



# A CAPTIVE ISLAND

## KALININGRAD BETWEEN MOSCOW AND THE EU

Jadwiga Rogoża, Agata Wierzbowska-Miazga, Iwona Wiśniewska

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**OSW** |

CENTRE FOR EASTERN STUDIES

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# Contents

KEY POINTS /5

INTRODUCTION /8

- I. KALININGRAD OBLAST: A SUBJECT OR AN OBJECT OF THE FEDERATION? /9
  1. THE AMBER ISLAND: Kaliningrad today /9
    - 1.1. Kaliningrad in the legal, political and economic space of the Russian Federation /9
    - 1.2. Current political situation /13
    - 1.3. The current economic situation /17
    - 1.4. The social situation /24
    - 1.5. Characteristics of the Kaliningrad residents /27
    - 1.6. The ecological situation /32
  2. AN AREA UNDER SPECIAL SURVEILLANCE: Moscow's policy towards the region /34
    - 2.1. The policy of compensating for Kaliningrad's location as an exclave /34
    - 2.2. The policy of reinforcing social ties with the rest of Russia /43
    - 2.3. The policy of restricted access for foreign partners to the region /45
    - 2.4. The policy of controlling the region's co-operation with other countries /47
  3. THE TWO SIDES OF THE COIN: Kaliningrad's interests versus Moscow's interests /53
    - 3.1. The interests of Kaliningrad /53
    - 3.2. Moscow's interests with regard to Kaliningrad /55
    - 3.3. The conflicts of interests between Kaliningrad and Moscow /56
- II. CO-OPERATION DESPITE DIFFICULTIES: KALININGRAD AND ITS EU NEIGHBOURHOOD /58
  1. EUROPE'S PERIPHERY: The EU's relations with the region so far /58
    - 1.1. Kaliningrad in the European Union's policy /58
    - 1.2. Kaliningrad's contacts with its EU neighbours /61
    - 1.3. Economic co-operation /65
  2. CO-OPERATION WITH KALININGRAD: Conclusions for EU policy /67
    - 2.1. Co-operation at the federal level /67
    - 2.2. Co-operation at the regional level /71



## KEY POINTS

1. Kaliningrad oblast is a Russian exclave surrounded by the European Union. Because of its special geopolitical situation, on the one hand it is part of the Russian legal, political and economic framework, while on the other it is physically separated from the rest of the Russian Federation, with all the consequences of that fact. The 'insular' location of this region influences the model of its economy, which heavily relies on imports and is focused on foreign co-operation. Its specific location also affects the mindset of this region's residents, who perceive themselves as a part of the Russian nation but at the same time have a sense of their separate identity, which is manifested in their openness towards Europe and their greater activeness and entrepreneurship in comparison to the rest of the Russian nation.
2. As a subject of the Russian Federation, Kaliningrad must adhere to the rules and solutions established by the central government, and all decisions regarding this region's most vital issues are taken in Moscow. The priority of Russian regional policy is preventing potential threats to the territorial integrity of the Russian Federation, which in the case of Kaliningrad oblast primarily means not allowing its bonds with the rest of the country to weaken. Moscow's policy towards this region is first of all aimed at compensating it for its separation from the rest of Russia. In effect, the oblast receives numerous benefits in the form of financial aid and economic privileges. However, Moscow's oversensitivity to issues which could pose challenge to Russia's integrity is at odds with Kaliningrad's desire to become more open to the EU neighbourhood, and in some cases has limited the region's economic potential. This is making the oblast a kind of a 'captive island'.
3. Both the political elites and the public in Kaliningrad have demonstrated their willingness to enhance co-operation with their neighbours in the EU. From Kaliningrad's point of view, it would be beneficial not only to develop economic relations but also to intensify people-to-people contacts, including unrestricted travel, to which the introduction of a local border traffic regime between Kaliningrad oblast and Poland may contribute. From the perspective of the European Union, Kaliningrad is not an independent partner for co-operation, but only one element of the EU's relations with the Russian Federation as a whole. However, the island-like situation of Kaliningrad oblast makes it a distinct question in EU policy, especially regarding transit and visa issues, as well as aid programmes. In the opinion

of the authors of this report, the European Union's more intensive activity in Kaliningrad oblast in response to this region's aspirations is feasible and would be beneficial to both parties. This region will remain surrounded by the EU, and it will still share numerous practical issues with its neighbours which need to be resolved together, for example in the area of ecology. Developing the oblast and bringing it up to living standards similar to those in the neighbouring EU member states would contribute to building a stable and safe neighbourhood for the EU, something which is especially important for Poland and Lithuania.



Map. Kaliningrad oblast and Polish counties covered by the local border traffic regime



## INTRODUCTION

The purpose of this publication is to present the special features of Kaliningrad oblast, the Russian exclave<sup>1</sup> inside the European Union. This analysis of the current situation in this region is intended to help finding a model of co-operation between the EU and this region which would take both its potential and its limitations into account.

The report has been divided into two parts: the first section (chapters 1-3) concerns the current situation in Kaliningrad and its relations with Moscow. The first chapter characterises the current political, economic and social situation in Kaliningrad oblast, the second chapter assesses Moscow's policy towards the region, and the third specifies the interests of this region and of the federal centre and indicates the conflicts between them. The second section of the report outlines the region's co-operation and contacts with its EU neighbourhood. The text concludes with a chapter containing recommendations for EU partners of areas of possible co-operation with the region, using contacts at both the federal and regional levels.

<sup>1</sup> Formally, Kaliningrad oblast, which has access to the Baltic Sea, should be defined as a semi-exclave (from the perspective of the Russian Federation) and a semi-enclave (from the perspective of the European Union). However, for the needs of this text, the authors have used the term 'exclave/enclave' with regard to this region, as do most experts who write about Kaliningrad oblast.

# I. KALININGRAD OBLAST: A SUBJECT OR AN OBJECT OF THE FEDERATION?

## 1. THE AMBER ISLAND: Kaliningrad today

### 1.1. Kaliningrad in the legal, political and economic space of the Russian Federation

Kaliningrad oblast, as one of the 83 federal subjects of the Russian Federation, is bound by the same legal regulations as all Russian regions. As with the remaining Russian federal subjects, the status of Kaliningrad oblast is determined by the constitution of 1993, the statute adopted by the regional parliament in 1996<sup>2</sup>, and other legal acts which regulate specific areas of socio-economic life (codes and federal laws). However, it is the practical governance and the regional policy adopted by the central government which is of key significance for this region. Back in the 1990s Russia witnessed processes of decentralisation due to the weakness of the central government and severe economic problems. Leaders of numerous Russian regions, including Kaliningrad oblast, demonstrated their political ambitions at that time, enjoying significant independence (for example, establishing their own foreign contacts) and successfully lobbied in Moscow for political and economic decisions beneficial to themselves and their regions (for example, concerning the extraction of raw materials, the distribution of taxes, etc.). Since 2000, **when Vladimir Putin was first elected president of Russia, the policy of centralising power has been applied to Kaliningrad oblast, as to the other Russian regions.** In this period, the most important legislative changes that have affected Kaliningrad oblast were as follows:

- the financial reform of 2001, which deprived the regions of some of the direct revenues from taxes (these were transferred to the federal budget<sup>3</sup>), and in exchange introduced a mechanism for granting them subsidies and subventions. As a consequence, the regions' financial situation has become more dependent

<sup>2</sup> The text of the statute is available at <http://duma39.ru/region/ustav.php>

<sup>3</sup> The regions lost control of the redistribution of part of their incomes from VAT, social insurance and the road fund (at present, 99% of PIT remains in the regions, and all revenues from VAT go to the central budget). It is worth noting that only part of the subsidies are granted under federal budget acts, while a greater part is transferred to the regions on the basis of decisions taken by the government and individual ministries. As a consequence, the regions do not know how much funds they will receive from the centre at the time they are drawing up their budgets for the next year.

on decisions taken in Moscow. The federal budget received almost US\$1 billion in taxes and duties collected in Kaliningrad oblast in 2010, while the revenues (including from taxes) which went directly to the budget of the oblast itself were slightly over US\$500 million. The region got less than US\$400 million back in the form of subsidies, subventions and donations. According to data from Kaliningrad oblast's Finance Ministry, subsidies, subventions, donations and transfers accounted for 40% of the oblast's budget incomes. This assured the region a medium position in the ranking of Russian regions. However, when calculated *per capita*, Kaliningrad is among the ten regions receiving least support from the federal budget<sup>4</sup>. The dependence of the regional budget on the central government increased in the first nine months of 2011 by up to 61% (the oblast received around US\$350 million from Moscow, i.e. 34% more than a year before);

- the process of adjusting regional laws to federal legislation, for example, the elimination of provisions which contradict legislation at the federal level (in the 1990s, some federal subjects introduced provisions into their legal acts which were contrary to federal law, concerning such issues as special autonomy, or even 'sovereignty', as was the case with Tatarstan);

- the introduction of a new administrative division of the Russian Federation in 2001: the creation of the federal districts (each of which encompasses more than ten regions) led by presidential envoys (plenipotentiary representatives), whose real competences were much broader than their formal powers (monitoring and advising). Kaliningrad oblast became part of the North-Western Federal District (FD), with its administrative centre in Saint Petersburg, and the envoy in charge of the FD had a representative in Kaliningrad;

- changes in the election procedure concerning the heads of the regions: instead of being elected in general elections, between 2005 and 2012 they were nominated by the president upon motion from regional parliaments, where the 'party of the ruling class', United Russia, predominates. The liquidation of elections for heads of regions enabled the Kremlin to replace the previous

<sup>4</sup> In 2011, Kaliningrad oblast received 1894 roubles of subsidies *per capita* from the federal budget. The least-subsidised regions include the prosperous Krasnoyarsk krai (1044 roubles *per capita*) and Sverdlovsk oblast (997 roubles), and also such poor regions as Kaluga oblast (1066 roubles) and Vologda oblast (1572 roubles). Kaliningrad is far behind the leading recipients of federal aid: Chechnya (13,021 roubles), Yakutia (42,998 roubles) and the record-breaking Kamchatka krai (86,957 roubles). See *Nezavisimaya Gazeta*, 16 November 2010, [http://www.ng.ru/Economy/2010-11-16/1\\_dotacii.html](http://www.ng.ru/Economy/2010-11-16/1_dotacii.html)

governors with people who were more loyal to Moscow. As a consequence, Georgy Boos, a trusted aide of then-President Putin, was nominated governor of Kaliningrad oblast in 2005; in 2010 he was replaced by Nikolay Tsukanov, a member of the local branch of United Russia<sup>5</sup>;

– regional political parties and blocs have ceased to exist and have been replaced with the regional structures of the federal political parties. As a consequence, only officially registered parties may take part in elections (previously, the participants of elections included blocs of parties with political movements), and the regional groupings existing in the oblast have been proscribed (such as the Baltic Republican Party in 2005).

As one of the Russian regions, Kaliningrad oblast is also subject to the economic regulations adopted by the federal centre, which cover, for example, the customs and budget codes, international agreements, acts and decrees which set the rules for running business and investing in Russia as a whole. The federal government also decides on granting economic preferences to a region, such as the creation of a Special Economic Zone in Kaliningrad oblast, or offering transport relief. It is also up to Moscow to decide on the implementation of large infrastructural projects in the oblast (for example, by granting funds), such as the construction of a power plant or the development and modernisation of road infrastructure. Moscow's anti-crisis policy, as part of which money transfers were increased, was a great support for Kaliningrad oblast. It allowed the region to balance up its budget and meet its financial obligations in 2009<sup>6</sup>. The federal regulations offer some limited autonomy to the regional government: for example, it can create a system of incentives for investors by offering them tax allowances<sup>7</sup>, assistance in finding land for investment, easier access to infrastructure, or simplified administrative procedures.

<sup>5</sup> The procedure of direct elections of the heads of the regions was reinstated in June 2012, although numerous restrictions have been introduced in this process, allowing the Kremlin to sustain control over the governor elections.

<sup>6</sup> For example, Moscow granted 4 billion roubles to Kaliningrad oblast in summer 2009 to enable the regional aviation company KD Avia, which was about to go bankrupt, to pay outstanding wages.

<sup>7</sup> According to the Budget Code of the Russian Federation, the regions are free to set the rates of regional taxes, including transport tax and corporate property tax, and also to lift part of the federal taxes which go to the regional budgets, for example, the 20% corporate income tax; 18 percentage points of this tax go to the regional budget, and the region may reduce it by 4.5 percentage points.

On the other hand, even though in terms of applicable laws **Kaliningrad oblast is governed by the same regulations as the other regions, its small area and unique location** (as an exclave surrounded by EU member states) **mean that some standard regulations have non-standard consequences in the case of this oblast, and result in tighter control by the central government.** One of non-standard aspects in the case of Kaliningrad has been Moscow's staffing policy. It is a rare practice across the Russian Federation to nominate as governor a politician from outside a given region, as has taken place in Kaliningrad oblast (the aforementioned nomination of Georgy Boos, a Moscow-based politician with no links whatsoever with Kaliningrad). As a result, Boos did not identify himself with the region and was loyal to Moscow, and therefore focused on supporting big federal business in the region (at the expense of local businesses) and reinforcing the central government's control of this region<sup>8</sup>.

The essential role Kaliningrad oblast plays in the **Russian security policy** has also had non-standard consequences for the oblast itself. Kaliningrad is the westernmost region of Russia, which borders on EU and NATO member states. Also, Kaliningrad is the only Russian ice-free port on the Baltic Sea. The concentration of military units in Kaliningrad oblast is among the highest in Russia, which – given its small area, low population density and separation from the rest of the country – makes the military factor here much more important than in other regions of the Russian Federation. Kaliningrad oblast is seen in Moscow as an essential element of Russia's military potential. Numerous army and fleet units which report directly to the relevant federal ministries are stationed here<sup>9</sup>. The command of the Baltic Fleet is located in Kaliningrad oblast, which is part of the Western Military District. Additionally, fleet units (including four ship brigades), an armoured brigade, a marine infantry brigade,

<sup>8</sup> The regulations imposing an obligation on officials to seek special consent from Moscow for foreign official trips were enforced during Georgy Boos's rule. Although no formal ban or restrictions on such trips had been imposed, officials admitted off the record that Moscow was ill-disposed towards regional officials' contacts with their neighbours from the EU. Therefore, public servants applied for relevant permits relatively rarely, and their official contacts with the neighbouring countries were quite limited. Governor Boos himself set a negative example in this respect: he did not visit Poland at all, and went to Lithuania only once throughout his entire five-year term in office.

<sup>9</sup> Federal ministries do not consult their decisions with the regions' governments, which sometimes complicates regional affairs. For example, the Cup of Three Governors regatta in July 2010, organised by the governor of Kaliningrad oblast among others, was unexpectedly disturbed by the military exercises of the Baltic Fleet in the Vistula Lagoon, as a result of which the Polish yachts taking part in the race were stopped at the Polish-Russian border. For more, see <http://www.portel.pl/artykul.php3?i=51022>

an artillery brigade and a missile brigade are deployed there. In total, around 15,000 soldiers are stationed in Kaliningrad oblast (when counted jointly with other law enforcement agencies, the number of armed personnel is around 25,000)<sup>10</sup>. The oblast's military potential is also being constantly reinforced as part of the modernisation of the Russian armed forces. A Voronezh-DM early-warning missile defence radar station was put into operation in Kaliningrad oblast in December 2011. The programme to modernise the Russian armed forces also envisages the deployment of Iskander ballistic missile systems (with a range of up to 500 km), capable of carrying tactical nuclear warheads, in this oblast; preparations for their deployment started in January 2012. In turn, in April 2012 the air defence troops stationed in Kaliningrad oblast were equipped with S-400 air-defence missile systems (thus this oblast will become the second Russian region, after Moscow and environs, to be covered with the protection offered by these systems)<sup>11</sup>. The oblast also has storage facilities for tactical nuclear weapons, which means that such weapons can be deployed there in a relatively short time.

Since this is a frontier region, a well-developed structure of customs and border services operates here which also reports to the central federal authorities. Kaliningrad oblast has extensive restricted-access zones which in total make up as much as one-third of the oblast's territory (for more see section 2.3.1.).

## 1.2. Current political situation

Nikolay Tsukanov has been the governor of Kaliningrad oblast since August 2010 (see box 2). Tsukanov was born in this oblast. He was the mayor of Gusev (2005–2009) and the head of administration of Gusevsky District (2009–2010) and earned a reputation of one of the most efficient officials in the entire Kaliningrad oblast<sup>12</sup>. Tsukanov has been a member of the ruling party United Russia for many years, although rather a rank-and-file member (the most senior position he has held in the party was that of secretary of the regional political council).

<sup>10</sup> For example, see [warfare.ru](http://warfare.ru)

<sup>11</sup> For more, see Andrzej Wilk, 'Iskanders in the Kaliningrad region regardless of the 'missile shield'', *EastWeek* no. 281, 1 February 2012, [www.osw.waw.pl](http://www.osw.waw.pl)

<sup>12</sup> In 2009, the town of Gusev was recognised by the government of Kaliningrad oblast as the best managed municipality in the region. In 2010, Gusev received a governmental prize of 13.5 million roubles for running the best-managed town in Kaliningrad oblast.

The federal political parties have their regional structures in Kaliningrad oblast: the ruling party United Russia, and the parties which are believed to be the 'licensed' opposition, namely the Communist Party of the Russian Federation, the leftist populist party named A Just Russia (established in 2006 upon inspiration from the Kremlin, although it was later persecuted by the government) and the nationalist Liberal Democratic Party of Russia led by Vladimir Zhirinovskiy. Structures of the democratic party Yabloko and of the Patriots of Russia (a moderately nationalist party which has been dominated by the trade union movement in Kaliningrad oblast) also operate here. As in the other regions, United Russia predominates in the local parliament in Kaliningrad (see box 1). However a greater political variety, compared to the rest of Russia, is characteristic of Kaliningrad oblast. This is manifested through the stronger position of the smaller parties (primarily Patriots of Russia) present in Kaliningrad's parliament than in other regions, and also through the poorer results achieved by United Russia than the national average (see chart 1).

As with most of the regions, the regional structures of the large federal political parties have their characteristic features resulting from the influence of local interests. United Russia in Kaliningrad is the party of the local political and business elites, and so its activity is affected both by guidelines from its headquarters in Moscow and the local interests (including business) of its members linked to the region. Sometimes these interests come into conflict<sup>13</sup>, such as for example in the case of visa-free movement between Kaliningrad oblast and the European Union: members of the regional United Russia (led by the current Governor Nikolay Tsukanov) were appealing for Kaliningrad to be made a pilot region in the process of establishing a visa-free regime between the European Union and the entire Russian Federation. These appeals have not been supported by the federal political elite, who instead have negotiated a local border traffic agreement with Poland for Kaliningrad (for more see part I, chapter 2.4.1.).

