Zentrum für Europäische Integrationsforschung
Center for European Integration Studies
Rheinische Friedrich Wilhelms-Universität Bonn

Gennady M. Fedorov

Kaliningrad
Alternatives Today

Discussion Paper

C 80
2000

Prof. Dr. Gennady M. Fedorov, born in 1949, is the Head of the Department of Economic Geography of the Kaliningrad State University since 1982. From 1994-1998 he was the Rector of this university. He directed many programs on social and economic development of the Kaliningrad region. Fedorov contributed to the international Tacis-Projects "Improvement of economic education in the Kaliningrad State University", 1996-1998 and "Support to a global development plan for the Kaliningrad oblast", 1997-1998. He co-operates inter alia with Kiel and Munich Universities, Bundesinstitut für wissenschaftliche und internationale Studien (BIOst) in Cologne, and the Institut für Länderkunde in Leipzig. In August 1999 he was Senior Fellow at the Center for European Integration Studies (ZEI), Bonn.

Among his recent publications we find: Wirtschaftsentwicklung des Gebiets Kaliningrad und eine Konzeption der regionalen Entwicklung. In: Die Entwicklung der Region Königsberg/Kaliningrad. München, 1997; The Social and Economic Development of Kaliningrad. In: P. Joenniemi and J. Prawitz (eds.): Kaliningrad: The European Amber Region, Aldershot, 1998.

Gennady M. Fedorov

Kaliningrad Alternatives Today

"Kaliningrad Alternatives" has been published about four years ago.[1] The authors talked about good possibilities for the Kaliningrad Region to develop its economy playing as "a bridge between East and West" (it was a cliché for the future role of Kaliningrad in the Russian economy). It was then thought to be of importance to have a regional strategy of economic development based on the balance of federal, regional and international interests, and that this strategy as well as a program of the regional development should be federal. Kaliningrad region has a federal law about a special economic zone (SEZ) in the region and a federal Program of the SEZ development, too. But, unfortunately, the region did not have a strategy of its development. Like before, there is a problem about the future of the regional economy. What happened to this law and the program? How is it possible to maintain that there is no acceptable regional strategy?

The development of the Kaliningrad region at the beginning of the 1990´s was under a strong influence of the Free Economic Zone (FEZ) concept. There were three sources of this concept: federal, regional and international interests.

Interests at the federal level were introduced by free enterprises zones ideas, which stand for the most market developed regions in the non-market Russian economy. An expert from St. Petersburg, Khodachek

1 Fedorov, G./Zverev, Yu: Kaliningradskie alternative. Kaliningrad: Kaliningradskij gosudarstvennyj universitet, 1995. See also: Fjodorow, G.: Wahrscheinliche Perspektiven der politischen und sozioökonomischen Entwicklung des Gebietes Kaliningrad: Die Wahl der Strategie der regionalen Entwicklung. In: E. Müller-Hermann (ed.): Königsberg/ Kaliningrad unter europäischen Perspektiven. Bremen, 1994. pp. 31-40; Zverev, Yu.: Rußlands Gebiet Kaliningrad im neuen geopolitischen Koordinatenfeld. In: Berichte des Bundesinstituts für ostwissenschaftliche Studien, Nr. 6,1996.

introduced this idea for Kaliningrad for the first time in 1988 (during the special research “Expertise of the directions of the economic development of the Kaliningrad Region” for the Scientific-technical association). But he only dealt with local special economic zones Yantarny – Primorsk and Pionersky – Zelenogradsk at the Baltic sea coast.

Christian was probably the first one to introduce the whole Kaliningrad region as a special zone. He spoke about a joint Russian-German special industrial zone "K" (both Kaliningrad and Königsberg).[2]

At last "the fathers" of the free economic zone, Matotchkin and Barinov, worked out a concept a of a special economic zone "Kaliningrad" in 1989. In 1990 Matotchkin became a deputy of the Supreme Soviet of the Russian Soviet Federative Socialist Republic (RSFSR) with this idea. He could include the Region in the list of six Russian regions, which have got a status of the free enterprise zones by Decree of the President of the Supreme Soviet of the RSFSR in the end of 1990. But, in fact, it was only a political declaration. A practical step was an enactment of the Ministry of the Russian Federation at the end of 1991. The Kaliningrad region became a status of the Free Economic Zone “Jantar” (“Amber”).

In 1992 Yu Matotchkin became the governor of the region and he tried to put the concept of a free economic zone into practice. But there were many difficulties in the realization of this concept. It was only an enactment of the Ministry (not law) on the FEZ “Amber”. There was a large instability with FEZ-rules, because there was not (and still isn`t) a decree about FEZ in Russia.

