



EASTWEST INSTITUTE
Институт
«Восток – Запад»



**Office of the Authorized Representative
of the President of the Russian Federation
for the Northwest Federal District**

Kaliningrad Regional Administration

**Аппарат полномочного представителя
Президента России в Северо-Западном
федеральном округе**

Администрация Калининградской области



Калининград
агентство регионального развития

**Regional Development
Agency**
Агентство регионального
развития



International conference
**INVESTMENTS TO THE
NORTH – WEST OF RUSSIA:
KALININGRAD PERSPECTIVE**

October 25-26, 2002, Kaliningrad

Международная конференция
**ИНВЕСТИЦИИ
В СЕВЕРО–ЗАПАД РОССИИ:
КАЛИНИНГРАДСКАЯ
ПЕРСПЕКТИВА**

25 – 26 октября 2002 года, Калининград

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The International Conference «Investments to the North-West of Russia: Kaliningrad Perspective» took place on October 25-26, 2002 in Kaliningrad and there was organized by the EastWest Institute, Regional Development Agency (Kaliningrad), the Administration of the Kaliningrad Region, the Office of RF President Official Representative to Northwest Federal District. The partnership support for the Conference was rendered by the investment corporation «Gosinkor», the investment company «AVK», «Impexbank», «Avtotor», the Baltic Business Club (Kaliningrad), the Baltic Interregional Institute of Social Studies, Tacis project «Promoting Trade and Investments in the Kaliningrad Oblast - Russia». The information coverage of the Conference was given by the news agencies «Rosbalt» and «Cascad».

The Conference was aimed at elaboration of recommendations for investment climate improvement in the North-West of Russia and in the Kaliningrad Region in particular, and also at introduction of foreign and Russian business circles to investment opportunities of the region. More than 250 people took part in the Conference work, among them - the representatives of the RF President's Administration, the RF Government,

the State Duma, the Russian Federation Council, Ministries and Departments Offices, the Administration of the Kaliningrad Region, Regional Duma, leading business and scientific circles, officials and experts from EC member states and candidates. The representatives of Russian, central and regional, international and foreign non-governmental organizations, public organizations, scientific centers made an important contribution in Forum realization.

The Conference was opened by Andrey Stepanov, Deputy of RF President Official Representative to Northwest Federal District, who read the welcoming speech of Victor Cherkesov, RF President Official Representative to Northwest Federal District. Vladimir Yegorov, Governor of the Kaliningrad Region, George Russell, Co-chairman of the Board of Directors of the EastWest Institute addressed the participants with their welcoming speeches.

On the first day at the **plenary session «Favorable Investment Climate as a Main Condition for Accelerated Development of the Regional Economy»** the participants discussed factors and conditions that influence investment activity in Northwest Federal district. A special attention was given to the Kaliningrad Region. In the course of

reports presentation and discussion it was repeatedly emphasized that solution of problems related to the Kaliningrad Region becomes one of the major priorities of the Russian Government and cannot be delayed. At the same time this circumstance gives a real opportunity to accelerate reforms implementation in the country as a whole, it can clearly demonstrate new approaches and opportunities in Russian external and internal policy to the world community.

The participants of the Conference highlighted the significance of teamwork of the Russian and foreign partners in elaboration of the mechanism of investments support and elimination of bureaucratic barriers on the way to increase efficiency of economy. In this context a special role was allocated to Kaliningrad which in the nearest future will find itself inside the European Union.

On the second day the work was organized in three parallel sections.

At the first section «Improving Economic Mechanism of the Special Economic Zone of the Kaliningrad Region» the participants discussed proposed approaches to further improvement of economic mechanism of the Special Economic Zone of the Kaliningrad Region.

At the second section «Fiscal Transparency as a Condition for Improving Investment Climate» the participants discussed publicity of budgetary materials in the Kaliningrad Regions, issues of reforming budgetary system and budgetary

process, issues of financing the quality of budgetary expenditures, market tools of loans, influence of state finances and budget on the economic development of the regions. The following reports were brought to the participants attention: EC requirements to public finances management as a reference point for the Kaliningrad Region; experience in development and realization of social technology «Transparent Budget» by St. Petersburg Humanitarian Politology Centre «Strategia»; experience in program realization of reforming the public finances in the Vologda Region; experience of the Lithuanian Republic; the investment strategy of St. Petersburg.

At the **third section «Presentations of Investment Projects»** the investment projects of Northwest federal district and the Kaliningrad Region were presented and discussed.

The participants of the Conference have worked out a final document, Resolution, where the consolidated opinion of the public, business circles and authority on the issues of acceleration of social and economic development of the Kaliningrad Region and creation of an attractive investment climate in the Northwest of Russia as a whole has been reflected.

The full texts of reports and additional information on the investment projects can be found on Internet site of the International Conference <http://www.iewts-tfcp.ru/invest>. □

Welcome addresses

A. Stepanov, Deputy of RF President Official Representative to Northwest Federal District on the Kaliningrad Region

V. Yegorov, Governor of Kaliningrad Oblast

G. Russell, Co-Chairman of the Board, EastWest Institute

Plenary Session.