Several political movements exist in the exclave; most of them are inclined towards opposition. As well as the regional structures of federal organisations (for example of the liberal and democratic opposition Solidarity movement),

<sup>13</sup> The conflict of interest between the regional structures of political parties and their headquarters in Moscow was noticeable, for example, during the protests against the policy adopted by Governor Boos and Putin's government in January 2010: regional sections of the Communist Party and the LDPR took part in the protest actions, contrary to recommendations from their respective party headquarters in Moscow.

there are also movements which have emerged in the region itself. The best-known of them is the Justice movement led by Konstantin Doroshok<sup>14</sup>. Justice declares itself as a movement in opposition to the region's government. Since its emergence in 2008, it has been among the main organisers of protests in the region (including the protests in January 2010). The Solidarity and Justice movements and the regional structures of the political parties (the CPRF, A Just Russia, the LDPR, the Patriots of Russia and Yabloko) have formed the 'Our Kaliningrad' coalition, which has declared itself as an opposition bloc targeted against the political domination of United Russia (in March 2010, this coalition was engaged in monitoring the regional parliamentary elections). Numerous social organisations also operate in Kaliningrad oblast, in addition to political organisations (for more see section 1.5.).

### **Box 1. Parliament of Kaliningrad oblast (elected in March 2011)**

United Russia – 24 seats (60% share)\*

Communists – 6 seats (15%)

Patriots of Russia – 2 seats (5%)

A Just Russia – 2 seats (5%)

LDPR – 2 seats (5%)

Independent MPs – 4 seats (10%)

(Total – 40 MPs)

\* United Russia gained additional MPs thanks to single-member constituencies (mixed voting regulations apply during elections in the region; half of the MPs are elected from party lists and half seek election by themselves)

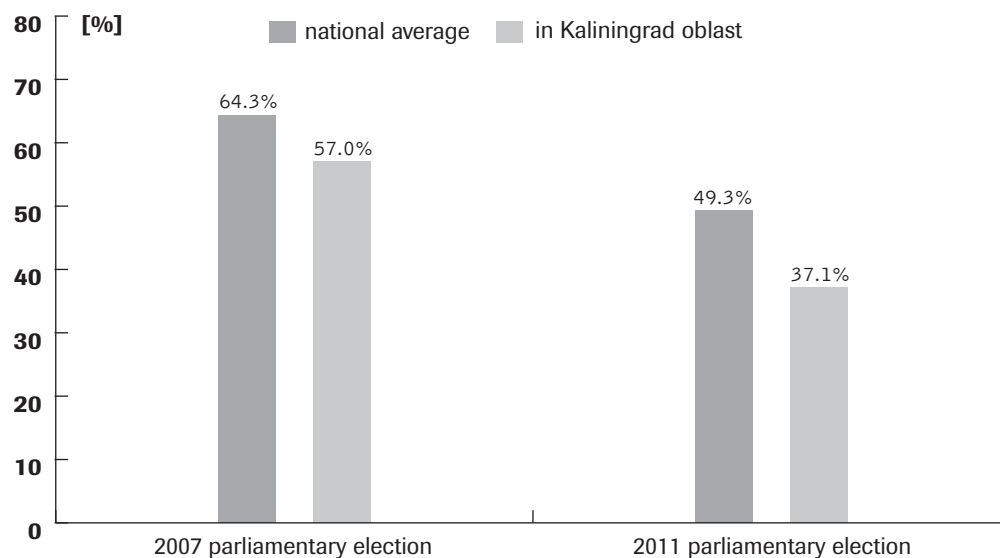
<sup>14</sup> The leader of this movement, Konstantin Doroshok, became engaged in protest activity when the customs service imposed huge outstanding taxes on him and many other businessmen who imported used cars, thus forcing them to wind up their businesses. He established the Solidarity movement, which since 2008 has organised regular protests against the policies of the region's government, especially regulations unfavourable for small- and medium-sized businesses.



## Box 2. Governors of the oblast

Period	Governor	Previous career	Manner of election
1991–1996	Yuri Matochkin	civilian fleet captain, served in the Soviet KGB Border Troops	appointed by President Boris Yeltsin
1996–2000	Leonid Gorbenko	director of the State-Owned Fishing Port in Kaliningrad	elected in a general election
2000–2005	Vladimir Yegorov	Baltic Fleet Admiral	elected in a general election
2005–2010	Georgy Boos	a Moscow-based politician, a high-ranking member of the United Russia party	appointed by President Vladimir Putin
since 2010	Nikolay Tsukanov	a politician who was born in Kaliningrad oblast, a member of United Russia	appointed by President Dmitry Medvedev

**Chart 1. Levels of electoral support for United Russia in Kaliningrad oblast, and in Russia as a whole**



Source: Central Election Commission of the Russian Federation

### 1.3. The current economic situation

The region's economic situation is closely linked to the economic situation in the rest of Russia. The Russian market is the main outlet for the goods manufactured in the exclave (TV sets, cars, furniture and food). Furthermore, Russian companies (predominantly state-owned) are the key investors in the region. The exclave's economy is characterised by a small outlet market (less than one million people), low investment potential for global companies, and practically complete dependence on supplies (from both Russia and abroad) of raw materials, consumer goods and semi-finished products used in the region's industry.

The economic crisis has had a very strong negative impact on Kaliningrad's economic situation (in 2009, Gross Regional Product (GRP) fell by 14.9%, while the GDP of Russia as a whole fell by 7.8%). Although economic revival has been observed since 2010, as in the rest of Russia, the socio-economic indicators are returning to the pre-crisis levels quite slowly. The oblast's GRP grew by 7.8% in 2010 and by 7% in 2011 (in comparison to 4% in the Russian Federation as a whole). According to forecasts, growth will be slower in the next years due to the difficult situation on the European and Russian markets.

In contrast to the rest of Russia, Kaliningrad oblast has a well-developed **small business sector** (see chart 2). **Their number in Kaliningrad (23.5 per thousand residents) is double the Russian average (11), and they generate around to around 35% of the exclave's GRP (only 17% in Russia as a whole).** This is a result of the privileges the region had before 2006, which allowed for duty-free import of goods to the region, and contributed to the development of trade. Yet on the other hand, this is an effect of intensive contacts between the region's residents with their neighbours.

However, the main branches of the region's economy are trade and industry (assembly plants of goods such as cars and TV sets operate there); each of these sectors generates around 20% of GRP (see chart 3 for more details). In recent years, together with the development of Kaliningrad's heating plant and plans to build nuclear power station, the importance of big business in the region has risen noticeably. This is the main driving force behind Kaliningrad oblast's development and the key source of funding for investments. The seven

largest businesses (including Avtotor Holding, LUKoil-Kaliningradmorneft and TEC-2) account for 20% of the exclave's GRP<sup>15</sup>.

Since 2006, large business entities which invest over around US\$5 million in the region have been offered the possibility to use fiscal and customs privileges until 2031 (in compliance with the law) as part of the Special Economic Zone (SEZ) which covers the entire Kaliningrad oblast (for more on the zone see chapter I, 2.1.1.). However, the benefits offered have failed to bring about a rapid development of the region; around 50 businesses were residents of the zone in 2011. Over the five years of the zone's operation, these businesses have only invested around US\$120 million in this region, while total investments in the region's basic capital in 2010 reached around US\$2 billion. Despite the privileges granted to Kaliningrad oblast, it is significantly below the Russian average in terms of economic development – its Gross Regional Product (GRP) *per capita* is still at around 60% of the Russian average (see chart 4).

The region is famous first of all for its amber deposits<sup>16</sup>, since up to 90% of global amber reserves are located in this exclave. Amber is predominantly exported without having been processed, to the region's financial detriment.

Agriculture is poorly developed in this region<sup>17</sup>, and is of low importance for its economy (it generates around 6% of GRP). As a result, most of the raw materials necessary for the regional food industry come from outside the oblast. For example, the meat industry imports as much as 90% of the raw material. Small farms account for almost half of the region's agricultural production, while the remaining part is produced by large agricultural firms (mainly privatised *kolkhozes* and *sovkhozes*).

In 2011, **Kaliningrad oblast produced enough power to meet its demand for electricity.** This was possible because the (gas) heat and power plant

<sup>15</sup> In 2010, investments in the exclave reached 66.7 billion roubles (around US\$2.2 billion), i.e. almost 15% more than a year before (the value of investments fell by more than 30% in 2009). Investments were fuelled mainly by large infrastructural projects, such as the TEC-2, the nuclear power plant and the road infrastructure.

<sup>16</sup> In 2010, the Kaliningrad Amber Factory produced 340 tonnes of amber in the region.

<sup>17</sup> Around 60% of arable land was cultivated in 2010. It needs to be noted that part of the land is below sea level and requires intensive melioration efforts.

TEC-2<sup>18</sup> had been completed, and its second block had been put into operation in December 2010. After the collapse of the USSR, Kaliningrad oblast received as much as 80% of the electricity it needed by transit via the networks of the Baltic states from power plants in the Leningrad and Voronezh oblasts. Kaliningrad's energy grid is now (since December 2011) connected with the rest of Russia by means of three energy lines (330 kW each) running through Lithuania. The technical possibility of energy transmission is ensured through the synchronisation of the Baltic states' power system with the post-Soviet system (IPS/UPS) which operates in Russia. The planned inclusion of the Lithuanian network in the European system (ENTSO-E) would cut off Kaliningrad's grid from that of Russia.

As regards the region's energy needs, the construction of a nuclear power plant in Kaliningrad oblast, which Moscow has been pushing through since 2009, is of limited significance. Its planned output is higher than the region's needs. Only part of its production could be used in the region, for example to satisfy a possible increase in demand for energy and to replace the production of small coal heat and power plants which adversely affect the natural environment. According to Moscow's concept, energy from the nuclear power plant would be exported, mainly to EU member states (for more on the nuclear power plant project, see chapter 2.1.3. and box 5).

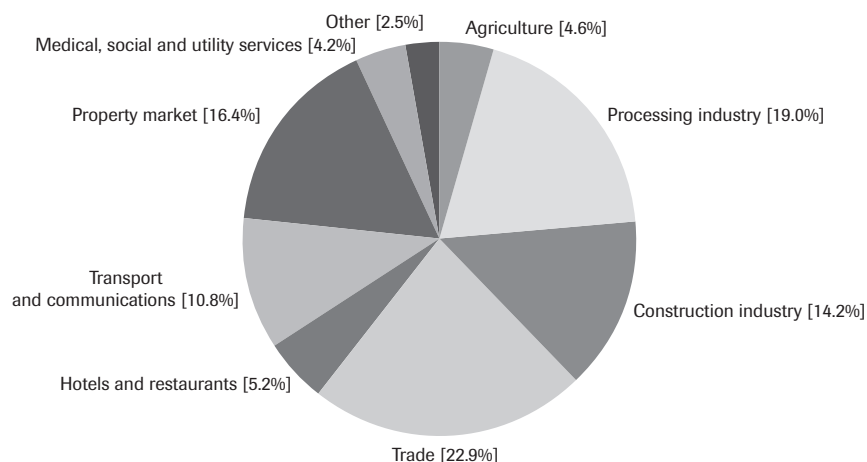
Production of electric power in the enclave relies on the following raw materials: natural gas<sup>19</sup>, mazout and coal, all of which are principally supplied from mainland Russia, in transit via Belarus and Lithuania or by sea. The regional energy sector's dependence on supplies of raw materials is causing some difficulty to the region. In the case of gas conflicts between Russia and its neighbours, this may lead to shortages of raw materials. This happened in 2004, when Kaliningrad was unable to receive gas as a consequence of Moscow cutting off its supplies to Belarus. Although the region has its own small oil fields, where the oil company

<sup>18</sup> The electricity deficit was until recently a serious impediment to this region's economic development. The construction of TEC-2 had been ongoing since the early 1990s. The main problem was the unwillingness of the key investor, Gazprom, to increase unprofitable gas supplies to this region.

<sup>19</sup> As TEC-2 has been developed, Gazprom has increased the annual capacity of the gas pipeline system used to supply gas to the enclave from 1.5 to 2.5 billion m<sup>3</sup>, and is also developing its gas storage facility in the region. These increased supplies will not only meet the needs of the heat and power plant, but also allow the residents to be connected to the network (over 60% of the residents were connected to the system at the end of 2010).

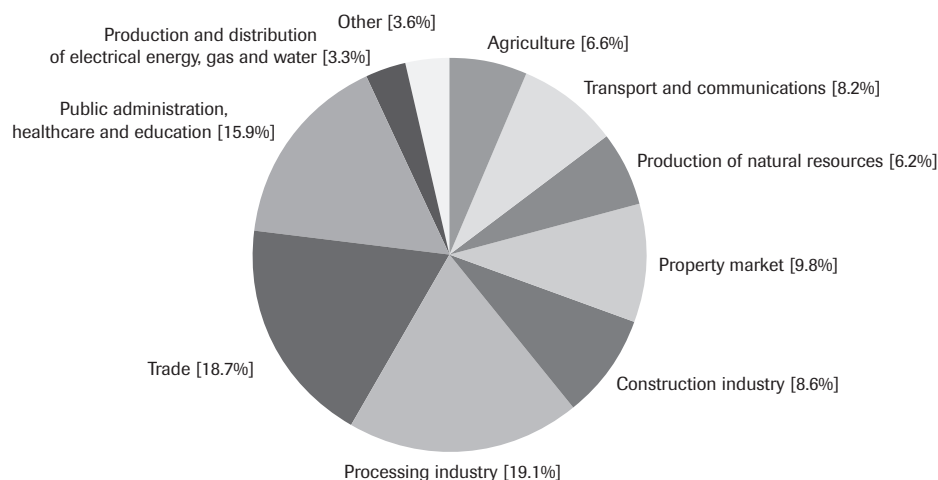
LUKoil operates<sup>20</sup>, as the oblast has no facilities to process this raw material, its demand for petroleum products must be satisfied by imports from the rest of Russia or from its neighbours, which makes fuel prices higher.

**Chart 2. Small and medium businesses, a break-up into individual sectors of Kaliningrad’s economy, value as of 1 October 2010 (in %)**



Source: Report on the results and general policies of the government of Kaliningrad oblast in 2010 (DROND 2010)

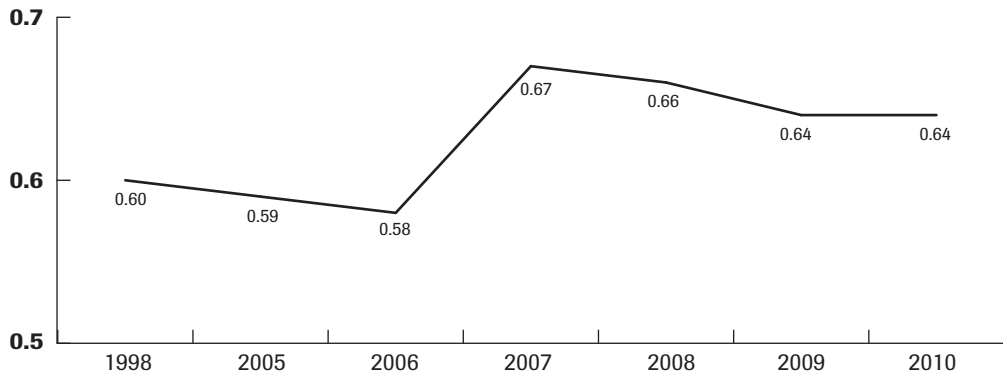
**Chart 3. The structure of Kaliningrad oblast’s GRP (in %) in 2010**



Source: Report on the results and general lines of activity of the government of Kaliningrad oblast in 2010 (DROND 2010)

<sup>20</sup> The Russian oil company LUKoil extracted over 1.2 million tonnes of oil from the fields on land and sea shelf in 2010. Its entire production is exported outside the region. The company has also built an oil terminal in Izhevskoye by the Vistula Lagoon, among other projects.

**Chart 4. Ratio of Kaliningrad oblast's GRP per capita to the Russian Federation's GDP (in %)**



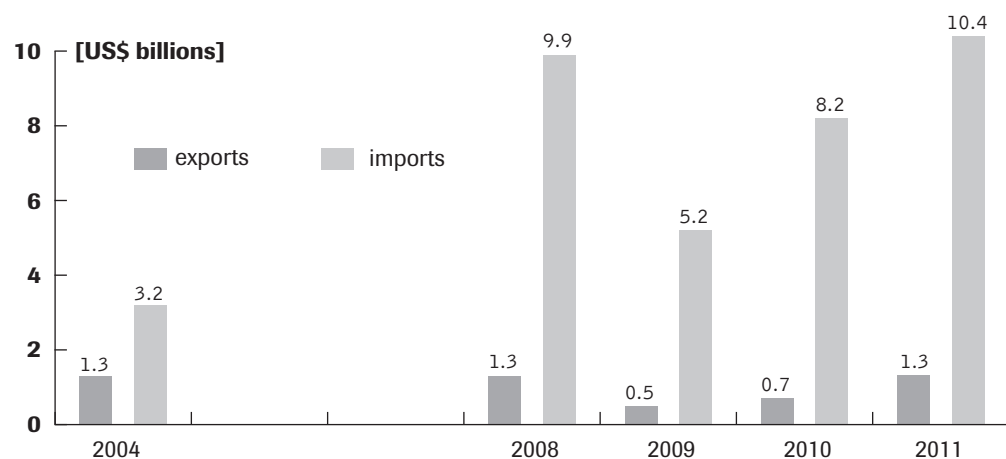
Source: Report on the results and general policies of the government of Kaliningrad oblast in 2010 (DROND 2010)

The region's economy is closely linked to foreign markets, and the value of trade (excluding trade between Kaliningrad oblast and the other regions of Russia) is one and a half times higher than the region's GRP. This region has a vast trade deficit due to its underdeveloped economy and the fact that it is used only as a way-station towards the Russian market. Imports account for over 90% of the region's foreign trade (see chart 5). Apart from consumer goods, which are necessary to meet the exclave's needs, a vast majority of the imports are semi-finished products which the local assembly plants use to manufacture goods which are then sold in the rest of Russia. Almost 90% of the value of imports are generated by the residents of the special economic zone<sup>21</sup>, who have customs privileges. Kaliningrad's top ten importers (including Avtotor and Sodruzhestvo Soya) account for 50% of the value of imported goods. The region's trade structure in terms of goods has not changed significantly. The exclave predominantly imports processed goods: electrical and machinery products (especially components for the assembly of cars and TV sets), household chemical products, agricultural and food products, footwear, clothes and furniture. Despite their geographical proximity, Poland and Lithuania are not among the key suppliers of goods to this region; they have been outstripped not only by Germany, China and South Korea, but even by Slovakia (they supply components for car assembly; see chart 6).

<sup>21</sup> Data from the Ministry of Economy of Kaliningrad oblast; <http://economy.gov39.ru/news/index.php?ID=2664>

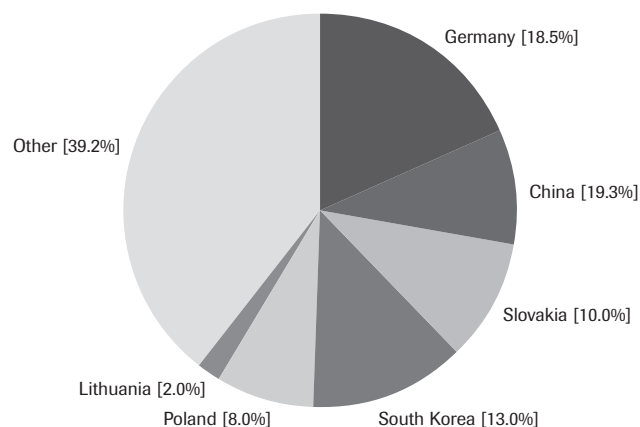
The region's exports in 2011 increased twofold compared with 2010, and therefore returned to the pre-crisis value of US\$1,3bln. This spectacular export growth was achieved mainly owing to an increase in the sales of petroleum products (their export value rose six-fold; production from other regions of Russia was re-exported from Kaliningrad oblast). Raw materials (around 70%), especially the output of the fuel and energy sector (mainly crude oil and petroleum products) and cars (although the vast majority of the production goes to the Russian market) predominate in exports. Goods from this region are exported to Germany, Poland, Lithuania, Holland and the United Kingdom.

