Chapter 4
Eastern Neighbourhood: Territorial Cooperation Implies a Common Energy Strategy

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Abstract The chapter outlines the major stakes of this neighbourhood. The Baltic Sea case study gives an on-the-ground insight of the EU-Russia partnership's reality. It shows that Kaliningrad could be a stumbling block to or a touchstone of cooperation with Russia; that cross-border cooperation is a means to foster ties with Russia; that people mobility is a key issue in the relationship between the EU and its neighbours–all neighbours. Last, it shows that intergovernmental institutions include Russia but not always as efficiently as it could. Another case-study focuses on the Black Sea. The chapter presents innovative research results on city twinning and diplomacy networks, so as to compare the relative influence of EU and Russia on this area. The third case study provides a territorial analysis of the Ukrainian crisis, and explains why the East of the country is taken in a jaws effect. In conclusion, the chapter insists on the role of territorial cooperation, and on the need for a genuine European energy policy because it is indispensable for a genuine partnership between the EU and Russia.

4.1 Stakes

The Eastern neighbourhood (Map 4.1) encompasses the territories from the Baltic area to the Black Sea, which are Russia, Belarus, Ukraine and Moldavia. Such a grouping is motivated by geographical reasons (various historical and cultural links between these countries, decisive issue of European energy supply security from Russia through Ukraine, etc.), by historical (USSR) and political reasons (the Eastern Partnership), and by practical reasons: the data system of these countries remains close due to their common Soviet past and in all countries two post-Soviet censuses have been already held which allows time comparisons. Russia is not a country of the ENP, but the EU-Russia Strategic Partnership is crucial for territorial integration of the Baltic area.

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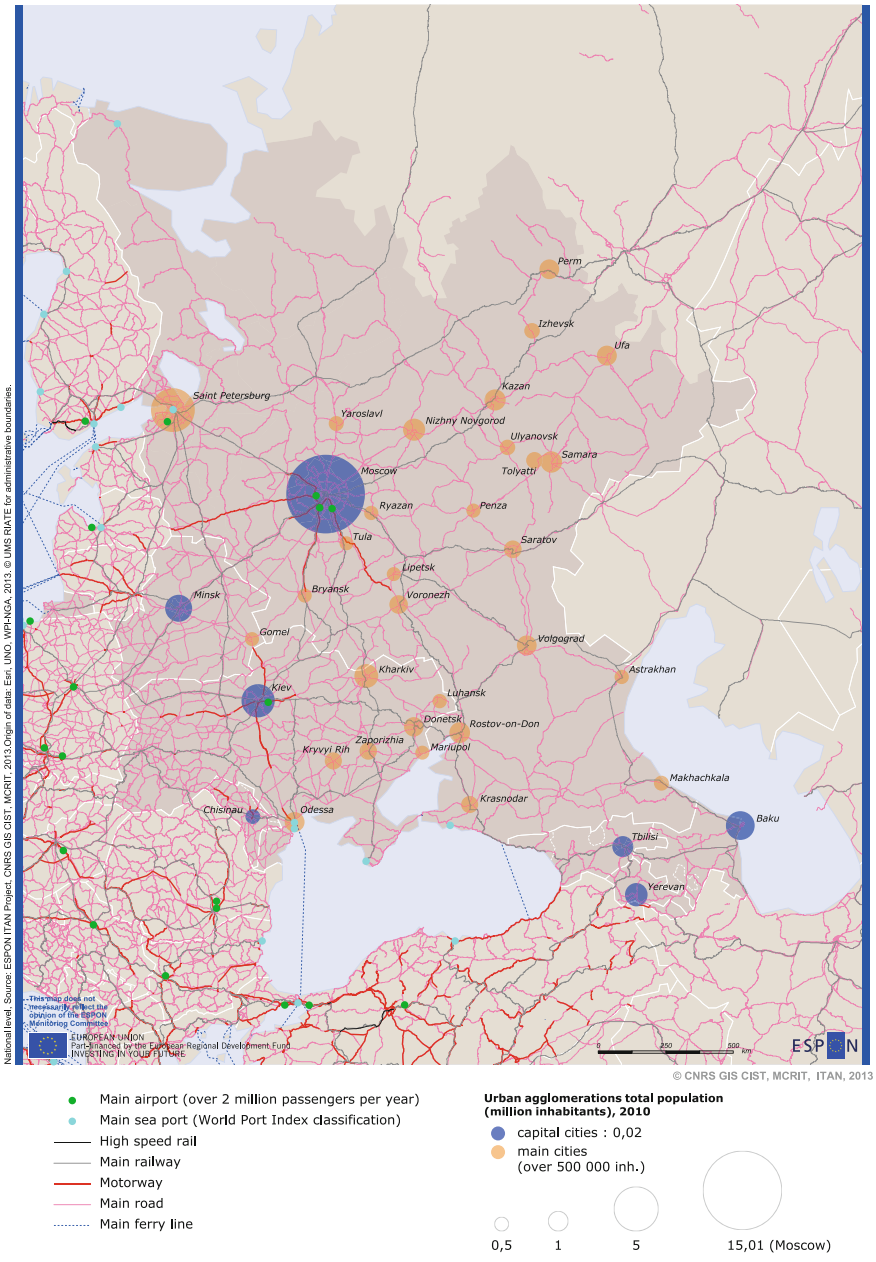


Map 4.1 The Eastern neighbourhood

Russia is the EU's biggest neighbour and the third biggest trading partner. It is an important supplier of oil and gas to the EU member states, in particular Central Europe countries. Deeper regional cooperation is essential for ensuring security and

improving environmental and economic stability of the neighbourhood thanks to a better EU/Russia partnership. Among the issues is environmental deterioration of the Baltic Sea, climate change, trafficking in human beings, smuggling of harmful goods, communicable diseases, illegal immigration and organized crime. Moreover, through diminishing socio-economic imbalances and inequalities between the EU countries and western Russia, some of these challenges could be overcome, which would contribute to the overall stability of the area.