«Favorable Investment Climate as a Main Condition for Accelerated Development of the Regional Economy»

Chaired by: A. Stepanov, Deputy of RF President Official Representative to Northwest Federal District on the Kaliningrad Region

A. Stepanov, Deputy of RF President Official Representative to Northwest Federal District on the Kaliningrad Region

V. Pirogov, Vice-Governor of Kaliningrad Oblast

I. Garivadsky, Deputy Head of the Department of Investment Policy, Ministry of Economic Development and Trade of the RF

V. Shcherbakov, Chairman of the Board, JSC «Avtotor»

S. Kozlov, Deputy Chairman, Kaliningrad Oblast Duma; Chairman of the Committee on SEZ Development, Kaliningrad Oblast Duma

G. Russell, Co-Chairman of the Board, EastWest Institute, Russell 20-20 Association

J. Coolidge, Program manager, Europe, Foreign Investment Advisory Service (a joint service of International Finance Corporation and the World Bank)

Yu. Savenko, Kaliningrad Mayor

V. Kozhemiakin, Vice-President, FSUE «Gosincor»

G. Bunatyan, Chairman of the Board, Fund «Kaliningrad Regional Development Agency»

V. Belday, Consultant of the Regional Development Department, RF Government

S. Prikhodko, Deputy Director of the Institute of Transition Period Economy

A. Khodachek, Head of the Department, Expert Council, Office of RF President Official Representative to Northwest Federal District

A. Kirillov, General Director, Holding «Baltincenter»

S. Vlahovich, President, «Produkty Pitania» Company

O. Shlyk, Chairman of the Association of Kaliningrad Oblast Municipalities

A. Boboshin, PR Director, TV Company «Ostankino»

A. Blinov, President, Baltic Business Club

Section 1.

Improving Federal and Regional Investment Legislation and Lowering Administrative Barriers

Chaired by: **G. Bunatyan**, Chairman of the Board, Fund «Kaliningrad Regional Development Agency»

M. Pliuhin, Chairman of the Committee on Special Economic Zone Development, Kaliningrad Regional Administration

K. Rao, Expert on SEZ, Foreign Investment Advisory Service (a joint service of International Finance Corporation and the World Bank)

G. Dykhanov, CEO, Fund «Kaliningrad Regional Development Agency», representative of the Tacis project «Support to Investments and Trade in Kaliningrad Oblast»

C. Coldicott, Project Manager, TACIS «Promoting Trade and Investment in the Kaliningrad Region - Russia»

N. Vlasenko, Vice-President, Union of Industrials and Entrepreneurs of Kaliningrad Oblast

Yu. Matochkin, Chairman of the Committee on Economic Policy, Kaliningrad Oblast Duma

I. Samson, Professor of the Grenoble University

G. Panova, Director of the Financial Academy, RF Government

Y. Palochkin, Chairman of the Board of Directors, «Kim and Partners»

V. Zhdanov, Chairman of the Committee on Economic Development and Trade, Kaliningrad Region Administration

Section 2.

Fiscal Transparency as a Condition for Improving Investment Climate

Chaired by: **L. Sergeev**, Head of the Main Department on Budget and Finance, Kaliningrad Regional Administration

L. Sergeev, Head of the Main Department on Budget and Finance, Kaliningrad Regional Administration

L. Bogdanov, representative of the Fiscal Policy Center (Moscow)

A. Gustafsson, P. Molander, Boholmen Consulting Company (Sweden)

K. Gimbitskiy, CEO, Association of Kaliningrad Region Municipalities

A. Kholodov, Deputy General Director of the Investment Company AVK

R. Zarembo, Vice-Mayor, Chairman of the Committee on Finance and Control, Kaliningrad City hall

T. Vinogradova, Program Director of the SPB Humanitarian-Politology Center «Strategia»

G. Bukhmicheva, Deputy Head of Finance Department, Vologda Region Administration

A. Vasiliauskaite, Head of Finance Department, Kaunas University of Technology

V. Khodachek, Vice Rector on Scientific Work, Academy of State Service

V. Ivanov, Project Manager, EastWest Institute

P. Arkin, Professor, Head of Economy and Law Department, SPB State Technological Institute

Section 3.

Presentations of Investment Projects

Chaired by: S. Laptev, Deputy Governor, Kaliningrad Region Administration

State support of investment activity in Kaliningrad region

V. Zakharov, Chairman of the Committee on Incomes and Investments, Kaliningrad Region Administration
Ferry route: Ust-Luga - Baltysk - ports of Germany

A. Zamuraev, General Director, «Baltiysky Parom» Investment projects for fuel and power supply complex

A. Ehimov, Chief Manager, «Gazoyl» Investment projects in Kaliningrad

Yu. Bedenko, First Vice-Mayor of Kaliningrad on Economic Development, Kaliningrad City hall
Investment projects for resort and recreation complex

V. Zimogliadova, Chairman of the Committee on Tourism, Kaliningrad Region Administration
Investment project: Preservation and development natural complex Baltic split

A. Scheulin, Deputy Director on Science, Institute of Sustainable Development and Analytics
Investment projects of the Direct Investments Institute

M. Danilevsky, General Director, Kaliningrad Institute of Direct Investments

A. Zvontsov, «Civil Aviation» program manager, Ministry of Transport of the Russian Federation

Closing Session

Press Conference

Victor CHERKESOV

Russian Deputy of RF President Official Representative to Northwest Federal District

Dear ladies and gentlemen,

Russia and Europe are on the threshold of taking exceptionally important decisions that will not only modify the future of geopolitical and geo-economical space of Europe and Asia but also will shape the world architecture in many years ahead. The eastern parts of the enlarging European Union and the Russian Northwest demonstrate how good-neighbor relations can be used in favor of regional development and prosperity. New EU-Russia borders must not divide the continent, but ring together different states and peoples and promote trade, business and relations between people.

Kaliningrad, a small Russian island that will soon find itself in the EU surroundings, plays the big role in this context. Today a resolution of the Kaliningrad question will be central to the future EU-Russia relations. We stated many times that Russia continues the policy aimed at EU-Russia strategic partnership and considers the Kaliningrad oblast as a pilot region of this effective cooperation. At the same time we believe that true partnership is a two-way street. Therefore, we expect adequate actions from the EU side.

Today we are seeing a development of the favorable investment climate in the Russian Northwest. This encourages Russian and international investors to fulfill many business projects that have a significant impact on the quality and the rate of social-economic reforms in the regions.

A concerted effort of Russian and international partners becomes more and more important. The effort is aimed at elaboration of the investment promotion mechanism and removal of the bureaucratic barriers on the way of the new efficient economy.

I hope the participants of this high-level forum will in the most pragmatic and open manner discuss practical issues of investment cooperation of the Russian Northwest as a whole and of the Kaliningrad oblast in particular.