**Chart 5. Kaliningrad oblast's foreign trade**



Source: Ministry of Economy of Kaliningrad oblast, Customs Service of the Russian Federation

**Chart 6. Share of the key trade partners in the exclave's imports in 2011 (in %)**



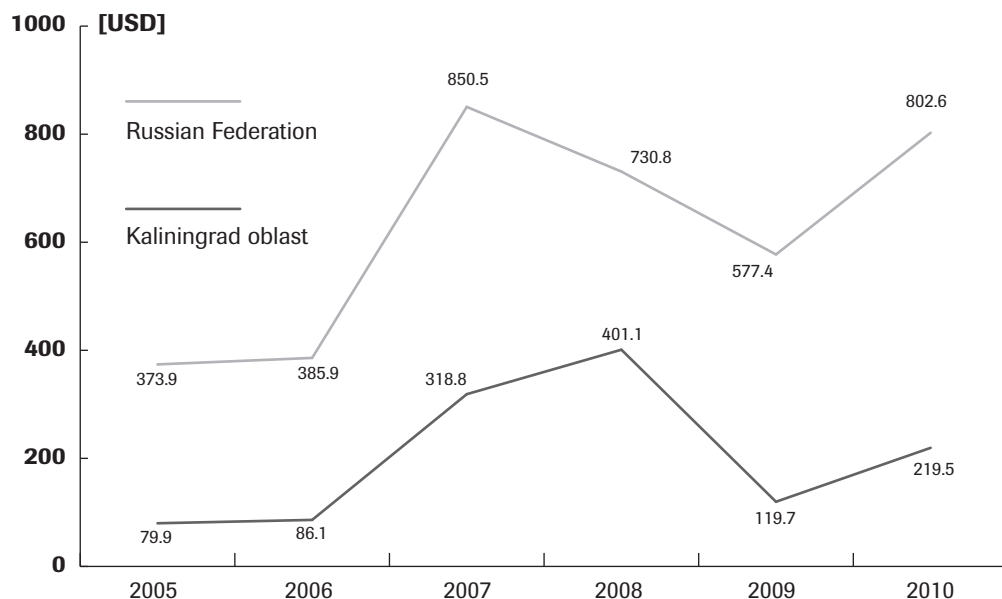
Source: Ministry of Economy of Kaliningrad oblast

**Kaliningrad oblast is not very popular with foreign investors due both to the limitations which are typical of Russia as a whole** (corruption, insufficient protection of property rights, inefficient courts and changing law) **and those characteristic of the region** (the market's isolation from the rest of Russia and the higher business costs linked to that, namely costs of energy, transit and imports). The privileges offered in Kaliningrad are insufficient to attract foreign investors. Any foreign capital which is interested in presence in the Russian market primarily chooses locations in Russia proper, especially in the numerous special economic zones already established (such as Dubna, Zelenograd and Skolkovo near Moscow). Several foreign investors have withdrawn from the region over the past few years, which is proof of the region's declining competitiveness. Two examples are Snaige, the Lithuanian manufacturer of refrigerators and coolers (which is planning to launch production in Kazakhstan), and the Polish construction firm Budimex, which have already wound up their businesses in Kaliningrad oblast. Furthermore, IKEA's investment there did not come into effect in 2010 (this Swedish firm decided to develop its presence in the rest of Russia).

As a consequence, total foreign investments in the region at the end of 2010 were estimated to have reached only around US\$800 million (over 20 billion roubles), while over US\$420 billion was invested at the same time in Russia as a whole. Yet it must be noted that the level of foreign investments has been increasing over the past few years. The value of foreign capital invested in Russia in 2010 was 80% higher than a year before (2009, being the crisis year), which means over US\$200 million more, and additionally US\$143 million more was invested in the first half of 2011. The main investors in this region are Cyprus (predominantly Russian capital returning to Russia - 21%), the USA and Poland (around 20% each), Denmark (over 10%), Lithuania (almost 9%) and Switzerland (5%). **The indicator for Kaliningrad oblast presenting the value of foreign investments per capita is equivalent to only one-third of the average Russian value** (see chart 7).



**Chart 7. Foreign investments per capita in Kaliningrad oblast and the Russian Federation**



Source: Report on the results and general policies of the government of Kaliningrad oblast in 2010 (DROND 2010)

#### 1.4. The social situation

The social situation in the region is more difficult than in Russia on average. This is principally a result of the costs related to the separation of the regional economy from the rest of the country, and of its reliance on imports, which results in high prices. This difficult situation has deteriorated further due to the global economic crisis, which affected Kaliningrad oblast especially severely. In December 2009, the unemployment rate in the region reached 10.9% (in comparison to 8.4% on average in the Russian Federation), and was among the highest in the European part of Russia. The wage arrears were also among the highest in this region, which more than tripled during 2009 (to 470 million roubles, or US\$15.6 million)<sup>22</sup>.

<sup>22</sup> Source: Rosstat.

The social situation has been improving since 2010, although most indicators have not returned to the pre-crisis levels and are still below the Russian average. The unemployment rate continues to be quite high (the average rate in September-November 2011 was 9.7%, compared to 6.2% on the average in the Russian Federation)<sup>23</sup>. People's real incomes are gradually growing (in 2010 by 2.6%). The value of outstanding wages was also reduced to 74.4 million roubles (around US\$2.5 million) in December 2011<sup>24</sup>, although the outstanding wage indicator is still among the highest in European Russia. **Kaliningrad is also among the ten regions with the lowest average wage** (in January-September 2011 it was around 19,600 roubles, or US\$650, while the average wage in Russia is 22,600 roubles)<sup>25</sup>, **while the living costs in Kaliningrad are higher than the average in Russia**. Despite this, the number of residents living below the poverty line has been decreasing over the past ten years<sup>26</sup>. The stratification of society in terms of incomes is much smaller in the region in comparison to the average levels in Russia as a whole<sup>27</sup>.

This region has a negative birth rate (in 2010, the number of deaths was around 3000 higher than the number of births, while in the first nine months of 2011 this difference was over 1000<sup>28</sup>). However, these losses are compensated for by migration. Migrants come to this exclave predominantly from the CIS, mostly from Kazakhstan. 3004 people came to settle in Kaliningrad oblast from CIS countries and the Baltic states in 2010. The positive migration balance was 3307 people<sup>29</sup>. Since January 2007, Kaliningrad oblast (along with other regions of Russia) has been engaged in the resettlement programme, which encourages

<sup>23</sup> *Ibidem*.

<sup>24</sup> *Ibidem*.

<sup>25</sup> The average old-age pension in Kaliningrad between January and September 2011 was 7900 roubles (around US\$242), while the average pension in Russia as a whole was 8300 roubles. Source: Rosstat. According to surveys carried out by the Kaliningrad Monitoring Group, in addition to traditional sources of income, 27% of the residents of this region own a garden plot, where they grow fruit and vegetables for their own needs. 31% of all residents of Kaliningrad and 40% of pensioners make fruit, vegetable and mushroom preserves every year for the winter.

<sup>26</sup> Between 2001 and 2010, the number of such people in Kaliningrad oblast fell from 395,000 to 126,100 (from 39 to 13.2%). Source: Report from the human rights ombudsman in Kaliningrad oblast 'O soblyudienii prav i svobod cheloveka i grazhdanina v kaliningradskoi oblasti za 2010 god', [http://ombudsman39.ru/annual\\_reports](http://ombudsman39.ru/annual_reports)

<sup>27</sup> Source: Ministry of Economy of Kaliningrad oblast, <http://economy.gov39.ru/socialno-ekonomicheskoe-razvities/osnovnye-pokazateli-ser/>

<sup>28</sup> The average life expectancy in this region is 67.7 years, one year shorter than the Russian average (and five years shorter than in Lithuania); Rosstat 2010.

<sup>29</sup> Source: Kaliningrad Statistical Office, [www.kaliningrad.gks.ru](http://www.kaliningrad.gks.ru)

former citizens of the USSR to settle in Russia<sup>30</sup>. The region's demographic problems have been deepened by the difficult healthcare situation: the lack of reforms in the healthcare system and insufficient funds allocated from the budget<sup>31</sup> are restricting access to medical services and are lowering their quality. There is a growing shortage of physicians and hospital beds in Kaliningrad oblast; their number per resident here is among the lowest in the entire Russian Federation, while in the Soviet period, given the military character of this region, its healthcare system was one of the best-developed in the USSR<sup>32</sup>. This situation is causing many residents to use paid healthcare services in Poland and Lithuania, where standards are higher and the charges are lower than those offered in paid healthcare within the Kaliningrad region.

Other persistent significant social problems are HIV/AIDS and tuberculosis, incidences of which are higher than the Russian averages. Nevertheless, it has been possible to prevent these diseases from spreading further, compared to the 1990s. 98.5 new cases of tuberculosis per 100,000 people were registered in 2010 in Kaliningrad oblast (82/100,000 in Russia), while in 2006 this number was 135. At the same time, tuberculosis mortality has been falling over the past few years<sup>33</sup>. The number of people diagnosed with HIV was 771 per 100,000 in Kaliningrad oblast at the end of 2010 (while the average number in Russia is 413/100,000<sup>34</sup>). However, it is worth emphasising that European countries invested funds in screening and disease prevention in this region in the 1990s. Therefore, it is difficult to conclude clearly whether the higher incidence rate concerning these diseases in Kaliningrad oblast reflects a genuinely high occurrence of these diseases in comparison to the other regions of Russia, or is simply a reflection of better diagnostics.

<sup>30</sup> 9500 people settled in Kaliningrad oblast as part of this programme by December 2010.

<sup>31</sup> The regional healthcare programme for 2009 envisaged such low funds for free healthcare in comparison to the federal standards that it was brought to court by the region's prosecution authorities. Source: Report from the human rights ombudsman in Kaliningrad oblast 'O soblyudienii prav i svobod cheloveka i grazhdanina v kaliningradskoi oblasti za 2009 god', [http://ombudsman39.ru/annual\\_reports](http://ombudsman39.ru/annual_reports)

<sup>32</sup> In 2009, there were 34.8 physicians (50.1 on average in Russia) and 80 hospital beds (97 in Russia) per 10,000 residents of the region. In 1990, there were 41.5 physicians (45 on average in Russia) and 143 hospital beds (137 in Russia). Source: 2010 Statistical Yearbook, Rosstat.

<sup>33</sup> Source: Report on the results and general policies of the government of Kaliningrad oblast in 2010 (DROND 2010), prepared by the Ministry of Economy of Kaliningrad oblast.

<sup>34</sup> Our own calculations, on the basis of data from the Russian centre for HIV and AIDS research and policy <http://www.hivpolicy.ru/statistic/national/>

## 1.5. Characteristics of the Kaliningrad residents

Although a vast majority of residents of Kaliningrad (over 82% according to the census conducted in 2002) identify themselves as Russians, they still see themselves as residents of a special area, 'a different Russia in Europe'<sup>35</sup>. This sense of being distinct is an effect of the unusual location of this region – its physical distance and separation from the rest of Russia, which has a strong impact on the identity of the residents of this region, and is forming a community of interests which are often unnoticed and unconsidered in Moscow (see box 3).

### Box 3. The evolution of Kaliningrad's historical identity

The residents of Kaliningrad make up a relatively new and constantly evolving community. It started to be formed as late as 1945, when the ethnic German residents of East Prussia, who had either fled or been displaced, were totally replaced by people from various parts of the USSR, many of whom were forced to settle in this area. The identity of Kaliningrad's residents in the Soviet period and immediately after the collapse of the USSR could be defined as 'Soviet', the components of which included the varied ethnic structure of the residents, their lack of roots in the region, and the closed and military character of the region (including the strong army presence, who together with their families accounted for up to 30% of the oblast's entire population).

Twenty years since the collapse of the USSR, the historical and social identity of the residents of this region has visibly evolved. The feeling of alienation and the lack of ties with the region and its history are gradually being replaced with growing interest in the past. The Prussian history of this region and its legacy is no longer a taboo issue. For example, this is manifested through frequent references to elements of the history of Königsberg and East Prussia (omnipresent pre-war photographs and publications which present the topography of the towns and habits of their former residents) and its famous representatives (especially Immanuel Kant), and also

<sup>35</sup> The phrase 'a different Russia in Europe' occurs in many surveys and works concerning the identity of the residents of Kaliningrad, which reflects their identification with Russia and at the same time their sense of regional specificity, distinctness from the rest of Russia and proximity to Europe. For example, see M. Berendeyev, 'Kto my? Kaliningradtsi v poiskakh identichnosti', *Sotsiologicheskiye issledovaniya* no. 4/2007, pp. 127-132., S. Ginzburg, 'Identichnost v zarubezhnoi Yevrope i v Kaliningrade', [http://rugrad.eu/communication/blogs/blog\\_Ginzburg/1147/](http://rugrad.eu/communication/blogs/blog_Ginzburg/1147/)

through care of the monuments, and discussions about reinstating historical names (including the name of the region's capital city). In everyday life, residents often use the name 'König', a Russified reference to the city's historical German name, both when speaking about Kaliningrad and in the names of firms, sports clubs, etc. Extracurricular classes in the history of Königsberg are held in many schools.

Interest in the past creates a bond in what is still a strongly diversified society in this region. Königsberg's history is referred to not only by the new generation of citizens who were born or raised in Kaliningrad, but also by settlers from other regions, including active and retired military personnel, to whom the idea of the region's being part of Europe is not a strange concept (military staff were among the groups who regularly travelled abroad in the Soviet period, so they fitted in well with the new free-market reality after 1991 partly thanks to their trading contacts with Europe).

Furthermore, historical references to the Prussian past – albeit not spoken of directly – emphasise the region's belonging to Europe, and derive from the need to intensify contacts with the European Union.

Because Kaliningrad oblast is an exclave, its residents are more open to travel to the EU. They tend to contact their neighbours in the EU more often than residents of other Russian regions. In 2011, consulates of EU member states in Kaliningrad oblast issued around 215,000 visas (out of 941,500 residents of the exclave)<sup>36</sup>. Only 18.5% of the urban population in this region have never been abroad, while 8.7% of them go abroad several times a year<sup>37</sup>. The weakness of Kaliningrad's economy and its heavy reliance on external supplies makes goods and services in the neighbouring countries more attractive and competitive. As a consequence, Polish and Lithuanian shopping centres, holiday resorts and clinics are very popular with residents of Kaliningrad oblast, and the neighbouring countries are becoming a point of reference for them in terms of living standards, including the quality and prices of goods and services.

<sup>36</sup> Source: information from the Polish consulate in Kaliningrad.

<sup>37</sup> Data from surveys carried out in 2011 among Russians living in the towns and cities of Kaliningrad oblast by Tsentr obshchestvenno-politicheskikh issledovaniy 'Russkaya Baltika'. According to the census of 2002, ethnic Russians make up 82.37% of the region's population, 78.5% of the region's residents live in towns and cities, so the results of the survey can be treated as more or less representative of the entire region.

Residents of Kaliningrad oblast also visit other regions of the Russian Federation often: 10% of them go to the rest of Russia several times a year, while less than 7% of its urban population do not visit other Russian regions at all<sup>38</sup>. They go to Russia predominantly to visit their families or on business trips, and to a lesser extent as tourists or for small-business purposes.

The intensity of external contacts and the region's dependence on imports make this oblast's residents more active and resourceful than people living in other parts of Russia. The Kaliningrad oblast has a well-developed small business sector (see part I, chapter 1.3.), **and is also Russia's leader in terms of public activity: 3.6 non-governmental organisations per thousand residents operate there, which is clearly above the Russian average** (2.6 per thousand residents)<sup>39</sup>. Organisations dealing with social issues, protection of the natural environment and cultural heritage, youth organisations and those devoted to certain professional or hobby groups predominate among the almost 3500 NGOs which are registered in this region<sup>40</sup>. Public and private partnerships, as part of which the state co-operates with NGOs in implementing social services, function in Kaliningrad oblast, something rare in Russia<sup>41</sup>. The Kaliningrad bloggers have also brought some new quality into public activity. They established a discussion club called Amberkant in 2010. This club has turned into a platform for exchanging views between young, active and educated residents of Kaliningrad on the Internet and in real life. It has become so popular that invitations to meetings with this club have been accepted by Kaliningrad's governor, Nikolay Tsukanov, and the then speaker of the State Duma, Boris Gryzlov, among others.

Despite the clear feeling of distinctness among the residents of Kaliningrad, it cannot be said that separatist tendencies exist in this region. They occurred for a while in the 1990s, when supporters of the region's independence such as

<sup>38</sup> Source as above.

<sup>39</sup> Source: Ministry of Justice of the Russian Federation <http://unro.minjust.ru/NKO.aspx>

<sup>40</sup> Lists of non-governmental and social organisations are available on the website of the Kaliningrad oblast's Justice Ministry, [http://www.klguprminjust.ru/structure\\_48](http://www.klguprminjust.ru/structure_48)

<sup>41</sup> *Maria*, an association of mothers of handicapped children, entered into a public and private partnership with the government of Kaliningrad oblast. Pursuant to an agreement with the government, it keeps a dayroom and a rehabilitation centre for handicapped children in a former school building in Olekhovo. This association has received foreign grants for equipping this facility.

the Baltic Republican Party<sup>42</sup>, few as they were, were still active and noticeable in the media. Meanwhile, today even those who held 'separatist' views at that time only want a certain amount of autonomy for this region and its special interests to be respected in Moscow's decisions. The most radical proposals from autonomy supporters at present are that the exclave should be given the status of a separate federal district<sup>43</sup>. Local activists are also making attempts to publicise the oblast's problems abroad. One example of this is the 'prisoners of Europe' action, as part of which a number of pickets were held in 2010 in front of consulates of the Schengen-area member states in Kaliningrad and in Brussels. The participants demanded that the EU should facilitate visas for residents of this region. No proposals for formal or real separation of the region from the rest of Russia have been mentioned in public debate.

As a consequence of the higher social activity of Kaliningrad's residents and their aspirations inspired by contacts with the international environment, the significant deterioration of the living standards in this region in 2009 gave rise to public protests. The direct catalyst for the protests were Governor Boos's decisions, for example increasing the rate of the transport tax several times, which adversely affected most people in this region. The protest consolidated the regional political and business elites and the public. At that time, they were the most numerous protests on the scale of Russia as a whole in a decade (up to 10,000 people participated in them). Their participants were the first to use anti-Putin slogans (for example, they appealed for the dismissal of Vladimir Putin's government). However, it turned out later that the residents' dissatisfaction was fuelled mainly by local problems. By resolving some of them, Moscow was able to reduce the resistance potential to such an extent that the wave of protests which swept across Russia in December 2011 did not affect sentiments in this region (for more details, see box 4).