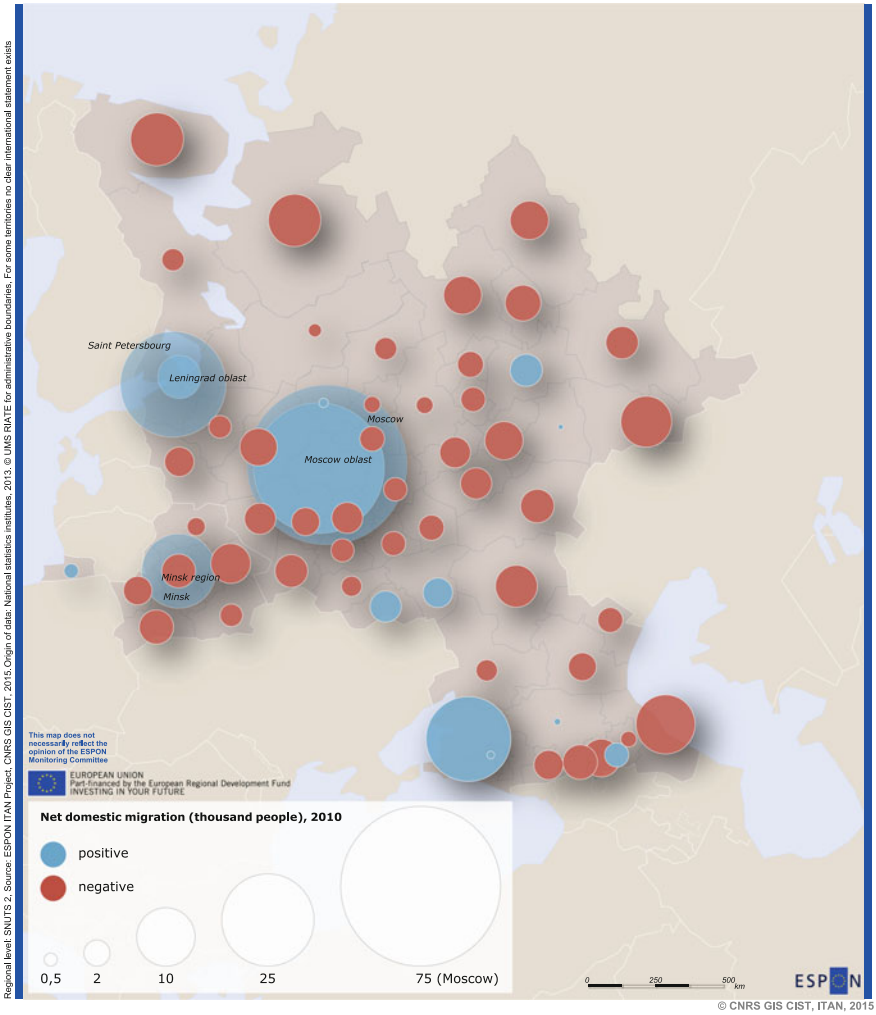
4.1.1 Demographic

The demographic decline is one of the major stakes of this neighbourhood. In January 2012 the population of Russia was 143 million, unevenly distributed across the country: 80 % live in the European part of the country while 75 % of its territory is located eastward of the Urals. Just after the collapse of the Soviet Union, in 1993, the population in Russia hit a historic peak at 149 million; then a 15 year long trend of population decline began. The main reasons were related to natural population decrease. In 1994–2009 the population in Russia decreased by 11.9 million due to natural change, but thanks to immigration surplus the total population decreased by "only" 6.7 million. Due to several major conflicts before 2002, in particular to the—often quite compelled—return of displaced people, Chechnya has a positive demographic trend during the last decade. But most of the regions do experience a loss in population. Population shrinkage mostly takes place in the most northern and eastern territories, as well as in the most rural regions. The regions located between St. Petersburg and Moscow suffer from the great attractiveness of these two metropolises. Russian regions along the border with Ukraine also experience a shrinking demographic trend.

In Ukraine and Belarus, nearly the entire country experiences negative demographic trends with the exception of the capital city. In Moldova, the entire country has declining population figures, mainly due to emigration to the EU, Russia and Turkey. Among the countries of the southern Caucasus, only Azerbaijan experiences a demographic growth despite strong out-migration.

Moscow dominates the neighbourhood with more than 11 million inhabitants, followed by St. Petersburg (5 million), Kiev (2.8 million) and Minsk (1.9 million).

The domestic migrants have their origins in the most rural and peripheral regions except when there is oil and/or gas. Domestic migrants in Belarus move from the provincial regions to Minsk. Internal migration is greater than external migration. In 2011 the annual migration turnover of those who moved permanently to another Russian region or city was 3.1 million, whereas the official (registered) international migration turnover was only 320,000. The most important destinations of migrants in Russia were Moscow, St. Petersburg and Krasnodar krai (by the Black sea), whereas the population of most subjects in the North, East Siberia and the Far East has decreased rapidly due to outmigration. After the collapse of the USSR, several shutdowns, degradations and relocations of industries and military activities took place. Also the fact that several support systems and privileges, such as the so-called