I hope that the conference will result in real acceleration of complex investment promotion in the main sectors of the regional development in the most western parts of Russia.

I wish all of you every success.

George RUSSELL

Co-Chairman of the Board of Directors of the EastWest Institute

Dear ladies and gentlemen,
As you probably know, this forum was originally planned for the fall of last year. However, the horrible terrorist attacks of September 11 in Washington and New York cancelled our plans. I am glad that today, a year later, our Conference on Investments in Kaliningrad Region has materialized. We missed one year, but it was by no means a waste of time, this year generated new opportunities and challenges that in 2001 we could only anticipate and that are demanding concrete actions from us today. New and closer ties between Russia and the West within the anti-terrorist coalition, faster enlargement of the European Union, on-coming Russia's entry into the World Trade Organization, energetic pursuit of major structural and economic reforms by President Putin – all these factors increase the chances of Kaliningrad Region to lead the rest of the nation in developing Russian-European cooperation. On behalf of the EastWest Institute it is my pleasure to welcome you at this important Conference.

The world is indivisible and interdependent. The East needs the West as much as the West needs the East. The EastWest Institute I am representing here is a private initiative of people, who are concerned with the future of this fragile world and strive to make it a safer and better place. For 20 years the Institute has worked in many places of the world to resolve existing and to prevent potential conflicts as well as to promote and expand various forms of international cooperation. The Institute is an international non-governmental non-profit organization working to fulfill its mission on all levels from a top political level to grassroots. The main asset of the Institute is a

broad network of intelligent and highly committed people. Networks like this are becoming more and more important to achieve positive change in the world.

With its the International Security and Economic Development programs the EastWest Institute has worked in Russia for several years. One of the Institute's worldwide priority areas is Transfrontier Cooperation as a means to reduce conflicts and tension in border regions and to promote these regions' economic development. Transfrontier Cooperation work in Russia focuses on the Northwest Federal District and, particularly, on Kaliningrad. We see Kaliningrad as a testing ground for coping with new challenges of the 21st century. We are confident that Kaliningrad can and must become a good example of effective international cooperation and partnership rather than a bone of contention. This idea has gained more importance after the events of September 11 when all civilized world united against a new global threat – international terrorism.

Another important project of the EastWest Institute gives Kaliningrad Region support in reforming its state-budget finances and in ensuring high standards of fiscal transparency to increase the investment appeal of the region. If successful, we plan to disseminate our Kaliningrad experience gained through this initiative to other regions of Russia's Northwest.

I would like to express my gratitude to the Russian President's Plenipotentiary in the Northwest Victor Cherkessov and Governor Vladimir Egorov for their support and cooperation in implementing these projects. Today's forum sends a clear positive

message to international investors that Kaliningrad Oblast is ready and willing to use its chance and make itself a gateway between Russia and Europe, a role once so successful assumed by St. Petersburg. The active role of Victor Cherkessov and Vladimir Yegorov in preparation of this Investment Conference is very important and reassuring.

This conference is not only about how much the East and the West need each other. It is about finding finance for promising investment projects – investors and entrepreneurs need each other as well. Russia is becoming increasingly interesting to big investors. The more stable and predictable the country is the more foreign investors will be willing to invest in it. The work of the EastWest Institute is focused specifically on Russia's Northwest that may soon have a common border with new member-states of the European Union. We believe that the investment potential of Kaliningrad region is very high. At the same time, much remains to be done to encourage Russian and foreign investors to bring their money to Russian regions other than Moscow and St. Petersburg.

Kaliningrad Region is a special case. We see this tiny part of the European continent as a drop of water reflecting the complexity and controversy of today's world. This land has repeatedly put people before the same choice: confrontation and conflict (as it happened twice in the 20th century) or consolidation and partnerships. We, of course, hope that Kaliningrad-related issues will be resolved in a manner that demonstrates that the mankind has matured to the awareness of the need

for consolidation and real partnership in the face of common threats.

It is clear that while hoping for the best, investors should have a good understanding and control of their risks. During the past year Russia enjoyed a period of macroeconomic stability and high growth. The latest surveys by the Russell 20-20 Association show that major international investors expect that traditional Russian country risks will continue to decrease. In light of the Western economic recession, such positive developments give Russia a sizable competitive edge as a recipient of international investments.

We are well aware of the fragility of this world and our responsibility for its future. All of us here should be ready to contribute to the future of Kaliningrad, that would be based on partnerships, cooperation, observance of the rule of law and adherence to common human values. I am confident that Russia is moving forward the right way and that its current reforms position the county as one of the world's leading nations. Together Russian, the European Union and Unites States can deliver many positive changes on a global scale; they can build rigid barriers to international terrorism, overcome global economic and social problems and move forward toward peace and prosperity. I hope this conference will be very practical and productive in that it will give a chance to Russian and international investors to learn about leading Russian companies, who follow best international practices and are ready to receive large strategic investments. I wish all of you every success with your initiatives. □

George RUSSELL

Co-Chairman of the Board of Directors of the EastWest Institute

Improving the Investment climate in Kaliningrad

Excellencies. Ladies and Gentlemen. With the impending enlargement of the EU and the wide-ranging reforms initiated by President Putin's administration, Kaliningrad is on the threshold of an era of strong economic expansion. Realizing this opportunity will require an improved climate for investment. As you all know, without sustained strong and broad-based economic growth that raises living standards for its approximately one million inhabitants in the decade ahead, Kaliningrad could become an economic backwater and a source of economic and social problems for Russia and neighboring countries. There is no need for that to happen. Yesterday afternoon I met in Moscow with Transportation Minister Sergei Frank who outlined some very impressive plans for this oblast. From the deepening of your port next year to new highways, another gas/coal power plant to modernizing customs facilities. This was very good news. As many of you know, I have taken the world's leading investors around the world many times. We have been in Russia, China, Brazil, India, Turkey and many other places. When I look at Kaliningrad, I am struck by several issues. Let me share them with you.