<sup>42</sup> The Baltic Republican Party was established in 1993 by Sergey Pasko, and had several hundred members. This party was banned in 2005, and is now operating as the public movement *Respublika*, with little impact.

<sup>43</sup> At present, the Kaliningrad oblast is part of the North-Western Federal District, whose capital city is Saint Petersburg. The authors of the project aimed at winning Kaliningrad oblast the status of a federal district are a group of regional politicians led by a member of Kaliningrad's Duma, Solomon Ginzburg. For more, see *Nezavisimaya Gazeta*, 'Kenigsbergskiy federalnyi okrug', 1 August 2011, [http://www.ng.ru/regions/2011-08-01/1\\_kenig.html](http://www.ng.ru/regions/2011-08-01/1_kenig.html).

#### **Box 4. Protests in Kaliningrad**

The public protests taking place in Kaliningrad in late 2009/early 2010 were unprecedented in their size at that time: five thousand people took to the streets in December 2009, and twice as many in January 2010. The protests were provoked by socio-economic problems: the residents who participated in the protests expressed their dissatisfaction with the rapid deterioration of the economic situation, rising taxes and utility charges, and the terrible condition of the healthcare system. At the same time, anti-governmental political slogans emerged during the protests, including calls to sack the then governor, Georgy Boos, and also to remove the central government led by Vladimir Putin, an act which broke a political taboo in Russia at the time. The protesters also voiced their dissatisfaction with the region's isolation from the EU, and demanded facilitations in travel to the European Union, including cost-free visas.

The direct organisers of the demonstrations were activists who were well-known in the region: the leader of the Kaliningrad-based movement 'Justice', led by Konstantin Doroshok (a former businessman who imported second-hand cars, and was forced to wind up his business under pressure from federal services), and local MPs Mikhail Chesalin (the leader of the local structure of the Patriots of Russia party, and a former shipyard worker) and Solomon Ginzburg (an independent MP, famous for his appeals to broaden the autonomy of Kaliningrad oblast). The January protest was also attended by the regional structures of the federal political parties (for example the Communists and Zhirinovskiy's LDPR), numerous businessmen and large numbers of residents.

The protests united the citizens and different interest groups. The ordinary residents were protesting against the deteriorating economic situation and the terrible condition of social institutions. A significant part of the political elite was opposed to Moscow's tightening control of the region, the governor's attempts to favour United Russia and persecute other political forces. The business elite protested against unfavourable economic regulations and the domination of Moscow-based business which the governor had been promoting. The 'dissatisfied' residents of Kaliningrad were supported by the leaders of political opposition from Moscow (including Boris Nemtsov, Vladimir Milov and Ilya Yashin), who in turn wanted to demonstrate that the elite focused around Putin and the heads of the regions whom they had nominated were losing public support.



The federal government responded to the protests in Kaliningrad in an atypical way; for the first time, the Kremlin decided to replace a region's leader under pressure from local elites and public. In August 2010, Boos was replaced by Nikolay Tsukanov, a politician born in the Kaliningrad oblast. Moscow also resorted to other political and financial instruments to lessen the dissatisfaction among the local elites and public: the unpopular regional ministers of healthcare and of labour & social policy were dismissed, the transport tax raise was postponed until next year, and a dialogue with the leaders of the protests was initiated. However, the protests failed to convince the Kremlin to revise its regional policy; its desire to retain control of the region is still among its top priorities. The new governor appointed by the Kremlin is a politician with a weak position, strictly controlled by Moscow. As regards the leaders of the protests, activities were taken to intimidate them and discredit them in the eyes of the other participants of the protest action.

The Kremlin's strategy has proved successful in the short term. The removal of the controversial governor alleviated tension among the local elites and the public, and the discredited protest leaders lost public confidence and were unable to mobilise the 'dissatisfied' any further. Mass protests on this scale have not recurred in this region. The pickets held afterwards were attended by only dozens or hundreds of people. Even during the protests against the electoral fraud of December 2011, which gathered dozens of thousands people in Moscow, were attended in Kaliningrad by as few as several hundred to one thousand people.

## 1.6. The ecological situation

Ecology and environment protection are major issues in Kaliningrad oblast. This region has to face such problems as high levels of water and air pollution, the lack of environmental infrastructure, the lack of regulations which would force businesses to respect the natural environment, and the lack of ecological habits among the public. At the same time, these problems are typical of Russia as a whole.

One of the greatest problems in Kaliningrad oblast is the lack of sewage treatment plants in most urban areas of this region, which has a strong impact on the entire Baltic Sea basin. Communal waste from the largest cities, including Kaliningrad itself, mostly goes directly into the Neman and Pregola rivers, and

flow with them into the Baltic Sea (see part II, chapter 2.1.2.)<sup>44</sup>. In effect, the city of Kaliningrad is one of the greatest sources of pollution for the Baltic Sea across its entire basin<sup>45</sup>. Most villages in the region have no sewage systems, so the waste goes into the groundwater. The existing environmental infrastructure is outdated (most of it was built before the war and needs to be modernised) and is working at the limits of its capacity. Another major problem is the lack of specialist facilities for the storage and disposal of industrial waste, which is dumped in landfill sites. Nor is there any developed system of household waste disposal and recycling.

Furthermore, the remnants of the military infrastructure built in the Soviet period are also having a detrimental impact on the region's ecology. Post-military areas, which need to be disarmed and recultivated (for example, some areas by the seaside which could potentially be attractive to tourists are still minefields), and the waste left by the army (scrap and remnants of military buildings), most of which has not been disposed of, also pose big problems.

The oblast's government has been making efforts to lessen the pollution of the region's natural environment. For example, the amount of waste water and the level of emissions have been reduced over the past few years<sup>46</sup>. Thanks to aid from the EU, a sewage treatment plant was built in Gusev, and a few others have been modernised (see part II, chapter 2.1.2.). Kaliningrad oblast is rated 29th among the 83 Russian federal subjects in the ranking developed by Russian ecologists<sup>47</sup>, which is a relatively good position. Kaliningrad's efforts to reduce the amount of waste entering the Baltic Sea were supported by the federal programme for developing Kaliningrad oblast until 2015, which envisages

<sup>44</sup> Construction work aimed at building an urban sewage treatment plant in Kaliningrad has been ongoing since 1997. However, despite receiving international funding for this project, the work has still not been completed due to the indolence of the public administration and the lack of co-financing from Russia.

<sup>45</sup> Report from the human rights ombudsman in Kaliningrad oblast 'O soblyudienii prav i svobod cheloveka i grazhdanina v kaliningradskoi oblasti za 2010 god', *op. cit.*

<sup>46</sup> The amount of waste water was reduced from 138 million m<sup>3</sup> in 2005 to 80 million m<sup>3</sup> in 2010, and the level of emissions was reduced from 300,000 tonnes to 119,000 tonnes. Source: Report on the results and general policies of the government of Kaliningrad oblast in 2010 (DROND 2010), prepared by the Ministry of Economy of Kaliningrad oblast, *op. cit.*

<sup>47</sup> The lower the region's number in the ranking, the better the evaluation of its ecological situation. The ranking system has been developed by the Green Patrol organisation, which monitors the ecological situation in the region, taking into account the protection of nature, the socio-ecological and the industrial-ecological situation. This organisation ranked Kaliningrad oblast 28<sup>th</sup> among the 83 Russian federal subjects in 2009, 35<sup>th</sup> in 2010, 38<sup>th</sup> in spring 2011, and 29<sup>th</sup> in summer 2011; <http://www.greenpatrol.ru>.

the implementation of pro-environmental projects. Russia has also signed up to the Helsinki Convention on the Protection of the Marine Environment of the Baltic Sea Area since 1992, which imposes on it the obligation to reduce the amount of waste water it produces.

## **2. AN AREA UNDER SPECIAL SURVEILLANCE: Moscow's policy towards the region**

### **2.1. The policy of compensating for Kaliningrad's location as an exclave**

Over the past twenty years, Moscow has been taking action to compensate to this region for the barriers caused by its situation as an exclave. These actions include granting the region the status of a Special Economic Zone (SEZ), subsidising transit costs and developing infrastructural projects. However, **Moscow's policy towards the exclave has so far been unstable and inconsistent, and as such has insufficiently reduced the existing barriers which prevent this region's development.**

#### **2.1.1. The Special Economic Zone in the exclave**

Kaliningrad oblast has enjoyed customs benefits since the collapse of the USSR, although it was only at the beginning of 1996 that these were written down in the act on the Special Economic Zone (SEZ) in Kaliningrad oblast. The SEZ of 1996 introduced exemptions from customs and indirect taxes (VAT and excise duty) for all goods imported to this region. This softened the economic shock caused by the collapse of the USSR and the emergence of the new state borders in the region. The existence of the zone made it possible to reduce the prices of consumer goods in this region, and also enabled business circles to use this area as a vast 'duty-free area', which formed a corridor for importing goods from other countries to the rest of Russia. Goods which had been brought on a duty-free basis to the region could be transported to other Russian territories with the benefits still applying, on condition that the added value following processing in the exclave was not less than 30% of the goods' initial value (15% in the case of electronic equipment and household appliances). Assembly plants were created in the region which assembled products from imported components; these were then sold across the Russian Federation. The existence of the zone, given the widespread corruption in Russia (allowing for the evasion of indirect taxes and duties) has been a source of numerous abuses, which have proved very expensive for the Russian budget.

A new SEZ act, which came into force on 2006, was aimed at liquidating the abuses existing so far, reducing the federal budget expenses, and changing Kaliningrad's economic profile based on assembly and reloading into one focused on production and exports. This act, which is to remain in force until 31 March 2031, granted new tax preferences and at the same time maintained the privileges of the 'old' zone vested in the entities registered therein for the next ten years. The new act ensured exemptions from income and property taxes to the business entities registered in the Special Economic Zone (i.e. its residents)<sup>48</sup>. However, firms could only benefit from these privileges on condition that they invested at list 150 million roubles (around US\$5 million) within the first three years of starting up their business there. Their business could not be done in the oil & gas and the financial sectors, nor could it cover the production of ex-cise goods (with the exception of cars) or wholesale and retail trade.

The benefits the new act has offered to this region are dubious. **The region's economic profile has not become production- and export-oriented by 2012, which was the main goal of the SEZ.** The implementation of the new law has primarily meant that the regional budget has been burdened with costs related to financing the SEZ. The customs exemptions (under the SEZ of 1996) were a burden for the federal budget, while the new tax privileges are to a great extent financed from the regional budget<sup>49</sup>. The new SEZ, which offers privileges only to large investors, has attracted only a few dozen of residents (around 50 at the beginning of 2012), and their investments have so far amounted to only around US\$120 million (the residents have declared they would invest 32 billion roubles, i.e. US\$1 billion, in total<sup>50</sup>). In the investors' opinion, the new SEZ's rules of operation are rather unattractive. Their reservations include the lack of a possibility to include the lease charges in the investment value, and the short period of tax exemptions<sup>51</sup>. All the residents registered in the 'new' SEZ

<sup>48</sup> Residents are exempted from the corporate income tax and the property tax for the first six years of their operation in the SEZ, and will pay only 50% of these taxes for six years after that.

<sup>49</sup> According to the Fiscal Code of the Russian Federation, revenues from customs duty go to the federal budget, while the property tax goes to regional budgets, as does the greater part of the corporate income tax (the rate of this tax in Russia is currently 20%, of which 18 percentage points go to the regional budgets).

<sup>50</sup> Twice as much was invested in this region as a total in 2010. One of the largest investments was the construction of a plant for the cultivation and processing of soya beans, whose declared investments exceeded US\$200 million.

<sup>51</sup> For example, lease charges cannot be included in the investment. Furthermore, the period of tax exemptions is too short in the case of some projects. For more, see <http://www.tks.ru/reviews/2011/03/05/02>

will compensate for these disadvantages until 2016 by using the privileges offered by the 'old' zone of 1996.

The most painful consequence of the change in the SEZ rules has been the reduction of support for the entities which until then were the most rapidly developing in the region: the small- and medium-sized firms (including foreign ones) and the services sector (the new SEZ act disregards these sectors). As a consequence, the number of companies in this region with foreign capital share has fallen by almost four times<sup>52</sup>.

The problems for the economic entities operating within the exclave have been further exacerbated by Moscow's disregard of the region's privileges during its preparation of federally-binding legal acts. For example, the documents of 2010 which established a customs union between Russia, Kazakhstan and Belarus did not take the Kaliningrad region's customs benefits into consideration. Local political and business elites were forced to intervene in Moscow to ensure that an appropriate regulation was included and that their privileges were maintained. Similarly, the reform of the Russian fiscal system of 2001 failed to consider the special conditions existing in this region, as a result of which VAT and excise duty were imposed on goods from Kaliningrad for two months; in turn, the exclave withheld exports from this region to the rest of Russia. It was only then that Moscow changed its decision.

Since spring 2011, Kaliningrad and Moscow have been involved in intensive discussions about the need to develop new rules for the zone which could begin to apply in 2017–2031, i.e. when the transition regulations on the operation of the SEZ of 1996 are no longer in force.

### **2.1.2. Compensating for the costs resulting from the region's peripheral location**

Subsidies and subventions from the federal budget are an important element of Moscow's economic policy towards this region. However, the benefits offered by the federal government are unable to compensate fully for the costs incurred by the region and its residents. One example of this is the price of gas, the key raw

<sup>52</sup> Over 2000 companies with a foreign capital share were registered in this region in 2005, including over 600 with Lithuanian capital and 500 with Polish capital (some of them were sham firms, which did not operate in reality, and were only established to enable goods to be imported into this region on a duty-free basis). In 2010, the estimated number of companies with foreign capital share was around 500, including 194 with Lithuanian capital and 106 with Polish capital. Source: Rosstat 2010, and data from the Polish and Lithuanian consulates.

material for producing electrical energy in this region. Although regional gas recipients are exempted from charges for gas transit via Belarus and Lithuania, the gas prices in this region are higher than average Russian prices.

The benefits which the state introduced for transport between Kaliningrad and the rest of Russia do not guarantee that such contacts will be intensified. Although air tickets from Kaliningrad to Moscow and Saint Petersburg for children, young people and elderly people are subsidised from the state budget<sup>53</sup>, their prices are still high (sometimes higher than the costs of flights to Western Europe), and their number is limited. As regards goods transport, the direct railway and ferry connection between Baltiysk-Ust-Luga<sup>54</sup> (Leningrad oblast) and the rest of Russia promoted by the federal government, their frequency is too low and they take too much time.

Moscow has exempted residents of Kaliningrad from charges for foreign passports, which are necessary to travel to the other regions of Russia by rail (the cheapest means of transport) through Lithuania, which in turn is very helpful for them. This makes it easier for residents of Kaliningrad to travel abroad also.

### **2.1.3. Federal infrastructural projects in the region**

According to Moscow's declarations, **large infrastructural projects funded from the central budget are to be an important instrument in supporting the development of Kaliningrad oblast.** The key projects implemented in the exclave over the past decade include the construction of the TEC-2 heating and power plant, and the modernisation and development of the road infrastructure. Khrabrovo airport has been modernised and developed thanks to funds from the central budget<sup>55</sup>. The construction of a highway to connect Kaliningrad and the holiday resorts by the seaside and the airport is underway (the Kaliningrad-Zelenogradsk-Khrabrovo section is already open to traffic). The federal government has also fostered more intensive use of the exclave's ports

<sup>53</sup> Pursuant to the Russian government's ordinance of 18 December 2010, a discount ticket running Kaliningrad-Moscow-Kaliningrad cost 7200 rubles (around US\$240), and Kaliningrad-Saint Petersburg-Kaliningrad 6600 roubles (around US\$220). The number of seats at discount prices is limited. The discount air ticket is more than twice as expensive as a railway ticket. Similar support is also offered to Russian citizens living in the Far East.

<sup>54</sup> Russian Railways introduced preferential transport rates on the Kaliningrad-Ust-Luga route. In 2011, ferries went twice a week, and travel from port to port lasted 36 hours, while a land trip to Saint Petersburg via Lithuania and Belarus takes around 25 hours.

<sup>55</sup> In 2008, this region had direct connections with thirteen airports in Russia and twenty in the CIS & Europe. However, the number of direct connections has fallen since the local carrier, KD-Avia, went bankrupt in 2009. The region had only seven direct connections in winter 2011/2012.

(Russia's only ice-free ports on the Baltic Sea) so that they can compete with the ports of the Baltic states (mainly Klaipeda). To this end, the approach track to the Baltiysk port was modernised, and a ferry and railway complex was built in this port. Baltiysk is primarily a military port, with two basins open for civilian vessels. Attempts to establish regular ferry connections between the exclave and German ports have been made for several years<sup>56</sup>.

Additionally, preparations for the construction of a nuclear power plant in this region have begun. The city of Kaliningrad was also put by Moscow on the list of potential hosts of the Football World Cup, to be held in Russia in 2018.

It has been possible to allocate funds for these projects, which account for a major part of the investments of basic capital in this region<sup>57</sup>, thanks to the good condition of public finances in the Russian Federation. Kaliningrad oblast has benefited from the increase in investment expenditure observed throughout Russia in the past decade (see chart 8).

The implementation of federal projects has brought numerous benefits to the exclave. It is contributing to the development of the region itself and the modernisation of its infrastructure (this especially concerns the networks of roads, railways and the port embankment) and the improvement of the exclave's energy security (new sources of electrical energy), creates jobs for local people and regional subcontractors<sup>58</sup>, and ensures demand for local construction materials. Therefore, these projects have been welcomed by the regional elites in most cases. However, a source of dissatisfaction is the strengthening of federal capital's position in the exclave and the marginalisation of local business entities. The large infrastructural projects in the region are predominantly being implemented by federal corporations (Gazprom, LUKoil, Rosatom and construction firms). Furthermore, decisions on the investments and their details

<sup>56</sup> A ferry connection between Kaliningrad and the German ports of Sassnitz and Kiel was also to be reintroduced in 2011. This was expected to be an extension of the route from Ust-Luga to Baltiysk. Several trips were made in that direction in 2007/2008, but the connections have been suspended due to their low profitability. At present, the Klaipeda port offers cheaper connections to Sassnitz.

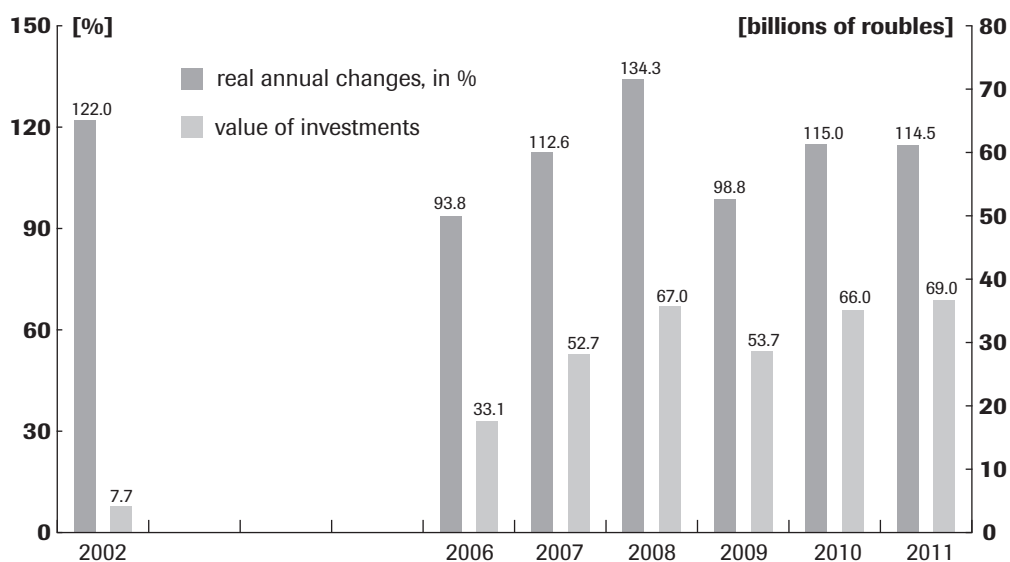
<sup>57</sup> For example, the construction of the second block of the TEC-2 heating and power plant alone cost 22.5 billion roubles (over US\$700 million), and the construction of the first section of the highway from Kaliningrad to the holiday resorts by the seaside (27 km) has cost 6.7 billion roubles (almost US\$250,000). The estimated cost of constructing a nuclear power plant in the region is €6.5 billion.

