assessments from 1996 to 2002 determined that there were several well-established organized crime groups with transnational connections in Estonia. These were believed to have close ties to organized crime groups in Saint Petersburg, Russia, with connections to Florida, New York, California, and the northeastern U.S. Estonian services believe that the links and influence of Russian organized crime groups have weakened in recent years, although some level of coordination among the leaders of those groups continues. Estonia currently has several relatively small organized crime groups, whose main focus is economic crimes such as bank and tax fraud, transit shipments of drugs, trafficking, and organized car theft.

In the counterterrorism field, the FBI and the Defense Threat Reduction Agency (DTRA) provided three training courses and delivered technical equipment valued at over $500,000 to Estonia in 2003. A recertification course provided retraining in the use of the WMD response equipment that had been previously provided. Fifty-eight Estonians from the Police, Security Police, Rescue Board, Customs, and other agencies participated in a WMD integrated exercise. At its conclusion, the remaining unused equipment (valued at about $300,000) was divided among the participating agencies. The FBI and DTRA also held an advanced radiation and detection class that gave the Estonian Radiation Safety Center and Rescue Board sophisticated radiation detection equipment (worth $202,000) and instruction in its proper use. The FBI Legal Attaché Office used this initiative as the catalyst for building counterterrorism and counter-proliferation liaison equities. The Legal Attaché also maintained close relations with services addressing terrorism finance matters in Estonia, including the Security Police, Tax Board, and Central Bank.

U.S. Customs, through the Department of State's Export Control and Related Border Security (EXBS) office in Latvia, provided Estonia with a WMD Undercover Investigation course, WMD Controlled Delivery training, a WMD Cyber crimes course, and a WMD Illegal Experts training course. The total estimated value of the equipment provided through FY 2003 NADR- and DTRA-funded initiatives is about $600,000.

To help support and expedite Estonia's adaptation and compliance with EU standards in the criminal procedures code area, the Department of Justice Office of Overseas Prosecutorial Development, Assistance, and Training (DOJ/OPDAT) conducted an assessment that resulted in a multi-year training program for judges, prosecutors, and investigators. Since Estonia had changed to a confrontational justice system, similar to that in the U.S., two of the OPDAT courses given in 2003 focused on training prosecutors and judges to adapt to their new system. OPDAT also provided one class on cyber crimes.

The Embassy executed a Law Enforcement Agreement with the GOE, which provided assistance from SEED and Department of State, Bureau of International Narcotics and Law Enforcement Affairs (INL) funds toward the development of a computer analysis and forensics technician training program, and procurement and donation of equipment. Implementation of these programs is under way.

Ten police and Security Police officers attended an Advanced Management Course in Roswell, New Mexico. This training was for mid-level officers who had graduated from one of the regional International Law Enforcement Academies. The FBI also sent an Estonian police officer to the FBI National Academy, in Quantico, Virginia. Four FBINA graduates received FBI-sponsored counter-terrorism training in Slovenia. The Embassy also sponsored three law enforcement officials for International Visitor Programs, funded by the Department of State's Bureau of Educational and Cultural Affairs (ECA).

The Legal Attaché Office has experienced an increase in contacts by Estonian law enforcement and bank officials in identifying suspicious and fraudulent transactions and getting regulatory agencies to freeze the proceeds pending forfeiture. The Legal Attaché Office facilitated the apprehension and extradition/deportation of eight Estonian fugitives from the U.S. to Estonia in 2003.

Trafficking in persons (TIP) within, from, and through Estonia continued during 2003. While some NGOs and international nongovernmental organizations (INGOs) have estimated the number of trafficking victims at 500, the true extent of the problem is unknown. The GOE continued to make progress in engaging on TIP in all relevant ministries, as well as in international and regional meetings. GOE ministries, the Nordic-Baltic Council, and various NGOs pursued TIP educational initiatives. The Embassy has been active in raising the information and awareness level in Estonia regarding the magnitude of the TIP problem globally and in encouraging progress in combating TIP nationally. On the law enforcement front, the first trafficking case reached the Estonian court system during the period, and five new cases involving 15 suspects are under investigation. Estonian police authorities assigned a police officer with sole responsibility for TIP; an Estonian police liaison has been posted to Russia to forge cooperation on cross-border crime, including TIP. An additional liaison officer is being considered for deployment to Finland or Sweden. GOE authorities cooperated with U.S. counterparts to break up an illegal alien smuggling and trafficking ring in Boston.

The largest Embassy-issued grant in this sector was to the International Organization for Migration (IOM) to quantify the extent of the TIP problem in Estonia. There were other anti-TIP grants to Estonian NGO's, including one to raise awareness of the problem among police and border guards, and another to educate high school students about the dangers of this trade. The Embassy also used SEED funds to send a large, diverse delegation to the Trafficking in Minors Conference organized by the U.S. Embassy in Helsinki. SEED funds transferred to ECA paid for a TIP-related International Visitor grant.

In the regional stability realm, a number of SEED- and FSA-funded encounters took place between residents of Tartu, Estonia, and Pskov, Russia, less than 50 miles apart on opposite sides of Lake Peipsi. City and regional officials, businesspeople, academics, and artists participated in these conferences. In the same vein, using cross-border travel funds, Estonians from various professions had opportunities to meet their counterparts at conferences in Russia, and Estonian journalists were able to write about Russia for their readers.

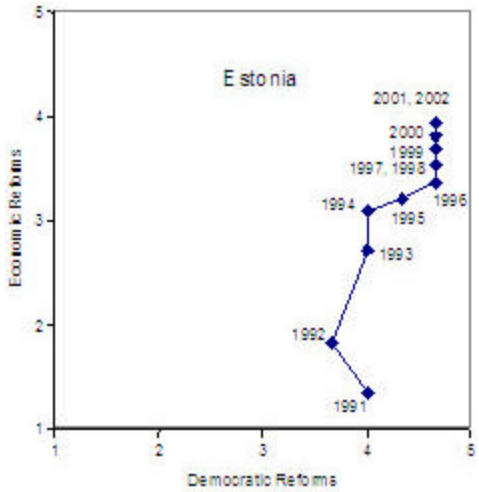
The Estonian Atlantic Treaty Association undertook a project to educate Russian-speakers in Estonia about NATO, and Association members used cross-border travel funds to attend a NATO enlargement conference in Russia. Also, in the framework of NATO education, the Embassy issued a Democracy Commission grant to an NGO to stage a play about Estonia's NATO accession and Estonian attitudes toward the military. Using an earlier grant, this NGO also organized a well-attended, successful play on HIV/AIDS awareness.

Humanitarian Assistance

In FY 2003, the U.S. provided $130,000 in Humanitarian Assistance (HA) funding for the renovation of Kohtla-Nomme orphanage, which houses about 45 children. In addition, the U.S. provided $235,000 in HA Demining assistance. FY 2003 funds were used to purchase bomb suits, mine detectors, and data recorders that continue to locate large quantities unexploded ordnance and landmines from World War II or the Soviet era. The funds also provided contractor-supported training to the Explosive Ordnance Detection (EOD) unit and supply and maintenance support to the organization. The new purchases enabled the EOD team to locate mines and unexploded ordnance in areas previously cleared by less sensitive equipment.

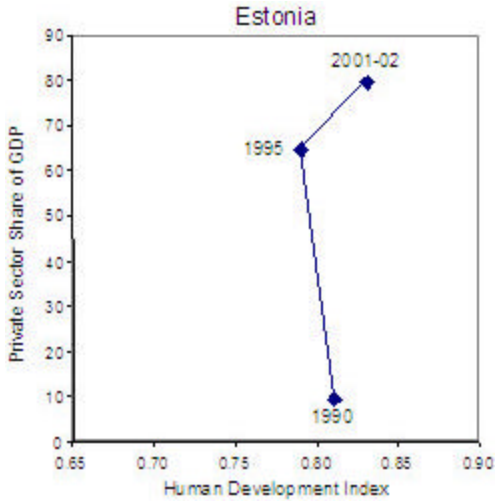
COUNTRY PERFORMANCE MEASURES

Economic Policy Reforms and Democratic Freedoms in Estonia, 1991-2002



Ratings based on a 1 to 5 scale with 5, representing the most advanced.
Sources: EBRD, *Transition Report 2003* (November 2003); Freedom House, *Freedom in the World 2003* (2003); and (various years).

Economic Structure and Human Development in Estonia, 1991-2002



The Human Development Index (HDI) is based on three indicators: longevity, as measured by life

expectancy; educational attainment, as measured by a combination of adult literacy and combined primary, secondary, and tertiary enrollment ratios; and standard of living, as measured by real per capita GDP ($PPP). The HDI ranges from 0 to 1, with higher values representing greater human development. UNDP, *Human Development Report 2003* (July 2003), and previous editions; EBRD, *Transition Report 2003* (November 2003), and previous editions.

II. Country Assessment--Hungary

Area: 93,030 sq km, slightly smaller than Indiana
Population: 10,045,407 (July 20036 est.)
Annual Inflation: 5.3% (2002 est.)
Population Growth Rate: -0.29% (2003 est.)
Gross Domestic Product (GDP): $134 billion (purchasing power parity, 2002 est.)
Life Expectancy: male – 67.84 years; female – 76.81 years (2003 est.)
GDP Per Capita: $13,300 (purchasing power parity, 2002 est.)
Infant Mortality: 8.58 deaths/1,000 live births (2003 est.)
Real Annual GDP Growth: 3.3% (2002 est.)

U.S. STRATEGIC INTERESTS

Hungary is one of the most prosperous countries in Central Europe. It is stable, democratic, and slated to seal its "return to Europe" with accession to the EU in 2004. Hungary's location makes it a potential linchpin in the stability of Central and Eastern Europe, where it can act as a mentor to neighboring countries that have made less progress in modernization and integration. U.S. interests are focused on the further increase of Hungary's already active cooperation in the global war on terror and improving its performance in NATO, both on the military and political levels. Hungary remains an important economic partner. Its congenial domestic economic policies help to ensure that U.S. firms enjoy greater access to foreign markets and enhanced investment opportunities. Once Hungary enters the EU, the U.S. will be engaging with it on an increasing number of economic, commercial, political, and security issues. With the exception of the military component, U.S. assistance to Hungary has been declining for several years and will continue to do so as Hungary joins the EU and becomes a donor itself.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

In FY 2003, the U.S. Government (USG) provided an estimated $22.8 million in assistance to Hungary:

- $20.9 million in security, regional stability and law enforcement programs;
- $200,700 in democratic reform programs;
- $738,898 in economic and social-sector reform programs;
- $640,000 in humanitarian programs; and

Privately donated and U.S. Defense Department excess humanitarian commodities valued at over $355,000

In FY 2003, more than 170 Hungarians traveled to the U.S. on USG-funded exchange programs.

U.S. ASSISTANCE PRIORITIES

Democratic Reform Programs: In FY 2003, the highest priorities for U.S. democratic reform assistance in Hungary included strengthening non-governmental organizations (NGO), promoting

civic participation and education, minority issues, legal reform, equal opportunity, and the fostering of a healthy political climate. With less than a year left before accession, all sectors of Hungarian society are changing fundamentally to adapt to EU norms. USG-funded exchange programs sought to familiarize Government of Hungary (GOH) officials, politicians, educators, journalists, and researchers with U.S. best practices and resources to assist them in evaluating how to modernize and to meet European standards.

Economic and Social Sector Reform Programs: Reflecting the development and stability of Hungary's economy and financial markets, U.S. assistance in this area has focused on counter-terror finance, anti-money laundering, fostering Hungary's emergence as a donor nation, and the incorporation of marginalized minorities. Future U.S. priorities will remain largely the same, albeit with steadily declining resources.

Security, Regional Stability and Law Enforcement Programs: The Department of Defense (DOD) provided 95 percent of all U.S. assistance to Hungary in FY 2003. Assistance in the security area focused on improving Hungary's military performance, helping it meet NATO force goals, thwarting trafficking in persons, and enhancing cooperation in combating transnational organized crime, weapons trafficking, and drug trafficking. A number of USG agencies – DOD, Department of Justice (DOJ), Department of Homeland Security (DHS), USAID, and Drug Enforcement Agency (DEA) – administer these programs. With Hungary's increasing prosperity and entry into the EU, U.S. assistance efforts will remain focused on these programs in the future.

SECTORAL ASSESSMENTS

Democratic Reform

In FY 2003, Hungary's performance on democratization was good. Some important steps were taken, particularly in the field of federal support for NGOs. There were no major elections in Hungary during FY 2003. The Constitution provides for freedom of speech and of the press, and the GOH generally respected these rights. However, both the current and previous governments were criticized for interference in editorial and personnel decisions of state-owned media. Privately owned media, although free, generally continue to report along predictable political lines. Parliament amended the Media Law in 2003 to conform to EU standards. USG funding supported the awarding of a prize for investigative journalism, one of the weakest aspects of the media in Hungary. USG assistance also provided professional media training to senior GOH spokespersons and supported several programs that provided opportunities for Roma in the field of journalism.

Hungary's judicial system continued to make positive strides in 2003. Parliament passed numerous "transparency" laws to combat corruption with respect to government officials and agencies. Implementation of those laws will continue in FY 2004. USG-sponsored exchange programs included participants on a broad range of topics from five government ministries, academia, the private sector, the media, and Parliament.

In June 2003, the Parliament enacted the Law on the National Civil Fund, designed to help provide institutional support to Hungarian NGOs. To finance the Fund, the GOH will provide matching funds based on the amount taxpayers donate, up to 1 percent of their income. Sixty percent of the money collected will provide institutional support to NGOs, with the remainder going to help programs. USG assistance to local NGOs also helped shape other examples of progress, including an initiative to increase private resources for the NGO sector and a law on volunteerism that supports best practices. A USG-supported NGO advised the GOH on donor tax incentives, endowments, and other financing mechanisms; hosted university non-profit law clinics; and sponsored internship programs in Hungary and the U.S. Several programs helped create a better-informed NGO community by strengthening Internet networks and newsletters. Several USG grants supported projects that sought to integrate underserved populations fully into the democratic process and pass laws to protect their rights.

In 2004, USG assistance will continue to build capacity in the NGO sector. Hungary's EU accession, the phase-out of the Democracy Commission small grants program, and transition from being a recipient to a donor country will make working with NGOs to enhance their sustainability crucial for the long-term health of this sector. The U.S. Embassy's DCSG program will announce a competition for NGOs to propose projects to help create a culture of volunteerism and to host programs in leadership development, grant writing, and fundraising. The implementation of the new National Civil Fund will need to be tracked in 2004, to follow how "institutional support" will be defined. USG assistance will also continue to encourage improvement of the climate of political discourse through exchange programs that include both ruling and opposition political parties.

Economic and Social-Sector Reform

Hungary has a robust private export sector, solid economic growth rate, and low unemployment. It has had a strong record of structural reform even before the change of regime. Per capita Gross National Income (GNI) is slightly over $5,000; on a purchasing power parity basis, per capita income is about $14,500. Life expectancy, literacy rates, and other indicators, such as access to potable water, reflect Hungary's status as an upper-middle-income country. However, some parts of the population, particularly the Roma, have benefited less than others. Thus, U.S. assistance in this area has focused on grooming Hungary to play a role as a donor, helping to improve prospects for the Roma community and combating money laundering and terror financing.

The Hungarian-American Partnership Initiative (HAPI) is a training activity that provides opportunities for the countries in Europe and Eurasia to learn from Hungary's successful transition to a market economy and democratic society. This training activity is designed to involve the GOH in the implementation process, with the express purpose of jump-starting a Hungarian assistance program, required for EU entry, which would contribute to the stability and development of the region, with priority given to Stability Pact member states. In FY 2003, USAID provided $150,000 in SEED funding under a grant to the Foundation for the Development of Democratic Rights.

Since it began in 2000, HAPI has delivered short-term training programs to 507 participants in 45 groups, from seven Central and Eastern European and six Newly Independent States. Topics have included investment promotion, municipal government strengthening, taxation systems, community development and outreach, SME development, NGO financial management, anti-corruption, pension reform, privatization of the energy sector, multi-ethnic governance, the establishment of brokerage companies, regional health reform, and Roma community development.

The Roma Integration Program (RIP) is a $2.8 million four-year regional program in the Czech Republic, Hungary, and Slovakia that seeks to expand access to services and leadership opportunities for Roma at the community level and to contribute to a change in perceptions of Roma through anti-discrimination public awareness programs. The program also aims to produce models of integration that can be replicated in communities within the three countries, with possible implementation later in other countries with Roma populations and USAID Missions.

The RIP is a new activity, implemented by Partners for Democratic Change and its Centers in the Czech Republic, Hungary, and Slovakia. In FY 2003, $27,200 was spent starting up this four-year program, over the course of which Hungary will receive about $884,500 in funding, including small grants. During the program's initial months, Partners completed an assessment and selected target Roma communities in the three countries; hired key staff to manage all elements of the program; established program advisory boards in the three countries; and began a training series in conflict management, leadership, and advocacy. In the future, participants will utilize these skills in community-level programs, in cooperation with local government, social service agencies, and other sectors.

The GOH has worked with the USG to counter terrorist financing and money laundering. With additional legislation passed in 2003, Hungary now has the legal infrastructure in place to combat financial crimes and money laundering. The Department of Justice (DOJ) conducts a two-pronged

program that counters money laundering and government corruption. In May 2003, DOJ held a weeklong conference for prosecutors and law enforcement agents to train them in money laundering prosecution. In FY 2003, DOJ also donated anti-corruption equipment and trained law enforcement officials in its use. Total funding for DOJ programs in Hungary is $400,000, about three-quarters of which was spent in FY 2003.

The Treasury Department, through its Office of Technical Assistance (OTA), also provides anti-money laundering technical assistance. The first training event was held in early July 2003, at the International Law Enforcement Academy (ILEA) in Budapest. Total Treasury funding committed to Hungary is $125,000. Finally, the Marshall Center in Garmisch, Germany, has provided anti-money laundering training for senior Hungarian financial officials on an ad-hoc basis.

Public Diplomacy has three main vehicles with which to administer programs to strengthen economic and social reform in Hungary: Democracy Commission small grants, Individual/Project Grants, and the International Visitor Program. For FY 2003, those programs included projects that strengthened:

- Ability to fight trafficking in persons;
- Public participation in community environmental management;
- Creation of environmental databases for public use;
- Prison programs to educate Roma youth;
- Awareness of gender equality;
- Promotion of the development of social enterprises from private funds;
- Holocaust education and Jewish history and culture;
- Trade and the world economy;
- Administration of U.S. educational systems;
- Multiculturalism and the role of minorities;
- Civil aviation;
- Electronic commerce;
- Education for the less able; and
- Environmental public policy.

The total sum expended for these fields was $231,698.

Security, Regional Stability, and Law Enforcement

Security: Hungary is a NATO member, but the legacy of its Warsaw Pact participation still shadows its military, which is currently involved in a fourth try at restructuring. If successful, this attempt will result in a much-downsized military with a radically different mission. U.S. military-military assistance has been designed to improve Hungary's performance in NATO and, by extension, in the war on terror. The GOH is strong committed to non-proliferation and export control regimes and often passes on U.S. technical assistance in these areas to neighboring countries through mentoring and training.

During FY 2003, Hungary received $1,843,346 under the International Military Education and Training (IMET) program. With these funds, Hungary sent 90 officers and enlisted students to the U.S. for various military courses. In addition, IMET funding was used for five other major events, including: 1) a U.S. Requirement Survey Team that traveled to Hungary to discuss development of a Non-Commissioned Officer (NCO) corps; 2) a U.S. Mobile Education Team (MET) visit to the Czech Republic to train both Czech and Hungarian military personnel; 3) a MET visit to Hungary to discuss defense restructuring with senior civilian and military leaders; 4) a trip by a senior Hungarian delegation (led by the MOD Political State Secretary) to the U.S. under the Distinguished Visitor Orientation Tour regime; and 5) the installation of an English Language laboratory in Hungary by a U.S. Mobile Training Team. The FY 2003 IMET program was very successful in exposing Hungarian military and civilian leaders to U.S. military training and in assisting Hungary in determining its future defense structure.

Hungary also received $18.9 million in FY 2003 for Foreign Military Financing (FMF) and has made great progress by using this grant money. All FMF requests are tied to NATO Force Goals or to increasing interoperability and military capabilities. Major ongoing programs include: 1) a Letter of Request for air-to-air missiles to arm the Gripen fighter aircraft; 2) Link 16 for the Gripen; 3) Multiple Integrated Laser Evaluation Systems (MILES) for use at the Varpalota Training Facility; 4) continuation of the Air Sovereignty Operations Center program; 5) Identification Friend or Foe (IFF) Mode 4 for Hungary's helicopters and MIG aircraft; and 6) continuation of the CUBIC contract, which provided expert defense advice as the Hungarian MOD developed and approved a defense review that will totally restructure the armed forces to meet national and international objectives.

Joint Contact Team Program (JCTP) and State Partnership Program (SPP) activities in FY 2003 were limited due to U.S. operations in Iraq and Afghanistan. Nevertheless, Hungary participated in three U.S.-funded events: 1) a senior Hungarian delegation familiarization visit to the U.S. to discuss U.S. military budget processes and financing international military activities (JCTP); 2) a public affairs workshop in the U.S. with the Ohio National Guard (SPP); and 3) a visit headed by the Hungarian military surgeon general to gather information on medical readiness and planning strategies for disaster relief/terrorism mitigation (both JCTP and SPP).

Hungary participated extensively in FY 2003 at the George C. Marshall Center (GCMC) in Garmisch, Germany, sending 21 military and civilian leaders to various conferences and seminars. GCMC activities are supported by joint U.S./German funding.

Regional Stability: Hungary is considered a Tier II country in terms of trafficking in persons (TIP), as the GOH does not fully comply with the minimum standards for the elimination of trafficking. Hungary is primarily a transit and secondarily a source and destination country. In addition to having developed an action plan which will assist the GOH to make concrete efforts in combating trafficking, the State Department's Office to Monitor and Combat Trafficking in Persons recently awarded $500,000 to the Budapest office of the International Organization for Migration (IOM) to complete several projects with the goal of assisting Hungary to reach Tier I status.

In March 2003, the USG organized a Regional Conference on Trafficking in Persons and Public Health. USAID provided $92,000 to the IOM to organize this event, which was attended by over 200 people from 17 countries for three days. Participants represented NGOs, donor organizations, victims of trafficking, and governments. The main conference theme was the impact of trafficking on all aspects of the victims' health. Discussion topics included physical and psychological abuse and trauma, sexually transmitted and other infectious and non-infectious diseases (including HIV/AIDS and tuberculosis), human rights issues, treatment and prevention, and appropriate government policies toward this growing problem in the region. Following two days of working group sessions, findings and recommendations were presented to high-level government representatives from 10 countries in the region, and all present adopted the Budapest Declaration on Public Health and Trafficking in Human Beings.

Law Enforcement: Hungary's cooperation with USG agencies on law enforcement issues has generally been excellent. The DOJ and its Hungarian counterparts have worked productively via a task force on transnational organized crime. The DEA has begun promising cooperation with the Hungarian National Drug Police. The Department of Homeland Security works with Hungarian Customs to track and interdict illegal weapons procurement. The Department of State, Bureau of International Narcotics and Law Enforcement Affairs (INL), administers SEED and FSA funding to support the Budapest-based International Law Enforcement Academy. It indirectly enhances regional stability and contributes to law enforcement efforts by offering police and law enforcement courses to officials from Central and Eastern Europe, the Trans Caucasus, and Central Asia. INL also works with DOJ, Office of Prosecutorial Development, Assistance and Training (OPDAT), to provide training and assistance on money laundering and combating public corruption. OPDAT also procured and donated specialized investigative equipment to the GOH.

Public Diplomacy uses three sources from which to administer programs to strengthen security,

regional stability, and law enforcement in Hungary: Individual/Project Grants, Expert Speakers, and the International Visitor/Voluntary Visitor Programs. Projects included those focused on:

- Understanding of the implications and responsibilities of NATO Enlargement;
- Networks of young political leaders interested in transatlantic security issues;
- Public understanding of the war on terror;
- Group and individual International Visitor Programs on regional stability;
- Counter-Terrorism (included police, aviation authorities, and a disaster director);
- U.S. engagement in a post-9/11 world;
- Transatlantic security/NATO;
- Iraq; and
- U.S. strategy in foreign policy.

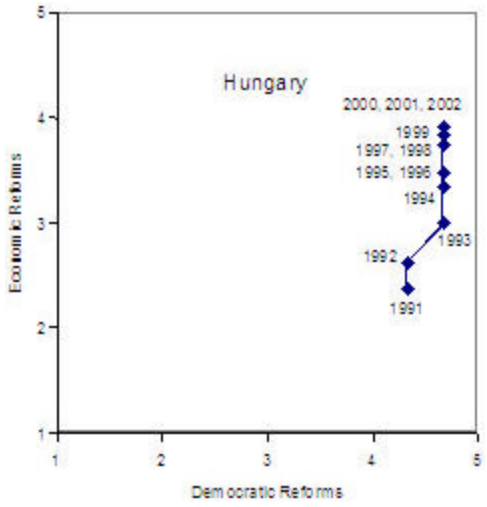
The combined amount spent for these fields was $75,792.

Humanitarian Assistance

In FY 2003, the U.S. provided DOD-managed humanitarian assistance donations of over $640,000 to Hungary under the U.S. European Command Humanitarian Assistance Program (HAP). These included funding for construction, renovation, and equipping of refugee reception centers and providing disaster management equipment (heavy machinery, vehicles, and supplies) to the Ministries of Interior and Environment. Specific donations included $200,000 for construction of a refugee home for unaccompanied minors (in Bekescsaba) and an additional $50,000 for improvements at Hungary's three major refugee camps, in Bekescsaba, Bicske, and Debrecen. In addition, the Ministry of Interior received over $355,000 worth of excess property that was distributed among these refugee centers.

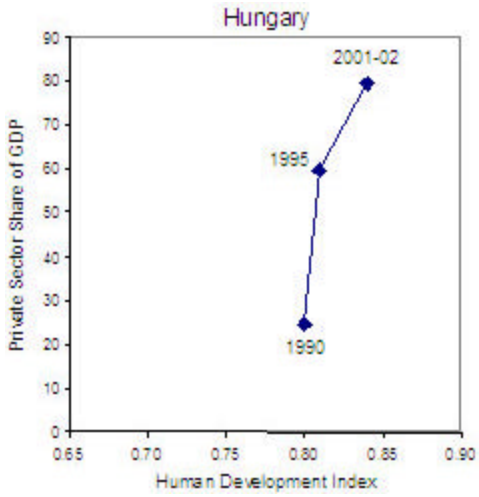
COUNTRY PERFORMANCE MEASURES

Economic Policy Reforms and Democratic Freedoms in Hungary, 1991-2002



Ratings based on a 1 to 5 scale with 5 representing the most advanced.
Sources: EBRD, *Transition Report 2003* (November 2003); Freedom House, *Freedom in the World 2003* (2003); and (various years).

Economic Structure and Human Development in Hungary, 1991-2002



The Human Development Index (HDI) is based on three indicators: longevity, as measured by life expectancy; educational attainment, as measured by a combination of adult literacy and combined primary, secondary and tertiary enrollment ratios; and standard of living, as measured by real per capita GDP ($PPP). The HDI ranges from 0 to 1, with higher values representing greater human development. UNDP, *Human Development Report 2003* (July 2003), and previous editions; EBRD, *Transition Report 2003* (November 2003), and previous editions.

II. Country Assessment--Latvia

Area: 64,589 sq km, slightly larger than W. Virginia
Population: 2,348,784 (July 2003 est.)
Annual Inflation: 2% (2002 est.)
Population Growth Rate: -0.73% (2002 est.)
Gross Domestic Product (GDP): $20.99 billion (purchasing power parity, 2002 est.)
Life Expectancy: male – 63.46 years; female – 75.45 years (2003 est.)
GDP Per Capita: $8,900 (purchasing power parity, 2002 est.)
Infant Mortality: 14.59 deaths/1,000 live births (2003 est.)
Real Annual GDP Growth: 6.1% (2002 est.)

U.S. STRATEGIC INTERESTS

Latvia's full integration into the Euro-Atlantic community, evidenced by imminent membership in the North Atlantic Treaty Organization (NATO) and the European Union (EU), is a testament to its commitment to democracy and free-market economics. SEED funding has enabled the U.S. to assist in Latvia's successful transition and advance key U.S. foreign policy goals – regional stability, the spread of democracy and American values, and expanded economic growth. Yet, acknowledged achievements in these areas cast in sharper relief Latvia's most important remaining challenge – strengthening the rule of law. While corruption remains less pervasive than in many other transition economies, the USG's top SEED priority in Latvia is to ensure that it continues to improve its law enforcement and judicial institutions in order to consolidate the gains of more than a decade of transition. As Latvia becomes a full-fledged member of Western security and economic institutions, SEED monies invested here will show that it is not just a recipient but can also be a provider of political and economic security by sharing its expertise with other transition countries still in the throes of difficult reforms.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

In FY 2003, the U.S. Government (USG) provided an estimated $13.9 million in assistance to Latvia:

- $12.5 million in security, regional stability, and law enforcement programs;
- $955,000 in democratic reform programs;
- $130,000 in economic and social-sector reform programs; and
- Privately donated and U.S. Defense Department excess humanitarian commodities valued at $320,000.

In FY 2003, a total of eight Latvians traveled to the U.S. on USG-funded exchange programs.

U.S. ASSISTANCE PRIORITIES

Security, Regional Stability, and Law Enforcement Programs: Strengthening the rule of law in Latvia remained the top USG priority for SEED spending in FY 2003. Rule of law priorities included training for law enforcement officers, prosecutors, and judges; technical assistance to the Anti-Corruption Bureau (ACB); and outreach to Government of Latvia (GOL) authorities involved in the fight trafficking in persons and financial crime. Security-related assistance continued to promote

regional stability by helping Latvia to enhance its interoperability with NATO forces through Foreign Military Financing (FMF) and International Military Education and Training (IMET) programs. The U.S. also provided $1.4 million in training and equipment through the Export and Border Security Program (EXBS), aimed at helping Latvian border guards and customs officials bolster export controls.

Democratic Reform Programs: In FY 2003, the U.S. provided SEED-sponsored support for democratic reform through the U.S. Embassy's Democracy Commission, which makes small grants to the NGO sector to support an array of USG policy goals; support for GOL programs aimed at integrating the large Russian-speaking non-citizen population; assistance to the Ministry of Education in creating a formal Holocaust curriculum; and the provision of not only formal educational exchanges, but also U.S. Embassy-issued travel grants to familiarize current and future Latvian leaders with U.S. policies and institutions, and to promote mutual understanding among Baltic and Russian officials by facilitating travel for Latvians to regional seminars and conferences.

Social Sector and Economic Reform Programs: Latvia's strong economic performance has allowed the USG to focus its efforts in this area predominantly on social-sector spending. In FY 2003, SEED regional funds supported important public health initiatives in Latvia, including the successful Multi Drug Resistant Tuberculosis (MDRTB) Center of Excellence in Riga. The USG also pooled money with other donor countries to provide bloc grants to UNDP that will help combat the spread of HIV/AIDS. While the U.S. Environmental Protection Agency (EPA) closed out its presence in Latvia in FY 2003, environmental programming continues through the Regional Environmental Office (REO) in Copenhagen. Finally, the USG did direct SEED resources into economic reform programs, most notably through a commitment of FY 2003 funds to hold in Latvia a 2004 follow-on to the successful 2002 Helsinki Women Business Leaders Summit.

SECTORAL ASSESSMENTS

Security, Regional Stability, and Law Enforcement

Latvia has been a willing, supportive partner in pursuing important U.S. foreign policy goals of peace and stability, both within Europe and beyond. Since 1996, Latvia has participated in every NATO-led peace keeping deployment in the Balkans, last year dispatching two medical teams to Afghanistan, and Latvian soldiers are currently on the ground in Iraq. Latvia's strong, principled stand on the need to bring freedom to Iraq and maintain a robust trans-Atlantic relationship springs from its history as a victim of both Nazi and Soviet oppression -- Latvia understands that free peoples have a moral obligation to confront dictatorships before the costs become too great to bear. The USG works with Latvia in conjunction with other NATO allies and friends in the region to contribute security in its neighborhood through healthy relationships with Russia, Ukraine, Belarus, and other former Soviet states.

Non-SEED security assistance thus plays a vital role in promoting U.S. regional stability goals in and with Latvia. From 1995 through 2003, Latvia received over $39 million in Foreign Military Financing (FMF) and has made steady use of available funding. FY 2004 allocations show another but very modest increase. The majority of FMF is used for improving individual soldier defense capabilities, communications equipment, a regional airspace initiative, and a long-term contractor technical assistance team to provide direct support to the Ministry of Defense in the areas of personnel, C4, force structure, logistics management, and defense procurement. The USG also provided $1.1 million in International Military Education and Training (IMET) to Latvia in FY 2003. The near-term focus for IMET remains professional and technical training for junior members of the defense establishment and leadership and management courses for mid-level and senior personnel. Many senior personnel, including the Minister of Defense, Land Forces Commander, and Navy Commander, have attended U.S. training through IMET. Latvia's emphasis on indigenous English language training (ELT) has virtually eliminated the need to use IMET funds for ELT. Overall, Latvia sends about 55 students per year to the U.S. for training and receives, on average, two Mobile Education Teams from the Defense Institute of Internal Legal Studies (DILLS). These seminars on

various topics relating to military justice have been well received.

Latvia is also eligible to purchase lethal and non-lethal Excess Defense Articles (EDA) (at 5-50 percent of acquisition value, based on condition) and to receive lethal and non-lethal EDA on a grant basis, under section 516 of the Foreign Assistance Act. From 1993 through 2003, Latvia received EDA with an original acquisition value of about $13 million (current value of over roughly $6 million), with about $800,000 acquired in FY 2003. Recent authorized transfers include additional M-14 rifles and ammunition, as well as excess light anti-tank weapons (LAW) and commercial utility cargo vehicles. Latvia has also requested information on which to base a possible request for excess navy and coast guard vessels.

Another important non-SEED regional security activity is the successful Export and Border Security (EXBS) program that has trained dozens of Latvian security police and border guards in interdicting shipments of dual use goods and weapons of mass destruction. That success was again underlined in July when Latvian officials intercepted a shipment of military hardware (labelled as "agricultural goods") bound for Iran. The experience the Latvians have gained in searching for such items has also paid off in the more prosaic, but still important, fight against contraband. Once Latvia forms part of the EU's border with Russia, the professionalism of its border control authorities will become even more visible and significant.

Most USG law enforcement assistance in Latvia takes place under the broader rubric of rule-of-law or anti-corruption programming, most of which is funded through regional SEED-sponsored programs. SEED funds also support regional initiatives designed to combat trafficking in persons. While Latvia is considered primarily a source country for such trafficking, it was designated Tier II in the Department of State's most recent annual report on trafficking. In 2003, there were 14 new criminal cases against traffickers and 23 convictions in outstanding cases. The Embassy thus chose to commit an additional $100,000 of FY 2003 post-level funds, beyond the $300,000 already set aside for FY 2003 regional programs, as a way to strengthen Latvia's efforts to train border guards, police, and judicial officials in anti-trafficking techniques and prosecutorial methods.

Basic to any concept of national security are the laws and mechanisms that underpin it, and the USG's top SEED priority in Latvia remains strengthening the rule of law. This is done predominantly through regional anti-corruption and rule-of-law programs, which, in Latvia's case, have focused on training for law enforcement officials, prosecutors, and judges. These SEED monies are co-mingled with funds from the State Department's Bureau for International Narcotics and law Enforcement Affairs (INL), which also bring significant Department of Justice (DOJ) resources, in the form of both financial and technical assistance, to bear on the fight against corruption. In early 2003, Latvia formally launched its Anti-Corruption Bureau (ACB) with a specific charter to combat corruption. The center-right government of Prime Minister Einars Repse continues to make headway in its efforts to dismiss officials tied to previous conflict-of-interest and corruption scandals. Regional rule-of-law and anti-corruption initiatives and training are predominantly coordinated though INL, with the help of other offices like DOJ's Office of Prosecutorial Development, Assistance and Training (OPDAT) and regional USG law enforcement personnel. Latvia was allotted about $150,000 of these regional funds in FY 2003. These monies will help fund initiatives such as ongoing judicial, legal, and police and ethics training; technical assistance; and training to the ACB (including an IV program for five persons from the ACB). The USG will also use FY 2003 regional rule-of-law SEED funds to pursue expansion of an existing Letter of Agreement between the U.S. and Latvia on judicial assistance, to include broader U.S.-Latvian cooperation in the fight against Russian organized crime. Other anti-corruption and rule-of-law assistance projects included travel and program funding for five participants from the Ministry of Justice (two judges), Ministry of Interior (State Police) and Office of the Prosecutor General (two prosecutors) to the U.S. for three weeks to learn how corruption is handled there.

Another area worthy of close scrutiny is Latvia's progress in fighting financial crime, specifically money laundering. Latvia has a tough and respected banking regulator, and its Financial Intelligence Unit (FIU) has shown increasing interest in utilizing U.S.- and EU-proffered training. Latvia's 22

commercial banks, partly as a result of SEED-funded programs (offered primarily through USAID's Partners for Financial Stability program) that emphasize know-your-customer rules and stress the importance of the U.S. PATRIOT Act, have shown increasing readiness to report and freeze questionable accounts. The FIU recorded a dramatic increase in the number of suspicious transaction reports filed in 2003 by Latvian banks, and this is clearly partly attributable to training provided by the USG. The FIU is also excellent at updating and passing along to Latvian financial institutions all new additions to the U.S. Office of Foreign Assets Control (OFAC) terrorist finance list.

Democratic Reform

The USG has helped Latvia bolster its democratic reforms through a variety of SEED-sponsored means, the two most prominent of which are the Embassy Democracy Commission and support for Latvian efforts to integrate its large Russian-speaking non-citizen populace.

The Embassy Democracy Commission, funded at $250,000 for FY 2003, welcomes proposals from NGOs and academic institutions to further the development of civil society as the country continues to build and consolidate its democracy. In particular, the Embassy looks for projects promoting integration of Latvia's non-citizen, mainly Russian-speaking minority; the research and discussion of historical issues, including Latvia's role in World War II and the Holocaust; rule of law and transparency in business and government; and public health and environmental protection. Examples of specific projects included:

- $23,998.00 grant for the Latvian Judicial Training Center, "Promotion of Judicial Power in Latvia through Public Education" project;

  The project reinforced the importance of the rule of law by increasing knowledge of the Latvian judicial system and procedures, and was aimed at a wide audience -- high school students and teachers, public officials, and judges, as well as the general public. Project activities were mainly focused in larger cities across Latvia, instead of just Riga, so that people with less access to information and education about judicial issues could take part. The project received extensive press coverage.

- $19,479.00 grant for the President Guntis Ulmanis Foundation, "Book: Outstanding Jewish Personalities in Latvia" project;

  The project published a book on 100 distinguished Jewish citizens of Latvia. The book will be available at schools and libraries and will help coming generations to learn about the contribution of outstanding Jewish artists, scientists, and others to Latvia's cultural development.

- $15,000.00 grant for Betphage Fund in Latvia, "Mobile Assistance Team--demonstration pilot project";

  The project provided public information on the rights of individuals with disabilities and promoted the active involvement of local communities in improving the lives of people with special needs.

- $4,873.00 grant for Carera Film Production, "Film: What does it mean to be a Latvian?" project;

  The goal of the project was to reach both ethnic Latvian and Russian audiences in Latvia to promote dialogue on social integration. The documentary encompasses well-known figures and regular residents of Latvia, from various cultural and ethnic backgrounds, discussing

integration-related topics.

Latvia's large non-citizen Russian-speaking population and its incorporation into Latvian society is a highly important political and social concern for the GOL and USG. In FY 2002 and FY 2003, the Embassy pooled funds with other donors through the UNDP to support two major projects: the first to enhance the work of the Naturalization Board, providing information to non-citizens on how to become naturalized, and the second to support the Latvian National Language Training Program, which develops programs and materials for teaching Latvian to non-speakers. SEED funds (FY 2002) to be committed in FY 2003 total $250,000. The Embassy has also set aside an addition $50,000 for social integration projects yet to be determined -- these funds will contribute to, among other projects, a public information campaign organized by the GOL's Naturalization Board and targeted at non-citizen Russian-speaking parents on the benefits of naturalization to their children.

Educational exchange programs remain an important tool in reaching out to Latvian policy makers and publics in ways that reinforce key U.S. policy goals and messages. The USG committed $205,000 to exchange programs in FY 2003, including $140,000 for university affiliations and student advising. One such university affiliation is the Lewis & Clark College University Partnership, under which that college cooperates with the University of Latvia's (UL) Law School to expand judicial access through research and professional collaboration. After teaching at Lewis & Clark during the spring 2003 semester, the Dean of UL's law school and has now committed to a required ethics course for all law students at UL, beginning in the spring of 2004. An Alternative Dispute Resolution (ADR) course has also been added to the UL curriculum for the spring of 2004, with two UL faculty members traveling to Lewis & Clark next fall to prepare the course. It is hoped that increased use of ADR will relieve pressure on Latvia's overcrowded courts by reducing caseloads. The Embassy has also set aside $50,000 for an ADR program at the Riga Graduate School of Law, which will be made available as a continuing education module for lawyers and judges.

FY 2003 monies will extend the Lewis & Clark university partnership with the UL Law School, with the aim of establishing a "judicial watch" in Riga. Lewis & Clark is spearheading an initiative that will create a judicial watch modeled on an American law review, with the new publication to be housed at the UL Law School.

In addition to the eight Latvians the USG sponsored for travel to the U.S. in FY 2003 through International Visitor programs, the Embassy also made $40,000 available in Embassy-level travel grants to help Latvians attend regional conferences and meetings where they would interact with other Baltic and Russian counterparts. This extremely popular program helped sponsor the travel of 132 Latvians through 21 grants.

Finally, the U.S. remains committed to using SEED funds to help Latvians study and teach their World War II history, including Latvia's role in the Holocaust. The USG provided $110,000 ($50,000 in FY 2003 and $60,000 in FY 2002 funds) for a project to help the Ministry of Education develop its first comprehensive Holocaust curriculum for Latvian students.

Economic and Social Sector Reform

Latvia's strong economic growth (with annual GDP increasing by over 5 percent every year since 1999, and expected growth of nearly 7 percent in 2003) and approaching EU accession have provided it with ample resources for sustained macroeconomic development. Latvia has low taxes and wages and an underdeveloped capital market. Latvia's economy is small, relatively open and agile, and has largely reoriented its trade away from Russia and the Commonwealth of Independent States (CIS) and toward the EU over the last five years.

The USG has targeted SEED assistance in this area largely at the social sector, specifically at public health programs aimed at combating Multi Drug Resistant Tuberculosis (MDRTB) and HIV/AIDS.

The Latvian TB Center of Excellence, a regionally funded SEED program based in Riga, received $440,000 in FY 2003. The Center has contributed directly to Latvia's success in stopping a serious and growing MDRTB crisis. Its work has led to a drop in infection rates and is producing an ever more highly trained cadre of physicians capable of helping other countries tackle the MDRTB challenge. The Center recently opened a new laboratory that the U.S. Centers for Disease Control (a TB Center of Excellence partner since its inception) view as being on par with any available in Scandinavia and as offering immediate clinical advantages for targeting and combating TB. The Center is competing for regional training grants to begin exporting its experience in treating MDRTB, in an effort to develop a sustainable, long-term business plan. The Center has already offered training to health care professionals from other Central and Eastern European states, and from states as far away as the Philippines.

The USG also provided $130,000 in FY 2003 SEED funds to combat the spread of HIV/AIDS in Latvia through a bloc grant to UNDP, which will be pooled with other donor contributions for use in sponsoring youth education and peer training campaigns.

One long-term area of SEED-funded assistance that came to an end in FY 2003 was environmental programming offered by the Environmental Protection Agency. While EPA is ending its presence in the Baltics, SEED monies will still be available for environmental projects undertaken and managed by the Regional Environmental Office in Embassy Copenhagen.

While most USG assistance to Latvia in the social and economic sectors went to public health programs, SEED monies were also designated for entrepreneurial and businesses projects. Entrepreneurial programs to be identified are receiving $75,000 regionally, and some of the regional SEED funds spent under USAID’s Partners for Financial Stability (PFS) program went for programs other than those aimed at anti-money laundering efforts. Finally, the U.S. Embassies in the three Baltic States agreed to set aside $100,000 of SEED funds to hold a follow-on to the 2002 Helsinki Women Business Leaders Summit, to take place in 2004 in Riga. This Summit, like its predecessor, will bring together American, Baltic, Russian, and other women CEOs and business owners to exchange experiences as entrepreneurs and encourage transfer of that knowledge to other women business owners and managers in local markets.