The economy is small by international standards

The GDP of Kaliningrad is a little more than US\$1 billion. Kaliningrad must therefore look to trade with the rest of Russia and with its neighbors as the basis for sustained improvements in living standards in much the same way as Singapore

and Hong Kong have over the past half century. Success depends on fostering an internationally competitive and open market economy. This will require private investment in new technologies, improved management of labor and business assets, close attention to product development and marketing in Russia and internationally, and increased public investment in basic services, including infrastructure, health and education.

As the experience of Poland and other transition economies demonstrates clearly, sustained strong growth can be led by small and medium business. The challenge for Kaliningrad will be to create the conditions that support strong growth by the SME sector. With some 20,000 to 30,000 small businesses and individual entrepreneurs, Kaliningrad has the basis for building a vibrant economy around the small and medium business sector.

What will it take to achieve results?

Higher levels of domestic investment will be required. Investment levels are rising, but are still too low for sustained strong growth. There appears to have been an impressive recovery in investment in the Oblast in the past two years. According to Goskomstat and regional data, the ratio of fixed investment to regional GDP was about 22% in 2001, up from 13% in 1998 and 1999. Even so, this level of investment is still too low. Experience elsewhere suggests that Kaliningrad will require an investment rate of at least 25% of GDP on a continuing basis if it is to have sustained strong growth in output, employment and incomes.

Increased inflows of foreign investment can complement domestic investment

With an improved climate, private investment flows from abroad – mainly in the form of FDI – can complement increased domestic investment. The level of FDI in Kaliningrad is reported to have averaged about \$5 million a year during 1999-2001. This is in line with the exceptionally low levels of FDI inflows to Russia in general. If we compare this performance with other small countries whose economies are about \$1 billion in size, we find FDI inflows in 2000 as follows: Burundi, \$12 million; Lesotho, \$118 million; Mongolia, \$30 million; Togo, \$30 million; Malta, \$630 million; and Maldives, \$13 million. These small countries compete strongly for FDI investment. The more successful ones give close attention to the environment for foreign investment.

I am happy to say that we are seeing an improvement in the investment climate in Russia. A recent report prepared by the Frank Russell Company indicated a clear improvement in the past year. According to the report, international investors believe that a more stable political and business environment and increased emphasis on economic reform under President Putin's leadership are contributing significantly to the investment environment. Continued strong economic growth, timely repayments of external debt obligations, improved macroeconomic fundamentals and larger foreign exchange reserves have also contributed to increased investor confidence. The perception among many investors is that the risks associated with investment in Russia may continue to decline with further progress on economic and structural reform.

To attract foreign investment, particularly from Poland, Lithuania, Germany and the Nordic countries, Kaliningrad can capitalize on these improved investor perceptions about Russia and on the Oblast's favorable location. But location alone is not enough.

High levels of investment require an improved investment climate within Kaliningrad

A concerted effort to improve the investment climate within the Oblast will be needed if higher levels of domestic investment and increased inflows of foreign investment are to be realized.

The general perception is that while progress is being made, the business environment lacks transparency, predictability, stability and incentives. There is insufficient investor and property protection, legislation is often not enforced, and the tax environment remains complex and not business friendly.

There is a need for a stable and secure legal and institutional environment. Good corporate governance, fair and efficient enforcement of legislation (e.g., to guarantee the protection of shareholder and investor rights, bankruptcy, auditing and accounting), enterprise restructuring and further development of SMEs will be central to efforts to promote sustained growth. Other priorities include measures that strengthen institutional capacities in financial markets, insurance and taxation, including in particular, the removal of impediments to the growth of small and medium business. Transparency of budgetary flows and public-private fiscal interactions are also important elements of the overall business climate. As Co-Chairman of the EastWest Institute, I'm happy to note the success of the project supported by the Institute that aims to promote fiscal transparency in the Kaliningrad Oblast.

As part of the effort to strengthen institutional capacities, international investors would welcome actions by the authorities to ensure that Kaliningrad has the capacity to enforce existing legislation, as well as meet obligations under international conventions to combat crime and other illegal activities. According to official statistics for example, the level of crime is 20% higher than the Russian average, including in

particular organized crime, which, as elsewhere, has a pervasive negative effect on the business and investment climate.

A particular aspect of the business environment of concern to investors is the future status of Kaliningrad as a Special Economic Zone (SEZ). Russia's entry into the WTO in the coming years is likely to raise questions about the compatibility of SEZ benefits with WTO rules. Will the status and benefits of the SEZ have to be modified to conform to Russia's international obligations upon entry into the WTO?

Uncertainties about the impact of EU enlargement on Kaliningrad need early resolution

It is essential that the impending enlargement of the EU is a positive development for all concerned. The adoption of the *acquis* by Poland and Lithuania will inevitably mean changes in some existing rules and practices between Russia, the EU and the new Member States. Some of these changes will affect all regions in Russia. But a number of changes will be specific to Kaliningrad. An early resolution of the outstanding issues affecting Kaliningrad will be central to efforts aimed at reducing uncertainty in the business and investment climate.

- Movement of people. Much attention is already being given by Russian and EU authorities to the movement of people and the visa issue. From the viewpoint of private investors, suffice to say that the solution should facilitate the movement of people across borders in a timely and efficient manner, with due attention to measures that combat cross border crime and other illegal activities.
- The movement of goods. The business community is also concerned about arrangements for the efficient movement of goods across Kaliningrad's borders into Poland and Lithuania. Early attention to improvements in the physical infrastructure and in processing the transit

of goods can make an important contribution to the business climate and the attractiveness of Kaliningrad as an investment destination for Russian and international business. Funding for improvements in border crossing facilities and procedures can come from the Russian and Kaliningrad governments and from the EU, with perhaps some assistance from neighboring countries.