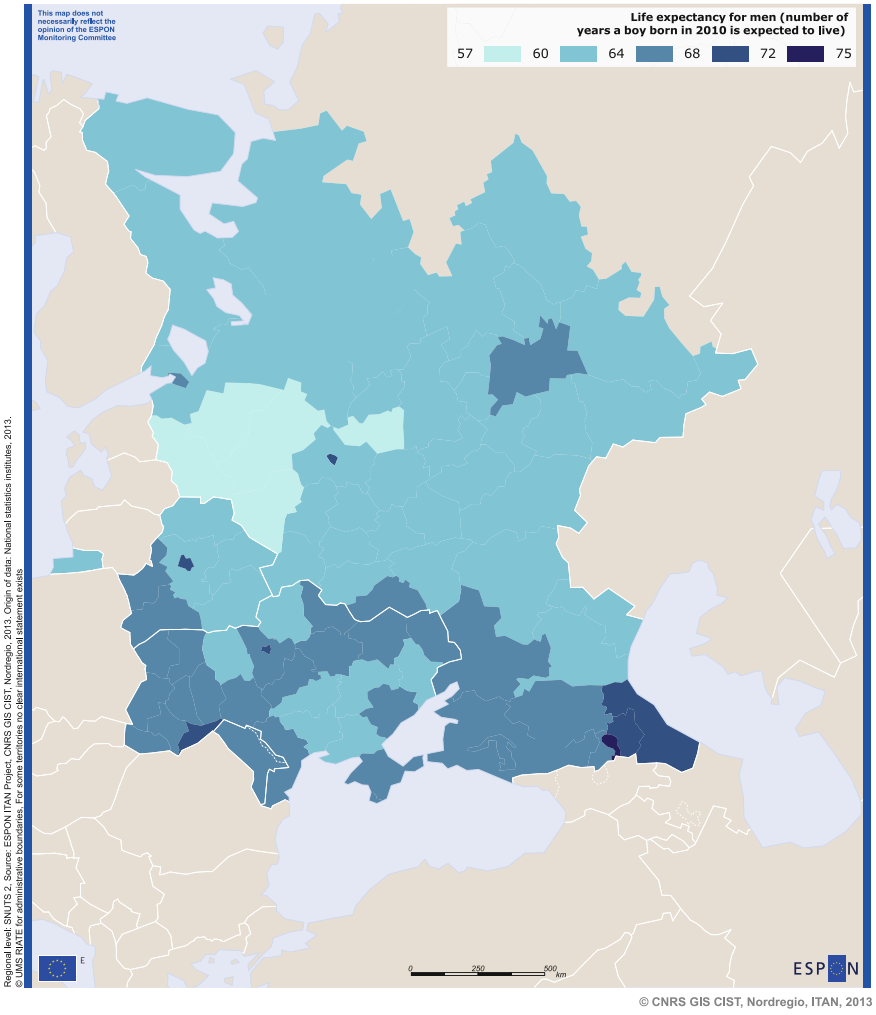
Map 4.2 Domestic migration in 2010

"northern wage increments"—extra money for working in remote regions with a harsh climate—were terminated had an impact as many people had taken advantage of these incentives to work in these regions temporarily for earning money (Map 4.2).

4.1.2 Socio-economic

In terms of gender balance, there is an urban-rural divide in Russia, Belarus and Ukraine with the capital regions (and St. Petersburg) having a more balanced

number of males to females of working age. This is especially significant in Belarus where the Minsk metropolitan region stands out as more balanced compared to the surrounding region which has a lower number of females, perhaps due to the greater number of females moving to Minsk from the surrounding regions for employment or education. There is also a North-South divide, whereby the northernmost oblasts —Murmansk and Arkhangelskaya oblast—have fewer than 90 females per 100 males in working age. In Ingushetia republic in the North Caucasus, the female population of working age strongly dominates; among the reasons could be the high mortality rate of men of working age as a consequence of war—but some experts refer to mistakes made in population census….



Map 4.3 Life expectancy for men, 2010

Looking at the gender balance of all age groups in 2010 in total, one can notice a numeral superiority of females over males in the central regions of Russia, with the exception of Moscovskaya oblast. This could be a sign of a premature mortality among males (Map 4.3). Despite instability in North Caucasus, life expectancy for both genders is here the highest, in Ingushetia in particular. In this region with predominantly rural population, low level of education, strong religious and socio-cultural traditions there is a higher uncertainty about the mortality rates (Kvasha and Harjkova 2010). But higher life expectancy could be also attributed to a lower consumption of alcohol by the Muslim population residing here, as well as in the Republic of Tatarstan which also stands out in terms of longevity of both genders.

Life expectancy is somewhat higher in the capital cities (Moscow, Minsk and Kiev) and the St. Petersburg urban area due to a high number of jobs in the tertiary sector, highest income of the population, economic stability and a better access to high quality medical service. In many regions of Ukraine, life expectancy is higher than in Russia, particularly for men. Life expectancy is also higher in the Belorussian and Ukrainian regions on the EU border, especially when it comes to women.

The North Caucasus region (Chechnya and Dagestan) is characterised by a high fertility rate which can be explained by strong cultural and religious traditions, and a low level of education. At the same time there is a lower proportion of the elderly in these regions and a fairly low share of active population. Besides the North Caucasus there are only two oblasts in North-East Russia (Republic of Udmurtia and Republic of Bashkortostan) with a slightly higher share of children and young. The same goes for Moldova—a high proportion of children and young people, with a low proportion elderly and active population.

The Murmansk Oblast of Russia has the highest rate of active population while Belarus (except in the greater Minsk region) and the Ukraine regions have a lower share. Chechnya and the Moldova are the areas with lowest working populations and active populations.

We have seen how tricky it is to address the employment issue, due to a high rate of informal activity (see Sect. 1.3.2). Yet we know that GDP in Russia is centred on the Moscow and St. Petersburg metropolitan regions. The regions bordering the Urals eastern edge also have slightly higher GDPs than the regions bordering the EU. When looking at GDP per capita, the Moscow and St. Petersburg region are still dominating, but along with Murmansk, Belorod oblast and Tatarstan (one of Russia's most economically developed regions). Ukraine as a country was hard hit by the economic crisis and thus performs worst in GDP per capita, along with Moldova.