2 Christians, F. Wilhelm: Wege nach Russland. Hamburg, 1990. p.180.

The federal law "On the Special economic zone in the Kaliningrad oblast" was signed by the President of Russia in 22.01.1996. This law itself is a compromise between different political groups (including communists) in the State Duma of the Russian Federation. Therefore it is called "on the special (not free) zone". And there is no law about free economic zones in Russia at all, though the first project has already been prepared in 1991. The situation in the region with FEZ-rules instability is very complicated just as it was before.

The FEZ (SEZ) envelopes practically all territory of the Kaliningrad region (without military objects and sea oilfields). It is a free customs zone in fact. The tax privileges for investors are too insignificant.

These are some components of this concept, which should be taken into account:

- The taxes stimulation of the influx of the foreign investments and new technologies.
- The stimulation of the export-oriented and import-substitution production.
- The mechanism of the free customs zone as a method of stimulation (see pp.1, 2).
- The federal support for the region.

The Kaliningrad region has got all of these privileges only partially. The realization of the FEZ-concept was inconsequent. That is why it is impossible to know exactly if FEZ is a good strategy for the region or not.

Almost all economic and social statistic dates are very poorly recopilated. The decrease of the real economic sector here is higher than in whole Russia. Only the industrial downfall of 1/5 Russian regions is the more of than in Kaliningrad region. According to some estimations the investment serious potential of the Kaliningrad region in 1998 turned out to be lower than in 1995-1996. In the rating of 89 Russian regions, Kaliningrad's position dropped from the 27th to the 41th place.[3]

What has happened to the idea of a Free Economic Zone and the attempt to put it into practice? Which regional development strategy is being carried out now? Will the concept of a free area as the main line of the regional development revive in its former scale, though in new conditions?

There are a lot of publications about the small (15.1 thousand km²; 951 000 population in 1999) Kaliningrad region in Russia and abroad. There are a lot of conceptions for the Kaliningrad development. What development plan could be acceptable for the Kaliningrad exclave?

It is very difficult to give a good recommendation because the regional conditions are becoming more and more complicated. Firstly, the regional economic potential is now lower than is was before. Secondly, the bureaucracy is too powerful and market relations have not yet been developed. Thirdly, the border countries - Poland and Lithuania - are going to join the EU. Moreover, Poland is in the NATO and Lithuania has a desire to join it too. Russian authorities as well as Kaliningradian Administration are not taking these facts into account. Additional discrepancies have been brightened by the Kosovo crisis.

Vardomsky, Vorobjeva and Ershov wrote about the future of Kaliningrad in 1995: "It is doubtful that Kaliningrad could be 'Hong-Kong in the Baltic Sea' in the short-term perspective. It could be 'Baltic Gibraltar' (or, worse, Port Arthur) more likely."[4] My opinion was quite opposite just a year ago. I supposed Kaliningrad could not be a military fortress in the future. It would be a centre of economic and cultural integration in the Baltic Sea. I have not yet changed my mind. But I think about it with less confidence.

In this respect it is nowadays a common feature to decide about all the Baltic Sea security problems. Russian military presence in Kaliningrad is

3 Expert, No. 39, 1998. p.26.

4 Vardomsky, L./Vorobjeva, L./Ershov, A.: Kaliningradskaja oblast Rossijskoj Federatsii: Problemy i perspectivy. In: Nauchnye doklady Moskovskogo Karnegi Tsentra, vypusk 5. Moskva: Carnegie Endowment for International Peace, 1995. p. 49.

discussed very thoroughly in foreign publications.[5] The key point of these discussions is usually the view about a too large concentration of armed forces in Kaliningrad. Russian objections state this to be merely Russian internal affairs, that armed forces are not large, and that NATO expansion to the East is threatening Russian security. It was after the Kosovo crisis that the idea of strengthening the Kaliningrad special defence region arose. Thus, this question is very difficult and needs special consideration. The question of principle is the renewal of the co-operation between Russia and NATO.

The solution of the defence problem in the Baltic Sea region is very important for the economic development of the Kaliningrad Region. It is the only way that leads to new possibilities of the international connection and regional development. I will still view the problems of the Kaliningrad region development by presuming that these discrepancies are only temporary and they will be overcome in the short future. Other variants are not possible since they contradict the interests of all Baltic countries.