- Improvements in transport infrastructure will also be essential to the investment climate. Significant improvements will be needed to bring the EU road corridors that will pass through Kaliningrad up to European standards. Financing for such improvements could come from the EU and perhaps the international financial institutions such as the EBRD and the World Bank.
- Future sources of energy need further clarification. Kaliningrad confronts a range of issues related to its future sources of energy, the resolution of which will have a bearing on investment decisions by the private sector. Central to the debate is the future source of Kaliningrad's electricity, almost all of which is currently supplied from the Russian grid. Given Lithuania's plans for a link to the central European grid, Kaliningrad will need to decide whether to generate more electricity within the oblast, switch to the central European grid, or maintain its link to the Russian grid.

Kaliningrad can capitalize on the impending enlargement of the EU

Upon accession into the EU, tariffs on imports into Poland and Lithuania will decline to those of the EU as a whole. Given their proximity, the prospect of easier access to these markets represents an important opportunity. Kaliningrad will want to encourage Russian and overseas investors to set up manufacturing and service industries for export

to these neighboring countries and as a base for sales to the rest of Russia.

Kaliningrad has the potential to become a «pilot region» in a new partnership between Russia and the enlarged European Union. Since trade is the lifeblood of a small economic entity such as Kaliningrad there is a compelling case for early adoption of EU technical norms and standards to take full advantage of these opportunities. With sustained support from the national government, the introduction of these standards and practices would enhance international competitiveness and would help create a more attractive climate within

the Oblast for foreign investment. European and U.S. investors are likely to welcome the initiative. Such a pilot would also provide other regions of Russia with valuable experience in the growing trade integration with the rest of Europe. After all, Europe already accounts for more than 60% of Russia's merchandise exports and provides half of all imports.

In closing, I'd like to thank you for this opportunity to share my thoughts. I also want to assure you that the EastWest Institute and I are fully committed to helping Kaliningrad become a success story and a flourishing part of Europe. □

Jacqueline COOLIGE

Foreign Investment Advisory Service, a joint service of International Finance Corporation and the World Bank (FIAS)

The Foreign Investment Advisory Service (FIAS, a joint facility of the International Finance Corporation and the World Bank) started its most recent activities in the Russian Federation in the summer of 2000. We initially carried out a Study of Administrative Barriers to Investment in five Subjects of the Russian Federation - in Leningrad Oblast and in St.Petersburg, Veliky Novgorod, Sverdlovsk and Tomsk Oblasts. We have been continuing our work in Tomsk Oblast, have also started follow-up work in Leningrad Oblast, and we are adding a few new regions including Kaliningrad, Perm, Nizhny Novgorod Oblasts and Magadan City. If you are interested in the report it is on the web-site of the FIAS (www.fias.net) and also in Russian on the web-cite in the World Bank Moscow Office (www.worldbank.org.ru).

Our work goes forward in difference stages. Two years ago when we did our first study we were working on the analysis and description of administrative barriers in the regions we were working.

But this was two years ago and there already have been a lot of changes and a lot of reforms and part of the work we will do is to update our study.

But we will not wait for that. We are in fact going to get started already on the Phase II and help facilitate a constructive dialogue between the oblast administration, government agencies and representatives of the business community about the priorities for new reforms.

Phase III, the implementation of reforms, will be primarily in the hands of the oblast administration and other government bodies, both at the municipal level and possibly also on the federal level. And the last stage is to monitor the impact of the reforms and what improvements are important to improve the investment environment. That is an overview and now we are going in more detail about our work.

Two years ago we started already to do quite a bit of analysis and we will be updating it; we will be looking for information from the relevant government agencies. This will include things like the official fees, the volume of transactions, how many applications have been processing, what is the average amount of time required for processing of application, about which some agencies are able to make quite precise calculations on the basis of the dates applications are received and the dates they are completed. Also hopefully data about the number of applications that were rejected, the number that were appealed, and the outcome of the appeals.

This is information that comes from the government agencies, oblast and municipal level agencies and we also turn to business community and have a business survey to ask them their own actual experience about all those procedures.

So we ask the businesses how long do each of the procedures take from the business point of view, how much do they costs, we try to find out if people are treated equally or not. And any special

problems which businesses face with each of the procedures.

We can ask the business their opinion about the ranking of some of the different prominent agencies and services, which are the best and the worst.

We could also make comparisons between different regions on the basis of objective data about the time and cost requirements associated with all the different administrative procedures.

Once we have the data, we put it together in a report. We include a description of each of the procedures and analysis that compares the investors' experiences with these procedures, comparisons between different regions, and also international, and some of the strength and weaknesses of the procedures.

And make recommendations for improvement.

On the basis of the work that has already been done and work that has been carried out already by the regional administration we will get started on the dialog between the public and private sectors.

Our facilitators will be helping develop the dialog. This will include participation by the relevant government agencies, especially on the oblast level and municipal level, representatives of the business community, the donors will probably be involved to some degree. And our team of consultants.

What we will be trying to encourage first of all is a discussion among these group of people about the findings and recommendations of the FIAS report. And also other reports that have been carries out in the regions. There are many recommendations that have been offered. But there are too many recommendations, we cannot enact all of them, so it is necessary to prioritize.

And to discuss in the practical way how the recommendations can be implemented. And to put it all together in the form of a concrete and clear Action Plan and to present to decision-makers in the government.

The Action Plan is organized in a very precise way. First it is the answer to the questions what are the objectives that we agree and we try to achieve, and there may be several of them. For each of these objectives then we must ask what exactly is going to be done. So in other words what are the concrete reforms measures which are being proposed and hopefully agreed. And then who will be responsible for carrying out these reforms. What are the deadlines for each of the measures. And finally how we can measure the impact, that is, how we know whether we have succeeded in achieving what we want to achieve.

This process will involve the Oblast administration, municipal administration and in some cases representatives of the federal agencies, in dialog with representatives of the business community, and to formally agree.