Humanitarian Assistance

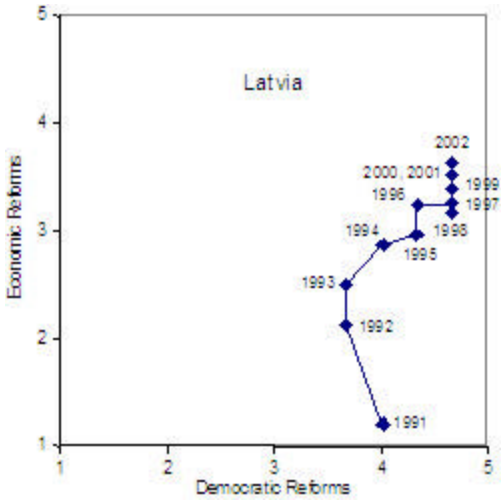
Humanitarian Assistance funding for Latvia from FY 1999 through FY 2003 was $3.2 million, with $320,000 contributed in FY 2003. Among the projects that have been completed or provided during this time period are:

- a wheelchair-equipped bus for the Children's Rehabilitation Center in Riga.
- funding for a Crisis Management Center and disaster response/preparedness training.
- renovation of a refugee reception station.
- a commercial utility cargo vehicle ambulance for the Riga Jewish Hospital.
- refurbishment of the medical academy of the Children's Hospital.
- renovation of an orphanage in Liepaja.
- 256 wheelchairs distributed to the disabled.
- replacement of the heating system in an orphanage in Rezekne.

- replacement of the roof and windows in a retirement home in Daugavpils.
- replacement of windows and bathrooms in an elementary school in Aluksne.

COUNTRY PERFORMANCE MEASURES

Economic Policy Reforms and Democratic Freedoms in Latvia, 1991-2002



Ratings based on a 1 to 5 scale, with 5 representing the most advanced.
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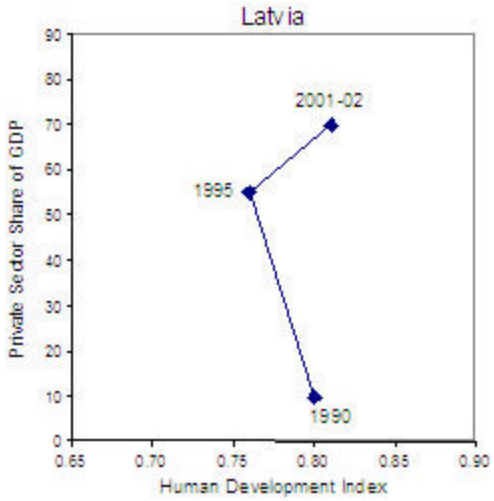
Economic Structure and Human Development in Latvia, 1991-2002



The Human development Index (HDI) is based on three indicators: longevity, as measured by life expectancy; educational attainment, as measured by a combination of adult literacy and combined primary, secondary, and tertiary enrollment ratios; and standard of living, as measured by real per capita GDP ($PPP). The HDI ranges fro 0 to 1, with higher values representing greater human development. UNDP, *Human Development Report 2003* (July 2003), and previous editions; EBRD,

Transition Report 2003 (November 2003), and previous editions.

II. Country Assessment--Lithuania

Area: 65,200 sq km, slightly larger than W. Virginia
Population: 3,592,561 (July 2003 est.)
Annual Inflation: 0.8% (2002 est.)
Population Growth Rate: -0.23% (2003 est.)
Gross Domestic Product (GDP): $30.08 billion (purchasing power parity, 2002 est.)
Life Expectancy: male – 63.78 years; female – 75.7 years (2003 est.)
GDP Per Capita: $8,400 (purchasing power parity, 2002 est.)
Infant Mortality: 14.17 deaths/1,000 live births (2003 est.)
Real Annual GDP Growth: 6.7% (2002 est.)

U.S. STRATEGIC INTERESTS

Lithuania's large, educated population and strategic location make it a potential force for economic growth and stability in the Baltic Sea region. Lithuania borders one current (Poland) and one future (Latvia) NATO ally, contributed troops to Operation Iraqi Freedom and Operation Enduring Freedom, and cooperates fully on international law enforcement matters. More than 800,000 U.S. residents consider themselves Lithuanian-Americans. It is in the U.S. interest to promote Lithuania's economic and political prosperity by increasing commercial ties, academic and cultural exchanges, and security cooperation.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

In FY 2003, the U.S. Government (USG) provided an estimated $14,158,000 in assistance to Lithuania:

- $1,120,000 in democratic reform programs (including Public Diplomacy exchange programs);
- $473,000 in economic and social sector reform programs;
- $12,412,000 in security, regional stability, and law enforcement programs;
- $30,000 in cross-sectoral programs; and
- U.S. Defense Department humanitarian assistance valued at $123,000.

In FY 2003, a total of 23 Lithuanians traveled to the U.S. on USG-funded exchange programs.

U.S. ASSISTANCE PRIORITIES

Democratic Reform Programs: In FY 2003, the main priorities of U.S. democratic reform assistance in Lithuania included development of a vibrant, sustainable non-governmental organization (NGO) sector, tolerance and inclusion of minority ethnic groups, and building governmental and civil society capacity to fight administrative corruption. USG-funded exchange programs targeted a range of issues on the bilateral agenda and included managing diversity, biotechnology, U.S.-European security, government accountability, and narcotics demand reduction.

Economic and Social Sector Reform Programs: In FY 2003, more than one-third of U.S. economic and social sector reform assistance went to economic and entrepreneurial training to build the skills necessary to manage a modern economy and develop small and medium enterprises (SMEs), and to create cross-border commercial opportunities within the region and with the U.S.

Specific technical assistance targeted accounting standards, corporate governance, and money laundering to improve the business environment. The second third went to fighting trafficking in persons, including monitoring the situation, raising awareness, training law enforcement officials, and providing job-skills training for at-risk populations. Less than one third went to other priorities, including international research cooperation, science and technology partnership building, implementation of the Global Learning and Observations to Benefit the Environment (GLOBE) program, and developing practical energy management tools and planning concepts for local authorities and district heating suppliers.

Security, Regional Stability, and Law Enforcement Programs: In FY 2003, International Military Education and Training (IMET) funds for the Armed Forces targeted the continued professionalization of senior and mid-level leaders, logistics training, civil-military operations, and special operations to prepare Lithuania for its role as a full NATO member in 2004. The focus for the Foreign Military Financing (FMF) program continued to be the transformation of the military from a static territorial defense force to a deployable NATO-compatible military. The U.S. Nuclear Regulatory Commission continued its regular technical assistance at the Ignalina Nuclear Power Plant (INPP), providing a valuable second opinion on maintenance and closure issues as the INPP enters its final decade of operation. SEED Act funding administered by the Department of State, Bureau of International Narcotics and Law Enforcement Affairs (INL) allows the U.S. Secret Service to target the skills and equipment gap necessary to fight the counterfeiting of U.S. currency and documents.

SECTORAL ASSESSMENTS

Democratic Reform

In FY 2003, Lithuania remained on its steady course of democratic reform. The Criminal Code, Code on Execution of Penalties, and Criminal Procedure Code entered into force in May 2003. Amendments to the Code of Administrative Infringements provide for more rational penalties for administrative offences, as well as for postponing arrest and penalties. The new Civil Procedure Code, in effect since January 2003, should facilitate and speed up legal proceedings. Following the approval of its national anti-corruption program in January 2002, Lithuania created an inter-agency coordination commission to oversee its implementation, in February 2003. A special anti-corruption service accountable to the President and Parliament has been operating since May 2000. Lithuania ranked 41st, out of 102 countries, on the Transparency International Global Corruption Perception Index 2003. Lithuanian law enforcement officials have sought assistance and training from U.S. and European law enforcement agencies. Lithuania continued to hold free and fair elections. Municipal elections and the first round of the presidential elections took place on December 22, 2002, with the presidential runoff election following on January 5, 2003. The political parties continue to demonstrate growing levels of maturity.

On minority and ethnic issues, fairly little changed in FY 2003. About 6.3 percent of Lithuania's citizens are of Russian ethnic origin -- they are fairly well integrated and face no official discrimination. In June 2000, the Government of Lithuania (GOL) adopted a national program for integrating the Roma minority, numbering some 3,000 people. However, the OSCE and others have noted that Lithuania could be doing more to address the social issues affecting Roma. Religious freedom continues to be respected. There is a well-established ombudsman system, which functions satisfactorily. The GOL continues to address historical justice issues (virtually all of Lithuania's 200,000 Jews were killed in the Holocaust). An official Historical Commission, established in 1998 by Presidential Decree, examines the Nazi and Soviet occupations. The Commission remained active in research and public education in FY 2003, in part due to Democracy Commission grants from the Embassy. Following the 2002 cooperation agreement with the Ministry of Education and Science to implement a large-scale program of Holocaust education (including the prevention of crimes against humanity and tolerance development in the country's schools), the Commission signed similar agreements with Yad Vashem, the New Jersey Commission on Holocaust Education, and other organizations. Several exchanges took place in FY 2003. The Commission also organized

a number of local and international conferences and seminars to promote the development of a tolerant civil society. Throughout FY 2003, the GOL reiterated its plans to start restituting Jewish communal property and has successfully restituted many Jewish religious properties.

The NGO sector continues to develop, despite decreased international funding and the lack of a philanthropic community in Lithuania. Progress was particularly noticeable in NGO-GOL cooperation in areas such as trafficking in persons (TIP), conflict resolution, environmental planning, and small business development. While the legal tax status of NGOs represents a financial barrier for some organizations, the NGO community is actively working to reduce legal barriers and to promote NGO sustainability. NGO networking throughout the country has also increased.

In FY 2003, the Democracy Commission remained the Embassy's front-line resource for building capacity in civil society to promote democratic and free market values and institutions. Grants focused on raising people's awareness of Roma and other minority groups, promoting the health care system's financial viability, building women's leadership skills in rural areas, fighting corruption, and promoting transparency.

The Embassy-funded Governmental Ethics Training program is becoming a self-sustaining part of the GOL's own ethics training for officials. In FY 2003, a new program focus was on government procurement, aiming to reduce malfeasance and increase private-sector knowledge of procurement strategies, to pressure the GOL to adopt fair practices. Thirty-six seminars are planned in five major cities for over 150 participants from the Parliament, including the members of Ethics and Procedure Commission; Parliament legal and procurement staff; members of national, regional, and local governments; media representatives; and NGO leaders. The training is intended to help deter corruption in the issuance of contracts and in other government expenditures.

In FY 2004 (with FY 2003 SEED Act funds), the Embassy plans to continue Democracy Commission programs and anti-corruption/ethics training. Other programs will bring Lithuanians to the U.S. to improve mutual understanding in critical areas, including public sector reform, intellectual property rights, and trafficking in persons.

Economic and Social Sector Reform

Lithuania had the fastest growing economy in Europe in 2003, winning it the sobriquet of the "Baltic tiger." Real GDP grew by 6.7 percent in 2002, and by 8.4 percent in the third quarter of 2003. Despite the overall slowdown in Europe, investments and exports continued to drive growth, while inflation has remained very low. The current account deficit was 5.3 percent of GDP in 2002, and 7.9 percent in the second quarter of 2003. The general government budget recorded a deficit of 1.2 percent in 2002. The projected budget deficit for 2004 is 2.95 percent. In July 2003, public debt accounted for 24.3 percent of projected GDP. The unemployment rate declined to a four-year low of 9.2 percent in October 2003. Employment in SMEs made up 53 percent of total employment. Average real wages were equal to 851.9 *litas* (€247) per month in the third quarter of 2003.

On July 1, 2003, overall FDI reached €4.6 billion, with per capita FDI rising to €1,177. The U.S. is in fifth place, with 8.5 percent of FDI. Most U.S. investments were in the food and beverage industries sector. Foreign investors consider Lithuania attractive on account of its infrastructure, close links to suppliers in the east, and inexpensive, educated labor force. Further, they view Lithuania's upcoming membership in NATO and the EU as guaranteeing security.

In 2002 (latest statistics available), 48.4 percent of Lithuania's exports went to EU countries and 19.2 percent to the CIS countries. Most imported goods came from EU countries. Trade with the U.S. accounted for 3.0 percent of exports and 3.2 percent of the imports. The main export goods include textile goods, refined oil products, and machinery, while the principal imports are raw materials, chemicals, and cars. The export share of GDP is 45 percent. In 2004, harmonization of the country's trade regime with that of the EU may result in an increase in some tariffs, including

those applied to the goods traded with the U.S.

In the social sector, the rapid economic development of Vilnius and other major cities masks a stagnant economic situation in rural areas that have yet to experience many of the benefits of Western integration and FDI. A difficult climate (long, dark winters) and high unemployment in rural areas fosters social problems, including alcoholism, drug addiction, suicide, and crime. Although Lithuania has developed and begun to implement numerous strategies to reduce poverty, rural unemployment, and substance abuse, some contend that social services rarely reach groups at risk for these activities. With agriculture and rural reforms a significant aspect of EU accession, disparities in income between urban and rural areas may diminish in the coming years.

The GOL has been active in developing strategies and programs for poverty reduction, alcohol and tobacco control, national drug control and prevention, and crime deterrence. However, many of these programs have gaps, particularly in utilizing existing public health and social work resources to implement the plans regionally. Better countrywide access to social services might help keep families together and decrease the number of juvenile first-time offenders. Effective intervention against alcoholism and drug use might reduce the number of juvenile offenders progressing to violent crime. More importantly, economic development must be addressed to get at the root cause of these social problems. Although a small portion of the total population, unemployed working-age people not enrolled in school/university have committed two-thirds of the recorded crimes in the past few years.

Substantial USG assistance has been focused on initiatives to prevent trafficking in persons (TIP). Through USG support, Lithuanian NGOs continuously monitor the National Program for Control and Prevention of Trafficking in Human Beings and have made recommendations to fill in gaps and insufficiencies in preventive work. Other programs will address the effectiveness of TIP prevention by building collaboration among NGOs, the police, municipal authorities, and other local partners. To raise awareness, a separate information program has been conducted at 81 schools in 13 towns. This campaign alerted young people to the danger and insecurities in seeking illegal work abroad. Recently, NGOs engaged on anti-TIP issues have started cooperating and networking to exchange information systematically, extend support to victims, and coordinate their activities. Finally, the USG supported programs to help victims of trafficking by providing medical equipment and aid, as well as social support.

The Regional Economists Training for Lithuania, Belarus, and Kaliningrad program trained about 100 economists from state authorities, research institutes, and NGOs in free-market-based solutions to economic problems. It also established cross-border cooperation for work on joint economic projects, 10 of which were developed on various forms of cross-border economic cooperation and regional networking. In FY 2002, over 200 people were trained through USAID's Regional Entrepreneurs Training Program for Belarus, Kaliningrad, and Lithuania program. All participants found the program extremely useful in terms of professional improvement, contributions to their work, and cross-border cooperation. Over 10 individual and joint ventures have been formed. The recently initiated FY 2003 entrepreneurs program will train additional Lithuanians.

Through the Municipal Energy Efficiency (MUNEE) program, over 30 Lithuanian municipalities have learned about integrated resource planning (IRP). Fifteen of them expect to use IRP in their development plans, as required under a new Heat law. The current stage of MUNEE assistance focuses on capacity building of municipalities to attract private capital and stimulate job growth in the energy efficiency field.

In FY 2004 (with FY 2003 SEED funds), the Embassy will work closely with the Ministry of Health and the NGO sector to implement the National HIV/AIDS Policy by assisting in the development of regional HIV/AIDS action plans. The Embassy also plans to increase U.S.-Lithuania cooperation in research and development. Other regional programs will target financial sector reforms, tuberculosis, and TIP.

Security, Regional Stability, and Law Enforcement

Lithuania was invited to join NATO in November 2002, and expects to join the alliance in spring 2004 (at about the same time as it will be entering the EU). Lithuania continues to contribute actively to alliance activities, such as peacekeeping and counter-terrorism missions. Lithuania will continue spending 2 percent of GDP on defense in 2004. Finally, Lithuania is an enthusiastic participant in the activities of the OSCE and numerous other international organizations.

Throughout FY 2003, Lithuania demonstrated its commitment to allocating resources for meeting NATO obligations. As of 2003, Lithuania had one battalion fully equipped, fully interoperable, and ready for deployment alongside NATO forces for any Article 5 operation outside Lithuanian territory. No later than 2006, Lithuania expects to complete preparation of one Reaction Brigade for the same type of operations. As much as 22 percent of the defense budget is devoted to procurement, including a contract signed with the U.S. for procurement of the JAVELIN anti-tank weapon system. Lithuania also demonstrated commitment to specializing and force restructuring. The Baltic States have already been specializing at the regional level, including BALTRON and BALTNET. BALTNET is already fully interoperable with NATO's air-surveillance system and could be connected to this system in a matter of hours. BALTRON will potentially become a part of the mine-countermeasure element of NATO's naval force. There are a number of other areas where Lithuania could provide useful capabilities, including special forces, medical personnel, engineering, and logistics units.

The Foreign Military Financing (FMF) and International Military Education and Training (IMET) programs in FY 2003 continued to give the U.S. significant influence in the development of Lithuania's armed forces. FY 2003 FMF and IMET programs were key elements in transforming Lithuania's military to a U.S.-style expeditionary force that is deployable, sustainable, and fully capable of operating alongside U.S. and NATO forces. In addition, a large portion of the FMF and IMET programs initiated or extended with FY 2003 funds directly and indirectly supported the over 250 Lithuanian soldiers deployed in support of Operation Iraqi Freedom (OIF), Operation Enduring Freedom (OEF), and Balkan peace operations.

The FY 2003 IMET grant of $1.2 million funded the attendance of over 50 officers and NCOs at nearly 100 courses in the U.S. In addition, the U.S. conducted three separate IMET-funded Mobile Education Team (MET) courses in Lithuania. The focus of IMET is the continued professionalization of senior and mid-level leaders, logistics training, civil-military operations, and special operations. Five Lithuanian officers attended Senior Service and Command and Staff colleges in FY 2003. Lithuania continues to place graduates from these mid- and senior-level courses in key command and staff positions throughout the military, resulting in the introduction of U.S. doctrine, military philosophies, and ideals at the highest levels. Lithuanian attendance at logistics, special operations, and civil-military operations courses continues to develop a gifted cadre of young officers with a strong foundation in U.S. and NATO doctrine. This training is critical for the transformation of Lithuania's military into an agile, deployable force that can support U.S. and NATO operations.

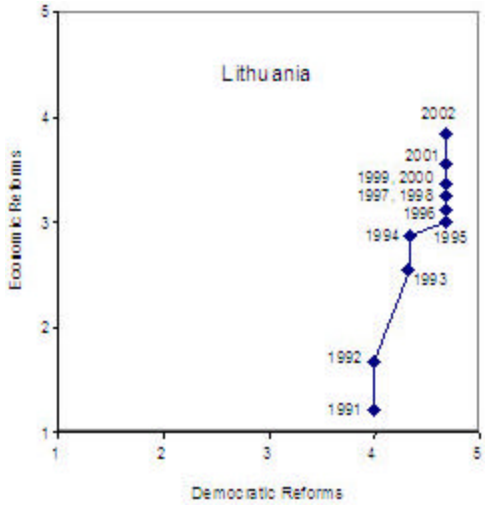
Lithuania obligated all $7 million of its FY 2003 FMF funds, as well as remaining previous-year funds. The focus of the FY 2003 FMF program continued to be the transformation of the military from a static territorial defense force to a deployable NATO-compatible military. The major FMF acquisition of over 60 military vehicles greatly increases the readiness of the military and its interoperability with NATO. These modern vehicles will enhance Lithuania's ability to support its armed forces when deployed out of country. Funds were also obligated to an existing FMF case, which is providing valuable military advice, focused on the ongoing transformation of the military. This contractor support has been instrumental in helping Lithuania design a National Military Strategy and a road map for transformation and procurement through 2014. The five-person U.S. team, headed by a retired Marine Corps general, interacts daily with Ministry of Defense officials, providing significant U.S. influence on the transformation of the military. In addition, FY 2003 FMF money as well as $4 million in supplemental funds were used to support conventional and special operations forces deployed in support of OIF and OEF.

Regarding law enforcement, the U.S. and Lithuania cooperated in FY 2003 in numerous investigations, and several extraditions have been initiated under the new extradition treaty. Close cooperation also continues in narcotics and counterfeiting cases. The U.S. Secret Service has been allocated funding to provide training and equipment in counterfeiting that will prove vital for current and future investigations. The Lithuanian Special Investigations Service (STT) continued to ramp up its anti-corruption investigations, and the rewards of previous training and equipment are apparent. The STT's progressive stance was aided by the watchdog role of Transparency International Lithuania, which also received Embassy funding to investigate corruption in Lithuania.

In FY 2004 (with FY 2003 SEED Act funds and renewed IMET/FMF funds), assistance will continue to help prepare Lithuania for NATO membership. Law enforcement cooperation will also be vital, and other regional programs will focus on narcotics control and prevention.

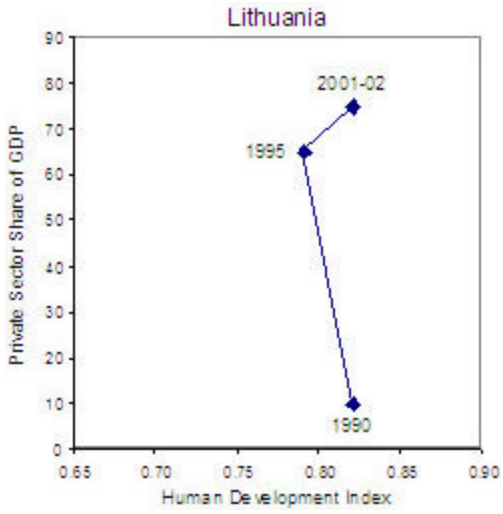
COUNTRY PERFORMANCE MEASURES

Economic Policy Reforms and Democratic Freedoms in Lithuania, 1991-2002



Ratings based on a 1 to 5 scale, with 5 representing the most advanced.
Sources: EBRD, *Transition Report 2003* (November 2003); Freedom House, *Freedom in the World 2003* (2003); and (various years)

Economic Structure and Human Development in Lithuania, 1991-2002



The Human Development Index (HDI) is based on three indicators: longevity, as measured by life expectancy; educational attainment, as measured by a combination of adult literacy and combined primary, secondary, and tertiary enrollment ratios; and standard of living, as measured by real per capita GDP ($PPP). The HDI ranges from 0 to 1, with higher values representing greater human development. UNDP, *Human Development Report 2003* (July 2003), and previous editions; EBRD, *Transition Report 2003* (November 2003), and previous editions.

II. Country Assessment--Macedonia

Area: 25,333 sq km, slightly larger than Vermont
Population: 2,063,122 (July 2003 est.)
Annual Inflation: 1.1% (2002 est.)
Population Growth Rate: -0.78%
Gross Domestic Product (GDP): $1.057 billion (purchasing power parity, 2002 est.)
Life Expectancy: male – 72.23 years; female – 76.94 (2003 est.)
GDP Per Capita: $5,100 (purchasing power parity, 2002 est.)
Infant Mortality: 12.14 deaths/1,000 live births (2003 est.)
Real Annual GDP Growth: .7% (2002 est.)

U.S. STRATEGIC INTERESTS

A Europe whole, free, and at peace is the overriding U.S. strategic interest in South Central Europe, including in Macedonia. Throughout the region, the U.S. supports continued peace and stability, ethnic reconciliation, good neighborly relations among states, development of market-based economies, and integration into Euro-Atlantic institutions. Macedonia's relatively well-educated population, strategic location in the Balkans, and mineral resources also make it a potential force for economic growth and stability in its region. Macedonia lent its airspace and its voice at the UN in support of Operation Enduring Freedom, sent troops to Iraq and Afghanistan, and continues to provide lines of communication to KFOR for its Kosovo operations. It aspires to membership in the EU and NATO and is working to modernize its military. It is also striving hard to overcome its legacy as a transit route for smugglers, traffickers, and money-launderers, and to make the transition from a command to a market economy. It is in the U.S. interest to promote Macedonia's prosperity and ensure that its limited high-technology capabilities are applied to legitimate, civilian purposes.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

In FY 2003, the U.S. Government (USG) provided an estimated $50 million in SEED assistance to Macedonia, including:

- Economic development programs- $21.10 million;
- Democracy programs - $17.81 million;
- Social development - $4.93 million;
- Anti-crime programs - $1.80 million; and
- Program development - $4.36 million.

Other U.S. assistance in FY 2003 included:

- OTI – Confidence Building Initiative - $11.0 million
- FMF - $11.9 million (includes $1.0 million supplemental funding)
- IMET - $650,000
- NADR --EXBS program - $300,000
- Peace Corps - $1.25 million

In FY 2003, a total of 305 Macedonians traveled to the U.S. on USG-funded exchange programs.

U.S. ASSISTANCE PRIORITIES

Democratic Reform Programs: In FY 2003,USAID's SEED-funded democracy and governance program focused on: 1) expanding citizen participation in political and social decision-making; 2) enhancing adherence to the rule of law; 3) improving the effectiveness and accountability of local

government; and 4) increasing confidence in government institutions and political processes. The Department of Justice, Office of Overseas Prosecutorial Development, Assistance and Training (DOJ/OPDAT) program focused on strengthening the independence of the judiciary; enhancing the efficacy of public prosecutors; promoting the reform of the substantive and procedural criminal codes of law, including the adoption of the law on electronic surveillance; and encouraging cooperation between prosecutors and the police.

Economic and Social Sector Reform Programs: USAID's SEED-funded program to accelerate the development and growth of the private sector focuses on strengthening financial sector institutions, increasing the competitiveness of private firms, and improving the investment and business environment. To mitigate the social impacts of the socialist-to-market economy transition, USG assistance concentrates on increasing the demand for labor, addressing the country's unemployment problems through local economic development, and making the education system more relevant to the labor market. This program includes training and technical assistance to improve the quality of schools, decentralize the education system, and increase access to education at all levels for minority groups.

Security, Regional Stability, and Law Enforcement Programs: Several USG programs targeted corruption, organized crime, and the lack of rule of law. The Department of State, Bureau of International Narcotics and Law Enforcement Affairs (INL) administers SEED funding in support of three projects in Macedonia: the Department of Justice, Office of Overseas Prosecutorial Development, Assistance and Training (DOJ/OPDAT) Resident Legal Advisor (RLA); Department of Justice, International Criminal Investigative training Assistance Program (DOJ/ICITAP) Police Reform; and OPDAT/ICITAP collaborative efforts to combat trafficking in persons (TIP). In addition to the work described under Democratic Reform, OPDAT worked on raising the awareness within the law enforcement community of the need to run parallel proceedings in prosecuting financial crimes, while encouraging the courts to use the applicable laws on freezing and seizing assets of the accused. The courts first utilized these laws in 2003. The DOJ/OPDAT program also focused on strengthening Macedonia's institutional capacity to stop the trafficking of women and children across its borders. The DOJ/ ICITAP program works in the areas of professional standards, community policing, organized crime, and trafficking in persons. A Department of State Export Control and Related Border Security (EXBS)program will provide training and materials to deter and interdict the proliferation of materials and technology related to WMD and ballistic missile applications, through an efficient export control regime. U.S. Customs has been working closely with the Macedonian Customs Authority to control smuggling and corruption, while reducing waiting times at the border for legitimate cargo. Foreign Military Financing (FMF) and International Military Education and Training (IMET) funding promote military reform in support of Macedonia's NATO candidacy. This funding has also allowed the Macedonian military to interoperate with NATO-country forces in regional exercises, as well as in Iraq and Afghanistan.

SECTORAL ASSESSMENTS

Democratic Reform

The Framework Agreement (FWA), the peace agreement that ended Macedonia's 2001 internal conflict, prescribes political reforms to guarantee minority civil rights. Its successful and timely implementation, jointly overseen by the U.S. Embassy and an EU Special Representative, is key to maintaining stability.Decentralization of government is a major component of the FWA. Full implementation of the decentralization provisions requires the amendment or adoption of more than 80 relevant laws. The USG provided technical assistance to the Government of Macedonia (GOM) in drafting the Law on Local Finance, a cornerstone for decentralization, as well as the Property Tax Law and other key pieces of legislation. The USG and EU collaborate closely in donor coordination to ensure that decentralization assistance and advice are complementary.

USG assistance facilitated an accurate 2002 census, as mandated by the FWA. The politically sensitive census was a prerequisite for many of the decentralization reforms. The USG provided

training, technical assistance, and equipment to strengthen the capacity of the State Statistical Office (SSO) to conduct the census in accordance with international standards. This assistance complemented the EC's Eurostat Monitoring Mission to confirm the census process and results.

Consolidation of the rule of law is essential to the transition to a market-oriented democracy. To promote the development of rule of law in Macedonia, the USG supports training and technical assistance to strengthen the professionalism and independence of the judiciary, police, and public prosecutor's office. To ensure that cases will be adjudicated in a fair, consistent, transparent, and timely manner, the USG provides assistance to reduce the case backlog and improve the effectiveness of the courts. USG technical assistance helped in the drafting and passage of the Independent Court Budget Law in September 2003, to increase the judiciary's control over its budget -- a major step toward judicial independence. The U.S. coordinates its legal reform assistance closely with the EU to ensure harmonization with EU legal standards.

To strengthen citizens' ability to participate effectively in making the decisions that affect their lives, the USG is providing assistance to build a sustainable and vibrant civil society. As a result of USG assistance, civic education is being taught in all public kindergarten and first through sixth grade classes. The USG supported the drafting of a new Broadcast Law to enhance the independence of the public broadcaster and regulatory bodies in this sector. Grants, training, and technical assistance were extended to 30 local NGOs to address organizational and financial sustainability issues, as well as critical social issues, such as conflict prevention, anti-trafficking, youth unemployment, and HIV/AIDS. The Embassy worked with a coalition of five NGOs to advocate increased GOM attention to the HIV/AIDS issue, and to develop activities to reach out to the most at-risk populations. This coalition of NGOs was invited to serve on the Ministry of Health's Multi-Sectoral Committee on HIV/AIDS, the first time that NGO input was sought on a key policy issue. Its contribution was instrumental in Macedonia's successful proposal to the Global Fund for HIV/AIDS.

Citizen confidence in government institutions and the political process is a critical reflection of the level of trust that citizens have in democracy as a system. In addition to its support for the conduct of free and credible elections, the USG provides assistance to help make the Parliament more independent, representative, and accountable, as well as to encourage the members of parliament to reach out to and represent the interests of their constituents. This included the opening of three constituent offices in 2003. Work with the political parties continues to build local branches that are more democratic internally and responsive to party members and citizens, as well as to strengthen youth and women's political organizations.

The 2004 democracy program will continue to emphasize support for decentralization, in the context of encouraging FWAimplementation. The focus of the local government work will shift from the legal framework to capacity building for local government officials, in order to prepare them to assume additional responsibilities. In anticipation of the local and presidential elections in 2004, the USG will provide comprehensive support for the work of the State Election Commission, including voter education and poll worker training.

Macedonia's corrupt and inefficient judicial system requires continued attention. The judiciary benefited from the workshops provided by OPDAT/ICITAP, along with the OSCE Mission.

In 2003, OPDAT and the Drug Enforcement Agency (DEA) Regional Office provided a training workshop for police, prosecutors, judges, and customs officers in investigating, prosecuting, and adjudicating complex narcotics cases. With USG assistance, police seizures of illegal narcotics increased by 40 percent over 2002, and convictions for narcotics-related offenses jumped by 33 percent. Illegal narcotics seized included heroin, hashish, marijuana, cocaine, and ecstasy.

Two issues that will receive increased attention in 2004 are corruption and organized crime, both of which remain serious obstacles to Macedonia's further democratic and economic development. Through continuing dialogue with the Government of Macedonia (GOM), DOJ will continue to press for a stronger role for the government's Anti-Corruption Commission. It will also support

establishment of an independent judicial review board.

In 2004, OPDAT will present programs in which a federal prosecutor from an Organized Crime Task Force, and the RLA from Belgrade, will offer workshops on combating organized crime. OPDAT will give workshops for judges, prosecutors, and police on the newly amended Criminal Code, Law on Criminal Procedure, and the revolutionary new Law on Electronic Surveillance.

The Embassy Democracy Commission's small grants program facilitated grass roots-level explication of U.S. policy objectives. The program supported over 20 projects, covering such critical areas as trafficking, multi-culturalism, ethnic diversity and tolerance, the environment, and women's and human rights. Projects related to Macedonia's NATO candidacy also received funding, in anticipation of GOM efforts to hasten reform and build public support for membership.

Economic and Social Sector Reform

Shortly after taking office in November 2002, the new government realized that a spending spree by its predecessor had nearly depleted the GOM's coffers. Subsequently, the Ministry of Finance (MOF) implemented stringent fiscal constraints for the first half of 2003, to comply with IMF targets. Funding FWA-mandated reforms imposed an additional burden. Foreign direct investment in 2003 was well below early expectations. GOM discussion of possibly revisiting earlier privatizations caused some investors concern. Seeking a more vigorous economic team, PM Crvenkovski replaced the Ministers of Finance, Economy, Justice, and Transportation, in November 2003. The GOM signed a Stand-By Agreement with the IMF in February 2003, that was approved by the IMF Board in April. The first review was positive, and the GOM continues to comply with the program.

Despite the stable but stagnant macroeconomic climate, progress in 2003 was significant. The USG played a direct role in the setting up of the National Entrepreneurship and Competitiveness Council, composed of representatives from government, private industry, and the labor unions. The Council has selected and focused on four sectors – tourism, lamb/cheese, wine, and information and communications technology (ICT) – as Macedonia's areas of greatest competitive potential.

Agriculture plays a significant role in the economy. The targeted meat and dairy, retail, and sheepherding agricultural sectors increased sales and market share in domestic and export markets, improved profitability and compliance with industry standards, and introduced new technologies. With USG help, the first International Standards Organization-certified quality control laboratory was created. Private companies from Kosovo have also used the lab's facilities. U.S. assistance activities resulted in investment and job creation.

Many USG assistance programs have components designed to reduce or eliminate corruption. The Financial Police, for example, will focus on the most blatant financial crimes. The first financial police officer training has been completed, and officers now better understand evidence gathering, investigative procedures, and computer forensics. To further prevent corrupt practices, USG assistance has improved GOM budget formulation by establishing a Single Treasury Account and developed new practices for treasury operations in the areas of cash planning, arrears reduction, and commitment accounting.

Although the passage of the comprehensive Company Law was delayed until January 2004, several important interim steps were taken to improve the business and investment climate. With USG support, the GOM passed several key articles to the current law that halted the egregious practice of managers extorting voting rights from workers. A baseline survey on corporate governance was completed, and it will track the effectiveness of the "Good Corporate Governance Makes a Difference" campaign. The campaign includes seminars, radio broadcasts, and town hall meetings with citizens, companies, and journalists.

The U.S. coordinates its financial sector assistance closely with EU, Dutch, and German aid. The

USG has focused on a new audit law to create accounting and auditing standards that are consistent with International Financial Reporting Standards. All the major capital market laws (Laws on Securities, Investment Funds, and Takeovers) have been reviewed, and extensive recommendations have been given to the GOM on amendments needed for these laws to conform with international best practices. Legislative action is expected in 2004.

In 2004, USG assistance will remain focused on small and medium-sized enterprise (SME) development and financing, employment generation and training, and expansion of information technology, as well as fiscal transparency and decentralization, competitiveness, and the business environment. At an estimated 37 percent in 2003, unemployment in Macedonia is among the highest levels in the region and could be politically destabilizing, if the GOM cannot find ways to stimulate faster job creation. Investors' rights and management obligations with regard to equity financing will also become more important as Macedonia, with USG and World Bank assistance, moves to a Pillar II pension system on January 2005. Emphasis on the financial sector as a whole will be reduced slightly. Though problems remain, the banking sector continues to mature, with increases in direct foreign ownership, liquidity, competition, reduced lending rates, and the inevitable closure of weak banks. The new ministers of Economy, Finance, Justice, and Transportation have a mandate drastically to improve performance in their respective domains. Initial signs are excellent for assistance and cooperation with USG entities, and U.S. programs will reflect their new priorities.

A Rapid Response Law passed that will require employers to offer training prior to laying workers off. This law is based on methodology the USG used effectively in one of its assistance programs and will enhance the skills of laid-off workers, and expand their employment options.

Increasing access to and the quality of education, particularly for minorities, is a high GOM priority. In FY 2003, the USG was among the largest supporters of the multi-ethnic, multi-lingual private South East European University (SEEU), that offers classes in Albanian, English, and Macedonian. Enrollment exceeded expectations and continues to rise. A new initiative to increase enrollment and retention of the Roma minority in primary schools was also successful. The USG provided assistance to improve teaching methods and furnished schools with computers. Both of these interventions will enhance the quality of education and encourage students to stay in school. The World Bank is designing an education reform project; the USG coordinates with the Bank as it progresses.

In 2004, the USG will continue to provide support to the SEEU. In addition to enrollment, better faculty and facilities will be the focus. To increase Roma minority enrollment at the primary and secondary school levels, the USG will expand assistance designed to reduce the obstacles Roma face. The USG is initiating a new program that will use information technology to boost SME efficiency and give them a technological edge that will allow them to compete in the global arena.

The TV Cooperative Program on economic development and Macedonia's collaboration with IFIs helped to educate viewers. Programs featuring U.S. examples and experiences of small business development and entrepreneurship and their applicability in Macedonia were highlighted. Media training and development programs also continued to be important in promoting U.S. objectives in Macedonia. Issues such as accountability, objectivity, and other basic tenets of journalism were effectively reflected in local reporting.

After a 15-month suspension due to internal unrest, Peace Corps Macedonia was re-established in November 2002. There now are 43 volunteers serving throughout the country in four sectors. Sixteen volunteers work with English language education, 18 assist with municipal governments, six work on environmental education and management programs, and three serve with local NGOs. These volunteers continue to assist and support their counterpart organizations through capacity building, information technology support, cross-cultural understanding, USAID small projects assistance ($50,000), networking, and research. Small projects assistance has included playgrounds, computer centers, libraries, clean-up projects, and city park restoration.

Security Regional Stability and Law Enforcement

Stability improved greatly in Macedonia during FY 2003, with no major outbreaks of ethnic violence and a reduced number of minor, isolated incidents. The emphasis of the USG and international community has shifted to controlling cross-border crimes, strengthening the rule of law, preventing criminal violence, and preparing Macedonia's military for accession to NATO.

Although Macedonia has started reforming its criminal justice system in recent years, the country's institutional infrastructure remains plagued by low salaries, insufficient training and equipment, and widespread corruption. In FY 2003, the USG provided training to law enforcement officials, prosecutors, and judges in the areas of money laundering and financial crimes, corruption, narcotics, and trafficking in persons. The DOJ and the Treasury Department have been working closely with senior GOM officials on improving the money laundering laws and strengthening the ability of the prosecutors to charge parallel crimes and to seize the proceeds of crime in corruption, narcotics, and trafficking-in-persons cases. In FY 2003, Macedonian law enforcement officials initiated a series of cases involving corruption, money laundering, and other financial crimes allegedly committed by former government officials.

The USG funded a variety of seminars on anti-corruption, anti-trafficking in persons, and anti-narcotics; training for prosecutors, police, the judiciary and customs officers; and sessions on judicial and criminal legislation reforms. It also supported a number of regional conferences in Bulgaria, Kosovo, Romania, and Serbia and Montenegro that facilitated cooperation among local judges, prosecutors, police, and legislative drafters from Macedonia and its neighbors. In addition, USG assistance helped to develop a witness protection program, especially for anti-trafficking cases. DOJ, through the Embassy's Public Affairs Office, sent a group of Macedonian prosecutors to the U.S. under its International Visitors Program (IVP). DOJ designed an English language course for judges and prosecutors, financed and administered by the Public Affairs Office, in FY 2003. The course will operate in three regions in Macedonia through FY 2004.

Trafficking in persons (TIP) remains a formidable challenge for Macedonia. SEED funds have helped Macedonia continued its steady progress and improvement regarding TIP. It is both a transit and a destination country for trafficking of women and children, as evidenced by the number of search warrants executed. Over 600 women have been rescued since the transit center, operated by the Interior Ministry with the support of the International Organization for Migration (IOM) and local NGOs, started functioning in early 2001. As the only Tier I country in Southeastern Europe according to the Department of State's latest Trafficking in Persons Report, Macedonia also received SEED support for extensive outreach programs focusing on public education. Other projects included training seminars to enhance reporting and coverage of TIP and computer access to trafficking assistance and support offered by the U.S. and regional NGOs. In FY 2003, the USG also supported IOM and local NGOs financially to operate a shelter for rescued trafficking victims. It provided reintegration assistance, medical care, and counseling.

The FY 2003 ICITAP police development program began a transition from conducting community policing assessments to implementing a pilot project encompassing six sub-components: a comprehensive, self-paced/modular community policing curriculum for certifying police officers; a series of community leadership training courses; a Community Action Team (bicycle unit); a Community Advisory Group; a local presence of the Professional Standards Unit; and a Citizens Police Academy. These components will be tested and improved, incorporating "lessons learned" into future iterations anticipated in other parts of the country. The Professional Standards Unit effort in the Ministry of Interior continues to address issues in staffing, training, policy and procedure, legal reform, case tracking/investigation, and community confidence. Representation on ministry-level bodies related to trafficking in persons is also mandated in this program component.

In FY 2004, ICITAP will continue to expand its grass-roots development of community policing through pilot projects. However, the impetus and responsibility for these initiatives will begin to shift to the Macedonian police, so that sustainability will be a realistic goal. ICITAP's program will retain

four full-time advisors to help the GOM at the Ministry level to focus on the specific areas of community policing, organized crime, trafficking in persons, as well as continued commitment to professional standards. In the community policing program, a train-the-trainer emphasis will promote sustainability through increased participation by Macedonian police personnel and community members. The organized crime/trafficking-in-persons advisor will provide professional training, advice, and consultation to the Ministry of Interior, working closely with the OPDAT RLA, to promote a coordinated task force approach. In professional standards, the program will continue to strengthen the Ministry of Interior's internal audit capacity.

The Department of State's Export Control and Related Border Security (EXBS) program funds export control detection equipment and training for border posts and personnel, including the tracker licensing control system, risk report database, and WMD awareness. Other non-proliferation assistance is planned from the Department of Commerce (USDOC) on training for an export control licensing system, possible help from the Department of Energy (DOE) to provide radiation portal monitors, and a Customs border security program to complement these efforts

The Southeast European Cooperative Initiative (SECI) in Macedonia is part of a joint World Bank-U.S. sponsored, regionally linked program that also supports efforts by Albania, Bosnia and Herzegovina, Bulgaria, Croatia, and Romania to facilitate trade. The program seeks to promote more efficient, less costly trade flows across the borders of the participating countries by providing EU-compatible customs standards. The SECI project supports the implementation of ongoing customs reforms, with a focus on integrated solutions at selected pilot sites at main European corridors. These sites are intended to increase the productivity of border agencies and reduce the waiting time and lines at border crossing stations. USG support funds infrastructure upgrades, such as updated IT systems, training, and other essential programs in support of the Trade and Transport Facilitation of Southeast Europe (TTFSE) program. The project, begun in FY 2001, will run to the middle of FY 2005. Measurement results show reductions of 26 to 78 percent in average processing times at the four pilot sites in 2003, compared to 2002.

SECI has overseen the creation and development of a Risk Analysis Unit in the Macedonian Customs Administration (MCA). The team was trained and equipped with the tools needed to analyze and monitor cargo selectivity, based on the automated compliance measurement and risk-assessment/profiling system for cargo. SECI will support the extension of this process across the country. It also assisted MCA to develop a public hotline to report Customs offenses and corruption, and helped set up an Office of Internal Affairs to investigate alleged corruption.

The USG funded anti-terrorism programs to stress its commitment to combating this scourge worldwide. These Public Diplomacy programs also sent a powerful signal that terrorism of any kind will not be tolerated. As an innovative approach, the American Corner in Bitola included a specific section on terrorism. The section, which features the latest, most up-to-date computer access to the USG's policy on terrorism, offers videos and lectures on its various forms. The country programs are funded to underscore that U.S. actions in Iraq and Afghanistan are aimed at combating terrorism, and not at Islam.

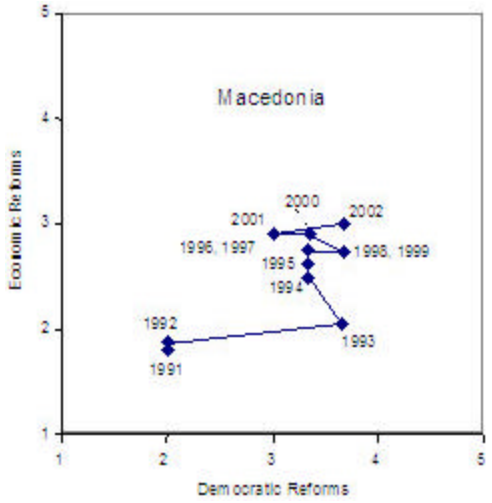
Various SEED programs were implemented to combat trafficking in persons. The Embassy's IVP program and several Department of State Educational and Cultural Affairs (ECA) Bureau-sponsored training projects on trafficking produced tangible benefits. Strategies targeting effective enforcing of the law, strengthening the prosecution, and developing community support and awareness, were among the themes highlighted in one multi-ethnic IVP group. The group, comprised of representatives from Macedonian NGOs, journalists, prosecutors, and a public official, met for the first time on the IVP. They interacted with their counterparts from Serbia and Albania, and developed a stronger sense of the need for regional cooperation. The Embassy's English language program for judges and prosecutors has facilitated understanding of U.S. policy and generated goodwill, in addition to achieving its stated objective.