<sup>58</sup> According to data for May 2011, thirty local firms are engaged in preparations for the project, and over five hundred residents of this region are employed in connection with it.

are taken in Moscow, without considering the opinion of the regional elite's and the expectations of the exclave. One example of this is the TEC-2 heating and power plant, which is of key significance for the region's energy security. The implementation of this project, which was initially financed by Gazprom alone, was dragging on for years because this gas monopoly was not interested in subsidising gas supplies to this region. The consequent power shortage was one of the major impediments to the region's development<sup>59</sup>.

The decision to build the Baltic Nuclear Power Plant in Kaliningrad oblast (see box 5) was also received unfavourably by the region's elite and public<sup>60</sup>. The exclave's elites had reservations in connection with this project because the decision had been taken suddenly (it was fostered by the then governor Boos), and they had been totally ignored during the decision-making process. The local public, fearing the project's adverse ecological impact, are also ill-disposed towards it.

**Chart 8. Investments in basic capital in Kaliningrad oblast**



Source: Rosstat 2012

<sup>59</sup> The completion of the heating and power plant was possible owing to the engagement of Inter RAO, a subsidiary of Rosatom (which is planning to build the nuclear power plant in the exclave), as well as regularly raising the internal gas prices.

<sup>60</sup> According to public opinion polls carried out in May 2009 by the Kaliningrad Monitoring Group, 43% of the respondents opposed building the nuclear power plant in the region, 19% favoured the implementation of this project, and 26% would not mind it, if the project was carried out in compliance with all ecological and technical standards. A social movement opposing this project emerged in this region; its members have demanded that a referendum should be held on this issue.



## **Box 5. Characteristics of the Baltic Nuclear Power Plant**

According to the government's guidelines, two VVER-type reactors with a total output of 2400 MW are to operate in the Baltic Nuclear Power Plant. The first reactor is expected to be built by 2017, and the second between 2012 and 2019. The state (Rosatom) will still be the majority shareholder (51%) of this project, and the remaining stakes will be sold to private investors, including foreigners. Most of the energy to be produced by the plant will be exported, because Kaliningrad oblast's demand for energy is met by other regional power plants. According to Rosatom's estimates, the construction of the Baltic Nuclear Power Plant will cost over US\$6.5 billion (200 billion roubles). In 2010, Prime Minister Vladimir Putin signed a decree under which US\$400 million would be allocated within the next two years for building the power plant in Kaliningrad oblast. Furthermore, Rosatom has been trying to interest private investors in this project; for example, it has come up with offers directed to Polish and Lithuanian business circles. Russia is pinning special hope on the possibility of German investors joining the project, especially in the context of the decision to decommission German nuclear power plants by 2022, and the need to meet the demand for energy from other sources. However, no private investor has become a shareholder of the plant thus far (February 2012). Nor has Rosatom found potential recipients of the power to be produced by the plant, or secured the routes for its supply. Rosatom is considering three potential routes for energy export to the European market: (1) through Lithuania and on to the other Baltic states (and possibly to Poland after the Polish-Lithuanian energy bridge has been created; this is planned to be completed by 2015); (2) building a direct connection with Poland, (3) laying a cable along the Baltic Sea bed in the direction of Germany. Despite these uncertainties, preparatory work connected to the implementation of this project has already begun, thanks to strong political support from the Kremlin.

### ***The genesis of the Baltic Nuclear Power Plant***

The idea of building a nuclear power plant in Kaliningrad oblast has been promoted since spring 2008, although this project had not been mentioned in the previous plans for developing the nuclear sector: the plant was not taken into account either in the 'General Scheme of the Location of Power Facilities in Russia until 2020' approved by the Russian government in 2008 or in the 'Action Programme of the Nuclear Power Corporation Rosatom for 2009-2015'.

**April 2008** – Rosatom signed a co-operation agreement concerning the power plant's construction with the government of Kaliningrad oblast.

**August 2008** – Rosatom issued an order, according to which the power plant's design was to be completed before 2010. The state-owned corporation Energoatom was entrusted with managing the project (it controls all the ten nuclear power plants in the Russian Federation). Atomenergo-proekt, a design and construction institute from Saint Petersburg, was put in charge of preparing the construction plans for the power plant (it has designed eighteen units of this type in operation so far).

**August 2009** – Prime Minister Vladimir Putin signed a decree on the construction of the Baltic Nuclear Power Plant in Kaliningrad oblast.

**February 2010** – the cornerstone was laid at the plant construction site near the town of Neman in Kaliningrad oblast. Prime Minister Putin signed a decree allocating around US\$400 million to implement this project within two years.

**November 2010** – a tender for the construction of casings for the power plant's reactors was held. It was won by a factory from Petrozavodsk (Karelia) owned by a subsidiary of Rosatom, ZAO Inzhenernaya Kompaniya AEM-Tekhnologii (which has no experience in this field).

**10 November 2011** – Inter RAO, the Russian investor in the Baltic Nuclear Power Plant, signed a memorandum with the Swiss energy company Alpiq on examining the possibilities for co-operation on laying an underwater cable for power transmission (800 MW) to connect the Kaliningrad oblast with Germany. Additionally, the companies signed an agreement under which the technical and economic possibilities for co-operation on exporting electricity to Poland were to be analysed by 1 April 2012. For this purpose, an energy connection (direct current at 400kV) between Kaliningrad oblast and Poland would be created. Alpiq, which has operated in Poland since 2001, could purchase up to 600 MW of energy from Inter RAO for the Polish market.

**By early 2011** consultations concerning the plant's impact on the natural environment in Poland, Germany, Latvia and Estonia had been held; preparations for implementing the project were made at the construction site: melioration, devising and constructing a road, railways, infrastructure for the electrical system, etc.

#### 2.1.4. Developing tourism in the region

The local government has recognised tourism as one of the priority areas in the context of developing the exclave's economy. Actions taken to help develop the tourist infrastructure have included the creation of a special tourist zone and a special recreation and gambling zone (see Map). However, Moscow has failed to consider the key barriers to the development of this sector in the Kaliningrad oblast: limited attractiveness to tourists (for example in comparison to the Black Sea or the Polish and Lithuanian seaside), the low quality of the services considering their prices, and the impeded access to this region to both residents of other parts of Russia (distance) and tourists from the EU (visa issues)<sup>61</sup>. In turn, the visa facilitations introduced for tourists are subject to so many conditions that they have had no positive effect in the case of Kaliningrad oblast. For example, the possibility of a visa-free stay for 72 hours was offered in 2009 to tourists who came to the exclave by passenger ships. However, this can only be used on condition that lists of passenger names and a planned itinerary are sent to the port several days ahead, and in such a case tourists can only see the cities in groups, with a guide, and along previously agreed routes.

In 2007, the Russian government adopted a decree establishing a special tourist zone on the Curonian Spit. However, plans to attract investors to the zone ended in failure. Not a single investor has appeared in the zone for five years since the document was signed. The implementation of potential investments has been prevented by the fact that the ownership structure of the land on the Curonian Spit is unclear. Furthermore, this area is a national park on the UNESCO World Heritage list, which has reduced the possibilities of developing any infrastructure there. Another impediment is the fact that this area has not been completely cleared of mines since World War II, and remnants of military facilities can still be found on much of the area. As a result, the Russian Ministry of Economic Development brought a motion to close the zone in August 2011.

The concept the government devised in 2006 to create a recreation and gambling area next to the town of Yantarny has still not been realised. Investors have not been interested in spending money on building the infrastructure because the profitability of such an investment was dubious, due to the great

<sup>61</sup> These barriers have prevented the expectations the region had in the 1990s – that the tourist sector would develop owing to former residents' 'sentimental' visits – from being realised. German tourists usually come to this region in organised groups, and use local services to only a limited extent; they usually do not return after the first visit.

distance between this region and the prospective clients. Furthermore, contrary to appeals from the regional government<sup>62</sup>, Moscow chose a site for this investment which made it even less attractive (partly due to the need to buy land from private owners). The regional government dislikes this project because it fears it could have a negative social impact (increasing crime levels, drug trafficking, etc.).

The development of tourism outside the special areas in this region has also encountered a number of problems. The most popular holiday resort so far, the coastal town of Yantarny, with relatively well-developed tourist facilities, is located within the restricted access zone, entrance to which requires a special pass (see section 2.3.). Apart from this, access to the beaches is limited for tourists due to amber production, the richest deposits of which are located precisely in that spot. In 2010, the Russian Ministry of Finance, the owner of the Kaliningrad amber production plant, embarked upon amber extraction from a new deposit located in the immediate vicinity of the beach.

## **2.2. The policy of reinforcing social ties with the rest of Russia**

Since 2005, Moscow has intensified social programmes aimed primarily at strengthening the ties between the residents of Kaliningrad oblast (especially young people) and those of other Russian regions. The Ministry of Education in 2006 launched a programme called 'We, Russians', the purpose of which is to make young residents of Kaliningrad oblast feel attached to the rest of the Russian Federation. Educational excursions to the most interesting places in Russia are held as part of this programme. 60,000 people, around 25% of Kaliningrad's youth, took part in such excursions in the first five years of the programme's operation<sup>63</sup>. Furthermore, camps for young people from all of Russia have been organised in Kaliningrad oblast since 2010. The participants (around 2000 people annually) attend classes on patriotism, in the broad meaning of the term.

<sup>62</sup> The regional government has been making appeals for this to be moved near Svetlogorsk (a resort by the Baltic Sea), where the possible costs of the project would be much lower owing to the proximity of an airport, possibilities of developing the existing port, and the well-developed road, power supply and other infrastructure.

<sup>63</sup> The estimated number of young people in this region is 248,000 (data from [www.molod39.ru](http://www.molod39.ru) as of 1 January 2010).

**Strengthening the position of the Orthodox Church is a significant element of the strategy of building ties between the region and the rest of Russia.** The Orthodox Church has been present in this region for a very short time. Churches owned by the Protestant (the predominant religious belief in the region pre-war) and Catholic faiths were closed after 1946. It was only in 1985 that the first Orthodox church was opened in this region, in a building formerly used by an Evangelical congregation in a district of Kaliningrad. Since the collapse of the USSR, the reinforcement of the Orthodox faith in this region has been treated as a bonding element between the exclave and the rest of Russia<sup>64</sup>. One effect of this policy is a significant increase in the number of Orthodox parishes in this region (up to around 80 in 2010). Furthermore, this process has continued recently thanks to decisions taken at various levels of Kaliningrad's administration, which decided in 2010 to offer tens of historical buildings, mainly former Evangelical and Catholic churches, to the Orthodox Church<sup>65</sup>. This decision was passed shortly before a federal law on the restitution of property to religious organisations came into force, under which religious properties were to be returned to their previous use<sup>66</sup>. These decisions raised great controversies among the public, since public institutions operate in many of the premises subject to restitution. For example, Kaliningrad's intelligentsia has protested against the transfer of ownership to the Orthodox Church, claiming that this upsets the cultural heritage of the region. Furthermore, the change of ownership of some former places of worship has delayed

<sup>64</sup> The construction of the monumental Church of Christ the Saviour on one of the main squares of Kaliningrad has become a symbol of this policy, which the Orthodox hierarchs themselves referred to as 'linking Kaliningrad oblast to Russia'. For more details, see 'Pravoslaviye na Kaliningradskoy Zemle', website of the Patriarchate of Moscow [www.patriarchia.ru/db/print/592484.html](http://www.patriarchia.ru/db/print/592484.html).

<sup>65</sup> The election of Kirill I as the Patriarch of All Russia, who had been successfully lobbying for the interests of the Orthodox Church in the regions, had a great impact on these decisions.

<sup>66</sup> This law was passed on 19 November 2010. The transfer of ownership to the Orthodox Church also gave rise to two supra-regional conflicts. The list of the properties included a former Protestant church which is now a museum to Kristijonas Donelaitis, a Lithuanian pastor and poet. Following a protest from the Lithuanian president, Dalia Grybauskaitė, this monument was removed from the list. In turn, the Catholic Church has been applying for years for the restitution of a historic church in Kaliningrad, which is now used as a concert hall. However, this decision has not been changed, despite a protest from the head of the Russian episcopate. The Orthodox Church also wanted to take over a building which was once the Protestant cathedral in Kaliningrad, and now is a museum to Kant. It was not put on the list because of a personal intervention from Chancellor Angela Merkel to Prime Minister Vladimir Putin. For more on this issue, see V. Ryzhkov, 'Udar po kulture Kaliningrada', [http://www.scepsis.ru/library/id\\_2847.html](http://www.scepsis.ru/library/id_2847.html) and A. Karpenko, 'Istoriya o "tserkovnoy privatizatsii": sobytiya 2010 goda v Kaliningradskoy oblasti', [http://www.scepsis.ru/library/id\\_2995.html](http://www.scepsis.ru/library/id_2995.html)

renovation work, which was financed either as part of European projects or from money donated by associations of the region's former Prussian residents<sup>67</sup>.

## **2.3. The policy of restricted access for foreign partners to the region**

### **2.3.1. Restricted access zones**

**Kaliningrad oblast is a region** over a large part of whose territory **restrictions on access for foreigners** apply. Citizens of other countries may not enter the five-kilometre-wide strip along the state border<sup>68</sup>, which – given the small area of this region – is a serious impediment. Furthermore, other restricted access zones apply in Kaliningrad oblast, **which in total extend over around one-third of the region's territory**, including the entire Russian section of the Vistula Spit and a large part of the coastline<sup>69</sup> (see Map). Foreigners may move across these zones using special passes (it takes from ten to as much as sixty days to obtain one). An additional difficulty is posed by the fact that the borders of these zones are not marked; maps of these zones are not commonly available, although they were supposed to have been made available for consular agencies and investors. There have been many cases when people have unknowingly crossed the borders of these zones without holding the required documents, and were apprehended and punished<sup>70</sup>. **One of the largest investments made in this region over the past few years, the highway which connects the city of Kaliningrad to the airport and the seaside, also runs through a restricted access zone.** People who have come to Kaliningrad by air formally have no right to go to the city via the highway built for this purpose. **The local border traffic regime with Poland**, which was introduced in July 2012 **and which formally covers the entire territory of Kaliningrad oblast, will have no impact on the restrictions concerning the foreigners' access to these zones.**

<sup>67</sup> Examples of this are the withholding for formal reasons of funding to restore the castle in Guryevsk (formerly Neuhausen) under the CBC Neighbourhood programme, and renovation of the church in Rodniki (formerly Arnau) financed by German organisations.

<sup>68</sup> The list of restricted access zones in Kaliningrad oblast is provided in the ordinance of the Federal Security Service of 2 June 2006. Its text is available at <http://www.rg.ru/2006/07/14/kaliningrad.html>

<sup>69</sup> The list of the restricted access zones for foreigners is provided in the ordinance of the Russian government of 4 July 1991. Its text is available at [http://www.fstec.ru/\\_docs/doc\\_1\\_4\\_009.htm](http://www.fstec.ru/_docs/doc_1_4_009.htm)

<sup>70</sup> In February 2009, militia officers detained the Polish and German consuls-general, who were going to attend celebrations devoted to the victims of the Holocaust in Yantarny, which is located in a restricted access zone, and forced them to turn back.

Another significant limitation for investors is the ban on the sale of land to foreigners covering 90% of the Kaliningrad oblast's territory<sup>71</sup>; foreign citizens can only lease land. Furthermore, visa facilitations introduced for foreign investors (which the SEZ act includes) are not observed in practice. According to the regulations, investors with resident status and representatives of the entities which co-operate with them are allowed to receive visas immediately at the border. However, these regulations do not work in practice, because this procedure is usually undermined by federal border services.

### **2.3.2. Moscow's stance on the use of the Vistula and Curonian Lagoons**

Russia treats the Vistula and Curonian Lagoons as its internal waters, access to which should be restricted for foreign vessels for security reasons. As a result of this policy, the development of port infrastructure is being neglected on both the Curonian and the Vistula Spits. Although formally Moscow has decided to open the Curonian<sup>72</sup> and the Vistula Lagoons<sup>73</sup> for sailing, maritime traffic in these waters is limited in practice. In the case of the Curonian Lagoon, Lithuanian ships may not enter Russian waters because there is no border checkpoint where the ships could be cleared (although Moscow undertook to ensure this in the agreement). Russia opened the Vistula Lagoon to foreign maritime traffic again after a break of some years (2006–2009), although this has not brought about any significant revival of traffic in these waters. This is due to the poorly-developed coastline infrastructure and the fact that goods can only be cleared in the ports of Baltiysk or Kaliningrad. Furthermore, Russia has reserved the right to close the border on the lagoon for defence, security or environmental protection reasons. Another impediment to the traffic of ships under other countries' flags heading for Polish ports is the requirement to notify the Russian side of the voyage fourteen days in advance, and for the shipowner to have a representative

<sup>71</sup> Pursuant to the presidential decree of 9 January 2011, only three territorial units, which have a total area of 2700 km<sup>2</sup>, are not covered by these regulations (the Chernyakovsk, Gusev and Gvardeysk districts). For more, see <http://президент.рф/acts/10033>.

<sup>72</sup> The Lithuanian-Russian agreement on traffic in the Curonian Lagoon was signed on 4 December 2007. The Russian parliament ratified it in April 2009. The agreement was signed for a period of five years and can be automatically extended for another year; [http://www.sng.allbusiness.ru/BPravo/DocumShow\\_DocumID\\_139845.html](http://www.sng.allbusiness.ru/BPravo/DocumShow_DocumID_139845.html)

<sup>73</sup> On 15 July 2009 the Russian prime minister Vladimir Putin signed an ordinance admitting traffic in the Russian part of the Vistula Lagoon for ships with third-country civil ensigns going to and from Polish ports: <http://government.ru/gov/results/7562/>. On 1 September 2009, Poland and Russia signed an agreement on ship traffic in the Vistula Lagoon. Both documents became effective on the date of signing the Polish-Russian agreement. The agreement was signed for five years and can be automatically extended for another five-year term; [http://www.ms.gov.pl/files/docs/komunikaty/UMOWA\\_zalew\\_tekst%20polski.pdf](http://www.ms.gov.pl/files/docs/komunikaty/UMOWA_zalew_tekst%20polski.pdf)

in Russia. As a consequence, the Lagoon's potential is not used, and the traffic in it is limited to barges carrying coal and construction materials.