Then it is time for implementation of the reform. These include amendments to laws, specific changes to regulations and procedures, the establishment of specific performance indicators for certain agencies, training, technical assistance and/or other kind of reforms.

Then after that, after the reform have been implemented, then what we would like do to is to monitor the impact of those reforms. First we need to verify if the reform have actually been formally enacted by the authorities.

And then we can also look at data that comes from the relevant government agencies that have been the subject of reforms efforts, and repeat the business survey and try to measure the impact of the changes that have been resulted from the reforms in terms of the actual experiences of the

business community with regard to the relevant administrative procedures.

Whenever many reforms have been enacted it is only normal to expect that some of them would work well and some would work not so well. So what we want to do with the monitoring system is to identify which reforms are working and having a positive impact on the business community and which reforms have been less successful and perhaps need a new strategy.

So this becomes a cycle of reforms, starting with analysis which includes identifying the current problems and making recommendations, then a dialog between the public sector and private sector

to prioritize the recommendations and develop an action plan. After the action plan is approved and reforms have been implemented by the authorities, then the monitoring and evaluation of the reforms, and the results to be used to identify new priorities and thus revise and update the action plan.

So this makes a cycle that could be repeated many times, in fact many countries including the Western Europe and the United States, there is sort of a normal cycle of reforms, which never ends.

All countries and all regions are competing with each other for new investments. So there is always a reason to try to keep on improving. □



Key Trends & Implications for the Kaliningrad SEZ

How does Kaliningrad Rank?

- *Uncompetitive legal framework*
 - Conflicts between SEZ law & other laws
 - Uncompetitive SEZ law
 - Lack of integration between various regulations and administrative ordinances
- *Customs regime is cumbersome*
 - Complex and unconnected rules
 - Cumbersome procedures and documentation
- *Overlapping institutional framework*
 - Too many gov't bodies; lack of clarity

Key recommendations

- *Develop a new SEZ law*
 - Clear roles and responsibilities of national, regional & local governments and private sector
 - Specific amendments to other laws
 - Deregulation and simplified procedures
 - Fuller set of privileges
- *Design a new institutional framework*
 - Consider a centralized SEZ authority with links to national, regional and local governments
 - Simplify procedures & remove administrative barriers from an investor perspective
- *Enhance customs controls*
 - Adopt conceptual framework outlined in the Kyoto Convention (simplified customs system)
 - Automate procedures and controls
 - Improve customs controls to track use and movement of duty-free merchandise
 - Develop mandatory standards for origin certification for goods; remove this privilege over time
- *Reform taxation practices*
 - Issue special regulations to clarify applicability of deductions, allowances, credits for SEZ enterprises
 - Consolidate large number of local & indirect taxes
 - Streamline tax administration

Fiscal and Public Finance Management Requirements of the European Union as a Reference for Kaliningrad Region

In the "Medium-Term Strategy for the Relationship Development between the Russian Federation and the European Union (2000-2010)" the Kaliningrad Region is referred to as "a "pilot" Russian region in the cooperation between Russia and the European Union in the 21st century". One of the key issues formulated in the Program as a subject-matter for discussions between Russia and the EU is "the application of the EU standards on the territory of the Free Economic Zone in specific types activities and in respect of specific types of goods". The reliance on European experience for improving regional finance would also possibly provide an efficient solution to a large scope of budgetary and social-economic problems of the region, as well as a sound basis for developing the infrastructure of Russian-European cooperation in the region.

This report reviews EU-related requirements in the area of fiscal policy and public sector financial management and looks at international best practice in this area. The purpose is to lay the foundation for a review of current budgetary practices in the Kaliningrad oblast and for recommendations on a program to reform and modernize these practices.

EU-related requirements on fiscal policy and financial management practices are rather diverse and not always relevant as yardsticks for other countries and regions. Nonetheless, the following elements are relevant in a general context:

- Delineation of public sector: The borderline between public and private must be clear. Subsidies should be accounted for in the public budget.
- Transparency of budget documents and procedures: Budget documents should be easily accessible. The budget should be comprehensive and based on gross budgeting principles. Background information such as macroeconomic forecasts should be clearly presented.
- External audit: External audit institutions should live up to international standards on autonomy, adequacy of resources etc.
- Statistics: The existence of a standardised and reliable database for reporting on and analysing the workings of the public sector is a prerequisite for transparency.

Article 3 of the protocol to the excessive deficit procedure, the Stability Pact, obliges member states to have and/or implement fiscal policies and instruments that enable them to live up to the specific constraints – on budget deficits, indebtedness etc. – established in the Pact. Exactly what these policies and instruments should look like is, however, not specified. The concept of «best practice» consequently has to be based on professional consensus and dialogue, rather than on specific requirements laid down in the treaty text.

International best practice in the area of public financial management is a moving target driven

forward by different trends and innovations. In recent years the focus has been on a) reassessing the role of the public sector, b) tightening fiscal discipline, c) servicing the citizens effectively and efficiently, and d) increasing transparency.

The spectrum of arrangements to execute what the public considers incumbent on the public sector has broadened. Activities that traditionally have been executed and financed by the public sector may be: a) privatized, b) executed by government-owned corporations with no subsidy, c) executed by government agencies but partly fee-financed, or d) financed fully or partly by the public sector but executed by private enterprises.

Two sets of instruments have been applied to strengthen fiscal discipline, a clear top-down budgeting process and global budget constraints. In Sweden, for example, the parliament now

establishes ceilings for the total expenditure envelope and for the budget deficit before it votes on appropriations.

