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"RUSSIA AND EUROPE: PAST, PRESENT AND FUTURE"

KALININGRAD REGION OF RUSSIA  
AND THE EU ENLARGEMENT.  
ISSUES OF THE PAN EUROPEAN  
INTEGRATION

Analytic report

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The analytic report describes the federal and regional approaches to the solution of the Kaliningrad problem in the light of the EU enlargement. Well-known experts and analysts offer their opinion and give consideration to the problem.

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# **KALININGRAD REGION OF RUSSIA AND THE EU ENLARGEMENT. ISSUES OF THE PAN EUROPEAN INTEGRATION**

## **Abstracts of the analytic report**

1. Königsberg region as part of the Russian Federation was established on April 7, 1946 when lands previously belonging to Germany became Polish and Soviet as a result of the Potsdam (Berlin) conference (17 July – 2 August 1946) decisions, the region was renamed Kaliningrad in July of the same year. The inviolability of the established frontiers is confirmed by the international treaties of the USSR, including the ones signed with the Federal Republic of Germany (one of them is the treaty “2+4” signed on September 12, 1990 by the USSR, the USA, Great Britain, France and Germany). After the demise of the USSR the Russian Federation became its assignee and that is acknowledged by the world community. That is why the effect of all the treaties concluded by the USSR holds true, including the ones touching upon the issues pertaining to the Kaliningrad region.

2. During the Soviet period the Kaliningrad region developed as an ordinary administrative and territorial entity of the Russian Federation and maintained good economic and cultural links with other Russian regions. The economic development of the region was in line with the Russian average and the region had close links with the other areas of the Soviet Union. The region performed a significant role in the defense doctrine of the USSR and the Warsaw Treaty.

With the Baltic republics withdrawal from the USSR in 1991 and its further demise the development conditions of the Kaliningrad region changed significantly. The other most important changes were the collapse of the communist regimes in Eastern Europe and Russia’s transformation to a market economy and a democratic system of government, and an end to the confrontation between the East and the West. The Kaliningrad region became a

region of cooperation between the Russian Federation and the EU within the Partnership and Cooperation Agreement, between the Russian Federation and NATO within the “Partnership for Peace” programme.

Changes in the external conditions of the regional development affected the region in two ways. On the one hand, it became a Russian exclave on the Baltic; and as a result of the geographic isolation from mainland Russia, the links with the other regions of Russia became difficult to maintain. On the other hand, the possibilities for closer cooperation with foreign, first of all with European countries emerged.

3. The economic mechanism of the free and later Special Economic Zone was initiated by Russia and aimed at enhancing the openness of the economy of the Kaliningrad region. Cross-border cooperation with Poland and Lithuania has increased, and the region began participating in the projects of interregional Baltic cooperation, in the activities of the Euroregions “Baltic”, “Neman”, and “Saule”. About 1800 joint ventures and foreign enterprises have been set up in the region. They are mainly oriented to the Russian market because there have been no reciprocal moves on the part of the European Union as concerns facilitation of access of Kaliningrad goods to EU markets.

4. The EU enlargement to the East, worsening of the region’s position as a Russian exclave due to its turning into an enclave inside the EU change the conditions for cross-border cooperation and complicate the transit of goods and passengers between the Kaliningrad region and mainland Russia. There is an urgent need for special agreements between the RF and the EU on the sustainability of the Kaliningrad region.

In 2001 consultations between the Russian Federation and the EU on the issues emerging in connection with the EU enlargement were launched. The Russian party intended to complete a special agreement on Kaliningrad. Russia changed its stance slightly having expressed its readiness to sign a series of documents on Kaliningrad, addressing each set of issues separately, instead of signing one agreement. However, not a single binding agreement between Russia and the EU on Kaliningrad has been signed so far. Perhaps, this could be explained by the fact that the EU from the very beginning intended to act only within the frames of the PCA avoiding assuming additional commitments.

At the moment finding a solution to the problems that emerge for the Kaliningrad region in connection with EU enlargement takes time and a lot of effort. For instance, Russia and its western counterparts managed to some extent to come to a mutual agreement on the visa issue only in No-

vember-December 2002. But, according to most observers, a lot of joint work must be done to find the final solution to the issues of providing communications for the Kaliningrad region with mainland Russia and with foreign states, including its immediate neighbors.

5. As a result, the conditions for regional development are worsening, and the freedom of movement for the citizens of the Kaliningrad region is significantly reduced. The visa regulations for travelers to Poland and Lithuania will replace the presently existing visa-free border crossings. In accordance with the Joint Statement of the Russian Federation and the European Union on the transit between the Kaliningrad region and mainland Russia (Brussels, November 11, 2002) beginning on July 1, 2003 a Facilitated Transit Document (FTD) will be required to Russian citizens for transit between the Kaliningrad region and mainland Russia. It is assumed that the FTD will be issued when applying to the Lithuanian Consulate and on condition that the applicant meets the necessary requirements. In fact it is that same visa but named differently.

Besides, Russian citizens intending to make a single journey by train via the territory of Lithuania can be issued a Facilitated Travel Document for Railways (FTD-RW) based on the passport data provided when buying a ticket. The exact procedure for issuing the FTD-RW has not yet been determined, but as it is stated in the RF and the EU Joint Statement on Transit, the Russian authorities will not issue tickets to those Russian citizens whose transit via the territory of Lithuania raises objections on the Lithuanian part. This is virtually the very permissive transit arrangement which Russia initially strongly objected to at the negotiations with the EU.

Lithuania agreed to admit domestic passports of citizens of the Russian Federation as the basis for issuing both kinds of the FTD until December 31, 2004. After that time the FTD and FTD-RW will only be valid in the presence of the foreign passport of a citizen of the RF. That is, Kaliningrad will actually become a foreign area for other Russian citizens.

6. Thus, at present the relationships between the Russian Federation and the European Union based on the Partnership and Cooperation Agreement (1994) are going through a difficult stage of transformation determined by the changes in the political and economic situation both in Europe and the rest of the world. The most important among these changes are the EU enlargement to the East and Russia's recovery from the economic crisis.

7. Settling of political, legal and economic issues of the Kaliningrad region emerging in connection with the EU enlargement is of special im-

portance for the development of partnership relations between the Russian Federation and the European Union. Settling of these issues is a clear indication of the readiness of both parties to pass from the political statements about cooperation over to actual practical moves. Solution of occasional international and legal issues (such as the visa issue) is not only an indicator of the present state and prospects for the cooperation between Russia and the EU, but is also a prerequisite for generating conditions for the rapid economic development of the Kaliningrad region as one of the most important regions of such cooperation in the XXI century.

8. Settling of the issues of the Kaliningrad region in connection with the EU enlargement has an international dimension and presupposes the harmonization of interests of Russia (including both federal and regional ones) and the European Union (including the interests of its member-states). Consequently, the regional interests should be an integral part of both the federal (Russian) economic strategy of development and EU strategy. Moreover, both strategies should be clearly defined and well coordinated.

This is going to require joint work by experts from Russia (including specialists from Kaliningrad) and the EU. At present there is no coherent strategy relating to the role and position of the Kaliningrad region. With the aim to organize this work in the interests of the Russian Federation and the European Union it is advisable to *establish a special international analytical Center in Kaliningrad* financed jointly by Russia and the EU. The Center could be established on the basis of the Baltic Center for Advanced Studies.

9. The main constituents of the strategy of the European Union as regards the Kaliningrad region, as far as it can be judged from public statements of its political leadership, are as follows:

- The European Union considers the Kaliningrad region as an integral part of the Russian Federation; the issue of the “sovereignization” has been closed once and forever;
- As concerns politics regarding the Kaliningrad region as an entity of the Russian Federation, the European Union does not intend to deviate from the common rules and procedures established for the non-member-states;
- At the same time the European Union is ready to consider the possibility of a mutually acceptable solution to the problems concerning the viability and development of the Kaliningrad region that is turning into a Russian enclave inside the enlarging European Union;

- The European Union is interested in the further development of the partnership relations with Russia and in the establishment of the Russian-European area of free trade, in the enhancement of the cross-border cooperation on the basis of the “immediate neighborhood” concept, in the Kaliningrad region as well;
- The EU is ready to extend its assistance to Kaliningrad region within the programs of scientific and technical assistance to foreign countries implemented by the EU.

10. As concerns strategic approaches of Russia and the EU to the further development of cooperation, there are more coincident than mutually exclusive stands. It is conditioned by the interests of widening mutual cooperation and concerns various aspects of cooperation between Russia and the enlarging European Union, political, legal, economic, cultural, environmental etc.

At the same time the EU enlargement to the East determines a number of recent external and domestic issues for Russia which are first of all connected with the development of Kaliningrad region. Among them are the issues of transportation, energy, visas, Customs, a change in conditions of the cross-border cooperation of the region with Poland and Lithuania acceding the EU, etc. To solve these issues effective measures must be taken which would reflect the interests of both the Russian Federation, the European Union and its member-states. In this connection the main course is the development of Kaliningrad region as a region of cooperation between the RF and the EU with the simultaneous strengthening of the domestic base of regional development and rise of the region's role in the economy of the country, especially in servicing its foreign economic links.