It is crucial to maintain the different interests in the territory of the region in balanced: national, regional and local ones, as well as those of overseas partners.[6] This balance is extremely important for the Kaliningrad region, being an exclave and at the same time remaining an integral part of the Russian economic space and bound to join the Baltic economic space (thus the world's economy). Otherwise the region might find itself on the periphery of both Russian and foreign interests, its economic potential would be limited by the regional market, and the economy, instead of the expected recovery, would plunge into deeper stagnation.

A basis of the most perspective position is the analysis of mutual interests, of the cooperation in the Baltic Sea region. Kaliningrad is a key-point of this interest versatility. Many interests, including Russian and foreign (It

5 See for example: Kaliningrad: The European Amber Region. Aldershot, 1998; 21st Century Challenges for the Baltic Sea Region and European Security. Helsinki: The Finnish Committee for European Security, 1998; Die Entwicklung der Region Königsberg/Kaliningrad. München, 1997.

6 See: Fedorov, G./Kornejevets, V.: Multilevel Interests for the Development of the Kaliningrad region as an Enclave Territory of Russia. In: Vision and Strategies around the Baltic Sea 2010, IOR, Schrift 17. Dresden, 1996. pp.45-47; Fedorov G./Zverev Yu./Kornejevets V.: The Russian Exclave at the Baltic Sea. Kaliningrad,1997.

can be considered a melting pot of Polish, Lithuanian, German, Swedish and other Baltic countries, EU, NATO, Nordic countries), Russian federal and Kaliningrad regional interests. There are interests of different Russian, foreign and join corporations and enterprises. It is necessary to take into account the opinion of the Kaliningradian population, which is not homogeneous.

The whole Russian interests have a priority. It is quite natural just as the federal legislation determinates most important processes in the regions in general and in the Kaliningrad exclave especially. Examples of these are the border and customs rules or the location of military objects. The federal investments are very significant of course. Unfortunately there is not a clear federal policy on the Kaliningrad Region (as well as the other regions too). The East-West Institute estimation for example is following: “The federal centres do not have yet a single approach to the decision of the fundamental questions of the Kaliningrad region development.”[7] Only one thing is not doubtful: That the Kaliningrad Region is a legal part of Russia.

Kaliningrad is classified in the budget process as a depressive region. It must get subsidies from the federal budget. The free (special) economic zone is not considered as an instrument of the regional development stimulation but it is a way to help Kaliningrad as a depressive region first of all. According to the East-West Institute estimation the region received an indirect financial support of 2.5 billion USD in 1996-1998 thanks to customs privileges.

The ministry of the RF has to enact the federal program of the SEZ development of 1998-2005. Such a program was enacted in 1997. It provides investments (2.3 billion USD pro 8 years, incl. 1.1 billion USD of federal investments) of the infrastructure and industry. Unfortunately Kaliningrad has obtained these funds only partially.

Foreign investments are very low in Kaliningrad. There are a lot of joint ventures and foreign firms: about 1,300 are registered and more than 300 are reported in the official statistics. But foreign direct investments made

7 Special Economic Zone (SEZ) in the Kaliningrad Region: pro and contra. East-West Institute, July 1999. See: http//www.iews.org.

less than 70 million USD in 1993-1998, i.e. only 50,000 USD pro firm. The majority of firms works in services.

Kaliningrad Region has 0.65% of the Russian population, but only 0,5% of foreign direct investments coming to Russia. But since 50% of these are concentrated in Moscow, investments per head in Kaliningrad are higher than in other Russian regions (without Moscow) average. This exceeding comprises only 25% and it is not a big achievement. Foreign investments bring only 5-10% of all (very small) investments to Kaliningrad Region.

Poland, Lithuania and Germany are the three most important partners for Kaliningrad. They occupy the three first places in the list of Kaliningradian trade partners. They had 56% of the Kaliningrad Region export and 59% of import in January-September of 1998: Poland had 33% and 19%, Germany 16% and 26%, Lithuania 7% and 15%, simultaneously. Germany occupies the first place in foreign investments (1/3 of all foreign investments in 1993-1998), but Polish investments compose only 1% and Lithuanian 1%, too (Sweden 12%, Israel 9%, France 7%, Norway 4%).

Cooperation with Lithuania is very important for Kaliningrad because all connections between the region and the Russian mainland are crossing through this country. There is a project to organize a new way through Poland to pass by Lithuania in order to get over this transit monopoly. Another project is to activate the water-connection with St. Petersburg.

Poland and Lithuania are competitors in the Kaliningrad market. Poland was more active in the beginning of the 1990´s. Lithuania came to Kaliningrad later on. But its food-transports press Polish goods, construction gangs (about 2,000 worker) built a lot of objects in Kaliningrad, 200 Lithuanian-Russian joint-ventures are registered in Kaliningrad now (there are 400 Polish-Russian, 250 German-Russian firms).