An important instrument to improve the effectiveness of public activities is to improve the flow of information on resource use, outputs and effects from the executing to the decision-making level, most importantly parliament, and to strengthen the capacity to monitor, audit and evaluate this information. Efficiency and quality of service to the citizens is improved by decentralizing authority to the executing level. Rather than very detailed budgets focusing on the inputs, agencies are given framework appropriations linked to activities and given the authority to decide on the appropriate input mix. Accrual accounting is introduced to strengthen the capacity of the local institutions to manage their operations. □

The International Conference «Investments to the North-West of Russia: Kaliningrad Perspective» brought together a wide range of qualified participants. The Conference was co-organized by the Office of RF President Official Representative to Northwest Federal District, the Administration of the Kaliningrad Region, the EastWest Institute and the Regional Development Agency of the Kaliningrad Region. The Conference was attended by the representatives of the RF President's Administration, the RF Government, the State Duma, the Russian Federation Council, Ministries and Departments Offices, the Administration of the Kaliningrad Region, Regional Duma, leading business and scientific circles, officials and experts from EC member states and candidates. The representatives of Russian, central and regional, international and foreign non-governmental organizations, public organizations, scientific centers made an important contribution in Forum realization.

The participants of the Conference, having listened to and discussed the reports, come to the conclusion:

Due to its potential and geographical position the Russian Federation as a whole and its regions are certainly in the range of closed attention of large-scale investors. The goal-oriented activity of the Russian Government during the last years has resulted in significant stabilization of political and social and economic situation in the country, it has a positive effect for domestic economy attractiveness to external investments. At the same time, having a well-determined strategy of social and economic development with falling behind appropriate launching mechanisms of its realization prevents realization of large-scale strategically significant projects.

In northwest of Russia a favorable investment climate is being developed; it makes possible for both

Russian and foreign investors to successfully carry out various business projects, that may essentially influence quality and rate of social and economic reforms in the regions. The potential and the geographical position the Northwest region of the Russian Federation can be considered by strategic investors as a jump-off place for development of integration processes between Russia and Europe. The development of steady geo-economic space within these frameworks will both be an essential factor of global stability and security provision and promote investment attractiveness growth of Russian - European investment projects.

A teamwork of Russian and foreign partners on elaboration of a mechanism of investments support and elimination of bureaucratic barriers on the way to new effective economy is getting essential importance.

In this context a special role is given to Kaliningrad – a Russian exclave that in the nearest future will find itself inside the European Union. Today the decision taken on the Kaliningrad issue determines Russian - European relations in general. The Russian orientation towards strategic partnership with EU has no constructive alternative and is an obvious priority. The Kaliningrad Region as a pilot region of this real partnership should become an example of new relations in Europe. In particular, it should be the site to elaborate issues of joint system of Russian - European security provision, creation of transcontinental transport communications with the entire infrastructure, an energy basis for a joint Russian - European economic space, and also control systems of Russian - European integration processes.

Such perspective for the Northwest of Russia, the Kaliningrad Region and the Baltic Sea states will be possible only under the condition of a common Russian - European development strategy and jointly developed mechanisms of its realization.

At the same time, at present the absence of mutually coordinated decisions on the key issues of the Kaliningrad Region related to frontier regimes change with Lithuania and Poland entering the EU is one of the main concerns. These changes sufficiently complicate conditions of transit for Russian citizens and cargoes following to Kaliningrad from the main Russian territory and back, prevent development of frontier trade and cooperation. We should not let the EU enlargement process follow a negative script, when the absence of a constructive position of the parties will become a factor of deterioration of investment and business climate in the Kaliningrad Region and lead to creation of social tension hot spot in the centre of Europe.

Taking into account the above-stated positions the participants of the Conference consider it expedient:

1. To recommend *the Administration of RF President, the Federal Assembly, the Government and the Security Council of the Russian Federation* in the development of a concept of development strategy of the Kaliningrad Region to provide:

- Special economic status of the Kaliningrad Region requiring the appropriate legislative registration, including adoption of changes and amendments to the Federal law **On Special Economic Zone in the Kaliningrad Region**. The negative consequences for business development in the region related to the process of EU enlargement and Russia entering WTO should be taken into account and leveled at the maximal degree;
- Creation of conditions for large investment projects realization by leading domestic and foreign financial and industrial corporations with government provision of long-term guarantees of investments and invariance (predictability) of economic modes;

- Maintenance of liberal and non-bureaucratic system of SME support; creation and support of insurance institutes and financial services comparable to the world standards;
- Maintenance of openness and a full fiscal transparency of budgets at all levels, at all stages of budgetary process: elaboration, adoption, and control over expenses;
- Maintenance of state order transparency, turning to tender forms of order distribution;
- Creation of a social and economic monitoring system on the principles of an independent expertise according to international standards and techniques;
- Maintenance of the level of preparation and projects support for domestic and foreign investors, meeting the international criteria.

2. Taking into account utmost importance of the Kaliningrad problem solution to provide world stability and development of integration processes between Russia and Europe, to recommend

To the Government of the Russian Federation, the Ministry of Foreign Affairs of Russia, and also other state bodies and authority structures and management: realize systematic work on concept development of Russian - European economic integration and on elaboration of mechanisms of its realization. The strategic partnership of the Russian Federation and EU on development the Kaliningrad Region into a pilot Russian region should become an essential element of the concept. It is also necessary to provide development of an action plan of joint Russia and EU activities on complex development of the Kaliningrad Region and creation of Russian - European permanent expert group for these purposes.

The participants of the Conference believe that these statements should become determinative for the project **Guidelines and Principles of Federal Policy concerning the Kaliningrad Region**. The attention of the international and Russian community, looking forward to a precise definition of strategic perspective of the region development, asks for quick adoption of the statements.

To Administration of RF President: consider a possibility to increase the level of preparation coordination and decision taking process, and also acceleration of the process of interdepartmental coordination of urgent questions concerning intensive development of the Kaliningrad Region.

In this connection to provide creation of the appropriate, permanent interdepartmental institution on interaction of authorities and management of all levels as soon as possible.

To aim for creation of conditions for passengers and cargoes transit through the territory of the EU countries (especially, shipment of essential commodities), following from the main Russian territory to the Kaliningrad Region, and also the electric power, gas and other energy carriers. These regimes should exclude an opportunity of discrimination measures application on the part of the EU member-states.

