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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

The EU and Kaliningrad

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INTRODUCTION

Kaliningrad is a unique part of Russia, separated geographically from the rest of the country and destined after enlargement to be surrounded by the EU. As enlargement draws nearer, increasing attention is being focused on the region. In keeping with the Commission's Enlargement Strategy Paper of November 2000, the purpose of this Communication is to contribute to a debate which the EU should launch with Russia (including Kaliningrad), and with the two neighbouring future Member States, Poland and Lithuania, on issues which will affect our common future.

The Communication looks at the impact of EU enlargement and distinguishes between issues which will arise for all Russian regions¹ and those which are specific to Kaliningrad. Enlargement of the EU will be a positive development for its neighbours, contributing to stability and prosperity. Russia stands to benefit substantially from enlargement and regions such as Kaliningrad are well placed to take advantage of the new opportunities which will be created.

The adoption of the *acquis* by Poland and Lithuania will inevitably imply changes in some existing rules and practices between Russia, the EU and the new Member States. Some of these changes will have an equal impact on all Russian regions while others will have specific implications for Kaliningrad, mainly on the movement of goods, people, and the supply of energy. This paper also looks at ways in which the EU and Russia can work together to their mutual benefit to reduce the impact of existing problems confronting Kaliningrad, which are not directly related to enlargement, in areas such as environment, the fight against crime, health care and economic development.

This paper does not set out formal Commission proposals for decision, but rather outlines ideas and options for discussion between the parties. Responsibility for Kaliningrad lies with Russia and the region itself. However, the EU and its future Member States have an interest in helping to ensure that the changes required by accession are made smoothly and in fostering co-operation with Kaliningrad on a number of regional issues. A number of suggestions are made to provide ideas for tackling the issues which are highlighted in the paper. If they prove worthwhile, they can subsequently become the basis for decisions by the appropriate authorities.

Background information on the current situation in Kaliningrad and on its relations with its neighbours and international organisations is set out in the annexes to the paper.

¹ And all neighbouring third countries

ISSUES ARISING FROM THE ENLARGEMENT PROCESS

Movement of goods

At present EU-Russia trade relations are governed by the Partnership and Co-operation Agreement (PCA) signed in 1994. Upon accession Poland and Lithuania will take over the PCA as part of the *acquis* and the common external tariff will apply in trade between Russia and the enlarged EU. Since the EU already has very low MFN tariff levels for trade with Russia in industrial goods, 4,1%, while Poland's MFN tariff level is 15,8% and Lithuania's 5,3%, Russian goods will benefit from significantly lower tariffs after enlargement. These lower tariff levels will apply to goods originating in Kaliningrad on the same basis as the rest of Russia. Given its proximity to EU markets this prospect of easier access represents an important opportunity for Kaliningrad. Since Kaliningrad relies strongly on trade with neighbouring areas, it should have an interest in adopting EU technical norms and standards to enable it to take full benefit from this improved market access. However, until a more detailed assessment is done, it cannot be excluded that the changes in the trade regime which will take place on accession might have an impact on particular products.

It is suggested that the EU and Russia examine the trade impact of enlargement on Kaliningrad, in the trade and industry sub committee of the PCA. If particular problems are identified, the sub committee can be asked to recommend ways of dealing with them. This assessment should be carried out in the first half of 2001.

At present goods originating in Kaliningrad which are destined for Russia, and vice versa, transit through Lithuania and Latvia/Belarus. After enlargement, the PCA will provide for free transit through Lithuania and/or Latvia, without customs duties or any other transit duties (other than charges for transport and administration). The PCA will also benefit trade in goods between Russia and the EU, since it grants Russia MFN treatment. When Russia joins the WTO, its rules will apply to EU-Russia trade.

From time to time, proposals have been made for a special trade regime for Kaliningrad. Since Kaliningrad is an integral part of Russia, it would be difficult to grant any special status, such as free trade or a customs union. This would raise a number of political and legal issues apart from the fact that Russia is unlikely to grant the necessary degree of autonomy to Kaliningrad. Given the generally favourable situation described above it is not clear that any special treatment would be needed.

One aspect of movement of goods which will require attention is border crossings. At present, there are 23 crossing points between Kaliningrad, Poland and Lithuania. In order to ensure the efficient flow of goods across the EU's external border, improvement could be made both in physical infrastructure and in processing, including through upgraded information systems. Experience of the last enlargement has demonstrated that the introduction of the *acquis* on the border between Finland and Russia can speed up border crossing formalities. Considerable investments have been made in infrastructure and in procedures in Lithuania which should lead to similar positive results. It should be possible to build on this positive experience and to use some of the funds available through the Phare and Tacis programmes to finance improvements in border crossing facilities and procedures, in close co-operation with the Russian authorities.

The EU, Russia, Poland and Lithuania should discuss the functional management of border crossings, starting with the main road and rail crossings, particularly those linking the region to the Pan-European Transport Corridors I (via/rail Hanseatica) and IX (middle section). Discussions should include customs, border guard, phytosanitary, veterinary and health aspects. They could be held in working groups, with Russia under the relevant PCA Sub-committees and with Lithuania and Poland within the framework of the Europe Agreement. Discussions should encourage ratification of pending agreements on border demarcation and on crossing points, and should aim at agreeing a multi-annual approach to upgrading facilities to be implemented by the relevant national authorities. They should include advice on the optimal use of funding from all sources.