11. The basic constituents of the Russian approach, that should be fixed in the Main Principles and Guidelines of the Federal Policy as regards the Kaliningrad region, are as follows:

- the sovereignty of Russia over the Kaliningrad region is beyond doubt;
- Kaliningrad region is to become a Russian pilot region of cooperation, the connecting link in the integration rapprochement of Russia and the enlarging EU. Thereupon, Russia considers the Kaliningrad region as a specific area and creates special economic conditions for it;
- the region will continue to function in accordance with the defense doctrine of the Russian Federation and to implement state objectives within Russia – NATO partnership in the Baltic sea region;

- the threat of economic and political isolation of the Kaliningrad region from the mainland Russian Federation must be completely removed, retaining the region within the Russian cultural space should be provided for;
- at the same time it is necessary to remove the possibility of strict isolation of the region from the territories of neighboring countries and to provide favorable trends for the further development of the cross-border cooperation, to develop cultural links with the countries of the Baltic sea region;
- the standards of living for the population of the region should be raised and should not be lower than the Russian average.

12. The Russian Federation gives necessary financial support to the Kaliningrad region as an exclave namely via the implementation of the Federal Special Programme “The Development of the Kaliningrad region for the period until the year 2010” which should be adjusted in accordance with the changing conditions of the regional development.

13. To overcome the drawbacks of the exclave position of the region and to provide for the favorable conditions for its economic activity the Federal Law “On the Special Economic Zone in the Kaliningrad region” is to be altered to support the following:

- favorable taxation conditions for the economic actors in the SEZ (investment tax loan, tax benefits for manufacturing of export goods);
- facilities for the banks providing credit to the projects of the Federal Special Programme “The Development of the Kaliningrad region for the period until the year 2010”;
- abrogation of the quotas for the duty-free imported goods as contradictory to the principles of the free Customs zone;
- the system of economic protection of the region’s interests considering the possible negative effect of the external economic processes connected with the EU enlargement and Russia’s accession to the WTO (including the match between the added value determined in accordance with goods origin and the duty on goods imported to the RF);
- the guarantees for retaining the regulations of the SEZ for the period of 25 years and non deteriorating of the zone regulations during the period of the SEZ activities.

14. The Federal concerns were expressed at the RF – EU summit on November 11, 2002, and at present attention should be given to the region's demands that correspond to the concerns of the Federation and result from the processes of cooperation development between Russia and the European Union. Kaliningrad region which is considered both by Russia and the European Union as a special pilot region of active mutual cooperation is to become an area for testing new mechanisms of cooperation between the EU and Russia. The case in point is the approbation of new forms of economic integration, of cross-border cooperation, and facilitation of unimpeded movement of people and goods.

The Russian Federation aims to conclude an *international treaty* with the European Union and its member-states on the conditions for the development of Kaliningrad region as a Russian enclave inside the EU. The treaty is to contain conditions relating to the following:

- unimpeded transit of citizens and goods between mainland Russia and the Kaliningrad region;
- travel of the citizens of the Kaliningrad region to neighboring states and EU member-countries with entry visas issued at the common border;
- visits to the Kaliningrad region by the citizens of neighboring states and EU member-countries with Russian visas issued at the common border;
- active economic cooperation between the RF and the EU in the Kaliningrad region;
- facilitation of access for goods produced in the Kaliningrad region to the EU market;
- establishment in the Kaliningrad region of an international *investment and financial corporation* for the development of economic cooperation between the Russian Federation and the European Union.

15. In order to create favourable conditions for sustainable development of the Kaliningrad region as a region of cooperation between the Russian Federation and the European Union it is necessary to adopt a federal law on the Kaliningrad region as an exclave territory of Russia with the following provisions:

- Kaliningrad region should be given the status of an exclave area where the Federal law “On the Special Economic Zone in the Kaliningrad region” is in force;

- the administrative and territorial reform should be conducted in the region including enlargement of municipalities and strengthening the administrative “system” with the simultaneous enhancement of independence and financial base of the institutions of local government;
- the Federal Special Program “The Development of the Kaliningrad region for the period until the year 2010” should be managed by the Federal authorities; guarantees for the program implementation should be provided for, it should be permanently adapted and improved as a result of issues arising in connection with the EU enlargement to the East and Russia’s accession to the WTO;
- additional expenses of the population, enterprises and institutions of the region connected with the EU enlargement are to be reimbursed by the federal authorities;
- a regional insurance foundation should be established with the assistance of international institutions and guarantees should be provided by the federal authorities for the insurance of investments to the SEZ;
- a council on the issues of the Kaliningrad region under the President of the RF or the RF Security Council should be established.

**KALININGRAD REGION OF RUSSIA  
AND THE EU ENLARGEMENT.  
ISSUES OF THE PAN EUROPEAN INTEGRATION**

**Analytical report**

**Report contents**

- Introduction
- Political aspects of Russia – EU cooperation
- Legal aspects of the EU enlargement and Russia – European Union cooperation. Pan European legal environment building
- Economic integration: problems and prospects
- Kaliningrad region – a region of cultural cooperation

## **Introduction**

EU – Russian relations are given top priority in the Foreign Policy of Russia as stated in the “General Conception of the Foreign Policy of the Russian Federation” adopted in 2000. EU countries account for 40% of all Russian imports and direct foreign investment. The Kaliningrad region, the Russian exclave now becoming an EU and NATO enclave, is the Russian territory where both positive and negative effects of the EU-Russia co-operation are becoming strikingly apparent.

The EU and NATO enlargement is a matter of major concern for both regional and federal authorities. With the accession of Poland and Lithuania to the EU, the role of the EU in the external economic co-operation with Russia is bound to increase. However, the existing legal provisions regulating cross-border co-operation, free travel of people and goods via Lithuania are at stake. It is not yet clear whether it is possible to maintain the existing mutually beneficial links with the neighbouring regions of Poland and Lithuania under the changing political conditions.

The new EU-Russia border will create numerous opportunities for cross-border cooperation with all the EU member-states. In the context the role of the Kaliningrad region in the EU-Russia co-operation will significantly increase.

The geopolitical location of the region, the interest of foreign political scientists to the Kaliningrad region, a number of research projects and conferences on Kaliningrad testify to the fact that the westernmost part of Russia is in the focus of international interest including that of the Baltic Sea countries. A great number of laws on the Kaliningrad region passed in the last decade make it evident that Kaliningrad has become of vital importance to Russia. Numerous decisions of the regional authorities, appeals of Kaliningrad politicians and NGOs to the Federal and the EU bodies reflect a special vision of the future of Kaliningrad.

Such a clash of the regional, federal and international interests may lead either to a rapid economic and social growth or hamper it. Should there be a clash of economic interests in the Baltic sea region, any progress

in the region will be halted. Provided that economic and social cooperation continues, the Kaliningrad region is sure to become a region of co-operation and the EU enlargement will have positive effects.

The EU has a detailed concept of integration – the so-called “Immediate neighbourhood concept”- defining cross-border cooperation between the EU member-states and neighbouring regions. This theory has been tested in practice, EuroRegions having been set up. Experience in this area has been gained in some border regions of Russia. But in Russia there is no national strategy of cross-border co-operation with neighbouring territories. It should be worked out and tested taking into consideration the existing economic and geographical theories on the basis of the experience gained.

The Baltic region is a region of intense EU-Russia co-operation. The region is gradually becoming not only a geographical concept but also an economic, social and even political entity. The integration processes in different areas are especially active in the region, being supported by the federal government, as well as by the region's administration, business community and non-governmental organizations. The EU-Russia co-operation in the Baltic region is currently under development and will certainly expand in the future.

Kaliningrad has already become one of the prominent centres of international cooperation, an area with numerous pilot projects and programs in which Russian and western experts play an active role. Following the EU enlargement the Kaliningrad region will become an enclave within the EU and may face a number of economic, social and political problems. The method of tackling these problems will echo the existing state of the EU-Russia partnership. The Russian experience – both positive and negative – may prove worthwhile in enhancing Russia's external economic and political strategy.

Both the Russian Federation and the European Union, as reflected in various legal documents, regard the Kaliningrad region as a "pilot" region of international cooperation. However, in order to bring this idea into being, it is necessary to work out a well-grounded concept, outline the appropriate strategy and develop the Region Development Program, which should take into account the local national and international interests of the region. The elaboration and implementation of such a programme will foster integration of the EU-Russia cooperation.

A thorough examination of the EU enlargement and its impact on the development of Russian society at different levels (pan-European, the Bal-

tic Sea region and the Kaliningrad region) implies the study of the following aspects of the EU-Russia co-operation:

1. political and geopolitical aspects of the EU-Russia co-operation; the perspectives of geopolitical development of the Baltic Sea region and the role of the K.R. in this process
2. legal aspects of the EU enlargement and the EU-Russia co-operation.
3. economic issues of the partnership, the feasibility of the strategy for the development of the Kaliningrad region as a "pilot" region within the EU-R co-operation.
4. cultural issues- (cross-cultural co-operation between Russia and the West, ethnic cultures of the Baltic Sea region and the role of the Kaliningrad region in this co-operation.)

