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RESTRUCTURING AND REVITALIZING THE KALININGRAD REGION* (PHASE I-A)

TF/RUS/94/001 and US/RUS/93/134

RUSSIAN FEDERATION

Technical report: Study on regional development**

Prepared for the Kaliningrad Administration
by the United Nations Industrial Development Organization

Based on the work of R. Liff, consultant in regional development
and A. Barinov, national consultant

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TABLE OF CONTENTS

LIST OF TABLES

LIST OF APPENDICES

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

- There is a narrow specialisation of the industry, which once had been developed to meet the needs of a centrally planned economy. Some of the traditional industries might prove not to be competitive. Industries based on combinations of natural resources and labour-intensive processing can prove to be competitive.

- The enclave position increases the cost of products and services. Restrictions, introduced by Lithuania, have led to the decrease of cargo transportation to the Kaliningrad region by almost one third.

- The region has a highly qualified labour force. But the investors have not yet been attracted, due to high political and economic risks.

- The industry trends show many times a decline of 50% compared to 1991.

- The hard infrastructure is at large adequate to support a short to medium term industrial development.

- The region is at present not suitable as a transit region, due to high transit tariffs through Lithuania.

- The necessary investments in the industry sector have to be financed primarily by company profits. The main strategy is to support especially the large enterprises to gain profits.

- If the pulp and paper industry can prove that they can and will take the costs to use more sound technology and appropriate treatment of air and water effluents, including their costs of municipal sewage treatment, the industry should be supported.

- Without the region commitment to a solution to the waste water problems it is hardly possible to give any support to heavy polluted industries, such as pulp and paper and meat processing.

- A restructuring of the amber industry should be given priority.

- The SME-sector is underdeveloped and should be supported by a general SME-programme.

- The food processing industry and construction industry are ideal to support to stimulate the regional development

Recommendations

- The large enterprises are in general in an urgent need to be restructured despite the previous privatisation. They should be directly supported in restructuring and management development programmes. The restructuring of the old structure can release resources and speed up the development with fewer losses of resources compared with the laissez-faire strategy (Business restructuring)
- The SME-sector represents a new industry structure and should also be directly supported.
(Business development)
- The institutional infrastructure needs to be developed for example by establishment of the Investment Promotion Authority, Centre for Support of Privatised Enterprises, agencies to guide foreign investors to assess investment projects and elaboration of regional and municipal bonds.

- The importance to come to an acceptable settlement with Lithuania should be recognised not only by the RF but also in relations between Lithuania and the Western countries.

- Normal business conditions should be created in accordance with the expectations of foreign investors. It is about possibilities to own, to make profits and to repatriate profits.

- The enclave position is disadvantageous and has to be compensated, for example by exemptions customs in some cases, in order to make the region competitive with other regions.

INTRODUCTION

The report is based on findings and analyses of Mr A. Barinov and the consultant. The consultant has stayed in Kaliningrad during three periods; 6th of June to 16th of June, 8th August to 18th of August and 19th of September to 29th of September.

The terms of references of the mission are attached in Appendix 1.

During the stays a number of persons have been interviewed and some of them have also participated in the seminar. A list of these persons is given in Appendix 2.

I BACKGROUND

A Objectives

RD in general is about using and developing resources given to the region and about solving economic, social and ecological problems in order to develop the wealth of the region. The aims of this project are:
a) to develop a strategy supporting the economic development
b) to identify, evaluate and prioritize industrial investment projects, including evaluation of importance and feasibility (possibly, preliminary contacts with investors can be made but there can't be any direct contacts and substantial financial results at this stage)
c) to identify the needs to improve the conditions for the development of the industrial sector and recommend actions concerning the legal framework, infrastructure, supporting institutions and human resources.

Therefore the purpose is to concentrate on economic aspects and aspects directly influencing the industrial development. This does not mean that social and ecological aspects would be neglected in identifying out a strategy or in the prioritization of investment projects.

The thoughts behind this interpretation of the RD-concept are that the region is in such a difficult economic situation that a kind of the best return on the investment-concept should be applied to the whole region. The logics behind the regional development is, therefore, analogous to how to manage a company. A company needs to formulate a business mission telling what customers and what products should be prioritized. A strategy telling how the company would act to be successful in fulfilling its business mission is also essential for managing the company. A good strategy is based on knowledge about the interdependence between different actions. Based on the insights of the main strategies and their logics it is possible for the management to assess investment proposals. The first criterion is what the accepted proposals have to be in line with the business mission and the main strategies. The second is that the investment should be profitable, in the sense, that it must give a high enough return on the investment.

It can be profitable to invest in:
* Optimizing the production capacity (cost reductions per produced unit):
- reduce bottlenecks: that is to expand the capacity to produce by a relatively small addition in a unit in the production chain or in capacity in other interrelated units.
- sell out redundant capacity, that just needs maintenance and keeps capital.

* Adding value to the products (revenue increases)
- process raw materials and semifinished products further to more valuable products when the value increases to a larger extent than the costs
- give services connected to the products (education and training-investments)
- quality guaranty of the products, license the products

* Reaching the right customers (revenue increases)
- marketing
- brand names, advertising
- selling efforts

Beside these kinds of investments a company can, for example, invest in completely new equipment in order to take up production of new products or to be established in a new region. Usually, these investments are great and more risky than the above mentioned, all of which represent an incremental way of making investments.
In case of investments in Kaliningrad, we think that the former way of investing on the marginal, incremental, as a company usually does, can offer several advantages:
- it is possible to register improvements gradually, it gives a possibility to learn something about the logics of the market

- the effects of mistakes would not be disastrous, the risk levels will be acceptable
- incremental investment has not been used thoroughly (it is better to optimize before building something new)
- companies and industries which are connected with heavy investments are usually less profitable than others
- it is easier to keep independence without large amounts of invested money

It is understandable that a company needs a strategy about thy should there be a regional strategy in market economy?

A regional strategy will be used by:

- The public sector, in order to make it possible to develop a strategy for creating proper business conditions. The public sector is not supposed to use a strategy as a guideline for its own business activities, such as making investments in production capacity, as in planned economy.

- Serious foreign investors, to make the region more understandable, to reduce perceived risk.

- Foreign aid-organisations, to guide them in supporting the right projects.

- Federal organizations, to guide them in supporting the right projects

One further aspect of the RD-concept is that the purpose is to create consensus among the most important actors about what to do. A successful company, and any successful organization, have a great ability to create shared values and ideas among its members. That ability is necessary to get anything to go without commanding. In this case it is an organization governed by politicians. They are not supposed to have the same opinions, but hopefully, the ambitions of this project: "increase the wealth of the region by an industrial development", can be a common point to start from.

B. Scope of work

To reach the objectives, information was collected through interviews, statistics and visits to factories and the local districts. A seminar was held to get a thorough analyses of possible strategies to develop the region of Kaliningrad.
The conclusions and recommendations are also based on the sector reports.

C. Frame of references

The context of successful investment projects

A traditional way of thinking is as follows:
* We can prepare a presentation of our present products, facilities and necessary investments. Our skills and technologies are good. The most difficult problem is our heavy depreciated plants and machines and the lack of working capital. The problems can obviously be solved with a capital transfusion. Regional development is a question of presenting investment proposals and finding investors, willing to put in money. The investors should not ask for a too high interest rate or for too much influence in the business. To get the money it is important to apply to powerful people and compete with other project proposals based on the same logics.

One problem with this way of thinking is that the investors of the described kind are very rare. Opposing interests are more common. However, the main problem, the shortage of capital, is a symptom of problems and not the cause. Therefore, additional money will vanish.

The expressed expectations about this project are as follows; to identify concrete, economically grounded projects, possible for foreign investors and aid-organizations to support. If the managers in the companies, finally given support, do not work in the right context and with sound mental models about a company in a market economy, there will be a waste of money, and no real help to develop the region.

What is the right context and which are the adequate mental models?

Stability in the rules for business activities

The nature of investments is that the company makes an offer at present time and expects gains in the future. There are no uncertainties connected with the offer. The company is sure to pay. However, we know nothing about the future. We can believe that we can count on certain things to happen. If we feel that the uncertainty is too big, we can avoid to act or we can act, but with only a small amount of input, which we can afford to lose. In the last case, however, we expect to gain a lot if it is a success, in order to compensate for the taken risk. That means that the investors ask for high interest rates. Which means that only very profitable projects can be financed.
The consequences of a perceived high degree of uncertainty will give very short-sighted and speculative business, probably a trading-business. These businesses can compensate the investors for taking the risk, but at the expense of the sellers economy. A few external and internal traders can make enormous profits. Gradually, these profits will pour down to a growing middle-class and then create wealth.
Another consequence of uncertainty is the local actors, who, more easily than foreign actors, can follow and understand and even have an impact on what is going on. The uncertainty creates also a soil for illegal methods.

Establishing stable conditions for making business is crucial to develop the region. The conditions have to be stable in reality and in appearance. It is a question of trustworthiness and it takes time to prove stability. Writing new laws does not immediately change the feeling of instability. However, the constitution is regarded as more stable than laws, laws are more reliable than presidential decrees and decrees are better than regional regulations, and they are better than nothing. The question of ownership is important, because the right to buy (instead of lease) real estate and land is normally regulated in a country constitution. The conditions for leasing contracts can be changed relatively easily

Laws create a stability and also reduce the perceived uncertainty among investors. Other methods of reducing the real and perceived uncertainty are to offer foreign investors co-operation with local actors, banks and different kinds of agents. The agents can be part of the public sector or can be private companies.

In this context, the free economic zone-concept can be regarded as an enclave one, not only having privileges, but stable conditions too. Creating a zone could shorten the period of creating stability, compared with the rest of Russia, and in that sense, give Kaliningrad a competitive advantage, except tax- and customs privileges.

The conclusion is very important to reduce uncertainty, in reality and in appearance, by traditional methods like writing laws and by developing new institutions and concepts.

A shared vision and shared values

Creating stable conditions is necessary, but it is not enough. Something is needed to guide people aspirations:

That is, a vision of a positive picture of the future. Values are guidelines for how to behave. A vision and values give a collective sense of what is important and why.
A group of people is motivated to cooperate with each other if they can see a common future, otherwise is it more interesting for them to think about their individual share.

For example, in Kaliningrad there is Federal Administration and community administrations, both city- and district administrations. A shared vision and shared values are necessary for them to get develop co-operation. The same thing is necessary between the civil and the military sector. And the same thing is necessary between Kaliningrad and its neighbours.

An example of a shared vision is that Kaliningrad should be like Scania, the Southern province of Sweden. Kaliningrad and Scania both cover a surface of 15 000 square km, both have about the same climate, a population of about 1 million, and the same topography with fertile soil. Scania is probably regarded as the wealthiest landpart of Sweden. Kaliningrad is regarded by a lot of people as almost practically without natural resources.

A vision shared by the Federal and local administrators, of creating a prosperous region, based on its natural resources and trade with its neighbours, could have an impact on the regional strategies.

Supporting conditions

Private enterprises need a public support system as regards hard and soft infrastructure.

An important part of the soft infrastructure is the system of education. Kaliningrad could choose to emphasize engineering. However, this is probably not the bottleneck in knowledge when a company would like to increase its revenues. The Japanese imported know- hows, patents and licences, the South-East Asian countries started to improve their engineering capabilities and East-Europe should put stress on business and commercial skills. The ability to train students and businessmen in these skills will perhaps, give the best leverage of all investments and is of profound importance to the region.

In a planned economy, as in public organisations in general, a profit is not regarded as necessary. It is even regarded as improper to try to get a profit. Neither capital costs, nor a risk premium, are taken into consideration when pricing. When it is necessary to make an investment, it is time to ask the owner for money, arguing with all the problems, a lack of capital will cause, and already has caused for activities. Investments will then be consumed. This is an example of a mental model, that has to be changed by the business schools.
Considering the hard infrastructure, it is essential to cope with the fact that Kaliningrad is an enclave. The conditions for transiting goods and people through Lithuania, Poland and Belorussia are the most decisive factors for the future development of Kaliningrad.

D General, principal strategies of the Kaliningrad region

The present situation in Kaliningrad can be described as per;
A. The general political and economic situation in RF.
B. The enclave position.

The strategies to develop the Kaliningrad region can be divided, and, further on, also subdivided, into two categories according to whether they are supposed to deal particularly with the general situation or with the enclave situation.

The below shows the different strategies.

REGIONAL DEVELOPMENT

General strategies

RF-tasks
natural resources
support and incentive systems
powerhouses

Enclave strategies

reduce disadvantages
use advantages/compensate disadvantages

A. General strategies

1. Fulfill the task from a RF perspective.
The region is then supposed to concentrate on its uniqueness, compared to other regions of RF. That means, for example, that the following missions/industries should be regarded especially.

- fishery
- machinery
- recreation zone (health-resort)
- transport
- defence complexes
- edge knowledge

2. Use of natural resources
This strategy is about using resources given to the region.

The region has natural resources, namely;

- wood
- land
- fish
- amber
- oil
- gas
- sand, clay

and in addition to the above, there are resources for free, such as:

- localisation
- climate

and the population of about 900 000 inhabitants.