Future transit activities will also be facilitated by improved transport links and Kaliningrad is being integrated into the pan European transport corridor network, in particular Corridors I and IX. The Tacis programme has already funded a multi-modal transport strategy for Kaliningrad. Significant investment would be necessary in order to upgrade road corridors I and IX to European standards.

It is suggested that the output of this study be discussed with the IFIs and the Russian and neighbouring authorities, with a view to securing funding for priority projects.

At present military goods and personnel are transported through Lithuania under a special agreement with Russia. These arrangements need to be examined in the context of enlargement.

Energy supplies

At present most of Kaliningrad's electricity needs are met through imports from the rest of Russia which pass through Lithuania via a common grid. Lithuania envisages a link to the central Europe electricity grid by establishing a connection with Poland. Depending on the technical solution to be adopted for such connection (electrical line with or without a conversion station) and on the related costs, Kaliningrad could either maintain its link with the Russian electricity grid or switch to the Central European grid, which is connected to the main EU electricity grid, UCTE.

Without pre-empting the future choices to be made, it is suggested that a Tacis study on energy needs, energy potential and possible scenarios should be undertaken, to assess, *inter alia*, the feasibility of electricity generation in Kaliningrad, alternative electricity supply and electricity exchange solutions. The question of new gas pipeline projects in the Baltic region, as well as related transit issues should also be included in the study, which will require close co-operation between the EU, Lithuania, Russia, (including Kaliningrad) and the IFIs.

Movement of people

The introduction of the *acquis* by new Member States will have an impact on third countries in terms of visa requirements and border controls. While the requirement of the *acquis* will be no different for Kaliningrad than for any other part of Russia or other neighbouring third countries, it is possible that the impact on the population may be greater there than in other parts of Russia, given the geographic situation of Kaliningrad.

Poland intends to introduce the Community *acquis* in 2001 and Lithuania at the latest upon accession. This will have implications for transit and travel of persons. Travel, for whatever

purpose, to or through EU Member States will require possession of a visa. Visa-free transit (currently available to Kaliningrad and certain categories of Russian citizens transiting Lithuania) will no longer be possible. In addition, Kaliningrad citizens will be obliged to travel in possession of a valid passport (as opposed to the internal identity documents which are currently accepted).

These new requirements will not necessarily impede the movement of people between Kaliningrad and the rest of Russia and to and from future Member States (nor will all requirements necessarily apply as of the date of accession, as parts of the *acquis* will not have to be implemented until the moment internal border controls in the enlarged EU are lifted for new Member States). The *acquis* provides for the issuance of transit visas, short-term visas and long-term national visas allowing for smooth border crossing and the possibility of multiple entries.

In the wider context of Community policies on visas and on external borders, there may be a need to examine a number of areas from the point of view of ensuring smooth movement of people: the possible development of further rules on small border traffic (traffic within areas adjacent to the external border) in order to avoid disrupting local socio-economic ties; the effect of existing rules on transit in view of the specific situation of Kaliningrad; the cost of passports (the responsibility of Russia) and visas (responsibility of current and future EU Member States); the presence of consular offices in Kaliningrad to facilitate visa issuance (responsibility of EU Member States) and the possibility to take advantage of any special arrangements permitted by the *acquis*. In this latter context, the examples offered by other candidate countries should be examined.

However, most important will be the efficient operation of border crossings, through the upgrading of facilities and procedures and exchange of best practice. This would speed up slow and arbitrary border crossings procedures. The EU is already contributing to the development of infrastructure at border crossing points, modernisation of procedures and training to facilitate the movement of persons and goods across the future external border. Such practical measures facilitate border crossings, while combating organised crime and other illegal activities.

Without pre-empting the accession negotiations with Poland or Lithuania, it is suggested that practical measures to conduct proper and efficient border control be continued, facilitating the movement of persons and goods across the future external border. The use of liaison officers could be considered.

EU technical and financial assistance can contribute to the creation of a functioning border control system, including appropriate sufficiently fake-proof travel documents.

In the wider context of Community policies on visas and on external borders, the suitability of Community rules on small border traffic and transit for the specific situation of Kaliningrad could be assessed. The possibility to take advantage of any special arrangements permitted by the *acquis* should be looked into, using examples offered by existing arrangements, including in candidate countries.

The cost of passports (the responsibility of Russia) could also be examined, as well as the cost of visas (responsibility of current and future EU Member States), in the wider context of the Community policies. Both new and current Member States could consider opening consulates (or sharing facilities to reduce costs) in Kaliningrad, to facilitate visa issuance and manage migration flows efficiently.

Such moves to ensure smooth movement of people across borders would imply some co-ordination between Russia and the EU on visa policy, which would also be of broader mutual benefit. They would need to be accompanied by appropriate controls and action against inadequately documented travellers and passengers. The early conclusion of a readmission agreement between Russia and EU would help to build confidence.