Much of the USG's FMF program has supported the Defense Reform Project, implemented by Booz

Allen Hamilton. It provides training in logistics and personnel, planning, and programming budgetary assistance. The project has helped Macedonia to meet its NATO reform targets, specifically in encouraging the transition to a lighter, more flexible force. FMF also financed radios and other equipment to enhance the interoperability of Macedonian forces with NATO-country forces during regional exercises, as well as with Coalition Forces in Iraq. Under the IMET program, 65 officers, from lieutenants to generals, expanded their military education in the U.S.

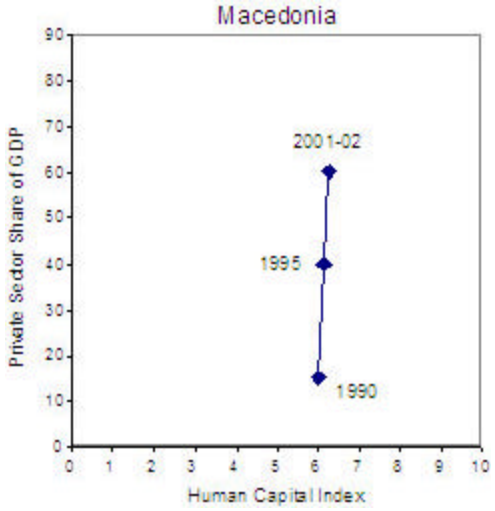
COUNTRY PERFORMANCE MEASURES

Economic Policy Reforms and Democratic Freedoms in Macedonia, 1991-2002



Ratings based on a 1 to 5 scale, with 5 representing the most advanced.
Sources: EBRD, *Transition Report 2003* (November 2003); Freedom House, *Freedom in the World 2003* (2003); and (various years).

Economic Structure and Human Development in Macedonia, 1991-2002



The Human Capital Index (HCI) is based on an average rating of four variables, scored on a 1 to 10

scale: per capita income; secondary school enrollment; health, as measured by life expectancy and under-5 mortality; and public policy, as measured by public expenditure on health and education a % of GDP. World Bank, *World Development Indicators 2003* (2003); and UNICEF, *Social Monitor 2003* (2003). Private sector share of GDP is from EBRD, *Transition Report Update* (May 2003).

MEASURES OF PROGRAM EFFECTIVENESS IN FY 2003

DEMOCRATIC REFORM

Performance Indicator: Freedom House *Nations in Transit* Governance Rating (1 = highest; 7 = lowest)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
4.25 (based on events in CY 2001)	4.50	**4.50 (based on events in CY 2002)**

FY 2003 Results: Macedonian institutions remain at a comparatively low level in Freedom House ratings, due to a slow transition after the election of a new government, in 2002. Decentralization is just getting underway. Local governments have very limited autonomy and have yet to assume increased responsibilities; operating budgets only cover personnel costs. On the positive side, the pace of implementation of the Ohrid Framework Agreement (peace agreement) is on schedule and is expected to accelerate in the next few years.

Performance Indicator: Freedom House *Nations in Transit* Constitutional, Legislative, and Judicial Framework Rating (1 = highest; 7 = lowest)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
4.75 (based on events in CY 2001)	4.50	4.50 **(based on events in CY 2002)**

FY 2003 Results: The judiciary remains unable to provide adequate checks and balances on the government. The court system is currently functioning poorly, with limited resources and heavy caseloads. Current programming (initiated in FY 2003) will help improve the situation. The adoption of the Independent Court Budget Law, and the focus on the reduction of delays in the processing of court cases, already represent major achievements toward an efficient, independent judiciary.

ECONOMIC AND SOCIAL REFORM

Performance Indicator: Foreign Direct Investment (Source: National Bank, Bulletin II / 2003)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
$103.65 million Q4 2001 = $40 mil; Q1 2002 = $2.87 mil; Q2 2002 = $16.23 mil; Q3 2002 = $44.55 mil	$50 million Assumes large FDI inflow due to ESM (Electric Company) privatization.	**$47 million (estimate)** Q4 2002 = $13.51 mil; Q1 2003 = $4.86 mil; Q2 2003 = $18.05; July 2003 = $3.68; August 2003 = $2.93; September 2003 = ?

FY 2003 Results: Focusing on Framework Agreement Implementation in FY 2003, the new government was unable to attract significant FDI, promote trade linkages, or create a better enabling environment for businesses. However, there are signs that considerable pent-up foreign and

domestic investment will materialize in the 2004-2005 period and drive economic development. This includes the ESM (electric company) privatization, which was postponed. A new, long awaited Investment Promotion Agency will also be formed in the Ministry of Economy. The National Entrepreneurship and Competitiveness Council (NECC), composed of 25 council members from public, private, and civil society sectors, engaged in substantive public/private dialogue around three priority areas of national importance, including increased foreign investment. In FY 2003, the USAID-assisted equity fund sold its share of a Macedonian newspaper publishing company to a foreign investor, WAZ, with a capital gain of $2.8 million (eight times its initial investment). This investor also purchased two other national newspapers, at a total cost of about $7 million, thus accounting for 15 percent of total FDI in the country.

Performance Indicator: Securities Markets and Non-Bank Financial Institutions (Source: EBRD)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
1.67	1.67	1.67

FY 2003 Results: With USAID assistance, all the major capital market laws were extensively reviewed (Securities Law, Law on Takeovers, and Law on Investment Funds) and recommendations were given on necessary amendments to bring them up to best international standards. Total market turnover in FY 2003 was 7 billion *denars* (about $135 million); however, the volume of market turnover continues to grow as the Macedonian Stock Exchange matures. Equity markets were adversely affected by the worker/employee role in privatization, which has effectively blocked trading in many shares. In many companies, workers, presumably under duress, ceded their voting rights to management under long-term agreements, making the shares non-tradable. Such agreements became illegal this year. Traders (again generally current management) traded shares through block transactions, taking advantage of a loophole to avoid the transparency and market pricing of trading over the stock exchange. The loophole, allowing an aggregation of small share purchases to qualify for block sale treatment, will be changed.

Performance Indicator: Unemployment rate. The unemployment rate, or the percentage of the labor force which is unemployed, is determined using the ILO definitions. The basis for these data, reported by the EBRD, is an annual Labor Force Survey done by the Macedonian Statistical Office. However, a recent World Bank Economic Memorandum (9/03) indicates that there is probably considerable underreporting of those employed in the informal sector by about 10 percent, suggesting that the rates of unemployment, though still quite high, are significantly lower than those reported by the EBRD. (Source: EBRD, 2003)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
31.9%	30%	**37% (estimated)**

FY 2003 Results: The key to reducing unemployment in Macedonia lies with enterprise generation and sustained economic growth, particularly with small and medium enterprises. While some progress has been registered, the GOM overall has been slow to improve the business environment, including the development and implementation of regulations to facilitate business growth; undertake improvements in the effectiveness of the court system to protect rights and handle disputes; attack corruption, an important disincentive to business; and create a better legal environment for creditors and shareholders. Local and foreign investors have been reluctant to invest, with the result being sluggish growth and poor employment. Efforts are under way to help the GOM to make necessary adjustments in the business environment. The medium-term prospects are more positive, assuming that reform measures are fully implemented.

SECURITY, REGIONAL STABILITY, AND LAW ENFORCEMENT

Performance Indicator: Peaceful Conflict Resolution (Source: 2005 MPP)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
No renewal of organized violence; advances in FWA implementation; all but 3,500 of original refugees have returned.	No renewal of organized violence; advances in FWA implementation continue; refugees return home.	No renewal of organized violence; advances in FWA implementation continue; all but 1,660 refugees have returned.

FY 2003 Results: There was no return to organized violence during FY 2003, and the number of isolated security incidents continued to fall. FWA implementation was well advanced and generally on-track. EUFOR Concordia, the EU's military mission, finished December 15, and the country no longer required an international military presence. The 1,660 remaining refugees represent less than 2 percent of the original number. Given that not all refugees will return home, this number represents substantial progress.

Performance Indicator: Money Laundering Prevention (Source: 2005 MPP)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
Macedonia passes Money Laundering Prevention Law; Directorate established to record suspicious transactions.	Macedonia implements Money Laundering Prevention Law and passes and implements Law on Financial Police; both organizations are staffed and trained.	Financial Police Law passed, staff of both organizations trained; lack of will by Minister of Finance results in incomplete and dysfunctional organizations.

FY 2003 Results: The GOM's first Minister of Finance was not able to appoint a suitable director of the Financial Police, nor was he able fully to staff either organization. His successor took office in November 2003, and has promised to get both programs back on track.

FY 2003 Support For East European Democracy (SEED)
Funds Budgeted for Assistance To:

Macedonia (In millions $, as of 12/31/03)

USAID - Democratic Reform $20.26
USAID - Economic Prosperity & Security $4.56
USAID - Private Sector $12.51
USAID - Social Sector Reform $6.72
USAID Total: $44.05

State - Anti-Trafficking $0.28
State - Bureau of Public Affairs $0.05
State - DRL/Int'l Commission Missing Persons $0.20
State - ECA Exchange Programs $2.15
State - EUR Law Enforcement Programs $0.03
State - EUR Public Diplomacy $0.28
State - IIP Public Diplomacy $0.08
State - INL Law Enforcement Activities $1.80
U.S. Department of State Total: $4.85

Broadcasting Board of Governors - Public Diplomacy $0.23
DHS/Customs - Law Enforcement Activities $0.40
U.S. Department of Treasury - Advisors $0.48
Other Agencies Total: $1.10

GRAND TOTAL: $50.00

II. Country Assessment--Poland

Area: 312,685 sq km, slightly smaller than New Mexico
Population: 38,622,660 (2003 est.)
Annual Inflation: 1.9% (2002 est.)
Population Growth Rate: -0% (2002 est.)
Gross Domestic Product (GDP): $373.2 billion (purchasing power parity, 2002 est.)
Life Expectancy: male - 60.62 years; female - 71.96 years (2002 est.)
GDP Per Capita: $9,700 (purchasing power parity, 2002 est.)
Infant Mortality: 21.4 deaths/1,000 live births (2002 est.)
Real Annual GDP Growth: 1.4% (2002 est.)

U.S. STRATEGIC INTERESTS

Poland has been a staunch ally of the United States in the fight against terrorism, most notably by contributing both to the liberation and the reconstruction of Iraq. It is also a close working partner of the U.S. in NATO, and has provided important assistance in the Balkans and Afghanistan. Poland has served as a model of successful economic transformation since its transition from communism after 1989, creating a sound financial market. Most SEED Act money for economic and social programs will end in early FY 2004. It is in the U.S. interest to use the limited remaining assistance money to support training for the Polish military, continued public outreach programs, and the development of civil society through NGOs.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

In FY 2003, the U.S. Government (USG) provided an estimated $32.64 million in assistance to Poland:

- $520,000 in democratic reform programs (International Visitors and Democracy Commission);
- $720,000 in economic and social-sector reform programs (DOL and PFS); and
- $31.4 million in security, regional stability, and law enforcement programs (IMET, FMF, EXBS and INL)

In FY 2003, a total of 52 Poles traveled to the United States on USG-funded exchange programs.

U.S. ASSISTANCE PRIORITIES

Democratic Reform Programs: In FY 2003, the main priorities for U.S. democratic reform assistance were to build and maintain strong bilateral relations with Poland that can continue after its EU accession and to strengthen the operation of civil society. Poland has already instituted a fully functioning democratic society. Some legacies remain, however, from its recent transition from communism, most notably in the relatively underdeveloped state of civil society and NGO programs. The Embassy has used its Democracy Commission money ($200,000) to foster a more active NGO community. While supporting Poland's entry into the EU, the U.S. is also very concerned to maintain the historically close ties with Poland. USG-funded exchange programs ($320,000, primarily for International Visitors -- IVs) have been used to improve the understanding of Polish decision-makers of the U.S. perspective on EU-related issues.

Economic and Social Sector Reform Programs: In FY 2003, the U.S. provided $600,000 through the Department of Labor's program for worker retraining, which created an institutional structure to

replicate several important models for local communities to follow to attack chronic high unemployment (17.5 percent in September 2003). The U.S. also extended technical assistance to the financial sector through USAID's Partners for Financial Stability (PFS) Program. While Poland has established one of Central Europe's leading financial sectors, it must be developed further to give companies and municipalities the flexibility they need to meet evolving financing requirements. PFS was also instrumental in improving the Polish Central Bank's ability to offer advanced training in banking supervision to countries of the Former Soviet Union (FSU) and Southeastern Europe. USAID provided an estimated $120,000 in bilateral and regional technical assistance to Poland under PFS in FY 2003.

Security, Regional Stability, and Law Enforcement Programs: In FY 2003, U.S. security- related assistance focused on supporting military modernization to meet Poland's NATO commitments and on providing Polish military leaders with the needed training to integrate their armed forces better with U.S. forces in NATO and elsewhere internationally, such as cooperation in Iraq. Poland received $2 million in International Military Education and Training (IMET) and $27.9 million in Foreign Military Financing (FMF) funding. IMET supports continued professional military education. FMF funds are primarily intended to support the acquisition of critical elements for force modernization, specifically Humvees and C-130's. (Note: in addition, Poland received a $3.8 billion FMF loan in 2003 to support the purchase of 48 F-16's. End Note.) The U.S. also signed agreements to extend $512,000 in assistance to help Poland combat trafficking in persons (TIP), particularly along its border with Belarus and Ukraine. The U.S. made available $200,000 in EXBS assistance to improve the ability of Polish Customs Border Guards to detect nuclear and explosive material at border checkpoints and within the country. In FY 2002, a Letter of Agreement (LOA) with Poland was signed to provide $1.3 million in Bureau for International Narcotics and Law Enforcement Affairs (INL) funds over several years to help Poland combat cross-border drug smuggling, corruption and money laundering, and modernize its police force. In FY 2003, the Embassy developed five programs to implement this assistance.

Democratic Reform

In 2003, Poland experienced the trials and tribulations of a strong, multi-party parliamentary democracy. The Prime Minister enjoyed foreign policy successes, including completing negotiations for Poland to join the EU in May 2004, and a successful referendum on EU entry. He has also deepened a strong relationship with the U.S., capped by a visit by President Bush in May 2003. Continued high unemployment, however, and a string of scandals linked to corruption allegations dogged him at home.

Poland's most significant remaining democratization challenges include raising the efficiency of the judicial system, improving education, and fostering a more active civil society. In 2003, USG democratization assistance aimed to improve the ability of Polish NGOs to establish themselves and raise funds. Polish NGOs still need help in developing techniques to raise independent revenue -- the Government of Poland (GOP) provides 30 percent of funding, foreign donors 18 percent, and the Polish private sector 25 percent. Revenue raising is particularly important to meet the necessary capital requirements to be able to register as an NGO. An estimated 100,000 Poles work fulltime in NGO's, and up to one quarter of Poles volunteer in some fashion for the 50,000 foundations and associations. Strong grassroots civil organizations are crucial to enable Poland to overcome the legacy of decades of central planning. In FY 2003, the Embassy Democracy Commission approved $200,000 in grants for 33 projects with local NGO's.

The Polish public is increasingly concerned about corruption. Transparency International and other international organizations have consistently described problems in Poland, often stemming from the country's overburdened, inefficient judicial system and government red tape. The Deputy Prime Minister in charge of the economy has proposed a package of reforms to cut the red tape involved in registering a business, which he hopes will be passed in the first quarter of 2004. The Prime Minister has also announced a number of investigations into officials alleged to be involved in corruption. Through the Democracy Commission, the Embassy supported the work of several small NGO's to

address this issue.

Given the close, long-standing ties to the U.S. rooted in past Polish immigration (there are at least 10 million Americans of Polish ancestry), Polish public opinion generally supports USG policies and American ideas about democracy and free markets. Maintaining these close links after Poland joints the EU has a high priority for the U.S. In FY 2003, the Embassy maintained an active International Visitor (IV) program, spending $320,000 to send 46 of tomorrow's decision-makers to the U.S. for in-depth exchanges with U.S. counterparts on a wide range of issues, from human rights to economic policy and the arts. The Embassy also sponsored six Voluntary Visitor programs. (Note: the U.S. Fulbright Commission is also active in Poland, spending $1.5 million in 2003 to support educational exchanges. End Note)

Economic and Social Sector Reform

Poland was one of the leaders of the economic transformation of Central and Eastern Europe (CEE) in the 1990s, reflecting its early adoption of an aggressive program of market-oriented reforms ("shock therapy") following the fall of communism in 1989. Economic growth averaged over five percent per year from 1996 through 2000, driven by double-digit rates of investment growth, as well as a substantial rise in private consumption. After two years of virtual stagnation (1.2 percent growth in 2002), the economy began to recover in 2003 (expected growth of 3.5 percent by year end) and is forecast to expand by 4.5 percent in 2004. Exports have been an important economic driver, growing 12 percent in 2003, compared to 2002. As a result, the current account deficit has fallen from 4.6 percent at the end of 2002, to 1.9 percent at the end of 2003. Remarkably, growth has resumed with low inflation (under 2 percent in 2003, and forecast at 2.5 percent in 2004). Much of this growth has come as companies have started to invest again, largely in preparation for entry into the EU.

Poland will undergo a second important transformation when it joins the EU, on May 1, 2004. To complete the EU accession process (and pay its costs), Poland will have to implement a number of much-needed reforms. Most notably, Poland must reform its public finance system to reduce overall spending and find ways to reduce unemployment. This will be difficult because nearly 70 percent of the national budget is already obligated to fund social transfers and debt servicing. The public sector fiscal deficit in 2003 was 4.8 percent of GDP, and it is forecast to increase to 5.6 percent in 2004, despite higher economic growth.

While the economy is improving, important challenges remain. Unemployment has stayed constant. Wages are low by Western European standards, with average gross monthly earnings of only $500. Despite new legislation which somewhat liberalized the labor market in 2002, companies complain that high labor taxes and the rigid labor code make it hard to increase employment. Worker mobility is limited, in part for social reasons, including the lack of affordable housing in larger cities and in part because of the general absence of effective worker retraining programs. The GOP hopes to stimulate the economy over the next two years, partly by cutting business taxes and reducing red tape. Poland will have to develop its agricultural sector, which accounts for about 25 percent of the working population, but less than 4 percent of GDP. Most farms are a fraction of the size of their EU counterparts and would not likely survive without the generous subsidies that have become a major budget burden for the GOP. As Poland develops, the GOP expects an influx of rural residents to the cities to increase unemployment.

Poland has not attracted the investment needed to create more jobs. Partly because of the slowdown in the GOP's privatization program, foreign direct investment (FDI) has also slowed from its record inflow of $8 billion in 2000 to an estimated $3 billion in 2003. Privatization revenues have been very disappointing since 2001, with the GOP realizing only 3 billion *Zloty* ($750 million) in sales in 2003 (well below its $2.2 billion target). The GOP has had difficulties designing programs to bring the unemployed back into the labor market and to retrain workers from older industries. These programs are often left to the cash-strapped local governments to develop. The majority of U.S. economic assistance in FY 2003 was spent through a $600,000 Department of Labor (DOL)

program to address these issues. Under this program, DOL funded the replication of several model programs in many parts of Poland, drawing on the success of an earlier pilot project promoting locally based job-creation programs.

The financial sector situation is brighter, where Poland has created one of Central Europe's most advanced financial markets. However, Poland would benefit from further financial market liberalization, allowing the creation of securitized instruments, expanding pension fund investments, and supporting the creation of a secondary mortgage market. In FY 2003, the Embassy helped coordinate $120,000 in technical assistance on capital market development provided under USAID's Partners for Financial Stability (PFS) program. The flagship program was assistance to the National Bank of Poland's Training Initiative on Banking Supervision (TIBS), which has created a training institution for banking supervisors in the FSU and CEE. TIBS held five training programs in 2003 for supervisors from more than 30 countries, teaching them advanced techniques for dealing with a number of issues, including currency risks and cross-border flows. PFS programs also provided assistance to the Polish bond market, explained U.S. views on International Accounting Standards and helped develop a credit database to support a secondary mortgage market. PFS will end in early FY 2004.

The Overseas Private Investment Corporation, U.S. Export-Import Bank, and U.S. Trade and Development Agency all are active in Poland, supporting the development of U.S. trade and investment projects.

Security, Regional Stability, and Law Enforcement

Poland has significantly improved its ability to counter threats to security, regional stability, and the rule of law since 1989. Since joining NATO in March 1999, Poland has supported a number of top U.S. security priorities, including NATO enlargement and USG efforts to find a workable compromise on a European Security and Defense Policy (ESDP). At the end of 2002, Poland signaled its desire to maintain close defense ties over the long term by deciding to buy 48 F-16 fighters. In March, the GOP signed a letter of offer and acceptance worth $3.5 billion for the F-16 sale. In 2003, Poland contributed to allied operations in the former Yugoslavia and Afghanistan. The highlight of U.S. security cooperation with Poland, however, is Poland's strong contribution to both the liberation and the reconstruction of Iraq. Poland contributed troops to the liberation and has taken a leadership role in providing security for the reconstruction. The U.S. provided $27.9 million in FMF assistance in 2003 to help the GOP meet NATO force modernization obligations while also contributing equipment to Iraq. The Embassy also coordinated $2 million in IMET to improve the professional education of Polish military officers.

Poland still faces a security threat from organized crime, elements of which are involved in cross-border activities, including narcotics and trafficking in persons. Domestic drug use is also a growing problem. The domestic drug trade is controlled by three organized crime groups linked to international traffickers. In FY 2002, the U.S. signed an agreement with Poland to provide $1.3 million in INL funds over several years to help it combat cross-border drug smuggling and money laundering, address the corruption issue, and modernize the police force. In FY 2003, the U.S. developed five programs to implement this assistance, including providing significant support to the Polish Police in improving training for officers. The U.S. also supported a drug abuse awareness program, and worked with Poland's Financial Intelligence Unit to support the development of an analytical database to improve its ability to investigate money laundering cases (money for the latter will be spent in FY 2004). DEA officers based in Germany provided significant training and operational assistance to Polish counterparts. In FY 2003, the Embassy continued its effective program of providing $200,000 in assistance under the State Department’s Export Control and Related Border Security (EXBS)program to the Polish border guards to improve their ability to detect and interdict nuclear or chemical items being smuggled across the border. Poland also faces challenges from groups trafficking in persons. Up to 20,000 people are estimated to leave or transit via Poland annually through these organized criminal rings. The GOP has become more active over the last year in combating this scourge, improving inter-ministerial cooperation and dedicating

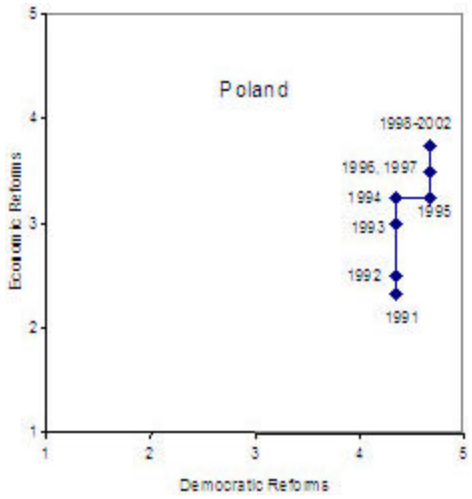
greater resources to it. At the end of FY 2003, the Embassy signed agreements with five entities to provide $512,000 in assistance, funds that should be disbursed beginning in FY 2004.

The GOP has also acted as a regional leader in the fight against terrorism. In September 2001, President Kwasniewski organized a Central European counterterrorism conference to engage regional governments. Poland has established a very sophisticated Financial Intelligence Unit (FIU) within the Ministry of Finance to combat money laundering and terrorism finance. Poland's FIU also works closely with other CEE FIU's and provides assistance to Ukraine and the Balkans.

In terms of physical security, Poland has one research nuclear reactor (Swierk), which was built in the 1970's with Russian assistance and is supplied by Russian fuel. A team of Department of Energy (DOE) experts has been working under an IAEA contract to help Poland improve physical security at its small fuel storage site. At the end of 2003, a DOE team also began talks with the Ministry of Economy about including Poland in a program to improve physical security for civilian institutions storing nuclear isotopes (e.g., hospitals). No assistance had been provided under this program by the conclusion of FY 2003.

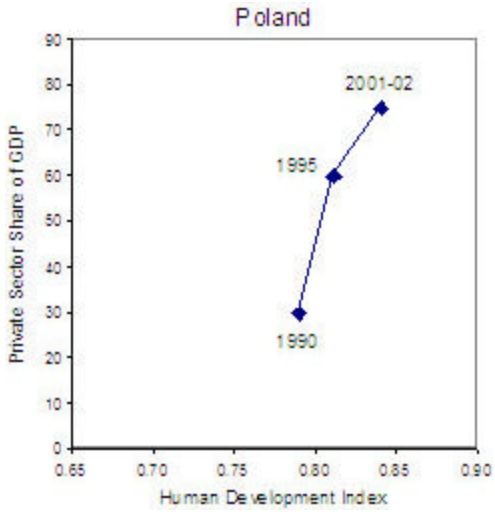
COUNTRY PERFORMANCE MEASURES

Economic Policy Reforms and Democratic Freedoms in Poland, 1991-2002



Ratings based on a 1 to 5 scale, with 5 representing the most advanced.
Sources: EBRD, *Transition Report 2003* (November 2003); Freedom House, *Freedom in the World 2003* (2003); and (various years).

Economic Structure and Human Development in Poland, 1991-2002



The Human Development Index (HDI) is based on three indicators: longevity, as measured by life expectancy; educational attainment, as measured by a combination of adult literacy and combined primary, secondary, and tertiary enrollment ratios; and standard of living, as measured by real per capita GDP ($PPP). The HDI ranges from 0 to 1, with higher values representing greater human development. UNDP, *Human Development Report 2003* (July 2003), and previous editions; EBRD, *Transition Report 2003* (November 2003), and previous editions.

II. Country Assessment--Romania

Area: 238,391 sq. km. (approx. size of Oregon)
Population: 21.7 million (2002)
Annual Inflation: 14.5 (2003 est. - annual % change in CPI)
Population Growth Rate: -2.8% (2002)
Gross Domestic Product (GDP): US $57 billion (Purchasing power parity, 2003 est.)
Life Expectancy: male – 68 years; female - 75 years (2002)
GDP Per Capita: $2,120 (2002)
Infant Mortality: 17.3 deaths/1,000 live births (2002)
Real Annual GDP Growth: 4.5% (2003 est.)

U.S. STRATEGIC INTERESTS

Romania is at the heart of America's foreign policy goals in Central and Eastern Europe (CEE). The largest country in Southeast Europe, it has a large, well-educated population and substantial natural resources. It has the potential to become a political and economic model in this troubled region. Even before its November 2002 invitation to join NATO, Romania was an active partner in Balkan peacekeeping and had begun to develop "niche" military capabilities needed by the evolving Alliance. The bilateral strategic partnership is growing, with U.S. and Romanian soldiers now serving together in Afghanistan and Iraq. Anchored by President Bush's visit to Bucharest in November 2002, U.S.-Romanian relations are stronger than at any time in history. The U.S. is now Romania's fourth largest foreign investor. Romania has welcomed U.S. help to develop its economy and to strengthen its democracy and the rule of law -- goals as important for the Romanian people as they are for the country's aspirations to join NATO and the EU. Unfortunately, while the pace of change has been commendable in the past few years, almost a decade was lost after the 1989 revolution, as political elites pursued an unsure and stop-and-go reform process, putting Romania behind some of its neighbors.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

The Government of Romania (GOR), NGOs, small businesses, and the donor community recognize that USG assistance is an essential, flexible means to intervene in "real-time" to achieve lasting reforms. Such reforms strengthen key institutions and increase Romania's capacity to compete successfully in the global economy. The U.S. provides critical technical assistance, without which there would be serious delays in Romania's transition to a secure, democratic country, with a full market economy -- a state that can assume its full roles in NATO and the EU.

In FY 2003, the U.S. Government (USG) provided an estimated $60.85 million in assistance to Romania:

- $8.90 million in democratic reform programs (including Public Diplomacy exchange programs);
- $20.65 million in economic and social-sector reform programs;
- $31.30 million in security, regional stability, and law enforcement programs; and
- U.S. Defense Department excess humanitarian commodities valued at $2.25 million.

In FY 2003, 303 Romanians traveled to the U.S. on USG-funded exchange programs.

U.S. ASSISTANCE PRIORITIES

Democratic Reform Programs

Fighting corruption and advancing the rule of law are key Embassy goals that support the U.S. national interest in strengthening Romania's democracy. Progress in these areas is essential for attaining other strategic goals. At U.S. initiative and with U.S. assistance, Romania created an anti-corruption prosecutor's office; is strengthening the independence of the Superior Council of Magistrates; and is drafting new laws to regulate conflicts of interest, tighten public financial disclosure requirements, and provide for freedom of information. The U.S. is strengthening these institutions and practices. Moreover, by providing ethics training for judges and court staff, USG assistance is promoting greater independence, integrity, and transparency in the judiciary.

USG-funded programs assist local governments to improve the delivery of services, strengthen financial management, increase local government responsiveness to constituents' needs, and open decision-making to citizen participation. The U.S. is helping civil society organizations so that they can monitor and improve local government performance. To further decentralization, U.S. experts are recommending changes in legislation governing local governments. The program is promoting more effective citizen participation in local politics to increase the accountability of local political parties.

With the Romanian and American Chambers of Commerce, the U.S. is promoting corporate philanthropy in order to create a "culture of giving" and volunteerism, while at the same time encouraging resident companies to become more involved in solving local community problems. Finally, democracy programs promote the rights of ethnic minorities, particularly the Hungarian and Roma communities, and help to ensure that the lessons of the Holocaust are not forgotten. U.S. programs also press for expanded opportunities for Romanian youth through active civic involvement.

Economic and Social Sector Reform Programs

Completing the privatization of Romania's state-owned companies and improving its troubled business climate can make the economy more competitive and increase U.S. trade and investment. The economy is in its fourth straight year of growth. Sustaining, or even accelerating, that growth is a challenge that must be met to reduce the still high poverty rate and to increase the public's faith in the political and economic choices made since the 1989 Revolution. The U.S. is working with the IMF and the World Bank to press for faster, more transparent privatization, especially in the energy sector. The U.S. is also pushing for a better business climate -- one with less red tape and corruption, and more legislative consultation and predictability -- in which local businesses, particularly small businesses, and U.S. trade and investments can thrive.

U.S. assistance to the financial markets supports insurance reform, the introduction of mortgage-backed securities and mortgage bonds, and the improvement of company listing and corporate governance rules for the stock exchanges. Anti-money-laundering and other fraud-detecting measures at the National Securities Commission, Anti-Corruption Prosecutor's Office, and the National Bank of Romania are being improved. In agriculture, U.S. programs focus on forming water user's associations to facilitate the privatization of state-owned irrigation systems, reforming subsidies, improving food sanitation standards, and drafting legislation for a market information system that will make Romanian agriculture more competitive. Assistance is also being provided to the National Water Authority to improve water management, enabling Romania to move closer to the EU's requirements.

Strengthening the competitiveness of private companies is an important goal of U.S. programs. New financial instruments are being developed to provide long-term capital and encourage new companies to list shares, issue bonds, and trade debt instruments. Micro-lending organizations are being established in seven poor counties. Additional capital funds for micro-lending in these counties will be leveraged from the GOR and World Bank. The U.S. is providing assistance to new service centers for agricultural exports and clusters of high-value agricultural producers. Business

associations, chambers of commerce, and government agencies are being helped to improve their services for small businesses. The U.S. is spearheading development of a specialized Arbitration Chamber of the National Securities Commission and the improvement of the National Bank of Romania's supervision functions. Five telecenters are being established in impoverished, rural communities to implement the Universal Services Obligations of phone companies and promote economic growth.

In the social sector, USG assistance focuses on child welfare, family and reproductive health, and infectious disease services. Such assistance is helping to close the worst state-run children's homes and increasing the community child welfare services provided by NGOs, partnering with local governments. U.S. assistance is sponsoring comprehensive services for family planning, safe motherhood and sexually transmitted diseases, (including HIV/AIDS), breast and cervical cancer, and domestic violence. Activities in each area will improve policies, legislation, and quality of services; train a professional cadre in child welfare and reproductive health; and educate the public and decision-makers.

Security, Regional Stability, and Law Enforcement Programs

Romania's strategic location near the Balkans, access to the Black Sea, and impending NATO membership increase its importance to U.S. national security. Romania is an active partner for stability in the Balkans, with troops serving in Kosovo (KFOR) and Bosnia (SFOR). It plays a key role in the Georgia Train and Equip program and contributes directly to the fight against terrorism in Afghanistan and Iraq, with troops serving in both countries. The U.S. is helping to restructure Romania's military and to develop new airlift and "niche" capabilities that can contribute to NATO's evolving new missions. This program is being pursued in close cooperation with USNATO and EUCOM -- the more so in view of Romania's November 2002 invitation to join NATO. The U.S. is assisting the GOR to improve its relations with neighboring states, particularly those along NATO's new frontier to the north and east. Apart from resolving outstanding disputes, improved relations can lead to increased success against cross-border criminal activity and set examples for democratic and free market behavior in the region.

Post-September 11, America's border security interests clearly require that Romania strengthen its law enforcement and anti-terrorism capabilities. The U.S. is training police and prosecutors in new investigative techniques and in tracing money flows (a capability needed in the fight against corruption as well). The U.S. is also working to improve coordination among law enforcement agencies, both within Romania and among state members of the Bucharest-based Southeast European Cooperative Initiative (SECI) Center, in order to enhance Romania's ability to control cyber-crime and trafficking in humans and narcotics.

SECTORAL ASSESSMENTS

Democratic Reform

Romania's elections ever since 1990 have been free and fair. Nevertheless, confidence in democracy is undercut by endemic corruption, continuing high levels of poverty, and a lack of accountability among office holders. Civil society remains weak, with little influence on public policy or opinion. Partially as a legacy of communism, the concept of citizenship -- including the responsibility of constituent involvement -- has yet to take root among much of the population. This is exacerbated by a "party list" system for parliamentary elections, eliminating any real tie between national-level office holders and their constituents. In recent elections, a large number of disaffected voters turned to an extremist and xenophobic party, which offers no practical solutions to the country's problems. Despite progress on some fronts, significant challenges remain. The central government is transferring responsibility for many services to local governments, without providing necessary fiscal and management resources. Unfunded mandates in utilities, education, social welfare, and health care are a pressing problem. There appear to be no coherent plans for decentralization, roadmap, or analysis of the impact of decentralization on local governments. Too

little attention has been given to the efficient use of local resources, the need to establish community priorities, and the means to enhance local service delivery.

USG assistance is building on successful projects in decentralization, social service delivery, advocacy and citizen participation, civic education, alternative dispute resolution, community development, and political party development. All the programs increase citizen participation in local decisions and policies and improve the delivery, effectiveness, and accountability of public services. Expanding the give-and-take between NGOs and local branches of political parties is at the heart of another project, which helps local party members to develop issue-focused platforms. Judicial independence and integrity remain problems in Romania, fueling public cynicism toward democratic institutions and discouraging investors. The U.S. judicial anti-corruption program supports the implementation of codes of conduct for judges and court staff, and strengthens the independence of the judiciary.

USG assistance in FY 2003 contributed directly to better democratic governance. Fifty U.S.-assisted civil society organizations (CSOs)now participate in strategic planning, implementation, and oversight activities with local authorities. Thirty-one CSOs work with 134 local governments on priority projects identified by citizens. Ten political party branches are communicating more effectively with local CSOs and actively promote democratic reforms within national parties. CSOs advocate local government reforms that address citizen concerns, such as the lack of shelters for domestic violence victims, dearth of medical personnel in villages, and need for transparent local budgeting. They also work with local governments on procedures for allocating local government funds to CSOs, and to increase the capacity of small, rural authorities to manage development funds. In one program, USG assistance of $2.7 million has leveraged another $3.2 million from private U.S. sources, Romanian NGOs, and local governments for partnership in Romania. As a result of the civics education program, over 600 teachers are employing a new civics text and curriculum in their classes. USG assistance has supported an Alternate Dispute Resolution pilot program in a large city, and a cadre of 20 lawyers now is using mediation to resolve civil cases more rapidly and cheaply than by taking them to court.

In 2004, USG assistance will continue to focus on advancing reform, supporting civil society, and strengthening interaction between citizens and local government and political officials. In 2003, the local media and public focused increasingly on corruption, pressing the government to address the issue more directly. This presents the USG a new opportunity -- through training and other support -- to help ensure that current anti-corruption legislation is implemented and press for further needed measures. Romania will hold crucial presidential, parliamentary, and local elections in 2004. Already the Embassy has initiated an aggressive public outreach program targeting key audiences to encourage voters to become educated on the issues and vote wisely.

Economic and Social Sector Reform

Ceausescu's policies left Romania the poorest country in East Central Europe at the fall of communism in 1989. Until 2000, Romania’s economic progress was hampered by slow privatization and stop-and-start economic reform. Under the current government, the macro-economy has made substantial progress:

- The economy completed four years of solid growth in 2003, with 4.5 percent expected growth for the year, despite a serious drought;
- Inflation has declined from 40.7 percent in 2000, to an anticipated 14.5 percent for 2003; and
- Most major privatizations have been completed, with the significant exception of the energy sector.

Despite this progress, the microeconomic situation remains mixed. Romania is still one of the poorest EU applicants. GOR statistics indicate that almost one in three Romanians lives in poverty. The proportion is higher in rural areas, where wages are far below the $140 per month average. GDP per person reached only $2,100 in 2002. Although employment has increased, many remain

underemployed, and attractive job options remain limited. Over 40 percent of the population is engaged in agriculture, most on a subsistence basis. Many young, educated workers continue to leave the country in search of better opportunities elsewhere. The U.S. has encouraged the GOR to devise stronger incentives to encourage more "greenfield" investments, particularly in poorer parts of the country.

Over 67 percent of Romania's GDP is now produced by private companies. Completing privatization of state-owned commercial assets is a high GOR priority. In October, Romania completed its November 2001 IMF Stand-By Agreement -- after six failures, the first successful conclusion of an IMF accord in Romania's history.

Since 1999, foreign direct investment (FDI) in Romania has been just over $1 billion annually, continuing a steady upward trend, except for a small dip in 2002. This contrasts with Romania's neighbors, where foreign investment has dropped off markedly is the last few years. The pace of U.S. direct investments in Romania has slowed over the last three years, however, and totaled about $700 million in October 2003. The U.S. is Romania's fourth largest foreign investor (behind the Netherlands, Germany, and France) at current exchange rates. Corruption, red tape, and Romania's slow economic reforms are limiting investment. The U.S. is pressing the GOR to improve the business climate in order to attract more investors. Needed steps include expedited attention to investor problems; elimination of burdensome license and permit requirements; reduced time to obtain licenses; revisions in the fiscal and labor codes; lower taxes for small businesses; improved responsiveness to intellectual property concerns; and a range of measures to counter corruption.

The U.S. provides assistance in four key economic areas: reform of the legal and regulatory environment for businesses; backing for organizations and government agencies that support business; increasing the competitiveness of private enterprises; and privatization of state-owned commercial companies.

U.S. advisors continued to address key legal constraints to business development. For example, they drafted a new Fiscal Code and developed anti-money laundering procedures that are now being used at the National Bank and the National Securities Commission. U.S. programs helped to finalize the legislation governing the electronic commerce and the universal service obligations of the telephone companies, and also draft regulations standardizing computer network protocols. A new mortgage law was passed, with USG assistance, and the legal framework for the secondary mortgage market is being developed. With U.S. support, the GOR budget has been made more transparent through the production of the first "Budget-in-Brief," which has been distributed to all members of Parliament, the Ministries, and the press.

U.S. assistance with the Warehouse Receipts Law leveraged $200,000 from the World Bank (WB) to develop an Indemnity Fund to support the implementation of the warehouse receipt program. The enactment of that law increased the confidence of banks in lending to farmers. For example, the EBRD signed an agreement with the Romanian Bank for Development, committing $40 million in loans to agricultural traders against warehouse receipts. USG assistance with agricultural legislation facilitated WB approval of an $80 million loan for the rehabilitation of state-owned irrigation systems and their transfer to private farmers.

With U.S. assistance, the GOR increased its ability to manage Romania's water resources. As a result of a USG-funded feasibility study and the subsequent pilot project for a water monitoring and decision support system, the GOR approved the sovereign guarantee for a $46 million loan from U.S. EXIM Bank to expand the water monitoring system nation wide. The contract for the national program has been signed with Lockheed Martin, and implementation has started in the Somes-Tisza river basin. Under the Stability Pact and USG-funded Regional Infrastructure Program, the Ministry of Public Administration and county and municipal officials developed a program to rehabilitate small and medium town infrastructures. Based upon two pilot projects, the GOR and EU have provided $48 million for a rehabilitation program in more than 200 communities with six million inhabitants.

With USG assistance, the GOR has taken important steps toward privatizing the electricity generating industry and the state-owned irrigation systems. The U.S. program has played an important role in developing the Ministry of Industry and Resources' privatization strategy for electricity and a "road map" for developing the power sector over the next decade. Created with U.S. assistance, 87 water users' associations have signed protocols transferring state-owned irrigation equipment to the private farmers in the associations.

The competitiveness of some small businesses increased during FY 2003, with USG assistance. A U.S.-funded project provided small businesses with loans totaling $1.7 million. These loans were used for investments in new technology and business development. Grants of $340,000 made to agricultural producers for new equipment leveraged another $460,000 from the producers for the projects. The U.S. helped to create Romania's first private residential mortgage company and attracted $27 million of lending capital from private sources. The mortgages for houses are expanding business for private construction companies.

In FY 2004, work will continue on the structural reforms that are crucial to building the competitive market economy necessary for successful EU integration. The USG will also assess its agricultural assistance in order to focus more precisely on reforms that will move rural farmers more rapidly away from small-plot susbsistence agriculture toward market-oriented, niche crops and increased exports. A poor economy may weaken democracy, producing a fertile breeding ground for extremist political parties. By strengthening and supporting the development of the private sector in the coming years, USG assistance will play a crucial role in ensuring the irreversibility of Romania's market reforms.

The health and child welfare situation in Romania remains fragile. Life expectancy at birth is 71 years, one of the lowest levels in Europe. Romania's infant mortality, under-five mortality, and maternal mortality are among the highest in Europe. Indeed, maternal mortality rates were six times the EU average, in 2000. Romania has the largest number of pediatric AIDs cases in Europe, and more than 34,000 children still live in state-run institutions. Romania's nascent community services, which care for 60,000 children, will require considerable assistance to mature into an effective, sustainable system.

While these statistics remain negative, Romania is moving in the right direction. In FY 2003, USG assistance helped directly in reducing the number of children in institutional care by 8,550 (17 percent); closing 43 institutions with over 50 children each, creating over 200 alternative community services; the drafting of legislation to govern standards for adoption; and implementation of life skills training for youth, child welfare case management, and procedures to follow up on child abuse and neglect cases. The U.S. has obtained over $3 million from business and local public services, and another $6 million from governmental programs to close institutions for disabled children, programs that are being conducted for the first time through NGOs. The U.S. has helped the GOR to develop and implement a national reproductive health strategy. USG programs are integrating reproductive health services into 1,740 primary care clinics, three-quarters of which are in rural areas. Mayors from all of Romania's 41 counties have been trained in child welfare services. Four national campaigns about unwanted pregnancy, reproductive health services, early detection of breast cancer, prevention of HIV/AIDS, sexually transmitted infections, and the fight against stigma and discrimination were held. Three targeted campaigns for hard-to-reach populations, including Roma and those at high risk of HIV/AIDS, were completed.

This good news is an incomplete story, however. The child welfare system still lacks adequate community preventive services, day care centers, maternal shelters, and specialized support services for children with special needs or for youth who leave institutions. The U.S. is the only major donor supporting decentralizing the child welfare system to the community level. Information about children in the system is still incomplete and unreliable. The U.S. is assisting the development of an efficient national child tracking system to provide dependable information on which to base decisions affecting children. The prevalence of HIV/AIDS continues to rise, and without a sustained prevention program, the rate will accelerate with the growing number of infections in high-risk

groups. Romania received a $38 million grant from the Global Fund to Fight AIDS, Tuberculosis, and Malaria, and the U.S. is assisting key stakeholders to develop a strategy for program implementation.

Romania is drafting new legislation to regulate the child welfare system and adoption. During FY 2004, once a law on adoptions has passed, USG assistance will facilitate implementation procedures that stress permanent solutions for every child as the ultimate goal of the child protection system. Romanian legislation on health financing is still weak and is conducive to waste and inefficiency. The system requires a switch from an over-emphasis on hospital care and specialized services to one in which basic health services are provided in the least-cost primary care setting. In 2004, the U.S. will continue to have a leading role in reforming health financing through policy support and the development of standards and protocols for women's health care.