## **2.4. The policy of controlling the region's co-operation with other countries**

### **2.4.1. Moscow's approach to Kaliningrad residents' travel**

One of Moscow's priorities is to control the process of opening up the Kaliningrad oblast to co-operation with the European Union, and in the first order with its neighbouring countries, Poland and Lithuania.

Travel facilitations for residents of this exclave are among the key issues concerning this region's contacts with the EU after Poland and Lithuania introduced a visa regime with regard to Russia (and thus also to Kaliningrad oblast) in 2003, shortly before their accession to the European Union. This made it more difficult for residents of Kaliningrad oblast to travel both to the neighbouring EU member states and to the rest of Russia, since the trip by land involved crossing the border of a EU member state, Lithuania. Given this situation, **Moscow focused its efforts on ensuring facilitations for people travelling between Kaliningrad oblast and the rest of Russia.** After Moscow's long and tough negotiations with Vilnius and Brussels, it was agreed that a Facilitated Transit Document and a Facilitated Rail Transit Document would be introduced on 1 July 2003. These documents have applied with regard to Russian citizens travelling in transit through Lithuania to or from Kaliningrad, and offer significant facilitations in comparison to the visa regime<sup>74</sup>.

**However making it easier for residents of Kaliningrad oblast to travel to the European Union has not been Moscow's priority.** The government of this region (including Governor Nikolay Tsukanov<sup>75</sup>) has issued numerous appeals to make Kaliningrad a 'pilot' region in the process of establishing a visa-free re-

<sup>74</sup> Russian citizens who wish to go through Lithuania to or from Kaliningrad must apply for an Facilitated Transit Document/ Facilitated Rail Transit Document to the Lithuanian consular service. In the case of rail transit, the traveller should submit an application in the railway ticket office 24 hours at the latest before the planned trip. The document itself is issued at the time of Lithuanian passport control on the Lithuanian-Russian border. The Facilitated Rail Transit Document is issued free of charge.

<sup>75</sup> Tsukanov has made such appeals both in contacts with representatives of Poland; for example, to Wojciech Zajączkowski, the Polish ambassador to Russia (see: <http://kaliningrad-first.ru/?p=88969>), during the meeting of the EU-Russia Parliamentary Co-operation Committee in Warsaw on 21 September 2011, and in numerous statements made for the local and national media (see: <http://www.governors.ru/?statja=191161>).



gime between the European Union and the entire Russian Federation. However, this proposal has not been backed by the government in Moscow, and the issue has not been raised in talks with Brussels. Instead, Moscow has intensified efforts for the local border traffic rules, which envisage visa-free movement in the frontier area along the external borders of the Schengen zone, to apply to Kaliningrad oblast<sup>76</sup>. At the same time, Moscow changed its tactics; while it had previously been negotiating an agreement to this effect with Lithuania in line with the applicable Schengen zone regulations (visa-free movement in a 30 kilometre-wide frontier belt), the Russian Ministry of Foreign Affairs in 2010 came up with the proposal for **the local border traffic rule to be extended to the entire region**, which goes significantly beyond EU regulations (the total area is 205 km long and 108 km wide). Moscow's proposal was backed by Warsaw, and the two countries brought this initiative to the EU forum. Lithuania did not join this initiative because it had had a negative experience negotiating the local border traffic agreement with Russia (in 2009, when the negotiations were over, the Russian government chose not to sign the already arranged agreement). At the same time, Lithuania raised objections against the proposal to extend the local border traffic rule to a comparable area on the Lithuanian side, as this would cover a large part of the latter country's territory.

The Polish-Russian proposal in 2011 was accepted by Brussels, and the foreign ministers of Poland and Russia signed a bilateral local border traffic agreement on 14 December 2011 (see box 6). The parliaments of the two states have endorsed the ratification of the agreement (the Polish Sejm voted it in March 2012, and the Russian State Duma in May 2012). The agreement came into force in July 2012<sup>77</sup>. At the same time, doubts have been raised in the region as to whether the capacity of the existing border infrastructure will be sufficient to ensure smooth local border traffic<sup>78</sup>. Such concerns (especially about the border crossing points being jammed by individuals engaged in small frontier trade) have been expressed in particular by representatives of business circles, who hold multiple-entry Schengen visas.

<sup>76</sup> According to Schengen regulations, visa-free movement applies within a 30 km-wide border region (in exceptional cases this is extended to 50 km). Residents of frontier regions cross the border on the basis of special permits issued by consulates. See, for example, [http://www.migrant.info.pl/pl/pobyt/wjazd\\_do\\_polski](http://www.migrant.info.pl/pl/pobyt/wjazd_do_polski)

<sup>77</sup> The Polish parliament endorsed the ratification of the agreement on March 16, 2012 (president Komorowski signed it on May 4, 2012). The Russian State Duma endorsed the ratification on May 25, 2012 (president Putin signed it on June 16, 2012).

<sup>78</sup> Such fears have been expressed by members of the regional parliament, among others; see for example: <http://www.kaliningrad.net/news/49259/>.

## Box 6. Local border traffic between Kaliningrad oblast and Poland

Under the agreement, residents of Kaliningrad oblast who have lived there for at least three years are entitled to benefit from a local border traffic regime. The pass to cross the border is issued by the Polish consulate for a period of between two and five years, and costs €20 (free of charge to people under 16 and over 65). The individuals who use the local border traffic are allowed to stay in Poland uninterruptedly for thirty days (but no longer than ninety days within every six months). This permission does not authorise the holder to work or run a business in the Republic of Poland.

The local border traffic agreement extends to the entire Kaliningrad oblast, and on the Polish side to the cities of Sopot, Gdańsk, Gdynia, Elbląg and Olsztyn and the counties (*powiaty*) of Puck, Gdańsk, Nowy Dwór Gdański, Malbork, Elbląg, Braniewo, Lidzbark, Bartoszyce, Olsztyn, Kętrzyn, Mrągowo, Węgorzewo, Giżycko, Gołdap and Olecko.

Although the local border traffic regime in relations with Poland has been implemented, Moscow's stance on this issue seems to be ambivalent. For Moscow, visa facilitations for residents of the Kaliningrad oblast appear to be a negotiating tactic in its talks with Brussels, rather than a goal in itself. This issue has not been a priority for Moscow, which can be proved by the fact that implementing local border traffic regime has been delayed for several years (the facilitations offered under the Schengen regulations, for example with Lithuania, have not been used earlier). Further confirmation that this is the right assumption could be the lack of any official reaction from Moscow to the EU's consent for the local border traffic regime to be extended to the entire Kaliningrad oblast, which was given in response to requests from Russia itself, and should thus be seen by Russia as a success for its negotiations<sup>79</sup>.

The fact that Vladimir Putin criticised the idea of introducing the local border traffic regime in the Kaliningrad oblast immediately before the Russia-EU summit in June 2011 may indicate that Moscow has been merely capitalising on this issue. Putin then stated that it was unacceptable to offer "visa privileges

<sup>79</sup> Politicians in Moscow did not comment on the European Commission's decision. President Dmitri Medvedev visited Kaliningrad oblast two days after the decision had been made public (1 August 2011), yet the issue of the EU having accepted the Russian proposal was not raised officially.

to one region at the expense of the others”<sup>80</sup>. This statement may be seen as a form of pressure on the EU in the ongoing negotiations on lifting the visa requirement for all citizens of Russia. Moreover, making proposals which go significantly beyond the applicable regulations at the EU forum (such as that of extending the local border traffic regime to the entire Kaliningrad oblast) can be seen as Moscow’s negotiating tactic aimed at establishing the extent to which Brussels is ready to make concessions. Moscow may use its experience with successfully modifying EU regulations in other areas, including its efforts to change provisions which are unfavourable to Russia (such as the so-called Third Energy Package).

#### **2.4.2. Moscow’s influence on the region’s cross-border co-operation**

Another manifestation of Moscow’s control of the region’s co-operation with its neighbours from the EU was the stance it took on the EU-funded programmes covering cross-border co-operation with Russian regions located in the EU’s neighbourhood, including the Kaliningrad oblast. **As a consequence of its actions - or inaction -, Russia has limited the possibilities for entities from the Kaliningrad oblast to benefit from financial support offered by the European Union.**

Kaliningrad oblast could have benefited from two programmes envisaged in the EU financial framework for 2007–2013. Brussels allocated €132 million for the land-based Cross Border Cooperation (CBC) Lithuania–Poland–Russia (LT-PL-RU) programme<sup>81</sup>, and €217 million for the maritime Baltic Sea Region programme. However, due to Moscow’s failure to sign a Financial Agreement with the EU, Russian entities have been unable to receive the funds offered as part of the Baltic Sea Region Programme. In turn, in the case of the land-based CBC programme, Moscow’s actions have caused serious delays in implementing the project.

The EU’s Baltic Sea Region Programme was aimed at intensifying co-operation between eleven countries<sup>82</sup> in the Baltic Sea basin, covering the management of

<sup>80</sup> At that time Putin made references to the LBT rules (although he referred to them as visa-free movement). See for example <http://kaliningrad.ru/news/item/12142-putin-rossiya-ne-budet-dobivatsya-vizovyh-privilegij-dlya-kaliningradskoj-oblasti>

<sup>81</sup> CBC is an instrument of the EU’s European Neighbourhood Policy. For more on the Lithuania-Poland-Russia programme see: <http://www.lt-pl-ru.eu>

<sup>82</sup> Eight EU member states: Denmark, Estonia, Finland, Germany, Lithuania, Latvia, Poland and Sweden; together with Norway (which co-operates closely with the EU), Belarus and Russia. See <http://eu.baltic.net/>

marine resources, transport development and improving security. The funds allocated by Brussels for 2007–2013 as part of the Baltic Sea Region Programme were to help implement such tasks as the continuation of previous actions in this region supported by the EU, from which entities in north-eastern Russia (including to a large extent from Kaliningrad oblast) also benefited. However, starting from 2009, they were no longer able to benefit from EU support and were excluded from these projects, due to Russia's failure to sign the Financial Agreement before the deadline set by the EU (31 December 2008).

The main tasks of the land-based CBC project (for 2007–2013) include the development of frontier regions, intensifying their co-operation, and fostering contacts between people. Earlier, these projects were financed as part of the EU's TACIS programme. Since Poland and Lithuania joined the European Union, funds have also been provided as part of a new support programme covering these two countries and Kaliningrad oblast<sup>83</sup>. The process of preparing a new agenda for Kaliningrad began in 2006, when the EU took a decision to continue its support for Kaliningrad oblast as part of the Lithuania–Poland–Russia programme. The EU set the goals and priorities of this programme in consultation with the region's government, with whom the exclave's problems and needs were discussed. Moscow was merely an observer in this process. The Kremlin decided to become directly involved in this programme at the final stage of the preparations for the project in late 2008, when work on the Financial Agreement was in progress. It offered financial support of €44 million,<sup>84</sup> and started demanding that it should have the same rights in the decision-making process as the EU, including control of the money spent. As a result of the negotiations, Moscow was given the opportunity to co-participate (upon invitation from the EU) in project audits held by EU bodies, albeit on condition that the country where the audit was conducted accepted the Russian presence. The negotiations concerning this issue were concluded as late as autumn 2009. The implementation of the programme still could not commence because Russia deemed

<sup>83</sup> TACIS was aimed at supporting democratic and pro-market reforms in the CIS region. Its funds were allocated for the modernisation and development of cross-border infrastructure, co-operation between the communities and technical assistance. In 2004–6, Poland and Lithuania allocated €12.3 million each to the Poland–Lithuania–Russian Federation (Kaliningrad oblast) Neighbourhood Programme from the funds offered by the European Regional Development Fund, and €8 million more was granted as part of TACIS. This co-operation brought about 162 projects.

<sup>84</sup> The Kremlin offered financial support to all the EU's CBC programmes which concerned Russian regions. In addition to Kaliningrad oblast, there are four other programmes concerning co-operation between Russian frontier regions with Latvia, Estonia, Finland and Norway.

that it had to ratify the Financial Agreement (which was a new solution, not previously employed in CBC projects). This happened as late as July 2010. The approach Russia has taken has significantly contributed to delaying this project. The first applications started to be received as part of LT-PR-RF as late as June 2011, and it has not been possible to begin implementing them by February 2012<sup>85</sup>, five years since the commencement of preparations for the project. Moscow is still delaying (as of February 2012) the transfer of its funds allocated for the cross-border programmes. It has only announced that an adequate instalment of funds would be made available after the projects to be subsidised as part of the programme have been selected. Since the parties (Poland, Lithuania and Russia) have not been able to agree on the procedure of choice and the audit of the projects financed under the programme, there is a risk that the European Commission could decide to close this programme.

From Brussels' point of view, the financial engagement of Russia in this EU programme has been unnecessary, and has only given rise to formal difficulties. A definitely better and more effective solution would be for Russia to create its own programme for frontier areas. Instead, Moscow has made the launch of the CBC project dependent on its participation in the financing, and thus turned a technical instrument into a political one<sup>86</sup>.

As a consequence, the approach Moscow has taken towards cross-border co-operation has in fact caused delays in implementing the Lithuania-Poland-Russia CBC programme, reducing its efficiency and excluding Russia from the Baltic Sea Region Programme. Thus Moscow has been acting contrary to the interests of the exclave – the local government, the NGOs and other organisations which could have benefited from EU funds. Furthermore, by marginalising the role of the Kaliningrad oblast's representatives in co-creating the project, it has reduced the chance of achieving the main goal of this instrument – establishing closer cross-border co-operation between local governments and communities<sup>87</sup>.

<sup>85</sup> The second intake of applications began in May 2011, in a similar project being implemented by Poland, Belarus and Ukraine.

<sup>86</sup> One example of how politics need not influence the functioning of a similar project is the Poland-Belarus-Ukraine programme. In late April 2011, despite serious political tension between the EU and Belarus, it was decided to open a branch of the Joint Technical Secretariat in Belarus (in Brest), whose task would be to promote the cross-border programme.

<sup>87</sup> Similar problems to those the Lithuania-Poland-Russia programme has been facing, have also been encountered by the EU's cross-border programmes with Latvia, Estonia, Finland and Norway in which the Russian Federation is engaged.

### 3. THE TWO SIDES OF THE COIN: Kaliningrad's interests versus Moscow's interests

#### 3.1. The interests of Kaliningrad

**Kaliningrad's elites are interested in using the opportunities offered by the status of Kaliningrad oblast as a subject of the Russian Federation and also by the special location of this region, surrounded by the European Union.** Its status as part of the Russian Federation allows the regional government to obtain subsidies and subventions from the central budget. Additional financial support from Moscow has allowed the region to meet its budget obligations, especially during the global economic crisis. Secondly, federal investments (including those made as part of federal projects designated for specific purposes) have made it possible for the region to build and modernise large infrastructural facilities. Examples of such investments include the construction of the Baltic Nuclear Power Plant and the modernisation of the airport and road infrastructure. Large projects like these also bring (or are intended to bring) major economic benefits to the region, although some of them have given rise to controversies in the region itself: for example, the construction of the nuclear power plant has given rise to concerns about both ecological security and the increasing influence of big federal capital, and by extension the possible marginalisation of the regional elites.

Furthermore, Kaliningrad's elites have been making efforts to reinforce the position of their region within the Russian Federation, which would allow them to lobby more successfully for its interests in Moscow. A group of politicians from Kaliningrad (including members of the local parliament) came up with a proposal to grant Kaliningrad oblast the status of a special federal district, and its governor the status of special presidential envoy, with the rank of deputy head of the Presidential Administration<sup>88</sup>. A draft containing such changes was submitted to President Dmitri Medvedev during his visit to Kaliningrad oblast in July 2011.

The **regional elites** also want to capitalise on the region's location in proximity to the European Union and the Baltic Sea. This is primarily manifested by efforts to liberalise the visa regime with the European Union, which could help activate contacts between the exclave and its EU neighbours. For years appeals

<sup>88</sup> See footnote 43.

have been made from this region to decision makers in both Moscow and Brussels, to consider Kaliningrad's special location during the Russian-EU visa talks and make it a 'pilot' region, for which the EU would lift the visa requirement before doing so with regard to the entire Russian Federation<sup>89</sup>.

For their part, **local business circles** are principally interested in improving the investment climate, which to a large extent is dependent on Moscow. One of the economic elite's top priorities is stability of legislation, which would enable them to plan their business activity in the long term and would curb corruption and bureaucracy. In comparison to these goals, privileges aimed at compensating for the region's separation from the rest of the country are of much less importance to business circles. From the perspective of local business representatives, the present functioning of the SEZ serves their interests to only a limited extent. The benefits are only available to large investors, whose number in this region is small; the sectors which were the most active in the region until recently have been excluded from the special regime. As a consequence, economic preferences are offered to investors from outside the region, mainly representatives of federal capital. Therefore, the regional government and the local business elite are lobbying in Moscow for new privileges to be developed for the regional entities, which would give due respect to the needs of Kaliningrad's economy, especially after the transitional regulations of the SEZ act of 1996 expire. This would allow this region to develop, and an influx of investments, especially from abroad, to increase.

The interests of the **residents of Kaliningrad oblast** are expressed in their expectation that the government will create conditions which will allow living standards in the region to improve. Social claims are predominant among the expectations they have of the government. These expectations are strengthened by the awareness of the disproportion between the living standards in this region and those in the neighbouring EU member states, which have undergone an effective transformation over the past twenty years. Improving the situation in the regional healthcare system is one of the key expectations. At the same time, residents of Kaliningrad oblast are more enterprising and aware of their citizens' rights which leads them to criticise the excessive role of the state bureaucracy, and contributes to their desire to be given a wider

<sup>89</sup> Governor Nikolay Tsukanov has regularly made such appeals (for example see Itar-Tass, 30 November 2010), most recently during the meeting of the EU-Russia Parliamentary Cooperation Committee in Warsaw on 21 September 2011, as have other politicians from Kaliningrad (for example, MP Solomon Ginzburg, *kaliningrad.ru*, 20 October 2010).

scope of freedoms, especially economic. This also entails a need for pluralism and competition, one effect of which in the political area has been the creation of a greater number of political parties in the regional parliament (in comparison to other regions), and visibly lower support for United Russia, the ‘party of power’, than on average across the Russian Federation.

The residents of Kaliningrad oblast also want to benefit from its special location by taking advantage of opportunities linked to travel, trade, transfer of services, education abroad, business co-operation and collaboration with non-governmental organisations. From this point of view, lifting the travel barriers to the EU is a key issue. The residents of Kaliningrad oblast would support any travel facilitations which could make the existing regime more liberal. The optimal solution for them would be visa-free movement between the EU and Russia. However, since this perspective is remote, they are ready to accept facilitations within the existing regime, including the introduction of a local border traffic regime with their neighbours, Poland and Lithuania, especially as the version adopted is intended to cover the entire Kaliningrad oblast, as well as several big cities and frontier counties in Poland (see box 6). It has to be said, though, that the region’s business elites oppose the local border traffic concept, as they fear that existing border checkpoints could be blocked by numerous travellers. The region’s residents are also interested in maintaining and even increasing transport subsidies, thanks to which the costs of their travel to other regions of Russia and the costs of bringing goods from there are lower.