An information initiative should be conducted to dispel misconceptions about the consequences of EU enlargement for the movement of both people and goods across the future external border of the EU.

It is suggested that the EU and Russia conclude a readmission agreement as soon as possible.

It is suggested that the EU should provide the administration and population of Kaliningrad and bordering regions with information on the way in which the future external border of the EU will function taking into account the need for fast and efficient border crossing for goods and people whilst preventing illegal activities.

Fisheries

Following enlargement, the Baltic Sea will almost become an exclusive EU fisheries zone, except for smaller areas around Kaliningrad and St Petersburg.

It is suggested to review the EU-Kaliningrad fisheries relations in the light of the consequences of enlargement on fishing access and of future fisheries agreement between the EU and Russia.

ISSUES OF MUTUAL INTEREST NOT DIRECTLY RELATED TO ENLARGEMENT

Economic Development

Unemployment and poverty have increased dramatically in Kaliningrad since 1991 and the main welfare indicators suggest that the standard of living is below the Russian average (see annex 1 for more details on the economic situation). Responsibility for the economic development of Kaliningrad lies with the central authorities in Moscow and the local authorities in the region. Kaliningrad is dependent on budgetary allocations from Moscow and on its trade and economic links with the rest of the country. As yet, Russian regional policy is less developed than that of the EU, in terms of financial transfers and investment incentives and current Russian policy is oriented towards greater centralisation. Nonetheless, there is much that the central and local authorities can do to stimulate economic development. As elsewhere in Russia there is a need for a stable and secure legal and institutional environment. Good corporate governance, fair and efficient enforcement of legislation (e.g. to guarantee the protection of shareholder and investor rights, bankruptcy, auditing and accounting), enterprise restructuring and the further development of SMEs. Market institutions should be strengthened, e.g. in the financial sector and the tax system.

There are various ways by which the EU can contribute to the economic development of Kaliningrad. Already now, the EU can help by providing advice, sharing experience and by providing funding through the Tacis programme and bilateral Member States programmes.

It is sometimes suggested that a special fund should be established for the development of Kaliningrad. However, the Commission rather believes that the first priority is to work with the Russian and local authorities to identify priority areas for support and then to help them find appropriate grant and/or loan funding for these activities. Tacis funding for Russia can be implemented regionally, and in its discussions with the Russian authorities on future priorities, the Commission can take account of priority activities in Kaliningrad.

More specifically officials and companies based in Kaliningrad can participate in Tacis funded training programmes to help develop market institutions such as banks, insurance and local tax services. Local managers could participate in training programmes in EU companies. With a view to developing Kaliningrad's export potential and markets in neighbouring countries, the EU could also provide assistance in areas such as harmonisation of standards and conformity assessment procedures. Tacis is supporting a Regional Development Agency in Kaliningrad, which could play an important role in promoting trade and investment in Kaliningrad.

The Special Economic Zone (SEZ) has been created mainly in order to offer companies based in Kaliningrad advantages through tariff and tax exemptions for their imports and for locally produced goods, exported to other countries and to the Russian mainland. The idea of promoting economic activity and investment through a Special Economic Zone is interesting, even if in its present form, the SEZ may have trade distorting effects through subsidies incompatible with the PCA and WTO rules. In practice, the SEZ has never been fully in operation and has had only limited backing from the authorities. Nevertheless, the possible benefits and the status of SEZ should be clarified with the federal authorities and, if necessary, adapted to bring it into line with Russia's international obligations.

Information society is a key enabler for prosperity and sustainable development. A favourable environment for uptake and the use of the Internet is of crucial importance for developing the economy, business, government and democratic participation. Information Society development should be encouraged and efficient ways of supporting Kaliningrad's participation in regional co-operation actions on Information Society need to be identified.

Governance, democracy and the rule of law

Kaliningrad's own development and its involvement in the wider region depends on the strengthening of the rule of law, and the broad implementation of good governance principles, particularly through promoting institution building and civil society development. The EU could contribute to this process by encouraging Kaliningrad's participation in EU projects for public administration and judicial reform, and participation of local civil servants in training programmes. Regional and local budget management and management of municipal services could be supported.

Through the Tacis Local Support Office, established in Kaliningrad in December 2000, the participation of local actors in partnership programmes with EU organisations and people-to-people activities will be promoted, including training institutions, NGOs, trade unions, media, professional organisations, enterprises, municipalities and courts.

As elsewhere in Russia there is a need for action to combat illegal activities, which are likely to affect neighbouring EU member states. Strong action is needed by the federal authorities, for example to enact and enforce legislation and international conventions. The Task Force on Organised Crime in the Baltic Sea Region can make a valuable contribution to tackling these problems. On the local level co-operation should be developed to deal with problems such as

car crime and then be extended to other areas. Co-operation could also be directed at improving the independence of the local judiciary, in particular via training and twinning programmes targeting magistrates. Efforts to develop effective border/customs control measures should also be linked to the wider anti-crime agenda.