Using and cultivating these resources for many, many years created industries - and trade traditions with specialised skills. A lot of other basic industries are being created to support the industries necessities to use the natural resources. Handicraft, retailing and other service industries can be developed. This strategy is started with applying elementary knowledge and technology in the basic industries.
The domestic is started with applying elementary knowledge and technology in the basic industries.
The domestic market and local trade are important in this strategy.
Gradually, it is possible to develop more specialized knowledge and technology, suitable to apply in the niche strategies.

The industry-related studies are supposed to give answers related to this strategy.

According to this principle, the following tasks can be defined:

* Find out facts and potentials about available natural resources, qualified workers, infrastructure facilities, markets etc. This should be done especially about the basic industries and to related industries. This will be done in the industry-oriented projects. Small business industry, infrastructure and tourism also belong to this category. All these aspects of projects are primarily taken care of in the infrastructure-project.
From the fact findings and the SWOT-analysis, these projects are supposed to result in formulated strategies for each industry. From the strategies concrete projects could be devised.
The regional development project should, therefore, follow these projects and their results should be integrated into the Regional development project.

3. Develop support-and incentive systems - privatization, legal framework, institutes and institutions.

This strategy is about creating driving forces for the people in the region.

The finest mechanisms in economy are related to individual beliefs, thoughts and expectations. The individuals self-confidence, experiences and knowledge are crucial matters to develop a market economy. Especially in small scale business, it is necessary for the individuals to be able to act and gain something from it.
The privatisation process shouid be regarded in this context. The content and the consequences of that process have, so far, to be studied.
Also, the legal framework and the institutional way of supporting the individuals have to be studied.
Another aspect is the management capacity, especiaily in bigger companies. The management capacity must be related to what is needed when transforming the companies from being production units to modern enterprises.
According to this principle the following tasks can be defined:

* Find out the content of the privatization process and evaluate and suggest improvements.
This work should be based on findings from all the other groups, especially those dealing with investment promotion.
* Evaluate the legal framework and the public institutions. This task should be based on findings from all the other groups. For this purpose a checklist could be used during the company-visits. (See appendix).
This task should primarily be fulfilled by the group working with conversion of the military industries, also responsible for management training aspects.

4. Support the powerhouses - entrepreneurs, institutions, technologies and companies.

This strategy is a kind of portfolio strategy, cherry picking

The resources are being invested, where the possibilities of results seem to be the best. This strategy is the opposite of spending money, where the problems seem to be the biggest. The "cherries" can be technologies, companies, business units, institutions, managers and entrepreneurs.

According to this principle the following tasks can be defined:

* Find out promising and already good technologies, institutions, companies, entrepreneurs etc. All groups are supposed to take this into consideration. The military conversion group is responsible for this task.

B. Enclave-strategies.

1. Reduce/take away the disadvantage of being an enclave.

* Economic independence and self-support
- specialize in still strong sectors (fishery, machinery);
- improve underdeveloped sectors (agriculture, construction, infrastructure);
- turn to the western countries;
- self-financing;

* Decrease the dependence on single neighbouring countries
- diversity (energy and transport);

* Reduce the strains between Kaliningrad and the neighbours. Improve the regional co-operation.

According to this principle the following tasks can be defined:

* Find out possibilities to cooperate with the neighbours, improve customs-relation and improve transit-agreements. Also, these aspects are primarily dealt with in the investment project.

2. Use the advantages/compensate for the disadvantages.

* Offer special advantages (-FEZ-);

* Get financial support from RF;

* Turn to the western countries

According to this principle the following tasks can be defined:

* Find out linkages and restrictions given by Moscow. The feasibility of the FEZ-concept should be studied. These aspects are primarily studied in the investment promotion project.

The task is to assess the possibilities to successfully fulfil the different strategies.

E. Specific problems and possibilities of the Kaliningrad region

The Kaliningrad region is the only territory of RF which does not share borders with the latter. The region occupies the territory of 15,1 thousand sq. km. It was founded in 1945 on the one-third of the former Eastern Prussia according to the decision of the Jalta and Potsdam (Berlin) Conferences. The other two-thirds of the Eastern Prussia territory formed part of Poland.

One part of the German population left the city in 1945 together with the retreating German Army, another was moved to Germany soon after the war. The present population are migrants from the former USSR and their descendants: more than half of the population of the Kaliningrad region was born on the territory of the region. The 3rd generation of the native population of the Kaliningrad region is growing: Russians, Belorussians, Ukrainians, representatives of other nationalities.

It is estimated that the population of the region of 894,000 people comprises 700,000 Russians (78,5%), 76,000 Belorussians, 65,000 Ukrainians, 18,000 Lithuanians. The other 35,000 are Germans, Poles, Mordva, Tatars, Jews, Chuvash, Azerbaidjans, Armenians, Gipsys and others.

<u>The former specialized region in a planned economy</u>

An important economic complex, meeting all-Russia's needs, was created in the Kaliningrad region, fishing and supporting it industries being the most important. The region produced about 10% of fish food products in the country. Machine building is developed in the region. Pulp-and-paper industry produced about 6% of pulp and 4% of paper of the total volume of production in Russia. 90% of the world deposits of amber are concentrated on the territory and its extraction is equal to no other place of the world. About 1 mln tons of oil extracted annually, deposits of other valuable minerals are located. Per capita production of milk, meat and eggs in the region is much higher than the average per capita production in Russia, and the share of furs, produced in the region, is above 5 of cent. About 4 mln tons of import-export cargoes are carried annually by sea-transport, river-sea type ships are also widely used for cargo transportation. Recreation and tourism are also developing very fast. Some scientific and educational centres are of all-Russia and world importance.

More than 70% of products manufactured by Kaliningrad enterprises are exported. About 90% of raw materials and components and accessories are imported from other regions of the former Soviet Union. Fish and fish products, pulp, amber and amber products, some types of machinery and equipment, articles of clothing are exported abroad.

There is a narrow specialization of the industry, which is the main source of budget revenue. Under these conditions fishing, machine-building and pulp-and-paper industries accounted for more than 3/4 of fixed assets (mainly depreciated), 2/3 of people - employed and half of production volume.

The peculiarity of the power supply system lies in the fact that 80% of electric power comes from Lithuania. In the absence of own hydropower resources in the region, this has become one of the reasons for the highest tariffs in Russia on electric and heat power.

The specialization has been developed to meet the needs of a centrally planned economy. In a market economy all the existing resources can be seen as potential resources, and be developed, based on comparative advantages. Probably some of the traditional industries will not be proven competitive, in the open market economy, and some natural resources will give a base to new competitive industries. Some of the national resources have a low value per weight-unit and they can not be transported to long distances without loosing their competitiveness. Locally they are unique and they should be processed localy. If processing is labour-intensive and, because in Kaliningrad the salary-level is comparatively low and the unemployment level is high, then the conditions are excellent to build a competitive industry. Such possible combinations of natural resources and labour-intensive industries can be found:

In Kaliningrad there are big deposits of high quality clay and gravel which might become the basis for establishment of a competitive construction material industry. During 50s -60s brick production was completely liquidated and moved to Lithuania due to the heavy depreciated plants and the beginning of labour-division in a planned economy.
Nowadays, it could be possible to take up that production of tiles, brick, ceramics and concrete products. This will improve the conditions for the whole construction sector in the oblast, and possibly in the region. That means also the creation of new working jobsplaces in the form of small companies, serving the new production plants.

There are also a number of mineral water sources found in the oblast. Only a few of them are exploited and only one is bottled and marketed through modern methods in the oblast, not to speak about foreign methods. This can be a new industry, getting the same advantages as said above, regarding clay and gravel.

The forests could give valuable raw materiel for a thriving home industry producing all sorts of wooden products, used in the construction sector, and in furniture productions. Today the forests give some hundreds of thousands of cubic meters sold on export as round timber or processed to paper and pulp, a capital intensive industry.

The agriculture, with a potential like Scania, seems to be a disaster.

Amber with possibilities for handicraftsmen, the coastline, with its splits and the climate, must give the region the best tourist potential along the Baltic sea.

An enclave

The Kaliningrad region has a unique potential for the economic development due to its location - it offers Russia a network of transit roads in the Baltic region.

The Kaliningrad region, therefore, plays a very important role for the economy of Russia and this will be constantly growing due to the development of foreign economic links, the need for ports on the Baltic coast, the possibilities for the development in the region of joint ventures with foreign partners. The region has good preconditions to become a region of accelerated and priority development.

But nowadays - given the position of the Kaliningrad region, separated from the main territory of Russia, to get from Russia to the Kaliningrad region by land, a cargo or a passenger has to cross the territories of two independent states - Lithuania and Belorussia.

This increases the cost of products and services, freezes current assets. Restrictions, introduced by Lithuania, have led to the decrease of cargo transportation to the Kaliningrad region by almost one third. Recent increase of Russian railway tariffs and the introduction of the obligatory prepayment for freight traffic, ignoring the existence of isolated regions in the Russian territory, have brought decrease of trans-shipment via Kaliningrad ports- Thus apart from all-Russian problems - high inflation rate, the level of basic prices (on power carriers, transport, corn) its solvency of Russian producers, as well as, the taxation system, which is inconsistent with normal economic activity, the economy of the region is under a great influence of the Customs policy of the neighbouring states, which is a powerful factor of "winding up" the cost of products. In the crisis of selling industrial products all the above mentioned factors predetermine the position of the Kaliningrad region in RF as one of the regions with the worst conditions for the economic activity.

Criteria of the standard of living of the population in the Kaliningrad region are lower than those of Poland and Lithuania. The level of unemployment is increasing.

The legal status of the region greatly increases political risk for the potential Russian and foreign investors, business circles and entrepreneurs who are ready to participate in the social and economic development of the region.

<u>FEZ</u>

There is one more special feature of the Kaliningrad region to be mentioned. Today it has the status of the "Free Economic Zone". The region enjoys some very important factors that can attract both Russian and foreign investors. This is, first of all, the availability of a highly qualified labour force. But up to the recent days, important investors have not yet been attracted. The main reasons for this are: high political, legal and economic risks and absence in the region of prominent structures which can take great credits and guarantee their repayment.

To summarize the strengths and weaknesses and the opportunities and threats:

The <u>strengths</u> of the Kaliningrad region development are:

1. Climatic conditions favourable for agriculture as well as for recreation and tourism.

2. Natural resources such as oil, amber, fish and raw materials for building constructions.

3. Developed transport infrastructure, ice-free port being part of it.

4. Convenient geographical location: intersection North-South, East-West.

5. Highly qualified labour force.

6. Status of a free economic zone.

7. Social stability in the region.

8. Experience in foreign economic activities gained by the enterprises of the region.

So the <u>weaknesses</u> in the development of the Kaliningrad region are:

1. Enclave position as to the territory of Russia.

2. High transport expenses as far as import/export of goods is concerned.

3. Depreciated production plants in most industries and old technologies.

4. Ecological pollution of the region.

5. Lack of stable Russian legislation, regarding the Kaliningrad region.

6. Non-proportional development of economy of the region: dependence on energy supply, weak development of construction materials industry and too much stress on fishing and pulp/paper industry.

<u>Opportunities:</u>

1. Creating stable legislation base for the region during 1995-1996: adopting the Law on the Kaliningrad region, Law on the Free Economic Zone, tax legislation, adopting the federal programme for the Kaliningrad region development.

2. Gaining the first result of privatisation: recovering of enterprises activities, charge of management of enterprises and increasing management potential as a whole.

3. Building stable infrastructure of the region as a whole.

Threats:

1. Lack of necessary legislation on the regional development.

2. Increasing competition from Lithuania and Poland.

II PRESENT SITUATION

A description of the macro-economic situation is attached in Appendix 3, and a description of the demographic and educational situation is attached in Appendix 4.

A. Findings from the sector analyses

From the sector analyses we can get the following descriptions of the situation in Kaliningrad: (Being aware that the analyses also describe potentials and opportunities)

* Infrastructure
The road network and the rail network are fairly well developed and extensive. The air transport service and the existing port facilities are adequate for supporting an industrial development in the region. The needs of repair and reconstruction are big. Locomotives and cars are worn out and cannot operate without constant repair. Regular works of maintaining the marine channel to the inner harbours of Kaliningrad demand many millions of dollars annually. Due to the lack of financial resources, these works have not been undertaken since 1991. This decreases the depth of the channel.
Since 1990 the amount of cargo has decreased from about 10 millions tons to about 5 millions tons. The capacity of the harbours is therefore heavily under utilized. Besides the general economic decline the high transit tariffs through the neighbouring countries and complicated customs procedures are the main explanations of the decline. The telecommunication, based on analogous systems, provides a bad quality of communication. Telequipment is to a high extent worn out. The telephone installation cost is very high and too high for

the majority of people. The number of telephones per 100 people is far lower in Kaliningrad than in other regions of Russia.
There is a shortage of water supply in certain areas of Kaliningrad city, which restricts these areas for residential and industrial purposes. The treatment of waste water is quite insufficient, particularly in Kaliningrad city and in Neman, where the pulp and paper industries are severe pollutants.

* Energy

Kaliningrad is very dependent on an electric energy and natural gas transited through Lithuania. The transit costs are high. About two thirds of the energy costs are due to the transit tariffs through Lithuania. In 1992 about 10% of the consumption of electric energy was supplied by the production in the region. In spite of a decrease in the consumption by 10% the selfsupply in 1994 was just 6-7%. This is caused by the fact that the production units are outdated. The high energy costs are a considerable competitive disadvantage to some energy intensive industries, such as paper and pulp.
The heat consumption has decreased by about 25% from 1992 to 1994. The main explanation is inability of the customer to pay.
The energy sector is characterised by a high dependency on Lithuania, which causes high costs and low safety of supply. The production and distribution facilities are, to a large extent, close to their operational life.