4.1.3 Environmental

The Eastern neighbourhood's countries share a number of common environmental challenges. Most of them are related to water quality, waste management, hazardous nuclear namely military activities, industrial pollution, obsolete pesticides, land, forest and biodiversity management, non-rational and depleting use of natural

Table 4.1 Summary of major environmental challenges in the countries of the Eastern neighbourhood

Belarus	Land degradation (wetland areas of Polesie)
	Chernobyl disaster consequences
	Hazardous industrial sites and polluting facilities
	Stockpiles and disposal sites of toxic waste, incl. obsolete pesticides
	Defence facilities and activities
European Russia	Nuclear-waste and accidents
	Erosion and degradation of land and water
	Climate change
	Deforestation
The Republic of Moldova	Land and water body pollution with mineral fertilizers and pesticides
	Loss in biodiversity
	Excessive use of natural resources
	Excessive pollution
	Soil erosion
Transnistria	Degradation of water resources
	Air pollution
	Accumulation of solid household and industrial wastes
	Reduction of the forest area and illegal cutting of forests
	Degradation of land resources
	Soil pollution with agrochemicals and pesticides
Ukraine	Hazardous and military activities (industrial and mining facilities, radioactive contamination, hazardous waste)
	Nuclear power and waste (Chernobyl)
	Obsolete pesticides and industrial pollution
	Water management and water scarcity
	Land, forest and biodiversity management

resources, low energy efficiency, as well as pollution of the Sea of Azov, the Black Sea and the Caspian Sea (ENPI 2007) (Table 4.1).

The region's major environmental problem is related to the consequences of the Chernobyl nuclear accident in 1986, which continues to pose long-term environmental and health damages to Ukraine, the neighbouring Belarus and Moldova and Bryansk oblast in Russia.

Belarus and Ukraine were among the most industrialized countries in the former Soviet Union. Although, with the collapse of the Soviet Union, industrial production levels decreased significantly, the environmental problems linked to *industrial processes* remain. The deposits of industrial waste, obsolete pesticides and unsustainable mining practices from the past pose serious environmental risks today (i.e. the regions of Donbas in Ukraine and Soligorsk in Belarus) (ENVSEC 2010). In Belarus, one third of all pesticides are stored under unsuitable conditions (e.g. at farms or industrial facilities). Ukraine is home to about 16,800 tons of highly toxic

and hazardous rocket fuel component 'melange' since 1961; the storage facilities are no longer safe but the country does not possess the capacity, both financial and technical, to recycle or dispose of the compound in an ecologically sound manner. Overall, low technological capacity results in higher emission levels, higher waste volumes from production processes, while insufficient treatment of industrial wastewater affects the stability of ecosystems.

Military heritage also left its mark on the region—toxic and radioactive material can be found in all countries of the neighbourhood. The decommissioning of nuclear submarines and disposal of nuclear waste is an on-going process in Murmansk and Arkhangelsk oblasts, where many of the submarines are still docked. Moreover, even today pollution at defence sites and facilities, as well as disposal of obsolete armaments are important issues for Belarus and the Caucasus region.

When it comes to *radioactive and toxic waste*, the countries often do not have suitable infrastructure and available financial resources to handle it. In the Republic of Moldova, for instance, there were about 8000 tons of toxic waste products in 2004 and no available disposal sites to store them.

Poor status of the water environment is another environmental challenge. The leading causes are weakly developed sewerage systems, industrial discharges and non-existant or out-dated wastewater treatment plants, but also agricultural pollution and soil erosion. In the Republic of Moldova, most sources of underground water do not meet water quality standards due to a high content of chemically harmful substances, such as fluorine, sulphates and chlorides (ENVSEC 2006). The pollutants have accumulated in seas with limited water exchange, such as the Caspian Sea, the Black Sea and the Sea of Azov.

- Water quality problems are severe in the Volga Basin in Russia. Volga is Europe's longest and among its most polluted rivers, as a result of the cumulative effects of overuse, untreated sewage and heavy industry. Volga's water is far beyond the quality norms for drinking water and is unsuitable for fish farming or irrigation. The Caspian Sea which receives about 85 % of its freshwater from the Volga River is dramatically affected (Henry and Douhovnikoff 2008). The Caspian Sea is an example of excessive chemical pollution through running rivers (the Volga, Kura and Ural Rivers) and offshore and onshore oil and gas industry. Underwater oil pipelines which surround Absheron peninsula and some area of Mangyshlag are also among the sources of pollution of the Sea. During the Russia-Chechnya war, military waste was dumped into the sea. Today the Caspian Sea is also polluted by radioactive waste. The Sea is experiencing a decline in commercial fish stocks, such as Caspian sturgeon.
- The nutrients from agricultural, domestic and industrial sources and insufficiently treated sewage waters cause eutrophication and degradation of the ecosystems in these seas. Water quality of the Black Sea is affected by the polluted waters of the Dnipro and the Danube rivers which pass through Central

Europe and the territories of Russia and Belarus before emptying into the Black Sea. In recent years, chemical pollution by oil and toxic substances has become a serious trans-boundary problem affecting the Black Sea.
– Exhaustive nature management aimed at fostering economic growth and active utilisation of aquatic ecosystem services of the Sea of Azov has left irreversible damages to the ecosystem (Lagutov 2011).

In all countries of the Eastern neighbourhood and in the Caucasus in particular, *land degradation and desertification* is a serious environmental challenge. Fertile soils are being exposed to degradation as a result of human activity, reduced deforestation, unsustainable agricultural practices and mismanagement. The lower Volga River was degraded beyond repair during the Soviet period. Wind erosion has affected the more arid parts of the North Caucasus and lower Volga River basin. In the Republic of Moldova the area of eroded land grows by approximately 0.9 % each year which results in losses of 26 million tons of fertile soil.

The Eastern neighbourhood comprises about 30 % of the world forest reserves which act as major sinks of greenhouse gases and play an important role from climate change mitigation perspective. Yet, illegal logging and corruption represent a major threat for *forestry* in the region. Most likely pressure to increase extraction will grow as the domestic and international demand for lumber grows.

4.2 Baltic Sea Region: Case Study on the EU/Russian on-the-Ground Partnership

4.2.1 What Delineation?

There is no precise definition of the boundaries of the BSR. From the geographical point of view, the BSR comprises the countries which have coastlines on the Baltic Sea (Sweden, Finland, Denmark, Estonia, Latvia, Lithuania, Poland, Germany and Russia). Normally, only the northernmost coastal regions of Germany are included (Hansestadt Hamburg, Mecklenburg-Vorpommern, and Schleswig-Holstein), northern Poland (Pomorskie, Warminsko-Mazurskie, and Zachodnio-Pomorskie) and some parts of the north-western federal district of Russia (Kaliningrad oblast, Leningrad oblast and Republic of Karelia). Moreover, the BSR comprises the areas which are in a drainage basin of the Baltic Sea. So, besides nine coastal states, there are five countries in the basin—Belarus, with almost half of its area in the basin, and smaller parts of Ukraine, Czech Republic and Slovakia draining through Poland, and very small parts of Norway. The whole drainage area covers 1.7 million square kilometer, and is home for 85 million people.