Environment

As part of wider efforts to improve the quality of life in Kaliningrad there is a need to focus on the environment, and in particular on reducing water pollution. A cleaner Baltic Sea would benefit all Baltic Sea regions and should be a priority objective for regional co-operation. More could also be done to reduce pollution originating in smaller towns in the region. Kaliningrad should be actively involved in federal efforts to monitor the environment, harmonise standards, etc.

In view of the past military presence in Kaliningrad, there may be problems relating to the disposal of nuclear waste. There are also problems arising from stockpiles of chemical weapons left over since the second World War.

The environment has been a focal point for EU assistance. Current activities include a Tacis CBC project dealing with water quality on the borders with Lithuania and Poland and a Tacis waste management project in Kaliningrad's coastal zone. There is an EBRD/NEFCO/NIB loan for a sewerage treatment plant in Kaliningrad City, and several bilateral projects to improve the water network in the region (see Annexes II & III).

Health

The spread of communicable diseases is a serious problem in Russia and particularly in Kaliningrad. These problems must be tackled at the federal level but preventive action can also be taken in Kaliningrad itself. Tacis is supporting several initiatives at local level and in the non-governmental sector to help reform health care delivery systems and to help deal with HIV. In the future, the recommendation of the Task Force on Communicable Diseases Control in the Baltic Sea area will help address the issue of TB and HIV at the regional level.

NEXT STEPS

The aim of this paper is to contribute to a discussion. As outlined in the paper there are many issues to be considered, involving different partners. It will be important to take this discussion forward in the right framework, fully respecting the responsibilities of each of the partners. In the PCA, the EU and Russia already have the mechanisms which will allow for discussion of these issues at the highest political level, as well as for thorough technical preparation of the debate. In the enlargement process, the EU can discuss all of these issues with the candidate countries. Where it is necessary for all the partners (EU, Russia, Lithuania and Poland) to discuss together meetings can be arranged.

In keeping with the Commission Enlargement Strategy Paper of November 2000, issues concerning Kaliningrad should be addressed in co-operation with Russia, Poland and Lithuania. It is suggested, once this paper has been discussed internally by the EU, that the EU-Russia Co-operation Council include Kaliningrad on its agenda and discuss how to take the various issues forward. This co-operation should be prepared with Russia by the Presidency and the Commission. Based on the outcome of these political and technical discussions, problems and possible solutions can be identified for consideration in the PCA bodies. It is also suggested that Kaliningrad be discussed at the EU–Russia Summit in May

2001. In parallel, the EU will continue to discuss the same issues with Lithuania and Poland within the fora established under the Europe Agreements. If necessary, meetings between all the parties can be arranged. In addition, to facilitate cross border co-operation, specific meetings may be called between interested partners so as to, inter alia, establish practical arrangements.

SUMMARY OF MAIN SUGGESTIONS

It is suggested that:

- the EU and Russia examine the trade impact of enlargement on Kaliningrad, in the trade and industry sub committee of the PCA, during the first half of 2001.
- the EU, Russia, Poland and Lithuania discuss the functional management of border crossings, starting with the main road and rail crossings, particularly those linking the region to the Pan-European Transport Corridors I and IX. Discussions should include customs, border guard, phytosanitary, veterinary and health aspects. Discussions could be held in working groups, with Russia under the relevant PCA sub committees and with Lithuania and Poland within the framework of the Europe Agreement.
- the output of the Tacis study on a multi-modal transport strategy be discussed with the IFIs and the Russian and neighbouring countries authorities, with a view to securing funding for priority projects.
- a Tacis study on energy needs, energy potential and possible scenarios should be undertaken.
- the practical measures to conduct proper and efficient border control be continued, facilitating the movement of persons and goods across the future external border, . The use of liaison officers could be considered.
- without pre-empting accession negotiations with Poland and Lithuania, EU technical and financial assistance can contribute to the creation of a functioning border control system, including appropriate sufficiently fake-proof travel documents.
- the suitability of Community rules on small border traffic and transit for the specific situation of Kaliningrad be assessed. The possibility to take advantage of any special arrangements permitted by the *acquis* should be looked into, using examples offered by existing arrangements, including in candidate countries.
- in the wider context of Community policies on visas and on external borders, the cost of passports (the responsibility of Russia) could also be examined, as well as the cost of visas (responsibility of current and future EU Member States). Both new and current Member States could consider opening consulates (or sharing facilities to reduce costs) in Kaliningrad, to facilitate visa issuance and manage migration flows efficiently.
- the EU and Russia quickly conclude a readmission agreement.
- the EU should provide the administration and population of Kaliningrad and bordering regions information on the way in which the future external border of the EU will function taking into account the need for fast and efficient border crossing for goods and people whilst preventing illegal activities.
- the EU-Kaliningrad fisheries relations be reviewed in the light of the consequences of enlargement on fishing access and of future fisheries agreement between the EU and Russia.
- the EU and Russia discuss key issues of environmental concern in Kaliningrad.

- issues concerning Kaliningrad be addressed in co-operation with Russian in the relevant PCA bodies and, in parallel, that the EU continue to discuss the same issues with Lithuania and Poland in the Europe Agreement for a. In addition, to facilitate cross border co-operation, specific meetings may be called between interested partners so as to, inter alia, establish practical arrangements.