* Housing

In the planned economy there was an annual production of 400 000 m2 of residential buildings, 2-3 schools, 2-3 kindergartens, 1-2 large public buildings, in addition to industrial complexes and infrastructure. The publicly financed projects have almost ceased. The total construction market has dropped by two-thirds since 1990. The need for new housing is very big.

* Investment promotion

The financial market is almost non-existent and the banking sector is very weak. Many important institution of financial intermediation, such as pension funds, mutual funds, specialised savings and loans organizations, security firms equity and bond markets are absent or very embryonic. The existing commercial banks have a very small capital base. Due to high inflation and rates, most banks deal only with the state treasury bonds and foreign exchange speculations.
The rate of domestic savings is low due to lack of incentives (and not only to the low level of income) and limits the potential for domestically financed investment.

* Military sector

About 4000 officers have been early retired from the Baltic Fleet since 1991. Many of them have stayed in the Kaliningrad region. About 700-800 of them have civil jobs and retraining.

In the planned economy there were 19 000 employees in the defence industry. In 1994 there were not more than 3 500 people directly engaged in the defence production in the Kaliningrad region. Nine companies have been defined as defence oriented. In 1990 six of them had a share of military output of half or more of their total output. In 1994 only one company, Yantar, has a dominating share of military output.

* SME-sector

The region has a low amount of SME's and newly registered companies compared to developed countries like Germany and Sweden.

This fact is in itself causing a severe bottleneck in different sectors of the economy. For example tourism, the maintenance sector, construction material sector and development of natural resources. The main reasons for this are to be found in the younger history of this region. In planned economies SME's generally were seen as disturbing factors and the only experience from more systematic individual business has been gained from more or less illegal business.

* Big companies

The situation in the companies can be characterised as follows:

- unreliable supply of raw material
- they cause environmental problems
- they use outdated technology and/or worn out equipment
- high transport costs
- marketing deficiencies
- low operating efficiency
- lack of long term credits
- the privatisation policies have not lead to any decisive results
- to a very high degree vertically integrated
- very diversified
- no flow of material orientation
- no process rationalisation
- inflexible functional department organisation
- lack of strategic thinking.

* Agriculture

The agricultural production and especially the output from the food processing industries has dropped considerably since 1991. On average the food processing industries produce half of what they did in 1991. The quality is not high enough and the prices are too high in relation to the foreign competition. The raw material is not available. An increasing share stays at the farms and is consumed locally.

In 1990 800 000 tons of fish were landed and for 1995 the volume is estimated to 150 000 tons.

The actual situation in the agricultural production is that considerably less area is used for especially intensive production purposes. The yields have dropped by 30-50% since 1991. The drainage systems practically do not work, the farm equipment is outdated and too heavy to be mobile when the soil gets wet and muddy and the use of fertilizers has decreased considerably.

The overwhelming impression is that the situation is very bad. The trends show a many times a decline of 50% compared to an already difficult situation in 1991. Very little has been identified in the sector reports of forces and activities in the economy that can turn the trends. The only examples are the paper and pulp industry and telecom reinvestments. However the reports naturally focus on the formal economy and consequently focus on the direct support to the development of the formal economy.

The informal economy can have a big importance to the economical development. Parts of the informal economy contribute to the wealth of the economy, while other parts are outright parasites by stealing rather than adding value.

The findings indicate a dramatic drop in formal output that would likely have had more severe consequences on the welfare and the social situation than seems to be the case on the surface of it. This fact is, as in many other places, due to the fact that considerable informal restructuring is taking place.

B. Foreign economic activity

With regard to the number of registered companies and organizations the foreign trade turnover from the companies own contracts, direct production links and goods exchange operations accounted for 299 mln dollars and increased 2,4 times in comparison with 1993.

The export of goods was growing more slowly and accounted for 156 mln dollars, the growth being 1,8 times more than the relevant figure in 1993. It is estimated that during the first half of 1994 the export of the region made up 0,5% of the Russian export in general.

The goods were delivered to 52 countries in the world, mostly to the industrially developed countries where the export volume reached 100 mln dollars and increased 2,1 times. The volume of the turnover of the export deliveries to the developing countries accounted for 27 mln dollars and increased by 2,5 times. The share of the industrially developed countries in the total export volume comprised 64%, incl.: Switzerland - 17%, Germany - 15%, Norway - 6%, Great Britain - 5%, Netherlands - 5%, Italy - 4%, Spain - 3%, France - 2%.

The developing countries accounted for 17% in the export volume, incl. Namibia - 9%.

The export with the Baltic states equalled to14 mln dollars and increased nearly two times in comparison with 1993. These countries accounted for 9% of the total export.

The export deliveries to the East European countries and former Socialist countries decreased by 30%, incl.: Poland - by 42%, Czech - by 36%.

The leading exporters were represented by open stock company "Tralflot" (17%), closed stock company "Gas-Oil" (16%), joint venture "Ceprus" (13%), Marine Fishing Port and open stock company "Western Shipping Company" (5% each), open stock company "Kaliningradmorneftegas" and open stock company "Reftransflot" (4% each).

Mostly the raw material was exported. 88 thousand tonnes of frozen fish, 25 thousand tonnes of coke, 59 thousand tonnes of pulp, 1,4 thousand tonnes of newspaper, 1828 thousand meters of cotton tissue were exported during the year. In comparison with 1993 the export of frozen fish increased by 1,5 times, export of pulp decreased by 25%, coke - by 28%.

In 1994 the import of the region equalled to143 mln dollars and increased by 4 times in comparison with 1993. Its special weight in the foreign economic turnover made up 48%.

The imported products were delivered from 40 countries. The volume of the import of the industrially developed countries was defined as 58 mln dollars and increased by 3,9 times as compared to 1993. The volume of the import of the East European and former Socialist countries was 56 mln dollars and increased by 3,3, times, the import of the Baltic states - 17 mln dollars and increased by 6,2 times.

In the geographical distribution of import the leading places are occupied by Poland and Germany. Their share accounted for nearly half of all import deliveries. Among other countries the highest specific weight in the import was acquired by Lithuania (9%), Namibia (5%), Czech republic (4,75%), Netherlands (4%) and Great Britain (4%).

There were not drastic changes in the structure of import. Mostly consumer goods were delivered: meat and meat products, oil and butter, potato, apples, citric plants, sugar, strong and soft drinks, refrigerators, washing and sewing machines, TV and radio-equipment, furniture, cars and lorries.

Among the consignees of the imported goods the highest special weight was obtained by: open stock company "Tralflot" (11%), open stock company "Kaliningradbummash" (5%), open stock company "Sovietsky Pulp and Paper Plant" (4%), open stock company "Parus" (4%), joint venture "Ray Corporation" (4%), open stock company "Rosvestalko" (2%), poultry plant "Kaliningradskaja Ltd." (2%), factory "Shvei Ltd." (2%), joint venture "Danka" (2%), individual company "Fri-Fisheries Ltd." (2%).

As of October 1, 1994, the authorized fund of the joint ventures accounted for 4,9 mlrd rbl. The share of the foreign partners comprised 43,5%.

During 9 months of 1994 both joint ventures and foreign companies produced goods, work and services for the sum of 82 mlrd rbl., which is 3,6 times increase in comparison with the corresponding period of 1993 and makes up 11,9% in the total volume of the regional plants production. The main types of goods produced are: volume of the regional plants production. The main types of the goods produced are: pulp, card-board, paper, fur and fur articles, furniture, clothes, ice-cream, ship-repairs and services.

The special weight of the joint ventures in the foreign economic turnover of the region accounted for 25%. 32 shapes with 3143 sq.m of sales area and 9 public catering enterprises were in operation.

Imported industrial goods were mostly dominating the local market due to the difficulties in connection with the transportation of goods across the boarders of the two states.

Foreign Economic Turnover Table 1

Countries	Foreign economic turnover, mln doll.*	incl.		special weight, %	
		export	import	export	import
The region in general, incl.	332,1	185,6	146,4	56	44
1. East-European countries and former socialist countries, incl.	73,0	16,3	56,7	22	78
- Poland	59,7	11,0	48,7	18	82
2. Industrially developed countries, incl.	184,4	122,4	61,9	66	34
- Germany	45,2	26,7	18,6	59	41
3. Developing countries, incl.	39,4	29,1	10,2	74	26
- Namibia	23,2	15,7	7,5	68	32
4. Baltic States, incl.	35,3	17,7	17,5	40	60
- Lithuania	20,9	8,3	12,6	65	35

* - without joint ventures and foreign companies

C. Legislative base for the development of the Kaliningrad region

Since 1991 a number of legislative and normative acts on regulation of the economic mechanism of the Kaliningrad region both on the federal and local levels were adopted. They concerned the promotion of external investments, export and import regulation, reduced customs tariffs and duties, the degree of the involvement of foreign investors in the privatization.

Certain measures to attract foreign investments were outlined within the framework of the creation of the Free Economic Zone (FEZ) "Yantar" in the territory of the region. Measures and privileges to attract external investments and promote foreign economic activity are developed on federal and local levels in such normative and legal documents as "On Foreign Investments". Regulations about FEZ "Yantar", Russian President's Decree of 7.12.93 No. 2117 "On Kaliningrad Region", etc. Due to these measures the process of foreign investments attraction to the Kaliningrad region has been activated.

But the main disadvantage of the present legal base is its instability. Thus, in March 1995, customs privileges proclaimed for 10 years were annulled. The taxation regime for joint ventures had been changed before.

Under these conditions the Legislative and Executive power of the Kaliningrad region works in two directions.

1. Adopt normative acts for the promotion of the region's development on the local level and within their competence not infringing upon the federal rights. For example, they exempt enterprises from local taxes preserving the federal part of the latter.

2. Emphasize the adoption of the Laws directly or indirectly concerning the Kaliningrad region rather than passing Regulations, Decrees or similar acts. Today a lot of emphasis is given to the development of the Law on the Kaliningrad region which defines a special economic mechanism of its functioning. The work on the development of the law on free economic zones is being completed, a special article being planned to describe the possibility of their setting up within the subject of the Federation (i.e. the region). The Customs Code regulating the mechanism of the unbounded area creation has already been adopted. Today the regional administration is working at setting up offshore and banking

zone in the region which also has to be reflected in the Law on the Kaliningrad region as well as in the Taxation Code being developed.

The completion of this work in 1995 and its co-ordination on the federal and local levels will make it possible to strengthen the legal base for the economic activity of the Kaliningrad region.

Further to the Legislative Base for the Development of the Kaliningrad region

The RF law "On Special Economic Zone in the Kaliningrad region" was passed in its first reading in summer 1995. Its adoption is an obvious success of the local authorities in the process of forming a stable legal base for the development of the Kaliningrad region. It'll be the first Law on the region, the status of a law being substantially more important than that one of the decrees and resolutions of the President and the Government.

The change of the concept "free economic zone" into a special economic zone" in the text of the Law doesn't involve drastic changes in the strategy for the region's development. Actually two concepts are identical.

The second reading of the Law will take place in the Parliament this autumn.

In order to fulfil the programme of the Administration for the development of the financial and banking Zone in the region, some changes and addenda have to be implemented. It will help to make the concept of the Kaliningrad region offshore more definite. These changes have to cover the following points:

- currency and foreign economic regulations should be realized in a special order differing from that of Russia in general;
- economic entities should be distributed depending on the place where the economic operations are carried out;
- system of privileges should be differentiated depending on the economic entities.

If these changes are not taken into consideration during the discussion of the Law on special economic zone, the development of the offshore will remain just an abstract idea.

D. Relations to the Neighbouring Countries

The Kaliningrad region is actively involved in the economic relationship with the bordering countries: Poland and Lithuania. Poland has the first place in the total volume of the region's foreign economic turnover. It makes up 19,4%, the regional import comprising 33,5%. Lithuania holds the 5th place in the foreign economic turnover with the special weight of 6,8%. Export to Lithuania exceeds import considerably: 5,2% and 1,3% correspondingly.

Most of the joint-ventures registered in the Free Economic Zone "Yantar" are also set up with the participation of these two countries. Most of them are engaged in commercial and purchasing activity and intermediary services. In the production field the Lithuanian and Polish investments are minor. The best results in the joint entrepreneurship are observed in small businesses.

The relations with Poland develop dynamically. Poland considers our region to be a good market for its goods, food products and furniture prevailing in its import share. Poland continues to activate its work in this direction, including the extension of its co-operation geography with Russia through the Kaliningrad region. The 2nd Economic Forum held in Sopot (Poland) which was attended, apart from the Kaliningrad region, by Smolensk, Yaroslavl, Kaluga, Pskov, Yakutia, Tataria, Siberia, etc. testifies to this.

The construction and modernization of the border crossings with Poland in the proximity of Mamonovo, Bagrationovsk and Gusev are under way. This will help to facilitate and improve the customs and immigration control.

Car and railway communication between Poland and Kaliningrad is also being developed. There is a constant communication with Gdansk, Elblang, Olzhtyn, Warsaw, Belastok.