## **1. Political aspects of the EU-Russia co-operation**

As long as the EU enlargement brings about certain problems for Russia, and especially for Kaliningrad, the EU should be involved in solving these problems. A joint strategy is needed, based on the synthesis of the regional, national and international interests. The Kaliningrad region Development Program might prove to be such a strategy. Kaliningrad can become a "pilot" region of co-operation within the united Europe where the newest internal and external economic technologies could be tested. To implement this, joint effort are needed on the part of all parties involved.

The major Russian concern is to secure the status of the Kaliningrad region as an integral part of the Russian Federation, and of Russian common economic space as well. For that reason any speculation about its political and/or economic isolation is unacceptable. This should become an axiom, the basis for any discussion on the Kaliningrad issue.

One of the prerequisites for further development of the EU-Russia political relations is the fact that the EU itself and all the EU member-states have no claims to Russia at an official level. That is the Kaliningrad region is unconditionally recognized as being an integral part of the Russian Federation. The neighbouring regions, the EU candidate-states Poland and Lithuania are of the same opinion on the Kaliningrad issue.

Russian international interests in the Kaliningrad region are of major military importance. After the accession of Poland into NATO in 1999 and the forthcoming accession of Latvia, Lithuania and Estonia to the EU, the Russian territory of the Kaliningrad region will become an "island" sur-

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rounded by the NATO countries. Russian-Western relations significantly improved, when Russia, after the terrorists attacks in New-York and Washington on 11 September, joined the antiterrorist coalition, headed by the USA. In addition to the joint program "Partnership for Peace", a new Russia-NATO Council was set up. Thus, the military-strategic aspects of the regional development depend on that of international relations in general, and in the Baltic region, in particular.

But it is the economic issues that are of much greater importance for the development of the region. The Kaliningrad region has got all the necessary preconditions to fulfil national economic functions. So far, however, as evidenced by the way the Region Development Program is being implemented, the federal government has not yet defined what particular functions in the national division of labour the region should take, how well it is able to establish and maintain international relations, and what concrete measures should be taken to give an impetus to the development of the region.

After the forthcoming EU enlargement the Kaliningrad region will not only have to establish and develop cross-border economic co-operation with each of the neighbouring countries (separately), but to take into account their integration into the EU structures. If these processes come about and the interests of Russia are not taken into consideration, the geopolitical and geo-economic situation of the Kaliningrad region may deteriorate.

There are two main aspects of the EU interests. On the one hand, it is the impermissibility of the emergence of the centre (area) of economic, social and ecological, and eventually, political tension in Europe. On the other hand, the use of the Kaliningrad region as a link between the section of economic ties with Russia (the local region market is less important because of its minor capacity).

Russia is recognized as an equal member of "Great 8", and at present stands on the threshold of accession to the WTO. However, relations between Russia and its Western partners so far remain uncertain. The Kaliningrad region could become an area where new methods of economic co-operation are to be explored.

EU interests regarding the Kaliningrad region are not explicitly expressed. It is the interests of separate EU member states (Germany, Sweden, and Denmark) and candidate countries (primarily Poland and Lithuania) that are clearly defined.

The regional authorities consider it vital to match the standard of living of the population in Kaliningrad with that of the neighbouring countries. This could only be achieved through rapid socio-economic develop-

ment in the region. All the necessary prerequisites are in place for that. However, regional resources are insufficient for such a task, so both foreign and Russian investments should be attracted into the region, the technology and service industry should be further expanded and a steady goods in-flow should be maintained.

However, Kaliningrad has not as yet a fully defined general concept of the needs and interests of the region as there is no serried elite able to develop the concept. To some extent, the General Strategy of the Social and Economic Development of the Kaliningrad region as a region of co-operation may be regarded as a set of basic provisions which are to be used while preparing the document. According to these provisions, Kaliningrad is part of the common Russian economic space, and should therefore strengthen its role in the external economic activities of Russia and in promoting the EU-Russia co-operation.

Thus, given EU enlargement, the only possible political solution to the problem of Kaliningrad is the participation of the region in the integration processes, which are to gain momentum in EU-Russia relations. This is certainly the first step towards transforming Kaliningrad into a region of co-operation between the European Union and Russia. Having made the first step, one can clearly see the perspectives and tasks of the following stages. The region is not becoming an entity under International Law. All the activities of the regional authorities are monitored and coordinated by the Federal authorities. The regional bodies put forward their suggestions, but it is the Federal Centre that makes final decisions.

Having accepted the fact that the Kaliningrad region is an entity of the Russian Federation playing a part in EU economic activities, the region should be regarded as a large-scale transnational economic project. A special agreement between the EU and Russia on Kaliningrad as a participant in EU-Russia co-operation should be concluded. Unfortunately, the EU has not yet agreed to the Russian proposals, considering the PCA to be enough for the development of its co-operation with Russia.

Russia in its turn has not fully developed a policy towards the EU and consequently, has not defined the role and place of Kaliningrad in it. It is not yet clear how the accession of Russia to the WTO might affect the Kaliningrad region and the mechanisms of the Special Economic zone and regional co-operation. Controversies have arisen between Russia and the EU Commission on visa- free transit of Russian citizens via the territory of Lithuania, joining the EU and the Schengen Treaty. The interests of Kaliningrad are not paid sufficient attention to in the discussion of possible con-

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sequences of the accession of Russia to the WTO in spite of persistent requests by the regional authorities.

The visa issue, being technical in character, has acquired political importance. Russia could afford to compensate 1,5 mln Russian citizens (the annual number of trips between Kaliningrad and mainland Russia) for the air fare, even though it is a considerable sum of money – approximately 2 bln rubles. The introduction of a compulsory transit visa regime for Russian citizens by Lithuania (Latvia did that some time ago) is an unfriendly political act towards Russia.

The decisions made at the Summit in Brussels on November 11, 2002 were a delicate compromise on the transit issue. But the mechanisms of implementing these decisions are to be elaborated and described in legal documents. The agreement on reciprocal travel of citizens signed by Russia and Lithuania (December 30, 2002) was one of the important steps in this direction. The visa problem hasn't been fully resolved, but its final solution has been postponed, because Russian citizens travelling to and from Kaliningrad by land will have to have foreign passports from January 1, 2005. But not every Kaliningrader, let alone inhabitants of other Russian regions, has a foreign passport. In essence Kaliningrad has become a "foreign" land for the Russians living in other Russian regions as travel formalities are the same. The situation is unclear, so it is rather difficult to determine which measures should be taken by the Federal authorities in order to guarantee a satisfactory standard of living for Kaliningraders under the new conditions. It is difficult to speak about the strategy of "the region of co-operation" or the "pilot region" strategy as both presuppose the strengthening of co-operation and the expansion of mutually beneficial ties while the would-be partners erect barriers at border-crossings.

It should be stressed that it is Russia that has always displayed initiatives and goodwill in all the discussions on the Kaliningrad issue. The Russian military contingent in the region has shrunk to a minimum. A number of border crossings have been constructed. It is even more important that the Kaliningrad region has already been working in the Free Economic Zone regime, and currently in the Special Economic Zone regime for ten years. Most goods imported into the region are tax-exempt. 1800 foreign and joint ventures have been registered in the region. Numerous international projects are being run in the economic, social and cultural spheres.

The major reasons for conflict around the Kaliningrad region are produced by the **difference** of opinion concerning the future of the region given the EU enlargement. The Regional Duma launched an initiative to

introduce a visa-free entry to the region for EU citizens and forwarded this proposal to the Federal authorities.

The Russian Federation expresses its concern about the Kaliningrad region which has become an enclave of an alien political, legal and economic space, having its own *modus operandi*. There are well-grounded fears that it might weaken the existing ties between Kaliningrad and mainland Russia and might result in more or less rapid “drifting of Kaliningrad towards the West”. That is why the EU initiatives (in Seville) on special privileges granted to Kaliningraders in getting Schengen visa cause a negative reaction of the Russian Federal authorities. Moreover, in federal documents on Kaliningrad a special emphasis is made on proving adequate external conditions for the viability of the region and its development as an integral part of the Russian Federation. As soon as Kaliningrad becomes an active participant in cross-border and regional co-operation, an actor in the EU-Russia co-operation in the XXI century, the necessary conditions will be created.

The official stance of Russia looks very coherent though not devoid of certain weakness.

Firstly, the problem of the viability of Kaliningrad and the weakening of its links with Russia is often seen as a deliberate attempt undertaken by the EU, Poland and Lithuania. The reality proves that the ties may weaken irrespective of the EU actual intentions – as a consequence of EU enlargement, brought to life without any consideration of the vital interests of Russia. And it should be made clear to all the partners of Russia – Russia doesn’t suspect them of evil intentions, but their actions might lead to the destruction of the territorial integrity of the Russian Federation. If there are no such intentions, it should be proved by concrete positive actions (deeds).