Security, Regional Stability, and Law Enforcement

Romania's location makes it particularly relevant to U.S. security goals in a potentially volatile region. U.S. assistance has helped the GOR to implement an aggressive military reform program to prepare Romania for NATO integration. Activities have included the provision of an advisory team to support military restructuring, English language training for officers and NCOs, and deployment of Romanian troops with NATO forces. The U.S. has supported cooperation among Southeast European Cooperative Initiative (SECI) states to address regional problems and encouraged Romania to resolve bilateral issues with Moldova, Ukraine, and Russia. The U.S. has financed a wide range of military equipment, regional diplomatic training programs, and exchanges with Moldova and Ukraine to familiarize them with NATO requirements. The number of military personnel declared "deployable in support of NATO Collective Defense" has risen by 400, with slightly over 1,600 being deployed in FY 2003. Romania has also signed a treaty with Russia dealing with post-Cold War relations, and the headquarters of the Southeast Europe Peacekeeping Brigade has been rotated successfully to Romania.

In law enforcement, the Department of State, Bureau of International Narcotics and Law Enforcement Affairs (INL) administers SEED funding in support of three projects: Department of Justice, Office of Overseas Prosecutorial Development, Assistance and Training (DOJ/OPDAT) Resident Legal Advisor (RLA); Cyber Crimes; and Counter-Narcotics Assistance. USG support to the SECI Center continues, which increasingly is becoming a focus for effective regional cooperation. In addition to serving as a operational and intelligence center for combating organized crime, SECI now includes regional task forces to combat trafficking in persons, narcotics smuggling, commercial fraud, and terrorism. The effective working of Romania's multi-agency National Focal Point also is an indicator that it is ahead of the curve in the region with regard to interagency law enforcement cooperation. With U.S. support, Romania has passed new cyber-crime laws and recently expanded the number of police officers dedicated to drug and cyber-crime violations. Cooperation between U.S. and Romanian agencies in combating these crimes is excellent.

The RLA provided U.S.-funded surveillance equipment to increase the National Anti-Corruption Office's capacity to investigate cases within the police and other government offices. The equipment was put to immediate use and led to the arrest of 45 police officers involved in the theft and illegal sale of petroleum products. The U.S. Rule of Law program has successfully tested in eight courts case assignment software that is being turned over to the Ministry of Justice for nationwide distribution and implementation. The National Magistrates' Institute has created, with USG assistance, a judicial ethics handbook and reference materials for use in training programs.

Cyber-crime has a direct impact on U.S. businesses, in both the U.S. and Romania, and Romania is one of the top five countries of origin for computer hacking and fraudulent Internet transactions. Criminal organizations in Romania routinely bilk American merchants and individuals out of money and products through computer fraud and intrusions. Assistance from a U.S. cyber-crime team to the Romanian Directorate for Combating Organized Crime and the Romanian Information Service (SRI) has led to marked progress in the fight against cyber-crime. In FY 2003, 85 people were

investigated for Internet fraud and 15 groups dismantled. Because of the cyber-criminals' capabilities and Romania's lack of law enforcement resources, many U.S. companies will not ship products there. In counter-narcotics, last year Romanian police shut down 144 narcotics groups and investigated more than 900 people.U.S. assistance to the Romanian Police Academies will help to create a more professional police force.

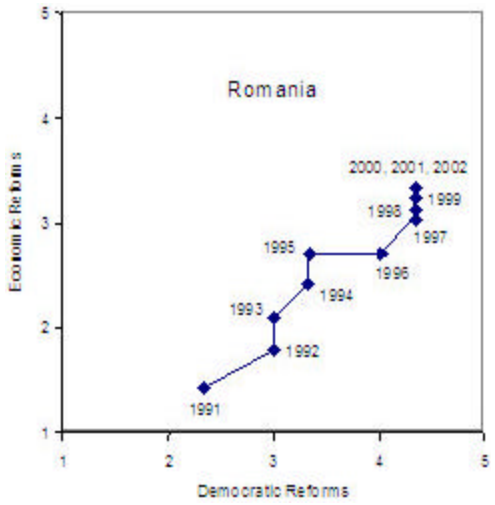
At present, 12 officers are working in the Human Trafficking Task Force in Bucharest, and 50 other specialized officers work in the regions. USG assistance is also providing small grants to NGO-police partnerships for anti-trafficking awareness campaigns, and is facilitating the work of NGOs that rehabilitate and re-integrate returned victims of trafficking into Romanian communities.

In FY 2004, the U.S. will continue to support the development of Romania's strategic lift capability, with emphasis on the C-130 program. The U.S. defense reform advisory team will remain in the Ministry of Defense. Programs will focus increasingly on anti-terrorism training and on building the capabilities of Special Forces. Efforts to develop a Western-style NCO corps will continue, as will support for the development of English language training centers for defense personnel. The program will review current institutional capabilities and will seek to strengthen the skills of instructors to develop and sustain effective police training. The U.S. also will focus on building connectivity and cooperation among agencies, with common computer systems and databases, to increase their effectiveness. The training of border control and export officials and support U.S.-based technical training in the use of CBW and radiation detection equipment will continue. The U.S. will fund the purchase and distribution of tool and detection kits for use at ports of entry. The Rule of Law program and assistance to the National Ant-Corruption will continue. The U.S. will assess, with the Romanian Prosecutor General's Office, the feasibility of the victim/witness program for trafficking-in-persons cases. U.S. experts will continue to assist in the investigation of organized crime, money laundering, and terrorism.

Humanitarian Assistance

There were no natural disasters during the year that required emergency humanitarian assistance funds from the Embassy. The Department of Defense (DOD) implements a variety of humanitarian and civic assistance programs that complement its military assistance. In FY 2003, medical clinics, preparedness centers, and children's residential homes were refurbished and anti-hepatic vaccines provided for residents in Tulcea and Botosani counties.

COUNTRY PERFORMANCE MEASURES
Economic Policy Reforms and Democratic Freedoms in Romania, 1991-2002



Ratings based on a 1 to 5 scale, with 5 representing the most advanced.
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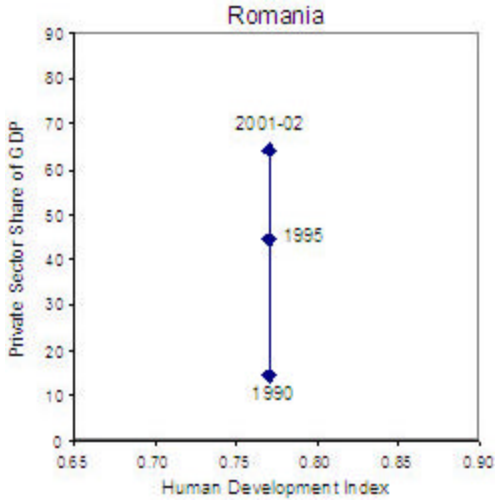
Economic Structure and Human Development in Romania, 1991-2002



The Human Capital Index is based on an average rating of four variables scored on a 1 to 10 scale: per capita income; secondary school enrollment; health, as measured by life expectancy and under-5 mortality; and public policy, as measured by public expenditure on health and education as % of GDP. World Bank, *World Development Indicators 2003* (2003) AND UNICEF, *Social Monitor 2003* (2003).

MEASURES OF PROGRAM EFFECTIVENESS IN FY 2003

DEMOCRATIC REFORM

Performance Indicator: Legislative changes to combat corruption.

FY 2002 Baseline	FY 2003 Target
• Passage of Freedom of Information Law. • GOR agreement, as part of NATO Action Plan, to close corruption-related loopholes in existing law.	• Freedom of Information Law fully implemented and tested. • Passage of laws on declaration of assets, conflict of interests, and political party financing. • Police Organization Bill passed. • Penal and Civil Procedure codes drafted and debated.

FY 2003 Results: Target partially achieved. The Anticorruption Law (no. 161/19.04.2003) includes measures to ensure transparency in the civil service and interactions by civil servants with private citizens. It also regulates public officials' conflicts of interest and assets disclosure. It amends existing measures regarding corruption, ministerial accountability, and tax dodging. Parliament

passed a law, in January 2003, regarding political party and electoral campaign financing. The law stipulates legal sources for political party and electoral campaign financing and maximum electoral expenditures for categories of candidates.

The draft of the new criminal code was completed, after consultations with civic groups, magistrates, and the media. It is being debated in Parliament. The Criminal Procedure Code was amended to make significant changes in the administration of justice. The legislature formulated and citizens endorsed the amendments by a significant margin in a nationwide referendum in October. Law 360/2002 was amended to allow the use of undercover police officers and informants to prevent and fight against corruption, organized crime, and terrorism. The Code of Ethics for Police Officers was drafted; the National Office for Witness Protection has become operational; and, offices have been established in each county to allow dialogue and cooperation between police forces and civil society.

Performance Indicator: Structural changes to combat corruption.

FY 2002 Baseline	FY 2003 Target
• GOR creates National Anti-Corruption Prosecutor's Office. • E-procurement initiative launched.	• PNA completes staffing and identifies most serious areas of corruption. • Technical assistance and training programs for PNA are in place, and prosecutions begin. • Steps taken to assure independence and authority of the Supreme Council of Magistrates. • GOR reviews organization and personnel of Customs Department. • E-procurement reaches 50,000 tenders.

FY 2003 Results: Target partially achieved. The National Anti-Corruption Prosecutor's Office (PNA) has 90 percent of its staff. It made good progress, investigating over 2,200 corruption cases by October 1, 2003. The PNA has made judicious use of technical assistance and training programs. Furthermore, under provisions of an emergency ordinance, the PNA will be attached to the Supreme Court of Justice, as a prosecutor's office specialized in combating corruption offences. The country appeared ready to vote, early in FY 2004, in favor of constitutional revisions to include the creation of a more independent Supreme Council of Magistrates. The Customs Department has not yet initiated a formal internal review of its organization and personnel structure. However, the entire Customs Department was realigned under the National Control Authority (along with most other regulatory agencies) and re-named the National Customs Authority. The National Control Authority itself now reports directly to the Prime Minister's office, a reorganization whose implications remain unclear. The number of e-procurement tenders reached nearly 200,000 by the end of the year, far exceeding the 50,000 goal.

ECONOMIC AND SOCIAL REFORM

Performance Indicator: Accelerated economic reform.

FY 2002 Baseline	FY 2003 Target
• GOR fulfills key obligations of IMF program. • Foreign Investment Agency (ARIS) established. • Government begins anti-corruption campaign.	• Privatization Ministry (APAPS) privatizations 90% completed. • First privatization in the energy sector achieved. • IMF program completed; follow-on agreement negotiated successfully. • ARIS increases support for tackling investor concerns.

FY 2003 Results: Target partially achieved. The Privatization Ministry (APAPS) completed over 90 percent of the privatizations in its portfolio. The IMF program was completed, but follow-on negotiations were not. The first three privatizations in the energy sector were announced, but none concluded. The Foreign Investment Agency (ARIS) continued to operate as an investment-promotion agency rather than a one-stop shop for tackling investor concerns.

Performance Indicator: Rate of change in U.S. exports to Romania compared with rate of change of GDP.

FY 2002 Baseline	FY 2003 Target
• U.S. exports to Romania are $531.9 million.	• Growth of U.S. exports to Romania equals GDP growth. • Local U.S. subsidiaries lead in market development. • Tariff discussions begin.

FY 2003 Results: Target partially achieved. Growth of U.S. exports to Romania through September 2003 was 3.27 percent, which lagged behind the GDP growth. Local U.S. subsidiaries developed some market sectors -- e.g., consumer products, IT, and machine tools -- but European competitors still dominate most market sectors. U.S.-Romanian tariff discussions began, and the GOR made some minor reductions.

Performance Indicator: Child Institutionalization Rate (number of children living in state-run institutions per 100,000 children).

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
764	700	560

FY 2003 Results: Target achieved. There was a steady decline in the number of abandoned children in institutions over the past decade -- from over 100,000 to just over 31,000 -- and the number of institutions to be closed has exceeded the target. This has been accompanied by increase in community care services. During the past year alone, 8,000 more children were

receiving alternative community services than the year before, bringing the total number receiving community services to more than 65,000.

SECURITY, REGIONAL STABILITY, AND LAW ENFORCEMENT

Performance Indicator: International law enforcement cooperation.

FY 2002 Baseline	FY 2003 Target
• The SECI Center is in place and operational. • MOU between SECI and Interpol signed. • National Focal Point for SECI established.	• SECI-Interpol Coordination continued. • Human trafficking task force activity results in successful prosecutions. • Anti-Terrorist working group created. • Links created among SECI Center, Black Sea Economic Council, and GUAAM to fight trans-border crime

FY 2003 Results: Target achieved. SECI-Interpol coordination continued in FY 2003. Operation Mirage 2003 was conducted in Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Macedonia, Greece, Hungary, Moldova, Romania, Slovenia, Serbia and Montenegro, and Ukraine. Between January and October 2003, 499 criminal procedures were started. So far there have been 139 prosecutions, 14 convictions, and 2,175 administrative procedures applied (interdictions, expulsions, and fines). Several cases are still before the courts. Regional links to fight trans-border crime been established through the SECI Anti-Terrorism Task force, headed by Turkey. The Task Force is focusing on small arms and light weapons, as well as weapons of mass destruction.

Performance Indicator: Improvements in regional relations.

FY 2002 Baseline	FY 2003 Target
Romania signs agreement with Hungary regarding application of Hungary's Status Law on Romanian territory.	Romania concludes Basic Treaty governing post-Cold War relations with the Russian Federation.

FY 2003 Results: Target achieved. At the end of the fiscal year, the treaty with Russia had been negotiated and was scheduled for signing early in FY 2004.

FY 2003 Support For East European Democracy (SEED)
Funds Budgeted for Assistance To:

Romania (In millions $, as of 12/31/03)

USAID - Democratic Reform $7.50
USAID - Private Sector $11.65
USAID - Social Sector Reform $8.25
USAID Total: $27.40

State - ECA Exchange Programs $0.55

State - EUR Public Diplomacy $0.60
State - IIP Public Diplomacy $0.05
State - INL Law Enforcement Activities $0.95
U.S. Department of State Total: $2.15

U.S. Department of Treasury - Advisors $0.95
Other Agencies Total: $0.95

GRAND TOTAL: $30.50

II. Country Assessment--Serbia and Montenegro (Serbia, Montenegro, Kosovo)

This chapter is divided into three separate sections, covering Serbia, Montenegro, and Kosovo. The statistical data appearing below cover the three entities.

Area: 102,350 sq km, slightly smaller than Kentucky
Population: 10,655,774 (July 2003 est.)
Annual Inflation: 19.0% (2003 est.)
Population Growth Rate: 0.07% (2003 est.)
Gross Domestic Product (GDP): $ 23.15 billion (2002)
Life Expectancy: male – 71.03 years; female – 77.16 years (2003 est.)
GDP Per Capita: $2,200 (2002 est.)
Infant Mortality: 16.9 deaths/1,000 live births (2002 est.)
Real Annual GDP Growth: 4% (2002 est.)

U.S. STRATEGIC INTERESTS

The primary U.S. interest in Serbia and Montenegro, as throughout South Central Europe, is promoting the political and economic development that is central to maintaining peace and stability in the region and to integrating it into a Europe whole, free, and at peace. Throughout the region, the U.S. supports continued peace and stability, ethnic reconciliation, good neighborly relations among states, development of market-based economies and civil society, and integration into Euro-Atlantic institutions. Through regional and bilateral efforts, the U.S. also endeavors to fight terrorism and extremism; trafficking in persons, weapons, and drugs; and organized crime and corruption. In pursuing these goals, the U.S. Embassy in Serbia and Montenegro promotes the highest U.S. national objective, the security of the United States and its citizens.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

In FY 2003, the U.S. Government (USG) allocated the $110 million appropriated as follows in Serbia:

- $69.17 million in democratic reform programs (including Public Diplomacy exchange programs);
- $31.84 million in economic and social sector reform programs;
- $4.36 million in security, regional stability, and law enforcement programs;
- $1.25 million in humanitarian programs;
- $3.38 million in cross-sectoral and other programs; and
- Privately donated and U.S. Defense Department excess humanitarian commodities, valued at $0.25 million.

In FY 2003, a total of 116 Serbs traveled to the U.S. on USG-funded exchange programs.

U.S. ASSISTANCE PRIORITIES

Democratic Reform Programs: The Embassy's democracy programming emphasizes support for civil society and more effective governance at all levels. SEED-funded USAID democracy and governance assistance for Serbia in 2003 totaled $67,624,000. USAID's flagship Community

Revitalization through Democratic Action Program (CRDA) and related Serbian Local Government Reform Program (SLGRP) are now entering their third year. They focus on increasing citizen participation at the grassroots level and the transparency and management capacity of local governments. Through its democracy and governance strategic objective, USAID also supports civil society (NGO, media, trade union, and anti-trafficking programs), a more democratically oriented political process, and the rule of law. The Embassy's SEED-funded Public Diplomacy programming promotes democratic reforms through media training, NGO support, and educational exchange programs. Democratization programs are particularly needed in southern Serbia, where as recently as two years ago, ethnic tensions flared violently.

Economic and Social Sector Reform Programs: In FY 2003, the USG provided $31.57 million in economic-related assistance to Serbia. This supported overall U.S. policy objectives by addressing critical aspects of reform necessary for the economic recovery and growth that are a key for Serbia to become a stable component of a region moving toward integration with the rest of Europe. USG assistance focuses on strengthening the institutions required to sustain economic reform and support the development of a market economy. USG programs provide assistance in a wide variety of areas, including macroeconomic policy reform, fiscal reform (including tax policy, tax administration, development of Treasury functions, and debt management), bank supervision, non-bank financial sector regulation, strengthening the central bank, anti-money laundering, preparation for WTO accession, customs reform, agriculture, restructuring and privatization of troubled banks and enterprises, enhancement of the business and investment environment through commercial law reform, and developing real estate and mortgage markets. USG assistance activities are conducted in close coordination with the programs of multilateral and other bilateral donors. The USG's highest social sector priority is poverty reduction through lowering barriers to private sector development, helping communities to help themselves through infrastructure and income generation projects, and pension reform. Programs will increasingly focus on job creation in southern Serbia, where unemployment rates hover at 30 percent.

Security, Regional Stability, and Law Enforcement Programs: In FY 2003, the U.S. shifted a significant amount of its law enforcement assistance to Serbia to address the related issues of war crimes and organized crime. The Department of State, Bureau of International Narcotics and Law Enforcement Affairs (INL) administered SEED funding for programs focused on criminal justice sector reform, criminal investigative skills development, combating trafficking in persons, and police reform. The newly established Resident Legal Adviser (RLA) Program in the Embassy serves as a linchpin for U.S. efforts to bolster Serbia's domestic capacity to prosecute war crimes cases and to combat organized criminal activities. A U.S. Marshals Service (USMS) judicial and witness security assistance project directly complements the work of the RLA. In addition, INL procured and donated communications equipment for the VIP Protection Directorate within the Ministry of Interior. FY 2003 SEED funding is also being employed to develop Serbia's capacity to use forensic lab and examination results as evidence in organized crime and war crimes trials.

USAID has helped the Serbian Government to build and equip a Special Court for War Crimes and Organized Crime. It used SEED funding to put together an international expert team to help Serbia prepare a Law on Prosecuting Perpetrators of War Crimes. In addition, the U.S. has devoted a significant portion of its law enforcement assistance in Serbia to promoting police reform, with a particular focus on training. The most tangible achievement of U.S. assistance in this area is the training of a multiethnic police force in southern Serbia, which has proven to be a key source of stability following the adoption of a peace plan in this volatile area two years ago. INL used FY 2003 SEED funding further to institutionalize achievements in multiethnic, democratic policing by seconding U.S. law enforcement personnel to the OSCE for training and monitoring activities. Training topics include human rights, codes of ethics and conduct, and modern law enforcement techniques. Also in southern Serbia, legal aid in the conflict-prone region resulted in two successfully resolved human rights-related court cases, including a decision against the (then) Yugoslav Army.

SECTORAL ASSESSMENTS

Democratic Reform

The year 2003 saw the assassination of Serbian Prime Minister Zoran Djindjic, on March 12; accelerated, chaotic, and paralyzing political infighting in its aftermath; three failed presidential contests; preparations for major organized crime and domestic war crimes trials in the wake of the assassination; and the parliamentary elections held on December 28, 2003, as a last-ditch effort to break the stalemate between leading parties. In the run-up to those elections, support for Serbia's nationalistic Radical Party (SRS) was increasing, and the SRS secured the largest number of seats in Parliament, though democratically oriented parties garnered a thin majority from which a coalition might be formed. Coalition negotiations began the next month. Progress in legal reform may be characterized as two steps forward, one back, with positive developments in the passage of new laws that provide prosecutors and judges with more effective tools to pursue organized crime and domestic war crimes cases, and the establishment of a Special Court to serve as the venue for these high-profile trials. In other areas, however, the Serbian executive reversed direction on legal reform in asserting greater control over the judiciary and rolling back key elements of a package of laws on the courts that established the framework for reform in this sector.

Against this backdrop, Embassy support for democratic development at all levels of government and society is more critical than ever. USAID takes the lead in this area, with SEED funding of $67.6 million in related programming in FY 2003. State Department Public Diplomacy activities augmented USG democracy and civil society efforts with $3.045 million in SEED-funded programming. USAID's program includes the flagship U.S, assistance activity, the Community Revitalization through Democratic Action Program (CRDA) and the related Serbian Local Government Reform Program (SLGRP); a civil society program designed to support NGO, independent media, trade union, and anti-trafficking efforts; political process and elections support activities; and initiatives focused on strengthening the rule of law.

Begun in 2001, CRDA is the U.S. Government's most visible and popular initiative in Serbia. By the end of FY 2003, CRDA's five American Private Voluntary Organization (PVO) partners were active in 348 communities with a population of 4 million. Of 2,270 community projects initiated to date, over 1,300 have been completed. A thousand new projects will be started during the third year. The scale and rapidity of CRDA's implementation exceeds that of any other program of this type in the world; over 90 percent of CRDA funding is expended within a year of obligation. The response of the communities has been extraordinary; they have contributed over 45 percent of project costs. Although the communities highly appreciate and desperately need the CRDA-funded schools, clinics, roads, bridges, water supply systems, and income-generating activities, citizens consistently report that the program's most important aspect is that for the first time they are being heard. An August 2003 survey conducted in selected CRDA communities found that the program had improved attitudes toward democracy, community involvement, and the U.S. By providing citizens with a means to voice their concerns and priorities, CRDA has motivated citizens to work together to achieve common community goals and contributed to strengthening grassroots democracy in Serbia.

The Serbia Local Government Reform Program (SLGRP) is working in 40 municipalities and is about to expand operations to another 47, including those in the metropolitan Belgrade area. The 87 participating municipalities will cover over 70 percent of Serbia's population. During the first two years of operations, 1,022 training sessions, attended by 26,363 participants, were held to improve the management capacities of local government staff. More than half (58 percent) of the participants were women, reflecting the important role women play in local government. The training includes financial management, public services management, information technology applications, and citizen participation. As a result of these efforts, transparent and accountable budgeting and financing systems have been established in 38 municipalities, and all 40 participating towns have held public budget hearings for the first time. Public-private partnerships to create business improvement districts have been established in four municipalities. Municipal information centers and/or one-stop permitting centers have been set up in five municipalities and will be extended to other municipalities. The Association of Municipalities and Towns is receiving technical assistance

and support to enable it better to represent and provide services to its membership. At the national level, SLGRP has been providing the Ministries of Finance and Local Government with technical assistance on decentralization. This work has included assistance in identifying appropriate policy approaches and assistance in drafting related legislation.

USAID and Freedom House-supported achievements in 2003 include NGO campaigns that resulted in productive collaboration with government on the passage of a federal decree on conscientious objection, a draft freedom of information act, and the initiation of meaningful dialogue with the Ministry of Interior on police reform. Media support via the International Research and Exchanges Board (IREX) helped leading independent Radio/TV B92 realize its national expansion plans -- the station now covers all major municipal markets, has a modern, well-designed studio facility, and runs the second most-watched news programming in Serbia. USAID support also helped establish an investigative reporting training program that has trained eight journalists monthly, created a web-based forum for exchange of information on regional anti-corruption efforts, and trained reporters on covering trafficking stories. A USAID partner, the American Center for International Labor Solidarity (ACILS), helped leading independent union Nezavisnost increase participation by women and youth in its activities, contribute to four pieces of economic legislation, and foster ties among Serbia's leading unions to ensure a more coordinated voice in tripartite dialogue with government and business. USAID's anti-trafficking-in-persons grant to the International Organization for Migration (IOM) supported counseling and return/reintegration assistance to 56 victims through Serbia's only trafficking shelter, supported new services to domestic victims, and helped facilitate NGO-government linkages, transfer of lessons learned, and data collection through a regional clearing point in Belgrade.

Political process activities helped stabilize Serbia's chaotic political scene in FY 2003 through their emphasis on helping democratically oriented parties develop more effective organizational structures, gauge citizen concerns better, and mobilize both volunteers and voters. Individual consultations with parties have reinforced these efforts and provided (prior to the initiation of a 30-day pre-elections freeze on such assistance) more specific advice on tailoring messages for specific elections and building more effective electoral and governing coalitions. Regular polling and focus groups conducted by USAID's partners inform training and consultations with parties. In addition to work with parties at the national level, the International Republican Institute (IRI) has stressed support to selected local governments in improving services for citizens. An IRI-supported one-stop municipal services shop in Indjija municipality continues to draw excellent reviews from citizens surveyed, owing largely to IRI-conducted customer service training for local government employees. Municipal activities are coordinated with and complement USAID's larger SLGRP program. The National Democratic Institute (NDI) also achieved significant results. Together with USAID's implementing partner IBM and the Embassy's Public Diplomacy Section, NDI helped establish a resource and information center in the Republic-level parliament that will increase MP and staff research capacity. Sixty parliamentary interns were trained on subjects ranging from legislative procedures to organizational and management skills. "Mobile parliaments" connected citizens, NGOs, and MPs at the grassroots level and contributed to concrete changes, including progress in addressing water quality issues in the Vreoci municipality. Women and youth leadership development activities have helped participants gain more prominent roles within their parties. Several have been elected to office after applying their new skills to their own campaigns.

Embassy Belgrade's SEED-funded Public Diplomacy programming promote democratic reforms through media training, support for NGOs, and educational and exchange programs. Media training programs, in cooperation with local journalists associations and U.S.-based participants, help Serbian journalists and media owners to learn basic skills, improve professional standards, and assist in reforming the media sector, advancing and developing independent media outlets. Education programs, particularly civic education and school connectivity projects, help in reforming the country's educational system while programs at the university level, i.e., junior faculty development, English language training (pedagogical), and Ron Brown fellowships, are reforming higher education by giving new perspectives and training to future generations of Serbia's students and professors. Exchange programs, whether those that send young Serbians to the U.S. or Freedom Grants, which expand the traditional International Visitors program to allow a greater

number of Serbs to travel to the U.S., help to implement democratic norms and standards in many fields once the participants have returned. Finally, the Embassy Democracy Commission, working closely with indigenous NGOs, helps to develop a key sector that had been mostly unknown previously, namely, citizen involvement and volunteerism, empowering the average citizen to have a voice and participate in the reform process.

Economic and Social Sector Reform

The IMF projects the Serbia and Montenegro State Union's GDP growth at about 3 percent for 2003. Since Serbia's share of the Union economy is about 92 percent, its growth is similar. Growth slowed in FY 2003 from 4 percent in 2002, and remains slower than expected, given the low starting base in 2000. The IMF reduced its growth forecast twice during FY 2003 -- first, from 5 to 3.5-4.5 percent after the March 2003 assassination of PM Djindjic, due to expectations of lower FDI linked to perceptions of increased risk, and then again in September, as a result of persistent declines in industrial production. In a July 2003 survey, 66 percent of respondents cited the economy or unemployment as Serbia's most urgent problem.

Macroeconomic stability continued in FY 2003, with inflation declining to 8 percent from 14.5 percent in 2002. The Serbian *dinar* remained stable, as a result of the central bank's continued policy of virtually pegging the *dinar* to the Euro. However, in line with IMF and OECD recommendations, the central bank increased flexibility in its exchange rate policy to counter a trend of real appreciation, resulting in a gentle nominal depreciation of 8.6 percent. The success in reducing inflation and maintaining currency stability are still the most visible benefits of reform for Serbs. Despite strict IMF controls on public wages, real wages rose by nearly 15 percent in FY 2003. While Serbs are generally dissatisfied with the pace of improvement in their economic conditions, the reform program has shown results. Per capita GDP has increased from less than $1,000 in 2000 to about $1,940 in FY 2003, but remains at half of the 1989 level. Macroeconomic stabilization has arrested a dramatic rise in poverty during the 1990s under Milosevic, but 10 percent of Serbs live below the poverty line, with another 10 percent just above it. Official statistics put unemployment at about 30 percent, but more accurate measures estimate it at 16-20 percent. The discrepancy is due to the still large informal economy, estimated at 30-40 percent of GDP.

Serbia has made progress on economic reform. However, the initial vibrant pace of reform slowed during FY 2003, due to political distractions and a poorly functioning parliament. The IMF program has been successful in stabilizing macroeconomic indicators and restoring fiscal discipline, while the enterprise sector remains dominated by loss-making, socially owned firms in need of drastic restructuring or liquidation through bankruptcy, hindering growth and export performance. Higher tax revenues and modest export growth indicate that the newer private businesses, particularly services and retail trade, are expanding, but the private sector is still not captured well by official statistics. Microeconomic weakness underlies Serbia's greatest macroeconomic risk -- a high current account deficit (11 percent of GDP) that could threaten medium-term stability and Serbia's capacity to service its large external debt.

The bulk of USG economic assistance is managed by USAID and directed by an interagency-approved three-year agreement, accepted in early 2002. U.S. Treasury advisors continued to be a key component of the USG economic assistance program. In FY 2003, $2.3 million of SEED resources were used to fund four resident and two intermittent advisors. These advisors assisted the Government on reform of tax policy and administration to develop a more effective tax and revenue collection system; debt management in Serbia's fledgling Treasury; budget issues; bank bankruptcy and privatization; and money laundering and other financial crimes. The USAID CRDA program also includes substantial additional activities conducted at the community level in support of improving economic conditions and employment.

The microeconomy and development of SMEs is a prime focus of USG economic assistance activities. Analysts agree that greater foreign and domestic investment is the key to economic growth in Serbia. Investment and SME development are principally constrained by a poor business

environment and a lack of sufficient financial intermediation, both of which are linked to the need for legal/regulatory reforms.

The Government of Serbia (GOS) passed some important commercial laws in 2003, including laws on concessions, leasing, and secured transactions. However, political wrangling and poor functioning of the parliament left a backlog of over 80 draft reform laws pending parliamentary action. This pipeline includes critical new laws on bankruptcy, execution of legal judgments, and company registration. Significant further legal/regulatory improvement is needed to drive private sector growth and fuel increased FDI. In cooperation with other major donors, the USG has been actively engaged in the development of numerous key economic laws and institutions. It is through these efforts that such a large body of modernized legislation stands ready to be enacted and implemented.

Privatization has been one of the most successful elements of the reform program. The Privatization Agency (PA) sold 940 enterprises by the end of FY 2003, for €1.2 billion in revenues and €700 million in future investment. USAID advisors, working with the PA, registered substantial progress in the restructuring of Zorka Sabac, a complex holding comprising 22 subsidiary companies. The initial project term was extended by several months to accommodate delays imposed by the courts. All of the subsidiaries should be offered or prepared for privatization by the end of 2003, completing this project.

In July 2003, USAID initiated a three-year project, following on the successful one-year pilot Serbian Competitiveness and Economic Efficiency project. The follow-on Serbia Enterprise Development Project promotes growth, jobs, and prosperity by providing guidance to a National Competitiveness Council comprising public, private, and civil society representatives, and through focused assistance to target industry groups. The pilot succeeded in increasing sales and exports in the furniture and fruit/fruit juice industry clusters. It also developed a strong understanding among government and business leaders of the need to cooperate in order to increase Serbia's economic competitiveness, and thus prosperity. Under the new project, additional industry clusters were evaluated for focused engagement.

USG programs in support of trade and investment, such as those of the Overseas Private Investment Corporation (OPIC), Export-Import Bank (Exim), and the U.S. Trade and Development Agency (TDA), operated on a limited basis in Serbia in FY 2003. The Embassy used $200,000 of FY 2003 SEED funds to support activities with the U.S. Department of Commerce's Central and East European Business Information Center (CEEBIC). USG programs in support of trade and investment are promoting potential opportunities to attract more business interest in Serbia and Montenegro. Through CEEBIC, there is support for the Foreign Commercial Service (FCS) operations that work directly with Serbian companies to facilitate business. During FY 2003, OPIC organized an investment conference in Belgrade, recruiting more than 60 U.S. companies. Participants in the conference later consummated important investment deals and now form the base of American investment in Serbia, catapulting the U.S. into the leading investor role in 2003. TDA assistance has been leveraged in the energy, civil aviation (airport, air traffic management), and IT/telecom sectors, helping not only with improvements in the legal/regulatory framework in, for instance, the telecom sector that assists in moving Serbia along the development curve, but positioning U.S. companies for the project implementation stage. Similarly, ExIm is identifying a pipeline of projects that could lead to U.S. equipment exports. The pipeline consists of not only local companies (e.g., Serbia’s leading pharmaceutical company, Hemofarm), but also of U.S. investors that need to import new equipment/materials (e.g., Ball Corporation). There has been a healthy synergy among these four programs in coordinating and cooperating in order to be more effective in Serbia.

The Ministry of Finance has made solid progress on consolidating control of GOS spending and reforming the tax system. The fiscal deficit has dropped from 10 percent of GDP in 2000, to 3.62 percent for 2003. Revenues are up in 2003 by about 30 percent in real terms. Fundamental policy weaknesses, however, must still be addressed. The complexity and opacity of the current fiscal

regime imposes substantial burdens and costs on business at all levels and encourage evasion. Significant challenges remain in increasing the Tax Administration's weak capacity to implement reformed laws and regulations.

In order to use resources and expertise most efficiently better to promote integrated fiscal reform, the U.S. Treasury tax advisor and a USAID contractor teamed up on a new Tax Policy and Tax Administration project for FY 2003. With Treasury overseeing technical issues and engaging in policy dialogue, USAID advisors focused on policy implementation, and legal and regulatory change. USAID advisors delivered technical assistance to the Serbian Tax Administration in collections, audit, taxpayer service, IT, communication, and other key areas. Progress has been satisfactory in each area. USAID contracted with a local NGO, the Center for Liberal and Democratic Studies (CLDS), for an exhaustive tax policy study that is serving as a platform for further reform. As a result of the study, the GOS began drafting a new Property Tax Law that will radically overhaul the current system. The recommendation by CLDS to abolish a tax on financial transactions was accepted, which will free up financial and capital markets.

In FY 2003, USAID advisors also began working to address broader fiscal reform associated with the substantial employee benefits costs that are a major disincentive to increasing registered employment. USAID advisors initiated work with the Ministry of Social Affairs and the Ministry of Finance and Economy on legislation that will transform the current under-funded and fiscally burdensome single pillar pension system to more sustainable multi-pillar model.

Serbia made limited progress with banking and financial sector reform in FY 2003. The focus of financial sector assistance has shifted from initial assessment of the depth of problems in the banking sector and stabilization-related initiatives to technical assistance in strengthening supervision and regulation and reorganization of the National Bank of Serbia (NBS). The NBS slowly began to improve practices and procedures, notably in supervision, which contributed to better safety and soundness of the banking system. Starting in July 2003, USAID began assisting in the wholesale reorganization of the NBS, including supervision, debt and currency management, accounting, information technology, and human resources management.

USAID has also invested in two credit facilities -- Opportunity International (OI) and ProCredit (previously MicroFinance Bank). Both have been important facilitators of SME development, targeting mainly micro-entrepreneurs in agriculture, production, services, and trade. At the end of FY 2003, OI's savings and loan, known as Opportunity International Stedionica (OIS), had disbursed nearly 2,000 loans valued at €3.3 million. In the process, OIS created 945 jobs. OI's portfolio performance is sound, with only 0.63 percent of outstanding loans past due more than 30 days and with no write-offs. Together, OI and ProCredit have worked actively with other USAID projects, including CRDA, to multiply their impact. In northern Serbia, for instance, OI and ProCredit originated more than $1 million in agriculture-related loans to CRDA beneficiaries.

With SEED support, three former U.S. Customs officers continued serve in Belgrade as advisors with the SECI/World Bank's Trade and Transport Facilitation in Southeast Europe (TTFSE) project. They maintained important efforts on improving border crossings and customs systems to facilitate more efficient flow of legal trade and to combat smuggling.

Agriculture represents 25 percent of Serbia's economy. In FY 2003, $1.7 million of SEED funds supported USDA technical assistance activities in areas critical to the development of Serbian agriculture, such as compliance with WTO agriculture-related requirements, biotechnology, food safety, improving market information systems, and exchange programs. The animal health program centers on diagnosis and prevention of critical diseases. All senior official veterinarians successfully completed training programs on public health reporting and outbreak management. The Faculty Exchange Program expanded its curricula development from agricultural economics to providing new university courses in applied agricultural sciences. USDA continued to support development of the Serbian food sector through its young scientist research grants and agricultural extension service projects, all of which are linked to U.S. land grant universities. Due to strong local demand,

USDA undertook special training programs in eradication of selected plant diseases, introduction of new fruit varieties, and food processing pathogen reduction programs. USDA's market information service project began to produce price bulletins in Serbia and will expand to more comprehensive collection and distribution in 2004. Through the CRDA program, USAID extended more than $2.75 million in technical assistance, training, and grants to 118 agricultural cooperatives and associations. Over $3.5 million was provided to agricultural producers and processors to enhance production and quality, expand agri-businesses, and improve agricultural marketing systems. This produced an increase in agricultural sales in 2003 of at least a $2.5 million, even though many producers had lost crops due to drought.

In the social sphere, USAID's CRDA Program implemented 30 projects worth $1 million in FY 2003, with community groups, local governments, and the Ministry of Social Welfare, to assist vulnerable groups, such as the elderly and those with special needs. Projects included equipping and renovating special education facilities and homes for the elderly, as well as helping communities create barrier-free urban environments.

In the health sector, the CRDA Program expended over $4 million in FY 2003 to equip and rehabilitate health facilities and initiate community-based programs focused on such topics as reproductive health and breast cancer prevention in 83 communities throughout Serbia. The reproductive health activities included education and information projects on sexually transmitted infections, including HIV/AIDS. As a result of those activities, over 230,000 people have better access to modern reproductive health diagnostic tests and treatment.

During FY 2003, the CRDA Program undertook projects worth over $4.5 million to improve access to potable water. Some 400,000 people benefited from the resulting improvements to their drinking water supplies. Another 125,000 people in CRDA communities benefited from improved electrical supply projects. The combined value of USAID's contribution to these projects was $2.4 million.

Security, Regional Stability, and Law Enforcement

The March 2003 assassination of PM Djindjic spurred the GOS to conduct a major offensive against the organized criminal gangs believed responsible for the murder. This effort included a major roundup of organized crime figures in "Operation Saber," as well as an effort to strengthen the legal framework for combating organized crime and prosecuting and trying war crimes cases in Serbia. These two categories of crime are linked by new legal procedures to be used in investigating and prosecuting such cases, the use of a shared Special Court to try them, and connections between the perpetrators themselves.

The U.S., via USAID, has devoted $800,000 to support the building and equipping of this Special Court, and another $250,000 for training trial participants and court staff on all aspects of handling high-profile, high-security cases. The Court has already begun to try organized crime cases and is expected to host another 10 organized crime trials and perhaps three war crimes proceedings over the next year. Federal judges, court administrators, and U.S. Marshals have visited Belgrade to provide advice for the interior layout, security modifications, equipment, and personnel staffing at the Court. The U.S. Marshals have also begun to extend technical assistance on the development of a successful witness protection program, including promoting a regional dimension to the program. The U.S. plans to provide ongoing assistance to boost the Court's capacity to handle these types of trials.

At the same time, the RLA program is focusing on enhancing Serbia's war crimes prosecution capacity by implementing a training program for the new Special Prosecutor for War Crimes and his 10-member team, as well as for the war crimes investigation unit in the police. Such assistance will become increasingly critical as the mandate of the International Criminal Tribunal for the Former Yugoslavia (ICTY) expires in 2010, and the burden of war crimes prosecution shifts to domestic courts in the region. The RLA also provided technical assistance and training to the Special Prosecutor for Organized Crime as he prepared for several high-profile trials, including the Djindjic

assassination trial.

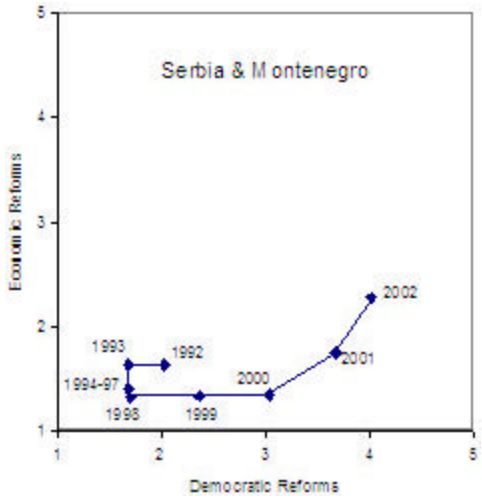
USAID-supported ABA/CEELI assistance to the Judges Association of Serbia led the association to adopt a progressive code of ethics. Support for legal aid in conflict-prone southern Serbia resulted in two successfully resolved human rights-related court cases, including a decision against the (then) Yugoslav Army. USAID has recently initiated a donor working group to coordinate rule of law assistance more effectively. An Embassy working group on organized crime/war crimes assistance is chaired by the RLA.

One of the Milosevic era legacies that the GOS has sought to address is the vast web of financial crimes and money laundering that underpinned his 13 years in power. The U.S. has helped the nascent Serbian Administration for the Prevention of Money Laundering to make major progress in developing Serbia's anti-money laundering regime, despite significant institutional and financial obstacles. The Treasury Department administered a series of training seminars for Administration officials, police, prosecutors, judges, tax administration officials, commercial banks, and bank examiners. SEED funds were used to purchase critical computer equipment and software necessary for the Administration to process suspicious transactions and for its cooperation with commercial banks and other government agencies. The U.S. efforts were instrumental in helping the Administration gain membership in the Council of Europe's MoneyVal Committee and, most importantly, the Egmont Group, a global network of Financial Intelligence Units. In its first 18 months, the Administration forwarded eight cases of possible money laundering to the prosecutor's office, with four still being investigated and two now in court proceedings.

For FY 2004, SEED funds will be used to continue support for police reform. Aside from advanced police training, funds will be allocated to train police in the use of VIP Protection equipment that the U.S. has already provided to help Serbian officials prevent any recurrence of the Djindjic assassination. Additional money will support the continuing activities of the RLA program and further initiatives to help Serbian officials bolster domestic capacity to prosecute war crimes and combat organized crime.

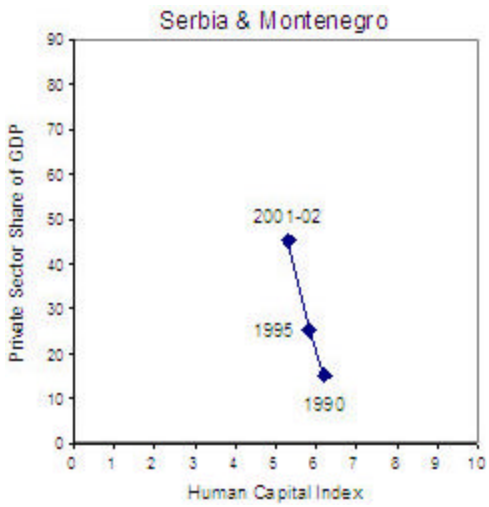
COUNTRY PERFORMANCE MEASURES

Economic Policy Reforms and Democratic Freedoms in Serbia and Montenegro (includes Kosovo), 1991-2002



Ratings are based on a 1 to 5 scale, with 5 representing the most advanced.
Sources: EBRD, *Transition Report 2003* (November 2003); Freedom House, *Freedom in the World 2003* (2003); and (various years).

Economic Structure and Human Development in Serbia and Montenegro (includes Kosovo), 1991-2002



The Human Capital Index is based on an average rating of four variables, scored on a 1 to 10 scale: per capita income; secondary school enrollment; health, as measured by life expectancy and under 5 mortality; and public policy, as measured by public expenditure on health and education as % of GDP. World Bank, *World Development Indicators 2003* (2003); and UNICEF, *Social Monitor 2003* (2003).

MEASURES OF PROGRAM EFFECTIVENESS IN FY 2003

DEMOCRATIC REFORM

Performance Indicator: USAIDNGO Sustainability Index (1 = highest; 7 = lowest)

FY 1997 Baseline	FY 2003 Target	**FY 2003 Actual**
5.4 (early transition)	3-5 (mid-transition)	**4.0**

FY 2003 Results: Serbia's average ranking on the USAID NGO Sustainability Index for 2003 has risen from 5.4 in 1997 to 4.0 in 2003 (draft ranking), up from 4.1 in 2002. This reflects a sector in "mid-transition," inching ever closer to a "consolidation" ranking of three or higher. Factors rated include the legal environment, organizational capacity, financial viability, advocacy, infrastructure, and public image. In all but two areas -- legal environment and financial viability, little changed from last year -- the sector scored modest gains. USAID activities contributed to NGO successes in advocacy and in increasing organizational capacity.