Germany is very active in Kaliningrad in the economic as well as in social and cultural spheres. In the beginning of the 1990´s there was even an unrealized project of German autonomy for "Russian" Germans in the Kaliningrad Region. Only 2,000 Germans lived in the Kaliningrad Region at the time, but it was a question of tens and hundreds thousands "Russian"-

Germans from the East who were able to arrive to the possible Autonomy. This proposal was turned down. But every inhabitant of the Russia and former Soviet Union has the right to move to Kaliningrad for a residence. More than 5,000 Germans are living in the Kaliningrad Region nowadays, about 1,000 people are coming every year. Some of the Siberian or Kazakhstan arrivals emigrate to Germany later on (600-700 a year).

In the end of 1990 Kaliningrad was opened for foreign citizens. It was the beginning a of nostalgic tourism from Germany. About 100,000 German tourists came to Kaliningrad in 1994. Then their number decreased to 25,000 in 1998. Only 6,000 tourists came from other countries that year, including 3,000 from Poland.

In 1993 the German-Russian House was opened as a German cultural centre in Kaliningrad. The German consulate has still not been opened although Polish and Lithuanian consulates have been founded since this time. This fact has a political meaning as todays Kaliningrad oblast used to be the northern part of German East Prussia before 1945.

The following countries are also quite active in Kaliningrad: Sweden, Byelorussia, Latvia, rather less active – Great Britain, France, Switzerland, Netherlands, Belgium, Italy, Ireland, Finland, USA and others. We can see in the list of investors also such exotic places like the Virginia and Marshall Islands, Panama, Israel and Cyprus, but this is in fact Russian capital abroad. Denmark has good contacts with Kaliningrad in the social sphere – ecology, education, social security. Kaliningrad has also many partners abroad. However, they are partners mainly in trade or in the social sphere, and they are rather insignificant in industry.

Trade partners are not Kaliningrads' partners in fact, because it is mainly transit trade with mainland Russia. It is true so far that the Kaliningrad export was 458 Mio USD, import – 1,286, and the Gross regional product – only 1,390 Mio USD. Our estimation is the following: minimum ½ of export is re-export from the mainland of Russia. 9/10 of import is transporting to mainland of Russia. It is the result of FEZ-SEZ rules and probably of smuggling.[8]

Nevertheless, Kaliningrad does not seem to be a very important gateway for Russian foreign trade. The utilized capacity of its ports is only 30% (4 million tons). At the same time the ports of Lithuania, Latvia and Estonia work over 50-60 million tons of Russian consignments. The difficulties and high tariffs of transit through Lithuania are very negative for Kaliningrad. This factor is very important for more international cooperation of the Kaliningrad region if Kaliningrad desires to succeed in the Russian transit trade servicing.

In the first half of 1999 the treatment of goods decreased 20% additionally. Any specialist believes that the reason for it is the insufficient capacity of the Kaliningradian canal. It is 43.2 km long and 8.5 m deep, about 60 m in width. Ships with freight-carrying capacity over 24,000 tons cannot use the canal. There is an opinion that reconstruction of the canal (up to 9.75 m depth, 80 m in width) is the solution of the problem of the Kaliningradian port development. Unfortunately, there are no investments for reconstruction (22 million USD). In my opinion, it is not a good solution at all. The solution is cooperation with Lithuania first of all. But Russian government has chosen as a priority the port construction nearby St. Petersburg.

If the ports are not a good perspective for regional specialization, at least, what are other promising branches for the Kaliningrad economy?

Kaliningrad region has an industrial-agrarian economiy. Industry specialization is fishery, machinery, and cellulose-paper industry. Main agrarian products are milk and meat, eggs and furs. There is a development in transport (seaports), tourism and ocean science. But industry production in 1998 was only 27% of 1990, agrarian – 46% (in RF 46% and 56%), retail commodity circulation – 42%. Now investments are six times less. Therefore, it is necessary to restructure the economy to make it correspondent to the new geopolitical condition of the Region.

8 For example: 21.06.1999 a large consignment of such contraband furniture (1 Mio USD) was stopped in the Lithuanian border. Kaliningradskaja Pravda. 23.06.1999.

Is it possible to revive any old branches? There are different opinions. About 40 conceptions offer ways for a lucky future of the Kaliningrad region. We cannot discuss all of them here. It is important to determine the direction and the sources of regional development and to think of the global Russian interests in the region and their co-ordination with interests of other countries. Taking into account that Russian investments cannot be too significant as a consequence of the economic situation and other regional priorities, it is important to attract foreign investments. In this connection, it is imperative to know the preferences of foreign branches.