ANNEX I

Background information on Kaliningrad

1.1. Economic situation

The Kaliningrad region is a Russian enclave bordered by Poland, Lithuania and the Baltic Sea. It has a land surface of 15,100 square km and a population of almost one million inhabitants, of whom about 430,000 are concentrated in the capital, Kaliningrad.

In the Soviet Union Kaliningrad was a closed military centre and the headquarters of the Soviet Baltic Fleet. The strategic importance of Kaliningrad has decreased in the 1990s. Since 1991, the number of military personnel in the region has fallen from 200,000 to 18,000 and the armed forces are unlikely to regain the political and economic significance they had in the past.

Kaliningrad has suffered from marked economic decline, along with the rest of Russia. Production has fallen by more than half since 1990. Kaliningrad was particularly strongly affected by the Russian financial crisis of August 1998 because of its dependence on foreign trade and particularly imports.

Overall economic decline has been accompanied by drastic changes in the structure of the regional economy. Military-related industries have shrunk dramatically. The fishing industry, which used to be a major economic activity, experienced a similar decline. Today, the main industries in the region are oil and amber extraction. Oil is extracted offshore (about 1 million tons a year) and sent to Lithuania for refining. Kaliningrad has some 90% of the world reserves of amber, virtually all of which is smuggled out of the region in raw form. Other important economic activities are food processing, pulp and paper production, furniture manufacturing, machine-building, and computer software development. Agriculture carries little economic weight, although the land in Kaliningrad is fertile and there is potential for growth.

Kaliningrad households have come to rely increasingly on unregistered economic activities. As a border province, Kaliningrad offers much scope for informal activity, estimated to account for more than 50% of GDP. About 10,000 people are believed to be involved in regular cross-border shuttle trading.

There are some 14,000 SMEs in the region. As such, Kaliningrad ranks third in Russia in terms of the number of SMEs per capita. The strong presence of Moscow banks in Kaliningrad also suggests that the region is economically attractive. This is not, however, reflected in inward investment which is on a par with the average in Russia. The business environment, like that of the rest of Russia, lacks predictability, stability and incentives. There is insufficient investor and property protection, legislation is often not enforced (the tax environment remains complex and is not supportive of business).

A Special Economic Zone (SEZ) provides, under certain conditions, for tariff and tax advantages for goods produced in Kaliningrad for export, for imported goods, and for goods "exported" to the Russian mainland and to third countries. The SEZ was intended to promote economic activity and foreign investment but its operation has, in practice, been fraught with uncertainty. With no clear backing from the authorities and indications of possible incompatibility with WTO rules, the relevance of the Kaliningrad SEZ has been limited.

As elsewhere in Russia, unemployment and poverty have increased dramatically since 1991. Thirty percent of the population is now estimated to live below subsistence level. The main welfare indicators suggest that the standard of living in Kaliningrad is lower than the Russian average, although a relatively high level of apparent consumption is visible in the region, for example in western-style supermarkets and restaurants.

1.2. Transport links

Kaliningrad's road network is relatively dense, but requires upgrading. Stretches of the Pan-European Transport Network passing through the territory are under-developed. Branch B of Corridor IX, connecting Kaliningrad to Kiev, via Vilnius and Minsk, is of particular importance for Kaliningrad.

Rail connections with neighbouring countries and Russia are under-utilised compared to the 1980s and early 1990s. The main railway line, Kaliningrad-Kaunas-Minsk-Moscow, serves freight traffic with Lithuania and Russia. The line Kaliningrad-Riga-St Petersburg is less used for international freight transport, as is also the case for lines to Poland (largely because of different rail gauges).

Traffic to and from the EU can use several routes and is not obliged to pass through Kaliningrad. When travelling to Western and Central Europe, Finns, Estonians, Latvians and Lithuanians typically use the Via Baltica branch of Corridor I, Helsinki-Tallinn-Riga-Kaunas-Warsaw, by-passing Kaliningrad to the east, avoiding the Via Hansaetica branch, Riga-Kaliningrad-Gdansk.

Kaliningrad's ports are less used by foreign cargoes than ports in Lithuania, Latvia and Estonia. They are also insufficiently competitive to handle Russia's internal trade; a rail journey from Moscow takes 25-28 hours and is more expensive than sending cargoes to alternative ports, such as Klaipeda. Kaliningrad does have the potential, however, to handle a share of cargo traffic from Belarus and northern Ukraine.

There is only one regular international flight from Kaliningrad, to Copenhagen.

Kaliningrad's contacts with neighbouring countries are hampered by slow border crossing formalities and infrastructure bottlenecks at the 23 international road, rail, air and sea border crossing points of the region.

1.3. Trade and transit

Due to its small size and enclave status, Kaliningrad is dependent on imports, the value of which is three times that of its exports, with heavy reliance on trade and economic interaction with mainland Russia. Every year more than 6 million tons of goods transit, mainly by rail, through Lithuania to and from Russia. 55% of this traffic is oil, coke and coal. Kaliningrad also imports many goods (including most of its food) from its immediate neighbours, Poland and Lithuania, which, with Germany, are Kaliningrad's most important foreign trade partners. Although Kaliningrad has relatively more trade links with its non-Russian neighbours than other Russian border regions, it is still relatively poorly integrated into the regional economy.