Performance Indicator: USAID Media Sustainability Index

FY 2001 Baseline	FY 2003 Target	**FY 2003 Actual**
1.86 (unsustainable)	2-3 (near sustainability)	Data not yet available

FY 2003 Results: Media index figures for 2003 are not yet finalized. Serbia's average index rating in 2002 was 2.416, indicating a media sector "near sustainability," up from an "unsustainable" 1.86 in 2001. Areas assessed include free speech, professional journalism, plurality of news sources, business management, and supporting institutions. The independent media climate has suffered considerable setbacks this year, amid extralegal government maneuvering to stack the deck on upcoming licensing processes in behalf of state-favored private media established during the Milosevic period. This will be reflected in lower than desirable "free speech" ratings for 2003, and will bring down the 2003 average. SEED assistance helped strengthen media performance in "professional journalism" and "business management."

Performance Indicator: CRDA communities mobilize at least 25 percent of project costs. (Source: CRDA PRS, USAID)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
0	25%	45%

FY 2003 Results: The ability and willingness of the CRDA communities to mobilize the required 25 percent counterpart contribution is a measure of their participation in and willingness to work together on activities to improve local living conditions. The contribution target remains at 25 percent throughout the life of the program, because this is the target stated in the cooperative agreements. To date, the target in Serbia has largely been exceeded (43 percent in Year One, 45 percent in Year Two) and is expected to continue to remain above the 25 percent mark for the program as a whole.

Performance Indicator: Percentage of SLGRP Municipalities with Transparent Financial Management Systems (n = 50) (Source: SLGRP, USAID)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
0	30%	30%

FY 2003 Results: To be fully transparent, the results of the annual local government budget process must include a concerted effort by local officials to inform the public of the key features of the budget, including how it was formulated, community participation was solicited, priorities were identified and decided, and how external factors are affecting the budget. The annual budget review letter provides an accessible summary of key issues to increase public understanding of the budget process and expected budget outcomes. Nonexistent before the advent of the SLGRP, the budget review letter is a good measure of a transparent financial management system. In FY 2003, the 30 percent target was reached, even though work was not yet ongoing in all 50 of the initial SLGRP municipalities.

ECONOMIC AND SOCIAL REFORM

Performance Indicator: Foreign Direct Investment (millions of USD, Source: IMF and National Bank of Serbia)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
475	623 (IMF revised July 2003)	1,200 (est.)

FY 2003 Results: Higher than expected receipts from the successful privatization of two tobacco companies and Serbia's second largest gasoline distributor to foreign strategic investors were the main contributor to the inflow of twice the projected amount of FDI in 2003. Acceleration and efficient conduct of Privatization Agency auctions of over 900 small and medium-size companies made for great success in FY 2003, but netted limited interest from foreign investors. FDI remains concentrated in industries with dominance of the local market and, in some cases sectors, granted significant domestic market protection through GOS trade policy. Greenfield FDI remains very limited, and a still poor business environment hinders efforts to increase FDI.

Performance Indicator: EBRD Economic Reform Index (Source: EBRD)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
2.29	2.50	2.44

FY 2003 Results: The GOS passed some important commercial laws in 2003, including the Concessions Law, the Law on Leasing, and the Secured Transaction Law. However, political wrangling and the poor functioning of the parliament left a backlog of over 80 draft economic reform laws pending parliamentary action. This pipeline includes critical new laws on bankruptcy, the execution of legal judgments, and company registration. Significant further legal/regulatory improvement is needed to drive private sector growth and fuel increased FDI.

Performance Indicator: EBRD Financial Sector Reform (unweighted average of EBRD banking and non-bank financial indicators)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
2.00	2.5	2.17

FY 2003 Results: Serbia continued to make progress in banking and financial sector reform in 2003, but with many fewer results than in FY 2002. The National Bank of Serbia (NBS) has slowly begun to improve practices and procedures, notably in supervision, which has contributed to generally improved safety and soundness of the banking system as measured by progress in compliance with the Basel Core Principles. The share of state-owned assets in the banking system has plummeted from 95 percent in 2001 to less than 42 percent in 2003. Non-bank financial sector regulation, however, remains weak, and capital markets are underdeveloped.

SECURITY, REGIONAL STABILITY, AND LAW ENFORCEMENT

Performance Indicator: Judicial Reform Index (Source: ABA/CEELI)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
% rated "positive" = 10	20% positive	Data not yet available

FY 2003 Results: The2003 ratings for the Judicial Reform Index are not yet available -- 2002 was the baseline for this Index. In 2002, across 30 factors rated, only 10 percent rated "positive." Factors assessed include quality, education, and diversity; judicial powers; financial resources; structural safeguards; accountability and transparency; and efficiency. It is unlikely that the 2003 figures will reflect major gains in any of these areas, as progress on advancing reforms in this sector generally

slowed or stalled over the past year. Exceptions are the passage of organized crime and war crimes legislation and the creation of a Special Court to try high-profile cases in these categories. Nonetheless, rule of law assistance programs were able to achieve notable results, as discussed in the Democracy and Security sectoral assessments.

FY 2003 Support For East European Democracy (SEED)
Funds Budgeted for Assistance To:

Serbia (In millions $, as of 12/31/03)

USAID - Democratic Reform $67.27
USAID - Economic Prosperity & Security $3.00
USAID - Private Sector $25.00
USAID Total: $95.27

State - DRL/Int'l Commission Missing Persons $1.10
State - ECA Exchange Programs $2.37
State - EUR Democracy Programs $0.23
State - EUR Public Diplomacy $0.45
State - EUR Social and Economic Programs $0.18
State - Humanitarian Programs/HPD $0.15
State - IIP Public Diplomacy $0.18
State - INL Law Enforcement Activities $0.40
State - War Crimes - ICTY $2.96
U.S. Department of State Total: $8.01

Broadcasting Board of Governors - Public Diplomacy $0.05
CDC - Balkan Investment Promotion Initiative $0.10
DHS/Customs - Law Enforcement Activities $0.50
TDA - Balkans Development Initiative $2.00
U.S. Department of Treasury - Advisors $2.35
U.S. Department of Agriculture - FAS $1.72
Other Agencies Total: $6.72

GRAND TOTAL: $110.00

MONTENEGRO

U.S. STRATEGIC INTERESTS

The Republic of Montenegro is the smaller constituent republic in the Union of Serbia and Montenegro. The primary U.S. interest in Montenegro, as throughout South Eastern Europe, is promoting the political and economic development that is central to maintaining peace and stability in the region and to integrating it into a Europe whole, free, and at peace. Throughout the region, the U.S. supports continued peace and stability, ethnic reconciliation, neighborly relations among states, development of market-based economies and civil society, and integration into Euro-Atlantic institutions. Through regional and bilateral efforts, the U.S. also endeavors to fight terrorism and extremism; trafficking in persons, weapons, and drugs; and organized crime and corruption. In pursuing these goals, the U.S. Embassy in Serbia and Montenegro promotes the highest national objective, the security of the U.S. and its citizens.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

In FY 2003, the U.S. Government (USG) allocated the $40 million of SEED assistance appropriated as follows in Montenegro:

- $24.69 million in democratic reform programs (including Public Diplomacy exchange programs);
- $9.0 million in economic and social-sector reform programs;
- $4.23 million in security, regional stability and law enforcement programs; and
- $2.08 million in cross-sectoral and other programs.

In FY 2003, a total of 89 Montenegrins traveled to the U.S. on USG-funded exchange programs.

U.S. ASSISTANCE PRIORITIES

Democratic Reform Programs: USG democracy programming through USAID emphasizes support for civil society and more effective governance at all levels through three pillar programs -- Community Revitalization through Democratic Action (CRDA), Good Local Governance (GLG), and the Judicial System Reform Project (JSRP). CRDA is well into its second year, and GLG and JSRP are just commencing. These programs focus on increasing citizen participation in community development and local governance; improving the transparency, fiscal soundness, and management capacity of local governments and intergovernmental systems; and modernizing the structure and operations of the judicial system at the Republic and local levels. USAID also assists independent media, NGOs, political parties, and trade unions to develop competence and effectively to represent citizens. It also provides support for victims of trafficking in persons.

Public Diplomacy (PD) supported democratic reform through over 15 education, media training, and exchange activities. The exchange programs -- mainly the International Visitors Program, which in FY 2003 sent 30 Montenegrins to the U.S. through SEED funding -- expose Montenegrins to Western democratic standards and practices through tailored study tours. PD media training programs and other activities teach Montenegrin journalists and editors basic and advanced job skills, and promote journalistic self-regulation and media reform implementation. Education programs provide civic education, regional cooperation, and applied economic skills to school students, in addition to scholarships for graduate-level study in economic reform-related areas at U.S. universities, in order to increase the limited capacity of the Government of Montenegro (GOM) and other key partners.

Economic Policy Reform and Private Sector Development Programs: In FY 2003, the USG, through USAID and U.S. Treasury assistance, continued to work with the GOM to implement a comprehensive economic reform program. The program's primary goal is to transform Montenegro's state-driven economy, battered by a decade of war and sanctions, into a stable, market-driven system buoyed by private-sector growth. The initial focus was drafting a new legislative infrastructure governing most key areas in the economy. In the last year-and-a-half, it has shifted more toward the implementation of that legislation and the capacity building in key institutions necessary for the functioning of a modern market economy.

Security, Regional Stability, and Law Enforcement Programs: In FY 2003, the USG directed the lion's share of its law enforcement assistance in Montenegro to border security. This change was guided by the establishment of the loose state union of Serbia and Montenegro, which transfers border security functions from the Army to republican authorities. It also reflected an assessment of significant shortfalls in Montenegrin border security that makes it susceptible to cigarette, narcotics, and human smuggling operations. In addition, the U.S. provided SEED funding to OSCE for police training in Montenegro to raise overall professional standards and, in particular, to combat trafficking in persons, partly in response to a trafficking scandal allegedly involving Montenegrin officials.

Meanwhile, the establishment of a Resident Legal Adviser (RLA) program provides the U.S. with an additional mechanism to facilitate training and provide equipment to law enforcement and judicial bodies in response to new investigative techniques made possible by revisions to the Law on Police and the Criminal Procedure Code. These amendments form the basis for the ongoing reorganization of the Montenegrin police that is being supported by an additional $330,000 in USG assistance. Finally, SEED funding has been used to help Montenegro adopt a Law on the Prevention of Money Laundering that regulates the establishment of a Montenegrin financial intelligence unit and strengthens Montenegro's actions, taken in 2002, to criminalize money laundering for the first time.

SECTORAL ASSESSMENTS

Democratic Reform

Unlike most of the former Yugoslavia, Montenegro escaped the devastating ethnic, nationalist conflicts of the 1990's, mainly due to its long tradition of ethnic co-existence. Montenegro's political system, however, still functions largely on Milosevic-era principles of party patronage and central control. Although the ruling coalition has an absolute majority in Parliament, fractious politics at the Republic and local level is a potential source of instability. The population remains sharply divided over whether Montenegro should remain in the union with Serbia or become independent. This could generate tension closer to 2005, when Montenegro plans to hold a referendum on it. In January 2003, Milo Djukanovic stepped down as the President of Montenegro in order to become Prime Minister. After several failed attempts, Filip Vujanovic, the previous Prime Minister, was elected as President, after Parliament dropped the 50 percent turnout requirement from the electoral law. Driven by the goal of European integration, the new administration launched a substantial Economic Reform Agenda (ERA), adopted by the GOM in March 2003. The ERA has been the key tool the PM and his cabinet have used to drive and track economic reforms. The ERA contains 13 components, including reform agendas for the judiciary, public administration, local government, and civil society. Reform is tied to public support for the democratic transition, which can only be ensured through a transparent, fair reform process and closer cooperation with civil society. The opposition sporadically participated in parliamentary sessions until May 2003, when it began a boycott to protest the decision under the new media law to limit live TV broadcasts of parliamentary sessions. Despite opposition tactics, substantial reform legislation has been passed. For the democracy sector, this includes the Laws on Local Self Government, Public Administration, Local Government Finance, and on Direct Election of Mayors. Key draft laws such as the Parliamentary Rules of Procedure, Law on the Prosecutor, and the Laws on Criminal and Civil Procedures were ready for adoption by Parliament at the end of 2003.

Against this backdrop, SEED support for democratic development at all levels of government and society through USAID was $14.7 million in related programming in FY 2003, with an additional $2.3 million of Public Diplomacy assistance under SEED. In addition to its major activities -- CRDA, GLG, and JSRP -- USAID also undertook smaller civil society programs designed to support the NGO sector, independent media, trade unions, anti-trafficking efforts, and political process and elections support activities that incorporate assistance to make the work of Parliament more efficient and transparent. Public Diplomacy programming supports democratic reform through more than 15 education, media training, and exchange programs.

The CRDA program builds community-level democratic processes and capabilities through partnership with communities to select and realize hundreds of small-to-medium scale development activities in basic infrastructure; environmental improvement; employment and income generation, particularly for low-income families; and civic activities. The process is inclusive, with emphasis on participation of and benefits for women, minorities, youth, and vulnerable populations, such as pensioners. The program has energized communities Republic wide into active dialogue and partnership among citizens, their local governments, the private sector, and other communities to develop their communities and improve the social and economic environment. Importantly, citizens and municipalities have set aside local party politics to collaborate on development. By the end of FY 2003, Montenegrin citizens had elected democratically and were operating 112 community councils, representing the majority of the Republic's population. Also, 61 cluster councils had formed

to facilitate collaboration among multiple communities. Two-thirds of these have an economic development focus, mainly in agriculture and tourism, and partner with business support associations. There has been extensive hands-on training of councils and interaction of citizens through a variety of forums. Collectively, the councils have selected, designed, and carried out 356 economic and social development projects, worth $17 million, over 17 months.

Poor and deteriorating basic infrastructure throughout Montenegro directed community selection of priority project expenditures on infrastructure investments during FY 2003. Investments included $3.3 million in transport, $2.2 million in sanitation/waste management, $1.9 million in school rehabilitation, and $702,790 in energy. Economic activities generated 4,792 person months of employment and increased the income and economic output of enterprises. Communities are required to provide a 25 percent cost share, but on average have contributed 41 percent of project costs to achieve a larger impact. Communities and their local partners who have benefited from significant capacity building and awareness raising under CRDA are expected to serve as a foundation on which democratic governance reforms mandated by new local government laws may be implemented. A new element of the CRDA program -- municipal development assistance -- was created during this fiscal year to bring the community development decision-making process to bear on municipal-scale issues, by mobilizing key stakeholders and formalizing citizen participation in local government decision making.

During FY 2003, USAID designed a new project, Good Local Governance, a three-year, $12 million effort to assist the Republic to implement the core local government laws passed by Parliament in July 2003. The project is designed to structure a transparent, equitable, inter-governmental fiscal transfers system, a local treasury function for municipalities to transition from a centrally-controlled, socialist payments system to one that complements the new Republic Treasury function. It also helps municipalities to implement new own-source taxing authorities, such as property taxation, and better to manage budgets and expenditures with their citizens for improved service delivery. At the micro level, the project aims to assist municipalities to develop citizen participation and awareness tools and processes mandated by new local government laws through a stakeholder-driven development decision-making process that improves local service delivery by engaging citizens in public service accountability and improvement, particularly for water and wastewater management services.

The rule-of-law activity under ABA/CEELI ended June 5, 2003. ABA/CEELI was instrumental in assisting in the drafting of the Law on Courts and facilitating the adoption of that Law, which establishes the foundation for an independent, efficient judiciary. Working with the Ministry of Justice, Supreme Court, subordinate courts, Judicial Training Center, and other Montenegrin counterparts, the JSRP is providing technical expertise, training, and commodity assistance to improve the structure and operations of the judiciary, including the creation of the new Appellate and Administrative courts and an Administrative Office for the judiciary. JSRP is also working to streamline the processing of cases, improve caseload management and reduce backlogs at all levels of the court system, and improve the physical infrastructure of the judiciary, including the computerization of the courts. The new judicial activity will help Montenegro's judiciary meet the realities of a market economy, enabling judges to make independent, reasoned judgments on an increasing commercial caseload.

The Montenegro Independent Media Program (MIMP) provides technical assistance to the media to improve professional journalism, supporting institutions, the legal and regulatory framework for the media, and efficient business management. In FY 2003, MIMP has concentrated on advancing the implementation of Montenegro's innovative media legislation. While challenges remain, MIMP results to date show advances in media capacity and competitiveness. The USAID-funded Montenegro Media Institute (MMI) is shaping a new generation of journalists, editors, and media managers by teaching skills and imparting knowledge to about 500 media professionals through 53 seminars and workshops, including a six-month diploma course with international certification.

The Montenegro Advocacy Program (MAP) has been providing NGOs training and technical

assistance to strengthen NGO institutional capacity and develop the skills, expertise, and credibility required to advance public policy. In FY 2003, the MAP established three Regional Advocacy Centers in Montenegro. The MAP's first round of Core Partner Advocacy NGOs achieved several successes, including the adoption by Parliament of the new Law on Higher Education that included amendments proposed by a MAP core partner. MAP assistance will continue through FY 2004. Montenegro still has a hierarchical political system, where political leaders maintain closed decision-making processes. To address this challenge, USAID's political processes activity worked in FY 2003 to strengthen internal party reform and modernization, and assisted Parliament in drafting new Rules of Procedure to make its work more efficient and transparent. The labor reform activity cooperated with the Confederation of Independent Trade Unions (CITUM) in educating nearly 1,100 union members on workers' rights and major economic and social reform legislation. As in other Southeast European countries, Montenegro is experiencing the problem of trafficking in women and girls for purposes of sexual exploitation. To address this, a USAID grant in FY 2003 provided operational support for a shelter for victims of trafficking in Podgorica and assistance to carry out a preventive public awareness campaign targeting young women and minors.

The Public Affairs Section's media training programs function in both directions -- bringing American trainers to Montenegro to reach large numbers of participants and sending smaller numbers of Montenegrin journalists to the U.S. for more extensive training. These programs, in FY 2003, covered areas as diverse as basic radio journalism; media management training (for owners and other executive staff); and anti-trafficking, economic-commercial, and investigative journalism. Special emphasis was placed on moving U.S.-based training to smaller cities and media outlets in order to be more in line with Montenegrin capacities. Programs used SEED media training funds allotted by the Broadcasting Board of Governors (BBG) and Department of State's Bureau of Educational and Cultural Affairs (ECA). In addition, the Working Group for Media Reform and the Journalistic Self-Regulatory Body each received Democracy Commission grants. SEED Coordinator of International Information Programs (IIP) Speaker funds were used to bring an American journalism professor to help revive the dormant Montenegrin journalistic code of ethics. The results of these efforts have been overwhelmingly positive. For example, the media management training was singled out by media owners as the most useful ever in Montenegro, and certain outlets immediately changed some of their basic business practices. The anti-trafficking training led to a series of articles in the main daily, "Vijesti," in cooperation with other journalists in SEE. The Journalistic Self-Regulatory Body has created an awards program for journalistic excellence and has enforced the code of ethics through public censure of several figures and outlets.

The Public Affairs Section funds education reform initiatives at all levels, from elementary through post-graduate professional training. In schools, programs in civic education, applied economics, and school connectivity (regional understanding through the Internet) are funded by SEED and executed in cooperation with NGO partners. In FY 2003, SEED university linkage funds developed substantive relationships between the Law Faculty and the University of Nebraska, and between the Economic Faculty and the University of Pittsburgh, exposing departments that have been isolated for more than a decade to international contacts. English Language monies were used to provide fellows to the English Department and Economic Faculty; these efforts will improve the English-speaking abilities of the leaders of future reforms, as most key GOM agencies and other partners lack sufficient English-speaking officials. The Ron Brown and Humphrey programs have placed another cadre of Montenegrins in graduate education programs in the U.S. that will assist with democratic reforms (journalism, public administration, and business administration). Finally, the new Junior Faculty Development Program has put six young Montenegrin professors under American mentors at U.S. universities. Upon their return, they will be able to promote concepts of interactive education and professor-student cooperation that are almost unknown at present. Although it is often hard to identify immediate results from education programs, the enthusiasm for them is clear. Elementary school pupils taking part in after-school civic education classes developed excellent awareness of their ability to make changes in the local community through democratic processes and grassroots efforts. The Law Faculty and Economic Faculty have made significant strides in implementing Western-style teaching and re-connecting with their peers in the U.S.

Montenegrin participation in the International Visitors Program nearly doubled, to 30 visitors. These

participants went individually or in groups on tailored programs that allowed them to see first hand how their U.S. counterparts face obstacles and succeed, within a democratic society. The PM's economic advisor went to study the making of American economic policy and wrote a positive appraisal of his visit for a Montenegrin newspaper. Three mayors and a government official went together to see decentralization in action in the U.S., and the leading newspaper prominently printed an interview with them about their experiences. Many Montenegrin officials have literally only seen democratic practices as conducted in the former Yugoslavia. Exposing them to how their area of work, be it education, economic policy, environmental policy, or partisan political work, is performed in a thriving democracy has changed their goals and understanding of their peers.

Economic Policy Reform and Private Sector Development Programs

Macro-Level Reform and Indicators: Due to severe problems with data reliability and current capacity within the Republic-level Bureau of Statistics, basic national accounts information is controversial and likely subject to a wide margin of error. Probably the best figures for GDP were constructed on an expenditure basis for 2001 by a USAID-supported effort and, accounting for growth, these calculations peg 2003 GDP at around €1.32 billion, or just under €2,000 per capita. Inflation is expected to be around 7.5 percent for 2003, down from 9.4 percent for 2002. This continuing inflation belies the official current account figures, which indicate a decreasing supply of Euros in the economy. Montenegro does have a high current account deficit, but this gap appears to be more than made up by unrecorded financing flows or from tourism receipts that fall into the "gray" economy. Given that credit cards are not widely accepted, and most tourists bring cash into the Republic, this is not surprising. Inflation may also be driven by the ongoing practice of automatic wage indexation and continuing inflationary expectations. The last official release of an average wage figure put the net monthly wage at about €118. More recent, but not officially released data, including those from household-level surveys, indicate that income is significantly higher and may approach €250 monthly.

The GOM fairly consistently slates more for expenditure than it collects in revenues. However, since there is no ability to print currency and limited ability to borrow (outstanding T-bills total less than €10 million), budgets balance on a cash basis, limiting macroeconomic spillover effects. Also, deficits are not high by international standards, generally coming in at under 3 percent of GDP. The structure of expenditures, both realized and unrealized, is the main problem. The GOM typically under-budgets for capital expenditures and related recurring expenses. Given that public sector wages receive priority, the budget deficit largely creates a further deterioration of this situation, resulting in an expenditures structure that does not support long-term growth objectives. It is also a bad fiscal discipline practice, since such arrears lead to discretionary final allocations. The USAID treasury system and procedures, and U.S. Treasury budget efforts, have done much to limit this phenomenon.

The financial sector has improved considerably over the past three years. With Montenegrobanka's sale to a Slovenian bank, only one bank with majority state ownership remains, and it is expected to be tendered by the end of 2003. After nearly three years of USAID assistance, bank supervision is much improved, with a recent Basel II Core Principles assessment showing the Central Bank of Montenegro to be mainly in compliance. As bank competition intensifies, interest rates are finally beginning to drop. One of the largest remaining problems is the low level of deposits, leading to low levels of financial intermediation and an over-reliance on expensive international sources of capital for on-lending. The seizure of all foreign currency deposits in the mid 1990s still leaves consumers wary. A deposit insurance scheme slated to come on line in mid-2004 may help restore confidence.

Following passage of a USAID-assisted set of commercial laws, implementation is moving at a satisfactory pace. The Business Organization Law, among the most progressive of its kind in the Balkans, is largely implemented. The Secure Transactions Law was effectively implemented, and following one-on-one training with credit officers, the on-line collateral registry is now used by all banks in Montenegro. Following passage of the Bankruptcy Law, a number of companies elected to use its voluntary restructuring provision, modeled after the U.S. "Chapter 11." However, initial

implementation efforts have not been as smooth as hoped, due to a lack of sound administrative practices in the courts, insufficient experience and knowledge among bankruptcy administrators, poor preparation by participating companies, and lingering training needs for the judges. USAID is working to address these weaknesses on several fronts. A new Licensing Law, currently being fast-tracked, and a new Mortgage Law in the final stages of development, both created with USAID assistance, will complete the core legislation.

Montenegro's precarious energy system suffers from over a decade of poor maintenance and related below-cost recovery rates. Rates were increased in the spring of 2003, however, largely due to USAID conditionality, although the entire benefit was absorbed into a worsening collections situation. This will be difficult to improve heading into the winter season. The GOM risks squandering the political capital it expended on energy rate increases if collections do not improve. Related to this, the payables situation has also deteriorated, with arrears building up largely to the coal mine, which supplies a thermal plant that produces about a third of the Republic's total electricity. Continuation of the current situation could lead either to load shedding this winter or to the need for transfers from the budget to finance energy imports.

Private Sector: Despite progress on reforms in the macroeconomy, Montenegro's private sector remains depressed. Unemployment and underemployment are high, and lack of local production contributes to a high dependence on imports and consequent trade imbalances. Employment is heavily oriented toward the public sector, both in administration and production. Much of the production in the key sectors has been ravaged by the types of problems that have characterized other economies in transition: weak management, especially in marketing and financial management; remaining regulatory burdens; lack of low-cost capital; and a restrictive, inflexible labor regime.

Widespread corruption continues to impede private sector growth. Many citizens do not trust the courts, with their reputation for venality, to give them a fair hearing on contractual and property rights issues. Similarly, though there has been some progress in removing bureaucratic discretion from simple procedures, administrative rules can still allow for rent seeking and long delays in basic licensing and other tasks. Since the market lacks a sound set of competition laws and practices, new entrants also fear that entrenched players will receive preferential treatment from regulatory and tax administration bodies. This also drives entrepreneurs into the gray economy, where they remain outside the tax regime. USAID continues to target these areas, but for reforms to take hold, time and additional GOM action to confront labor unions, complete the privatization process, remove residual barriers to business, and improve the judiciary will be needed.

The key sectors in Montenegro are tourism, agriculture, and metallurgy. Previously, the wood processing industry was a major exporter, and the GOM is working with donors in an effort to revive companies in that sector. Metallurgy is currently critical for maintaining export levels, but it is not a high value-added industry and requires considerable implicit subsidies to survive.

Security, Regional Stability, and Law Enforcement Programs

In March 2003, the Federal Republic of Yugoslavia was replaced by the new State Union of Serbia and Montenegro, resulting in a dramatic devolution of functions to the constituent republics. This exposed Montenegro's limited institutional capacity in key areas, including border security. Montenegro spent most of 2003 preparing for the accelerated transfer of all border security functions previously performed by the Yugoslav Army. To support Montenegro in these efforts, the U.S. Department of Homeland Security (DHS) assessed Montenegro's current customs and border security procedures, capabilities, and facilities, and recommended steps to help modernize them.

Based on this assessment, the U.S. is providing $4.5 million in border security improvements. This includes $1.2 million for a USAID-implemented project involving physical upgrades of 10 critical border crossings with Albania, Bosnia-Herzegovina, and Croatia, and three administrative checkpoints with Serbia. The purpose is to construct fully functional buildings with associated

infrastructure suitable for conducting border-crossing operations, as required by Montenegrin law. Construction is scheduled to conclude in February 2004, with completion of the entire upgrade project slated for mid-2004. The European Agency for Reconstruction agreed to perform the upgrades on two other major border crossings. In addition, with about $3.3 million of FY 2003 funds, the U.S. is providing training and procuring and delivering equipment identified by DHS for border and customs personnel and the maritime control unit.

Serbia and Montenegro has begun to transfer border security functions to republican authorities and hoped to complete the process by the end of 2003. However, because both the Serbian and Montenegrin Border Security and Customs Administrations are not yet ready to shoulder their full responsibilities, the transfer will carry over into 2004. The performance of Montenegro's border security service could be adversely affected by a planned cut in the Ministry of Interior's 2004 budget. Low wages, among other things, leave border security personnel open to corruption.

At the same time, U.S. law enforcement assistance seeks to help Montenegro to restore its international reputation following a scandal provoked late last year by the arrest of a deputy state prosecutor for involvement in sex trafficking. A tangible U.S. response to this scandal was the allocation of $400,000 to OSCE to carry out police training, including instruction focused on the fight against trafficking in persons. Political and bureaucratic foot-dragging on reestablishing a special anti-trafficking police unit, as well as inadequate training facilities, has hindered progress, although the GOM has given assurances that it will form this unit after it completes a review of police functions.

On financial crime, after helping Montenegro pass its new Law on the Prevention of Money Laundering, U.S. assistance now focuses on the setting up of the Republic's new anti-money laundering agency, regulated under the law. U.S. aid is being used to provide computer equipment and technical assistance to the new agency. In addition to making the new agency operational and compliant with international standards, a primary objective of U.S. assistance will be to prepare it for membership in the Egmont Group, a 100-member international organization for financial intelligence units. Egmont membership will enable Montenegro to assist local police and other authorities in money laundering investigations where activities involve other jurisdictions.

Enforcement falls under the judicial process and criminal law. There are unresolved questions or differing opinions as to whether or not the criminal law provides an effective process for the conviction those engaged in money laundering activities. During U.S. discussions with Central Bank attorneys, they agreed that the existing criminal law would need to be revised to charge an attempt to launder money. The GOM has forwarded new laws on the Criminal Code and Criminal Procedure to Parliament, which was expected to adopt the laws by the end of December 2003.

For FY 2004, the second phase of the $4.5 million border security program in Montenegro will be implemented. SEED funds also will be used to continue support for the GOM's anti-trafficking efforts and police reform. Additional money will support the continuing activities of the RLA program.

MEASURES OF PROGRAM EFFECTIVENESS IN FY 2003

DEMOCRATIC REFORM

Performance Indicator: NGO Sustainability Index (Source: USAID); (1 = highest; 7 = lowest)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
4.6 (mid-transition)	3-5 (mid-transition)	4.7

FY 2003 Results: Montenegro's average ranking on the USAID NGO Sustainability Index for 2003 declined to 4.7, from 4.6 in 2002. Factors rated include legal environment, organizational capacity, financial viability, advocacy, infrastructure, and public image. The 4.7 rating reflects a sector in "mid-transition" that is not yet sustainable; progress toward developing local capacity is hampered by a weak economy and a sector in which organizational development and advocacy skills are not fully matured. USAID's NGO development activities are addressing both areas. USAID/MAP-supported NGOs advanced multiple legislative and policy changes in 2003, and began to engage in partnerships with the GOM, including a successful civilian disarmament initiative titled "Farewell to Arms," which resulted in over 2,000 citizens turning in 34,000 pieces of illegal weaponry and ammunition to the police. In 2004-2005, the NGO program will assist these NGOs in triggering the next phase of their watchdog strategies, to include the enforcement and monitoring of legislation.

Performance Indicator: Media Sustainability Index (Source: USAID); (1 = highest; 7 = lowest)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
2.116(near sustainability)	2 - 3 (near sustainability)	Data not yet available

FY 2003 Results: Media index figures for 2003 are not yet finalized. Montenegro's average index rating in 2002 was 2.116, indicating a media sector "near sustainability," up from an "unsustainable" 1.58 in 2001. While the legal-regulatory framework for the independent media is well crafted, implementation of new legislation is moving more slowly than anticipated, as Montenegrin state media struggle to reform. Additional improvements occurred in the business management of media outlets, as seen in the increased commercialization of journalism with new TV networks, new print outlets, and foreign investment in the daily Vijesti.

Performance Indicator: CRDA communities mobilize at least 25 percent of project costs. (Source: CRDA PRS, USAID)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
0	25%	42%

FY 2003 Results: The ability and willingness of the CRDA communities to mobilize the required 25 percent counterpart contribution is a measure of their participation in and willingness to work together on activities to improve local living conditions. The contribution target remains at 25 percent throughout the life of the program because it is the target stated in the cooperative agreements. The target has been exceeded in Montenegro (42 percent in Year 1), and counterpart contributions are expected to continue to remain above the 25 percent mark for the program as a whole.

ECONOMIC AND SOCIAL REFORM

Performance Indicator: Foreign Direct Investment (millions of Euro)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
€ 76.3	€ 20.0	€ 13.02

FY 2003 Results: Performance was mixed in attracting the levels of FDI needed to invigorate and transform Montenegro's economy. A key success was sale of a majority share of the Republic's

largest bank, Montenegrobanka, to Nova Ljubljanska Banka of Slovenia. The privatization process continued in FY 2003, but foreign investors continued to show little interest, due to unattractive offerings and lingering weaknesses in the business environment. Foreign Investors bought two of 11 hotels offered. The GOM is placing great hopes on tenders set for release by the end of 2003 for the Republic's largest company, aluminum producer KAP, and the tobacco company and steel mill. These companies have substantial financial problems, so foreign investor interest is uncertain.

Performance Indicator: EBRD Economic Reform Index (Source: EBRD -- rates Serbia and Montenegro together)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
2.29	2.50	2.44

FY 2003 Results: With substantial assistance from USAID, new commercial laws were passed in FY 2003. Implementation is moving at a satisfactory pace. The Business Organization Law is one of the most progressive in the Balkans and is largely implemented. Following passage of the Bankruptcy Law, a number of companies elected to take advantage of its voluntary restructuring provision modeled after the U.S. "Chapter 11." However, initial implementation efforts have not been as smooth as hoped. USAID efforts continue to target significant remaining shortcomings in the business environment, such as weak government capacity, corruption, and a poorly functioning judiciary. But for reforms to take hold, time and additional GOM action to confront labor unions, complete the privatization process, remove residual barriers to business, and improve the judiciary will be needed.

Performance Indicator: EBRD Financial Sector Reform (unweighted average of EBRD banking and non-bank financial indicators -- rates Serbia and Montenegro together)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
2.00	2.5	2.17

FY 2003 Results: With the privatization of the Republic's largest bank, Montenegrobanka, only one bank with majority state ownership remained. This bank should be tendered by the end of 2003. Bank supervision efforts improved significantly. A Basel II Core Principles assessment showed the Central Bank of Montenegro to be mainly in compliance. A Secure Transactions Law was effectively implemented and, following one-on-one training with credit officers, all banks in Montenegro now use an on-line collateral registry. Interest rates finally began to drop, as bank competition intensified.

SECURITY, REGIONAL STABILITY AND LAW ENFORCEMENT

Performance Indicator: Judicial Reform Index (Source: ABA/CEELI)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
% rated "positive" = 16.75%	50% positive	30% positive

FY 2003 Results: Montenegro spent most of 2003 preparing for the accelerated transfer of all border security functions heretofore performed by the Yugoslav Army. To support the GOM in this, the U.S. Department of Homeland Security assessed Montenegro’s current customs and border

security procedures, capabilities, and facilities and recommended steps to help modernize them. Based on this assessment, the U.S. is providing $4.5 million in border security improvements. Political and bureaucratic foot-dragging on reestablishing a special anti-trafficking-in-persons police unit, and inadequate training facilities, constrained progress in FY 2003 in utilizing $400,000 provided to OSCE for police training. The 2003 ratings for the Judicial Reform Index (JRI) were unavailable. However, a 2003 update on judicial reform based on the JRI factors showed that there have been improvements. In 2002, across all factors rated, only 16.75 percent rated "positive," while the update revealed a 30 percent "positive" score. Positive developments in four factors (selection/appointment process of judges; minority and gender representation; objective judicial advancement criteria; and judicial conduct complaint process) can be attributed to the implementation of the flagship Courts Act, which establishes the independence of the judiciary.

FY 2003 Support For East European Democracy (SEED)
Funds Budgeted for Assistance To:

Montenegro (In millions $, as of 12/31/03)

USAID - Democratic Reform $20.69
USAID - Economic Prosperity & Security $2.00
USAID - Private Sector $9.90
USAID Total: $32.59

State - ECA Exchange Programs $1.53
State - EUR Democracy Programs $0.08
State - EUR Public Diplomacy $0.30
State - IIP Public Diplomacy $0.08
State - INL Law Enforcement Activities $0.93
U.S. Department of State Total: $2.91

Broadcasting Board of Governors - Public Diplomacy $0.10
U.S. Department of Commerce - CEEBIC $0.05
DHS/Customs - Law Enforcement Activities $3.50
U.S. Department of Treasury - Advisors $0.75
U.S. Department of Agriculture - Technical Advisors $0.10
Other Agencies Total: $4.50

GRAND TOTAL: $40.00

KOSOVO

U.S. STRATEGIC INTERESTS

The overriding U.S. interest is for all of South Central Europe to join a Europe whole, free, and at peace. In this vein, and in the context of encouraging Kosovo's smooth entry into Europe, U.S. goals in Kosovo are effective self-governance; adherence to the rule of law; rapid development of a dynamic, free-market economy; ensuring that the door to returns is effectively open; and deepening regional stability and integration. U.S. Government assistance is therefore targeted to promote progress in these areas, as the U.S. works to help Kosovo overcome its problematic history and the legacy of ethnic conflict in the Balkans.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

In FY 2003, the U.S. Government (USG) provided an estimated $92.26 million in assistance to Kosovo:

- $12.80 million in democratic reform programs (including Public Diplomacy exchange programs;
- $17.65 million in economic and social-sector reform programs;
- $46.36 million in security, regional stability and law enforcement programs;
- $12.80 million in humanitarian programs (not including regional contributions for the Balkans);
- $2.55 million in cross-sectoral and other programs; and
- Privately donated and U.S. Defense Department excess humanitarian commodities valued at $0.10 million.

In FY 2003, a total of 98 Kosovars traveled to the U.S. on USG-funded exchange programs.

U.S. ASSISTANCE PRIORITIES

Democratic Reform Programs: In FY 2003, SEED funding and other USG assistance allowed the U.S. Office in Pristina to engage in a broad range of democracy-building activities. SEED funds were used to advance the interwoven objectives of building an independent, effective, and impartial system of justice; strengthening the role of the independent media and civil society; and developing a multi-party political system that is representative of and responsive to its constituents. A common thread running through all of the programs is that they build local capacity, cross ethnic lines, encourage participation, and foster an atmosphere of reconciliation and peaceful coexistence. These programs will take on new significance in FY 2004, as the U.S. seeks to encourage the transfer of authority to local institutions, as well as preparations for the 2004 Kosovo Assembly elections, in the context of progress toward fulfillment of the UN's "Standards for Kosovo."

Economic and Social-Sector Reform Programs: USG assistance in FY 2003 -- primarily through USAID -- provided help and support for an economic reform program to stimulate a private sector-led economy by promoting reforms in fiscal and monetary policy, financial markets, commercial law, and privatization. SEED funds also supported business and enterprise development and financial intermediation programs aimed at generating income and employment. Special emphasis was placed on the agricultural sector through programs that foster increased production, as well as business partnerships that allow Kosovo's farmers to sell their goods locally or abroad. In addition, much of the USG's social sector reform targeted community services and facilities, including activities supporting economic and social recovery at the community level, through infrastructure rehabilitation, restoration of essential services, and community development. Under these programs, communities and municipal governments took part in identifying, designing, implementing, and sustaining the infrastructure activities undertaken, thereby contributing to the dual program emphases of institutional strengthening and community infrastructure rehabilitation. As in the democracy-promotion activities, economic reform aid in FY 2004 will focus on training and developing Kosovar institutions to assume greater responsibility for day-to-day affairs, as well as long-term planning, while also fostering adequate commercial law protections and a network of business partners that can conduct trade with Europe, the U.S., and beyond.

Security, Regional Stability, and Law Enforcement Programs: During FY 2003, the U.S. contributed about $53.52 million in SEED funds to provide a U.S. police officer contingent and support the operations of the Kosovo Police Service School, plus an additional $3 million for the training and development of the Kosovo Protection Corps (the non-military successor to the Kosovo

Liberation Army, now being reformed as a civilian disaster response unit). The Kosovo Police Service (KPS) is now 5,850 strong, with an expected end strength calculated by the UN Mission in Kosovo (UNMIK) at 6,500 to be in place by summer 2004. The transition of police authority from UNMIK's Civilian Police (CIVPOL) to KPS slowed somewhat during the year but remains on track, with four additional police stations handed over to KPS control, for a total of six police stations under KPS authority throughout Kosovo. UNMIK plans call for an additional three police stations to be handed over by the end of 2003, with the transition accelerating in 2004 to meet the goal of having all 34 stations in KPS hands by 2005. U.S. CIVPOL stands at 479 and will shrink by at least 25 percent by the end of 2004. There are about 96 international instructors at the KPS School, 15 percent of them from the U.S. CIVPOL is now introducing KPS to expanded investigative processes, including intelligence, organized crime, and covert operations.

SECTORAL ASSESSMENTS

Democratic Reform

Significant progress has continued since the end of the conflict in 1999toward establishing democratic institutions and good governance in Kosovo. Kosovar institutions -- primarily the Provisional Institutions of Self-Government (PISG) -- continue to build capacity and take on more competencies, but the weak economy, shortage of skills and experience in democracy and governance, and lack of clear responsibilities for PISG institutions all limit the extent of democratic reform. Municipal elections in early FY 2003 were deemed free and fair and marked the start of the transfer of significant competencies from UNMIK to local governments. Municipal governments have been granted more control over their budgets but are severely constrained in fulfilling many functions typically undertaken by local governments. Some basic services are UNMIK reserved powers, and the regulations and legislation pertaining to municipal government responsibilities are often vague or confusing. Municipal officials frequently lack the skills and resources to do their jobs effectively and to meet the municipalities' financial needs due to the poor economy, high unemployment, lack of investment, and an unfavorable environment for local economic development. As a result of the transfer of competencies to the local level in FY 2003, USG assistance in FY 2004 will include a new initiative focusing on improving the effectiveness of local governments while strengthening linkages to USG-funded civil society and media programs. The new initiative complements European funding for the nascent Association of Kosovo Municipalities and will complement local government reforms proposed by the Council of Europe.

Although there has been marked progress in reforming the justice system, an UNMIK-reserved power, significant problems remain. According to the UN Development Program (UNDP), a majority of Kosovars is dissatisfied with the courts. Insufficient salaries, lack of access to legislation, inefficient court administration, and low public trust all undermine the integrity and efficiency of the justice system. A major, new USG-funded rule-of-law assistance contract was awarded in FY 2003 to facilitate the transfer of judicial competencies to PISG, improve the administration of justice, and increase citizen access to and confidence in the legal system. Also during 2003, USAID continued activities to improve and advance the skills of legal professionals, judges, and prosecutors. The USG has improved coordination with the European Agency for Reconstruction and other donors in the judicial reform and court administration area.

Civil society has proven to be a dynamic, influential element of Kosovo's democratic governance. NGOs and informal citizens groups have successfully advocated for laws and regulations, influenced policy decisions, participated in public hearings, and demanded accountability of government institutions and officials. USAID support for specific advocacy efforts by NGOs and citizens groups had impressive results in FY 2003. Civil society advocacy has resulted in the adoption of laws, policies, and regulations; changes in government procedures; subsidized services for pensioners and the disabled; public discussion of municipal budgets; and other actions by public or elected officials. Also, FY 2003 saw an increasing trend of NGO coalitions to advocate at the central level on issues such as electoral law reform and equal gender representation in political processes, and assistance further strengthened women's NGOs, which have a long tradition in the

Balkans.

Preparations for the 2004 Assembly elections began in FY 2003, with the current Assembly attempting to take responsibility for drafting new electoral laws. However, the UN Special Representative (SRSG) clarified that elections remain a reserved power. The OSCE is turning over some election administration responsibilities to Kosovars but maintaining responsibility for key areas such as voter registration, adjudication of disputes, and the vote count. In FY 2003, the USG continued to provide training to the major political parties and assistance to civil society organizations involved in election monitoring and voter awareness, all of which will continue into FY 2004. Issues remaining to be addressed include the type of electoral system to use, capacity building for Kosovar election administration bodies, and improving the transparency and responsiveness of political parties. USG training and assistance in FY 2003 to political parties led to the strengthening of local party branches, greater participatory policy development, fostering the involvement of youth and women party members, and more constituent outreach. As preparations continue for the 2004 Assembly elections, U.S. assistance will play a key role in developing adequate local institutions while also providing necessary political party training to ensure open and fair elections.

Kosovo enjoys a relatively good environment for independent media and freedom of speech, but key laws and institutions have not yet been established, and private media struggle to survive financially. Kosovo requires new legislation on an Independent Media Commission and on Public Broadcasting, and the public broadcast fee needs to begin being collected. Public and private media depend largely on international donors for financial survival, raising concerns about their ability to maintain editorial independence in the long run. Journalists and media still must raise their professionalism, and media organizations require assistance in business management. In FY 2003, audience surveys showed substantial improvements in ratings for the two USG-supported private TV stations, now accounting for a combined share of 58 percent of all viewers (compared to 38 percent for the once-dominant public broadcaster RTK). With USG support, the privates have gone from broadcasting just a few hours a day in 2000, to full programming schedules complete with a variety of news and information programs, and satellite broadcasts to the Diaspora in Europe. With USAID support in FY 2003, the three major independent daily newspapers introduced weekly supplements reporting on economic and business news. The amount of investigative reporting is increasing in both print and broadcast media, with some of the stories prompting authorities to launch investigations into alleged corruption, in customs and the public post telecom corporation, for example. The USG has worked closely with OSCE and other European donors to find compromises on draft legislation that affects the viability of both the public and private broadcasters. Signaling relative success in improving the climate for independent media, FY 2004 SEED support for media training initiatives will decline somewhat with a shift toward text translation programs.