There are three possibilities for the branch strategy:

- Reconstruction of old branches,
- Creation of a quite new structure of economy,
- Combination of reconstruction and creation.

The examples of the first variant are the federal program of the SEZ development and conception of the sea economic development (V.V. Ivtchenko[9]). These conceptions are contrary to the new economic and geopolitical conditions of the region. Therefore, the federal program is not financed in fact. Ivtchenko's proposals now need high federal investments now and subsidies in the future (in the same way as it was in the USSR).

Biltshak and Zakharov wrote about the necessity of restructuring the regional economy.[10] But their proposals are only theoretical (about "improvement" and "perfection" without necessary economic mechanisms of investments). In fact this would mean restructuring the old branches.

The second direction has some conceptions. For example, the proposition of Kotch (Berlin) wants an agrarian development of the region.[11] Samson (Grenoble), the head of the Tacis-project "The global plan of the

9 Ivtchenko, V./Samojlova, L.: Svobodnye economicheskie zony za rubezhom i v Rossii. Kaliningrad, 1999.
10 Biltshak, V./Zakharov, V.: Regionalnaja economika. Kaliningrad, 1998. pp.239-251.
11 Kotch, L.: Räumliche Planung. Russische Version. Kaliningrad, 1993.

Kaliningrad region development",[12] proposes non-material technology and services like telecommunications, banks, trade, transport, and tourism.[13]

The proposal of Samson is very interesting and tempting but very expensive. It would take at about 22.6 billion USD in 1997-2010 (27% of gross regional product at the beginning and 33% at the end of this period). It needs the most direct foreign and Russian federal and especially private participation. Samson is right, that the mentality of Kaliningradian people is more market-oriented than in the whole of Russia and this is a good condition for the restructuring of the regional economy. But he himself notes that the difficulties of the present mentality of Kaliningrad people (and Russia at the whole) are however very considerable (we can add, that the opinion of regional and federal authority as well as of foreign politicians and businessmen is complicated in respect of the innovation, too).

It is common to work out pessimistic, optimistic and realistic scenarios now. In our opinion, the first variant could be a pessimistic scenario. It is only the improvement of the old (developed before the 1990) economic structure, the old industry which is not useful for the new geopolitical and economic-geographical conditions. The concept of Samson is very optimistic. It would be very beneficial for the region to build a quite new economy quickly, but there are no political and economic possibilities for its realization. What is more realistic (though maybe too optimistic in the Russian present political and economic situation also)?

Although it could be too optimistic, the idea consists of a combination of reconstruction and creation. Reconstruction has to be selective. Creation must be international.

It is useless to invest federal or regional resources to industry enterprises including fishery, machinery and paper industry. It is necessary only to provide good conditions for private investors. The regional law "On the locale free economic zones in the Kaliningrad Region" gives

12 This project was worked out in 1997/98. The main research institutes were the Perre Mendece University (Grenoble), the Institute of the Economic of Transition (Moscow) and the Kaliningrad State University.

13 Kaliningrad Region 2010. Draft version of the book (1999).

supplementary regional tax privileges for foreign investors. It came into force in November of 1997. Such a zone is created formally in the amber center Jantarny. But there are a lot of difficulties here, including reorganization of management. The regional administration makes an attempt to divide the amber industrial complex but its managers and workers are opposing this intention. There are of course no new investments or technologies in this situation.

There are other proposals about the federal privileges for foreign investors (off-shore zone, addition of the law about SEZ). There is an interesting proposal about Russian-European free-trade zone in the Kaliningrad region.[14] Kaliningrad regional market is opened to the west now. But the west (EU) is not opened for Kaliningrad industry. The idea is to organize a free-trade EU-Kaliningrad zone. It stands for the deeper isolation of the region from the whole-Russian market. So, the Russian-EU integration is a complicated question.

It is impossible to know exactly where the private investor will invest. Strictly speaking, in what branch will be invested in is indifferent for the region. It is much more important how much is invested. But establishment of branch priorities is still significant for the advertisement of the region abroad, for allocation of local zones, for teaching the specialists, for the distribution of privilege federal credits. What industry branches have good prospects in Kaliningrad?