Other factors matter when defining the region. Norway is included due to its strong economic ties with the countries surrounding the Baltic Sea and willingness to participate in regional cooperation. The definition of the Region varies across different institutions and intergovernmental organisations. For instance, if the

purpose of cooperation is environmental protection of the common water, then it makes sense to include the territories of Belarus which are in the drainage basin. The BSR is a highly heterogeneous area in economic, environmental, social and cultural terms, but at the same time the countries in the region share many common resources, have strong ties, common development trends and challenges (i.e. Baltic Sea environmental degradation) (EC 2013).

The Baltic Sea has brought people together for centuries by providing routes for trade and cultural exchange. In the Middle Ages until the 15th century, nearly a hundred cities in the BSR belonged to the Hanseatic League—a trading system which covered most of northern Europe. Economic ties with North-West Russia have traditionally been strong. Before the revolution in 1917, the St. Petersburg metropolitan area was a major export market for a number of eastern Finland's industries. Moreover, some areas of modern Russian Federation were previously foreign territories. Part of the Republic of Karelia belonged to Finland, while Kaliningrad was part of Prussia and, later, the German Reich before the World War II.

Integrative processes and cooperation in the BSR were hampered by historical events, including the Cold War. With the end of the Cold War, cooperation in the BSR resumed. Cooperation between the countries increased with further enlargement of the European Union, first Finland and Sweden in 1995 then the Baltic States and Poland in 2004. Today the BSR continues to benefit from exceptionally strong economic, social and trading ties in the region (State of the region report 2012). Development of the BSR identity would contribute to regional community viability and resilience, as well as improve overall understanding and conflict resolution.

4.2.2 Russia Versus Rest of the BSR

The Nordic countries have a long tradition of strong national and local governments. The local authorities carry out most of the planning activities sharing the responsibility with the national level, which is also referred to as the "Nordic approach". Cooperation between the administrative levels is well-functioning, partly due to a good coherence and a high level of trust between all governance levels. Public participation is a strong element of the Nordic culture, all the more as these countries have a strong civil society. The situation is quite similar in Germany, where power is divided between the federal governments and Lander.

On the other hand, the post-communist countries (three Baltic States and Poland) are lagging behind the Nordic neighbours in the field of governance. As young democracies, the priority in the 1990s was given to more pressing political and economic reforms, such as establishing an effective representative democracy rather than fostering public participation. During the last decades these countries made

significant progress towards better governance, largely influenced by the EU accession process. Requirements for the distribution of EU structural funds have supported the regional level of governance. Despite the principle of subsidiary applied in the Baltic States, the challenges for the local governance remain. The municipalities here have little decision-making authority, few administrative functions and are lacking financial independence (Böhme 2013).

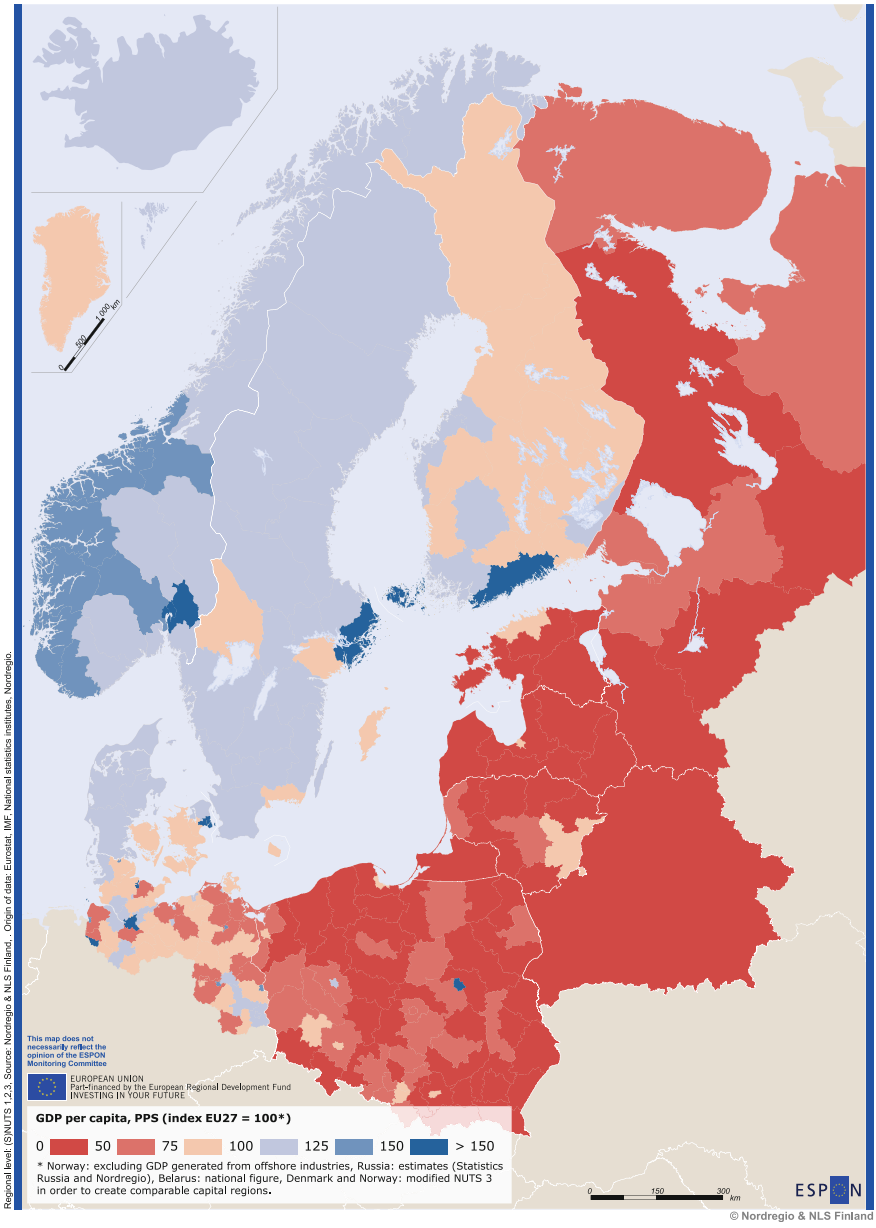
In Russia, local authorities historically have even less power. In the beginning of the 2000s, a policy of re-centralisation was taken, which diminished the newly found autonomy of regional actors. The majority of regions were subordinate to the central government, politically, economically and administratively, which limited opportunities for the regions to engage in international activities (Ross and Campbell 2008). In 2003, the Law on Local Governance implied decentralisation. However, the newly formed local self-governments remain weak and have limited financial independence, and have to focus on implementing activities delegated from the top. Corruption and the lack of transparency are additional challenges for the development of good governance.