Secondly, the federal government has not developed the concept of “the region of co-operation» and it has not been filled with any specific content. So far, the name “the region of co-operation” has sounded like a propagandistic slogan. Moscow appears to be unaware of the analysis carried out by Kaliningrad scientists and politicians.

Taking it into account it is necessary to elaborate (making use of what has already been done) a conception of the development of the Kaliningrad region as a region of EU-Russia co-operation. This conception should be taken as a basis of the EU-Russia agreement, which is to be concluded in the future.

The European Union seems to be solving some minor “local” problems pertaining to Kaliningrad, for instance, the lessening of the so-called “soft-risks”, whether real or imaginary, run by the enlarging EU – combat-

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ing organized crime, illegal migration, drug traffic, communicable diseases (including AIDS), environmental pollution. These problems are often exaggerated enormously and ridiculously, but the positive changes are ignored and hushed up.

EU enlargement is changing the external environment of the Kaliningrad region and it has to take on a fair share of responsibility for the development of the region. This responsibility should not be understood as just earmarking money for Kaliningrad. The biggest share of the sum then goes back to the EU as the salary of the EU experts and consultants, payments for equipment purchasing etc. It is indicative that the EU actually ignores the Russian proposals that Kaliningrad should be turned into the region of co-operation and there have been no comments on the point. The proposals elaborated by the EU on Kaliningrad, are in fact a set of unrelated specific issues for discussion. They are not based on a solid conceptual foundation; no wonder political problems are approached from a purely technical point of view. Moreover, the EU external policy is far from being coherent. For instance, the EU attempt to combine the EU internal security ("locked borders") and cross border co-operation, the setting up of Euroregions, etc.

In order to solve the problems existing between the EU and Russia, the EU should decide once and forever whether Russia is a partner or a potential threat, whether Russia is part of the European economy or a dangerous competitor. The EU should decide whether Russia is part of European civilization or not. Words are no longer enough – real actions are needed. If the EU considers Russia to be its friend and partner, there is no need to erect visa barriers for Russian citizens. Why does the EU admit the citizens of other countries posing a potential threat of terrorism? Why create myths about "Russia mafia" and then believe them? Why look only for the negative in Russia and then describe it with a poorly disguised sense of superiority in the EU mass media? A lot more similar questions could be added to the list.

The search for a solution of the problems caused by the EU enlargement should not be sidetracked by minor technical details. Russia must express its position on the future of Kaliningrad again and very clearly. It can be done in an official document (a draft agreement, an agreement between the EU and Russia). Then the western partners of Russia could comment on each and every point of the document. The unwillingness to discuss this document may be regarded as the reluctance of the EU to develop a closer co-operation with Russia. Consequently, the foreign policy of Russia in

general and its policy towards the EU in particular might have to be reconsidered.

The authors of the report proceed from the assumption that the existing political difficulties are temporary and they will be utterly overcome to mutual benefit. It will be a sign that the EU really considers Russia to be its equal partner and is really willing to co-operate. The signing of the EU-Russia agreement on providing the viability of the Kaliningrad region is to be the final confirmation of the EU new strategy.

## **2. The legal aspects of the EU enlargement. The Formation of the common European legal space**

Attention to the Kaliningrad region in the framework of the EU-Russia relations has increased since 1999. At the meeting of European heads of state and Government in Cologne in June 1999 the General EU Strategy towards Russia was adopted. In October 1999 in Helsinki President V. Putin promulgated a similar Russian Strategy towards the EU. Both documents regard the Kaliningrad region as a priority region of co-operation. On December 7, 2001 the Government of the Russian Federation adopted new Special Federal Programme "The Development of the Kaliningrad region for the period up to 2010". The State Duma is preparing a new revision of the Law on the SEZ in Kaliningrad. In the future, the State Duma is to adopt "The Basic Principles of the Federal Policy towards the Kaliningrad region".

At present, there is a legal basis for the EU-Russia international co-operation. In the summer of 1994, the PCA between Russia and the EU was concluded. A year later the interim agreement was signed and entered into force on February 1, 1996. In December 1997, the PCA signed in 1994 came into effect. It will facilitate further development of the EU-Russia co-operation. In this connection, it is vitally important to bring together a group of international lawyers that would be engaged in the harmonization of the EU-Russia legislation.

The EU is planning to tackle the issues concerning the Kaliningrad region in the relevant PCA bodies, and in parallel, continue to discuss the same issues with Lithuania and Poland in the Europe Agreement framework. In addition, to facilitate cross-border co-operation specific meetings may be called between the parties concerned, so as to, *inter alia*, work out practical arrangements.

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In keeping with the Commission's Communication of January 17, 2001, the EU suggests that:

- the EU and Russia examine the trade impact of the enlargement on Kaliningrad, in the PCA trade and industry subcommittee.
- the EU, Russia, Poland and Lithuania discuss the functional management of border crossings, starting with the main road and rail crossings, particularly those linking the region to the Pan-European Transport Corridors I and IX. Discussions should include customs, border guard, phytosanitary, and veterinary and health aspects. Discussions could be held in working groups, with Russia under the relevant PCA sub committees and with Lithuania and Poland within the framework of the Europe Agreement.

- the output of the Tacis study on a multi-modal transport strategy be discussed with the IFIs and the Russian and neighbouring countries authorities, with a view to securing funding for priority projects.
- a Tacis study on energy needs, energy potential and possible scenarios should be undertaken.
- the practical measures to conduct proper and efficient border control be continued, facilitating the movement of people and goods across the future external border. Officers, responsible for maintaining contacts, can be appointed.
- without pre-empting accession negotiations with Poland and Lithuania, EU technical and financial assistance can contribute to the creation of a functioning border control system, including appropriate sufficiently fake-proof travel documents.
- the suitability of Community rules on small border traffic and transit for the specific situation of Kaliningrad should be assessed. The possibility to take advantage of any special arrangements permitted by the *acquis* should be looked into, using examples offered by existing arrangements, including in candidate countries.
- in the wider context of Community policies on visas and on external borders, the cost of passports (the responsibility of Russia) could also be examined, as well as the cost of visas (responsibility of current and future EU Member States). Both new and current Member States could consider opening consulates (or sharing facilities to reduce costs) in Kaliningrad, to facilitate visa issuance and manage migration flows efficiently.
- the EU and Russia quickly conclude a readmission agreement.
- the EU should provide the administration and population of Kaliningrad and bordering regions information on the way in which the

future external border of the EU will function taking into account the need for fast and efficient border crossing for goods and people whilst preventing illegal activities.

- the EU-Kaliningrad fisheries relations be reviewed in the light of the consequences of enlargement on fishing access and of future fisheries agreement between the EU and Russia.
- the EU and Russia discuss key issues of environmental concern in Kaliningrad.

Unlike the EU Russia considers it expedient not to adhere to PCA only but to conclude a special agreement on the Kaliningrad region.

“The Strategy of the EU-Russia relations for a mid-term perspective (2000-2010)” approved by President Putin on June 3, 2000 addresses some of the problems pertaining to the EU enlargement – “taking into account the special geographic and economic position of the Kaliningrad region, it is necessary to ensure the viability of the region and its development as an integral part of the Russian Federation and an active participant of international and inter-regional co-operation. An adequate economic, energy and transport specialization of the region should be defined. It is necessary to develop transport communication with mainland Russia. If the need arises, a special agreement with the EU protecting the interests of Kaliningrad as an entity of the Russian Federation, in the light the EU enlargement, is to be drafted and concluded. The agreement has to consider the possibility of turning Kaliningrad into a pilot region in the process of the EU-Russia co-operation in the XXI century”.

The viability of the Kaliningrad region in the context of EU enlargement has been discussed at a number of official consultations between the Russian Federation and the EU. The official position of Russia has been expressed in the following way:

1. a special agreement with the EU protecting the interests of Kaliningrad as an entity of the Russian Federation is to be drafted and concluded
2. a number of special agreements have to be drafted and concluded:
  - an agreement on free transit travel of cargo and passengers to and from Kaliningrad and mainland Russia by land, air and water across the EU territories. The agreement is to define military cargo transit as well. The EU should confirm the validity of the Russian Federation – Lithuania agreement on the military transit concluded already
  - an agreement on providing free transit of gas, oil, energy and telecommunications to and from the Kaliningrad region and mainland Russia

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- an agreement on supporting cross-border co-operation, economy, facilitating cross-border trade for Kaliningraders. As an exception to the Schengen Treaty, Russian citizens can travel visa-free to Poland and Lithuania. In the framework of the existing agreements Russian citizens can travel to and from the Kaliningrad region via Lithuania visa- free.
- an agreement on visa free entry to the Kaliningrad region for the EU citizens
- an agreement on combining fish catch quotas and fish catching zones of the EU candidate-countries in accordance with the EU quotas and zones so that no damage is caused to the fishing industry of the Kaliningrad region
- an agreement on the participation of the Kaliningrad region (being monitored by the Federal government and on acceptable conditions for the region) in the “Northern Dimension” and the EU programs, aimed at facilitating the development of the Region, international co-operation, environmental protection and health care as well as academic and cultural exchanges.