A crosscutting issue affecting many of Kosovo's institutions is the effort to build a diverse, multi-ethnic society in which minority rights are fully protected. To accomplish this, the U.S. Office's Public Affairs Section awarded a number of Democracy Commission small grants to organizations that work, directly and indirectly, to promote the idea of a multi-ethnic society, with equal rights for men and women. Examples of the projects supported by such grants are a newsletter for rural women; a monthly women’s magazine; a one-episode TV production highlighting women’s rights; a women’s wellness center; multi-ethnic English language classes; and a center for conflict management. Additional Democracy Commission funding combated domestic violence and violence against women, while also working to educate the public about the dangers of trafficking in persons. The Public Affairs Section also had several International Visitors programs aimed toward accomplishing these goals. In particular, "Managing Diversity in a Multi Ethnic Society" sent five people to the U.S. for three weeks; "Combating Violence Against Women" sent six people for three weeks; and "Islam in America" sent one Islamic scholar to the U.S. on a regional program with scholars from other nations.

Economic and Social Sector Reform

In FY 2003, Kosovo continued to make significant economic progress. Institution building and sound economic policies remained the top priorities of international assistance in the economic sector. The Ministry of Finance and Economy, successor to the previously UNMIK-administered Central Fiscal Authority, implemented reforms in many economic areas, most notably in revenue collection. Domestic revenues in 2003 financed 100 percent of the Kosovo Consolidated Budget (KCB); in 2000, donor funds contributed half of the KCB and 95 percent in 2002. The World Bank estimates GDP growth at 5 percent for the year, though a recent IMF study calls the sources of that growth into question.

At the same time, Kosovo had a low level of domestic production and relied heavily on imports. Exports were negligible, covering only 3 percent of imports. However, the privatization process, which began in May 2003, is expected to attract foreign investment. So far, five of the 23 tenders for privatized companies were awarded to entities from Macedonia, Belgium, the U.S., Albania, and Turkey, for over $9 million. Final transfer of these assets has been delayed due to legal concerns, but as of the end of CY 2003, these obstacles appeared surmountable. Partly because the privatization process started late and is advancing slowly, Kosovo's public sector is among Europe's largest, with the private sector accounting for only 28 percent of the official economy. Despite the rapid development of the banking sector, financial intermediation remains the lowest in Europe, with a 39 percent loan/deposit ratio, although this is up from the 2002 total of 29 percent.

Fiscal policy changes have resulted in notable progress in fiscal decentralization. After an independent audit, 29 out of 30 municipalities have been certified to manage their own revenues and expenditures. The Tax Authority now administers a number of taxes, including VAT, presumptive tax, profit tax, and wage tax.

In the financial sector, the Banking and Payment Authority of Kosovo developed and implemented comprehensive regulations and procedures governing bank licensing and supervision, pensions, and insurance company licensing. In 2003, 12 new commercial bank branches were approved, bringing the total number of branches, sub-branches, and offices to 147, with seven banks represented. Two of the seven are international banks. A major success in 2003 was the complete privatization of the American Bank of Kosovo (ABK). Funded by USAID, ABK was to start privatizing in 2003, with all shares in private hands by the end of 2004. Instead, USAID completed the final sale of its shares (24 percent) to Raiffeisen Bank, and ABK became Raiffeisen Bank of Kosovo. Sixty percent of registered businesses now comply with deposit requirements for the Kosovo Pension and Savings Trust, covering 70 percent of employees. The Department of Insurance Supervision performed annual financial audits on eight insurance companies and operational audits on another four companies, covering all registered insurance companies. The USG has provided technical assistance to the Kosovo Trust Agency (KTA) to assist with privatization, an area on which progress has been stalled due to legal and political issues surrounding the privatization of Publicly Owned and Socially Owned Enterprises.

In the commercial law area, legislation governing mortgages, immovable property rights register, external trade, and bankruptcy has been enacted, furthering the comprehensive commercial law framework crucial to the establishment of a sustainable, market-oriented economy. The procurement, competition, and copyrights laws were drafted and are currently under review.

A tender for a turnaround management team at the electricity company was issued, and three firms are conducting due diligence. The Kosovar Assembly is discussing comprehensive draft laws on energy, electricity, and the sector regulator and tenders for mobile telephony are expected shortly.

The business sector is growing slowly. However, import substitution for poultry, dairy, and medicinal herbs increased by 8 percent, partially due to USG support to these sub-sectors. The recently signed (October 1) Albania-Kosovo trade agreement should increase exports. For instance, a fruit juice manufacturer who received USG business development technical assistance exported 100 tons of juice to Albania after the agreement went into effect. In November, the U.S. granted Normal Trade Relations status to Serbia and Montenegro. NTR status will reduce tariffs on Kosovar

products (which current USG regulations include in the Serbia and Montenegro products) from 37 percent on average to less than 3 percent. Further, Kosovo is diversifying its products to include juniper berry and mushroom exports, through export trials conducted with USG support.

The agricultural sector is using improved production technologies to expand production. USG assistance has led to 21 percent greater dairy sector production and a 40 percent increase in production in the vegetable sector. In the fruit sector, one of the most promising agricultural sectors in Kosovo, 57 orchard owners prepared for the adoption of improved technologies for commercial operations. Fruit production has been hampered by a serious drought, but farmers have reported favorable returns on adopted varieties/technologies vis-à-vis traditional practices. USG support also resulted in expanded institutional linkages. Linkages were developed across 21 farm associations and 20 private agribusiness processors in four sub-sectors. Twenty-three milk collection points throughout Kosovo began applying improved handling and business management practices. Forward contracts were arranged for 38 milk producers and processors, which required certifiable quality. The marketed diary sales of participating producers grew by 40 percent on average. Six feed mills signed agreements with 62 farmers for 6,900 metric tons of maize, sunflower meal, and soybean meal, valued at €1,260,000. These linkages are crucial to improving the coordination of the market chain.

Additional support for business development in 2003 came from Democracy Commission funding for a Women's Business Association, as well as for NGOs that seek to combine environmental activism with market principles. Other Public Diplomacy funds supported an International Visitors program on "Urban Environmental Issues," designed to introduce the local Ministry of Environment and Spatial Planning to U.S. concepts and practices in the urban planning and environmental protection fields.

Due largely to USG assistance, along with support from other donors, Kosovo has implemented sound economic policies. In 2003, the USG continued its technical assistance in the area of fiscal, financial, and commercial law. USG assistance helped Kosovar businesses to improve marketing skills, increase quality control, and substitute domestic products for imports on the local market. In addition, the USG supported accounting training for over 500 businesspeople and accountants.

In 2004, USG assistance will continue to support economic policy development and implementation. However, the focus will be on training Kosovars to take over the key positions in Ministries and Agencies that are currently held by foreigners. Commercial law support will focus on completing the framework, as well as training judges, lawyers, and the public in the new laws. Business development assistance will deal with quality control issues (including the new U.S. requirements on food safety and bioterrorism), increasing domestic and foreign sales, improving production, and strengthening agribusiness sector institutional linkages. The USG will also support and strengthen business advocacy organizations at both the sector and sub-sector levels. To address the serious problem of unemployment, USG assistance will tackle economic issues such as job creation and investment in order to both maintain political stability and encourage economic development in the Western Balkans. It will tackle small and medium enterprise development and the creation of a climate for business development - a working banking system with access to financing, a functioning judicial system and a streamlining of government regulations.

Security, Regional Stability, and Law Enforcement

Kosovo's law enforcement organs continued to develop in FY 2003, as the international community worked to transfer greater responsibility for law and order to Kosovar institutions. UNMIK's Civilian Police service (CIVPOL) stands at 3,757 officers, of which 479 are U.S. police officers with SEED-funded salaries. This reflects a 15 percent decrease from 2002 in both the overall size of CIVPOL and the U.S. contingent. In FY 2003, the international community sought to move day-to-day policing responsibilities from CIVPOL to the Kosovo Police Service (KPS), which is due to become the primary police force by 2005. Transfer of local police stations to KPS, begun in 2002, slowed somewhat due to a shortage of senior officers to command the stations. CIVPOL and KPS are addressing this by training and promoting a sufficient number of officers to appropriate ranks. Other

legal institutions continued to improve with the training of judges and prosecutors, fostering the development of Kosovo's courts. While the Kosovo Protection Corps (KPC), the civilian successor to the former Kosovo Liberation Army (KLA), continued to broaden its capabilities and responsibilities in disaster relief and public works improvements, some issues remained regarding the possible criminal ties of KPC members and the publicly stated desire of the KPC leadership eventually to assume defense and security responsibilities.

During the year, UN CIVPOL transferred much of Kosovo's basic police work to the KPS, while keeping primary responsibility for sensitive and complex investigations, such as those related to inter-ethnic crimes, economic crimes/corruption, and trafficking in persons. Efforts began during FY 2003 to develop the capacity of KPS to investigate such complex crimes through specialized training and to bring KPS officers into the Kosovo Organized Crime Bureau (KOCB).

The KOCB received new surveillance equipment during the summer of 2003, enabling it to take advantage of new surveillance and investigation regulations allowing for the use of covert means to develop evidence against organized crime groups. Construction of a new forensics lab also began in 2003, with completion expected in 2004. Basic police training classes continue at the Kosovo Police Service School (KPSS), with classes being expanded from a 12-week basic course to 20 weeks starting in 2004, as the result of a Kosovo-wide needs assessment. KPSS is on track to meet the target of 6,500 trained basic recruits by summer 2004.

In FY 2003, USG SEED assistance continued to fund the KPC’s primary training program, implemented by the International Organization for Migration (IOM). The KPC’s primary missions are responding to disasters affecting the population and territory of Kosovo; conducting search and rescue operations; and assisting in rebuilding Kosovo’s infrastructure. In close coordination with UNMIK/KFOR, the KPC engaged in operations requiring rapid reaction to emergency training scenarios, testing leadership and unit ability to meet internationally recognized standards of performance. Each quarter, KPC leaders and Zone-level Rapid Response Units participated in IOM-directed training, leading to the deployment of Rapid Response Units to training institutions in Turkey, South Africa, the Czech Republic, and Germany. As a result of intense development efforts by IOM over many months, the KPC Protection Academy, along with its higher headquarters (Training and Doctrine Command - TRADOC) were officially activated in November 2002, and began teaching its first professional development course in February of 2003. The KPC Simulation Center, developed and staffed by IOM and also subordinate to TRADOC, was activated on the same date and became the primary training tool in support of KPC collective training during phase IV. Using this assistance, the 5,052-member KPC broadened its activities to include public works and reconstruction support in areas with high numbers of internally displaced persons (IDP) and returnees.

In 2004, USG law enforcement assistance will continue to focus on providing a safe, secure environment for all of Kosovo's people, while further developing local institutions that can assume greater responsibility for that task. The rudiments of the rule of law are in place, including a judiciary and police force, to create a sense of fairness and justice. A capable, honest police force must work in harmony with a judiciary that is not only seen as independent and ethnically blind but also competent. The task ahead requires turning these rudiments of democracy into fully functioning and well-grounded institutions. The lion's share of planned assistance will go toward U.S. CIVPOL salaries, while reflecting the ongoing drawdown in the U.S. CIVPOL contingent. The Criminal Intelligence Unit (CIU) and the KOC are units that tackle serious crime. The KPS will continue to assume greater responsibilities from CIVPOL, reaching its full strength of 6,500 officers and becoming Kosovo's primary police force. Another important objective is the continued development of the judiciary, as reflected by improved competence of judges, lawyers, and prosecutors and rebuilt administrative capacity in the courts. Further support for the Department of Justice Office, Overseas Prosecutorial Development, Assistance and Training (OPDAT) criminal justice programs will play a key role in this effort.

Humanitarian Assistance

In FY 2003, USG humanitarian assistance to Kosovo focused on encouraging an open climate for returns and resolving outstanding humanitarian issues stemming from the conflict. Funding from the State Department's Bureau for Population, Refugees, and Migration (PRM) supported the activities of UNMIK's Office of Returns and Communities in its efforts to facilitate returns and encourage inter-ethnic cooperation. PRM's contribution to the region-wide activities of the UN High Commission on Refugees (UNHCR) and the International Committee of the Red Cross (ICRC) also gave substantial support to those organizations' efforts in Kosovo.

Additionally, PRM funding for NGO activities provided much of the direct assistance to returnees, as well as to communities faced with absorbing a high number of returnees. Many of these projects involved support for activities by branches of the same NGOs both in Serbia and Montenegro, where potential returnees are identified and briefed on their options, as well as in Kosovo itself. Project funding for the American Refugee Committee, the United Methodist Committee on Relief, and the International Catholic Migration Committee allowed those organizations to identify and educate potential returnees in Serbia and provide support for their return to Kosovo. Further support for the returns effort came from Mercy Corps International, whose program complemented the returns assistance of other implementing partners by providing agricultural inputs and assistance to returnees, thereby aiding their reintegration into their communities through meaningful employment and economic opportunities.

Kosovo's Housing and Property Directorate (HPD) and the Housing and Property Claims Commission (HPCC) have exclusive jurisdiction to receive and decide claims from individuals who lost residential property as a result of the apartheid-like discrimination in the 1990's, and the 1999 conflict. The work of the HPD and HPCC contributes to the restoration of property rights and return of refugees and IDPs; the ability of owners and legal occupants to use their property as collateral for investment, thereby reinforcing economic stability; and support for the rule of law through the enforcement of legal decisions. SEED funds facilitated the work of the HPD and HPCC during 2003, through support for general operating expenses.

During FY 2003, additional humanitarian efforts in Kosovo were supported by SEED funding for Save the Children, which focused on primary education assistance to communities through physical reconstruction of schools, as well as provision of school supplies and funding for pre-school programs.

A prominent humanitarian issue in Kosovo is the plight of those with family members whose whereabouts are still unknown. SEED funding in 2003 supported the activities of the International Committee for Missing Persons (ICMP), which sought to resolve outstanding missing-persons cases stemming from the 1999 conflict. The ICMP provided scientific and technical support to the identification of human remains found in Kosovo or in Serbia proper, using its relationships and formal agreements with UNMIK and the Serbian Government Coordination Center for Kosovo (the former agreement was signed shortly after the end of FY 2003). Beyond DNA matching and scientific identification of remains, ICMP also played an important role in the growth of civil society's capacity to deal with the issue of missing persons through NGO training and development and advocacy on behalf of the families of the missing.

One additional element of USG humanitarian assistance was the donation of $100,000 in Defense Department humanitarian commodities to schools and medical clinics in southeastern Kosovo. The primary recipient was an elementary school in the municipality of Gjilan that serves a Roma community, while a second school in the area also received donations of furniture and school supplies. Office and clinic furnishings were also provided to medical clinics in two other area towns.

MEASURES OF PROGRAM EFFECTIVENESS IN FY 2003

DEMOCRATIC REFORM

Performance Indicator: USAID NGO Sustainability Index (1 = highest; 7 = lowest)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
4.3	3.0	**4.0**

FY 2003 Results: The 2003 NGO Sustainability Index shows a gradual improvement of the NGO sector in Kosovo since 2000. While the improvement overall has been slower than initially anticipated, the most progress has occurred in sub-sectors in which USAID has focused assistance: advocacy and infrastructure. The past year saw a marked increase in the success of NGO advocacy, especially at the municipal level, and the NGO sector continues to benefit from a range of indigenous resource centers and grant-making foundations. On the other hand, international donors remain the primary source of NGO funding, and little progress has been made in finding alternative, longer-term funding sources. Similarly, the abundant availability of donor funding arguably provided little incentive for NGOs to improve their organizational capacity, another area of limited progress.

Performance Indicator: IREX Media Sustainability Index (1 = lowest; 4 = highest)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
2.3	3.0	**Data not available yet**

FY 2003 Results: Kosovo enjoys a relatively good environment for independent media and freedom of speech, but key laws and institutions have not yet been established, and private media struggle to survive financially. Kosovo requires new legislation on an Independent Media Commission and on Public Broadcasting, and the public broadcast fee needs to begin to be collected. Public and private media depend largely on international donors for financial survival, raising concerns about their ability to maintain editorial independence in the long run. Journalists and media still must improve their professionalism, and media organizations require assistance in business management.

ECONOMIC AND SOCIAL REFORM

Performance Indicator: Kosovo exports as a percentage of GDP (Source: Riinvest Institute)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
2%	4%	**3%**

FY 2003 Results: Kosovo's continued dependence on imports and difficulties in reaching trade agreements with neighboring states hampered the growth of exports. Some gains were realized from improved agricultural production and distribution within Kosovo (substituting domestic for imported products) and through limited progress in market penetration of Kosovo products. Significant further gains will depend on improvements in quality and the implementation of free trade agreements (such as that signed with Albania on October 1).

Performance Indicator: Number of state- or socially-owned enterprises privatized (cumulative) (Source: Kosovo Trust Agency)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**

0 of 350 SOE's privatized	10 of 350 SOE's privatized	**23 SOE privatization tenders awarded**

FY 2003 Results: Privatization moved forward swiftly during most of FY 2003, with two successful rounds of tenders producing buyers for 23 socially owned enterprises (SOEs). However, the process came to a halt at the end of the fiscal year, due to a number of legal concerns raised within the Kosovo Trust Agency (KTA), the body charged with liquidating SOE assets. As a result, none of the 23 SOEs was formally privatized during FY 2003, pending KTA Board approval of the contracts. As of the end of 2003, the KTA Managing Board voted to ratify the sale of four SOEs, authorize contract negotiations pending final ratification for another 14, and re-issue tenders for the remaining five. Further progress will depend on surmounting the legal and political obstacles in a manner swift and transparent enough to preserve investor interest.

Performance Indicator: Number of fixed and cellular telephone subscribers (Source: USAID/Post and Telecom of Kosovo)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
100,000 landlines / 200,000 mobile telephone numbers	105,000 / 220,000	**109,000 / 295,000**

FY 2003 Results: The level of telephone line penetration in Kosovo is one of the lowest in Europe, with only an estimated 7 percent of households possessing a fixed telephone line. Mobile penetration continued to grow in FY 2003, but further progress on both fixed and mobile telephone access will depend on KTA, PISG, and Kosovo Assembly action on the creation of a Telecommunications Regulatory Agency (TRA) and issuance of telecommunications tenders. The picture will likely improve somewhat with the Assembly's approval of a TRA Board in December 2003.

SECURITY, REGIONAL STABILITY AND LAW ENFORCEMENT

Performance Indicator: Number of trained Kosovo Police Service officers (Source: UN CIVPOL/KPS)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
5,500 officers	5,900 officers	**5,850**

FY 2003 Results: KPS officer training and recruitment fell just shy of targets for FY 2003, reflecting the strong effort made by UN CIVPOL to bring in new officers and transfer policing authority during the year. KPS continues to assume greater responsibility for daily policing tasks and should reach its target strength of 6,500 officers in 2004.

Performance Indicator: Number of outstanding Internally Displaced Person claims resolved by the Housing and Property Directorate/Housing and Property Claims Commission (Source: HPD/HPCC)

FY 2002 Baseline	FY 2003 Target	**FY 2003 Actual**
1,856 cases resolved during year 1,856 total cases resolved	9,000 cases resolved during year 10,856 total cases resolved	**7,895 cases resolved during year 9,751 total cases resolved**

FY 2003 Results: Though HPD/HPCC processing of claims fell shy of targets, the FY 2003 results testify to an increasing speed of claim resolution and improved management of the property claim caseload. The work of HPD is critical to rule of law, minority returns, and economic revitalization -- continued improvement in case processing will be a key component of encouraging returns and achieving a stable, secure environment in Kosovo.

FY 2003 Support For East European Democracy (SEED)
Funds Budgeted for Assistance To:

Kosovo (In millions $, as of 12/31/03)

USAID - Democratic Reform $8.95
USAID - Economic Prosperity & Security $0.93
USAID - Humanitarian Response $4.80
USAID - Private Sector $17.15
USAID - Special/Cross-Cutting $1.49
USAID Total: $33.32

State - Bureau of Public Affairs $0.03
State - Criminal Justice System $1.50
State - DRL/Int'l Commission Missing Persons $0.40
State - ECA Exchange Programs $1.28
State - EUR Democracy Programs $0.05
State - EUR Law Enforcement Programs $5.50
State - EUR Public Diplomacy $0.30
State - Humanitarian Programs/HPD $0.35
State - IIP Public Diplomacy $0.20
State - INL Law Enforcement Activities $37.08
State - INL Police Training $5.00
U.S. Department of State Total: $51.68

GRAND TOTAL: $85.00

II. Country Assessment--Slovakia

Area: 48,845 sq km, about twice size of N. Hampshire
Population: 5,430,033 (2003,est.)
Annual Inflation: 3.3% (2002 est.)
Population Growth Rate: -0.14% (2002 est.)
Gross Domestic Product (GDP): $67.34 billion (purchasing power parity, 2002 est.)
Life Expectancy: male - 70.44 years ; female - 78.64 years (2002 est.)
GDP Per Capita: $12,400 (purchasing power parity, 2002 est.)
Infant Mortality: 8.55 deaths/1,000 live births (2003 est.)
Real Annual GDP Growth: 4.4% (2002 est.)

U.S. STRATEGIC INTERESTS

Since the formation of a pro-reform coalition in 1998, the Slovak Republic has made great strides toward becoming a truly democratic society, market economy, and participant in Western structures. Slovakia lies at the center of Europe, with close ethnic and geographic ties to the Balkans and to transition countries in Central and Eastern Europe (CEE). Its strategic importance was demonstrated once again when the government of Prime Minister Dzurinda quickly lent its airspace and allowed transit of troops for Operation Iraqi Freedom, for Afghanistan, and for Kosovo. Slovakia has sent troops to Iraq and pledged $18 million for the reconstruction effort. The Slovaks also dispatched an engineering unit to Afghanistan in August 2002, and contributes to peacekeeping forces in Kosovo and Bosnia, as well as to numerous UN peacekeeping missions. Slovakia will become a full member of both NATO and the EU in May 2004.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

In FY 2003, the U.S. Government (USG) provided an estimated $16.73 million in assistance to Slovakia.

- $0.5 million in democratic reform programs (including Public Diplomacy exchange programs)
- $16.05 million in security, regional stability and law enforcement programs;
- $170,000 in humanitarian programs; and
- Privately donated and U.S. Defense Department excess humanitarian commodities, valued at $10,000.

In FY 2003, a total of 45 Slovaks traveled to the U.S. on USG exchange programs, such as those funded by SEED and the International Military Education and Training (IMET). In addition, 22 traveled on International Visitor programs and four more on grants from Public Diplomacy funds.

U.S. ASSISTANCE PRIORITIES

Democratic Reform Programs: In FY 2003, the main priorities for U.S. democratic reform assistance included encouraging the growth of a stronger civil society and the rule of law. The majority of FY 2003 SEED funds was allocated toward fighting corruption, promoting the sustainability of the NGO sector, and providing protections and increased opportunities for minorities. USG-funded exchange programs sought to introduce young Slovak policy makers and leaders to important elements of the democratic system, and U.S. Embassy Democracy

Commission grants increased local organizations' capacity to influence change in these areas.

Economic and Social Sector Reform Programs: Since the formation of a pro-reform coalition in 1998, Slovakia's business-friendly environment has attracted significant foreign direct investment (FDI), including from American firms. In the past, U.S. assistance goals focused on promoting stable, sustainable economic growth; promoting investment in Slovakia; and furthering social sector reform. In FY 2003, several anti-corruption programs that encouraged increased transparency and more consistent business practices helped improve Slovakia's investment climate. The Embassy hosted an annual investment conference, in close cooperation with the private sector and the American Chamber of Commerce. USG-funded exchanges helped local government leaders to learn more about local economic development and increasing employment opportunities for their regions.

Security, Regional Stability, and Law Enforcement Programs: The Slovak military is an active and growing participant in several NATO and UN-led peacekeeping operations. In FY 2003,U.S. assistance encouraged Slovakia to contribute more effectively to regional stability and the fight against global terrorism. Military aid programs promoted sound defense reform, with a focus on more mobile and better-trained and equipped forces. In addition, U.S.-funded exchanges and Embassy Democracy Commission grants addressed law enforcement issues, particularly related to transnational crime. The USG continued to provide the Government of Slovakia (GOS) with export controls training and equipment.

SECTORAL ASSESSMENTS

Democratic Reform

The democratization efforts of the reform-oriented coalition that assumed power in 1998 contributed to Slovakia's positive performance in FY 2003. In September 2002, the Slovak people voted for a dominant center-right government, which gave four coalition parties (three from the previous government) another mandate to continue pursuing their top priorities regarding democratic reform and Euro-Atlantic integration. Parliament passed legislation that advanced the decentralization of public administration and judicial reform throughout the year. As with the national elections in September, the municipal elections held in December 2002 were aided by a very active NGO sector skilled in democracy building. The U.S. Embassy's small grants program contributed nearly $22,000 from FY 2003 funds toward voter education and minority outreach. Slovakia enjoys a free and open press, vibrant NGO community, growing respect for the rule of law, and membership in the OECD. However, the country still faces many difficult social and economic reforms, and lingering symptoms from the communist system persist.

Corruption is still a large problem in Slovakia, and the GOS is actively trying to curb it. Officials serious about creating transparent rules and prosecuting abuses have been put in key positions, a new conflict of interest law is being discussed, and a special prosecutor to fight corruption will soon be instituted. The Ministers of Justice and Interior Minister are taking action against corrupt officers in the courts and the police force. The head of the GOS anti-corruption office is a noted human rights lawyer, who pushed successfully for extending the scope for "sting" operations and has introduced a "whistle blower" statute to protect government employees who report to investigators about corruption in their offices.

The GOS remains committed to improving relations with minority groups. Ethnic Hungarian parties are represented in the coalition government, and an ethnic Hungarian, Pal Csaky, is the Deputy Minister for Human Rights and Minorities. The GOS established the Office of the Roma Plenipotentiary, which is held by a Rom, Klára Orgovánová. Discrimination against Roma is still pervasive, but the GOS has initiated an action plan and operates several pilot programs to address some of the Roma communities' most pressing needs. Skinhead attacks against Roma occur with some frequency, and the police sometimes fail to protect Roma from such attacks or to investigate such crimes thoroughly. The National and Bratislava district police have taken many steps to

monitor and control skinhead movements, and new officers are to be assigned to each district to monitor and investigate crimes, starting in 2004. Unfortunately, Parliament has failed to pass anti-discrimination legislation yet, even though it is a EU requirement for accession in 2004.

FY 2003 was Slovakia's final year for new SEED funding, with the majority of the funds dedicated to the completion of the American Bar Association's Central Europe and Eurasian Law Initiative's (ABA/CEELI) Rule of Law programs and Transparency International Slovakia's (TIS) anti-corruption work. ABA/CEELI received $200,000 to assist the development of the anti-corruption office at the Office of the Government and worked closely with the Ministry of Justice determining effective anti-corruption tools applicable to Slovakia. It sponsored several workshops with an American expert in the public procurement area to discuss necessary procedural reforms, which will continue into 2004. The organization was on hand with expert assistance to help draft legislation and to prepare training workshops. The final SEED installment led to a successful electronic court management project, which sought to reduce corruption by assigning court cases electronically and relieving court officials from excessive administrative loads. TIS received $50,000 to continue organizing anti-corruption seminars and workshops.

The foregoing projects and nationwide strategies to reduce corruption made a positive impact in Slovak society. ABA/CEELI brought together judicial reform leaders from other CEE countries to share the successes of the computerized court management initiative. After the former Chief Justice of the Supreme Court, who obstructed reforms and rewarded cronies with huge bonuses, failed to win reelection, the ABA/CEELI project for computerized case management was successfully installed at the Supreme Court, providing a positive example for the rest of the judiciary and the region.

The Embassy's Democracy Commission continued to support organizations seeking to assist Roma communities and increase human rights awareness. Among numerous activities, the Democracy Commission gave grants to train Roma leaders in public policy and create employment opportunities through vocational training. The grants in this area totaled $35,674. The Democracy Commission has also contributed over $68,790 to local organizations focused on civic activities, such as training teachers in human rights and local government education. In addition, the Office of Defense Cooperation (ODC) managed several construction projects, which will give Roma children better access to primary education.

Both corruption and minority rights will continue to be a high priority for U.S. assistance in FY 2004. The last round of Democracy Commission small grants will consist of an open competition for NGOs to propose innovative projects on these themes. In FY 2004, Slovakia will enter the EU. With the limited funds still available, the Embassy intends to build public-private partnerships to sustain NGOs and sponsor exchanges to contribute to Slovakia's continued democratization.

Economic and Social Sector Reform

The Slovak economy has shown consistently strong growth in recent years. In 2002, Slovakia had the fastest growing economy in Central Europe, with a real GDP growth rate of 4.4 percent. This trend continued through the first half of 2003, when the real GDP growth rate was 3.9 percent. The pro-reform ruling coalition that has led Slovakia since 1998 has been highly successful in bringing macroeconomic stability to the country to help it catch up with those neighbors that got off to a faster start after the Berlin Wall fell. The OECD projects that Slovakia's real GDP growth rate will be 4.2 percent and 4.4 percent in 2004 and 2005, respectively.

Cumulative FDI at the end of 2002 reached $10 billion, 500 percent higher than at the beginning of 2000. In addition, during the first half of 2003, Peugeot announced it would invest over $800 million in Slovakia for a new assembly plant that will produce 300,000 cars annually, and help make the country the largest car producer per capita in the world. During the same six-month period, other foreign companies invested an additional $550 million in Slovakia. The Embassy, the American Chamber of Commerce (AmCham), and local American companies have sponsored two annual

investment conferences in Slovakia to help promote its advantages to foreign investors. The GOS has successfully privatized the majority of state-owned enterprises, selling 49 percent of ownership and management control.

The high level of FDI has helped mitigate Slovakia's economic Achilles heel -- unemployment. The country's unemployment rate peaked at about 20 percent in early 2002, but steadily declined to about 14 percent in September 2003. Large discrepancies still exist between the Bratislava region, with a per capita income equal to 99 percent of the EU average, and an unemployment rate of under four percent, and Eastern Slovakia, which has pockets of unemployment as high as 30 percent. Due to Slovakia's communist past, its network of social benefits for the unemployed is very generous and is regarded by many as a disincentive to employment. Therefore, theEmbassy, EU, and IMF all have encouraged the GOS to tighten eligibility criteria for receiving benefits, and also to discourage an active black market for labor.

Although deficits in the current account and the domestic budget plagued Slovakia in 2002, there was broad improvement in both of these areas in 2003. The current account deficit in 2002 was 8.2 percent of GDP (slightly better than 2001's 8.8 percent), but thanks to strong export growth, it dropped to 1.3 percent for the first half of 2003. This strength in exports is even more impressive considering that the Slovak crown has appreciated against both the Euro and the dollar, making Slovak exports comparatively more expensive. The Slovak crown appreciated 17.2 percent against the dollar in 2002, and by about 14 percent in the first nine months of 2003.

The budget deficit ballooned to 7.5 percent in 2002, partly due to election-year sweeteners such as large pay raises for public employees. The GOS worked hard to keep on track for a 4.9 percent deficit for all of 2003, and projects it to be even lower in 2004. In 2002, election year politics also affected the inflation rate, when the GOS decided not to continue its multi-year policy of cutting subsidies for utility prices. However, 2002's inflation rate of 3.3 percent jumped to 7.7 percent for the first half of 2003, when the GOS raised utility prices even faster than usual after the election to make up for the holiday it had offered the previous year. The GOS goal is for utility prices to reach 90 percent of market levels by 2004. Fortunately, core inflation for the first half of 2003 was only 2.8 percent.

The GOS has also undertaken important and often painful first steps to modernize its pension, education, and health care systems. Funding pay for all the planned fixes immediately remains tight, but a new and fairer pension system has been approved, and important cost-cutting and efficiency-enhancing health care system changes have been launched. Various international organizations, including the Embassy, AmCham, EU, and IMF, have worked with the GOS to improve these systems and help assure their sustainable development well into the future.

Security, Regional Stability, and Law Enforcement

The U.S. enjoys strong military-to-military relations with Slovakia. The GOS is making strenuous efforts to join NATO and has behaved as a de facto ally in the recent crises. Slovakia continues to reform its military in close consultation with NATO through the Membership Action Plan (MAP) process and participates actively in Partnership for Peace activities. Slovak military and observers take part in various peacekeeping operations, including in Bosnia, Kosovo, and Afghanistan. In addition, Slovakia has sent troops to Iraq and pledged $18 million for the reconstruction effort. The armed forces continued to meet most reform goals, established an academy for non-commissioned officers (NCOs) in the past year, and reduced the overall number of troops and officers.

In FY 2003, the USG provided the Slovak military $8 million in Foreign Military Financing (FMF) funds, $950,000 in International Military Education and Training (IMET) funds, and $500,000 in Enhanced International Peacekeeping Capabilities (EIPC) funds. A $6.5 million supplement was added to these numbers in recognition of Slovakia's support and assistance in Afghanistan and Iraq. The total amount for FY 2003 was $16.05 million dollars. A large portion of these funds was not spent, due to the freeze placed them as of July 1, in accordance with the American

Servicemembers‘ Protection Act (ASPA). This frozen money, combined with some funds from previous fiscal years, totals $10.5 million. A majority of these funds were released by President Bush in November 2003, and they are again being used to aid the Slovak military.

The Slovak armed forces have used U.S. funds effectively toward achieving their military reform goals and to increase their interoperability with NATO forces. Assistance provided by Cubic Applications, Inc., a U.S. military advisory firm, is an important FMF-funded effort that is advancing military reform progress. Other key FMF projects that will contribute directly to the increased interoperability and compatibility of the Slovak military include tactical radios, night vision equipment, English language training, and a National Military Command Center (NMCC).

Slovakia employs its IMET allocation prudently, sending students to courses at a number of U.S. institutions, including the Army and Air Force War Colleges. Starting in 2003, the Slovak military began to use a large part of its IMET funds to train its developing NCOs corps. Slovakia is already a leading force provider for international peacekeeping operations and utilizes its EIPC assistance funds to improve its capability to field well trained and prepared peacekeepers for both UN and NATO peacekeeping operations. FY 2003 EIPC funds were committed toward establishing and equipping Slovakia's new peacekeeping school in Martin.

During FY 2003, the Export Control and Border Security program provided equipment and numerous training opportunities for Slovak customs officers. The two most effective programs were the four weeks of joint training with Czech officers on the Czech-Slovak border and a similar program on the Slovak-Ukrainian border. The Slovaks are paying particular attention to the eastern border because, as of May 2004, it will be an external border of the EU.

Not unlike the military, police structures in Slovakia are undergoing rapid reform. Interior Minister Palko’s reorganization will improve both investigative procedures and internal communication, which will allow the police to respond more quickly. U.S. assistance provided police training throughout FY 2003. In coordination with ABA/CEELI, a trainer from the University of Louisville conducted workshops on domestic violence and the treatment of victims.

Last year the police force designated a special unit for combating trafficking in persons, and in March, over 100 police officers participated in a raid on a trafficking ring, whose members were later indicted for forcing an estimated 56 women into prostitution. In FY 2003, ABA/CEELI facilitated two workshops and conferences on combating trafficking in persons with American experts. Victim Support Slovakia, using Embassy Democracy Commission funds, created a hotline to assist trafficking victims and provide information about working abroad. In cooperation with the International Organization for Migration, it launched a public education campaign, using advertisements and special modules in school curricula, to alert young women to trafficking risks.

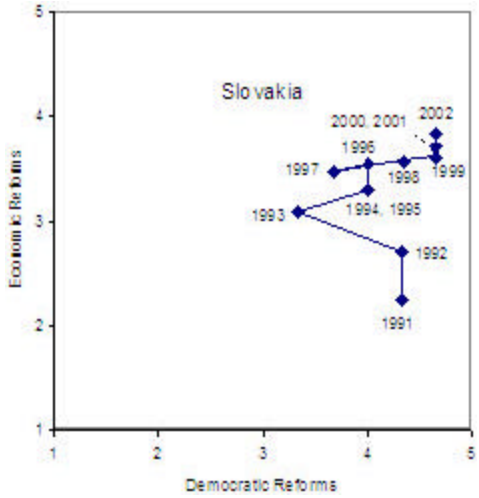
In FY 2004, U.S. assistance in this sector will decline significantly, due to NATO accession and the reformed police structures. However, border management will remain a challenge for Slovakia and a U.S. priority to strengthen controls as part of the war on terrorism.

Humanitarian Assistance

In Slovakia, many members of the Roma community live in isolated settlements on the outskirts of towns and villages. Many of these settlements lack clean water, are overpopulated, and have poor health conditions. Department of Defense humanitarian programs funded the construction of primary schools in several of the worst settlements. In one community, the Roma population was living over an abandoned mine that was sinking and at risk of collapse. The construction of the school enabled a portion of the inhabitants of the settlement to move to a safer location. Excess humanitarian commodities were also donated to newly constructed schools to help them to reach operational status.

COUNTRY PERFORMANCE MEASURES

Economic Policy Reforms and Democratic Freedoms in Slovakia, 1991-2002



Ratings are based on a 1 to 5 scale, with 5 representing the most advanced.
Sources: EBRD, *Transition Report 2003* (November 2003); Freedom House, *Freedom in the World 2003* (2003); and (various years).

Economic Structure and Human Development in Slovakia, 1991-2002

The Human Capital Index (HCI) is based on an average rating of four variables, scored on a 1 to 10 scale: per capita income; secondary school enrollment; health, as measured by life expectancy and under-5 mortality; and public policy, as measured by public expenditure on health and education as % GDP. World Bank, *World Development Indicators 2003* (2003); and UNICEF, *Social Monitor 2003* (2003). Private sector share of GDP is from EBRD, *Transition Report Update* (May 2003).

II. Country Assessment--Slovenia

Area: 20,273 sq km, slightly smaller than New Jersey
Population: 1,935,677 (2003 est.)
Annual Inflation: 7.4% (2002 est.)
Population Growth Rate: - 0.14% (2002 est.)
Gross Domestic Product (GDP): $37.06 billion (purchasing power parity, 2002 est.)
Life Expectancy: male 71.65 years; female – 79.58 years (2003 est.)
GDP Per Capita: $19,200 (purchasing power parity, 2002 est.)
Infant Mortality: 4.42 deaths/1,000 live births (2003 est.)
Real Annual GDP Growth: 3.2% (2002 est.)

U.S. STRATEGIC INTERESTS

A Europe that is whole, free, and at peace remains an important national security interest for the United States. Slovenia is economically strong, politically stable, and active in Southern and Eastern Europe. Slovenia's recent invitations to join the EU and NATO indicate the level of political and economic development the country has achieved during the last decade, and the regional role it can play in furthering the U.S. priorities of promoting stability, market liberalization, and anti-corruption. Slovenia's strategic location, productive workforce, and solid, growing infrastructure with free access to the world's second wealthiest market, make it an attractive venue for U.S. investments. As the new gateway to fledgling Southern and Eastern European markets, Slovenia, with its sound economic infrastructure, will continue to build bridges to the region through trade, investment, and direct assistance. Slovenia is the region's largest investor and plays a leading role in Balkan demining efforts, humanitarian assistance, and peacekeeping operations. The USG will continue to encourage Slovenia's involvement in the region, and to promote it as a regional model of political stability and economic development.

While no terrorist organizations are known to be active in Slovenia, its central location and short Adriatic coastline make it an attractive potential transit country for trafficking in drugs, persons, and weapons of mass destruction (WMD) by criminal and terrorist organizations. It is in the U.S. interest to provide training assistance and equipment, and to engage the Slovenian law enforcement community in efforts to detect, interdict, prosecute, and convict those involved in transnational criminal and terrorist activities. Slovenia already is actively promoting regional law enforcement cooperation, combating criminal activities, and providing technical assistance on economic, political, and judicial reforms.

OVERVIEW OF U.S. GOVERNMENT ASSISTANCE

In FY 2003, the U.S. Government (USG) provided an estimated $5,140,000 in assistance to Slovenia:

- $120,000 in Democracy Commission Small Grants;
- $4,940,000 million in security, regional stability, and law enforcement programs; and
- $80,000 for the Ron Brown Fellows program.

In FY 2003, a total of 37 Slovenians traveled to the U.S. on USG-funded exchange programs.

U.S. ASSISTANCE PRIORITIES

Democratic Reform Programs: In FY 2003, the main priorities for U.S. democratic reform assistance in Slovenia were the promotion of grassroots democracy and volunteerism in the country and the region; support for cultural understanding and ethnic tolerance; the forging of additional linkages among the countries of the former Yugoslavia; and encouragement to Slovenia to continue its mentoring role in the region.

Economic and Social Sector Reform Programs: Slovenia is not a recipient of economic and social sector Reform assistance. The Embassy has leveraged regional development assistance funds to host conferences promoting corporate governance through USAID's Partnership for Financial Stability (PFS) program and has cooperated with other USG agencies, including the U.S. Export-Import Bank, Department of the Treasury, Department of Labor, and the Securities and Exchange Commission, to encourage development of the private sector and financial institutional supervisory development.

Security, Regional Stability, and Law Enforcement Programs: In FY 2003, U.S. security-related assistance focused on preparing Slovenia for full NATO membership and on combating terrorism by increasing U.S. cooperation with local authorities. The USG continued to promote regional stability by helping Slovenia enhance its interoperability with NATO forces. To this end, the USG provided the Government of Slovenia (GOS) with $4 million in Foreign Military Financing (FMF) and $940,000 in International Military Education and Training funds (IMET). In the law enforcement arena, the USG focused on strengthening Slovenia's capability to detect and pursue money laundering, trafficking in drugs and persons, non-proliferation, and organized crime.

SECTORAL ASSESSMENTS

Democratic Reform

Slovenia has a well-functioning, multi-party democracy, independent judiciary, free press, excellent human rights record, and solid civilian control of the military. It is firmly committed to progress and democracy in the region, actively participating in regional initiatives such as SFOR, KFOR, and the Stability Pact. It also provides bilateral economic, commercial, and humanitarian assistance to several of the Yugoslav successor states. Presidential and local elections were held in late 2002, through which former Prime Minister Janez Drnovsek succeeded Milan Kucan as the country's president. In the local elections, 15 Roma community members were elected to town councils around the country. In March 2003, Slovenians approved EU and NATO membership referenda, with full membership expected by May and June 2004, respectively.

According to the United Nations Development Program (UNDP), Slovenia continues to register one of the lowest levels of citizen participation among developed countries. Although the GOS has made some efforts to increase cooperation with NGOs, civil society remains undeveloped. Over 16,000 NGOs/NGO-type organizations were registered in Slovenia, as of 2002, but only a few were active. Most Slovenian NGOs have weak organizational structures, small memberships, suffer chronic resource shortages, and require continued external support. There is a growing recognition, however, of the importance of NGOs to society in promoting democracy and economic development. Membership in the Center for Non-Governmental Organizations (CNVOS), an umbrella organization of NGOs to develop, unite, and strengthen the sector (and a previous Democracy Commission grantee) continues to increase. Within a few years, CNVOS membership has grown from 27 to over 100.

USG efforts have focused on developing grassroots democracy and citizen participation in the region, promoting ethnic tolerance and social integration, and assisting refugees from the countries of the former Yugoslavia. Social integration of displaced persons, particularly from Bosnia, is a work in progress. Positive steps were made in 2003, including, after much delay, a local government permit to build a mosque.

SEED funding was used to support the participation of two Slovene lawyers in the Ron Brown Fellowship Program. Program participants focused their research in legal areas not examined frequently in Slovenia -- family and bioethics, and refugee and asylum law. Ron Brown Fellows continue to be some of the best and brightest participants in U.S. exchange programs.

The Democracy Commission Small Grants Program provided funds to indigenous NGOs for: strengthening and development of NGO capacity, grassroots democracy/volunteerism, the environment, and tolerance and cultural understanding. A grant raising youth awareness about the meaning and importance of democracy allowed high school students to participate in mock elections a week prior to the actual presidential and local contest. Funds supported the "Europe, Slovenia, Roma" project, promoting social awareness of the Roma community in Slovenia and disseminating information about international human rights and standards for protecting minorities. A priority of grants this year, such as a project with the Legal Information Center helping set up financial counseling services to NGOs, was enhancing the long-term sustainability of NGOs in Slovenia.

Economic and Social Sector Reform

Slovenia ranks highest in most economic indicators among the states slated to enter the EU in 2004. A recent EU review praised Slovenia's macroeconomic performance, characterizing the country as being at the top of its accession class. With its export-oriented economy, Slovenia's per capita GDP reaches nearly $11,000; unemployment stands at 6.1 percent; and at 3 percent, the annual growth rate remains above the EU average, even in the current world economic slowdown. Measures to reduce inflation have been successful, lowering the annual rate from 7.5 percent in 2002 to an estimated 5.1 percent in 2003. The GOS has made entering the Exchange Rate Mechanism II a priority, and Slovenia expects to adopt the Euro by 2007.