1.4. Energy

Kaliningrad is almost totally dependent on imported energy from the Russian mainland and produces only 20% of its own needs (mainly at small fuel oil and coal-fired plants). The delivery of fuel oil and coal is costly and complicated, dependent upon the transit regime

agreed with neighbouring countries. Gas is received from Russia through a pipeline which transits Belarus and Lithuania. The Kaliningrad authorities want to increase the share of gas for electricity production. A new gas-fired power station is under construction.

1.5. Education, health, environment

Kaliningrad has a good level of basic education. Kaliningrad State University and five other higher education institutions in the region maintain high standards. Their faculties and courses do not cater sufficiently for sectors such as microelectronics, biotechnology, new manufacturing processes and business administration.

Public health care services in Kaliningrad are close to the Russian average. Diseases such as, tuberculosis, diphtheria, measles and epidemic paratyphoid are widespread. TB is becoming multi-resistant and its prevalence is growing, especially among the inmates of Kaliningrad prisons. Drug use and prostitution have led to the alarming spread of other communicable diseases. For instance, Kaliningrad is among the worst regions in Russia for registered cases of HIV, and is by far the most affected area in the Baltic Sea region.

Kaliningrad is the second worst source of pollution in the Baltic Sea region after St. Petersburg, generating more than 400,000 tons annually of domestic and industrial waste. Sanitary conditions in urban areas are deteriorating, and the sewage system dates back to pre-WWII. Russia has committed itself to decrease marine pollution. As a result, the discharge of pollutants has diminished somewhat since 1991.

1.6. Regional governance, democracy and the rule of law

In the past, Kaliningrad's regional administration has generally not been perceived as either skilful or competent. Its style of management has been considered autocratic and lacking in transparency. The quality of the Kaliningrad City administration has generally been perceived in more positive terms compared with that of the Oblast.

Freedom of speech has not always been respected. Journalists have been harassed, and there are only two independent newspapers in the region. The judiciary and law enforcement agencies have not been sufficiently independent for the regional government. As a result of the recent election of a new Governor there is now opportunity for improvements in the efficiency and transparency of the regional administration, a new momentum to enhance the image of the region and to tackle its problems in a spirit of co-operation with Kaliningrad's neighbours.

Kaliningrad's relations with Moscow have to be seen in the context of ongoing federal reforms, which point to greater centralisation. Kaliningrad is part of the North West federal district with its centre in St. Petersburg. Moscow's policy emphasises the creation of a "single economic space" in Russia, and its control over Kaliningrad will probably strengthen.

1.7. Crime

As in many other parts of Russia, crime is widespread in Kaliningrad, thriving on weak institutions. Organised crime, trafficking in human beings, drugs and stolen vehicles and illegal migration are all present. Smuggling - notably of amber, alcohol and cigarettes - and prostitution are also prevalent. According to official statistics, the level of crime is 20% higher than the Russian average, in particular for organised crime, as well as crime by minors and by people acting under the influence of alcohol. Organised crime has, as elsewhere in Russia, a pervasive negative effect on the business and investment climate. Criminality,

linked to corruption, poses a threat to economic development and the development of a democratic system governed by the rule of law.

Through its Operative Committee (OPC), the Task Force on Organised Crime in the Baltic region has been conducting joint, multi-disciplinary law enforcement operations. A communications system allowing for intensive exchange of information (BALTCOM) is operating 24 hours a day. From the start, Russia has been one of the most active members of the Task Force. In 1998-2000 Kaliningrad participated in a series of operations against stolen vehicles ("The Kaliningrad project, 1998"), drugs ("Channel, 1999") and illegal migration ("Baltic Guard 1997-98" and "VIVAN, 1999"). The fact that Russia has organised joint operations including the Kaliningrad region, has been highly appreciated by all other Baltic participants. These joint operations have contributed to confidence building and improvement of soft security in the Baltic Sea area. Thanks to this, the perception of Kaliningrad is today much better in the region than it was in 1996 when the Task Force started work.

1.8. Enclave related constraints on the mobility of persons

During the Soviet period people from Kaliningrad travelled freely within the USSR. Since the break-up of the USSR, they have to travel some 500 kilometres through Lithuania and either Latvia or Belarus in order to get to the rest of Russia. The same applies for other Russians who want to visit their relatives, friends and business partners in Kaliningrad.

1.9. Neighbouring States, regional organisations, regions, IFIs

• Lithuania

Lithuania is one of Kaliningrad's main trade partners and an important investor, located on the transit route between the region and the Russian mainland. It has the largest share of visitors and transit traffic from Kaliningrad and wants to maintain good relations with Russia, to ensure that Kaliningrad is not isolated and does not become a source of economic or political instability.

Lithuania and Russia have established an institutional basis for co-operation through bilateral agreements on Kaliningrad (1991,1999). In February 2000, Russia and Lithuania issued a joint statement on regional co-operation, known as the "Nida Initiative", and agreed on a set of common project proposals in the framework of the Northern Dimension, including transport, gas pipeline, water management and border crossing issues.