Russia considers it advisable that a special EU-Russia agreement on Kaliningrad be added to the already existing international legal documents.

This agreement has to tackle three groups of issues:

- providing an adequate basis for socio-economic development of the Kaliningrad region, which is gradually becoming a Russian enclave within the EU
- promoting the EU-Russia rapprochement, by virtue of testing new co-operation schemes and mechanisms in the Region; encouraging the development of a market economy and sharing the positive experience with other regions of Russia
- contributing to the integration of Russia with the European economic space.

This document should be based on the PCA of 1994, taking into account “The General EU Strategy Towards Russia” and “The Strategy of the EU-Russia Relations for a mid-term perspective (2000-2010)”. The EU and Russian commitments should be explicitly expressed as well as the joint commitments of the parties concerned. It is essential that the Kaliningrad region be regarded as an integral part of the Russian Federation. To make prompt decisions on economic

and cultural cooperation it is advisable to open up a representation office of the Kaliningrad region in Brussels and an EU representation office in Kaliningrad.

It is necessary to expand international co-operation with Belarus, Ukraine, and Kazakhstan. A special program to strengthen the role of the Kaliningrad region in the integration processes taking place in the Union State of Russia and Belarus should be elaborated.

### ***The Law on the Special Economic Zone in the Kaliningrad region***

The Law on the Special Economic Zone in the Kaliningrad region (adopted in 1996 to boost the economic development of the exclave) plays an important role in the Kaliningrad- Moscow balance of interests. The Statute on the Free Economic Zone “Yantar” had been in force till 1991. The Special Economic zone was set up as a compensation mechanism in the form of a free customs zone fostering the development of export and internal production to replace imports. Kaliningrad experts claim that the SEZ regime is not stable and contradicts the Federal legislation. For this reason the expected foreign investment into the regional economy was not made. At the initial stage of the SEZ regime there was a drop in production as a result of a rapid reduction of customs duties and tough competition from western producers.

Nevertheless, this law is the only legal mechanism taking the external economic environment of the Region into consideration. This law is especially important in the light of the EU enlargement and the forthcoming accession of Russia to the WTO. IT would be incorrect to claim that the SEZ law contradicts the WTO rules, as it removes customs barriers as opposed to just lowering them.

The accession of Russia to the WTO may result in the lowering of import tariffs and may waste the advantages of the SEZ regime. The economy of the Kaliningrad region, oriented towards inner-production replacing imports (the so-called import-substitution production), can further develop only under the conditions of the SEZ regime with all its economic privileges.

In 2001 the Kaliningrad regional Administration and the Regional Duma prepared a new revision of the law on the Special Economic Zone in Kaliningrad which takes into consideration all the changes in the regional economy brought by the EU enlargement and Russia’s accession to WTO.

It is necessary to make a number of amendments to the law ensuring:

- preferential taxation regime in the SEZ (investment credit, tax concessions on exports

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- tax privileges to the banks crediting the projects of the Federal Special Programme of the Social and Economic Development of the Kaliningrad region
- the abolition of quotas on duty free import
- longer-term functioning of the Special Economic Zone mechanisms for all the actors (subjects) of the regional economy even after the termination of the SEZ activities in Kaliningrad
- necessary changes in the Federal Special Programme brought about by the EU enlargement and the accession of Russia to the WTO
- the protection of the interests of Kaliningrad taking into account the possible negative consequences of EU enlargement and the accession of Russia to the WTO
- the setting up of a regional insurance company (or an international insurance company) for investment insurance
- the current mechanisms of the Federal Special Programme management as the now debated transfer of powers from the regional authorities to the federal ones contradicts the principles of regional self-governance and civil society principles.

The Ministry of Economic Development and Trade of the Russian Federation suggests that the regional authorities should be given the right to reduce the profit tax without any restrictions on the part allocated to the regional budget.

Article 66 of the Federal Tax Code states that the Russian Federation fiscal body should be given the right to a tax break on the enterprise profit going to the regional budget.

The enterprises manufacturing goods in the Special Economic Zone and exporting not less than 80 % of the goods should be exempt from the profit tax allocated to the federal, regional and local budgets as well as from property and road tax. The revenue (profit) gained by the above-mentioned enterprises is not levied to the profit tax if it is reinvested into the SEZ production sphere.

It is proposed that the SEZ regime in the Kaliningrad region should last 25 years.

The federal policy of Russia is aimed at an active integration of Russia into the World Community and Economy. The EU and NATO enlargement, the forthcoming accession of Russia to the WTO – the external factors less important for other Russian regions – affect the economy of the Region con-

siderably. That is why it is so important for the Russia exclave to raise the competitiveness of its economy in the world, Russian and local markets. To ensure the economic sustainability of the Region it is necessary that the changes in the Russian legislation (especially concerning the SEZ regime in the Region) should not destabilize the economy of the Region.

### *The Pilot region*

The Federal Government as well as Kaliningrad experts believe that testing new liberal economic reforms and mechanisms will facilitate the restructuring of the regional economy.

The economic mechanisms that are to be tested are as follows:

- tax privileges for Russian and foreign investors, the participation of major investors in the elaboration of the Development strategies for the Region and in the implementation of large scale regional programs (as an advisory committee), investment insurance, the compensation of interest rates to all participants of the regional priority projects
- new taxation principles on the rent basis for all the enterprises, companies and firms of the region
- effective use of military premises (port facilities, docks, military settlements, oil storage, aerodromes) for civil purposes
- reform of the housing and communal services system and provision of special social assistance
- mass housing construction on the mortgage principle

Taking into account the above-mentioned economic tools Kaliningrad experts suggest that federal and regional legal acts (legislation) regulating liberal economic development of the Kaliningrad region should be elaborated in the nearest future. These legal acts should also regulate the co-operation between the EU and the Kaliningrad region and facilitate the ongoing structural reforms in the region. A number of pilot projects should be launched and implemented in Kaliningrad – the developing of new methods of customs and border control, the testing of new schemes of cross-border co-operation, efficient operating transport network and border-crossings, implementing projects aimed at the harmonization of the EU and Russian production standards, institutional reform as well as projects in education and environmental protection.

Integration processes in Europe would never have worked if there had been no common European legal space (the founders of the Euro-

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pean Union, “common European home” realized it perfectly well). The formation of this legal space should take the lead over the formation of all other common European spaces – political, economic, military, technological, etc.

The introduction of EU norms, standards and regulations in Poland and Lithuania will affect the economy and social sphere of the Region. For instance, the introduction of the European safety regulations and air, railway and road accident prevention systems as well as the European environmental standards will become a real ordeal for the Region.

### *The Visa Issues*

There are urgent legal problems the solutions to which are offered by life. The visa issue is one of these problems. Being technical in its character, the visa problem has acquired a political significance having become a certain “litmus paper” testing the EU real intentions to develop partnership relations with Russia.

It has been clear from the very beginning that unconditionally abiding by the general Schengen Treaty regulations (the point the EU insists on) is not acceptable to Russia. It would mean the infringement on the sovereignty of Russia in the Kaliningrad region as an entity of the Russian Federation. It would also mean the violation of the rights of Russian citizens living both in the Region and in other regions of Russia. Nevertheless, Russian proposals to make an exception to the Schengen regulations for Kaliningrad are unlikely to be accepted by the EU. The Europeans fear that the Region might turn into a “Black hole” through which illegal migrants and criminals would flow into Europe. The Russian Federal Government rejected the compromise offered by the EU – the issuance of long term multiple entry visas for Kaliningraders. The reason for that is very simple: it is not yet clear how other Russian citizens will travel to and from Kaliningrad.

The other suggestions – sealed high-speed non-stop transit trains and travelling along special highways – are typical of the Cold War period and do not reflect the spirit of partnership.

Experts suggested many other variants – 30 days visa-free stay for the Kaliningraders going to the EU countries, 30 days visa-free stay for the residents of mainland Russia coming to Kaliningrad. But neither variant is legally acceptable.

The arrangements concluded at the EU-Russia summit in Brussels on November 11, 2002 on the so-called Facilitated Transit Document (FTD)

helped to prevent another crises but there are still more questions than answers. How should the FTD be issued? How should it be issued for railway passengers? The FTD is just a “substitute” for a visa and Russia has always been against the introduction of a visa for Russian citizens going from one part of Russia to another.

From January 1<sup>st</sup> 2005 Russian citizens will have to have a special transit document issued by a foreign state (Lithuania) – a special visa. So the final solution to the visa issue has been postponed again. It should be done in the future but time flies really fast.

Despite the agreement reached at the EU-Russia summit in Brussels (2002) the visa issue may still become the stumbling block for the declared EU-Russia partnership. But on the other hand it can give the EU a chance to demonstrate its good will and readiness to regard Russia as part of the common European legal space.

### **3. Economic Integration: Problems and perspectives**

#### ***The situation in the Kaliningrad region as seen by Russia and the European Union***

The Russian Federation and the EU differ on many points in their approaches to the problem of integration and the place of the Kaliningrad region in the integration process.