The relations with Lithuania are different. First of all, the export of the Kaliningrad region produce to Lithuania dominates. It involves raw material resources mostly. Secondly, there is a number of questions about the goods transit through Lithuania to be solved on the governmental level. Sometimes the existing agreements don't work. The lack of stability is evident from periodic publications containing Lithuanian claims on the territory of the Kaliningrad region. This also doesn't promote economic relations of two parties.

If we consider the relationship among Poland, Lithuania and Kaliningrad region with the view of division of labour these economic entities are competitors. This situation manifests itself in making up both political and economic decisions.

Thus, for example, the Kaliningrad region has arrived at the decision to build a motor way and a railroad from Gusev up to Grodno (Belarus) - roundabout Lithuania and via Poland. It was done in response to the tough position of Lithuania in respect to civil and military transit. This is a political rather than economic decision. Such this position of Lithuania makes a poor economic position of the Kaliningrad region even worse.

At the same time, the Polish party is reluctant to make repairs to an old motor way, the so-called "Berlinka" and suggests not to include Kaliningrad in the route of the VIA "Baltika". Thus, both Poland and Lithuania try not to allow the development of transport and ware-house complex in our region, this complex being considered as one of the priorities for the region just recently.

Lithuania tries to limit the advantages which the Kaliningrad region has as a free economic zone. Lithuania exempts its joint ventures and foreign companies from profit tax for 3 years, the profit deportation is free, the foreigners are allowed to lease land for 99 years. The Lithuanian government invests large sums of money in the branches of industry similar to those of the Kaliningrad region. They invested more than 500 mln. USD in the transport during the last years. The foreign investments are also being actively attracted. The project of the construction of the motor way Klaipeda-Vilnius-Minsk-Kiev is included into European plans. It stimulates the development of the port in Klaipeda. German companies are building a railway with the track of the European standard from the Polish border up to Kaunas. "Philips" is building a huge airport near Shauliai costing 29 mln USD. Thus, Lithuania tries to become a "transit country" and to obtain a relevant status the free economic zone "Yantar" was after at one time. It is obvious that the situation is not in favour of the Kaliningrad region. The total volume of foreign investments in our region made up about 5 mln USD for the whole period since 1991 up to the present time.

III ANALYSES

A further elaboration on the strategy of the regional development is in the paper attached in Appendix 5. It was presented by (Prof. G.M. Fyodorov, Prof.. V.V. Ivchenko, Prof.. V.S. Bilchak) and discussed at a seminar at Kaliningrad State University.

A. Review of Different Concepts of the Kaliningrad Region Development

When the concept of the regional development was being worked out, the authors started from the two most important positions:

a) priorities in the development of the region and promising trends of development,
b) the main sources of financing actions, included into the regional development programme.

If all the basic approaches to the development of the region which were put forward during five years are analysed three basic concepts can be singled out. The three concepts are stated bellow in the order of their presentation and attempts to be realised:

1. development of the region on the principles of economic independence and self support (1990-1991),
2. development of the region under the conditions of a free economic zone (1991-present time),
3. development of the region under financial support of economic interests of the Russian Federation in the region (in combination with concept 2).

The supporters of the first approach (Prof.. G. Fiodorov, V. Nikitin, Prof.. N. Medvedev) emphasised:

- economic priorities: strengthening of production infrastructure (building industry and construction, energy, transport), intensification of agro-industrial complex development, increased output of consumer goods;
- social priorities: social security, infrastructure development;
  In the sphere of branches and state enterprises development;
- refunding of the regional spending to enterprises
- allocation of preferences to highly profitable enterprises, producing consumer-goods for the local population;

- reductions of ecologically harmful manufactures;
- state and regional financing, involvement of foreign capital for perspective branches development, such as recreation-tourist and scientific-technical complexes;
- creation of a special open economic zone to enable export-oriented and sophisticated productions, starting with local zones and, in case of success, spreading the system all over the region (28).

The main sources of financing the whole economic complex were to be "created" by the region itself, redistribution of payments to local and federal budgets being an important part of self-financing. But this principle of development was not launched.

The supporters of the second approach - development of the Kaliningrad region within the framework of the Free Economic Zone "Yantar" (Prof.. Yu.Matochkin, Yu. Bedenko, A. Barinov) placed their hopes in foreign capital investments into most developed sectors of economy: transport, fishing industry, recr. ation, machine building. This was supposed to be performed by the system of privileges and preferences given to foreign investors. This mechanism didn't prove to be very effective, first of all, due to the Federal Government's inconsistency in giving preferences to the region as well as due to the Government's unwillingness to finance the first step of the Free Economic Zone, justified by economic and political instability in the country Nevertheless about 1000 joint-ventures and companies with 100% foreign capital have been registered in the region, their foreign trade turnover is steadily growing, which can be seen from the following table:

Table 2

Joint ventures and their turnover

:nin.$

Years	Foreign trade turnover	Including		Ratio in turnover	
		export	import	export	import
1992	74	55	19	75	25
1993	201	125	76	62	38
1994	380,5	234,1	146,4	61,5	38,5

IV STRATEGIES

A. Sector strategies

Infrastructure

• Hard infrastructure

The general impression is that the hard infrastructure is adequate to support a short to medium term industrial development.
The most important projects are the following:
- build capacity to treat the waste water;
- expand the clean water production;
- make improvements on the road network in the city of Kaliningrad.

The sewerage system of Kaliningrad city is overloaded by 2.5 times compared to the norms. The regional administration is responsible for Municipal treatment plants taking care of urban effluence, in accordance with the Helsinki Agreement. Without the region coming to a solution of this problem in Kaliningrad and other towns it is hardly possible to give any support to heavly polluting industries, such as pulp and paper and meat processing industries.

The insufficient and unreliable clean water supply could be a major restriction to development, for example, of processing industries and it is, therefore, necessary to expand the clean water production.

One of the most discussed strategies is the transit strategy of the region. Due to several factors:
- the political risk concerning the transit through Lithuania;
- the big difficulties to build an economically grounded bypass railroad;
- the long distance to the major Russian economic centre (Moscow with surroundings) and the costs it involves (the cost relation for transporting a container to Moscow from Saint-Petersburg and Kaliningrad respectively is about 2 to 3, including all handing transport and tariffs);
- very big investments to restore the harbour complex and the railroad.

The region is not judged to be suitable as a transit region. This does not mean that transit transport will vanish, but the transit concept is not regarded as the basis of an industry.

If the RF wants to use the region as a transit region the situation will be different and if the relations will be stable in the context of EC or if the market south-east (Belarus) of Kaliningrad will expand the situation will be different. Only the ambitions of RF can change fast enough to now motivate short-term investments.

The consequences of the above statement are very big, regarding investments in the harbour complex and in other transport warehouse complexes. Only investments needs are primarily due to the local transports.

The interregional railroad system is not a restriction to the industrial development. The regional railroad system is in a very bad condition. However, the transport of goods will be by trucks and the regional passenger transport by train has to be concentrated on a few main lines, mostly along the coastline. From a social point of view the rail transport situation is very poor.

* Energy

The energy situation can be a major restriction to the industrial development. Both the price level and the unreliable deliveries are problematic. This concerns both, electricity and heat-water. The only reasonable way to improve the situation is to negotiate with the neighbours, especially with Lithuania, about the region being connected to the circular nets, together with the Baltic states. That will provide much more reliable deliverance and lower prices. Better possibilities to optimise the common energy system will guarantee that.

It is out of scope of this work to form an opinion about the overall energy strategy for the region. Suggested investments in the production system are not possible to have an opinion about.

* Housing

There is a vast need for new apartments in Kaliningrad city and many of the houses are in an urgent need of maintenance. The situation with housing, schools and kinder-gardens is, however, not a constraint to the industrial development.

* Investment promotion

It is possible to identify three major strategies to allocate financial resources to the industrial sector.
The first is the basic element and the two others are important as a complement
- <u>The enterprises own resources.</u> From experiences in other transitional economies it is evident that the profits gained by the companies have financed most of their investments. Therefore to develop and support companies is one of the most essential strategies. Selling out redundant equipment also gives resources to expand profitable business ideas.
- The <u>domestic resources</u>
The domestic savings have to be increased. It could be done by elaboration of regional and municipal bonds, insurance companies, pension funds and collateral funds.
The regional and federal funds could be approached on the basis of investment support strategy. The rules to get support should be general, stable and transparent. Furthermore, the conditions should be related to changes of the ownership structure. Before getting a soft loan, for example, shares have to be sold out to a new owner.
Allow bankruptcies in order to sell out and reallocate resources to companies where they can be profitable. Partly desinvesting in surviving companies serves the same purpose.

In the long run, when a company has proven profitable, it is possible to attract new owners and equity capital.
- The <u>foreign direct investment</u> (FDI)
Foreign investors and joint venture partners can be attracted by reducing the perceived risk: investment promotion authorities and agencies, seminars, promoting activities, company visits and so on.
Foreign investors can also be attracted by liberal tax regulations, particularly by reliefs in company tax and possibilities to repatriate profits.

The strategies should be prioritised in the order mentioned above.

Big companies

Big companies build up the industry base of the region. They are in many respects outdated but never the less, it is necessary to change and restructure them into companies adapted to the market economy.

The alternative to rely only on the small companies is not realistic, given the time it will take to build up a new industry base. Many of the companies in the defence industry, shipbuilding, machinery, pulp and paper, amber and several companies in the light industry, in the construction industry and in the food processing industry operate on a large scale.
They all lack more or less the same things; efficiency, private ownership, modern company structures and management style, working capital and other financial resources, efficient distribution systems and marketing methods.

There is an obvious and urgent need of restructuring and management development programme.

* Military sector

The conversion of the military companies into civilian ones can mainly follow a general strategy of revitalising big companies.
This means helping to establish international contacts, market channels and commercial financing. Marketing consultancy, production development and management training are other ingredients. The result will be business plans based on the market needs telling what actions should be undertaken.

* Pulp and paper industry

Pulp and paper industry can be supplied by wood from Lithuania and the north-west of Russia. The wood cost is at the same level as in Sweden and Finland. The optimal strategy is to import wood and produce pulp geographically close to the paper mills, in this case in one pulp mill. It is also possible to use locally collected waste paper.

The strategy of the forest industry is to improve its efficiency of operation by:
- training at all levels
- modernezing its facilities in general to become more efficient.

If the pulp and paper industry can prove that they can and will take the costs to use more sound technology and appropriate treatment of air and water pollution, including their costs of municipal sewage treatment, the industry should be supported.

* Amber

The Kaliningrad region disposes of the biggest amber deposit in the world, assessed as 90 % of world known stocks. The main problem is illegal appropriation of amber from the mines. About 80-90% of the jewellery suitable stones were lost last and this year. The roughly estimated loss is minimum 22 M USD. This has caused a lack of good quality raw material and a lack of cash. Many skilled designers and chemists have left the amber factory. Now there are several dozens small firms in amber processing business, as well as individual designers.
A local bank, that now holds 24% of the shares, is prepared to be the majority owner and start to organize the necessary security system. The amber factory also needs marketing and financial management skills. Hopefully, a successful restriction can give possibilities to re-establish subcontracts with designers and researchers.
A positive effect of the decline of the factory is disintegration of designers and chemists in favour of establishment of small business enterprises.
A restoration, however financed by the owners, should give priority to a restructuring and management development programme. The designers should be invited to a SME programme.

SME

The SME sector is the root system of the market economy. As said "in present situation" above, the sector is under developed. The SME sector is, therefore, a serious bottleneck to the industrial development. The SME sector can be developed by single persons and by very small companies, as well as by down scaling big companies into small units. The restructuring of big companies in some cases gives the latter one important effect.

The way to support the existing SME sector and the potential managers start from the fact, that the sector has several bottlenecks, for example:
- not sufficient support from the regional and local administrations;
- the entrepreneurs lack appropriate knowledge; technical, economical and experience of market behaviour;

- insufficient network betw-.en entrepreneurs and other significant actors.

The remedy to this is:

a) a program to directly support the entreprencurs;
   - individual knowledge transfer, seminars
   - senior businessmen are attached to the progr-mme and individual entrepreneurs
   - search of and attachment of foreign partners;
   - if necessary so-called seed money to stimulate the process

b) A scope of efforts to create better conditions
   - net of supporters, offices of all towns, which will help to start business and look for partners,
   - centres of excellence; persons or institutions with outstanding competence are identified and linked to the entrepreneurs,
   - information about the region the administrative organizations and systems and the taxes.

These instruments should primarily be applied to the following typical SME sectors:
- maintenance,
- tourism,
- agriculture and food sector,
- building materials and construction sectors.
- military conversion sector.

The ambitions to systematically cover the whole region can give positive social and political effects, but can be too ambitious in the first attempts to support the SME sector.

* Agriculture and food

At present the agricultural sector and the food processing industry, with its distribu n systems, seem to be a chain of bottlenecks. The impression of the problems is massive.

The old chain from farmers to consumers is disintegrated. Three other alternatives are beginning to take shape. One is production for local consumption and minor volumes for selling. In the Kaliningrad region there are 3300 private farms The average size is however too small to sell any, worth mentioning, volumes to the food processing companies. The other one is imported food. About 10-30% of well off consumers can afford to buy imported food. The third way is that at least a few processing food companies have invested in a new technology which makes it possible for them to make a profit on buy imported raw material and sell at the local market.

The third way means that the processing companies are linked with market economy. The task is to link the local agricultural sector too, in order to use the natural resources of the region and substitute imported raw materials.