### **3.2. Moscow’s interests with regard to Kaliningrad**

Moscow’s interests with regard to Kaliningrad oblast fit in with the general logic of the country’s rule, defined by the political elite linked to Vladimir Putin. This concept is based on the desire to centralise power and limit the autonomy of other political and business entities. In the regional aspect, the centralisation policy boils down to imposing stricter financial, political and administrative control over the regions.

In the case of Kaliningrad oblast, Moscow’s urge to stick with its centralisation policy is intensified by the region’s location as an exclave surrounded by EU and NATO member states. **Moscow has been using Kaliningrad oblast as a tool of its foreign policy, principally to put pressure on its partners** in the West (the USA, NATO and the European Union), be it regarding security or political issues, such as visa negotiations. For Moscow, the unique location



of the region is not so much an opportunity to deepen relations with the EU (which could put Kaliningrad in the vanguard of integration with Europe) and develop mutually beneficial conditions for co-operation with Russia as a whole.

Kaliningrad oblast is of strategic importance for Moscow in terms of defence. Over the past few years, Moscow has been developing military infrastructure in this region, thus reinforcing the country's military potential. This potential is used by Moscow as a bargaining chip in geopolitical games, including with regard to the security policies of the United States and Central European countries (such as Poland) which envisages the deployment of strategic elements of the US missile defence system in Central Europe. In response to these plans, Russia has built a radar station and deployed Iskander missile launchers in Kaliningrad oblast. This is supposed to discourage Central European countries (including Poland) from backing the US security policy. Kaliningrad is also an important element of Russian energy security strategy; one reason for building the Baltic Nuclear Power Plant is the desire to reinforce Russia's position on the energy market in the Baltic region.

As regards internal issues, the priorities of Moscow's regional policy include the desire to maintain a stable situation in the regions, first of all as regards social and political issues (preventing public unrest, making sure that the parties and candidates linked to the federal elite achieve good results in elections). Moscow wants Russia to remain the most important point of reference in socio-political and cultural fields for the residents of Kaliningrad oblast. This is why it is ill-disposed to any solutions which would make this region more open to its EU neighbours, fearing that this could loosen the bonds between Kaliningrad oblast and the rest of Russia. Intensive contacts between Kaliningrad and EU member states would make the oblast's residents more receptive to European standards, which are different from Russia's, including those concerning democracy, elections and political & civic activity.

Moscow's economic interests with regard to Kaliningrad oblast are limited; this region has no large deposits of raw materials, and its low economic potential prevents it from yielding high revenues to the federal budget

### **3.3. The conflicts of interests between Kaliningrad and Moscow**

Although the government and residents of Kaliningrad oblast have not called the integrity of the Russian Federation into question, and accept with satisfaction the economic privileges and subsidies offered to them by Moscow, the

central government and the region still disagree about the way the Kremlin's regional policy should be implemented. These differences of opinion primarily concern how to deal with this region's location, the exclave. Moscow does not see any need to strengthen the region's administrative status in the Russian Federation (for example, by granting it federal district status). Nor did it support Kaliningrad's proposals concerning its contacts with the neighbouring EU member states (such as making it a pilot region for establishing visa-free movement with the entire European Union), and has instead negotiated the introduction of a local border traffic regime in this region with Poland.

Another area of disagreement (which is typical for many Russian regions) is the instability of legislation (especially concerning economic issues) and its incompatibility with the region's real needs. An example of this problem is the changing regulations concerning the Special Economic Zone, which additionally disregard the small and medium-sized businesses which are active in this region.

In turn, the socio-political situation in Kaliningrad has failed to meet the priorities set in the Kremlin's policy. The centre's anxiety is caused by the periodical protest actions partly targeted against the policy of the central government, as well as the below-average results which the parties and politicians linked to the federal government elite have achieved in elections.

## II. CO-OPERATION DESPITE DIFFICULTIES: Kaliningrad and its EU neighbourhood

### 1. EUROPE'S PERIPHERY: The EU's relations with the region so far

#### 1.1. Kaliningrad in the European Union's policy

The European Union perceives Kaliningrad oblast primarily as one of the Russian Federation regions, and for the EU, co-operation with it is an element of relations with Russia as a whole. However, the region's unique location ensures it special treatment in these relations; Brussels claims that Kaliningrad has strategic importance for both Russia and the EU<sup>90</sup>. The EU declares that **relations with Kaliningrad oblast should serve to intensify co-operation with Russia as a whole, and should at the same time bring living standards in this region up to a level similar to that in the neighbouring EU member states.** On the one hand, Brussels emphasises the need to respect the territorial integrity of the Russian Federation by ensuring an effective transit of people and goods between this region and the rest of Russia. However, on the other hand, the EU is making efforts to ensure the cohesion of the entire Baltic Sea macro-region, especially regarding socio-economic and environmental issues.

In 2003, the European Union and the Russian Federation signed an agreement to facilitate transit of people between Kaliningrad oblast and the rest of Russia after Lithuania joined the EU. The common arrangements made in 2004 in turn included rules for the transit of goods to and from the region. Furthermore, programmes for the modernisation and development of border infrastructure were launched to facilitate the transit of people and goods.

On the macro-regional scale, co-operation with Kaliningrad oblast is specified within the framework of the Northern Dimension of the EU and the EU Strategy for the Baltic Sea Region. Kaliningrad oblast participates in these initiatives, along with the north-western regions of the Russian Federation. The Northern Dimension, initiated in 1999, is a policy aimed at establishing closer co-operation in the Baltic Sea and Arctic regions to ensure sustainable development (in the broad meaning of the term) in this area. It envisages the equal participation of EU member states, the Russian Federation, Norway and

<sup>90</sup> See for example [http://eeas.europa.eu/delegations/russia/eu\\_russia/fields\\_cooperation/regional\\_issues/kaliningrad/index\\_en.htm](http://eeas.europa.eu/delegations/russia/eu_russia/fields_cooperation/regional_issues/kaliningrad/index_en.htm)

Iceland in the creation of this policy<sup>91</sup>. Projects in the areas of economic co-operation, ecology, nuclear safety, civil defence, development of scientific research and culture, social security and healthcare, internal affairs and justice are implemented as part of the Northern Dimension. Entities from Kaliningrad oblast, namely regional and local governments, public institutions and higher education facilities, have taken part in projects in all these areas. However, the Russian side has failed to meet many of these projects' co-financing requirements, and this cooperation has therefore encountered many difficulties. For example, problems of this nature have caused serious delays in implementing a flagship project aimed at modernising the water-and-sewerage and heating networks in Kaliningrad, which was first announced in 2000<sup>92</sup>. Although completion was scheduled for 2005, its implementation is still underway in 2012. Among the projects that are usually implemented successfully there are the so-called soft projects, such as youth exchange and training events.

In 2008 a EU strategy for the Baltic Sea Region was initiated, designed to coordinate and revive co-operation between the countries in this area, by compiling the existing initiatives, partnerships and platforms of co-operation. However, in the case of Kaliningrad oblast this strategy has failed, as it assumes that only EU member states may be its full participants, who decide on the priorities and directions of action. Other countries of this macro-region may only be co-operating partners of the EU members. This seemingly minor role is unacceptable to Russia, and although Moscow is formally participating in the strategy, it shows no particular interest in the initiatives launched as part of it.

Co-operation with Kaliningrad oblast may also take place within two cross-border programmes: Poland-Lithuania-Russia (Kaliningrad oblast only) and the Baltic Sea Region (with the other north-western regions of Russia). However, there are also many impediments to implementing these programmes (for more details see part I, section 2.4.2). Residents of Kaliningrad oblast may also benefit from all the programmes in which the Russian Federation's

<sup>91</sup> Other entities engaged in the activities taken as part of the Northern Direction include: the Council of the Baltic Sea States, the Nordic Council of Ministers, financial institutions, namely the European Bank for Reconstruction and Development, the European Investment Bank and the Nordic Investment Bank, regional and supraregional organisations and non-governmental organisations.

<sup>92</sup> The programme is worth €25 million in total. It is financed, along with EU entities, by the European Bank for Reconstruction and Development and the Swedish International Development Co-operation Agency (SIDA).

participation is envisaged, such as the educational programmes Tempus and Erasmus Mundus.

EU support for Kaliningrad oblast between 1991 and 2006 totalled approximately €100 million, of which €25 million were funds offered under the EU's TACIS programme to stimulate the exclave's socio-economic growth. The current financial framework (2007–2013) offers €50 million of aid to Kaliningrad oblast. The EU's support for this region is focused on such areas as: protecting the natural environment (sewage treatment plants and monitoring pollution in the Baltic Sea), developing the border infrastructure and an integrated border management system, developing small and medium-sized businesses, improving energy saving and energy efficiency, healthcare (including counteracting drug addiction, HIV/AIDS and tuberculosis), increasing the potential of the region's administration (especially in the context of handling business entities), and academic co-operation<sup>93</sup>.

Examples of the largest EU projects in this region include:

- the construction of the Chernyshevskoye high-capacity border crossing point on the oblast's border with Lithuania (opened in 2009), with an EU contribution of €8 million;
- the construction of the road border crossing point in Mamonovo on the oblast's border with Poland (opened in December 2010), with an EU contribution of €13.3 million;
- co-financing the construction of the sewage treatment plant in Gusev (opened in 2009), with an EU contribution of €3 million;
- the programme for co-financing the modernisation of sewage treatment plants in the region, with an EU contribution of €9.5 million;
- the project for improving the qualifications of the local administration (e-administration), with a total budget of €6.7 million.

<sup>93</sup> Every year, various kinds of foreign grants are received by hundreds of students from higher education schools in Kaliningrad oblast. Academic workers are also being exchanged (approximately 150 university teachers from universities in Kaliningrad oblast visit foreign higher-education institutions annually).

The immediate beneficiary of the EU's aid in the region is predominantly the public sector, which has been more successful in obtaining funds from the EU than non-governmental organisations. State organisations have more experience in international co-operation and easier access to funds for ensuring their own contribution (for example, in the case of cross-border projects, they must contribute 10% themselves). However, in many cases even the government's engagement does not guarantee that the project will be successful. Barriers to co-operation arise due to problems with co-financing events, insufficient competences and the inefficiency of the local bureaucracy. For example, despite the huge demand for environmental programmes in this region, it was only possible to obtain €2.5 million euros for six projects from LIFE, a key EU programme focused on co-financing activities to protect the environment<sup>94</sup>.

## **1.2. Kaliningrad's contacts with its EU neighbours**

Kaliningrad oblast has been co-operating with its neighbours within EU programmes and initiatives, and also within the framework of bilateral relations. Co-operation between Kaliningrad oblast and the EU member states located in its immediate or close neighbourhood (including Lithuania, Poland, Germany and Sweden) usually takes place at the regional and local levels. Local governments (provinces, cities and municipalities) are partners for Kaliningrad oblast. This co-operation is also supported by the consular agencies of Poland, Lithuania, Germany, Latvia and Sweden within the oblast<sup>95</sup>.

In addition to treaties signed by individual countries, bilateral relations are based on a number of agreements concerning regional co-operation. In 1992, Poland and Russia signed an intergovernmental agreement on co-operation between the north-eastern provinces of Poland and Kaliningrad oblast, under which the Polish-Russian Council for Co-operation of Regions of Poland with Kaliningrad Oblast was established. In 1991 Lithuania and the Russian Federation entered into an agreement on co-operation with Kaliningrad oblast in the areas of economic, social and cultural development; an intergovernmental

<sup>94</sup> For comparison, €1.36 billion were allocated in 1992–2006 from the LIFE fund for the implementation of 2750 projects worth a total of €4 billion in forty countries and regions. The programme's budget for 2007–2013 is €2.14 billion. For more, see <http://ec.europa.eu/environment/life/>

<sup>95</sup> Sweden had its own consulate in Kaliningrad until 2011. At present, its consul has his office in the Consulate of Poland. Honorary consuls of Croatia, Italy and Denmark are also present in Kaliningrad oblast. Of the CIS countries, Belarus and Armenia have representatives there.

agreement on co-operation between Lithuanian regions and the regions of Kaliningrad oblast was concluded in 1999. Lithuania's and Poland's contacts with Kaliningrad are also based on numerous local deals and agreements, such as partnerships of cities and municipalities, partnership agreements between institutions, and as part of the Euroregions<sup>96</sup> (Baltic, Neman, Saule, Sesupe and Lyna-Lava). Joint projects have to a great extent been financed by funds allocated for cross-border co-operation by the EU (a total of €46 million was allocated for this purpose in 2004–2006<sup>97</sup>). One of the examples of the actions taken is the creation of the tourist route along the castles and museums of the Baltic Sea region, with the participation of Bagrationovsk town from Kaliningrad oblast. One-third of the €132 million allocated for the EU's Cross-Border Cooperation programme for 2007–2013 comes from the budgets of Poland and Lithuania. Given the difficulties in implementing the CBC programme, Poland and Lithuania (and especially their regions which border Kaliningrad oblast) have also made efforts to continue co-operation, both within their own capacity (grants for academic co-operation and school exchanges & funds for co-operation offered by regions, municipalities and institutions), and by obtaining funds from other sources<sup>98</sup>. For example, 'Kaliningrad Days' are celebrated in the frontier provinces of Poland and in Lithuania as part of this co-operation<sup>99</sup>. Co-operation in the field of culture and historical heritage is also developing intensively; Russia and Lithuania are preparing for the 300th anniversary in 2014 of the birth of the Lithuanian poet Kristijonas Donelaitis, who was born and lived in what is present-day Kaliningrad oblast.

Germany has also shown interest in co-operation with the exclave. It has been engaged on the national and federal state levels, and also via German

<sup>96</sup> A Euroregion is a form of cross-border co-operation between member states of the European Union and their neighbouring regions. Representatives of local and regional governments take part in the creation of a Euroregion.

<sup>97</sup> TACIS allocated €9.5 million to Kaliningrad oblast as part of this pool.

<sup>98</sup> Good examples of this are the Ostbalticum archaeological project, which has been implemented for many years with the participation of Poland, Lithuania, Latvia, Germany and Russia under the auspices of UNESCO, as part of which the catalogue of the collection of the Prussian Museum in Königsberg has been restored and developed; and the co-operation of the Elbląg Mediation Centre with psychological support centres in Kaliningrad, as part of grants offered by the Polish-American Freedom Foundation.

<sup>99</sup> Thanks to these contacts, Kaliningrad oblast and the Warmia & Mazury Province signed a three-year plan for common enterprises in 2011. For example, participation in joint exhibition events, the continuation of the regattas in the Vistula Lagoon, the meetings of war veterans on the anniversary of Victory Day and co-operation between Kaliningrad's Musical Theatre and the Jaracz Theatre in Olsztyn have been planned.

foundations active in Russia<sup>100</sup>. It is difficult to estimate the total size of German support for Kaliningrad oblast, due to large number and diverse nature of the projects. The main project at federal level is the Russian-German House, which serves as an organisational base for German entities implementing projects in this region<sup>101</sup>. These projects are primarily linked to education, agriculture, economic development and healthcare<sup>102</sup>. One of the higher-profile German projects in this region is the Klaus Mehnert European Institute, the two-semester post-graduate European studies course at the Kaliningrad State Technical University, the only course of this kind in Russia<sup>103</sup>. German funds have been used to restore Kaliningrad's former cathedral, where the Kant Museum and a concert hall now operate. Initiatives for supporting the reconstruction of the region's historical heritage have intensified over the past few years. Associations of the former residents of this region and their families are especially active in this area. Contacts between people are also developing quite rapidly: numerous exchange programmes function at the level of federal states and individual cities, and a wide range of grants are available for residents of Kaliningrad oblast<sup>104</sup>. German federal states (Mecklenburg and Schleswig-Holstein), jointly with Polish provinces (Pomeranian, West Pomeranian and Warmia-Mazury), have created the Southern Baltic Sea Parliamentary Forum, an organisation intended at implementing European programmes as part of the EU maritime, tourism and youth policies. The German Ministry for the Natural Environment also organises the Russian-German Ecology Days in Kaliningrad, which were held for the eighth time in 2011.

Sweden, which primarily supports initiatives aimed at improving the ecological situation in the region, should also be mentioned among the EU member states which are strongly involved in co-operation with Kaliningrad oblast. The Swedish International Development Co-operation Agency (SIDA) offered

<sup>100</sup> This especially applies to foundations which have their offices in Russia: the Adenauer Foundation, the Ebert Foundation, the Boell Foundation, the Naumann Foundation, the Seidel Foundation and the Rosa Luxemburg Foundation.

<sup>101</sup> It also performs the function of a culture institute, since it organises cultural events and language courses, and also supports the German minority residents in Kaliningrad oblast.

<sup>102</sup> Co-operation is also conducted through joint projects of medical associations from Kaliningrad oblast and the German federal state of Schleswig-Holstein.

<sup>103</sup> The institute is financed by the Robert Bosch Foundation and the Moellgaard Foundation, with organisational support from the German Ministry of Education and the German Academic Exchange Service DAAD.

<sup>104</sup> Grants are offered by the German Academic Exchange Service DAAD, the Deutsche Bundesstiftung Umwelt foundation, Albertina, and the Moellgaard Foundation among other institutions.



over US\$17 million in 2003–2007 for the construction and modernisation of water and sewage infrastructure and sewage treatment plants in Kaliningrad oblast. The southern regions of Sweden are also active; they participate in co-operation both as donors to small projects and as participants in initiatives and programmes aimed at building people-to-people contacts.

The openness of the regional government is conducive to developing contacts between Kaliningrad oblast and its EU neighbours. These contacts have intensified since September 2010, when Nikolay Tsukanov was nominated governor of this region. The governor has visited to Poland on numerous occasions, both on official visits and unofficially (he took part in the Poland-Kaliningrad motorcycle rally to Braniewo in May 2011). The initiative of informal meetings between the Kaliningrad oblast governor and the governors of the Pomeranian and the Warmia & Mazury Provinces, the ‘Cup of Three Governors’ (a joint sailing regatta in the Vistula Lagoon) is also continuing. Nikolay Tsukanov has also paid visits to Lithuania. On the occasions of his visits to the neighbouring EU member states, the governor has consistently raised the issue of visa facilitations for Kaliningrad oblast, and expressed interest in welcoming foreign investors to his region.

Contacts between residents of this region and their neighbours in the EU, mainly Poland, Lithuania and Germany, are also developing rapidly. It is worth noting that residents of Kaliningrad oblast account for most of the traffic in these contacts, while citizens of the EU member states visit Kaliningrad oblast noticeably less frequently. Residents of Kaliningrad oblast usually travel to the EU for commercial purposes (popular weekend shopping trips to Poland and Lithuania), and as tourists (both for rest and relaxation, and also as ‘medical tourists’ due to the higher prices of medical services in Kaliningrad oblast).

The consulates of Poland and Lithuania issue the most visas to residents of Kaliningrad oblast; the German consulate and the Latvian consular office issue fewer visas. The number of visas issued has been constantly rising over the past few years (for more see box 7), which has become possible owing to the modernisation of the consulates and the introduction of more up-to-date procedures, for example the possibility of online registration<sup>105</sup>. EU consulates also use various kinds of visa facilitations, such as free-of-charge visas for children

<sup>105</sup> According to information from the Polish consulate, it takes four business days on average to obtain a visa from the moment of submitting the application.

under 12, or the requirement to declare a hotel reservation (instead of proof of payment for accommodation).