Structural challenges need to be addressed, including the privatization of parastatal companies, the removal of direct and indirect barriers to foreign direct investment (FDI), and the reduction in the role of the government in key sectors of the economy. After a banner 2002 for FDI -- due in large extent to the $900 million takeover of Lek Pharmaceuticals by Novartis -- direct investment has plummeted. Privatization procedures in key sectors, including banking, insurance, and telecommunications, have either been stopped or have yet to be carried out. The public sector continues to play a determining role in the economy, either directly, as sole proprietor, or indirectly, through shares. Transparency in government procurement remains an area of concern, particularly for foreign companies. Slovenia is not party to the WTO's Government Procurement Agreement (GPA).

The Embassy has leveraged regional development assistance funds to host conferences promoting corporate governance through USAID's Partnership for Financial Stability (PFS) program and has cooperated with other USG agencies, including the U.S. Export-Import Bank, Department of the Treasury, Department of Labor, and the Securities and Exchange Commission, to encourage private sector development and supervisory oversight of financial institutions. Democracy Commission funds helped several social service organizations encourage civic action by promoting volunteerism, public awareness of their activities and the populations they serve, and greater public support for and involvement in their social programs.

Security, Regional Stability, and Law Enforcement

Since March 1996, Slovenia has been eligible to purchase Foreign Military Sales (FMS) goods and services on a case-by-case basis and has been investigating the procurement of weapons systems in the U.S. and elsewhere. The principle of civilian control of the military has been accepted within both the government and the uniformed military. The Law on Defense defines the chain of command for the military and delineates the responsibilities between the Ministry of Defense (MOD) and the General Staff. The Defense Doctrine states the purpose of the armed forces is to deter aggression and to preserve territorial integrity. With its very small armed forces, Slovenia hopes to accomplish this by aligning itself with Western countries through NATO membership.

Slovenia's willingness to participate in regional military programs reflects both its rising confidence about its continued sovereignty and independence, as well as a calculation that it must assume a regional role as an invitee for NATO membership. Slovenia in the past year has in fact played a more active role in Southeastern Europe, a region in which it wants to promote stability and prosperity.

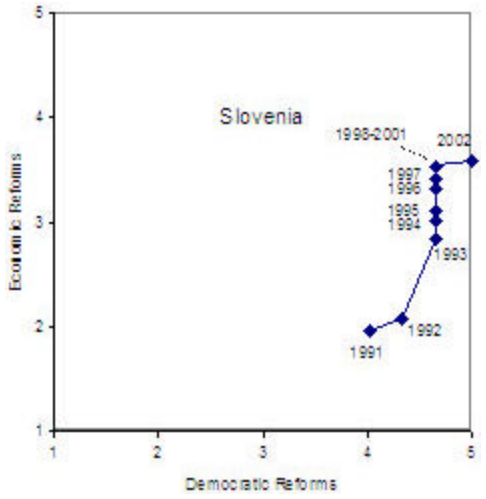
The primary U.S. security assistance programs benefiting Slovenia remain International Military Education and Training (IMET) and Foreign Military Financing (FMF). Slovenia has increasingly made the most of its IMET opportunities, since the FY 2002 program began, and continued emphasis on defense reform and restructuring led to maximum use of professional military education courses. In FY 2003, the USG provided Slovenia with $940,000 in IMET to train 82 military and defense-associated civilian personnel. Another 25 people took part in courses and seminars at the George C. Marshall European Center for Security Studies, in Garmisch, Germany. In addition, with current FMF cases, Slovenia completely expended its Warsaw Initiative Funds for the first time since becoming a recipient in 1996, with FMF totaling $4 million.

Slovenia's overarching, short-term military objective is full NATO membership in 2004. Long-term, the Slovenian armed forces are in the midst of restructuring, with the ultimate goal of establishing, by 2010, a small, effective, well-equipped military force that conforms to NATO standards. As part of the process, it is reducing its territorial defense component and increasing the peacetime active duty (professional) strength of the armed forces. The intention is to build a combined arms capability and to transition to a more NATO-compatible force structure. The military will eventually be comprised of rapid reaction forces, main defense forces, and support defense forces. The MOD and General Staff are using the 2000 U.S. Office of the Secretary of Defense-sponsored Defense Assessment to refine and adjust their reorganization effort, in an attempt to meet NATO Partnership Goals. These efforts mesh well with primary U.S. objectives for Slovenia and the region. They are to promote regional stability, reduce the likelihood of further armed conflict, advance democracy, expand civilian control of the military, enhance military professionalism, build military capabilities, and develop closer relations with the U.S. and NATO. Slovenia has already proven itself a stabilizing force in the region. A professional, effective, NATO-compatible military force can only promote U.S. goals overall.

Slovenia is an active member of the Global Coalition against Terrorism, and is party to nearly to all international anti-terrorism conventions.

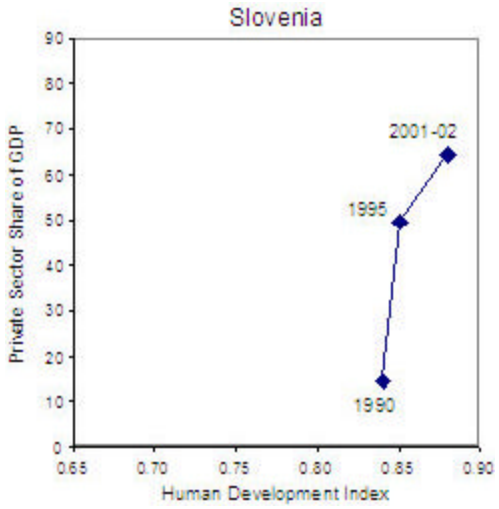
COUNTRY PERFORMANCE MEASURES

Economic Policy Reforms and Democratic Freedoms in Slovenia, 1991-2002



Ratings based on a 1 to 5 scale, with 5 representing the most advanced.
Sources: EBRD, *Transition Report 2003* (November 2003); Freedom House, *Freedom in the World 2003* (2003); and (various years).

Economic Structure and Human Development in Slovenia, 1991-2002



The Human Development Index (HDI) is based on three indicators: longevity, as measured by life expectancy; educational attainment, as measured by a combination of adult literacy and combined primary, secondary, and tertiary enrollment ratios; and standard of living, as measured by real per capita GDP ($PPP). The HDI ranges from 0 to 1, with higher values representing greater human development. UNDP, *Human Development Report 2003* (July 2003), and previous editions; EBRD, *Transition Report 2003* (November 2003), and previous editions.

III. Regional Program--U.S. Agency for International Development (USAID)

In FY 2003, as in previous years, the overwhelming majority of assistance activities implemented by the U.S. Agency for International Development (USAID) were conducted bilaterally. They are described in the 15 country assessments in Part II of this Report. However, some activities involved two or more Central and Eastern European (CEE) countries and therefore were regional in nature.

The development challenge in CEE in FY 2003 remained one of sustaining momentum in the movement of formerly authoritarian, centrally planned societies toward becoming participatory democracies with strong market economies. Policy reform, institutional development, and broad-based citizen participation are central to USAID's regional programs.

USAID regional assistance focuses on cross-border cooperation and regional integration in the health, financial development, infrastructure development, micro-enterprise, environment, energy, anti-corruption, and rule of law areas. USAID's cross-border approaches to address critical obstacles and changing circumstances in CEE include: 1) developing ethnic conflict mitigation programs to contribute to a better climate for reform; 2) creating social sector initiatives to broaden the benefits of reform; and 3) fighting corruption on many fronts. The following are examples of regional activities USAID is implementing in SEED-eligible countries to achieve those objectives.

Freedom House Regional Networking Program

The Regional Networking Program (RNP) aims to strengthen the capacity of non-governmental organizations (NGOs) through cross-border projects to inform public opinion and influence public policy in order to accelerate and help secure the region's transition to open political and economic systems. RNP grants and exchanges have been highly successful in helping NGOs throughout the region establish partnerships and networks and to share experience and knowledge. Between October 1, 2002, and September 30, 2003, Freedom House awarded 42 project and exchange grants totaling $355,517 to the Center for Free Elections and Democracy (Serbia), Center for Peace Studies (Croatia), European Institute (Bulgaria), Institute for Regional and International Studies (Bulgaria), and other organizations. The purpose was to share Serbian experience in public awareness-building campaigns, monitor public attitudes toward NATO accession in the former Yugoslavia, and conduct assessments of NGO influence in policy-making in western Black Sea states. Complementary exchanges allowed NGO activists to establish direct contacts with their counterparts in Southeast Europe (SEE) and the Newly Independent States (NIS) of the Former Soviet Union. This aspect of the program brought a Belarusian expert from a Minsk NGO to Belgrade to study think tank operations in repressive environments; allowed a Macedonian civic monitoring institution to launch a new project encouraging citizen participation in parliamentary affairs, as a direct result of an exchange spent in Croatia; and gave an up-and-coming Bosnian think tank invaluable insights into the organizational and project development experience of one of Bulgaria's most advanced policy institutes.

Hungarian-American Partnership Initiative

The Hungarian-American Partnership Initiative (HAPI) is a training activity, which provides opportunities for countries in the Europe and Eurasia region to learn from Hungary's successful transition to a market economy and a democratic society. HAPI is designed to involve the Hungarian government in the implementation process, with the express purpose of jump-starting a Hungarian assistance program, required for EU entry. Such a program would contribute to the stability and development of the region, with priority being given to the Stability Pact member states. In FY 2003, USAID provided $150,000 SEED-funded grant to the Foundation for the Development of Democratic Rights.

Since it began in 2000, HAPI has delivered short-term training programs to 507 participants in 45 groups, from seven CEE and six NIS countries in investment promotion, municipal government

strengthening, taxation systems, community development and outreach, SME development, NGO financial management, anti-corruption, pension reform, privatization of the energy sector, multi-ethnic governance, establishing brokerage companies, regional health reform, Roma community development, and telecottages.

Balkan Trust for Democracy

The Balkan Trust for Democracy, a $27 million ($10 million from USAID and the German Marshall Fund) grant-making initiative to support good governance in SEE, is a unique public-private partnership of the German Marshall Fund of the United States (GMF), USAID, and the Charles Stewart Mott Foundation. The Government of Greece has made an additional contribution.

The Balkan Trust for Democracy, based in Belgrade, supports the strengthening of democratic institutions in SEE through two principal programs: Linking Citizens with Government and Cooperation and Collaboration. The Balkan Trust makes grants in Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Macedonia, Romania, Serbia and Montenegro, and Kosovo.

The Balkan Trust has been operational since June 2003, and began grant making in August. It is working to respond to the needs of each country, support innovative and high-quality projects, and attain a relative balance of support among all recipient countries. Staff of the Balkan Trust have cooperated closely with USAID and have developed good communication and cooperation with other donors and international organizations as well. The Balkan Trust works with a regional Advisory Board, comprised of experts from various sectors and countries, which met first in July 2003 to offer the Balkan Trust guidance before it began operations. It will meet again, in late February 2004, to discuss the Trust's progress in its pilot phase and offer strategic guidance for the coming years.

The Balkan Trust has made 35 grants to date -- 23 in-country grants, 10 cross-border initiatives, and two regional networks involving all or most countries in the Balkan region. About 43 percent of the funded initiatives are to organizations based outside of the capitals. The grants awarded have addressed a range of issues, including citizen advocacy and political participation, development of youth leadership, analysis and improvement of participatory decision-making methods, reconciliation and public administration in ethnically diverse areas, strengthening of youth and media networks around SEE, as well as a number of other issues related to the consolidation of democracy in the Balkans.

Roma Integration Program

The Roma Integration Program (RIP) is a $2.8 million 4-year regional program in the Czech Republic, Hungary, and Slovakia, which aims to expand access to services and leadership opportunities for Roma at the community level and to contribute to a change in perception of Roma through public awareness programs to counter discrimination. The program also aims to produce models of integration that can be replicated in communities within the three countries, with possible implementation in other countries with Roma populations and USAID Missions.

The RIP is a new activity, implemented by Partners for Democratic Change. During the initial months of the program, Partners has completed an assessment and selected target Roma communities in the three countries; hired key staff to manage all elements of the program; established advisory boards for the program in the three countries; and begun a training series in conflict management, leadership, and advocacy. In the future, participants will utilize these skills in community-level programs, in cooperation with local government, social service agencies, and other sectors.

International Center for Not-for-Profit Law

The International Center for Not-for-Profit Law (ICNL) continued to work throughout CEE to develop an enabling legal environment that promotes sustainability of the NGO sector in the region. ICNL's technical assistance and regional activities, including publications and workshops, have bolstered ICNL's in-country assistance and influenced the development and passage of legislation in several countries. An example is a groundbreaking new law passed in Hungary, in June 2003, to set up a National Civil Fund that will provide institutional support to Hungarian NGOs. Through ICNL's regional educational initiative, which is well underway in Hungarian, Serbian, and Macedonian universities, more than 400 students are studying NGO law each year at 11 universities in eight European and Eurasian countries. ICNL also maintains an electronic, web-based legal library that is a valued resource throughout the region.
In June 2003, ICNL's Budapest office became registered as the European Center for Not-for-Profit Law (ECNL), a Hungarian public benefit organization, serving as the center for the development of NGO law in SEE and eastwards and as a catalyst for regional networking and cross-border initiatives. As an ICNL affiliate, ECNL will coordinate its future activity with a growing network of NGO legal experts to help ensure a lasting capability in the region.

Nations in Transit

Under a grant from USAID, Freedom House publishes a comprehensive annual progress report on the status of political reforms in 27 emerging democracies and transitional countries of CEE and the former Soviet Union, including the 15 SEED countries. The report, called Nations in Transit, provides detailed analysis and data on two main topics: democratization (including electoral process, civil society, independent media, and governance) and rule of law (including constitutional, legislative and judicial frameworks, and corruption). The 2003 edition is the seventh and covers events from January 1 to December 31, 2002. The 2004 edition, covering calendar year 2003, will be released in spring 2004. While the overall results reported in Nations in Transit are mixed, the findings show significant progress in the CEE countries in the time since this publication began.

Fiscal Decentralization Initiative

Jointly funded by USAID and the OECD, UNDP, Council of Europe, Soros Local Government Initiative, Danish Ministry of Interior, and Czech Ministry of Foreign Affairs, the Fiscal Decentralization Initiative (FDI) supports the development of task forces in CEE countries and implemented a wide range of capacity-building and policy-development programs in CEE and SEE to educate governments, think tanks, and academic leaders on the major issues of fiscal decentralization.

In FY 2003, FDI supported a research program measuring the progress of decentralization in CEE and the development of indicators for assessment of decentralization. Surveys and fiscal designs covering the Czech Republic, Estonia, Latvia, Lithuania, Hungary, and Poland were supplemented with similar studies focusing on Bulgaria, Romania, Slovakia, and Slovenia. In addition, FDI supported development of a certified course for local government finance officers in Slovakia. This program, funded by the Open Society Institute (OSI), USAID, and the UK Department for International Development (DFID) and developed jointly by the Chartered Institute of Public Finance (CIPFA), Slovak Association of Local Government Finance Officers and the University of Banska Bystrica, has resulted in the development of curricula covering areas such as public finance, accounting, public investment, public procurement, etc. The program will be launched in January 2004.

Rule of Law

This objective supports the establishment of the rule of law; the protection of civil, political, and property rights; and the limiting of arbitrary government action. The rule of law requires an impartial judiciary, professional and honest prosecutors, effective legal representation, and well-defined legal procedures that help ensure uniform, timely enforcement of laws. USAID-funded activities support legislative drafting, strengthening the independence and accountability of the judiciary, more

transparent and efficient administration of cases, judicial training, and association building. USAID's regional rule-of-law activities achieved substantial results during FY 2003.

A regional institution building advisor (RIBA) and three recently hired in-country institution building advisors (IBAs), fielded by the American Bar Association's Central and Eastern European Law Initiative (ABA/CEELI), provided comprehensive organizational development assistance to key legal reform partner NGOs in CEE. There has been significant progress toward organizational and financial sustainability and increased partnership activity by ABA/CEELI's priority partners in the region. ABA/CEELI plans to replace the expatriate RIBA position with an IBA, thereby moving the program toward indigenization.

Regional Media Program

The Regional Media Program, implemented by the International Research and Exchanges Board (IREX), focuses on regional, cross-border activities that support the development of independent media in SEED countries. The program aims to provide an integrated management architecture that facilitates and promotes country-specific and cross-regional learning in the four key areas of media sector development: business management, professional standards, supporting institutions, and legal frameworks. These objectives are met through the following activities:

- Media Sustainability Index (MSI), which assesses media systems in Europe and Eurasia. The MSI has proven to be a valuable tool for USAID Missions, other donors, media development organizations, and media professionals.
- Study on Capital Investment Issues Facing Independent Media
- Support to regional television news reporting
- Support to regional investigative journalism
- Annual media conference to discuss lessons learned, best practices, and hotspot issues, e.g., media in repressive countries.
- Media Law Reform, via SEED funding for initiatives under the umbrella of the Stability Pact for South Eastern Europe, national working groups are supported in SEE that provide support for media law reform.

U.S. Department of Labor

In FY 2003, the U.S. Department of Labor (USDOL) implemented the recommendations of independent evaluations and took strong positive steps to standardize performance measurements and develop exit and sustainability plans in SEED countries. SEED regional program funds helped advance the work of a Regional Task Force of professionals from Bulgaria, Hungary, Macedonia, Poland, and Romania, who met quarterly to exchange information about successful strategies and act as a resource for communities and governments. The Task Force successfully completed a region-wide manual on the implementation of the worker redeployment model, public relations/advocacy training workshops, a certification program for industrial adjustment specialists, and a case study analysis to compare local economic development programs in Bulgaria, Macedonia, and Romania. In winding down its Integrated Community Adjustment Program, USDOL also funded the development of a regional website that features the concrete job creation and business development results by country and community.

Regional Microfinance

The regional microfinance activity has strengthened the ability of USAID's Europe and Eurasia (E&E) Missions modestly to alleviate poverty and promote rapid, sustainable economic growth through efficient, country-specific micro, small and medium-size enterprise (MSME) strategies. The activity has supported the E&E Bureau's objective of promoting private enterprise in the region. Through regional funds, successful microfinance programs were started in Bulgaria, Croatia, Kosovo, Macedonia, and Romania. These programs have served poor, small, mostly female

entrepreneurs in the region. Regional SEED funds are dedicated to "best practices" research, training (including workshops and conferences), and practical applications to help E&E Missions on issues such as MSME financing, business services, and policy advocacy; the Microfinance Center (MFC) in Warsaw, Poland, has become the premier provider organization in the Region with E&E Bureau support.

The 6th Annual Conference of the Microfinance Institutions in Central and Eastern Europe (CEE) and the Newly Independent State (NIS), held in Moscow in May 2003, demonstrated the capabilities and the leadership of the Center. The conference attracted 280 participants from across the region to share and discuss the experience of microfinance organizations, discuss research by the Center, and to settle on plans to make the work of the Center yet more effective. A narrative of the conference, including the issues it dealt with, can be found on the MCF web site: www.mfc.org.pl. Support to the MFC has been instrumental in promoting "best practices" in microfinance, such as market interest rates and a plan for sustainability, throughout the region. Also, the MFC has analyzed the legal and regulatory constraints to SME lending. Such studies advance policy dialogues in each country. Training is creating a cadre of microfinance professionals in many places (Bosnia, Bulgaria, Croatia, Kosovo, Macedonia, and Romania), which promotes the development of commercially sustainable microfinance institutions.

Municipal Network for Energy Efficiency

USAID has been working with municipal governments and private/NGO groups to overcome policy and institutional barriers to commercial financing of energy efficiency. Funding support will continue to develop innovative policies and projects and disseminate the results throughout the region through the region-wide Municipal Network for Energy Efficiency (MUNEE) network. MUNEE is implemented under a cooperative agreement with the Alliance to Save Energy, working with NGOs and municipal associations on municipal energy efficiency activities, with a focus on capacity building, information dissemination and policy reforms, including innovative financing approaches and using energy efficiency to help low-income households meet rising energy costs. MUNEE fosters the exchange of experiences in municipal energy efficiency programs, focusing on replication of successful management approaches in district heating systems; the role of energy efficiency to help low-income households meet the rising costs of energy; and more efficient alternatives to electricity for space heating.

Regional Energy Regulatory Network and Association

USAID has supported the establishment of the Energy Regulators Regional Association (ERRA) in the Europe and Eurasia region, designed to strengthen regulatory capacity in the region through the exchange of experience and information and training. ERRA was formally established in Budapest, Hungary, in April 2001, and has grown from 14 to 19 member regulatory bodies from CEE, SEE, the Baltics, and Eurasia. ERRA technical committees on tariffs/pricing and on licensing/competition, including technical experts from the 19 regulatory bodies, met and focused on technical issue papers, including those on electricity and gas tariffs, service standards, interaction of regulators and regulated entities, public service obligations, cross-border capacity allocation methods, and privatization and regulation. ERRA members developed their own summer school course on energy regulatory practices, cost-shared by the Central European University in Budapest and given there. It was presented for new regulatory staff by experienced ERRA regulators and staff. ERRA brought together over 200 investor, utility, finance, and regulatory participants in an energy regulation and investment conference designed to increase the exchange of views and information. Regulatory peer reviews were initiated involving two regulators, who completed their reviews of each, other focusing on the organization, activities, and effectiveness of each. Finally, expanded technical sessions took place that engaged ERRA members with West European and U.S. energy regulators.

Stability Pact for South Eastern Europe: Regional Electricity and Gas Markets Initiative

USAID has worked with ministries, regulators, and utilities in the region to promote electricity sector reforms and lay the basis for a regional electricity market integrated with the larger, liberalizing EU market. On December 8, 2003, Ministers of Energy and Economy from SEE signed a 2nd Memorandum of Understanding (MOU) that builds on the one signed a year earlier, expanding it to include natural gas to the earlier commitment on electricity and aimed at adopting common rules for the operation of regional markets. In meeting the commitments in the 2nd MOU, the SEE countries will be in compliance with revised EU Directives in electricity and natural gas issued in 2003, essentially meeting accession requirements in these sectors. The 2nd MOU was signed by all SEE countries and Turkey, with UNMIK again signing for Kosovo. The EU is now also a signatory. Implementation of the MOU is being undertaken under the "Athens Forum" process. Over the past four years, USAID has been instrumental in laying the basis for this process through its Stability Pact regional program, and continues to work closely with the EU, World Bank, EBRD, Germany, and Canada to carry out the necessary reforms. Working through SEE energy organizations, USAID has focused on developing a sound, consistent legal and regulatory framework, creating competent energy regulators, designing internal electricity markets consistent with a proposed regional electricity market, and identifying from a regional perspective key investment requirements for teleinformation and transmission grid systems. The first loan from EBRD for a high voltage transmission interconnection was signed in 2003, linking Macedonia with Bulgaria. Progress was also made in 2003 in reconstruction of substations destroyed during the war that are essential for reconnection of the former Yugoslavia systems to the main EU grid. Implementation of the USAID-supported plan for developing a modern teleinformation system among national dispatch centers is proceeding very well.

Stability Pact for South Eastern Europe: Regional Energy Efficiency Initiative

USAID continued its support for a regional approach to energy efficiency financing and investment in SEE, addressing improvements to district heating systems; providing more efficient alternatives to electricity for space heating; and examining the role of energy efficiency to help low-income households meet the rising costs of energy. There are three main elements of this approach. First, it is helping to develop bankable municipal energy efficiency for funding by the international financial organizations (IFIs), export credit agencies, or commercial banks and energy service companies. Major activities supported World Bank and EBRD loans in Bulgaria and Serbia, preparing municipal energy plans and investment projects in Croatia, and preparing an energy efficiency strategy for Macedonia. Second, it is developing the region-wide Municipal Energy Efficiency Network (MUNEE), a network of NGO energy centers that carry out coordinated training and policy work on low-income energy efficiency issues and municipal project design and financing. Third, it is implementing a $15 million regional Development Credit Authority program to provide loan guarantees to municipalities or private energy service companies for energy efficiency projects in hospitals, schools, municipal facilities, and heat utilities. The initial agreements with commercial banks in Bulgaria and Croatia are under preparation. These projects will serve as models for other cities in the region and contribute to USAID clean energy and climate change objectives. Contractors are the Alliance to Save Energy and Nexant.

Balkans Regional Infrastructure Program

The Balkans Regional Infrastructure Program (RIP) includes a variety of components, either facilitating individual infrastructure projects throughout SEE or using tools such as innovative project financing approaches and regional cooperation to accelerate the infrastructure agenda in the region. Project Facilitation Activitieseach facilitated one or more projects with identified financing, including a canal rehabilitation project in Romania, two water supply system improvement projects in small Croatian towns, waste system upgrade investments in two large Serbian cities, and assistance to a variety of small and medium Romanian towns for preparing water and wastewater projects for a combination of grant and loan funding. Regional Cooperation Activities concentrated on supporting the Interim Sava River Basin Commission’s work toward ratification of a treaty among Bosnia, Croatia, Serbia, and Slovenia. Efforts on inter-basin cooperation in the fields of navigation, flood control, water quality, and other joint concerns are leading to important political concordance and

stakeholder involvement, while also preparing key infrastructure investments for IFI review. Innovative Financing Activities were initiated several years ago by recognizing the limitations of grants, as well as the sovereign borrowing capacity of SEE nations to meet the region's need for improved infrastructure. RIP created the Balkans Infrastructure Development Facility (BIDFacility), a revolving fund of $10 million to develop public infrastructure projects in water, energy, and transport for private sector investment, designed to recoup the costs of preparation from successfully financed projects. The International Finance Corporation (IFC) and USAID together pledged the first quarter of the revolving fund and were joined during 2003 by six European donors: Austria, Greece, Italy, the Netherlands, Norway, and Switzerland. A business plan was completed in 2003, with initial activities scheduled in 2004. The second financing activity under RIP will use USAID's Development Credit Authority to attract private sector investment in the water, energy, and transportation infrastructure sectors in SEE through a new Balkans Infrastructure Investment Guarantee Fund.

Partnership for Environmentally Sustainable Economies (ECOLINKS)

USAID's flagship EcoLinks program actively promotes environmental technology transfer, market-based partnerships, and environmental best practices to address critical environmental problems in municipalities and industries in Europe and Eurasia. Since its inception in 1999, EcoLinks offices have facilitated more than $70 million in environmental technology trade in the SEED recipient countries of CEE and leveraged additional investments of over $90 million in environmental infrastructure there. In FY 2003, the program facilitated more than $11.5 million in direct technology sales and services between U.S. environmental and energy firms and municipalities and firms in the SEED countries.

With its technical offices in U.S. Embassies in Bulgaria, Croatia, Czech Republic, Hungary, Poland, and Romania, EcoLinks identifies environmental infrastructure and technology needs and matches them with U.S. and regional expertise for ongoing business partnerships to meet local needs. EcoLinks' offices facilitate Quick Response Awards of up to $4,000 to assist local firms in cementing partnerships. EcoLinks also provides grants to the other SEED countries: Bosnia- Herzegovina, Estonia, Latvia, Lithuania, Macedonia, and Serbia and Montenegro, and also to selected countries in Eurasia. During FY 2003, EcoLinks facilitated the majority of its trade and investment transactions in the wastewater, drinking water, and renewable energy sectors in SEED countries, assisting them in meeting the infrastructure requirements of EU accession.

EcoLinks also facilitates critical environmental infrastructure development in SEED countries by assisting municipalities and industries in finding follow-on project financing from other USG and EU mechanisms, including the U.S. Trade and Development Agency (USTDA), the USAID Development Credit Authority, and the Polish EcoFund. One example is a Hungarian municipality that recently awarded a $44 million contract to a U.S. firm to build a wastewater treatment plant, after EcoLinks helped the municipality locate the U.S. partner and obtain a USTDA grant for a feasibility study.

Global Trade & Technology Network/Southeast Europe

The Global Trade & Technology Network/Southeast Europe program (GTN/SEE) is an Internet-based, trade-lead-matching system to facilitate trade. The program helps small and medium-size enterprises (SMEs) to establish regional and international business partnerships. The initiative complements USAID objectives by strengthening local economies, improving the competitiveness of local firms, and creating links to domestic, regional, and U.S. markets. GTN monitors interactions between interested companies and provides follow-up services to facilitate transactions or business links.

GTN operates in Albania, Bosnia, Bulgaria, Croatia, Hungary, Kosovo, Romania, and Serbia and Montenegro. Operations are coordinated through the Regional Manager in Belgrade, Serbia. The program is in the process of implementing Supply Chain Management services to its clients in the region, which will help SMEs improve their overall competitiveness by gaining visibility and access to global supply chains. In FY 2002, the first year of full operation, GTN representatives in the

foregoing countries and territory facilitated 20 transactions with a total value of $1 million. Two-thirds of those transactions involved companies within the region. Examples included a major food products importer and wholesaler in Hungary, who was introduced to several Bulgarian confectionery companies through GTN and now is purchasing from them on an on-going basis. Companies in Bosnia and Croatia have traded food items and related products such as packaging materials. Other sectors in which GTN/SEE facilitated transactions include consulting, information technology, construction, and the environment. In FY 2003, results improved further, with 87 transactions completed with a total value of about $2.5 million. It is anticipated that the supply chain services being offered via GTN in 2004 will have a positive impact on the manufacturing and agriculture sectors.

Partners for Financial Stability

Partners for Financial stability (PFS) focuses on promoting financial sector development through short-term, demand-driven activities closely coordinated with U.S. Embassy priorities. PFS assistance addresses the international standards required by today's competitive global marketplace, as well as helping EU candidate countries in CEE to meet the financial sector criteria for accession. Old age security and fiscal consolidation are still major policy issues throughout the region, and a high level of interest has been expressed in pension and insurance reform assistance. In bank supervision, PFS has continued to deliver regional training and technical assistance directly to senior managers of CEE bank regulatory authorities.

Since the passage of the Patriot Act's anti-terrorism financial measures and in reaction to the collapse of Enron and subsequent events, country counterparts throughout CEE have expressed strong interest in increased training and technical assistance to address a variety of financial crime, money laundering, and corporate governance issues. In collaboration with the U.S. Treasury and the Securities and Exchange Commission, as well as leading private sector financial institutions, PFS has provided regional training seminars and bilateral technical assistance projects in the CEE region to help meet these needs. During FY 2003, 50 projects were conducted under the PFS program: 21 regional training seminars, 23 technical assistance projects, and 6 grants.

Highlights of Regional Training Activities

- During 2003, the PFS Program continued supporting regional activities to combat financial crimes and money laundering. PFS organized a study tour on prevention of money laundering for the Money Laundering Information Bureau of Estonia, the Financial Intelligence Unit of Latvia, and the Financial Crime Investigation Service of Lithuania. Study tour participants visited a number of institutions in the U.S., including the Financial Crimes Enforcement Network (FinCEN), U.S. Department of the Treasury, and the U.S. Securities and Exchange Commission (SEC), as well as prosecutors and judges, providing participants with theoretical and practical insights into U.S laws and the workings of U.S. financial intelligence gathering agencies. In addition, in cooperation with the Ministry of Justice in Poland, PFS conducted a regional workshop on prevention of money laundering. Prosecutors, judges, and other law enforcement officials from Poland, Slovakia, Slovenia, the U.S., and the United Kingdom participated and presented case studies on a range of issues and experiences in combating money laundering in order to identify best practices.

- In cooperation with the Association of Latvian Commercial Banks, PFS conducted a seminar on compliance with the Patriot Act. Participants included 72 from Latvia, 10 from Estonia, and 10 from Lithuania. Prevention of money laundering specialists from the UK and the U.S. shared their expertise and the experiences of UK and U.S. banks in complying with this act and other prevention of money laundering legislation.

- During 2003, the PFS program also organized and co-financed groundbreaking research on a variety of capital markets issues, including corporate governance, corporate social responsibility (CSR), investor relations, and socially responsible investments. The research

enabled the PFS program to provide subsequent training on those topics, thus responding to the current specific needs of financial intermediaries, listed companies, securities regulators, and Self-Regulatory Organizations (SROs).

- In 2003, the PFS program continued to support the National Bank of Poland's regional Training Initiative in Bank Supervision (TIBS), which allows Poland to share its considerable bank supervision expertise with other European and Eurasian countries in order accelerate the implementation the Basel Core Principles of Bank Supervision. During the last year, TIBS conducted three additional week-long seminars on various aspects of bank supervision, risk management, and best practices. Over 60 bank supervision professionals from 20 countries participated.

- Finally, The PFS program, in close cooperation with the OECD, continued providing valuable support to the International Network of Pension Regulators and Supervisors (INPRS). The Network's aim is to serve as a forum for policy dialogue and co-operation on regulatory, supervisory, and financial issues related to pensions. In 2003, PFS presented the results of a final report on Investment Strategies for Pension Funds in CEE countries at a meeting of the INPRS and trained some 250 participants on pension regulation issues.

A summary of the 50 regional training and technical assistance projects conducted in FY 2003 through PFS, listed by subject matter, appears in the following chart:

Subject Matter	**# Regional Seminars[1]**	**# Participants Trained[2]**	**# Technical Assistance Projects**	**# Grants**
Pensions & Insurance	5	305	9	1
Corporate Governance	4	0	0	3
Accounting & Audit	5	208	4	0
Banking	1	47	5	2
Capital Markets Development	2	363	5	0
Financial Crimes & Anti-Money Laundering	2	0	0	0
General Financial Sector Development	2	0	0	0
TOTAL	21	923	23	6

[1]On a select basis, PFS sponsors participation by senior financial sector officials in training courses conducted by non-PFS organizations; and such courses are included herein.

[2]Please note that this figure does not include participants trained through bilateral technical assistance programs.

SEAF Trans-Balkan Equity Fund

The SEAF Trans-Balkan Equity Fund (TBEF) was formed in July 2000, by the Small Enterprise Assistance Funds (SEAF) and five other investors: IFC, Norfund, Black Sea Trade & Development Bank, SECO (Swiss State Secretariat), and the Finnfund. As a regional fund, the TBEF provides investment capital to SMEs in Balkan countries, usually in the form of equity and supplemented by technical assistance and business development support. TBEF's primary approach is to purchase equity shares in both new and existing SEAF-managed Country Funds in the region. The Country Funds make direct investments in a broad range of sectors, with a special emphasis on export and growth-oriented SMEs and entrepreneurs. TBEF is now established in Bulgaria, Croatia, and

Romania, with plans to expand to other countries of the region, such as Albania and Bosnia.

TBEF's management is provided jointly by SEAF, a Washington-based non-profit organization, and its offices in Bulgaria, Croatia, the Netherlands, and Romania. The TBEF is capitalized at $21,825,000. Of this amount, $6 million is for the Trans-Balkan Croatia Fund (including the merged SEAF Croatia Fund), $5 million for the Trans-Balkan Bulgaria Fund, and $8 million for the Trans-Balkan Romania Fund. The remaining $2,825,000 was left for future investment directly in Albania and Bosnia. As of September 30, 2003, TBEF had invested a total of $21,825,000 in 31 companies. The total European Venture capital Association (EVCA) valuation as of September 30, 2003 was $12,912,666. USAID's commitment of $6 million ($4 million for capital and $2 million for technical assistance) has now been obligated in full, but as of September 30, 2003, $2,358,255 had not yet been expended by SEAF. USAID's original three-year program has been extended for two years, through July 2005.

TBEF has invested in diverse business sectors, such as school/office products, wine producing, food distribution, supermarkets, electronics, telecommunications, energy, pharmaceuticals, cable TV, and the production and distribution of medical diagnostic products. The Fund has a strong pipeline of investment deals and has made progress toward investing in Albania and Bosnia. In its efforts to expand its activities to Serbia, SEAF is in currently raising capital for a new stand-alone Serbia fund. In addition to supporting individual SMEs, the Fund has established an important development model by providing guidance for the private sector in the following areas: 1) refining investment instruments and methodologies for use by other SME investors; 2) mobilizing loan capital through co-financing with local banks; 3) developing the equity capital market; 4) formalizing business operations within the SME sector; and, 5) providing examples to entrepreneurs and investors of successful private enterprises.

Europe Regional HIV/AIDS Initiative: Baltic Sea Initiative/Network of Excellence

Through the Baltic Sea Network of Excellence (NOE), USAID aims to strengthen NGO efforts to prevent the spread of HIV/AIDS and to facilitate greater collaboration at the national and regional levels in Estonia, Latvia, Lithuania, and St. Petersburg and Kaliningrad, Russia. In FY 2003, an enumeration exercise was completed to help public health officials better understand the potential size of hard-to-reach, vulnerable populations and better target HIV/AIDS interventions in the region. Fifteen small grants were awarded to three governmental and 12 non-governmental organizations in the Baltic States. In Estonia, two peer education and prevention efforts targeted youth, reaching 2,100 youth aged 13-19 in 132 interactive workshops. One intervention targeted young women involved in sex work and other risky behaviors, and two interventions targeted the improvement of life of people living with HIV/AIDS, including those in Estonian correctional facilities. In Latvia and Estonia, training was held to strengthen voluntary counseling and test the capacity of more than 35 specialists. Another grant was used to support the Lithuanian AIDS Center with a region-wide knowledge management system (KMS). The KMS will now serve as a focal point to link HIV/AIDS epidemiological and health promotional information in each country and allow for the documentation and sharing of regional best practices. An international donor group was formed, and small grants assisted in community-level advocacy efforts to support governments with strategic planning, implementation, programming, and monitoring. This initiative also piloted several innovative projects testing new approaches that could later be replicated by host-country counterparts, i.e., HIV voluntary counseling and testing, prevention of maternal to child transmission of HIV/AIDS, and programming for TB/HIV interaction.

Europe Regional HIV/AIDS Initiative: Southeastern Europe - RiskNet

RiskNet, initiated with joint support from USAID and UNFPA, seeks to reduce HIV/AIDS and Sexually Transmitted Infections (STI) among high-risk groups in Bosnia, Bulgaria, Croatia, Macedonia, Romania, and Serbia. RiskNet strengthens the capacity of local NGOs in the region to design and implement effective HIV/STI prevention interventions and promote sexual health through an innovative "gatekeeper" approach that targets people who have influence over and access to

high-risk groups. In FY 2003, USAID-funded efforts led to the implementation of six social marketing trainings with 20 NGOs to improve HIV/AIDS implementation capacity. On average, a 25 percent increase was observed in total outreach activities conducted with high-risk, vulnerable groups per NGO included in the RiskNet network. HIV/AIDS interventions included establishment of drop-in and mobile centers for outreach, as well as provision of vouchers to high-risk groups to access local health facilities for testing and treatment. The regional RiskNet network organizes technical workshops and produces a newsletter to share lessons learned across borders. This support has inspired NGOs in-country also to share lessons learned nationally with Global Fund implementation partners and other NGOs. Within Macedonia, for example, seven NGOs now work with 34 "gatekeepers" to reach about 1,000 new and existing clients per month with HIV/AIDS prevention, counseling, and outreach services. Regional efforts across borders have led to the collection of invaluable ethnographic research, which will now be used to guide future programming. All NGOs that are a part of this regional network use similar implementation strategies. These strategies were designed and continue to be improved upon by the partner NGOs at each regional workshop. The effect is reinforcement of HIV/AIDS prevention efforts across borders and throughout the region.

Global Fund to Fight AIDS, Tuberculosis, and Malaria

The Global Fund was established in January 2002, as a financial instrument to complement existing donor programs addressing HIV/AIDS, tuberculosis, and malaria worldwide. The Global Fund's purpose is to attract, manage, and disburse additional resources through public-private partnerships. Several countries in the region have already applied for funding, and have been awarded first-year grants to begin implementation of comprehensive responses. In 2003, using SEED regional funds, technical assistance was provided to Macedonia and Estonia respectively for their applications to the Global Fund. The grant applications were approved for $6.3 million and $10.3 million over five years respectively. USAID/Europe & Eurasia also provided $52,000 to support a regional workshop for all round one and two recipients of Global Fund monies. The workshop prepared a preliminary assessment of the recipients' future technical needs and helped to draft the countries' implementation plans.

Advances in TB Control in the Eurasia Region/Regional TB Evaluation

In 1998, USAID established its first TB control pilot project in the Eurasia region in Almaty, Kazakhstan. By 2003, USAID investments had expanded to include TB control activities in 14 countries across the Europe and Eurasia region, in an effort to assist host governments to effectively and efficiently control TB through implementation of the Directly Observed Treatment, Short-course (DOTS) strategy.

A recent evaluation assessed the impact of USAID'S five-year investment in assistance to TB programs in six countries and one province: Estonia, Kazakhstan, Kosovo, Latvia, Russia, Ukraine, and Uzbekistan. The evaluation results indicated that DOTS has been expanded and performance has been improved, political support for TB control based on the DOTS strategy has increased in all countries, and progress has been made in the management of Multi Drug resistant TB (MDR-TB). Other results of USAID activities include: 1) standardizing TB treatment regimens and increasing the use of sputum smear microscopy in the diagnosis of TB; 2) In Kosovo, DOTS coverage has reached nearly 100 percent, and treatment success has surpassed the WHO target of 85 percent; and 3) in Latvia, where an international MDR-TB electronic surveillance system has been developed and clinical capacity has been built for the management of MDR-TB, acquired MDR-TB has decreased from 54 to 28 percent.

Iodine Deficiency Disorder

Iodine deficiency disorder (IDD) is the world's leading cause of preventable mental retardation. Populations with even modest IDD show reductions in children's IQs of 10-15 percent. Largely through the efforts of UNICEF, Kiwanis, and USAID, 70 percent of the world's people now have access to iodized salt, but in the Europe and Eurasia (E&E) region, only about 28 percent of

households use iodized salt. Since FY 2000, USAID has invested $3.9 million in IDD programs in E&E, and the investment is paying off. For example, in FY 2003, Macedonia became the first E&E country to announce the elimination of IDD as a public health problem, demonstrating that IDD can be eliminated in the region.

Reproductive, Maternal and Child Health in Eastern Europe and Eurasia: A Comparative Report

USAID's E&E Bureau provided support to the Division of Reproductive Health at the Centers for Disease Control and Prevention and ORC/Macro International to prepare a comparative report of data from 16 health surveys conducted in 12 countries in Eastern Europe and Eurasia. The report, *Reproductive, Maternal and Child Health in Eastern Europe and Eurasia: A Comparative Report,* was the first of its kind at USAID and was completed in 2003. The CEE countries studies weretheCzech Republic and Romania. The surveys asked a series of questions of women of reproductive age, producing vital information on the following: fertility rates, abortion rates, contraceptive prevalence, knowledge of HIV/AIDS, percentages of babies breastfed, anemia rates, infant mortality rates, sexual knowledge and behavior of young adults, and extent of intimate partner violence. The data included evidence that in areas with greater prevalence of modern contraceptive method use, abortion was less common. The report provides essential information to policy makers and will influence future programming in family planning, reproductive/maternal health, and child survival.

Women's Wellness Centers

USAID has supported the development of nearly 30 Women's Wellness Centers (WWCs) in countries of the Former Soviet Union and CEE. The centers in the CEE include one each in Albania and Romania, with two new centers being developed through a current project in Kosovo. Each WWC utilizes a client-centered approach and serves women from adolescence through old age. These centers provide a comprehensive array of ambulatory clinical and education services, encompassing primary care, reproductive health, screening and early detection of disease, prevention services, and health promotion. In Tirana, Albania, the work of the WWC to improve the quality of cervical cancer screening and to foster use of screening as a disease reduction strategy has been especially notable.

USAID TB Program – Kosovo

In 2001, through a bilateral program funded with regional SEED funds and managed from Washington, USAID began support to Doctors of the World for implementation of the WHO DOTS strategy in Kosovo. USAID provided assistance for strengthening the TB laboratory system through the purchase of lab equipment and consumables and the implementation of a comprehensive training program for key staff, including pulmonary physicians, family practice doctors, patronage nurses, and health educators. In addition, USAID has supported extensive TB education efforts aimed at patients and a community-wide TB information, education, and communication campaign, using the mass media. Furthermore, USAID has promoted the development of a computer-based TB data recording and reporting system routinely to monitor and evaluate treatment outcomes at the national and district levels. Finally, USAID has supported the expansion of TB program activities beyond the majority Kosovar population into the Serbian and Roma minority areas, training Serbian TB doctors and nurses, general practitioners, and laboratory technicians.

USAID's program has contributed to substantial improvement in human and infrastructure capacity to implement DOTS, as well as to significant improvements in program performance, including: 1) standardization of anti-tuberculosis regimens according to the WHO protocol; 2) development and installation of a computer-based registry in all sites and subsequent entering of 100 percent of new patients into this registry; 3) laboratory quality control performance of nearly 100 percent agreement, and 4) despite extremely difficult circumstances, Kosovo has achieved 100 percent DOTS coverage, and treatment success rates have reached WHO's recommended target of 85 percent. The above-

mentioned activities have contributed to a decline in TB cases in Kosovo from more than 1,600 in 2001 to about 1,400 in 2002.

Romania Laboratory Strengthening and Drug Management Activities

Support to WHO/Euro TB Program for laboratory strengthening activities has led to the development of national laboratory quality control guidelines in Romania. Support to MSH/Rational Pharmaceutical Management Plus Project provided assistance for an assessment of TB drug procurement and distribution practices, which led to implementation of a training course for TB specialists based on the results of this assessment. All this has been done by USAID under a Washington-managed bilateral program funded with regional SEED funds.