One way to do this is the traditional way of co-operative solutions. The farmers then buy the next step in the production chain. They are stimulated to do so by the possibilities of profits in food processing. However, this will not substitut real improvements in farming, distribution systems and slaughter houses. An integration will just create even more difficult management tasks and prevent a sound price mechanism development.

The strategies will be:

a) support the bigger processing companies in the same way as the other big companies; restructuring and management, development.

b) support the farmers in the context of SME programme so as to develop their abilities to act in the market economy. Selective support, including also money, has probably to be given, too a lager extend, to this group than to other SME groups;

The importance from the social and political point of view of succeeding in the agricultural sector can hardly be exaggerated.

* Building materials and construction

The construction sector and the building materials sector are ideal to support to stimulate the regional development. The companies operate on the local market where they have good possibilities to understand the needs and quality norms. Obviously, the volume of building has decreased a lot, but the remaining market should be appropriate to local companies. The most important projects for the construction sector are the following:
- improve the workmanship through training in execution of modern building methods;

- improve the construction management skills for more efficient building process;
- improve the general management skills.

The building material companies can be supported by similar initiatives. The way to do it can be by co-operation with foreign producers and potential business partners, in job training schools, and management training programme. Instruments in improving the SME sector in general are also fully applicable to the building material sector.

* Military sector

Another aspect of conversion of the military sector is retraining of retired military officers. This aspect is close to how to support SME managers and entrepreneurs. Retraining and coaching of retired and retiring officers will probably be more successful in the context of supporting and developing SME managers and entrepreneurs. The possibilities to find a new future in a new job as an employee or in their own companies will then be the best.
A precise retraining concept has to be developed. The cost effectiveness can be supposed to be high, compared to a lot of separate development projects. This is also the case, if the military companies can participate in more general development projects.

B. Regional strategies

As mentioned in the introduction, a regional strategy will be used by the public sector, foreign serious investors, foreign aid organisations and federal organisations. Based on the discussed sector strategies the following conclusions could be addressed particularly to the regional administration and foreign aid organisations:
* The big companies are in general in an urgent need to be restructured.
Some industries can be pinpoint as priorities because they are built on natural, favourable conditions; amber, pulp and paper, construction and food.
Some companies especially in the military sector and machinery can for the same reasons be prioritised. However, the main conclusion is that the big companies, apart from industry, have locked in a great deal of the resources in the region without owners and managers able to develop the companies. Some companies, perhaps, had better go bankrupt, others be down scaled, others be divided and, in most cases, strengthened by new skills. This process has to

be speeded up if the resources, competence, and equipment would not be outdated. Support with money in a kind of laissez -faire strategy will just prolong the decline and increase the value of the losses.
It is necessary to stimulate both with the carrot and the stick. Favourable loans should be conditioned to changes of the ownership structure and management. Management development programmes could be offered to the company management teams on favourable conditions.

* The SME-sector should also be directly supported by the regional and the local administrations; net of supporters, information and individual knowledge transfer to entrepreneurs. It is essential for the sound development of economy, that much of the activity in the big companies in the present old structure, in the future will be taken over by the SME-sector.

What is for sure, is that the big companies in many cases will lose their positions and that a larger part of the economic activity will be handled by individuals and small enterprises. A regional strategy can have an impact on this transition process in two ways; the restructuring of the old structure can be done with fewer losses of resources and the new SME-sector could to a larger extent be built within the framework of the formal, legal economy.

The two above mentioned strategies represent the efforts to improve the "engines" of the economy in themselves. The following other kinds of strategies are about improving the conditions for the "engines". It needs not to be said that one kind is more important than the other. It is necessary to work with both kinds.

* One strategy dealing with the conditions is about the infrastructure. The hard infrastructure is surprisingly not a large a bottleneck for the industrial development. The transit strategy is not considered realistic, due to several mentioned factors. However, the treatment of waste water from the cities has to be in accordance with the Helsinki Agreement. Resources have to be allocated to solve this problem.
The institutional infrastructure needs to be developed, for example, by establishing Investment Promotion Authority, Centre for Support of Privatised Enterprises, agencies to guide foreign investors, to assess investment projects, elaborate the regional and municipal bonds.

(The following strategies regarding conditions could be addressed to the federal administration as well.)

* The relations with the neighbours, particularly Lithuania, have to be developed. It seems obvious that Lithuania is a competitor to the Kaliningrad region, with the same strategies, only considerably better off, and with possibilities to partly regulate the success of the economic development in the region of Kaliningrad. Actually, the Kaliningrad region seems to be under heavy economic pressure from Lithuania. This is a fact that makes the enclave position very difficult and disadvantageous, and not at all a privilege.
If the economic development of the Kaliningrad region is getting in to a much worse situation, and if Lithuania contributes to this by placing obstacles to the transit traffic it is perhaps not too far-fetched to think this is a reason for tension between Lithuania and Russia. This can be a fact, to take into consideration, when the other countries around the Baltic sea are discussing how to support Lithuania.
The urgency to come to an acceptable settlement with Lithuania, an already obvious fact, can only be stressed again.

* Another obvious fact is the need to develop normal business conditions acceptable to international investors too. It has to be possible to buy land or, at least, lease land for preferably up to 99 years. It has to be possible to buy the majority of the shares in a joint stock company. The profits after tax should be possible to repatriate and the company taxes have to be comparable with the company taxes in the EC countries. The situation today has to be improved in the following respects .....

* Because of the disadvantageous enclave position the customs can be exempted in the following cases as a compensation for;
a) goods imported to be processed or not in the region and then exported
b) goods produced in the enclave and exported to other countries (or self-evident to F ˋ)
c) goods imported and consumed in the region
(See Appendix 6 extracted from the "Special law on Kaliningrad region")

* To this can be added a wishful thinking about creation of stable economic, political and social conditions which can only partly be done within the framework of regional development. This strategy is for example about developing a stable legal framework. But it has also to do with the efforts to reduce the unemployment and to take into consideration the different situations between different cities and districts in the region.

To sum up, the regional strategies should comprise the following elements:

* Direct support to restructuring and management development of the present company structure, big companies.
* Direct support to the potential and present SME-sector.

* Creation of supporting systems to industrial development, including hard infrastructure, investment promotion and institutional infrastructure
* Negotiations with Lithuania
* Creation of normal business conditions including incentive systems
* Compensations of the enclave disadvantages by duty exemptions
* Creation of stable economic and social conditions

V PROJECT CONCEPT

The project should

a) focus on major problems and critical issues;
b) initiating a regional industrial process

and not attempting to address and solve all problems.

The project should also

a) concentrate the efforts and
d) integrate the sub projects and
e) activate the most important persons in the region; managers, entrepreneurs, administrations, university teachers and researchers.

The expectation is to create fast but lasting results using reasonable amounts of external resources. The project should create a momentum.
The suggested project concept is based on the following corner stones;

* The project should directly address to three categories; owners/ managers representatives of big companies, managers of small companies/ entrepreneurs and skilled unemployed/retired officers/retiring officers.

* Three different projects should be designed, one for each category, but the three projects will also interleave with each other. The third category of unemployed are, for example, supposed to work together with managers and

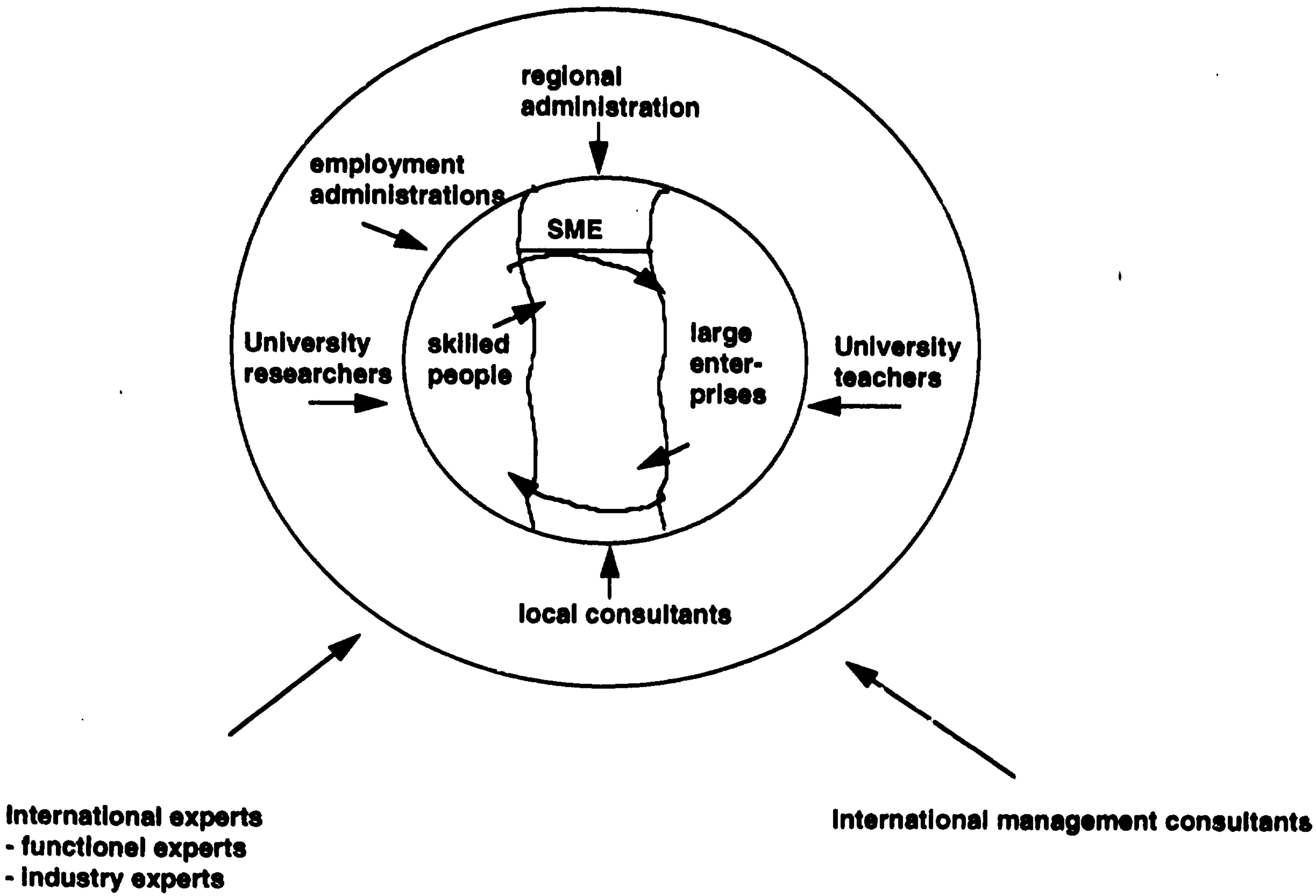
entrepreneurs in developing business plans. Thereby they will get a chance to expose themselves to potential employers in addition to the possibility to learn new adequate business skills. The entrepreneurs may have the same need of knowledge transfer and need of foreign partner contacts, as the managers of big companies. To stimulate business contacts between entrepreneurs and managers this can take place on the same occasions. The restructuring process will also get possibilities to identify new business units appropriate to the SME-sector.

* The three categories will be supported by national consultants, administrators from the regional administration and researchers/teachers from the universities/business schools. Thereby, they, in dialogue with the managers, can develop a better understanding of business activities and what kind of support is needed. Vice versa, the managers get a demonstration of what the national institutions can accomplish. A spin-off effect can be a restructuring of the public sector dealing with business support.

* International consultants and experts assist in designing a compound project with the mentioned features and assist in knowledge transfer, regular consulting and search of foreign partners and investors. The knowledge transfer and consulting can be in the areas of marketing, production development, business planning, quality management, financing.
(see illustration)

A project of this kind has to be planned and prepared in detail together with a task force supposed to be the core competence of the project. Potential attending managers, entrepreneurs and skilled unemployed have to be approached individually. The terms of company financing have to be settled. A selection of participants is another part of preparations.
A project proposal based on these cornerstones will be described separately.

The project concept illustrated



Appendix 1

Persons met

Alexandrovski, Alexander

Bedenko - Regional Admin. - Pus. FEZ Yanter

Bilchak, V.S., professor, Kaliningrad University

Filatenko - VP, Baltunesktorg Bank, mbv SC

Ivanov, Viktor, rector Kaliningrad Technical University

Ivchenko, Vladislav, professor, Kaliningrad University

Karpov

Klemesher, Andrey, associale professor, Kaliningrad University

Kornbov ?

Lagernikov - ? - Report Adm. UNIDO proj.coord.

Titkov, Telix, vice-rector, Kaliningrad Technical Institute

Ustugov, Valery, chairman Kaliningrad Regional Duma

Volik Anatoly, managing director, Regional Employment Center

Zabotkina, Vera, professor Kaliningrad University

Ziubanov

Apendix 2

Macro-Economic Situation of the Kaliningrad region in 1994

Macro-Economic and Social Characteristics

The main characteristics of the Kaliningrad region economic complex activity can be found in Table 1.