When it comes to demographic dynamics, the North-South territorial divide is primarily influenced by diversified climatic conditions. The BSR consists of a densely populated southern part and largely uninhabited and sparsely populated northern part. Connecting the remote rural settlements in the North to the urban networks and providing sufficient transport infrastructure remains a major challenge for the development there. The population decline in the northernmost parts of the region is expected to continue, except in cities (Nordregio 2012).

But, as a whole, population dynamics rather display an East-West divide. The population in the Baltic States and North-West Russia is declining both in urban and rural areas due to low fertility and high outmigration. The North-West Russia is experiencing the sharpest population decline in the region by 0,5 % annually and has fertility rates below western European averages, except for Kaliningrad oblast where the demographic situation is fairly good (State of the Region Report 2012; Sebentsov and Zotova 2013). High emigration rates of the working-age population from the Baltic States, Poland and the North-West Russia places an even higher burden on the remaining workforce in these countries. On the contrary, the population in the Nordic countries continues to grow due to high birth rates and immigration (e.g. from the Baltic States).

When it comes to economic dynamics, the East-West disparities are still visible two decades since the fall of the iron curtain (Map 4.4). GDP per capita in the western part accounts for more than 120 % of the EU average, whereas it is less than 50 % in the eastern part. Despite the financial crisis of 2008, the Baltic States are doing better. Before 2000 the prosperity levels in Norway were more than five times higher than in Latvia; today the ratio dropped to three—even if Latvia still remains one of the poorest countries in the EU.

There are also considerable differences within the north-western Federal District in Russia itself. The District consists of 11 federal “subjects” including 2 republics,



Map 4.4 GDP (PPS) per capita. An East-West economic divide, 2009. *Source* Nordregio

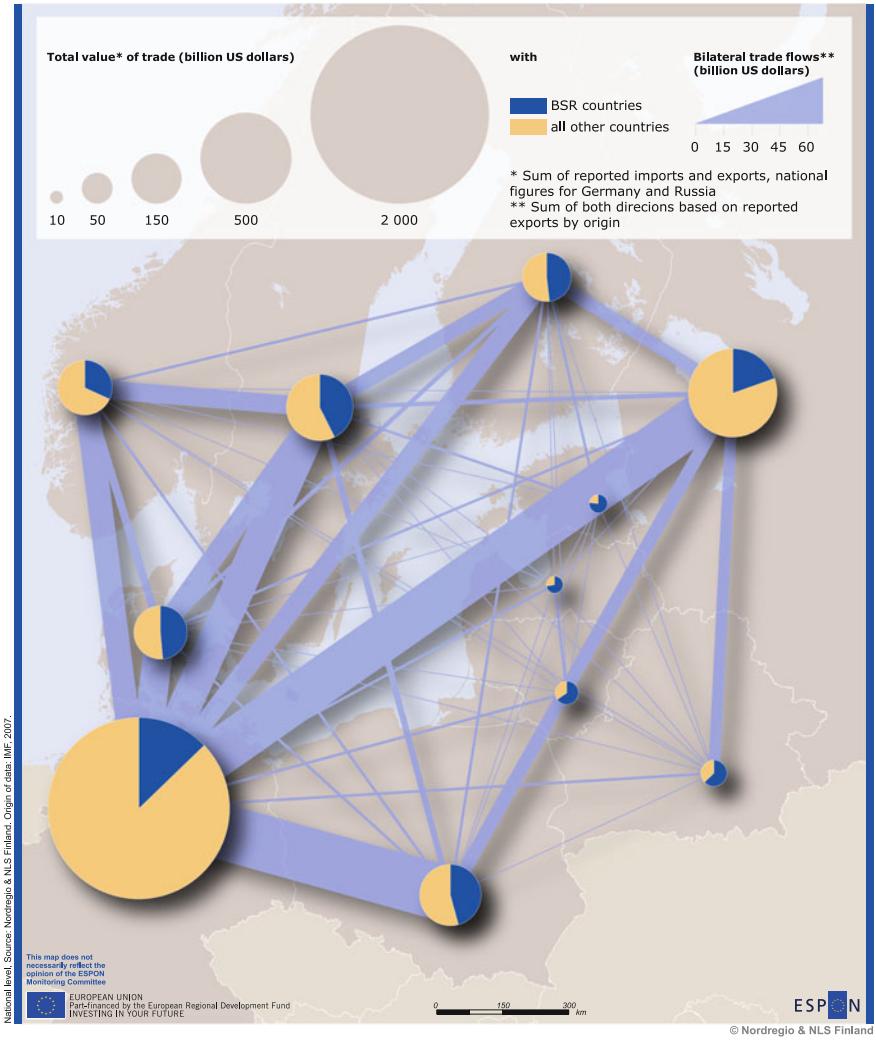
7 oblasts, 1 federal city and 1 autonomous oblast. It borders with Finland, Poland, Estonia, Latvia, Lithuania and Belarus, and has access to the Baltic, White, Barents and Kara Sea. The area covers 1.6 million square kilometer, which is almost as much as the catchment area of the Baltic Sea. Leningrad oblast and St. Petersburg are the fastest growing of all federal subjects in Russia, whereas the Komi Republic and Murmansk oblast are ranked at the bottom. The economy of the Kaliningrad oblast can be characterised as fragile and unstable. The economic crisis in 2008 had a worse impact on the exclave than other federal subjects of the north-western Federal District.