Fishery decreased in its production about 4-5 times. Privatization offers possibilities for new owners to sell their ships abroad, to rent ships, to sell fish abroad (as grey economy without taxes and statistics). New owners do not need to bring fish to Kaliningrad for re-making if it is not profitable. They do not need to repair ships in Kaliningrad. The former Kaliningradian fishing complex does not exist anymore. Kaliningrad is too far away from fishing areas in the Atlantic sea, and the Russian market is less profitable than a foreign one. Fishing in the Atlantic sea was possible in Kaliningrad on a large scale only for state enterprises with enormous subsidies. So, it is

14 Ignatjev, A.: Rossijsko-Evropejskaja torgovaja zona kak strategicheskaja perspectiva razvitija Kaliningradskoj oblacti. Morskaja industrija. N3, 1998. pp.18-20.

no regional priority now. It was a mistake to break the Kaliningrad fishing corporation complex and it is very difficult to restore it.

Machinery has other difficulties. Its factories had a lot of negotiations with works in different regions of the SU, raw materials and half-finished products were supplied by them. The disintegration of the SU and the exclave position of Kaliningrad intensify difficulties of transition period. Moreover, some of the factories were military and they need a change now. Only several of the works (joint-venture) produce output.

There are two possibilities for machinery development in Kaliningrad. The first one is an assembling of machines from foreign components for the Russian market (thanks to SEZ privileges). The prerequisites of the development for other branches, if their enterprises will work thus. Unfortunately such an experiment of organising a car production (“KIA-Baltic“) was not successful, because the KIA-corporation did not invest the earlier promised billions of USD. But such attempts are in progress now. There is a new project of "BMW"-cars production. The first cars assembled in Kaliningrad are to be produced already in this year. The second possibility is a project of Russian-foreign techno park,[15] which could give possibility to use the scientific and technical potential of the region (and Russia as a whole). The orientation could be towards foreign markets and the whole-Russian market. It is an interesting project, but it needs an active economic policy of the Russian federal authority.

The problem of machinery is also a problem of conversion. The problems of conversion are very important for Kaliningrad, although the role of defence industry was not that significant in comparison with the rest of Russia. There were 19,000 employees in 10 machinery factories under the Military-Industrial Commission in 1985, i.e. 16% of the total number of employees in the regional industry (in Russia 25%).[16] Moreover, about 50% of the total production of this sector was non-military (including dual-use products).

15 Ivtchenko, V.V.: Nauchno-technicheskij potenzial Special’noj economicheskoj zony Rossii. Kaliningrad, 1998.

16 Zverev, Yu: The Kaliningrad defence industry: problems of conversion. Defence and Peace Economics, Vol.9, p. 395.

All these factories have a lot of difficulties. The military production has almost been stopped, but the Kaliningrad regional program "Conversion" (1992-1995) with 2.5 million USD investments is not realized. For example there have been 8,000 employees in 1990 in the largest Baltic shipbuilding plant "Yantar" and there are less than 2,000 of them now. They do not have enough work, they do not get payed and they are more active (after teachers) in strikes and pickets. There were 12 strikes with 2,100 strikers (8,000 man-days) in 1998, including one strike in the plant “Yantar“ (740 strikers, 3,000 man-days); the others were strikes in the sphere of education.

The well-known joint-project with the South-Korean "KIA Group" should be realized exactly in the conversion factories "Yantar" and "Kaliningradbummash" (road building engineering vehicles), and a new project about "BMW" assembling too. But these projects are not very realistic and need billions of USD investments. There are similar problems at the instrument-building plant "Kvartz" (it had 5,400 employees), at the Experimental Design Bureau "Fakel" (2,400) and other factories. They have the scientific, technical and intellectual potential and they could be interesting for international cooperation.

Paper industry has no good perspective in consequence of the competition to other Russian regions with wood resources, as the Kaliningrad region itself does not have enough raw materials for cellulose production. Ecological limitations are as well as important.

The factories of other branches can use SEZ privileges and work for the whole-Russian market. The furniture factories have organized similar production. One firm makes an attempt to produce TV-set. Still these attempts are rare.

SEZ customs regime with conditions ousting the local producers of consumer goods from the regional market. After the financial crisis of August 17, 1999 in Russia, the situation has improved for Kaliningrad producers of foodstuff; and they have increased their production. It is typical for the whole-Russian industry, which increased the production to 3% in the first half of 1999. Specialists of the Expert Institute (Moscow) think that the producers of goods have good perspectives in Russia.[17] But few chances have producers of electronics or computers. The question is about goods for the "medium layer" of the population, some are headed for import consumer goods but cannot buy them now. A limitation is the capacity of the not large regional market and insufficiency of investments.

The tourist complex has had good indexes in summer 1999, too. A lot of Russian tourists went on holidays after the financial crisis. They did not travel abroad, they prefered to stay in Russia. Moreover Kaliningrad tourist firms have very good possibilities to organize cheap bus tours to several European countries. And Kaliningrad is cheaper for foreign (mainly German) tourists.