The plank of EU is set in the Paper prepared by the Europarlament in April 2002 under the title “The EU and Kaliningrad”. The paper concludes that the Kaliningrad region is unable to adapt to the emerging EU economic environment by itself due to its disadvantageous position relative to its neighbours’. The region may profit from its neighbouring member states’ rapid development only in case it is given outside assistance in upgrading its industry and developing infrastructure. As neither the oblast itself, nor the Federal government is able to sufficiently invest, it appears to be the EU’s mission to help – in its own interests.

In this connection Europarlament calls upon the European Commission to:

- support the Kaliningrad region in adjusting its export production norms and standards to those of the EU. This specifically concerns industrial production, its ecological requirements and consumer protection.

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- look into the possibility of reaching a mutual understanding with Moscow on the perspectives of the Special Economic Zone and its agreement with WTO norms among other issues. It is worth considering whether the Russian SEZ concept of export-oriented production is convergent, and to what extent, with that of the EU.

In the EU the Federal Special Programme is viewed not so much as the one intended for the Kaliningrad region but as an agenda to promote the Federal Centre's interests in the region.

The very nature of the programme must be changed – it should be converted to an agenda of EU-Russia strategic partnership in the Kaliningrad region, for which purpose a joint management of the programme and a consistent strategy are needed.

The plank of the Federal centre does not fully agree with that of the local government, neither of them being quite in accord with the EU guidelines. Moscow sees the oblast as a trouble-ridden federal entity rather than a priority development region with its potential for growth.

Both the SEZ mechanism and the Federal Special Programme are viewed as a means to compensate for the exclave situation of the depressed and problem-ridden region, with its shadow economy flourishing into the bargain.

There is much concern about growing separatist tendencies and the spread of 'germanization' or 'westernization' ideas in the oblast, as well as about widening of the cultural and economic gap between the oblast and mainland Russia.

According to the Federal government, the SEZ regime has failed expectations. As the bulk of the responsibility for this failure allegedly lies with the local government, it can be concluded that regional development programmes must be maintained on national or international levels. (They require external management, as in the case of bankruptcy). Functioning of SEZ has lead to creating "a grey economy" which neither wants nor welcomes investments. This situation cannot be tolerated. A still more 'closed' variant of regional development is impossible, while an open one will require provision of a legal basis for the declaration of all income and collection of all individual and corporate taxes. Meanwhile, as long as, according to some experts, the shadow economy constitutes up to 90-95% of the total volume, people will be opposed to any changes in the taxation policy fearing for their shadow profits.

As stated by the Ministry of Trade and Economic Development, economic growth in the Kaliningrad region has been below national level

since 1995. Meanwhile as Minister for economic development Mr.G.Gref has emphasized, mainland Russia neither enjoys any preferential treatment, nor does it act under the SEZ Law. (“Nezavyssimaya Gazeta”, March 20, 2001). Nevertheless, Mr Gref named the Kaliningrad region among the priority regions which, alongside The Northern Caucasus and Prymorye, will be getting funding from the federal sources. The priority industries, according to Mr. Gref, are energy, transport, ship-building and fisheries. (‘Vek’ March 22, 2001)

In the Kaliningrad region its own local potential has been rather overestimated, with the politicians being “overly hopeful” that the “pilot region” and “region of cooperation” models will provide for accelerated social and economic development. The primary goal of the oblast economic development is to narrow the gap between Kaliningraders and their neighbours in terms of the standards of living.

The region’s chief resources are constituted by qualified specialists, an advanced system of training and retraining of staff, a well-developed market infrastructure and market-oriented mentality, well-forged ties with foreign partners; access to the vast Russian market.

In the Kaliningrad region it is assumed that the situation in the region is aggravated as a result of the inconsistency of the Federal Government policies, namely, on-and-off cancellations of one or another article of the SEZ Law. Although the privileges envisaged in the law are now being reinstated, lack of stability adversely affects both the entrepreneurship and the investment activity in the region. Nevertheless, some experts presume that in spite of all shortcomings and weaknesses, the SEZ –FEZ model has promoted a rapid and significant transformation of the regional economy. As a result an open-type economy has begun to take shape, foreign economic activity being its basic mechanism. Abolition of customs duties has drastically increased import of spare parts and technological equipment which in its turn made it possible to set up export-oriented and import-substituting production. The oblast has seen formation of such new trades as assembly lines for domestic appliances and electronic devices; oil, cabinet-making and automobile industries, the two of the last-mentioned being both nationally and internationally competitive. Apart from this, a considerable share of small businesses has cropped up and the service industry has been given a boost. The Kaliningrad experts presume that introduction of social payments and regressive rates of the single social tax could solve the problem of public gains legalization. Regressive tax rates allow social tax to be cut in proportion to wage increases. Besides, once private pension

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schemes are introduced, employees will be anxious to get legally paid for their work rather than receive their earnings in an envelope, as their deductions to the pension fund will be directly related to their wages. Last, but not least, income tax cuts allow the legalization of wages without causing any damage to the employee's well-being. Instead of 'fighting' the current situation, this process creates a favourable tax climate and a lever that will help motivate employees to negotiate legal ways of payment with their employers.

One has to admit that, as some Kaliningrad experts assume, now and then, both nationally and internationally, the mass media paint a grim picture of the region.

Instead of constructive discussion in search of realistic ways and solutions to the crucial economic, social, demographic and ecological problems, the achievements are often discredited and hardships are dramatized, which in its turn triggers further social tension and portrays Kaliningrad as a conflict-prone region lacking in perspective.

Meanwhile, to judge the situation fairly, a well-balanced approach should be taken, capable of enhancing the mutual interests and ironing out the differences.

In terms of economic cooperation Russia's attitude, both federally and regionally, coincides with that of the EU in two main issues: firstly, economic isolation of the region is unacceptable, and secondly, the Kaliningrad region has a great potential for such a cooperation.

On top of this Russia views the Kaliningrad region as its special economic zone whose framework allows for the streamlining of most national legal procedures, such as customs, taxation, registration, etc., which is meant to attract foreign investors. Both the latest economic know-how and bygone ideas, like foreign concessions for example, could be put to the test here. The Kaliningrad region is perfectly suited to trying out WTO rules before Russia joins the organization shortly.

The cooperation between the EU and Russia does not start from scratch. In fact, having been first the Free, then the Special economic zone, the Kaliningrad region has become a testing ground for economic cooperation where new integration patterns are being experimented on.

The same role is played by cross-border cooperation. The last decade has seen a number of significant joint projects put into life in various spheres, such as environmental protection, energy saving, education (including conversion training of the military), healthcare (AIDS and drugs abuse prevention inclusively), transport and social issues. The international

research projects on the Kaliningrad region mainly involve transport, telecommunications and energy issues. Another big issue is development of industrial infrastructure as an indispensable foundation for attracting investments and, consequently, shaping up specialized regional industries. These projects are chiefly sponsored by the EU through TACIS programme in the first place; also by Denmark with its ecological projects and Sweden with its anti-AIDS programme.

These projects, though, do not exhaust the tremendous potential for international cooperation the Kaliningrad region possesses. Besides, Projects have slowed in most cases and remain in the feasibility study pre-investment phase. The principal contention between Russia and the EU – Kaliningrad being no exception to other regions of Russia in this – can be formulated as ‘money or advice’. The EU bodies tend to spend the lion’s share of their money on provision of their experts and advisors sent to Russia. The lack of a unified steering body slows down promotion of international projects. Although the recently founded Regional Development Agency of IEWS is now trying to do this job, it is still rather a virtual body with no clear-cut powers delegated to it.

There is no getting away from the fact that EU enlargement will inevitably cause Russia huge economic damages. Since 1995, when the EU was joined by Austria, Finland and Sweden, Russia has been yearly suffering \$350 mln in losses in foreign trade as a result of EU-imposed restrictions.

In this connection the Russian government expressed its anxiety about EU enlargement. The document presented to the European Commission in 1999 listed the following concerns:

- introduction of a unified external tariff, a tougher one than those used nationally;
- reorientation of new member-states’ trade towards EU internal market;
- extension of trade preferences for the new member-states, which can affect competitiveness of Russian exporters;
- outflow of foreign investments from Russia to Central and West European countries;
- shrinking of military cooperation between Russia and the new member states.

Besides, extension of the common agricultural policy to the new members will close their markets for Russia; adoption of EU technical standards will erect a huge barrier preventing the export of technical products to the new member states; extension of antitrust and antidumping legislation to

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the new member states will cause substantial damages to Russia; all this will exacerbate problems for Kaliningrad.

All these issues are being currently considered in the framework of the Agreement on partnership and cooperation between Russia and the EU. The negotiations are not proceeding without hindrance, though, and they may even need to be conducted on a higher level.