Table 1

Macro-Economic Indices

	1994	1994 in % to 1993	Reference: 1993 in % to 1992
	Economic	*Indicators*	
Volume of industrial production, mlrd rbl	1082	68,7	82,3
Production of the consumer goods, mlrd rbl	581	66	87
incl: food products	502	72	87
non-food products	79	45	97
Capital investments via all financial sources, mlrd rbl	441	67	122
Dwelling houses put into operation owing to all financial sources, thousands of sq.m	271	81	174
Gross agricultural production (in 1983 comparable prices, estimation), mln rbl	472	89	92

	1994	1994 in % to 1993	Reference: 1993 in % to 1992
Output of cattle-breeding products at the agricultural enterprises (of former public sector): (realization of cattle and poultry to be slaughter in the weight of the living stock), thousands of tones	43,7	88	69
Retail turnover of trading enterprises in actual prices, mlrd rbl	1.358	3,7 times	
in comparable prices	377	103,5	
Volume of paid services in actual prices, mlrd rbl	146	5,3 times	10,7 times
in comparable prices	14	49	
Dispatch of cargoes by all types of transport, mln of tonnes	14,8	65	87
Export (to foreign countries and Baltic states), mln US dollars	156	1,8 times	
Import (to foreign countries and Baltic states) mln US dollars	143	4,1 times	
	Social	Indicators	
Money income of the population, mlrd of rbl	1216	3,4 times	10,4 times
Average wage (a fore-cast), thousand of rbl	174	3,7 times	10,5 times
Consumer price index for goods and services		317**	844***

	1994	1994 in % to 1993	Reference: 1993 in % to 1992
Total number of people looking for a job (1.01.95), thousands of people	21,9	2 times	105
incl. unemployed registered at the Employment Centre, thousands of people	19,5	2,4 times	1,4 times

** - In comparance to December 1993, in %
*** - In comparance to December 1992, in %

The above data prove the continuation of the setback of production in 1994: - of 31,3% in industry, 21% - in agriculture, 34% - consumer goods production, 33% - capital investments. At the same time there is an increase in the retail turnover - in 3,5%, and a substantial increase of foreign economic turnover (export has increased in 1,8 times, and import in 4,1 times).

One fact to notice is that the growth rate of money income in 1994 outstripped the growth rate of consumer prices on goods and services in 3,4 and 3,17 times correspondingly. At the same time the number of unemployed continued to grow.

The analysis of the first half of 1995 shows that the rate of industry decline has slightly decreased in comparison with the first half of 1994: in 16% in industry, 31% - in capital investments, 23% - in production of consumer goods. The situation in the agriculture took a turn to the worse: the decline reached 39%. The average wage has increased to a lesser degree than the prices (2,2 and 3,44 times correspondingly).

It's interesting to compare the rates of growth in Kaliningrad region with those in Russia in general. Some of the facts of the comparative analysis can be found in Table 2.

The region has high figures in the volume of goods turnover. External turnover increases the Russian level in 2,4 times. The region has the highest indicator of the dwelling houses commissioning (1994:1991). In 1994 88% of houses were put into operation in comparance with 1991 level.

The profit growth rates of the regional economic system is several times higher than those of Leningrad, Novgorod and Pskov regions. The region is in the fourth group by the level of per capital income (the 1 st group is the lowest, the 5th - the highest). At the same time, the decline in the volumes of industrial production (1994:1991) is 7,8% higher than that one of Russia, the reduction of the gross milk yield is 18,1% higher. The level of the regional unemployment exceed that one of Russia.

Table 2

The Comparative Analysis of the Main Development Indices of the Kaliningrad Region and Russia

Indices	1992		1993		1994	
	Russia	Region	Russia	Region	Russia	Region
1. Industry	84,4	83,3	84	82,3	79	69
2. Agriculture	90,6	75	95,2	92	91	89
3. Capital Investments	60	43,1	88	122,1	74	67,1
4. Goods Turnover	75	58	102	107	103	103,5
5. Inflation (average annual growth, in times)	26,1		9,8	8,7	4,0	4,8
6. Unemployment level, %	0,69	1,1	0,84	1,4	1,7	3,4

At the same time, the production of the sausages, oxygen, acetylene, equipment for trade and public catering has increased. More poultry, oil and butter were supplied to the population. The recession rate in fuel, meat and fishing industries has slowed down.

Thus, social and economic position is still difficult and unstable. In general the dynamics of the main macro-economic indices doesn't improve.

The decline in production volumes, capital investments is still taking place. The inflation and the consumer price growth are high. The differentiation of the population according to the income level is taking place too. There are still problems to be solved concerning the financial state of the enterprises of different industries and their insolvency. The unemployment is growing.

The Structure of the Economy Complex of the Kaliningrad Region

There are several types of companies differentiated according to the form of ownership during the privatization and in the process of setting up new companies.

Table 3

Types of Companies according to the forms of Ownership

	Number	Specific weight, %
Total, incl:	16.958	100
state	804	5
municipal	636	4
public union	274	2
private	13.310	78
mixed type	1.224	7
belonging to foreign juridical and physical entities	198	1
mixed types, with Russian and foreign participation	512	3

The main part of the companies registered belongs to the private sector of economy (78%), every 11th company has either state or municipal ownership.

All the companies registered, depending on the character of the main activity can be grouped in different industries.

Table 4

Distribution of Companies in Industries

	Number	Specific weight, %
Total, incl:	16.958	100
industry	2.500	15
agriculture	2.973	17
forest industry	22	0,0
transport and communication	451	3
construction industry	1.624	10
trade and public catering	2.143	13
material and technical supply and sale	189	1
housing and municipal services	170	1
public health service, physical culture, social security	229	1
popular education	222	1
culture and art	209	1
science and science services	258	2
finance, credit, insurance, social security	288	2
management	533	3
public associations	217	1
other types	4.930	29

Table 5

Main Indices
of the Industrial Development of the Kaliningrad Region

No.	Indices	Units of measurement	1992	1993			1994		
				volume	to 1992		volume	to 1993	
					+/-	%		+/-	%
1.	Volume of industrial production								
	- real prices	mlrd rbl	68,1	428	+359,9	628,5	1082	+654	252,8
	- index of physical volumes	%	83,3			82,3			68,7
2.	Volume of industrial production (in comparable prices), incl.	mlrd rbl	68,1	56,0	-12,1	82,3	38,5	-17,5	68,7
	- machine building, metallurgy		9,4	7,4	-2,0	78,7	2,4	-5,0	32
	- forest, wood-processing, pulp and paper industries		12,9	9,5	-3,4	73,7	5,3	-4,2	55,7
	- construction materials industry		1,9	1,8	-0,1	92,5	0,8	-1,0	43,4
	- hight industry		1,4	1,3	-0,1	92,5	0,4	-0,9	29,4
	- food industry		26,9	21,9	-5,0	82,3	19,4	-2,5	88,6
3.	Production of the most important types of products								
	- coke, 6% of moisture	thousand, tone	259,4	217,0	-42,4	84	101,2	-115,8	47
	- electric power	mln kWt.hour	336,0	258,0	-78,0	77	175,0	-83,0	68
	- oil extraction	thousand, tone	988,0	893,1	-94,9	90	817,4	-75,7	92
	- wide track carriges	units	1387,0	386,0	-1001	26	131,0	-255,0	34
	- wood	thousand kub.	149,5	85,3	-64,2	57	33,4	-51,9	39
	- paper		102,5	58,5	-44,0	57	35,8	-22,7	61
	- pulp		232,1	160,7	-71,4	69	105,2	-55,5	65

Basic socio-economic indicators in the Kaliningrad region

Indicators	Unit of measurement	1992	1993			1994		
			Volume	By 1992		Volume	By 1993	
				±	%		±	%
1	2	3	4	5	6	7	8	9
. Industrial production volume								
• current prices	billion rubles	68.1	428	+359.9	628.5	1082	+654	252.8
• volume index	%	83.3			82.3			68.7
. Industrial production volume (in comparative prices)	billion rubles	68.1	56.0	-12.1	82.3	38.5	-17.5	68.7
• machinebuilding and metal	billion rubles	9.4	7.4	-2.0	78.7	2.4	-5.0	32
• forestry, woodworking, pulp/paper	billion rubles	12.9	9.5	-3.4	73.7	5.3	-4.2	55.7
• construction materials	billion rubles	1.9	1.8	-0.1	92.5	0.8	-1.0	43.4
• hight industry	billion rubles	1.4	1.3	-0.1	92.5	0.4	-0.9	29.4
• food processing	billion rubles	26.9	21.9	-5.0	82.3	19.4	-2.5	88.6
. Prime products production								
• coke, 6% humidity	thous.tn	259.4	217.0	-42.4	84	101.2	-115.8	47
• electric power	mln.KW.hour	336.0	258.0	-78.0	77	175.0	-83.0	68
• oil extraction	thous.tn	988.0	893.1	-94.9	90	817.4	-75.7	92
• wide gage carriages	pcs	1387.0	386.0	-1001.0	28	131.0	-255.0	34
• commercial timber	thous.cub.m	149.5	85.3	-64.2	57	33.4	-51.9	39
• paper	thous.tn	102.5	58.5	-44.0	57	35.8	-22.7	61
• pulp	thous.tn	232.1	160.7	-71.4	69	105.2	-55.5	65
• gantry cranes	pcs	125	121	-4	97	17	-104	14
• precast concrete	thous.cub.m	316	263	-53	83	119.5	-143.5	45

• fish catch	thous.tn	410.1	216.2	-193.9	53	210.7	-5.5	97
. Prime agricultural products in different sectors of farming								
• livestock and poultry (live weight)	thous.tn	99.2	79.6	-19.6	80	73.8	-5.8	93
• 'milk	thous.tn	450.3	400.2	-50.1	89	351.3	-48.9	88
• eggs	mln.pcs	328.8	316.2	-12.6	96	300.5	-15.7	95
• corn	thous.tn	359.1	268.4	-90.7	75	195.3	-73.1	73
. Capital investments from different funds (in current prices)	billion rubles	12.3	157.7	145.4	12.8 times more	441.1	-283.4	280
• growth (slowing down) rates	%	43			122			67
. Traffic volume	mln.tn	26.1	22.[illegible]	-3.5	87	14.7	-7.9	65
• railway transport	mln.tn	15.8	13.8	-2.0	87	9.3	-4.5	67
• road transport	mln.tn	7.7	6.8	-0.9	88	3.7	-3.1	54
• river transport	mln.tn	2.6	2.0	-0.6	76	1.7	-0.3	85

Appendix 3

Facts about population and unemployment and educational level

Population Statistics

Labour Market Situation

Population

The calculated population of the Kaliningrad region relevant for the 1st January, 1995 is 926,5 thousand of people, including 723,2 thousand of city-dwellers and 203,3 thousand of villagers.

In spite of the general growth of the population of 13,4 thousand of people, the demographic situation of the region remains complicated:

Table 1

	during 11 months		11 months of 1994 in % to 11 months of 1993
	1993	1994	
Born	7437	7789	104,7
Died	11093	12485	112,5
inc. children under 1 year old	146	165	113,0
Natural loss	3656	4696	128,4
Marriages	6625	6720	101,4
Divorces	4780	4996	104,5
Arrived to the region	33406	40458	121,0
Left the region	25318	24032	94,9
Migration growth	8088	16426	2 times

The growth of the regional population is due to the migration growth which is expected to reach about 19 thousand of people in 1994. The population of the region is being increased owing to the Russian-speaking migrants of the former Soviet republics, Northern and Eastern parts of Russia.

The population structure according to sex criterion has not greatly changed.

The part of the female population is still growing both in cities and countryside.
It should be noted that the part of the capable of working age is reducing while the specific weight of children and pensioners is increasing. The rate of the reduction of the capable of working age in the Kaliningrad region is higher than that one in Russia in general. The population of the region is growing old. The number of births is also decreasing during last 5 years.

Table 2

Structure of population by sex

	1989		1994	
	Men	Women	Men	Women
Kaliningrad - all population	48,0	52,0	46,4	53,6
Urban	47,8	52,3	45,8	54,2
Rural	48,9	51,1	48,6	51,4
Russia - all population	46,7	53,3	45,9	54,1
Urban	46,6	53,4	45,6	54,4
Rural	47,1	52,9	46,7	53,3

Table 3

Structure of population by age:

	Before capable of working age	To capable of working age	After capable of working age
Kaliningrad - all population			
1989	23,4	59,8	16,8
1994	22,1	57,8	20,1
Men			
1989	24,7	66,3	9,0
1994	24,5	63,4	12,1
Women			
1989	22,2	53,7	24,1
1994	20,0	52,9	27,1
Russia - all people			
1989	24,5	57,0	18,5
1994	23,2	56,2	20,6

Capable of working age: for men 16 - 59 year
for women 16 - 54 year

Comments: The population is "ageing". The number of births has decreased during the last five years. The group "capable of working age" is however a bigger part in Kaliningrad than in Russia.

Unemployment statistics

Unemployment Level and the Labour Market in 1994

Large changes took place on the labour market in 1994 under the conditions of the going on recession of production. The total number of people engaged in different types of economic activity at the main place of work has reduced by more than 4% during the year. The reduction of employment was the most intensive during the 4th quarter of the year.
The exchange of flows of the labour force in between branches of the industry formed in 1993 was still retained. The largest reduction of the employed

characterized machine-building, light industry, pulp and paper industry, science and science services (up to 15%).

The number of people engaged in the agriculture, geology, prospecting, geodesic and hydrometeorological services is still reducing. In these sectors of the economy the reduction rate of the employment in 1994 was in the interval of 5-10% At the same time, with the reduction of employment in many branches, the employment level in some other types of activity was growing. The latter include banking, real estate operations, taxation, notarial and legal services. The employment growth rate in some cases exceeded 10%.