To the Ministry of Foreign Affairs of Russia: to speed up consideration of the proposals to the Administration of the Kaliningrad Region on the procedure of simplified entrance to the Kaliningrad Region for foreign citizens having business in the region.

In a context of efforts on the Kaliningrad Region development as a pilot region to promote the further institutional registration of transfrontier cooperation of the Kaliningrad Region with the rest European territories (also by stimulating regional municipalities to participate in euroregions work) and also to promote consecutive realization of principles of transfrontier economic cooperation.

To the Government of the Russian Federation, the Ministry of Foreign Affairs of Russia, the Administration of the Kaliningrad Region: to render necessary assistance in realization of the international programs, projects and initiatives in this sphere.

3. To approve the work done within the framework of the international project **Fiscal Transparency of Regional Budgetary Process as a Means to Improve Investment Climate in the Kaliningrad Region.**

To Administrations of the Kaliningrad Region and the appropriate municipalities: to support experts participating in the project in getting trustworthy information on public finance condition in the Kaliningrad Region, on regional and municipal budgets performance and non-budgetary funds, and also the required documentation related to financing of the Federal target program of the Kaliningrad Region development for the period till 2010. To support the plan on establishing of interdepartmental working group at the Regional Administration on preparation of the program of reforming the regional finance and to recommend the Regional Administration to provide conditions for the group to start working no later than the end of November, 2002.

To the Administration of the Kaliningrad Region and the Association of Municipalities of the Kaliningrad Region: to pay attention to provision of efficiency growth of budgetary expenses in the budgetary process.

To consider it expedient to use the experience of this project in strategy development of reforming the regional finance in the framework of the Northwest federal district. *To the Regional Development Agency together with the EastWest Institute and other expert institutions,* participating in the international project: to elaborate the proposals and submit them to the Office of RF President Official Representative to Northwest Federal District before end of December, 2002.

4. To propose *the State Duma of the Federal Assembly of Russia, to the Kaliningrad Regional Duma* to join the process of harmonization of rules and regulations of economic life of the Kaliningrad Region as a pilot region of Russia and matching Russian and European quality standards, manufacture, goods and ecology standards. In this connection, the creation of system, studying the norms of European Law, application of which can have a direct effect on life-support of the Kaliningrad Region under the conditions of EU enlargement, is a priority. To provide consideration of the proposals of all the parties involved in creation of law drafts, in particular initiatives of municipalities and the recommendations of joint EU and Russia projects. Thus, to support the initiative on creation the professional integrated methodological and educational structure in Kaliningrad - Russian - European centre of quality. This work, carried out in the frameworks of the international project, should be performed in close contact with the Kaliningrad Chamber of Commerce and the State centre of certification and standardization.

To provide a legislative basis for the principle of «one window» in the system of administrative support of investors activity.

5. To ask *the Administration of President of the Russian Federation* to support efforts of federal structures, the Administration of the Kaliningrad Region, the Regional Duma, municipalities, business and expert community on creation transparent, unique, equal and predicted rules of game in interaction of business and authority.

To determine that representation of RF President to the Northwest federal district as the only authority structure, interacting with all parties involved, provides coordination in the elaboration process of integrated strategy of region development.

To support the initiative of the conference participants on consolidation of expert institutes in the sphere of elaboration of concept strategy

of region development as a pilot region of real Russia and EU partnership, using the basis of the Expert council of the fund **Regional Development Agency**.

For these purposes to use actively opportunities of the international project together with the EastWest Institute, the Russian - European project of the technical assistance **Support to the Development of the Kaliningrad Region**, with attraction of the most competent Russian and international expert organizations concerned.

Summarizing the proposals of the Conference participants, to encharge the fund **Regional Development Agency** to provide creation on the basis of the Agency the system of independent permanent social and economic monitoring of region development and the efficiency of the international and federal programs in the field, and also development of recommendations for priorities of region development with participation of the broad audience of foreign, federal and regional research institutes.

The priority should be given to the concrete applicable research, namely:

- evaluation of the real condition of region economy with taking into account its informal sector;
- analysis of vulnerability of the management structure under the conditions of EU enlargement;
- providing the transition to competitive export - oriented priorities in the development of the western Russian exclave and determination its place in European and Russian labor division.

6. To ask *the Office of RF President Official Representative to Northwest Federal District, the Administration of the Kaliningrad Region and the Kaliningrad Regional Duma* to develop proposals on establishing the system of banks support and

other financial establishments participating in federal and regional programs of SEZ development.

To consider it necessary to elaborate proposals and start creation of the international investment council in the Kaliningrad Region with the participation of authoritative representatives of business and financial circles, professional consultants from Russia and international community.

7. To come with proposal to *the Administration of President of the Russian Federation, to the Government of Russia* in order to simplify procedures and to maintain effective tools of investments promotion, to provide creation in the Kaliningrad Region the agency on management of the federal property, the international insurance fund, as basic elements for realization and warranting large investment projects.

To make use of the experience of the European Union and infrastructural and investment venture funds, working both in the East Europe and Russia,

for elaboration of the appropriate mechanisms in the Kaliningrad Region, taking into account, first of all, official proposals on the issue in the message of the European Commission on the Kaliningrad Region of 2002.

8. To ask *the Government of the Russian Federation, the Ministry of Economic Development and Trade of Russia* to provide a qualitatively new level of management and effective performance of the Federal target program of the Kaliningrad Region development for the period up to 2010, through activities of improvement of the organizational management structure of the Program and through introducing necessary changes into the list of priorities working for transparency and investment attraction of the projects important for the state. To envisage creation of the mechanism to maintain the level of technical preparation of projects within the Program according to the international standards and the system of realization of constant monitoring over efficiency of these projects realization for the state and society. □

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art & design Altist Ltd
 altist2000@yahoo.com
 картматериалы © ITC TENAX
 корректор Чекурина Ю.В.
 вёрстка Залецкий И.Г.
 дизайн Ивантаев Д.В.