#### *Regional strategy*

On close examination of the negotiating parties' stances one can conclude that in the Kaliningrad oblast situation, it is not so much its breakaway from mainland Russia that threatens the region's well-being, but its turning into a depressed territory. Such a turn of events or even a worse lagging behind the neighbouring states economically is most unwelcome for both the Kaliningrad region and the whole of Russia. Having a crisis-prone, problem-ridden and unstable region in the middle of prosperous Europe is not the best scenario for the EU, either. This is why it is urgent to have the strategy of accelerated economic development for the Kaliningrad region. To this end the problems of transport, visa regulations and power engineering industry must find their solution in the first place; priorities must be determined for economic development under the new conditions; the required documents on the regional, federal and international levels are to be drafted.

The Russia-EU agreement is to become but one single component of both regional and federal strategies in the Kaliningrad region. The core of this strategy should be constituted by the updated Law on SEZ. The latter is to envisage commitment on both the federal and regional levels and division of powers between the Federal center and the region.

The Kaliningrad region development strategy comprises four major components now and will do so in the future. They are as follows:

- firstly, the regional potential in economic and natural resources will be used to the full in the interests of the region and the whole nation;
- secondly, the Kaliningrad region will act as a region of cooperation between the Russian Federation and the European Union, CIS and countries of the world.
- thirdly, the oblast will become a Russian contact territory in Europe, a testing ground for the mechanisms of integration and interaction between Russia and the European Union in the 21st century
- fourthly, the oblast remaining the Baltic base of the Russian Navy, it will continue to guard Russia's military and strategic interests.

Going along these complementary courses will allow the region to overcome the period of transition and grow into a sustainable territory in the center of Europe.

The indispensable principle of this strategy consists in combining international, federal and local interests, all of them to be considered holistically. Based on the combination of interests, the regional development strategy will then rely not on the creation of new production and recreation of its potential alone, but match the two approaches. It will allow enterprises to head for regional, national and foreign markets. In the framework of the Strategy more freedom in capital flow can be expected and, consequently, a greater influx of both national and foreign investments hoped for. All this is to lead to invigorating the local economy.

The interests can be brought together by way of:

- upgrading the federal and regional legislations, with Russia's growing role in international cooperation in view. This implies improvement of the acting legislation including the Law on the Special Economic Zone in the Kaliningrad region, as well as adoption of new laws and regulations.
- carrying out the Federal target programme "The Development of the Kaliningrad region for the period up to 2001" and elaboration of a complex mid-term regional programme.
- formation of advanced market environment in the region
- region's greater involvement in the international division of labour proceeding from the new strategic perspective. The latter implies transition to the new type of relations between Russia and the EU (which can be made possible on the basis of a special agreement between Russia and the EU defining the Kaliningrad region as a region of cooperation) and increase of the region's role in the economic integration process within the Union State of Russia and Belarus.

If the oblast becomes a true Russia-EU region of cooperation, it will create realistic possibilities for the interacting parties to locally (in the oblast) try out the principles of common economic space and new forms of economic cooperation. Both international cooperation and the region's own efforts provided with assistance from the centre will promote shaping up effective regional economy suitable for a large-scale economic cooperation between Russia and the EU in the XXI century.

If, for the purpose of working out and implementing the strategy of developing the Kaliningrad region into a region of cooperation, efforts are

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united regionally, federally and internationally, it will help to solve problems beyond the local scale. Once the oblast has found its place in the territorial division of labour and become the integration hub, it will be able to play a greater role both in Russia and in Europe as well as in external economic cooperation.

Although the above-mentioned interests are yet to get a proper wording, we can voice the measures that are to be taken on the three said levels for the due fulfillment of the Development Strategy of the Kaliningrad region.

In the long-term the oblast's economic significance for the Russian Federation primarily consists in its advantageous geographical position (its location potential). These benefits have not been fully realized enough on the federal level for the oblast to be granted priority status. This is why the projects targeted to meet national interests must be warranted regionally. Such projects should be given a thorough feasibility study concerning their efficiency and economic wisdom. It is also advisable to compare them to similar projects carried out in other countries. These projects could involve such spheres as utilization of the ports, creation of consignment facilities and a body of international logistics, complex amber processing, agricultural production, development of health resorts infrastructure on the sea-side, and last, but not least – building a Russian-foreign technopolis based on the local and national scientific and technological potential with a system of export-oriented enterprises. This approach could draw more attention to the problems of regional development on the federal level.

For foreign investors the Kaliningrad region can be an attraction not so much as a site for large-scale export-oriented production, but as a region with a geographically advantageous position and relatively well-developed infrastructure. These factors enable the actor to have access to the vast Russian market; besides, the oblast being part of Russia's common economic space, locally produced goods travel outside the region duty -free. In order to attract foreign investments it will make sense to build well-equipped production and demonstration grounds lending additional incentives for investors.

On the federal level it is essential to do the following:

- set the validity term for SEZ and guarantee steady development for the said period (a 25year term was suggested above);
- provide for its functioning by introducing tax incentives for investors, benefits for Russian banks, etc.);
- adjust the Tax Code,
- ease customs procedures;

- prepare a new version of the Federal Special Programme of the Development of the Kaliningrad region;
- draft a Russia-EU Agreement on the development of the Kaliningrad region as a region of cooperation.

The regional concerns are many-faceted by nature too. Kaliningrad is very much interested in the rapid restructuring of economy, its harmonization with the new economic and geopolitical situation and orientation towards both internal and foreign markets. Some of the large and medium-sized enterprises have lost their potential and are impossible to revive; others are unable to restore their former capacity. This is why alongside drawing in home and foreign investments to traditionally leading industrial spheres it is necessary to strive for creating new industrial projects and development of new specialized branches of economy, such as transport, IT, tourism, service – provided territorial division of labour and economic integration with other Russian and bordering regions are envisaged.

On a regional level, information and publicity are to be improved; capital investments in basic infrastructure encouraged; functioning of the regional law on stimulation of capital investment activity is to be guaranteed; the new version of the regional law ‘On local FEZ in the Kaliningrad region must be adopted; a new system of small business centers is to be created, a thorough study of the formerly adopted regional laws conducted; regional programmes elaborated to promote a favourable economic climate.

Internationally, apart from the above mentioned Agreement, it is necessary to look into the possibility of applying EU standards in the oblast and to establish a special international economic regime in the SEZ which would allow all SEZ resident economic entities to enjoy similar rights in their relations with the EU to those available in existing EU economic entities. In addition, we should exempt all SEZ-produced goods of all customs duties and non-tariff limitations on their way to EU; by way of exception extend the PHARE programme to the Kaliningrad region; set up an international steering committee on combating organized crime.

The Kaliningrad region could become an East-West contact territory where know-how and expertise are exchanged. Western companies may find it suitable to set up their demonstration enterprises for their further proliferation to mainland Russia. Business people from Russia, Belarus and other parts would profit from export –oriented production based on Russian know-how, as well as from local import-substituting production using imported materials and spare parts.

### *3. Economic Integration: Problems and perspectives*

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By way of introducing visa-free or eased visa regime Kaliningrad is bound to develop into a meeting point for entrepreneurs from East and West, a contact business center where negotiations, seminars and conferences could take place. It can accommodate both western companies' delegations and trade houses from all over Russia.

The Kaliningrad region is to grow into a financial, telecommunication and consulting hub to provide the wide range of ties between East and West for remote parts of Russia, its towns and cities striving to promote small and medium businesses. This course has only recently emerged, but it is of great potential. Moving in this direction will enable the oblast to get rid of the side-effect of its remoteness from mainland Russia, for the above said technologies require no movement of material objects: consulting is a highly profit-yielding service with no material costs, the internet knows no borders, and financial flows do not need a moving vehicle. Alongside promotion of other services this direction appears to be most promising for the East-West contact territory.

Nevertheless, this perspective has no future unless certain obstacles are eliminated and conditions provided, the minimum prerequisite being easing visa regime. Besides, this challenge will require the construction of several permanent conference centers and their promotion in the east and in the west, developing of recreation infrastructure and bank networks, and attraction of experts.

The Kaliningrad region is perfectly suitable as a demonstration ground which could accommodate modern enterprises using latest know-how and up-to-date equipment for consumer goods and services. This Strategy direction is aimed at giving innovation impetus to the national small and medium business. The Baltic countries such as Germany, Denmark, Sweden and Poland could be of great help in setting up model enterprises in the oblast so that wide circles of entrepreneurs from all over Russia can get acquainted with their performance.

It is suggested that to encourage market infrastructure development the role of the Regional Development Agency should be enhanced. The Agency, set up in 1999 is intended to function as a business-incubator for small and medium businesses. Another suggestion is that creation of an international investment financial corporation could stimulate regional financial infrastructure development. Turning the oblast into a testing ground for WTO requirements to candidate states is yet another idea put forward in this framework.

To attract foreign capital it could be useful to look into the possibilities of an updated version of the foreign concessions idea BIOT (build-invest-operate-transfer) adopted by the UNIDO and the UNO.

A stabilized and improved national economy will enable the Kaliningrad region to turn into a foothold for developing internationally competitive production based on Russian scientific and technological potential. It is already possible now to retrofit some machine-building and other plants, particularly in the framework of military conversion. It is suggested that on the basis of 40 medium-sized and large research institutes the oblast should host a Russian-foreign technopolis capable of boosting regional economy.