Nobody can say what enterprise could be successful, since a great deal depends on management, and managers have not enough market experience. Nobody can know, how long the SEZ-regime in Kaliningrad will last, because laws are so inconstant in Russia. "Nothing venture, nothing gain" – it is the truth, but the risk for investors is too high in Russia, including Kaliningrad, and in Kaliningrad in addition, owing to insecure SEZ regime and transit (through Lithuania) rules.

So, the old industry production has no perspective, the new production has unstable perspective.

The situation in agriculture is very bad. The social sphere functions thanks to former potential.

Development in services is better. Commerce, tourism, banks, market infrastructure have new quality, they are more developed than in mainland Russia though less than in the west.

The last Tacis studies indicate a large development of the non-official economy in the region. The estimation of its share in the Gross regional product is more than 50% (in the whole Russia is 25-50% by different sources[18]).[19] There are a lot of forms of non-official economy: legal economy, out-of-law economy, semi-legal economy, non-legal (criminal)

17 Rossija na puti k 2000 godu. In: Woprosy economici. N2, 1998. pp.4-50.
18 Pro at Contra. Vol.4, N1. p.44.
19 Kaliningrad Region: Diagnosis of a crisis. Kaliningrad, 1998. pp.15.

economy. They all are developed in the Region to a high level, thanks to its border position, widely-distributed small and middle enterprises, and high share of services in GRP. On the one hand, this fact means that lifestandard in the region is higher than official data suggests, on the other hand it stands for a diffusion of crime into economy. This is a very negative factor, especially for foreign investors.

This means that the pre-conditions for the economic development are very complicated. Kaliningrad needs the new possibilities for its economic development. These would be co-operation with Baltic countries and EU, since the region has the greatest integration potentialities compared to other Russian regions owing to its geopolitical position.

The planned extension of the EU to Poland and then to Lithuania gives an additional dimension of the potential of the region’s geopolitical standing: the Russian exclave on the Baltic Sea is expected to become a Russian enclave within the EU; this could give a strategic advantage or contrary new difficulties to the Kaliningrad region. Kaliningrad can become a major place of communication between Russia and the EU; the objective may be to become the second one after Moscow. The use of this potential resource does not work automatically, it requires important institutional and infrastructural investments, which we are yet to identify and quantify.

It is very important that EC countries are interested in this co-operation. There are for example "the strategy of differentiated integration", "the strategy of direct neighbourhood" and "cross-border" cooperation, including "Euro-regions". It is possible to find materials of Bertelsmann Foundation: "The region of Kaliningrad, which belongs to Russia, should immediately become a geographical point of regional cooperation."[20] There are attempts to view Kaliningrad in "Northern Dimension". There is even

20 A new Ostpolitik – Strategies for a United Europe. Gütersloh, 1997. p.142/143. The authors explain that the biggest problem versus integration is the Russian military presence in the region. But the opinion of all Russian specialists is that Russian presence in the Russian region is a Russian question. It does not contradict with any international agreement. At the same time the number of military groups has impressively decreased in Kaliningrads special defensive area (“raion“).

the opinion about a possible entry of Kaliningrad into the EU as a first step of Russian integration in EU.[21]

Zänker indicates in his book "The future is in the East": "The best chance (for Europe) is a serious integration of the East with its immeasurable human and natural resources".[22] In my opinion, it should be added that best chance for the East is the intensive integration in the west with its market system, technical and financial resources. And in general: "The future is in integration." It is very important, "to use the large possibilities of the economic space from Atlantic to Vladivostok together."[23]

Kaliningrad has to do a lot for this integration. It is useful for RF, EU and Kaliningrad region itself. Therefore Kaliningrad has to be a specified pole in the growth of Russian economy – "the pole of integration".

There are a lot of possibilities to intensify the co-operation and integration processes especially in the baltic sea region.[24] Some of them are declared: "cross-border" co-operation with Poland and Lithuania, Euro-region "Baltica" (regions of Denmark, Sweden, Poland, Lithuania, Latvia, cities of Kaliningrad and Baltijsk – incidentally, the main base of the Russian-Baltic-fleet), program "Eurovision-2010" of all the Baltic countries, the Union of the Baltic cities. It is possible for the east and north part of Kaliningrad region to join the Euro-region "Neman", there are proposals about Euro-region "Saule" (it is an initiative of Latvia for the building of a motor highway Riga – Kaliningrad). Kivikary proposes: "The Southern Baltic Sea Growth Triangle."[25] Certainly SEZ-regime is precondition of cooperation too.