• Poland

Co-operation agreements exist between certain Polish regions and Kaliningrad. Activities mainly consist of partnerships and exchanges at the local level (SMEs, academic institutions, administrations), but also cover preparation of investment projects, e.g. in transport, energy and the environment. Poland is an important investor in Kaliningrad and the leading partner in terms of joint ventures with local enterprises.

- **CBSS, Euroregions and International Financial Institutions²**

The CBSS maintains close links with regional authorities and has recently opened a EuroFaculty at the Kaliningrad State University.

Kaliningrad is part of several Euroregions, established to promote cross-border co-operation. The Euroregion "**Baltic**" includes Denmark, Latvia, Lithuania, Poland and Sweden while the Euroregion "**Saule**" has been established between eighteen regional and local authorities from Lithuania, Latvia, Sweden and Russia (2 districts and 1 town in the northern part of Kaliningrad Oblast). Furthermore, a Euroregion "**Neman**" should link communities in Lithuania, Kaliningrad and Belarus.

For the IFIs, such as the EBRD the World Bank, the NIB and NEFCO, Kaliningrad is seen in an overall Russian and Baltic context, and it has so far not been given any special treatment.

² The Council of the Baltic Sea States (CBSS) consists of 11 littoral countries , and aims to secure democratic and economic development in the Baltic Sea region.

ANNEX II

Tacis and other EC activities in Kaliningrad in 1991-2000

Since 1991, the European Union has financed a variety of projects in Kaliningrad, mostly through Tacis, including large projects in the sectors of institution building, energy, transport, enterprise restructuring, management training and environment. If smaller partnership projects are added, Kaliningrad has been the recipient of more than EUR 30 million of Tacis assistance. In addition, some assistance has been provided under other EU programmes, in the fields of environment, transport and training.

1. 1991-1999

Tacis activities in Kaliningrad started in **1991** with a Food & Agriculture project, which promoted private farming. The Oblast also participated in two **1993** Tacis Russia projects aiming at establishing a network of SME Development Agencies in Russia. Tacis activities notably increased in **1994**, when Kaliningrad was selected as a priority region, with a specific Action Programme. Projects identified in 1994 were implemented during the following years, and completed by the end of 1999/ beginning of 2000. Under this programme, Tacis actions mainly focused on:

- **institution building**, with support given to the development of the Free Economic Zone/ Special Economic Zone (FEZ/SEZ). In the same context, assistance was also provided to the transport and energy sectors;
- **enterprise restructuring**, with the creation of an Enterprise Support Centre and the strengthening of the local SME Development Agency. Special attention was given to the fish industry;
- **human resources development**, with the establishment of a Business Management department at the Economics Faculty of the Kaliningrad State University (KSU).

After 1994, Kaliningrad has also been involved, as a pilot region, in several Tacis Russia projects, particularly in the field of energy. It has also significantly benefited from other Tacis facilities, such as:

- **City Twinning** (with Copenhagen, Aalborg, Southampton and Bremerhaven);
- **PIP** (Productivity Initiative Programme), which has created internship opportunities for local managers in EU companies;
- **ESSN** (European Senior Service Network), which has assisted wood-processing SMEs;
- **LIEN** (Link Inter European NGOs), which has focused on social and health issues, especially the social re-integration of former military staff and their families;
- **TEMPUS**, which has encouraged collaboration of the KSU with Swedish and Danish universities;
- **BISTRO**, which has implemented 9 projects in Kaliningrad, covering issues such as business and export promotion, pollution control and health issues;

- **CBC** (Cross Border Co-operation), which has mainly focused on improving cross-border infrastructure as well as on environmental issues (water quality management). Kaliningrad has been eligible to the **CBC Small Project Facility** since 1996, but interest in exploiting this opportunity has only emerged recently in the region, with the City being more active than the Region.

In addition to Tacis, other EU programmes have been active in Kaliningrad:

- DG ENV's **LIFE** fund has initiated two projects in Kaliningrad, in the areas of urban traffic and ecotourism. DG ENV has also financed the establishment of an Environmental Centre for Administration and Technology (**ECAT**) in Kaliningrad, which was, in 1997, transferred to the local authorities;
- DG REGIO's **ECOS/Ouverture** programme has implemented three projects in Kaliningrad, TROS (Training of Retired Officers), RUSSTI (Russian Short Sea Transport Investigation) and AMBER;
- Two **INTERREG II C** projects have been implemented in the Baltic region, which also benefited Kaliningrad, in efficient air transport development (**SEABIRD**) and urban environmental management.

2. 1999-2000

Considering the geographic location of Kaliningrad and the specific issues which, as a result, need to be addressed, the EU again identified, in 1999 and 2000, a significant package of new projects targeting the region and to be implemented in 2001.

First of all, in light of EU enlargement, within the 1999 and 2000 Tacis CBC Programmes, two **border crossings** in Kaliningrad received priority: Chernyshevskoe /Kybartai-Nesterov (road/rail) and Bagrationovsk/Bezledy (road), on the borders, respectively, with Lithuania and Poland. These crossings, identified after a detailed feasibility study, are the major ones located on the Pan European Transport Network. Trade and movement of goods and persons will be facilitated through the development of infrastructure, modernisation of border procedures, and training of enforcement agencies staff to detect unlawful activities and increase their capacity to collect tax revenue.