The continuation of the growth of the latent (hiden) unemployment can be considered as specific feature of the labour market. This growth was the highest at the industrial plants, and in the construction industry. More than a half of the plants had idle time. 4-8 plants stopped their operation every month.

Totally more than 30 thousand of people worked for reduced working hours during 1994. About 200 thousand of workers got their leave without pay or paid partially at the initiative of the Administration, i.e. 18 days for every worker in average.

The total number of the latent unemployment reached 20 thousand people at the end of the year.

The intensity of the labour force offer was growing in 1994, the fact worsening the situation on the labour market. If in the beginning of the year the monthly growth of the officially registered unemployment was up to 500 people in average, at the end of the year the relevant number was more than 1 thousand people.

The duration of the unemployment which has increased from 3 months at the beginning of the year up to 6 months at its end can be considered a dangerous symptom manifesting the worsening situation on the labour market.

Stagnant unemployment (lasting more than 4 months) was quite large, the specific weight of those unemployed for more than one year comprising 10% or about 2 thousand people. This brings us to the conclusion that chronic unemployment has appeared on the regional labour market. The overwhelming majority of the unemployed is represented by women (68%), and youth under 30 (37%), i.e. the most vulnerable population groups.

The actual unemployment of the population increased during the last year, its number reaching about 22 thousand of people or 5,4% of economically active population. 19,5 thousand of people among them have got the status of unemployed. The registered unemployment grew more than 2,4 times during the year.

According to its level of unemployment the Kaliningrad region is considered to have increased tension on the labour market. Thus, the unemployment level by the end of 1994 is likely to make up 2,0% in the RF and 2,4% in its North-Western region, which is much lower than in the Kaliningrad region.
The level of the unemployment registered officially in the Kaliningrad region in December 1994 is 3,6%. This is the second highest level after the Pskov region.
There is still a great difference between the demand for the labour force and its offer on the labour market. In the beginning of 1994 in average 10 people applied for one vacancy. At he end of the year this number increased nearly three times and made up 28 people.
Thus, by the end of last year the size of the forced unemployment reached about 40 thousand people or 9-10% of the economically active population, which has brought our region closer to the countries with a medium level of unemployment.

Table 4 a

Unemployment in the Kaliningrad region.

Year	Number
1991	727
1992	5838
1993	7991
1994	19501

Table 4 b

Unemployment in Kaliningrad city

Year	Number
1991	424
1992	2557
1993	2963
1994	6169

Comments: The number of unemployed has increased rather dramatically from 1993 to 1994 and especially outside Kaliningrad city. The cities of Chernyakhovsk, Neman, Svetlyj and Guser have all more than one thousand unemployed.

Table 5

Age structure of unemployed people in Kaliningrad city in 1994

- before 18 years old	4 %
- 18-21 years old	9%
- 22-29 years old	27%
- 30 - prepension age	54%
- prepension age (53-55 women, 58-60 men)	6%

Table 6

Placing in an job nonoccupied people by branches of economy in Kaliningrad city in 1994

Industry	16%
Building	4%
Transport &	4%
telecommunication	3%
Consumer service trade	3%
Other	74%

Table 7

Social composition of clients of Kaliningrad city employment centre in 1994

Workers	45%
White-colour workers	41%
Without profession	14%

Table 8

Level of education of unemployed people in Kaliningrad city in 1994

General secondary	37%
Secondary special	27%
High education	21%
Unfinished secondary	15%

Table 9

	Region	Including Kaliningrad
Working capable non-occupied people seeking for job	21892	7567
including unemployed	19501	6169
including:		
women	12882	4717
invalids	359	61
youth 16-29 years old	7196	2443
graduates of high school and technical colleges	508	211
graduates of secondary and professional schools	1455	229
unemployed over 1 year, total,	1843	822
including invalids	64	8
To fix an unemployment benefit	16450	4220
To get the unemployment benefit	12473	3429
Persons retrained in the education institutions	1554	1189
To place in a job, total	6541	1060
including unemployed	6127	1014
Free workplaces and vacancies	792	415
including workers occupations	549	279

Educational level

The level of education of the population in Kaliningrad is shown in table 10.

Table 10

Per 1000 people with the age of 15 years and over have an education in 1994.

	High	Unfinished high	Secondary	Unfinished Secondary
All population	142	21	521	195
Urban population	165	26	546	175
Rural population	52	8	421	291

Comments: A great number of educational establishments determines a high level of literacy per 1000 people older than 15.

Table 11

Number of students studying management

	To enter in 1994	To learn	To graduate from
Kaliningrad State University	69	180	0
Kaliningrad Technical University	50 88 0 25	54 403 263 25	0 35 x 58 xx 0 xxx
Baltic State Academy of Fishing	76	126	0

x Discount and audit
xx Economy and management of enterprises
xxx Correspondence course

School teaching (by the beginning of 94/95 school year)

There are 294 schools in the Kaliningrad region, including 3 lysees, 7 gymnasium and 44 school with intensified teaching of some subjects.

From 294 schools 30 are primary schools (1-3 years of education), 85 are basic (1-9 years of education) and 167 are full (I-II years of education). Other schools are boarding schools and schools for handicaps.

	There are pupils:
Total	127357
incl.	
in primary schools	357
in basic schools	10857
in secondary (full) schools	111591

There are 9789 pupils in schools with intensified teaching of some subjects, 2584 - in gymnasium and 6173 - in lysees.

	In 1994 graduated from:
9th class	10743 pupils
IIth class	5806 pupils

Table 12

<u>Kaliningrad region educational system in 1994</u>

	Number of institution	Number of pupils (students)
High schools	6 (incl.* 3 civil)	1100 (in 4 high schools)
Colleges, technical colleges	12	7500
Professional and technical schools	24	9900
Schools, lysees, gymnasium	294	127000
Private (non-state) educational institutions	38	3500
Institutes of qualification rise	2	2400

* Two military high schools were withdrawn from the Kaliningrad region by September, 1995. Now in the region there is only one military high school (Kaliningrad navy high school).

Comments: The educational level of the population is quite high, there being three higher schools, some millitary colleges, many vocational and special secondary schools. The system of non-governmental (private) schools is also developed. The number of different types of educational establishments is shown in the table below.

Teaching of foreign languages

The foreign languages are being learned in 244 schools (basic and full). There is not foreign language teaching only in 8 schools. English is being learn d in 140 schools, German - in 227 schools and French - in 6 schools. Others foreign languages are being learned in 4 schools. There are 49107 pupils in classes with English language studying. 36151 - in "German" and 141 - in "French" classes.

Table 13

Intensified studying of some subjects in schools
(number of pupils in classes with
intensified teaching in 94/95 school year)

	Schools	Lysees	Gymnasium
The humanities including	16016	888	1154
English language	2324	787	574
German language	889	101	-
French language	-	-	8
Other European language	43	-	-
Natural sciences	928	112	88
Technical sciences	1229	320	235
Agricultural sciences	19	-	-
Other sciences	4144	243	214

Note: in some classes there is intensified teaching of several subjects.

Labour market Dynamies
(Kaliningrad Region 1994)

Table 14

Numbers in thousands of people

Time	Unemployed having benefits	Recognized unemployed	Number of people seeking work
January	4	7	12
December	17	19	22

Professor G.M. Fyodorov,

Ph.D in geographic science

Professor V.V. Ivchenko,

Ph.D in economic science

Professor V.S. Bilchak,

Ph.D in economic science

(Kaliningrad State University)

On the Strategy of the Regional Development

By the beginning of 1990-s Kaliningrad region was referred to as one of the averagely developed industrial-agricultural regions of the country with a specialisation in the following branches: in fishery, machinery and paper & pulp industries (these three branches yielded 2/3 of the industrial production output); in agriculture, oriented on meat & milk production with a developed poultry- and swine-breeding (20-30% of milk & meat products were transported from the region); in sea transport, health-resort complex (400.000 tourists a year); with significant amber output (700.000 a year) and oil output (1.2 mln tons, nowadays - 0.8 man tons a year); with a developed scientific base (World's Ocean researches) and a wide system of education (especially, maritime education).

For the period of 1990-1994 the regional production dropped sharply, and the rates of recession were higher, than in the whole Russian Federation. According to the official statistics, industrial production was cut by 59%, agricultural production - by 41% against RF 49% and 23% respectively.[1] This situation is primarily caused by the changes in geopolitical state of the region - as a result of the USSR disintegration there appeared problems of transport connection with the main land of RF, and the traditional economic ties with the Baltic countries went broken. More than that, fishery, formerly state supported, turned out to be pressed for the critical situation due to the accelerated growth in prices for fuel, as well as due to the lack of the state support; machinery suffered from the harsh reduction of the military production. Finally, there were difficulties and mistakes in realisation of the regional development strategy and first of all - in the approved system of privatisation.

In 1991-1995 there were more than 20 conceptions and programmes of Kaliningrad region development. In political sense a part of them are not beneficial, as soon as they might result in the loss of RF sovereignty over this territory with all ensuing consequences for the population, such as formation of the "Euroregion Kaliningrad/Königsberg", a condominium under the auspices of the European Community or Germany, or an independent Baltic republic, etc.[2] Likewise are the proposals on creation of the autonomous German republic on the territory of the region with a consequential trans-settlement of the major part of Russian Germans into the region.[3] Such "projects" provoke separatism and arouse anxiety in the RF political

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[1] According to our estimations, the real decrease was even deeper, at least in industry. Official data do not fully highlight the changes in the structure of prices for goods, occurred after the price growth, which was more rapid, than in industry on the average.

[2] Stolz (1992), Golubov (1993), Kargopolov (1993), proposals of the Europarliament (1994), proposals of the Baltic Assembly (1994), etc.

[3] Widmeier (1991), etc.

circles and the regional population. Suggestions on the military priorities of the development of the region as a Russian Baltic outpost serve as a counterpoise to them.[4]

Conceptions, that are of real social-economic significance, regard Kaliningrad region as an integral part of the Russian Federation, playing an important role in the economy of the country.[5] They differ in the sources of development (federal budget, non-state domestic and foreign capital), in branch priorities, in suggested schemes of management and in the level of cooperation with foreign states.

For some time the defining aspect for the regional development (and also presently being of top importance), was the idea of a free economic zone (FEZ) creation on the whole territory of the region, as declared on 03.06.1991 in the Decree of the Chairman of the RF Supreme Counsel and approved by the RF authorities afterwards. Conception of FEZ "Yantar" presupposes an active involvement of the foreign capital at the expense of taxation, customs and other preferences. However, the preferences were allotted only partially and the main part of them was cancelled in Spring, 1995. The volume of export per capita, stimulated within the frames of FEZ, comprised only 250 $ in 1994 against 320 $ in RF on the average. So, the FEZ conception failed to become fully implemented due to the obvious reasons. This process is prevented by the legislation instability in the sphere of foreign investments and law, as well as by the lack of the Law on the free economic zones in RF.

As a result of the enterprises' split into "zonal" and "non-zonal" ones, the latter

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[4] Shakhrai (1994-1995).

[5] Conceptions, programmes and projects worked out by the Regional Administration, Central Research Institute of Economics and Industry (Moscow) and Kaliningrad State University (1992-1995), "Progress" Company; IEDC projects (1992), Bose (1992), Poznan group (1994), etc.

found themselves under pressing competitive conditions, that, according to some researchers' opinion, prompted a more rapid production drop. At the same time foreign investments turned out to be too insignificant for intensification of the export productions; the main part of the joint-ventures is engaged in the non-production sphere (trade, tourism, etc.). Finally, the lack of selective allocation of customs preferences has led a significant amount of food and non-food consumer goods import into the region, that ensured such competition for the local manufacturers. Many of the enterprises failed to stand it, especially in the sphere of food production. A complete restoration of the former FEZ regime conditions is hardly probable. The projects of the Federal Law on the free economic zones do not presuppose the allocation of such preferences to the republics and regions - they concern only small territories (local and spot FEZ). The project of the Law on a special economic zone in Kaliningrad region, adopted at the first reading, does not distinguish between Russian and foreign investors in the matter of allocation of preferences; moreover, the share of the foreign capital, kept by the joint-ventures, is limited to 40% and the land transfer to the foreign property is prohibited; a selective allocation of the customs preferences is also assumed (for certain branches and types of consumer goods). Besides, the state organs reacted negatively to the presented project We don't exclude the probability, that the Law won't be adopted at all by the present staff of the State Duma, and its content won't be changed at any rate. Anyway, we can expect, that the region will get a preferential taxation and customs regime, similar to the West-European preferential taxation zones, as well as some federal investments for the structural reorganization of economy in connection with the enclave position of the region. The FEZ regime will be allowed to the local zones. The corresponding projects are already available. But the FEZ "Yantar" conception made only a part of the complex regional transfer to the market economy.