#### **4. Development Strategy of the Kaliningrad region as the Region of Cultural Cooperation<sup>1</sup>**

For the organization of effective cooperation between Russia and the EU in the cultural domain it is necessary to proceed from the assumption that the development of the local culture can be effective only on condition that it is built upon a solid Russian tradition and includes the skills and habits of environmental interaction cultivated in the course of centuries-old history of the peoples who have been living here. It means that the optimal strategy of the regional cultural development has become a prudential combination and synthesis of different cultures. The first constituent of this strategy is the development of Russian culture. It implies mastering the full-fledged Russian language, Russian literature and traditional Russian communication strategies; another constituent implies the intensive study of European cultural heritage, the integration of the region and the country at large into the contemporary All-European cultural processes. Both strategies must be balanced. On the one hand, the region should be open to European tendencies, on the other hand, an effective means of promoting national identity protection should be established.

The regional cultural policy achievement can't fail to take into account the tendencies in the EU cultural policy. These tendencies include *network cooperation* (stated in the European Cultural Network Manifesto, 1991) and the active use of the *supranational programs* funds (including European programs) for the enrichment of cultural environment in differ-

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<sup>1</sup> This chapter was prepared in collaboration with Yu.Yu. Bardun and I.O. Dementiev.

#### **4. Development Strategy**

##### ***of the Kaliningrad region as the Region of Cultural Cooperation***

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ent countries. Everything stated above implies the foundations consideration and the study of the experience of cultural sphere restructuring in the neighboring countries undergoing the transition period, the encouragement of first-hand cultural cooperation between the Kaliningrad region organizations and partnership organizations from European countries, rendering assistance to the expansion of Russian cultural achievements abroad, education and training of competent professional communities and specialists, including cultural domain management staff.

Thus, the Programme of the Kaliningrad region development as a region of cultural cooperation between Russia and the EU should include the set of activities in the following ways.

Combined research activities:

- carrying out combined research including (1) the field of cultural consequences of the EU expansion; (2) elaboration of assessment criteria of the processes of regional cultural activities; (3) the encouragement and support of publications dealing with international cultural cooperation and cultural policy. The base line of the regional cultural policy should primarily be the orientation to *the analysis of Russian and world-wide cultural contacts*. It is necessary for *Russian culture to be studied and treated* as a part of European and world culture. Such familiarization with Russian culture would allow the latter to become more familiar to the people of other countries;

- the development of educational programs in the Russian language and culture for Baltic States;
- the development of educational programs in the languages and cultures of Baltic States for Russian people.

The development of facilities for cultural activities:

- the development of the infrastructure in Kaliningrad and other regional towns: the establishment and development of approved modern conference centers, show-rooms and pavilions and concert halls;
- the involvement of the regional cultural communities and associations in the network cooperation with Russian and foreign partners by joining the existing and advanced networks and by originating new Internet-assisted network projects. In this connection additional efforts are necessary to gain a better understanding of network cooperation principles;
- the creation of special programmes funded by both Russia and the EU for the encouragement and support of international cultural cooperation within the region;

- the development of educational, scientific and cultural resource centers, floating data exchange, experience exchange in the sphere of cultural cooperation between Russian and the EU, which can assist in the search for partners, the elaboration and realization of joint initiatives within the Kaliningrad region, monitoring the current situation and working out recommendations for state and local authorities and the EU institutions. At the same time “the growing points” should become the institutions, possessing profound material and technical basis, intensive relations with Russian and foreign partners and, above all, the personnel, experienced in working on international projects (for e.g. Kaliningrad State University, Kaliningrad Art Gallery and World Ocean museum in Kaliningrad, Tilsit-theatre in Sovetsk, the Brachert museum in Svetlogorsk, etc.).

Boosting cultural activities:

- the identification of various kinds of cooperation between Russian and European cultural organizations of different ownership forms; organizing international festivals, exhibitions and events dealing with European and Russian heritage, modern art, social life, cultural cooperation between Russia and the EU;
- ensuring the participation of the Kaliningrad region in EU educational, scientific and cultural programmes. Support programmes for exchange and joint projects are not of primary importance in this connection. The programmes for preserving cultural heritage, the programs for local development encouragement at the expense of projects which take into consideration the cultural constituent (for e.g. the reconstruction and development of historical memorials in the tourism infrastructure, the development of cultural tourism, the development of industry based on non-material cultural heritage use) are also very important;
- the development of specialized and popular libraries and mass media resources, TV programming dealing with different aspects of social (political, business, cultural) life in Russia and the EU.

## **Conclusion**

Russian policies as well as EU policy are policies of partnership and cooperation. The Kaliningrad region due to its geographical position should become a region of cooperation between Russia and the EU, where integration processes, mutually beneficial cooperation in the economical, cultural and environmental spheres are to undergo advanced development.

The **regional strategy** should be focused on the development of the Kaliningrad region as a region of cooperation between Russia and the EU. The fulfillment of the adopted regional strategy should be regarded as a matter of federal concern.

While settling the requirements of the **federal policy concerning Kaliningrad** it is necessary to take into account the exclave position of the region to a greater degree compared to other Russian regions. Thus, the foreign policy of Russia must be taken into consideration. The special character of Russian federal policy concerning the Kaliningrad region should be based on the encouragement of cooperation functions and should comprise the following guarantees:

firstly, the implementation of the Federal Special Programme “The Development of the Kaliningrad Region for the period until the year 2010”;

secondly, the Special Economic Zone status in the Kaliningrad region, in other words, a new version of the federal law on the Special Economic Zone in the Kaliningrad region and the adaptation of other legislative acts in accordance with its regulations (Customs Code and Internal Revenue Code especially). This new document should not lead to the deterioration of conditions in the region. It should include conditions beneficial to regional development of import-substituting industries in the context of Russia’s accession to the WTO. It is expedient to attract investors for the Federal Special Programme projects as well as investors for other major investment projects;

The primary task is to provide the forthcoming adoption of amendments to the Special Economic Zone Law, which should reflect European and world-wide development tendencies aimed at securing a greater freedom of movement of goods, services, capital and labour resources. The intention is to ensure further renewal of the Federal Special Programme taking into account the emergent problems due to the EU enlargement and Russia’s accession to the WTO. It is necessary to develop a system of regional protection taking into account the possible negative effects of these processes on the Kaliningrad region and Russia as a whole due to the convergence of their growth rates and due to the absence of proper harmonization of regional economical development processes with integration processes in the EU. It is advisable to earmark federal financing for additional expenditures of the regional enterprises and organizations;

thirdly, it is necessary to consider and implement proposals for investment corporations, which can ensure the financing of the Federal Spe-

cial Programme projects and other regional investment projects. The creation of the appropriate structure is necessary for the advancement of this process and attracting investments. The contributions of federal and regional authorities, municipalities, national and international investment banks, representatives of the EU commission are necessary for the establishment of such a corporation (foundation);

fourthly, it is advisable to provide for the federal supervision of the Federal Special Programme implementation. As long as the program reflects federal concerns, the government is virtually its customer. And it is up to the government to take responsibility for the fulfillment of the Programme.

Other important regulations of the federal policy concerning the Kaliningrad region should be guaranteed in the Federal law on Kaliningrad as a Russian Exclave.

On an **international level**, the negotiations between Russia and the EU within the framework of Partnership and Cooperation Agreement should grow in importance. It is advisable to engage Kaliningrad experts while discussing regional development issues.

It is necessary to complete an agreement between Russia and the EU on the viability and development of the Kaliningrad region. It should provide for mutual commitments ensuring the freedom of movement within the region and mainland Russia, working out integration mechanisms, taking part in cooperation projects, cooperation in the cultural, educational and environmental spheres, etc. Russia should advance an initiative concerning the respective agreement.

To attract investments it is necessary to set up an international investment corporation, attracting investments for the timely completion of the projects and ensuring the necessary guarantees for the investors. It is also necessary to work out the issue of fulfillment of the modern version of foreign concessions, to obtain exemption from customs duties and tariffs for all goods manufactured in Kaliningrad and exported to the EU.

In order to harmonize federal, regional and international concerns for the Kaliningrad regions it is advisable to establish a special international analytical center with headquarters in Kaliningrad as well as an international group of analysts and lawyers, in charge of coordination of European and Russian legal norms and precepts of law with a view to molding the common European legal space. It is also necessary to establish several permanent conference centers in Kaliningrad, to support the Regional Development Agency and its coordination with regional authorities. It is nec-

essary to expand such international programmes as FARE, SAPARD, ISPA, etc. in the Kaliningrad region.

To tackle the emerging economic and cultural cooperation issues it is necessary to form plenipotentiary Kaliningrad region representation in the EU (in Brussels) and the EU representation in the Russian Federation (in Kaliningrad).

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**THE KALININGRAD REGION OF RUSSIA  
AND THE EU ENLARGEMENT.  
ISSUES OF THE PAN-EUROPEAN INTEGRATION**

**Analytic report**

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