North-West Russia's economy is regarded as one of the most dynamic parts of Russia. Among the strongest industries in the Archangelsk and Karelia regions are forest, timber and pulp and paper; the fuel industry in Komi, ferrous metals in Vologda and Murmansk, and chemicals in Novgorod. Basically, EU/Russia trade shows a core-periphery pattern: the main imports from the EU to Russia are manufactured goods, services and food; Russia primarily exports raw materials to the EU.

Trade flows within the BSR are currently exceeding the trade flows outside the region. The Baltic States and Belarus have the highest shares of trade flows within the region, followed by the Nordic countries and Poland (Map 4.5). But despite (or because of) the communist past, the Baltic States and Poland have rapidly reduced economic ties with Russia. Estonia is increasingly oriented towards the Scandinavian trade blocks. Latvia and Lithuania are strategically turning to the western European countries. The unique location of the Baltic States on the crossroads between eastern and western markets is not fully used today.

Russian participation in the BSR economic integration is mainly limited to energy and transit projects, with Gazprom being the main investor. There are few Russian companies established in the EU part of the BSR. Although the volume of investment by the Swedish, Finnish and other transnational corporations in Russia is growing, the actual integration of Russian business into the BSR is still rather weak (Kuznetsov 2012).

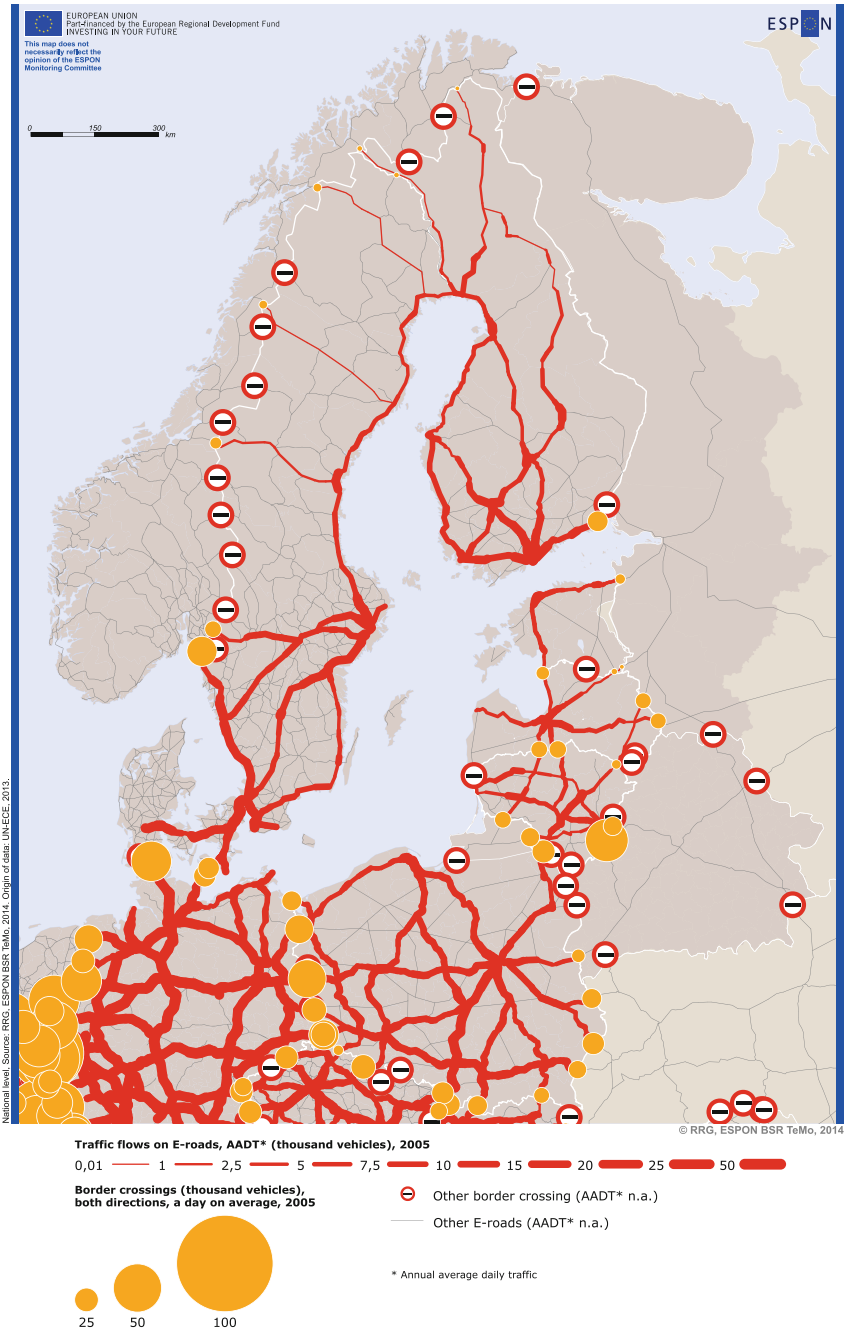
Due to the growth of EU-Russia trade, complemented by inefficient procedures and inadequate infrastructure on the Russian side, long queues of lorries at crossing points from Finland, Estonia and Latvia have become commonplace. Simplifying the customs legislation and improving infrastructure in Russia will help avoid similar problems in the future (EUSBSR Action Plan 2013). The perspectives of the development of Kaliningrad seaport are not that bright, primarily due to high competition with the neighbouring ports of Klaipeda (Lithuania) and Gdansk (Poland), and to barriers related to customs and border crossing procedures which hinder the formation of a strong transport cluster in the exclave (Map 4.6).