In addition, under the Special Action for the Baltic Region 1999 and 2000, several projects have been selected for the region. **Kaliningrad Port Development** aims to stimulate trade and transit via the region, by strengthening the competitiveness of its port facilities and their management. Ultimately, the port modernisation will contribute to a sustainable economic development of the area and its integration into the Baltic region. **Waste management in the Kaliningrad Oblast** will contribute to the establishment of an efficient and safe waste management system in the region in order to alleviate the impact of waste generation on both public health and environment.

Kaliningrad will also take part, as a pilot region, among others, to the **North West Health Replication Project** aiming at reducing health and social disparities across the borders by supporting the reform of the health system in the region, currently facing deteriorating living conditions and acute public health problems. As well as to the **Promotion of innovative SMEs in the Baltic region**, which will develop the existing infrastructure supporting innovative SMEs (the so-called technological parks or "technoparks"), by strengthening their

capacity to provide training, marketing services and general business advice. Possibility of twinning experiences with similar EU organisations will be explored.

Finally, the important **Technical Assistance Contract for Promoting Trade and Investment in Kaliningrad Oblast** will put the emphasis on the socio-economic stabilisation of the region. Its main objective is to strengthen the Regional Development Agency and thus to develop the economic potential of the region and to promote trade and investment.

Kaliningrad will also be eligible for participation in future Tacis **partnership and investment promotion** programmes, as well as in the CBC Small Project Facility. To allow Kaliningrad to participate appropriately in regional co-operation activities, when INTERREG funding is made available on the Community side of the border, may require matching Tacis funding.

ANNEX III

Main bilateral and regional activities in Kaliningrad in 1991-1999

Several EU Member States, as well as other States and donors, have been active in Kaliningrad during the past decade. Especially the near-by countries have demonstrated an interest in Kaliningrad and have provided considerable amounts of technical assistance, at the governmental and local levels. It has not been possible, at this stage, to include an overview table of all the bilateral and other projects conducted in Kaliningrad, as such data are not available yet, but a recent update of the list produced by the CBSS Secretariat shows the main trends.

Of all countries, **Denmark** appears to be the most active in providing technical assistance to Kaliningrad. It has implemented approximately fifty projects in the region since 1991, mainly in the areas of energy and environment (particularly water and waste water management), but also in human resources development and in the social sector. Its total assistance to Kaliningrad exceeds EUR 10 million.

Sweden, which has a common sea border with Kaliningrad, has also demonstrated notable amount of activity. Its projects have covered various sectors, with a focus on business development, administrative reform and support to local governments, land reform and prevention of transmissible diseases. Sweden's total amount of assistance to Kaliningrad is close to EUR 4,0 million. In addition, Southern Swedish local authorities are taking part to people-to-people and networking programmes with Kaliningrad.

Germany has implemented approximately ten projects in the region, with a total of over EUR 1 million. The projects have been realised in the spheres of education, agriculture and economic development. Significant exchange programmes are also taking place at the level of German Länder and cities.

Finland has provided assistance and resources for the prevention of HIV epidemic in Kaliningrad, and has also been involved, together with NIB/NEFCO/EBRD/Sweden and Denmark, in the Water and Environmental Services project for the City of Kaliningrad.

Lithuania's projects cover HIV prevention, civil society development, education and exchange initiatives in the academic sector. **Poland's** activities in the area concern mainly the regional level and cross-border co-operation.

An important initiative was the establishment, by the **CBSS**, in September 2000 of an EuroFaculty at the Kaliningrad State University. After Tartu, Riga and Vilnius, foreign language courses are being organised, lectures will be delivered by professors from European Universities to students, and new curricula developed in law and economics.

Other technical assistance providers include **Norway** (mainly energy saving projects) and the **USA** (in the field of civil society promotion).

ANNEX IV

List of abbreviations

CBSS	Council of the Baltic Sea States
EBRD	European Bank for Reconstruction and Development
ECAT	Environmental Centre for Administration and Technology
EU	European Union
FDI	Foreign Direct Investment
FEZ	Free Economic Zone
FTA	Free Trade Agreement
GATT	General Agreement on Trade and Tariffs
GDP	Gross Domestic Product
HIV	Human Immunodeficiency Virus
IFI	International Financial Institution
JHA	Justice and Home Affairs
LIEN	Linking Inter-European NGOs
MFN	Most Favoured Nation –treatment
NGO	Non Governmental Organisation
NIB	Nordic Investment Bank
NEFCO	Nordic Environment Finance Corporation
PCA	Partnership and Co-operation Agreement
SEZ	Special Economic Zone
SME	Small and Medium Sized Enterprise
TB	Tuberculosis
TEN	Trans-European Transport Network
UCTE	Union for the Co-ordination of Transmission of Electricity
USSR	Union of Soviet Socialist Republics
WTO	World Trade Organisation

ANNEX V