The general idea of the economic reform in the region was declared as a creation of conditions for the active entrepreneurship on the basis of the all-Russian statutes as well as on the basis of creation of special conditions in the region, involvement in economic turnover and the use of all regional resources, provision of the consumer market, recovery of finances, and, as a final goal, improvement of the living standards of the population. The rehabilitation of the regional economy, regaining of its capability to solve the regional and federal tasks were implied. All managing subjects were supposed to make a transfer to the market relations (more rapidly, than in RF as a whole) at the expense of implementation of the following programme terms: denationalization and privatisation, taking the anti-monopoly measures and creation of the competitive environment, price liberalisation, progressive taxation policy, involvement of investments, the growth of power of the Regional Administration. However, these terms were observed not to the full extend and with serious deformations, that now allows to dwell upon creation of the proper market environment in the region.

The process of denationalization turned into an alienation of the government from the reproduction process organization, while privatization appeared to be a mere transfer (selling out at understated prices) of the state objects to the private sector with no considerable changes in the production and commercial activity.[6] Demonopolisation on the regional level caused the artificial limitation of activities of enterprises-"monopolists", and ensured no real competitive environment. Liberalization of prices

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[6] A characteristic example is a reorganization of many former collective and state farms into the joint-stock companies and associated companies. Having been formally performed, it led to production and management break down.

resulted in denial of any attempts to regulate them, which is a usual thing in the countries with market economy. Now the taxation system bears a confiscation character; high taxes do not stimulate the growth of production and provoke their ignoring. An attempt to draw foreign investments was not successful, because of the high risk level and export of goods, preferred by the Western partners to investments. The local Administration didn't receive sufficient rights to solve the problems of the regional reality and in a majority of cases was forced to observe the decisions of the higher organs of power, which didn't take into account the regional specificity.

The process of FEZ creation didn't give any positive results in the economic development of the region, but it provided certain quantitative changes in the economic environment. Presently, about 1.000 joint and foreign ventures have been already established (the total number of the managing subjects in all branches is 17.000, out of which 14.5 thousands belong to the private and mixed property). Out of the total production volume and investments their share is 1-2%, but they are already contributing about 40% of the export-oriented products, manufactured in the region. Their activity helps to spread market relations, to update the working staff's qualification. They will serve as a base for the further growth of investments and production, if there are favourable conditions for economic development.

The programmes, implying a considerable support, offered by the government to the region, are largely hoped for,[7] and in particular, the main beliefs were in the federal programme of the regional development, worked out in 1994-1995. It presumes obtaining

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[7] Before the government also supported the region; a number of President's degrees and enactments were adopted, according to which large subsidies were allotted, although less in amount, than stipulated in these documents. However, now we speak about a long-term programme, envisaging financing.

of the budget federal sources, amounted to 26% out of the total volumes required, as by the way of direct dotations and investments, as at the expense of taxation preferences for the region and taxation credit, that should boost the influx of the private capital as well. A similar idea (as well as customs preferences, etc.) is outlined in the project of the Law "On a special economic zone in Kaliningrad region", adopted at the first reading at the State Duma on 20.07.1995. Therefore, while working out specific questions, it makes sense to follow conditions of the regional development, formulated in this document, although some of its postulates may appear to be amended in the final version of the Law. The Russian capital is interested in the future investments into the regional economy. It's not by chance, that many affiliates of the Russian banks are located here. The three regional banks (Investbank, Baltcredobank, Baltvneshtorgbank) belong to 100 largest commercial banks of the country. Investments will be encouraged by the preferential taxation regime, as well as by investment of the federal budget sources. However, the work on the definition of the prospects of Kaliningrad region economy has not been completed. To determine the rational strategy of the regional development, it's important, that this strategy could be able to solve the following three tasks:

1. To achieve lower rates of recession and stabilisation. In order to do this we need to work out a complex of the regional measures, additional to the all-Russian ones.

2. To provide qualitative changes in the economy mechanism and economic management, corresponding to the market demands and the geopolitical peculiarities of the region.

In 1994 import of 87% of resources to Kaliningrad region was performed from other RF regions, and the regional share of ready-made products export to RF reached 97%. Therefore, the formation of the regional market should be integrally linked with the similar process of the all-Russian market, especially when the interest of the foreign partners in the region is mostly reasoned by the available access to the wide Russian market.

Under the terms of territorial isolation of the region from RF, it's important to intensify the state regulation (and financing) of the regional economy with allocation of additional rights to the regional organs of power. This principle is laid as a corner stone in the project of the Charter of the region and its Agreement with the federal organs.

The region should receive a preferential taxation regime similar to that of off-shore zones and the right to regulate customs fees, that has been planned in the project of the Law on a special economic zone in Kaliningrad region. The federal financial support is needed to provide of the economic restructuring. On the one hand, the regional economy turned out to be territorially isolated from the all-Russian market, on the other hand, there are conditions for its integration into the common European market.

3. To outline the trends and to create investitional terms for economic restructuring, to define its branch priorities under the new economic and geopolitical conditions.

First of all, we need to answer two questions. Firstly, whether to stimulate the present specialisation and to prompt its changing or to get rid of the non-profitable productions at all? Secondly, how and what new enterprises to create: to promote establishment of new specific productions or to create conditions for entrepreneurship as a whole, awaiting the situation, when the market terms will spontaneously form the necessary branch structure.

The answer to the both questions is positive. And the tasks, stipulated in the first of them, should be solved primarily by the federal programme of the regional development. As for the problems, highlighted in the second question, they are mainly the problems of norm on the regional and federal levels (according to proposals and agreements with the local authorities).

A number of current branch enterprises of the regional traditional specialisation requires backing for their development. Among them is a transport-storage complex, corresponding to the priority of the regional development as a transit territory. That is, as a distributional centre for imported goods and as a production base for the future deliveries to RF, which is of value for foreign partners as well as for Russian exporters. In the future reinforcement of the regional policy, conducted by the federal government will inevitably draw its attention to the feasibilities, provided by the geographical position of the region, for the development of export-oriented productions, that make use of the domestic scientific-technical potential and process Russian raw for export to the external market.

Availability of the three sea ports - Kaliningrad trade port, Kaliningrad and Pionersk fish ports, small sea ports in Svetly and Baltyisk, river ports for vessels "river-sea", located in Kaliningrad and in Sovetsk - ensures favourable conditions for development of the sea transport and a massive cargo transit via the region from Russia to the West and from the West to Russia. The Russian Federation feels a great need in it. In 1994 the Baltic Russian ports accepted only 21 mln tons of cargo, whereas 47 mln tons of cargo were handled by the ports of the Baltic states, for which the RF had to pay more than 200 mln $.

Production capacities of Kaliningrad ports (including fish ports) comprise more than 6 mln tons of cargo a year, but in 1993 and 1994 only 2/3 and 1/3 of them were used. According to the state experts' estimation, perspective capacities (2010 tons) can reach up to 10 mln tons (that is less than amount, outlined in a number of suggested proposals), however considerable measures will be required for the ports' reconstruction, which is necessary to perform cargo transit via the territories of Lithuania, Byelorussia and Latvia (increased traffic capacity, regulation of transport fees). In all cases perspectives of Kaliningrad development as a transport link are connected with the way of formation of a common economic space in the Baltic region (including Russia), and with the measures against discrimination of the Russian cargo. Otherwise, any estimations of the ports' expansion will be deprived of their economic ground.

In order to increase efficiency of the RF Baltic sea ports, there should be a worked out project of the effective interaction between St.-Petersburg and Kaliningrad transport complexes, where Kaliningrad will play a role of St.-Petersburg's outpost.

Apart from the sea connection, Kaliningrad should enter the common system of European motor-, railroads and air routes.

As far as machinery is concerned, one should regard the problems of each enterprises, as soon as they do not present a unified complex and there are practically no production ties between them. On the whole, one should note a high material consumption at the majority of active productions, which doesn't seem to be expedient, because of the remoteness of the raw sources.

Before organization of the analogous productions in the raw-supplying regions (which will require minimum 5 years), export-oriented paper and pulp industry still has a good potential for proper functioning. And should the questions, concerning the full raw consumption and quality products' output, be solved, its preservation is possible for a longer period.

One should cast a new look at the prospects of development of fuel and power supplying complex. As some experts consider, input of new capacities as a counterpoise to the nowadays energy import is not sufficiently grounded. Such projects prove to be quite expensive and the means, required for their implementation, can be more efficiently used in other branches. On the contrary, it's more pertinent to study the problem of energy production drop.

A wide use of any local natural resources (rock salt, etc.), with exception for amber, is feasible only at significant expenditures and requires additional economic reasoning. Although there are projects of local oil and natural gas processing, their small deposits are hardly worth the on-site oil-processing, instead of deliveries to large processing enterprises (despite the fact, that the projects, concerning processing of imported oil are economically supported). But creation of small new productions by means of using local turf, brown coal, building materials are not ostracized.

Recreational opportunities may be more attractive for the Russian population, but creation of the appropriate infrastructure is viable only with the help of the federal investments; only after that one may count for the private domestic and foreign investments. There is a worked out programme of the regional recreational complex development and attempts for its implementation are already being made.

Provision of a varied production of a number of goods (for the regional population and for export) can be achieved by means of a special programme, presupposing development and endorsement of the small business. This programme has been already put into effect, but its realisation needs to be speeded up. This enables a rational use the natural and labour potential of the region, as well as partially unused production funds, and will give the opportunity to implement scientific-technical projects, suggested by the regional scientific and project design institutions. On this basis solution of many problems of the regional agro-industrial complex is viable.

Priority tasks of the small business support are solved by means of a special budget fund creation and allocation of taxation and other preferences. Consequently, the main concern should be about customs security of the developing productions and a special stimulation of export specialisation.

For foreign investors the region may be especially attractive due to the free access to the Russian market via the regional territory. Here we speak about various processing industrial branches (engineering, consumer-goods production). The opportunity to perform import of assembling parts and materials under the preferential taxation regime, their further processing, output of ready-made products and their export as products manufactured on the Russian territory, without taxation in other RF regions, may appeal to foreign investors. But we don't exclude the raise in taxes on a number of goods, imported to RF from the Western countries. The allocated preferences are expected not only to compensate further transport expenditures on import of goods to RF, but to ensure a higher profit, instead of their production at the place with high consumer demands. Besides, the region possesses quite a qualified working staff and a developed system of staff training.

The key question, predetermining further development of the region under different conditions, is a matter of formation of the population's appropriate mentality. According to the researches, Kaliningrad region is already among five more advanced regions of the country in this respect (standing in one row with Lithuania, St.-Petersburg, Nizhegorodskaya oblast and Primorsky region). The developing system of education and staff training facilitates this process, and its further advancement as well as strengthening of the financial base are rather vital.

One can admit, that the present day situation in Kaliningrad region can be seen as follows: A) common political and economic situation in RF; B) enclave position of the region. But plus to the above-mentioned, RF relations with the Baltic countries (especially with Lithuania), Poland and Byelorussia are of top significance. Weakening of the enclave position of the region is much dependent on these relations, i.e. elimination of barriers and reduction of prices for the regional transport connection with the main part of RF, as well as realisation of the Russian export-import operations via the territory of Kaliningrad region.

The state of the RF political and economic relations with the EC countries is of no less importance. Should RF be viewed in one row with the Baltic states as a future full-fledged EC member, RF relations with the Baltic states would be more firm and beneficial for Kaliningrad region.

On the one hand, the outlined political aspects require RF good will, and of the Russian partners, on the other hand. So far, we often encounter complicated attitude towards RF, like, for example, unreasonable requirements, concerning the regional demilitarisation. To our opinion, the main concern should be about the multilateral relations to provide security in the Baltic region, observing mutual interests of all countries, including the RF.

Formation of the common economic space (including RF) as a result of solution of disputable political questions and termination of all forms of opposition will allow to do away with many questions, that seem to be vital (less dependence on the neighbouring countries with the help of the own energy basis formation, searching for alternative transport connection, evading Lithuania, etc.).

Regarding the possible sources of financing of the regional economy restructuring, one should take into account the ensuing benefit of the realisation of the regional development projects, but not compensations for the territorial isolation of the region from RF or humanitarian financial support, offered by the Western countries.

To our opinion, settlement of all complicated questions of the regional development is rather feasible and perspectives of its accelerated development after solution of the above-mentioned problems seem to be rather real.

Appendix 5

CUSTOMS REGULATIONS

1. Goods produced in a special economic zone and exported to other countries are not considered to be in customs regime of export. They are exempted from duties. Measures of economic policy are not applied to them (on non-tariff state regulations of the foreign economic activity);

2. Goods imported to a special economic zone from other countries are not considered to be in customs regime of the production for free circulation. They are exempted from entrance duties. Measures of economic policy are not applied to them (on quantitative state regulation of the foreign economic activity);

3. Goods produced in a special economic zone and sent to other customs areas of RF are considered to be on the same customs territory of RF., They are exempted from entrance duties, value added tax, excise duty and special tax. Measures of economic policy are not applied to them (on non-tariff state regulations of the foreign economic activity);

4. Goods imported from other countries into a special economic zone and looked upon as being produced in it, are considered to be in customs regime of production for free circulation. They are liable to entrance duties, VAT, excise duty and special tax. Measures of economic policy can be applied to them (on non-tariff state regulations of the foreign economic activity).

   VAT and other taxes are withhold into the budget of the Kaliningrad region and forwarded for the financing of the regional investment projects.

5. Goods imported from other countries into a special economic zone and forwarded afterwards to foreign countries, both with the processing and without it, are considered being outside RF customs area. They are not liable to customs dues and taxes. Quantitative limitations for the export and import of goods and customs regime of the processing on the customs territory of RF or customs regime of temporary import into RF are not applied to them.