Map 4.5 Trade between the Baltic Sea Region countries, 2006. *Source* Schmitt and Dubois (2008), Nordregio

4.2.3 Kaliningrad: Stumbling Block or Touchstone of the Cooperation with Russia?

The Kaliningrad oblast is a special case due to its exclave status and geographical isolation from mainland Russia. The oblast is surrounded by EU countries, which influences the mindset of the residents. They often mention that they have a strong connection to the BSR and have developed a sense of a separate identity which is



Map 4.6 Border crossings and E-roads in the BSR. *Source* ESPON Temo, 2014, Nordregio

very close to Europeans (OSW 2012). There is a strong interest from the residents of the exclave in strengthening people-to-people contacts with the neighbouring European countries, cooperating in the field of culture, education, environment and social development issues.

Historically, Königsberg (now Kaliningrad) and its surroundings had been part of Prussia since the early 13th century. After World War II it was annexed by the USSR; millions of German residents were expelled, and the "Kaliningrad Oblast"—one of the smallest subjects of the Russian Federation—was predominantly used as a military base because it is one of the rare Russian seaports on the Baltic free of ice year-round. Until 1991, Kaliningrad was a "closed" area, impossible for foreigners to enter because of its strategic importance for Soviet defence. In 1991, Kaliningrad became an exclave of the no longer socialist Russian Federation, cut off from its motherland by Lithuanian land, or Polish territory.

The city is among the greatest sources of pollution in the entire Baltic Sea basin. Due to weak development of sewage treatment plants in the urban centres and villages of Kaliningrad oblast, communal wastewater mostly goes untreated into the Neman and Pergola rivers. The lack of adequate waste management systems in Kaliningrad oblast represents a threat to the quality of groundwater.

Energy security is an important issue for Kaliningrad: in the event of a gas conflict between Russia and its neighbours, the oblast may experience the shortages of raw materials. This was the case in 2004 as a consequence of Moscow cutting off its supplies to Belarus. In 2011, Kaliningrad oblast produced enough power to meet its demand for electricity due to recently completed construction of (gas) heat and power plant. Since December 2011 the region's energy grid has been connected with the rest of Russia through the energy lines running through Lithuania. But the prices of gas and petroleum products in Kaliningrad oblast are in general higher than average Russian prices. Since 2009, Moscow has been interested in the construction of a nuclear power plant in Kaliningrad oblast. As long as its planned output is higher than the area's demand for energy, some of the energy would be exported, mainly to the EU member states. Construction of the Baltic nuclear power plant would, on the one hand, contribute to establishing a closer relation between EU and Kaliningrad oblast. On the other hand, along with environmental concerns, the construction of the nuclear power plant would increase EU dependency on the energy supply from Russia, and thus reduce the energy security of Poland and the Baltic States.

Both federal and regional authorities in Kaliningrad have long been interested in fostering the production and export orientation of the economy of Kaliningrad. For this purpose, and in order to attract foreign investments, a free customs zone regime in the framework of a Special economic zone (SEZ) was established here. The SEZ grants exception from the customs duties and custom fees to all goods produced in the SEZ if companies—large companies and not small or middle-sized ones—add 30 % of added value locally and export to foreign countries or to mainland Russia. In general, there are also no import taxes in Kaliningrad with the exception of some categories of goods.

The economy of Kaliningrad oblast is oriented towards openness and enhancement of foreign economic activities. After the collapse of the Soviet Union, the hopes were great for Kaliningrad to become the "Singapore" of Russia. The exclave has a vast trade deficit due to its underdeveloped economy and the fact that it is used mainly as a gateway to mainland Russia for foreign goods. With introduction of the SEZ regime, Kaliningrad was expected to develop exports to neighbouring EU countries. However, instead of expanding exports, imports grew on a mass scale. Imports account for over 90 % of Kaliningrad's foreign trade: components for the assembly of cars and TV sets, household chemical products, food products, footwear, clothes and furniture. The key suppliers of goods to Kaliningrad are Germany, China, South Korea and Slovakia (Rogoża et al. 2012). In 2010 about 7 % of all EU exports to Russia went through Kaliningrad oblast. Consumer goods and the items that are processed and/or assembled in the region and then sold in the other regions of Russia constitute the largest share of the imported items.

In spite of the considerable benefits of the SEZ regime, the investment climate and business environment in general are far from being good in Kaliningrad. Even though business activities, including foreign investments in the region, have increased over the last decade, the full potential of the region as a gateway to Russian, Baltic and wider European markets has not been used. Instability of federal tax and tariff legislation, as well as uncertainty about the SEZ regime in Kaliningrad are among the barriers to attracting foreign investments. Other barriers include the lack of adequate competences at the regional level and, typical for Russia as a whole, excessive bureaucracy, corruption and a poor legal culture. Moreover, there are no cheap flights to and from Kaliningrad to the outside world, as well as no trains. Isolation of the market from mainland Russia and higher business costs related to that (i.e. costs of energy, transit and imports), are amongst additional drawbacks; as a consequence, most of big businesses who want to implant in Russia go to other SEZs "inside" Russia. For the Oblast itself, the financing of the SEZ has been a high burden on the budget, combined with high tax losses. Lastly, the SEZ will close in 2016 because of Russia's joining of the WTO and the incompatibility of some of its provisions with WTO rules.

4.2.4 Cross-Border Cooperation as a (Fragile) Means to Foster Ties with Russia

Border areas often share common problems. At the same time, geographical proximity to the border can present opportunities. This has been the case for the forestry sector in eastern Finland and the neighbouring Republic of Karelia, which has benefited from a proximity to the border due to lower transport costs and direct economic contacts. The border municipalities and regions in North-West Russia (particularly the Leningrad region and Vyborg municipal district) have also benefited from the proximity to the border and the development of Russia's oil and gas