But Kaliningrad itself is not very interesting for foreign investors, because the regional market is very small. Polish or Baltic countries ports can use

21 Gornig, G.: Das nördliche Ostpreussen gestern und heute: eine historische und rechtliche Betrachtung. Bonn, Kulturstiftung der deutschen Vertriebenen, Bd 22.

22 Zänker, A.: Die Zukunft liegt im Osten. Wien, 1995.

23 Genscher, H.-D.: Europa – ungeteilt. In: F. Ronge (Hrsg.): Die baltischen Staaten auf den Weg in die Europäische Union.,Bonn, 1998, p.42, ZEI – Discussion Paper . Nr.1.

24 Kivikari, U.: The legacy of the Hansa. Helsinki 1996, pp.65-57, 121-155; Fedorov, G./Korneyevets, V.: The Baltic Region. Kaliningrad, 1999. pp. 190-201.

25 Kivikari, U.: The application of growth triangle as a mean of development for the Kaliningrad region. In Kivikari, U. /Lindström, M./Luito, K.: The external economic relations of the Kaliningrad region. Discussion. C 2. 1998. pp. 1-27.

advantages of the national market now and the whole EU market in the future. Even stronger isolation of Kaliningrad from the rest of the Russian market (for example through Russian-European free-trade zone or another form of association with the EU) can reduce the region to the likeness of a very small Baltic country. It will have all present difficulties of these countries (and more in consequence of less potential) without their possibilities as sovereign States.

A very difficult question is whether it is possible to integrate into the EU and at the same time stay in the Russian economic space? It is important, if possible, to provide two of these aspects of regional market. This is the only way how Kaliningrad can compete with Polish Gdansk and Lithuanian Klaipeda, Latvian Liepaja, and Ventspils, Riga. And it is the only possibility for Kaliningrad to become the bridge between the West and Russia.

SEZ is not a bad economic mechanism at all. Non-stable laws and rules are as well as typical for Russia unobligingness of their execution (in consequence of their contradistinction, of insufficient inspection, of corruption) are the things, which are really very bad. If SEZ gains the federal tax privileges for investors and the laws are stable, then this economic mechanism could be acceptable. As a variant for law stabilization there is the possibility of an international agreement between Russia and EC about economic cooperation with articles about integration in the Baltic sea region and in the Kaliningrad region especially.

There is an agreement about the partnership between the EU and Russia (signed in 1994, in force since December of 1997). The EU has a well-defined economic strategy in the sphere of the co-operation with Russia. The “Common Strategy of the European Union on Russia” (adopted by EU-council on 4 June 1999) presumes in particular, that the Union is committed to the integration of Russia into the European and world economy, and there is a question about how to create the necessary condition “for the future establishment of an EU-Russia free trade area”.[26]

26 Bulletin EU 6-1999, 1999, http//europa.eu.int..

Timmerman points out that Russia gave a very positive reply to this EU-document, which has in addition a special reference to the Kaliningrad oblast as a region of active cooperation.[27] Now it is necessary to work a detailed joint EU-Russian programme of cooperation, including a regional level. It has to be more concrete and it has to answer to new conditions.

International agreements with Russia have priority in respect to national laws. Therefore such an agreement has to stabilize the economic rules in the region and to stimulate regional development. Therefore it would be very useful to organize the high-level conference of the Baltic countries with a large political and economic agenda, including the integration question at first. A special point has to be the Kaliningrad region as a pole of Russian-EU integration. It is very important for the co-ordination of multilevel interests in the Baltic sea region.

Kaliningrad has the challenge to realize the standards of the EU for international co-operation. There is a prospect to continue this political process in the region. And as Ludger Kühnhardt formulates, the only answer to the question about the European borders is: “Europe ends there, where the borders of its readiness and ability for action are ended”.[28] But it is possible to write about the probability of the European East-expansion as well as for the Russian approach to the west via Kaliningrad.

27 Aktuelle Analysen des BIOst, Nr 31/ 1999.

28 Kühnhardt, L.: Europa auf der Suche nach einer neuen geistigen Gestalt. Bonn, 1999., pp.18-19, ZEI – Discussion Paper. No.41.

ISSN 1435-3288

ISBN 3-933307-80-5

Zentrum für Europäische Integrationsforschung
Center for European Integration Studies
Rheinische Friedrich-Wilhelms-Universität Bonn

Walter-Flex-Straße 3
D-53113 Bonn
Germany

Tel.: +49-228-73-1880
Fax: +49-228-73-1788
http://www.zei.de