Strategic Technical Assistance for Results with Training (START)

In FY 2003, the Strategic Technical Assistance for Results with Training (START) program trained 5,913 participants from government, non-government, and private sectors from Albania, Bosnia, Bulgaria, Croatia, Macedonia, and Romania. Of these, 2,947 were women (50 percent). Over three-quarters of the training took place in-country (4,545), with the remainder in the U.S. or in third countries. This year has also seen the development of long-term in-country training activities, involving a series of interventions - workshops, follow-up, and other activities.

The Small Grants program was offered in four countries, with 40 grants awarded and a total of $216,970 disbursed. The training and supporting local organizations to become training providers continued, through the Third Country Training Program and through the support of local organizations, to provide both training and logistical support for in-country training programs. In addition, training-of-trainers continues to be an important component of training programs. For example, this year Bosnia managed two such programs, one in tax administration and the other in solid waste management. Across the region, training to support the development of local associations continued: for example, the Croatian Journalists Association and the Association for Independent Radio Stations, and in Macedonia, the Macedonian Bankruptcy Association, the Macedonian Bar Association, and the Macedonian Judges Association.

Cross-border training programs and Third-Country Training (TCT) continued as a major catalyst for regional cooperation. Bosnia hosted a month-long summer training -- the third such program -- for university accounting professors, which included professors from Macedonia, Kosovo, and Serbia and Montenegro. Also, mayors from Bosnia and Croatia attended separate training programs in Hungary and Slovakia, on the theme of multi-ethnic governance and economic revitalization. Through the Participant Training Program, USAID supported a conference on Corridor 8, the east-west highway that will link Albania, Bulgaria, and Macedonia. Third-Country Training has expanded beyond Central Europe. Recent programs have been held in South Africa, Latin America, and Western Europe. One interesting example was a TCT program in court administration, held in Austria and Slovakia, which provided Bosnian judges and senior court officials with the opportunity to exchange ideas and to establish interregional contacts with USAID-sponsored delegations from Moldova, Romania, and Ukraine.

III. Regional Program--Enterprise Funds

The Enterprise Fund program was originally authorized by Congress through the Support for East European Democracy (SEED) Act of 1989. That Act established the Funds as unique "public-private partnerships" for the purpose of investing U.S. Government (USG) funds to support the private sector and nascent market economies of Poland and Hungary. Subsequent Foreign Appropriations Acts extended the authorization to establish Funds in other Central and Eastern European countries, i.e. Albania, the Baltic States, Bulgaria, Romania, and Slovakia.

Financial Status of U.S. Government-backed CEE Funds as of September 30, 2003:

Fund	**Funds Authorized**	**Funds Obligated**	**Funds Expended**
Enterprise Funds			
The Polish-American Enterprise Fund (PAEF)	$262.5m	$254.5m	$254.5m
Hungarian-American Enterprise Fund (HAEF)	$72.5m	$72.5m	$72.5m
Czech-Slovak-American Ent. Fund (CSAEF)	$65m	$65m	$52.8m
Bulgarian-American Enterprise Fund (BAEF)	$58.25m	$57.85m	$57.85m
Baltic-American Enterprise Fund (BalAEF)	$50m	$50m	$50m
Romania-American Enterprise Fund (RAEF)	$61m	$61m	$61m
Albanian-American Enterprise Fund (AAEF)	$30m	$30m	$21.1m
Total	**$599.25m**	**590.85m**	**$569.76m**

Each Enterprise Fund operates as an independent, autonomous organization, managed by a Board of Directors, with the USG maintaining oversight responsibility for the operations of the Funds. This model was specifically designed so that the Funds could deliver assistance as rapidly as possible, with enough flexibility to develop programs and use a variety of investment approaches to address specific conditions in each country.

USAID's Bureau for Europe and Eurasia (E&E) is responsible for managing all Enterprise Fund activities, with oversight from the Department of State's Office of the Coordinator for U.S. Assistance to Europe and Eurasia ("the Coordinator"). Since their formation in 1990, the Enterprise Funds have created and saved thousands of jobs, transformed industry sectors, increased the levels of business experience and corporate governance, and have been an important U.S. foreign policy success.

The majority of the Funds have now privatized their management companies in order to attract new private investment capital and provide future incentives for their employees. In addition to their efforts in making equity investments and long-term loans to small and medium-sized businesses, the Funds have introduced home mortgage lending, mortgage securitization, credit cards, pension funds, mezzanine financing, leasing, and investment banking. These initiatives are a testament to the positive reputation that the Funds' management teams have earned. Moreover, each Fund has become a resource to which other investors can turn for information on the business climate in the countries of operation. A brief summary of each Fund follows.

ALBANIAN-AMERICAN ENTERPRISE FUND (AAEF)

Established in 1995, the Albanian-American Enterprise Fund (AAEF) was capitalized with a $30.0 million USAID grant. Since then, the Fund’s investments have been a stimulus to the Albanian economy by providing growth and export-oriented small and medium-sized enterprises (SMEs) with access to equity, loans, and leases.

As of the end of FY 2003, the AAEF had made significant strides in consolidating and strengthening its portfolio. Having disposed of most of its problem investments, the Fund has entered a growth track with its existing investments. In addition, new opportunities for investment are emerging in Albania. These developments bode well for the future of the AAEF.

The AAEF has achieved steady progress in enhancing its overall management and the professional skills of the staff. Detailed financial reports are standard and include a debt risk rating and review system that is designed to identify early signs of credit deterioration and to address solutions. Each of the Fund's investment officers has undergone intensive training with established European venture capital firms as part of the overall training program.

Over the last year, the Fund has exited profitably from a number of real estate investments. Brief details on some of these investments follow. Teqja, a manufacturer of PVC and polyethylene plastic pipe, grew quite successfully in 2003, and is one of the leading suppliers plastic pipe in Albania. Investment by AAEF has allowed the company to procure its products in a more energy-efficient and environmentally friendly manner. It recently won a number of contracts to supply plastic pipe. Albania Fiberoptic Backbone has encountered some issues with the local telecommunication company regarding the installation of its network and is working with resolve these issues in short order. AAEF has invested significantly in Global Gaz, a wholesale and retail distributor of liquid propane gas (LPG). This investment has allowed the company to import a greater volume of a more environmentally sound energy source for Albanians.

The American Bank of Albania (ABA) remains the Fund's largest investment. The ABA has become one of the most important financial institutions in Albania, and is regularly consulted on legislative and regulatory issues affecting the banking industry. At the end of December 2003, the ABA had $250 million in deposits and $65 million in loans outstanding. Unaudited pre-tax profit for the first nine months of 2003 reached $8.6 million, as compared to $3.1 million during the same period in 2002. The ABA now has 193 skilled employees and operates branches in Tirana, Durres, Vlore, Fier, Elbasan, Rinas Airport, and the U.S. Embassy. The bank offers traditional services and has pioneered many new products. This includes an innovative web banking product that allows Albanian expatriates to send remittances to relatives in Albania more effectively and transparently.

As of September 30, 2003, USAID had obligated $30.0 million to the Fund. From AAEF's inception to that date, the Board had approved 54 investments worth over $35 million, disbursed 53 investments worth over $30.6 million, and had four investments worth $4.7 million under review. The Fund has divested six investments worth $3.1 million and received 20 loan repayments of closed investments worth nearly $5.0 million.

The Albanian economy has remained relatively steady, with healthy growth estimated by the IMF at 6 percent and a projected inflation rate of 2-4 percent per annum for 2003. The balance of payments deficit is expected to increase to $25 million for FY 2003. The *lek* has appreciated moderately against the dollar. The most serious threats to sustained economic growth revolve around water and energy shortages, and the impact they have on domestic production. The political situation has remained relatively stable. Security remains an issue, as well as corruption and the rule of law.

BALTIC-AMERICAN ENTERPRISE FUND (BalAEF)

Since beginning operations in 1995, the $50.0 million Baltic-American Enterprise Fund (BalAEF) has become a reliable financial partner for growth-oriented private companies, entrepreneurs, and new homeowners throughout Estonia, Latvia, and Lithuania. In this role, the BalAEF is attracting additional capitalization from commercial sources, thereby leveraging the Fund's positive impact on the Baltic region.

As of March 31, 2003, the Fund had $130 million in investments approved and $125 million in investments disbursed. These figures represent 17 equities, 127 business loans, and over 400

mortgages. The portfolio has thus far returned $73 million in investment income and principal payments that have been re-invested.

In accordance with the build-out of the Fund's business lines, BalAEF has established Baltic-American Mortgage Holdings and Hanseatic Capital (both Delaware LLCs), with respective subsidiaries in the Baltic countries. Since the last Semi-Annual Review in June 2003, the Fund has made significant progress in its mortgage and finance operations. The Fund continues to expand its activities against a backdrop of positive GDP growth in the Baltic region. Highlights are as follows:

Mortgage Operations as of June 30, 2003:

- Baltic-American Mortgage Holdings has established subsidiaries in Estonia and Latvia.
- Total external funding for the mortgage program raised to date exceeds $80 million.
- Credit quality is strong, with total delinquencies over 30 days at 1.6 percent.
- Loan production has continued to grow; recent monthly loan approvals are averaging $5 million
- Portfolio growth is consistent, with $55 million and about 3,500 loans outstanding.
- A $50 million line of credit was arranged for the mortgage program through the International Finance Corporation (IFC). A total of $9.8 million of external financing has been drawn down to date.
- Through the Latvijas Unibanka line of credit for the mortgage program, $20 million of external financing has been drawn down to date, and the bank recently approved a $5 million increase to this facility.
- A new €8.5 million line of credit was established with Nord LB in Lithuania to expand mortgage lending there.
- The Fund now services $5.2 million in mortgage portfolio holdings it originated and sold to Latvijas Unibanka.
- Work toward portfolio securitization with Wachovia securities is ongoing, and Moodys' Investor Services reviewed the mortgage portfolio in preparation for securitization.
- Loan demographics cover a broad range of borrowers acquiring property, renovating/improving property, or unlocking home equity to improve liquidity.

Commercial Financial Operations:

- The Fund established Hanseatic Capital to provide subordinated debt and equity products to small and midsized companies operating in the Baltic countries.
- Hanseatic Capital has established a subsidiary in Estonia and is forming one in Latvia.
- Hanseatic has equity of $7.5 million committed from the Fund, subordinated debt of $7.5 million from IFC, and senior debt of $5 million from Hansabank of Estonia.
- The investment focus is on companies with strong management teams that can service debt and are capable of growth.
- New investments in the paint manufacturing, printing, and health care industries were approved for $2.6 million in commitments.

Real Estate:

In 2003, the Fund decided to phase out commercial real estate investment activities, which enables management to focus its complete attention on the growth of Baltic-American Mortgage Holdings and Hanseatic capital, both of which have succeeded in attracting external capital.

BULGARIAN-AMERICAN ENTERPRISE FUND

The Bulgarian-American Enterprise Fund (BAEF), which has received $57.8 million in funding, has actively invested in Bulgaria since 1992. As of June 30, 2003, the Fund had placed $72.1 million in 905 investments. Total reflows since inception are $39.5 million.

The Fund has benefited from an improved operating environment since 1992. Although the country's continuing transition has been uneven and at times turbulent, Bulgaria had made great strides toward building democratic political institutions, establishing the rule of law, and converting its economy from state-owned and politically directed to a market dominated by privately owned businesses. While its capital base of $57.8 million is miniscule compared to the total economy, the Fund has made a significant contribution to Bulgaria's progress. Since 1992, it has:

- Successfully exited the Rodina Pension Fund, Lebed Hotel, Europa Bioscience, Fest Office Building, and sold the last four units of the Exinovgrad Townhouse complex.

- Grown its investment in the Bulgarian American Credit Bank (BACB), its 100 percent-owned subsidiary, which has been recognized as Bulgaria's largest long-term lender, with a loan portfolio exceeding €80.8 million. As of June 30, 2003, BACB's assets were in excess of €89 million, with full-service banking branches in five major cities. The BACB has built a base of $7.2 million in deposits from local individuals and institutions. Its full-service retail bank has attracted $12.9 million. The BACB has also secured short-term interbank lines of about $15.7 million with 13 local banks. They have issued a $3 million unsecured bond and received loans from DEG and the Black Sea Trade and Development Bank.

- Created the country's first and largest Hotel Lending Program, providing financing to more than 150 hotels throughout the country. BAEF and its wholly owned subsidiary, the Bulgarian American Credit Bank (BACB), have been recognized by the Union of Private Hotel Owners for their efforts in developing Bulgarian tourism.

- Initiated Bulgaria's first Mortgage Lending Program, which provided financing of more than $29 million to more than 1,400 homeowners.

- Attracted outside financing from the European Bank for Reconstruction and Development (EBRD), IFC, and the Netherlands Development Finance Company (FMO), among others.

- Assisted in the passage of the Mortgage Bond Legislation Act and helped BACB become the first Bulgarian bank to issue mortgage bonds and have them registered with the Bulgarian Securities Commission for secondary market trading.

- Built a successful small and medium-sized enterprise (SME) lending program, financing more than 1,000 businesses through BAEF and BACB.

In addition, the Fund's Construction Lending Division has increased the number of its construction loans to 27, with $12.8 million committed.

BAEF, now in its 12th year of operation, is considering its options for phase-out. At this time, the Board of Directors has determined that the Fund's most promising legacy remains the BACB. The Fund has been actively reducing its exposure to equity investments and transferring many BAEF loans to the BACB.

CZECH-SLOVAK AMERICAN ENTERPRISE FUND (CSAEF)

The Czech and Slovak-American Enterprise Fund (CSAEF) was established in 1991 and capitalized with a $65.0 million USAID grant. CSAEF was set up to offer financing and management assistance to private enterprises in the Czech and Slovak Federal Republic (CSFR). The Fund helped privatize former state-owned enterprises, assisted with joint venture projects, and advised Western firms interested in investing in the CSFR. The forms of investment included loans, equity leases, and guarantees. Following the CSFR's dissolution on January 1, 1993, the CSAEF Board of Directors created two separate subsidiary Funds through which to pursue its objectives: the Czech-American

Enterprise Fund (CAEF) and the Slovak-American Enterprise Fund (SAEF). In 1996, the Board of Directors decided to discontinue the Fund's activities in the Czech Republic, the office in Prague was closed, and the investment portfolio was sold to a third party investment company. Today the Fund is active solely in the Slovak Republic.

The Fund regained momentum in 2003, taking critical actions to shore up existing investments and develop the pipeline for new investments. CSAEF is looking to make two to three quality investments over the next two years and expects to be fully invested by spring 2006. The Fund will also investigate possible mechanisms to attract additional private investment to Slovakia.

In 2003, the CSAEF committed $8.8 million to three new investments. The two most significant were the Value Growth Fund Slovakia ($5.7 million) and Gotive ($2.7 million). The Fund is a founding investor in the Value Growth Fund, along with EBRD, Raiffeisen, and locally owned Tatrabank, for a total of €14 million (about $16.8 million). This fund looks to invest in companies under restructuring and in need of finance, but with a good underlying business model. Gotive produces handheld wireless devices that uniquely integrate wireless, GPS, bar code, magnetic strip reader, and other technologies. This technology is attracting a lot of interest from the communications community, and the company is doing better than expected.

As a whole, the Fund's investment in the three wood companies began to turn the corner in 2003. Originally, the Fund planned for the sawmill (Novomanip) to supply Novo Horehronska (producers of three-layer board) and Slovlepex (wooden window scantlings). However, non-transparent pricing practices by the state-owned forestry enterprise forced these firms to look outside of Slovakia for raw timber. As a result, the companies are being managed by the Fund as individual entities. This shift in strategy has yielded positive results. The Fund also has invested in an Internet job-portal, a meat and sausage factory, and Slovakia's leading producer of chalk.

The investment climate in Slovakia turned around strongly in the last year, and significant FDI is starting to flow into the country. Economic stability, impending EU accession, relatively lower costs, highly educated labor, and a new across-the-board flat tax rate of 14 percent have brought Slovakia to the attention of many strategic investors, such as Peugeot, Johns Manville, and Whirlpool. Slovakia has experienced an increase in both the number of transactions and capital invested. However, reflecting the regional trend, the growth of new participants in the venture capital and private equity sectors has remained low. Despite these advances, issues of transparency and consistency in the judiciary continue to keep the level of risk for the foreign investor in Slovakia at a significant level.

Slovakia's accession to the EU, in May 2004, will mark the realization of one of its long-term economic and political priorities. Economically, the country experienced real growth of 4 percent, led by foreign trade. Inflation increased to 8.6 percent in 2003, largely as a result of needed price deregulation in the energy and utility sectors. Unemployment plummeted by 4 percent to end the year at 13.75 percent.

HUNGARIAN-AMERICAN ENTERPRISE FUND (HAEF)

The Hungarian-American Enterprise Fund (HAEF) is a $72.5 million investment fund fully funded by its USAID grant. The purpose of the HAEF, established in 1990, is to accelerate the development of Hungary's private commercial sector through the provision equity and loan capital, as well as technical assistance to small and medium-sized enterprises (SMEs). As of September 30, 2003, the HAEF had drawn down all $72.5 million from the grant and had invested about $130 million in Hungarian enterprises.

As of September 30, 2003, the HAEF had concluded its active investment activities and was starting the wind-down of the Fund. It is expected that this process and the sale of its investments will take about three to five years in order to ensure that the maximum return is secured. Similar to the

approach taken by the Polish-American Enterprise Fund, the HAEF will return one half of the proceeds from the sale of the Fund to the U.S. Treasury. The other half will go to establish and fund the Hungarian-American Enterprise Scholarship Fund (HAESF). The HAESF will provide yearlong, hands-on professional experiences for young Hungarians in the U.S., as well as post-graduate opportunities for senior Hungarian professionals for applied research in the U.S. This legacy of the HAEF will help to strengthen the relationship between the U.S. and future Hungarian leaders for decades to come.

While the Fund's active investment activities have concluded, it may still make investments to protect the value of the existing HAEF holdings or to meet outstanding commitments. Since it operates as a purely private equity fund, HAEF's final returns will not be known until all of the investments are liquidated. The final proceeds may be significantly more or less than the current book value. A notable example of this principle in action was the sale of Euronet Worldwide, Inc. The HAEF's $2.9 million investment in Euronet returned $21.6 million. It still holds about 120,000 shares and will keep them until market conditions improve enough to warrant their sale.

In 1997, HAEF established a parallel venture capital fund called Hungarian Equity Partners (HEP), LP. With $9.5 million of HAEF capital invested, the Fund has a 19 percent interest in HEP, while EBRD and private investors have the remaining 81 percent, with about $40.0 million invested. So far, the HEP has made nine investments costing $26.8 million.

In 1998, HAEF established the Hungarian Innovative Technology Fund (HITF) as a subsidiary specializing in financing smaller, high-tech start-up companies with global market potential. HITF was capitalized by HAEF at $5 million. HITF has four investments in the areas of computer software and biotechnology.

POLISH-AMERICAN ENTERPRISE FUND (PAEF)

The Polish-American Enterprise Fund (PAEF) originally received $262 million from the USG. The Fund officially began liquidation in 1999, and in keeping with the agreement with the U.S. Congress, it has returned $120 million to the Treasury and provided $120 million to launch the Polish-American Freedom Foundation (PAFF). Any Subsequent reflows from the PAEF were to be given to the PAFF. Currently, the PAEF has handed over $200 million to the Foundation, and it expects this amount to increase to $235 million when the remaining assets are liquidated.

The PAEF, which has privatized as Polish Enterprise Investors (EI), is now raising its fifth private investment fund for €300 million. When closed, this fund will bring the total of private funds raised by EI to over $1 billion. The EBRD has agreed to invest in 20 percent of the new fund ($60 million), and the majority of the funds will be invested in the Polish economy. The micro-enterprise bank Fundusz Mikro (FM), established by the PAEF as a for-profit foundation, is a successful group lending institution. FM operates 27 branches and employs a total of 90 people. The average loan is $2,500, and to date FM has made over 57,000 loans (30,000 micro loans), and disbursed over $100 million, with a loan loss ratio of 1.5 percent. FM is moving away from its group lending model and now promotes more individual programs, such as the partnership model, working with local banks (average interest rate is 18 percent). The issue of how to incorporate FM, a for-profit company into the PAFF, a non-profit foundation, remains unresolved.

The PAFF, in contrast to the business-related institutions created by the PAEF, is a not-for-profit entity. It makes grants to and exerts its influence through the Polish NGO sector. Since its inception in 1999, the PAFF has made over 50 grants, 20 of which are still active. The grants, which have an average life of 17 months, have totaled over $9 million, and range in size from $245,000 to $700,000 (average $250,000). PAFF's activities now involve 20 programs in four thematic fields: Initiatives in Education; Support for Local Communities; Citizens in a Democratic State of Law; and Sharing the Polish Experience in Transformation.

ROMANIAN-AMERICAN ENTERPRISE FUND

The Romanian-American Enterprise Fund (RAEF) was established in September 1994. USAID initially capitalized the RAEF with a $50.0 million grant and later added $11.0 million, bringing total obligations to $61.0 million. As of July 31, 2003, the cost of the investment portfolio was $47.16 million, and the Fund's net worth stood at $34.65 million. The Fund's various investment programs are as follows:

Major Transaction Program (MTP):

For the year ending September 30, 2003, the Fund's major investment portfolio had been experiencing some improvement. There has been no change in the negative investment situations with four companies under liquidation. The services sector is improving (better than manufacturing), and the financials are doing well. In November 2003, Banca Romaneasca (76 percent owned by RAEF) was sold to the National Bank of Greece for a cash gain of $10 million. Many of the other equity investments showed zero percent IRRs (Internal Rate of Return). However, the Fund regards these percentages as very conservative and has suggested that their investments, particularly in the financial services sector, manufacturing, and services are going up in value, and expects that in one year, with increased valuations, the IRRs will be more positive.Investments in the MTP 11-company portfolio for the most part remain in poor shape.

Small Loan Program (RO-AM):

Following a management decision in 2001, the Small Loan Program was sold to Banca Romaneasca. Any remaining RO-AM loans not sold to the bank will be maintained by the RAEF. The money received from the investments sold is being recycled into other RAEF programs. Operational between 1997 and 2001, the Small Loan Program disbursed 239 loans in the amount of $13.2 million.

Micro-Loan Program (MLP):

The MLP program, which has been operational since 1996, has demonstrated the capacity to provide financial services that assist the micro-enterprise sector with well-tested methodology. The MLP has improved its operation and procedures and has reached the best quality of loans since the program's inception. In 2001, the MLP became self-sustainable -- revenues covered program expenses, and the program started to earn a profit. CAPA (see below) and OMRO are self-sustainable, and CHF covers its operational expenses from USAID grants. The MLP has made almost 3,900 loans, helped create 6,883 jobs (3,211 for women, and sustained another 21,583 jobs (10,205 for women).

Funding for the MLP is mainly provided by RAEF from its own funds and from attracted sources. Total disbursed by the MLP since its inception is $20.73 million. The three MLP operations are:

- Project RAEF-CAPA (1996), operates in Cluj, Craiova, Iasi, and Constanta. Total disbursed since inception: $15.63 million; outstanding portfolio, $3.38 million; and portfolio at risk, 2.21 percent.

- Project RAEF-CHF (1998), operates in Timisoara, Arad, Deva, and Resita. Total disbursed since inception: $3.61 million; outstanding portfolio, $.660 million; and portfolio at risk, 0.77 percent.

- Project RAEF-OMRO (1999), operates in Targu Mures and Bistrita. Total disbursed since inception: $1.48 million; outstanding portfolio $.400 million; and portfolio at risk, 4.86 percent.

Investment banking:

The RAEF is pioneering the lucrative investment banking field and has developed a corporate finance strategy of offering solutions for foreign investors who are interested in Romanian assets. In the energy field, the Fund is providing merger and acquisition services as a part of various consortia, including firms such as Credit Suisse First Boston, Rothschild, and Deloitte and Touche. It also has provided financial servies to ABB Romania and Banca Romaneasca.

Home Mortgages:

The new mortgage company, re-named Domenia Credit, opened on September 18, 2003, and is positioning itself for both growth and securitization. With initial funding support from USAID/Romania and the Development Credit Authority (DCA), the company now has $5 million in equity ($1 million IFC), and loan agreements are being negotiated with DEG, EBRD (each negotiating secondary purchases of 20 percent in equity), and IFC. Loan funds from international financial institutions of $16 million plus $7 million from Raiffeisen Bank bring the total of debt funds available for the mortgage operation to $23 million.

Domenia Credit currently has 165 loans outstanding, valued at $2.24 million, and total commitments in excess of $23 million. Average home loan value is $16,000, principally in apartments; buyers are young people in Bucharest. Domenia Credit is studying the opening of new offices in Cluj and Timisoara, with others to follow. The new company expects to break even in the second quarter of 2004.

Energy Efficiency Fund (EEF):

The EEF is registered as an LLC under the name Romanian Engery Efficiency Company NV (RIEEC), with RAEF as the sole shareholder. The RIEEC plans to develop an Energy Services Company in Romania and will seek other partners. Currently, five prospective co-generation projects are developing across several industries. It is expected that regulatory issues will be of immediate concern, and RAEF is working closely with USAID to seek solutions to them.

III. Regional Program--Southern European Cooperative Initiative (SECI)

REGIONAL RULE OF LAW PROGRAMS UNDER THE SOUTHEAST EUROPEAN COOPERATIVE INITIATIVE (SECI)

There are two major SEED-funded projects that pursue a regional, cooperative approach to rule of law and border reform in SEE -- the Regional Center to Combat Trans-border Crime, located in Bucharest, Romania, and the Trade and Transport Facilitation in Southeast Europe (TTFSE) program. Both were originally developed under the umbrella of SECI, the Southeast European Cooperative Initiative that was launched with U.S. support in December 1996 to facilitate regional peace and stability through cooperative activities among the countries of Southeastern Europe (SEE) and to lay the foundation for their integration into the rest of Europe. SECI has provided a mechanism for these countries -- Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Greece, Hungary, Macedonia, Moldova, Romania, Slovenia, Turkey and, most recently, Serbia and Montenegro -- to cooperate on a regional basis to solve trans-national problems

The priority focus of the Regional Anti-Crime Center in Bucharest is fighting cross-border crime, while the TTFSE program, which is a cooperative program implemented through the World Bank, supports infrastructure development, customs reform, and trade facilitation in SEE. In FY 2003, these two programs received an allocation of $5.875 million from the SEED regional and bilateral budgets. Of that, $2.945 million was drawn from the SEED country budgets of six states (Albania, Bulgaria, Croatia, Macedonia, and Montenegro and Serbia) and the SEED regional budget and was devoted to technical assistance in support of the SECI/World Bank program in the customs reform and trade facilitation areas in SEE. An additional $600,000 from the SEED Regional budget was transferred to the Department of State, Bureau of Educational and Cultural Affairs, to administer a multi-year grant for Serbia and Montenegro for the training and trade facilitation component of the TTFSE project. The Vienna-based Coordinator for both SECI and Stability Pact, who receives administrative support from the OSCE, received $110,000 in SEED funds for administrative and travel expenses.

REGIONAL ANTI-CRIME PROGRAMS

Under regional programs related to the SECI initiative, $1.835 million in FY 2003 SEED funds was devoted to activities fighting cross-border crime in SEE.

Regional Center for Combating Trans-border Crime (SECI Center): Twelve SECI states are parties to an agreement to share information to combat trans-border crime, under which they established the Regional Center for Combating Transborder Crime in Bucharest, Romania, also known as the SECI Center.

The SECI Center functions as a regional focal point for the communication and transmission of "real time" law enforcement information on cross-border crime. It is staffed by 20 liaison officers (police and customs officers) from 12 states in SEE, working closely with law enforcement experts from most of the countries of Western Europe, Russia, Poland, Georgia, Ukraine, Azerbaijan, the U.S., and others. Liaison officers exchange law enforcement information related to trans-border crime in the region, and also lead and coordinate operational task forces in the field. The Center's four primary task forces target narcotics, commercial fraud, trafficking in persons, and terrorism (which consists of financial crime, small arms trafficking, and WMD), and include, *inter alia*, experts from international organizations, supporting states, and the region. In 2003, the task forces organized numerous regional operations involving cooperation and coordination among the law enforcement agencies of the member countries. Recent operations have targeted trafficking in persons, narcotics smuggling, and stolen cars. "Operation Mirage," for example, targeted trafficking in persons and sought to identify and repatriate trafficked women and identify and investigate criminal groups involved in trafficking. The Operation involved 12 states and, over a two-week period in September 2003, checked over 11,000 persons throughout the region, identifying 696 victims of trafficking and 831 traffickers. Criminal procedures were brought in 499 cases and 194 arrests were made.

For 2003-2004, FY 2003 SEED funds totaling $435,000 are being transferred to the SECI Center to support the anti-crime activities of the following task forces:

- $100,000 to support the task force on trafficking in human beings, to include additional iterations of Operation Mirage;
- $150,000 to support the task force on narcotics and its operational activities; and
- $185,000 for the task force on combating terrorism and financial crime.

An additional $125,000 was also budgeted to support the administrative, communications, and public affairs activities of the Center.

In FY 2003, $600,000 in FY 2003 SEED funds was used to fund the assignment of an expert to the Center from the Department of Justice, Office of Overseas Prosecutorial Development, Assistance and Training (DOJ/OPDAT). The DOJ expert will provide guidance on several matters related to assisting the Center in cementing its legal protocols, developing rules of information exchange such as Mutual Legal Assistance Treaties, advising on the implementation of a regional prosecutorial working group, as well a witness/victim protection program. U.S. Law Enforcement agencies also dedicated $300,000 to technical assistance to the Center in FY 2003-04.

Combating Global Terrorism

On September 14, 2001, the Joint Coordinating Committee (JCC) of the Bucharest Regional Anti-Crime Center unanimously adopted the Bucharest Declaration on the Suppression of Terrorism. The Declaration is meant to encourage the exchange of information among SECI participating states on criminal organizations that are closely tied to terrorism, including information on the financial resources and support of these groups. The Government of Turkey is serving as the project coordinator on this matter and has consolidated several task forces (Small Arms, WMD, and Financial Crime) under its umbrella. The task force is planning an operation for 2004 to target suspicious transactions.

Judicial and Prosecutorial Cooperation

FY 2003 SEED funds totaling $375,000 were devoted to initiating two regional working groups to further advance U.S. interests in SEE in the rule-of-law area. A total of $125,000 went to support the organization of the South East European Prosecutors' Advisory Group (SEEPAG), which brings together prosecutors from the SECI states to facilitate the prosecution of criminals in trans-border cases involving multiple states. The U.S. dedicated $250,000 to the creation of a Model Law Initiative, to be led by Slovenia, that will create a forum for the development of model laws with sufficiently defined elements and penalties to enhance the prosecution of sophisticated transnational crimes -- such as drug smuggling, human trafficking and money laundering -- in SEE. While the states of the region often have well-developed penal codes addressing domestic crimes, laws dealing with offenses associated with organized crime and other forms of trans-national crime mostly are either underdeveloped or nonexistent.

TRADE AND TRANSPORT FACILITATION IN SOUTHEAST EUROPE PROGRAM (TTFSE)

This program addresses the need to achieve quicker, cheaper cross-border transit of goods in the region, while also fighting smuggling and corruption at border stations. Long delays in transiting international borders are considered a serious obstacle to trade and economic development. The five key elements of this assistance effort promoting comprehensive institutional reforms are: 1) physical infrastructure improvement; 2) trade facilitation training and related activities; 3) customs information management systems; 4) customs training; and 5) anti-corruption programs.

III. Regional Program--Southern European Cooperative Initiative (SECI)

The Trade and Transport Facilitation in Southeast Europe (TTFSE) project has been a multi-year, joint effort of the World Bank, the U.S., and European counterparts. The U.S. and select European governments are providing technical assistance to participating countries to reform their customs services and facilitate trade in the region. U.S. funds are leveraged against about $80 million in World Bank loans to the region for the physical improvement of border crossing facilities in the six participating countries.

The U.S. invested $3.545 million of FY 2003 SEED funds in TTFSE. Of that amount, the Department of Homeland Security's Bureau of Customs and Border Protection (CBP) has received $2.945 million to provide technical assistance to customs reform projects in Albania, Bulgaria, Croatia, Macedonia, Montenegro, Serbia, and Romania, in support of the World Bank project. Border advisory teams in Bulgaria, Croatia, Macedonia, and Romania are working with host border services, customs, police, and national security agencies to address requirements of the TTFSE project. Work being performed includes developing workload, productivity, and performance indicators; creating performance monitoring systems; establishing Port Pilot sites and testing new procedures; enhancing cooperation among border control agencies; training prosecutors and magistrates in customs laws and procedures; and assistance to develop legal and regulatory amendments to customs codes, where needed.

For TTFSE to be effective, those directly engaged in cross-border transit activities must know the relevant laws, regulations, and practices. The Department of State's Bureau of Educational and Cultural Affairs is implementing a trade facilitation component of the project, led by a consortium of three regional educational institutions (Bulgarian, Greek, and Turkish) and consisting of a joint training program for public and private sector personnel from throughout SEE. SEED funds totaling $600,000 were allocated for this project in 2003, to provide for the participation of Serbia and Montenegro in the multi-year program.

III. Regional Program--Stability Pact for South Eastern Europe

The Stability Pact is an important component of U.S. cooperation with the European Union (EU) to promote peace and stability in Southeastern Europe (SEE) and to further integrate the region into European and trans-Atlantic institutions. Since it was launched in the summer of 1999, the Pact has served as an important vehicle for fostering regional cooperation, and as a mechanism for coordinating international assistance and for encouraging continued Western European focus on the region. Since the Pact's inception, more than $6 billion in assistance has been provided to the region, over 90 percent of which was pledged by European countries.

The Pact's activities are organized under three Working Tables: Table I – Democratization and Human Rights; Table II – Economics, Investment, and Infrastructure Development; and Table III – Security, Law Enforcement, Anti-corruption, Organized Crime, and Trafficking in Persons.

Several USG Agencies implement programs that contribute directly or indirectly to the objectives of one or more Stability Pact initiatives. In FY 2003, while only about $7 million from the SEED Regional Budget was allocated in direct support of Stability Pact initiatives, much more was contributed from the individual SEED-country budgets and through the AID-administered regional budget. SEED-funded programs that contributed directly to Stability Pact activities focused on the following main areas: Working Table I (local democracy and cross-border cooperation, media, reconciliation, and education); Working Table II (Sava River initiative, energy, infrastructure, trade cooperation, improvement in investment climate, and e-commerce); and Working Table III (combating trafficking in persons, the fight against organized crime and corruption, and disaster prevention and preparedness). Virtually all Stability Pact programs are supported by multiple donors, with the U.S. often playing a minor role.

Working Table I: Democracy and Human Rights

Through USG assistance activities both within and outside the Stability Pact framework, the U.S. has carried out many programs to help promote democracy in SEE. The four priorities under Working Table I are local democracy and cross-border cooperation, support for free media, parliamentary cooperation, and education and youth.

Local Democracy: In FY 2003, SEED support for Table I focused on developing cross-border cooperation with local governments and civil society in critical border areas, with special focus on border security, visa regimes, trafficking, and economic development. SEED has supported the development of a network of women parliamentary leaders, who will share experience and skills. Further details on SEED support to the Media and Education and Youth Task Forces follow below:

Media: Through its assistance to the Media Task Force, the U.S. has helped bring media legislation and implementation in line with international standards, and has contributed to regional co-production programs in news and public affairs. The U.S. has supported production of over 30 hours of quality TV documentary productions on issues such as corruption and ethnic reconciliation. In addition, U.S. funding has strengthened domestic media watchdog organizations.

Education and Youth: The Education and Youth Task Force, a platform of almost 40 members (experts, representatives of countries, NGOs, and associations from different countries), deals with six priority areas for education reform: policy development and system improvement, higher education, vocational education and training, young people, education for democratic citizenship and management of diversity, and history and history teaching. With funding from the U.S. and other European donors, the Center for Democracy and Reconciliation organized a series of four workshops for young leaders from different ethnic and religious groups to help the participants understand the meaning of civic participation and the rights and responsibilities of citizens in a democracy, by devising their own inter-ethnic civic projects. In FY 2003, the Joint History Teaching project continued, providing updated History Teaching Packets on Balkan History translated into 10

languages, as well as workshops for primary and secondary school teachers using the new materials. Through the School Connectivity Project, 15 secondary schools throughout the U.S. have been connected via Internet to about 80 schools in SEE states. Teachers and students can increase their understanding of shared history, citizenship, and tolerance through the use of technology and collaborative Internet communication, creating shared projects with peers in other countries. In addition, through the Stability Pact, SEED provided funding to enable governments of Balkan countries to open up their heretofore-secret historical archives to scholars and historians.

Working Table II: Economic Reconstruction and Development

The main priorities under Working Table II are trade liberalization and facilitation, fostering private investment, and regional infrastructure and environment (including e-commerce). SEED funds have been used to directly support all of these.

Trade Facilitation: The Commercial Law and Development Program (CLDP) of the Department of Commerce ($2.1 million) has been instrumental in helping SEE countries to cooperate to reduce barriers to trade and investment, while building mechanisms necessary for increased international and regional trade and investment. Its work has contributed significantly to the development of a regional network of 21 Free Trade Agreements (FTA), which will enlarge the regional market to 55 million consumers, creating better conditions for private investment and economic growth and facilitating the longer-term integration of the SEE countries into EU structures. In FY 2003, CLDP continued its technical assistance to ensure implementation of the FTA's, conformation with WTO rules, and work toward elimination of non-tariff barriers. CLDP also trained officials in drafting regulations and provided judicial training to ensure that laws and regulations are enforced. The CLDP added training for customs officials and worked with ministry representatives on conformation to international standards and certifications. CLDP continued its work with local American Chambers of Commerce to focus on how AmChams can better represent their members with their respective governments. Through CLDP, a technical expert was provided to help the government of Bosnia-Herzegovina with its WTO accession process.

The Investment Compact: The U.S. has supported the implementation of the Stability Pact's Investment Compact for Reform, Investment, Integrity, and Growth. The Investment Compact's (IC) objective is to lay the economic and structural policy foundations for sustained growth and development in SEE. The Investment Compact has continued its targeted strategy of calling on the countries of the region to commit to a number of specific policy actions that will result in an improved investment climate within a limited period of time. The peer review and the monitoring mechanism built into the Investment Compact have been instrumental in keeping SEE governments focused on the necessary economic reforms. The development of local Foreign Investors Councils has strengthened private sector involvement in the reform process and has brought constructive, practical advice. The first Regional Network of Foreign Investors Councils was held in Belgrade, in December 2003. Romania has taken the role of co-chair of the Investment Compact, a first step in gaining more active buy-in from the region. In addition, the IC is planning increased cooperation with Stability Pact Working Groups on Trade and on Anti-Corruption.

E-SEE: The E-Southeast Europe (E-SEE) initiative's main objective is to promote the development of an information society in the region and help governments to harmonize laws and policies in areas such as telecommunications, Internet regulation, and e-commerce. Through CLDP, FY 2003 SEED funds were used to help the SEE countries develop common policies on the Information Society.

Infrastructure: USAID provided valued assistance in the infrastructure field under its Energy and Regional Infrastructure projects. Please see the AID chapter for additional details.

Sava River: Using SEED funds, the U.S. provided critical legal and technical expertise and secretariat support, through the Stability Pact, to the Sava River riparian states to create a framework for negotiating and concluding an International Framework Agreement to reopen

navigation and protect the environment and natural resources of the Sava River Basin. Representatives of the four countries (Slovenia, Bosnia-Herzegovina, Croatia, and Serbia and Montenegro) are pursuing the ratification process to establish the International Sava River Commission, which will provide a process for reopening navigation, establishing sustainable water management and disaster prevention (floods, spills, drought, etc.).

Working Table III (Security and Defense/Justice and Home Affairs)

Initiatives under Working Table III are divided into two sub-tables: "Security and Defense" and "Justice and Home Affairs." SEED funds have been used to help implement initiatives under each of these sub-tables.

Security and Defense

The U.S. priorities under this sub-table relate primarily to the reduction of surplus small arms/light weapons in the region and disaster preparedness and prevention. During FY 2003, the U.S. provided $500,000 (of the total $1.68 million committed by other donor states) toward the development of an incinerator project to destroy almost 12,000 tons of small arms ammunition in Albania. In addition, the U.S. provided $100,000 to fund a public awareness campaign in the region to encourage the return of weapons in private hands. Under the Small Arms-Light Weapons (SALW) Initiative, the Stability Pact has succeeded in collecting almost 303,000 weapons and destroying more than 585,000 weapons throughout the region, through mid-2003.

Disaster Preparedness and Prevention: SEE is prone to natural disasters that transcend borders or overwhelm the capacity of a single country to cope. As the level of preparedness to deal with these threats varies from country to country and regional cooperation does not exist to the extent needed, the Stability Pact's Disaster Preparedness and Prevention Initiative (DPPI) provides a framework for developing regional cooperation. In concert with contributions from the governments of Switzerland and Norway, the U.S. provided $300,000 in SEED funds in FY 2003 to fund the operations of a two-person expert DPPI Secretariat and support a number of specific projects. A Joint Fire-Fighting Unit (JFFU) is being established to include BiH, Croatia, and Serbia and Montenegro to develop rapid, cross-border procedures to facilitate a joint response capability in case of emergency. In 2003, a Joint Fire-Fighting Management Team and eight Fire-Fighting Teams were trained and preparations were made to purchase interoperable fire-fighting equipment for the JFFU. The DPPI also conducted 14 training events and seven management courses in support of its Disaster Management Training Project for Southeastern Europe. It also has developed an effective consultative and coordination mechanism in fostering regional disaster preparedness and prevention.

Justice and Home Affairs

The U.S. is pursuing three main priorities under this sub-table: the fight against organized crime and corruption, migration and asylum (including trafficking in persons), and law enforcement/institution building. FY 2003 SEED funds have been used to support implementation of initiatives under the first two priority areas.

Organized Crime: The Stability Pact Initiative to fight Organized Crime (SPOC) was designed to strengthen regional capacities to combat organized crime, in accordance with internationally recognized standards. The Initiative focuses on adopting policies, strategies and legislation; developing multi-disciplinary, inter-agency co-ordination mechanisms; encouraging the establishment of specialized units; and enhancing regional and international co-operation. In FY 2003, the U.S. provided $70,000 in SEED funds to support the organization and operation of the SPOC Secretariat, which is co-located in Bucharest, Romania, with the Regional Center to Combat Trans-border Crime, a Southeast European Cooperative Initiative (SECI) initiative. In addition to creating awareness of the SPOC through public relations, the SPOC Secretariat is tasked with

advancing the development of legislation in the region aimed at facilitating witness protection and allowing for the processing and protection of personal data for law enforcement investigations.

Anti-Corruption: The Stability Pact's Anti-Corruption Initiative (SPAI) is based on four principles of action to develop institutional mechanisms and lay the foundations for the sustained fight against corruption in SEE: country ownership, regional cooperation, civil society involvement, and international coordination. Since the Iniative's inception, there has been significant progress. All countries in the region have signed the SPAI Anti-Corruption Compact, committing to specific actions to fight corruption, including working closely with civil society on reform. All countries have appointed Senior Representatives to oversee implementation of the Compact and have developed National Action Plans to combat corruption. In FY 2003, the U.S. committed $500,000 in SEED funds to support country-specific anti-corruption projects and the relocation of the SPAI Secretariat Office to the region. At its September 2003 meeting, the SPAI Steering Group approved the establishment of the SPAI Regional Secretariat Liaison Office (RSLO) in Sarajevo, under the sponsorship of the Bosnian Government. The RSLO will gradually assume the secretariat functions provided by the OECD and Council of Europe, thus fostering the U.S. priority of promoting regional ownership and leadership of this initiative.

Trafficking in Persons Task Force: Led by an Austrian expert, the Stability Pact's Task Force on Trafficking in Persons has prepared a multi-year strategy to promote international coordination and avoid duplication of efforts, identify sustainable solutions, and focus activities on the most urgent aspects of the trafficking problem in SEE. Countries of the region, with help from the Task Force, have taken major steps toward developing anti-trafficking policies. All have set up national working groups, nominated governmental coordinators, developed National Plans of Action, and approved an initiative to grant legal status and temporary residence to trafficking victims to aid in the prosecution of traffickers. In FY 2003, the U.S. provided $400,000 in SEED funds for projects (training, legislative reform, safe houses) to spur the development of anti-trafficking policies in the region.

Migration, Asylum, Refugees Return Initiative: The Migration, Asylum, Refugees Regional Initiative (MARRI) seeks to achieve a solution to the issue of population movements in the Western Balkans by promoting closer regional cooperation and a comprehensive, integrated, and coherent approach to the related issues of asylum, migration, border management, visa policies, and refugee return and settlement.

Under its Program of Action, the MARRI is developing a number of projects aimed at reaching lasting solutions to the problems of displacement in the Western Balkans. The proposed projects cover areas such as regional dialogue on migration/ asylum/refugees; capacity building and training with a regional and integrated focus; information exchange and better access to documentation; targeted cooperation among source, transit, and destination countries to reduce irregular migration; data exchange; housing; and closure of collective centers related to refugee return and settlement. A major strategic objective is to focus more on issues of freedom of movement, citizenship, and non-discriminatory access to rights.

The U.S. has contributed a total of $160,000 to the MARRI in FY 2002/2003 funds for support for a regional information exchange and for workshops on refugee and asylum issues.