### **Box 7. Visas issued for Kaliningrad residents**

In 2011, the Polish consulate issued almost 113,000 visas, of which 53,500 were multiple-entry visas. The Lithuanian consulate issued a total of almost 83,000 visas in 2011, the German consulate issued 21,700 visas, and the Latvian consular office issued almost 8000 visas.

In 2010, the Lithuanian consulate issued 55,000 visas, 37% of which were multiple-entry visas. The Polish consulate issued approximately 40,000 visas in 2010 (twice as many as the year before; 40% of these were multiple-entry visas), the German consulate issued approximately 20,000 visas, and the Latvian consular office issued 6500 visas (50% of which were multiple-entry visas).

## **1.3. Economic co-operation**

The European Union is interested in the economic development of Kaliningrad oblast and raising its living standards. The economic decline in the region in the 1990s raised concerns in the EU that the exclave could turn into a European poverty area. The EU's actions have been focused on preventing the differences in living standards from deepening. Brussels became interested in the region again when the decision was made that the region's immediate neighbours, Poland and Lithuania, would join the EU. Apart from transit questions, this entailed the need to regulate such issues as the development of border infrastructure, and the transmission of electric power via Lithuania in connection with the need to adjust the Lithuanian system to that used in the EU<sup>106</sup>.

**However, the region's significance in EU-Russia economic relations is limited.** From the EU's perspective, Kaliningrad oblast is of most importance as a recipient of EU exports to Russia. The value of these exports in 2010 reached approximately €90 billion, around 7% of which went to Kaliningrad oblast. This region is an important recipient of goods, especially from Slovakia (it accounts for over 30% of Slovakia's total exports to Russia, which is a result of the supply of components for car assembly in the region), and from Poland

<sup>106</sup> For more on the EU policy towards Kaliningrad oblast, see the website of the EU's Delegation to Russia [http://eeas.europa.eu/delegations/russia/index\\_en.htm](http://eeas.europa.eu/delegations/russia/index_en.htm)

(approximately 12%). Over the past few years, the role of EU suppliers to this region has been lessening as entities from China and South Korea have become increasingly active.

In turn, Kaliningrad oblast is of marginal significance for EU imports and investments. This region accounts for less than 1% of total EU imports from Russia; the proportion of EU investments in this country is similar. The EU member states which border Kaliningrad oblast in this context are relatively more involved. Polish business entities co-operate with this region quite intensively (in 2010, in terms of intensity of co-operation, Kaliningrad came fourth after Moscow, Saint Petersburg and Moscow oblast). At the end of 2010, total Polish investments in this region were estimated at US\$57 million (Polish firms invested more only in the Novgorod and Moscow oblasts, and in the city of Moscow), which meant that almost 10% of Polish investments in Russia went to this region<sup>107</sup>. Kaliningrad oblast is also a relatively important investment destination for Lithuanian business entities; by the end of 2010, approximately 25% of Lithuanian capital invested in Russia (around US\$40 million) went to Kaliningrad oblast. At the same time, this region played only a marginal role in Lithuanian exports to Russia (approximately 6%)<sup>108</sup>.

Support for foreign capital is offered by numerous organisations and associations which provide them with information on the region and help establish cooperation with local entities. These include the Kaliningrad Chamber of Commerce and Industry, the regional Economic Development Agency and an association of international experts for the development of Kaliningrad oblast. Organisations which lobby for the interests of entrepreneurs are also active, such as the Foreign Investors Association in the Kaliningrad region<sup>109</sup> and the Baltic Business Club, an organisation representing small and medium-sized businesses. Additionally, German firms are supported by the Committee on Eastern European Economic Relations (*Ost-Ausschuss*) and the Agency of the Hamburg Chamber of Commerce in Kaliningrad.

<sup>107</sup> For more on this issue, see the website of the Promotion and Investments Department of the Polish Embassy in Moscow, <http://www.moskwa.trade.gov.pl>

<sup>108</sup> Our own calculations, on the basis of information from the Lithuanian Central Bank and the Ministry of Economy of Kaliningrad Oblast.

<sup>109</sup> Its members number approximately fifty investors from various countries, predominantly from Lithuania. For more, see [www.fiak.biz](http://www.fiak.biz)

## **2. CO-OPERATION WITH KALININGRAD: Conclusions for EU policy**

### **2.1. Co-operation at the federal level**

Since Moscow decides on most issues concerning the principles of co-operation between Kaliningrad oblast and its neighbours, the EU and its member states must adopt a double-track approach to continuing the development of these relations. Their actions should include talks at both federal level (this especially applies to issues such as the movement of people, goods & services, infrastructural solutions, and the rules of economic co-operation with the region) and local level (such as establishing closer co-operation with the local government in Kaliningrad and involving it in regional initiatives).

#### **2.1.1. Supporting bilateral contacts: visa and border issues**

Russia and the EU have been making attempts for several years to develop a plan for the gradual introduction of a visa-free regime in their mutual relations. These talks have encountered numerous political and technical barriers, and the prospect of a visa-free regime between the EU and Russia still seems remote. On the other hand, the local border traffic regime between Kaliningrad oblast and Poland has been introduced (for more on this issue see part I, section 2.4.1.). However, its implementation does not mean that efforts to introduce visa facilitations in travel to the European Union need not be made, because local border traffic only covers some limited areas in Poland. Therefore, it is worth seeking a gradual liberalisation of the existing visa regime between the EU and the Russian Federation, and to make the requirements more flexible: shortening the visa wait time, reducing the formal requirements (invitations, vouchers, money for travel), increasing the number of long-term visas issued, and reducing the visa prices. Both in implementing the local border traffic regime with Poland and in the quest for visa facilitation with the entire European Union, it is worth improving the functioning and capacity of the border as much as possible; this would include creating more ‘green corridors’<sup>110</sup> at the border for travellers which have nothing to declare, and even considering the

<sup>110</sup> Two ‘green corridors’ are functioning at present on the border with Kaliningrad oblast: at the road border crossing points with Lithuania (Chernyshevskoye-Kybartai) and Poland (Grzechotki-Mamonovo-2).

feasibility of reopening currently inactive border crossings<sup>111</sup>. In the case of Kaliningrad oblast, the risk of illegal migration into the EU is minimal; the limited threat this exclave may pose for the EU is that of smuggling<sup>112</sup>.

Another important question which the EU should raise in talks with Moscow is the lack of symmetry in mutual requirements with regard to travellers. This firstly concerns the Russian requirement for foreigners to register their stay within seven days of entering the country. Another topic for discussion should be the restricted access for foreigners to one-third of the Kaliningrad oblast's territory (see part I, section 2.3.1.) and the lack of proper marking of these restricted zones. The EU member states which are directly interested in co-operation with Kaliningrad oblast, for example Poland, Lithuania and Germany, could play an essential role in this context.

### **2.1.2. Co-operation between societies and local governments**

When considering co-operation with this region at the local authority level, we should bear in mind that the competences of the local government in Kaliningrad oblast are more restricted in comparison to those of their equivalents from the EU. Most decisions can be passed only following approval from Moscow. Even if the decisions formally fall within the competences of the local government, any declarations, arrangements and even documents signed can be questioned by Moscow, if the latter deems them unfavourable from the point of view of its own interests.

We must also be aware that the local government has no access to the funds necessary for co-financing large projects, and so such issues must be arranged with Moscow. Even if Moscow gives its formal consent to co-operation between Kaliningrad oblast and the EU, it may still block it later by withholding the transfer of funds. Funds can be rejected for a project if it is deemed to have lower priority than other needs on the scale of the entire Russian Federation (as has been the case with the sewage treatment plants in Kaliningrad). At the same time, it must be stressed that it was Moscow who insisted on co-financing the cross-border co-operation programmes, and now Russia treats its financial

<sup>111</sup> In the debate on possible problems with the border infrastructure's capacity following the introduction of the local border traffic, members of Kaliningrad's parliament have appealed for the resumption of traffic on the border checkpoints which are now not in use, namely Perly-Krylovo and Mikhalkovo-Zheleznodorozhny. <http://www.kaliningrad.net/news/49259/>.

<sup>112</sup> Frontex report, data from the Polish Border Guard Service.

participation as a tool of control in co-operation between the EU and Kaliningrad oblast (an example of which is the problem already mentioned with Moscow signing the Financial Agreements as part of the CBC programmes).

### **2.1.3. The intensification of economic co-operation**

Most economic issues, such as the principles of the region's co-operation with foreign partners or the general rules of doing business, are regulated at the federal level by means of laws, decrees and international agreements. For this reason, it is Moscow that should be the main addressee of proposals to improve the protection of EU investments, facilitate access to the exclave's market, create better conditions for the operation of small and medium enterprises (the most active sector in the EU), etc.

From the point of view of EU business, it is necessary to create legally binding regulations for EU-Russia economic co-operation and effective mechanisms for resolving disputes, which should be included in the principal agreement currently under negotiation (the so-called PCA-2)<sup>113</sup>. Russian accession to the WTO, which is to take place in 2012, may prove helpful in this context. The implementation of the obligations Russia has assumed will be especially important, as these could lead to curbing corruption and improving economic competition on the market. To ensure that provisions which successfully protect EU business are included in the agreement, the EU must adopt a uniform stance, and the member states must offer support to the European Commission. Co-operation programmes in individual areas, such as the Partnership for Modernisation and the Partnership for Innovation (whether with the EU as a whole or with its individual member states) must also be negotiated at the federal level. Once approved by Moscow, such programmes may contribute to intensifying co-operation at the regional level.

A major impact on relations with Kaliningrad oblast could come from **the implementation of the project envisaging the construction of the Baltic Nuclear Power Plant. On the one hand, it could allow the EU to establish closer relations with Russia and Kaliningrad oblast; but on the other, it would reinforce Russia's position on the energy market in the Baltic Sea region, and thus reduce the energy security of Poland, Lithuania, Latvia and Estonia.**

<sup>113</sup> The PCA currently binding on Russia and the EU signed in 1997 is asymmetrical in nature, and less beneficial for the EU and its member states. In turn it offers Russia numerous privileges and great freedom in its trade policy, yet fails to introduce an effective mechanism for resolving disputes between the EU and Russia.

Given the planned increase of demand for electric power in the EU, and the implementation of the climate policy by the member states (which fosters energy sources with low levels of greenhouse gas emissions), the nuclear power plant's output could contribute to improving the energy balance in the EU. However, prospective investors expect the project to be made more attractive to them, and the conditions offered by Moscow to be improved. First, the investors expect guarantees of the rights of the minority shareholders: a 49% stake has been reserved for foreign investors, which in Russian realities means complete dependence on the state-owned investor (Rosatom). Secondly, protection from rapidly increasing investment costs needs to be ensured; this problem has already arisen with other infrastructural investments, such as Nord Stream<sup>114</sup>.

Foreign investors interested in building the Baltic Nuclear Power Plant in cooperation with Rosatom can improve their negotiating position by taking advantage of Russia's need for this project to be internationalised, i.e. to be co-financed by foreign investors, to have EU recipients of the energy produced by the plant and to ensure the routes for its transmission. Rosatom has not signed any agreements with importers, has not been given any clear declarations by potential recipients, and has not decided on the energy transmission route so far. Another element which makes the position of foreign investors stronger may be Rosatom's interest in intensifying its foreign activity (this especially concerns the export of Russian technologies and nuclear fuel), as well as the need to use the project in Kaliningrad oblast to establish closer relations with its foreign partners.

From the point of view of the Baltic Sea countries (Poland, Lithuania, Latvia and Estonia, to name a few) which heavily rely on the Russian oil and gas sector, the construction of the Baltic Nuclear Power Plant may further strengthen Russia's position on their energy markets. For this reason, the most important thing for the countries in this region is to focus on building up their energy security by introducing energy saving programmes, and developing & modernising their own power plants and infrastructural connections, which could ensure a greater diversification of energy supplies and transmission routes in

<sup>114</sup> However, the experience of implementing energy projects in Russia with the participation of foreign investors so far has shown that their success depends primarily on the political decisions taken by the Russian government, and not on economic calculations. For example, the majority stake held by Shell in the Sakhalin-2 oil and gas project and its long-term agreement with the Russian government failed to protect this company from losing control of the project and having to relinquish it to Gazprom in 2006. For more, see Iwona Wiśniewska, 'Controlled opening-up of Russia's energy sector to foreign investors', *EastWeek*, 9 March 2011.

this region. In particular, Poland and Lithuania's focus on building their own nuclear power plants would be of especial importance.

## **2.2. Co-operation at the regional level**

Although the key decisions concerning the exclave are made by Moscow, the regional government does play a role in developing co-operation with the neighbours. It can use its limited competences to support co-operation with foreign partners.

### **2.2.1. Regional political contacts**

The success of projects implemented in co-operation with Kaliningrad oblast depends to a great extent on how the region is governed, and on the stance adopted by its governor and his aides. Maintaining good, regular contacts between the administration of Kaliningrad oblast and the local governments of its neighbouring countries, Poland and Lithuania, contributes to the successful handling of concrete issues. This co-operation may have become easier owing to the fact that Governor Nikolay Tsukanov has a reputation of a successful manager, and to his interest in establishing contacts with Poland and Lithuania. One example of the success of these direct contacts at the regional level is the decision to reintroduce the maritime connection between Gdansk and Baltiysk as of autumn 2010, following the visit by representatives of the Pomeranian Province to the exclave.

Bilateral contacts also contribute to reinforcing the image of the new EU member states (especially Poland and Lithuania) as positive examples of transformation, which Kaliningrad's elites and public will want to model themselves on. At the same time, these contacts and co-operation with Kaliningrad need to be seen within a longer timeframe because, judging from previous experience, the existing conditions for co-operation are unlikely to improve soon.

### **2.2.2. Contacts between societies and local governments**

It is worth using the proximity of Kaliningrad oblast and its openness to co-operation to continue the development of people-to-people contacts. This especially concerns the neighbouring countries, whose local governments, communities and institutions are also interested in closer collaboration. It is not only the mere implementation of a given project which is valuable here, but also the fact that it contributes to building people-to-people contacts, which may result in doing away with stereotypes and thus increase the potential for further co-operation.



The relatively small size of Kaliningrad oblast means that even projects with a limited budget and a small number of participants may bring about significant changes in particular areas. When co-operating with Kaliningrad, it is worth targeting efforts and funds at precisely determined goals, and setting oneself the task of making the most comprehensive changes possible in selected areas.

From the European Union's point of view, projects with small budgets (so-called micro-projects) may prove effective. These can be financed at the level of local communities, institutions and organisations from Kaliningrad oblast. The fact that their objective is to resolve local problems that are of key importance to the residents, and that the entire decision-making process is within the competences of the local government, may also contribute to their successful implementation.

Actions in sectors which are seen as apolitical appear to stand the greatest chance for success in co-operation with Kaliningrad oblast (although these, too, can be politicised by Moscow, as has happened with the CBC). One such area where the exclave's co-operation with the countries from the entire Baltic Sea region could be improved is ecology. Co-operation in this area may be relatively trouble-free because Moscow is also interested in resolving the region's ecological problems. This kind of co-operation requires both investment projects and public education to promote pro-ecological behaviour.

Another area of co-operation could be projects targeted at improving the situation in the healthcare system in Kaliningrad oblast, which is in a serious crisis. This region needs great support in this area, in the form of both investments and education. Failure to prevent the development of diseases such as HIV / AIDS and tuberculosis, as well as influenza and unusual varieties of it (by treatment, prevention, and education) will worsen the social situation in the region and pose a potential threat to neighbouring countries.

The most durable results for developing co-operation can be achieved by joint educational projects. Academic centres in Kaliningrad oblast are already more active in this regard in comparison to the rest of Russia, for example in terms of the percentage of students and academic staff engaged in international exchange. It is worth taking advantage of this positive experience and intensifying exchanges, internships and grants.

An important, albeit sensitive, area of co-operation is linked to the protection and reconstruction of the region's historical heritage. Kaliningrad's

intellectual elite are interested in saving the historical heritage of this region; they are looking for opportunities to finance the reconstruction, renovation and maintenance of the historical buildings and sites. Since this area has been neglected for over sixty years, the scale of investment needed is vast. On this occasion, positive examples of co-operation in this field can be mentioned, such as the reconstruction of Kaliningrad's cathedral, which has mainly been funded by Germany. Investments in protecting the historical heritage could also offer a greater chance to develop tourism in this region.

However, it is worth keeping in mind that the limited availability of funds for partners from Kaliningrad may pose a barrier to co-operation, especially in the case of European projects, where co-financing by Russia is required. Other barriers include the lack of adequate competences at the regional level and, typical of Russia as a whole, excessive bureaucracy, corruption and a poor legal culture.

### **2.2.3. Economic co-operation**

Despite the numerous weaknesses of Kaliningrad's economy and the limited attractiveness of the preferences granted to this region by Moscow, co-operation with it can be beneficial for partners from the EU; for example, because of its geographical proximity and high demand for imports and investments. However, this co-operation will be attractive mainly to small and medium investors from the EU operating on the Kaliningrad market. As seen from the perspective of large corporations, Kaliningrad's attractiveness is limited due to its small market and the access impeded for products manufactured in this region to the EU (caused by the need to meet EU standards) and to the rest of Russia (transit costs).

Sectors where co-operation can develop especially fruitfully include agriculture and food industry. These sectors are underdeveloped and unable to satisfy the needs of the exclave. The region lacks not only agricultural machinery and technologies but also experience. It relies on imports of food and agricultural products, as well as other consumer goods (household chemical products, clothes, etc.). For this reason, trade is still one of the key sectors of the regional economy. EU firms may also seek business opportunities in the development of the exclave's harbour, since it offers a chance for co-operation on modernising the ports (for example, construction and service contracts), and for the use of water transport on a broader scale in the future.

More opportunities for EU firms to become engaged in the region are also offered by the ongoing modernisation of the utilities and housing sector in Kaliningrad oblast, which has become necessary due to the rising prices of energy and utility services in the exclave. The demand for materials and goods (including gas and water meters), construction services, energy-saving technologies and renewable sources is growing in Kaliningrad oblast. EU exports and investments could get greater support if implementing the guidelines of the Partnership for Modernisation at both the EU-Russia level and in bilateral relations between individual member states and Russia.

Tourism could be another area where co-operation could become closer in the future, although Russian shortcomings in this area are also enormous. This sector is underinvested regarding both accommodation and service facilities, and the tourist attractions need to be modernised, renovated or reconstructed.

Another effective instrument of support for EU business in the exclave is the operation of chambers of commerce and industry (predominantly German), consulates (especially the economic departments) and associations of foreign investors in the exclave. For this reason, it is essential to continue collecting and disseminating information on opportunities for economic co-operation with this region (for example, by creating websites). It is also important for business circles to organise presentations of offers from EU firms, which makes it easier for contractors to establish co-operation with them; direct contacts still play the main role in Russia. Co-operation can also be facilitated by spreading knowledge about the region and its residents, which would stress their openness to contacts and co-operation with their neighbours from the EU.

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The Centre for Eastern Studies (OSW) is an expert institution that monitors and analyses the political, economic and social situation in Russia, the Caucasus, Central Asia, Central and Eastern Europe, Germany and the Balkans.

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